



Ms. Melissa Jurgens
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Submitted Electronically

August 16, 2013

**Re: Final Exemptive Order Regarding Compliance with Certain Swap Regulations
(78 Fed. Reg. 43785 (July 22, 2013)), RIN 3038-AE05**

Dear Ms. Jurgens,

Reference is made to (a) the Interpretive Guidance and Policy Statement Concerning Compliance with Certain Swap Regulations¹ (the *Final Guidance*) and (b) the Final Exemptive Order Regarding Compliance with Certain Swap Regulations² (the *Exemptive Order*). The comments herein are submitted pursuant to the Exemptive Order comment period which opened on July 22, 2013 and closes on August 21, 2013.

There is concern, particularly with respect to corporate groups having U.S. affiliates and a non-U.S. parent, whether the non-U.S. treasury affiliate of such a group would be an "affiliate conduit", and we are submitting the comments herein in order to clarify the application of the Exemptive Order and the Final Guidance to such entities. Specifically, we seek clarification regarding (1) the types of entities that will be classified as "affiliate conduits" under the Commission's Final Guidance and (2) the applicable deadline for compliance with mandatory clearing requirements by an entity that is (x) an affiliate conduit facing a non-U.S. swap dealer or foreign branch of a U.S. swap dealer and (y) relying on the Commission's Clearing Exemption for Swaps Between Certain Affiliated Entities (the *Inter-Affiliate Exemption*),

¹ 78 Fed. Reg. 45291 (July 26, 2013).

² 78 Fed. Reg. 43785 (July 22, 2013).

including the outward-facing swaps conditions in Commission Regulation 50.52(b)(4)(i) (the *Outward Facing Swap Conditions*) and the alternate compliance in respect of the Outward Facing Swap Conditions.

1. *Entities classified as "affiliate conduits"*

The Final Guidance provides that certain factors are relevant to considering whether a non-U.S. person is an "affiliate conduit", and that such factors include whether:

- (i) the non-U.S. person is a majority-owned affiliate of a U.S. person;
- (ii) the non-U.S. person is controlling, controlled by or under common control with the U.S. person;
- (iii) the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person; and
- (iv) the non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or taking positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates.³

The Commission further explains that other facts and circumstances may be relevant. The Final Guidance does not specify whether, or in what circumstances, an entity that satisfies some but not all of the enumerated factors would be an affiliate conduit.

The Final Guidance provides that a swap dealer may rely on a representation from its swap counterparty as to whether such counterparty is an affiliate conduit, and accordingly we understand that many swap dealers will seek such a representation. However, in applying the Final Guidance in respect of affiliate conduits, we believe that it may be very difficult for

³ The factors are enumerated in 78 Fed. Reg. 45291 at 45359.



certain non-U.S. person counterparties to determine whether or not they are able to make this representation. Consider, for example, a corporate group having the following characteristics:

- (a) the ultimate parent is a non-U.S. person (*Non-U.S. Parent*);
- (b) the group has a central treasury affiliate, which is a non-U.S. person (*Non-U.S. Treasury Affiliate*);
- (c) various affiliates in different jurisdictions (each an *affiliate swap counterparty*) enter into inter-affiliate swaps with Non-U.S. Treasury Affiliate, in each case for the purpose of hedging or mitigating risks faced by such affiliate swap counterparty, and Non-U.S. Treasury Affiliate externalizes the resulting exposures through offsetting swaps with third parties;
- (d) one or more of the affiliate swap counterparties are U.S. persons (each, a *U.S. Affiliate*); and
- (e) Non-U.S. Treasury Affiliate and U.S. Affiliate are affiliates only by virtue of being under the common ownership and control of Non-U.S. Parent (*i.e.* they are "sister" companies sharing a common parent, neither affiliate having any ownership interest in the other).

Applying the Final Guidance regarding affiliate conduits to Non-U.S. Treasury Affiliate: prongs (ii) and (iv) above are satisfied, prong (iii) above is not satisfied, and prong (i) above appears to be satisfied on the basis of a plain reading of its language because Non-U.S. Treasury Affiliate is the majority-owned affiliate⁴ of a U.S. person (*i.e.*, U.S. Affiliate). The proper application of

⁴ Defined in the Final Guidance as a counterparty to a swap where "one counterparty directly or indirectly owns a majority interest in the other, *or if a third party directly or indirectly owns a majority interest in both counterparties to the swap*, where 'majority interest' is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution or the contribution of a majority of the capital of a partnership." (emphasis added) 78 Fed. Reg. 45291 at 45359, fn. 591.



prong (i) above is unclear, however, in that a plain reading captures even those affiliate relationships in which the ultimate parent is a non-U.S. person that has a single U.S. person affiliate within the group. In the context of the broader discussion of affiliate conduits in the Final Guidance, we think that this may be an unintended result due to certain discrepancies in the drafting employed. In particular, the discussion that precedes the listing of the enumerated factors refers to a conduit that "is located outside the United States, but is owned and controlled by a U.S. person"⁵, and the version of prong (i) that appears in Appendix E and Appendix F to the Final Guidelines reads "(i) the non-U.S. person is majority-owned, directly or indirectly, by a U.S. person".

