U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of
Market Oversight

Dorothy DeWitt
Director

Re: Extension of No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52

This letter responds to a request received from the International Swaps and Derivatives Association, Inc. ("ISDA") on behalf of its members and other market participants that engage in inter-affiliate swaps, that the Commodity Futures Trading Commission ("Commission" or "CFTC") extend the relief provided under CFTC Letter No. 17-67 until the Commission makes a decision with respect to the applicability of the trade execution requirement to inter-affiliate trades.[1] The no-action relief provided under CFTC Letter No. 17-67 extended relief provided by CFTC Letter Nos. 14-136, 14-26, 15-62, and 16-80 and will expire on 11:59 p.m. (Eastern Time) December 31, 2020.

On December 7, 2020, the Commission adopted a final rule (the "Rule") establishing two exemptions from the trade execution requirement.[2] The first such trade execution exemption applies to a swap that qualifies for, and meets the associated requirements of, any exception or exemption under part 50 of the Commission's regulations. The second codifies relief provided under CFTC Letter No. 17-67, and prior staff letters, and applies to a swap that is entered into by eligible affiliate counterparties and cleared, regardless of the affiliates' ability to claim the Inter-Affiliate Clearing Exemption (as defined below) under Commission regulation 50.52. The Rule will become effective 30 days after its publication in the *Federal Register*.

As the effective date of the Rule is after the expiration of CFTC Letter No. 17-67, the Division of Market Oversight ("Division" or "DMO"), pursuant to Commission regulation 140.99, will extend the no-action relief provided under CFTC Letter No. 17-67 until the effective date of the Rule.

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1 ISDA, Exemption from the Swap Clearing Requirement for Certain Affiliated Entities—Alternative Compliance Frameworks for Anti-Evasionary Measures, (Feb. 21, 2020).

2 *See* Final Rule, Exemptions from Swap Trade Execution Requirement, available on the Commission's website: https://www.cftc.gov/media/5386/votingdraft120820Part36Section4c/download.

Background

Section 2(h)(8) of the Commodity Exchange Act (the "Act") requires that transactions involving swaps subject to the clearing requirement set forth under 2(h)(1) of the Act be executed on or pursuant to the rules of a designated contract market ("DCM") or swap execution facility ("SEF"), unless no DCM or SEF makes such swaps available to trade or such swaps qualify for the clearing exception under section 2(h)(7) of the Act (the "trade execution requirement").[3] Swaps subject to the trade execution requirement must be executed in accordance with the execution methods described in Commission regulation 37.9(a)(2).[4]

Commission regulation 50.52 provides that a swap between affiliates is exempt from the clearing requirement if (1) the counterparties are eligible affiliate counterparties as set forth in Commission regulation 50.52(a),[5] and (2) the conditions set forth in Commission regulation 50.52(b) are satisfied (the "Inter-Affiliate Clearing Exemption"), including documentation requirements, centralized risk-management requirements, and a requirement to clear outward-facing swaps that are of a type identified in the Commission's clearing requirement (subject to applicable exceptions, exemptions, and alternative compliance frameworks). In addition, the counterparties must satisfy reporting requirements set forth in Commission regulations 50.52(c) and (d).

In the *Federal Register* release adopting rules setting forth a process for a DCM or SEF to make a swap available to trade, the Commission stated that inter-affiliate swaps that are exempt from clearing under Commission regulation 50.52 are not subject to the trade execution requirement.[6] However, swaps involving eligible affiliate counterparties that do not satisfy Commission regulation 50.52(b) or another exception or exemption from the clearing requirement are subject to the trade execution requirement.

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3 7 U.S.C. § 2(h)(8).

4 Under Commission regulation 37.9(a)(2), swaps subject to the trade execution requirement must be executed on an Order Book, as defined in Commission regulation 37.3(a)(3) or a Request for Quote System, as defined in Commission regulation 37.9(a)(3) in conjunction with an Order Book.

5 Commission regulation 50.52(a) defines eligible affiliate counterparties to be related entities, in which (1) one counterparty, directly or indirectly, holds a majority ownership interest in the other counterparty, and the counterparty that holds such majority interest reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), and the statements include the financial results of the majority-owned counterparty; or (2) a third party, directly or indirectly, holds a majority ownership interest in both counterparties, and the third party reports its financial statements on a consolidated basis under GAAP and IFRS, and the statements include the financial results of both counterparties. 17 C.F.R. § 50.52(a)(1)(i)-(ii). A counterparty or third party directly or indirectly holds a "majority ownership interest" if it directly or indirectly holds a majority of the equity securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership." 17 C.F.R. § 50.52(a)(2)(i).