Comments:

- (a) Please clarify whether prong (i) above is intended to capture a non-U.S. person affiliate that (1) forms part of a group where the ultimate parent is a non-U.S. person and there is a single U.S. person affiliate within the group or (2) is itself majority-owned, directly or indirectly, by a U.S. person.
- (b) If the correct interpretation is (a)(1) above, please clarify whether prong (i) should be given less weight if the ultimate parent of the purported affiliate conduit is a non-U.S. person; and if so, whether a central treasury affiliate would be an affiliate conduit if it (x) satisfies prongs (i) and (ii) above but is not majority-owned, directly or indirectly, by a U.S. person, (y) satisfies prong (iv) because it engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by its U.S. affiliate(s) and (z) does not satisfy prong (iii).
- (c) If the correct interpretation is (a)(2) above, please clarify whether a Non-U.S. Treasury Affiliate would be an affiliate conduit if it (x) satisfies prong (ii), (y) satisfies prong (iv) because it engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by its U.S. affiliate(s) and (z) does not satisfy prongs (i) or (iii).
- (d) In anticipation of swap dealers requesting their counterparties to make a representation whether they are, or are not, an affiliate conduit, it would be helpful to market

⁵ See 78 Fed. Reg. 45291 at 45358.

participants if there were a safe harbour on which they could rely, e.g., a safe harbour to the effect that a non-U.S. person counterparty will not constitute an affiliate conduit if it (x) satisfies prong (ii) but not prong (iii) above, (y) is not majority-owned, directly or indirectly, by a U.S. person and (z) satisfies prong (iv) because it engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by its U.S. affiliate(s).

2. *Applicable timeframe for clearing*

The Final Guidance provides that "[w]here one of the parties to the swap is a conduit affiliate, the Commission would generally expect the parties to the swap only to comply with (to the extent that the Inter-Affiliate Exemption is elected), the conditions of the Inter-Affiliate Exemption, including the treatment of outward-facing swaps condition in Commission regulation 50.52(b)(4)(i)."⁶ The Outward Facing Swap Conditions require, in respect of an eligible affiliate's outward-facing swaps, compliance with any of the following: (a) compliance with the Commission's clearing requirements; (b) substituted compliance clearing in a foreign jurisdiction; (c) clearing the swap through a registered DCO or other clearing organization subject to government supervision in its home country and assessed to be in compliance with the Principles for Financial Market Infrastructures; or (d) reliance on the End User Exception or a comparable exception in a foreign jurisdiction. If the outward-facing affiliate is not able to comply with (b), (c) or (d), the outward-facing swap must be cleared in compliance with CFTC clearing requirements. Under the Exemptive Order, an affiliate conduit must comply with the Commission's clearing requirements as of October 9, 2013.

However, the Inter-Affiliate Exemption, in certain circumstances, provides for time-limited alternate compliance (*Alternate Compliance*) with the Outward Facing Swap Conditions. An affiliate that is relying on the Inter-Affiliate Exemption and satisfies the conditions required to rely on the Alternate Compliance would not be required to satisfy the Outward Facing Swap Conditions (including CFTC clearing requirements) until March 11, 2014.

⁶ See 78 Fed. Reg. 21750 at 21783-84.



In the event that an affiliate conduit that (i) has elected to rely on (x) the Inter-Affiliate Exemption and (y) Alternate Compliance to the Outward Facing Swap Conditions and (ii) enters into an outward facing swap with a registered swap dealer or foreign branch of a swap dealer for purposes of hedging its exposure under its Inter-Affiliate Swaps, it is not clear whether it must comply with CFTC clearing requirements from October 9, 2013 onward (pursuant to the Exemptive Order), or from March 11, 2014 onward (in reliance on the Alternate Compliance provisions of the Inter-Affiliate Exemption).

Comment:

Please clarify whether, in the case of an affiliate conduit that (i) has elected to rely on (x) the Inter-Affiliate Exemption and (y) Alternate Compliance to the Outward Facing Swap Conditions and (ii) enters into an outward facing swap with a registered swap dealer or foreign branch of a swap dealer for purposes of hedging its exposure under its Inter-Affiliate Swaps, (a) October 9, 2013 is the applicable compliance deadline for CFTC clearing requirements pursuant to the operation of the Exemptive Order or (b) March 11, 2014 is the applicable compliance deadline for CFTC clearing requirements pursuant to the operation of the Alternate Compliance provisions of the Inter-Affiliate Exemption.



Freshfields Bruckhaus Deringer US LLP

We thank the Commission for its kind consideration of our comments. Please feel free to contact us if you wish to discuss our comments further.

Very truly yours,

Jerome Ranawake

cc: Brian Rance
Justin McKellar

The Freshfields Bruckhaus Deringer US LLP partners include members of the Bars of the State of New York and the District of Columbia, Solicitors of the Supreme Court of England and Wales and Rechtsanwälte of Germany

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