6 *See* 78 Fed. Reg. 33,606 n.1.

On March 6, 2014, the Division issued CFTC Letter No. 14-26 in response to a request for relief received from ISDA.[7] In its request, ISDA asserted that applying the trade execution requirement to inter-affiliate swap transactions between eligible affiliate counterparties that do not satisfy Commission regulation 50.52(b) would introduce unnecessary costs and inefficiencies without any benefits. ISDA stated that inter-affiliate transactions are intended to manage risk between affiliates and are not arms-length transactions. According to ISDA, requiring that such transactions be executed on a SEF or DCM would not promote the pre-trade price transparency and price discovery goals associated with the trade execution requirement because affiliate counterparties are not primarily concerned with obtaining fully competitive pricing. ISDA further stated that execution of such swaps through an order book or request for quote would not assure that the affiliates would be matched with one another as intended and thus preclude the intended inter-affiliate risk transfers.

The Division granted ISDA's request, providing that it would not recommend that the Commission take enforcement action against any eligible affiliate counterparty that executes a swap transaction with another eligible affiliate counterparty without complying with section 2(h)(8) of the Act. Such relief was provided until December 31, 2014. In granting this relief, the Division acknowledged the adverse impact the trade execution requirement could have on the ability of companies to manage risk. The Division also was mindful of the trade execution requirement under the Act and the intent of the Commission's implementing regulations to promote pre-trade price transparency in the swaps market. The Division stated that it would assess whether applying the trade execution requirement to inter-affiliate swap transactions would promote pre-trade price transparency in the swaps market during the period of relief.

The Division has extended the relief provided in CFTC Letter No. 14-26 on four occasions, issuing CFTC Letter Nos. 14-136, 15-62, 16-80, and 17-67. In each extension, the Division explained that the rationale for relief was unchanged from when it issued the initial CFTC Letter No. 14-26, and it needed additional time to find a permanent inter-affiliated execution solution. The Rule establishes two exemptions from the trade execution requirement for swaps, both of which are linked to the Commission's exemptions from and exceptions to the swap clearing requirement.

Request for Extension of No-Action Relief

On February 21, 2020, ISDA requested that the Commission further extend the relief granted in CFTC Letter No. 17-67 for affiliates that do not elect to use the inter-affiliate clearing exemption until the Commission makes a decision with respect to the applicability of the trade execution requirement to inter-affiliate trades.

Extension of Time-Limited No-Action Relief for Eligible Affiliate Counterparties from the Trade Execution Requirement

[7] The initial request from ISDA was dated February 19, 2014.

Pursuant to Commission regulation 140.99, the Division has determined to extend the no-action relief granted by CFTC Letter No. 17-67 until the effective date of the Rule, which will occur 30 days after its publication in the *Federal Register*. The Division will grant the above no-action relief and will not recommend that the Commission take enforcement action against any eligible affiliate counterparty that executes a swap transaction with another eligible affiliate counterparty without complying with section 2(h)(8) of the Act.

Market participants should be aware that the no-action positions taken herein do not excuse affected persons from compliance with any other applicable requirements of the Act or the Commission's regulations thereunder, in particular, the applicable swap reporting requirements and clearing requirements, including the requirements and conditions for eligible affiliate counterparties not to clear a swap pursuant to Commission regulation 50.52 or the requirements to clear a swap pursuant to Commission regulations 50.2 and 50.4.[8] This letter, and the no-action positions taken herein, represent the views of the Division only, and do not necessarily represent the positions or views of the Commission or of any other division or office of the Commission's staff. As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

Finally, as with all staff letters, the DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of relief provided herein, in its discretion.

If you have any questions concerning this correspondence, please contact Roger Smith, Associate Chief Counsel, DMO, at (202) 418-5344 or RSmith@CFTC.gov; or Richard Mo, Assistant Chief Counsel, DMO at (202) 418-7637 or RMo@CFTC.gov.

Sincerely,

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Dorothy D. DeWitt
Director
Division of Market Oversight

[8] The applicable swap reporting requirements are set forth under parts 43, 45, and 50 of the Commission's regulations. The applicable clearing requirements are set forth under section 2(h)(1) of the Act and part 50 of the Commission's regulations. Eligible affiliate counterparties that wish to avail themselves of the inter-affiliate clearing exemption must fulfill additional conditions and requirements set forth in Commission regulations 50.52(b)-(d).