

Public Statements & Remarks

Statement of Chairman Heath P. Tarbert in Support of Final Rule on Alternative Compliance for the Inter-Affiliate Swap Clearing Exemption

June 25, 2020

I am pleased to support our final rule codifying the alternative compliance framework for the Commission's inter-affiliate swap clearing exemption, which has been in place via the CFTC's staff no-action relief since 2014. As I previously stated in connection with the proposed rule, codifying this relief is good policy and good government.^[1]

From a policy perspective, the rule advances the goals of our swap clearing requirements by making anti-evasionary provisions of the inter-affiliate exemption workable for cross-border corporate groups. Stepping back for a moment and looking at the bigger picture, our clearing and initial margin requirements are meant to address counterparty credit risk. These measures generally are not appropriate for credit exposures between members of a single corporate group, where risk is managed internally on a centralized basis.^[2]

However, the CFTC has long been concerned that U.S. entities may misuse the inter-affiliate exemption to evade the clearing requirements more generally. For example, a U.S. entity may use back-to-back swaps to interpose a non-U.S. affiliate in the middle of the U.S. entity's trade with a non-U.S. counterparty, where the non-U.S. affiliate and counterparty are in jurisdictions that do not have mandatory clearing regimes comparable to the Commission's. In this way, the U.S. entity could improperly circumvent the clearing obligations that would apply if it were trading directly with the non-U.S. counterparty (because it would be exempted from clearing the trade with its non-U.S. affiliate, and the non-U.S. affiliate's back-to-back trade with the non-U.S. counterparty could fall outside U.S. clearing requirements).

This evasion concern was particularly acute in the early years of the CFTC's clearing regime, when a number of other jurisdictions had yet to implement their own clearing requirements in accordance with the G20 commitments at the 2009 Pittsburgh Summit. Moreover, section 2(h)(4)(A) of the Commodity Exchange Act requires us to prescribe rules to prevent evasion of the clearing requirement.

Accordingly, as an anti-evasionary measure, the Commission required members of a corporate group taking advantage of the inter-affiliate exemption to clear their outward-facing swaps if such swaps would be clearing-mandated under CFTC rules, regardless whether the parties to the outward-facing swap were in fact subject to such rules.^[3]

The "clearing outward-facing swaps" condition to the inter-affiliate exemption is unworkable for many market participants, however, because of inter-jurisdictional mismatches in clearing requirements and infrastructures. Accordingly, the CFTC's staff no-action relief has extended the rule's time-limited alternative compliance framework allowing affiliates to exchange variation margin in lieu of clearing outward-facing swaps.^[4]

This alternative compliance option has allowed cross-border corporate groups to attain the risk-mitigating benefits of inter-affiliate swaps,^[5] while complying with important anti-evasion measures in a way that is practicable for their global business. Indeed, the CFTC staff's review of recent swap data indicates that over 70 eligible affiliate counterparties located outside the United States rely on the alternative compliance framework under the available staff no-action relief. By codifying this relief, we are providing the swaps market with clarity, certainty, and transparency—consistent with the CFTC's mission, core values, and strategic objectives.^[6] I commend my fellow Commissioners and the CFTC's staff for working to finalize the rule before us today, and I look forward to further efforts to advance these principles and goals in the near future.

[1] Statement of Chairman Heath P. Tarbert: “Tripling Down on Transparency” n.12 (Dec. 10, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement121019>.

[2] See Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21753 (Apr. 11, 2013) (justifying the inter-affiliate clearing exemption in view of incentives to avoid defaulting to affiliates and the common practice of centralized risk allocation decisions and default remedies, which reduce inter-affiliate default risk).

[3] 17 CFR 50.52(b)(4).

[4] CFTC Letter No. 17-66 (Dec. 14, 2017), <https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm>; see also previously granted relief under CFTC Letter Nos. 14-135 (Nov. 7, 2014), 15-63 (Nov. 17, 2015), 16-81 (Nov. 28, 2016), and 16-84 (Dec. 15, 2016). CFTC Letter No. 17-66 expires on the earlier of (i) December 31, 2020 at 11:59 pm (Eastern Time); or (ii) the effective date of amendments to Commission regulation 50.52.

[5] See 78 Fed. Reg. at 21754 (citing to commenters and the 2012 inter-affiliate exemption notice of proposed rulemaking in support of the conclusion that “inter-affiliate transactions provide an important risk management role within corporate groups” and that “swaps entered into between corporate affiliates, if properly risk-managed, may be beneficial to the entity as a whole”).

[6] See Draft CFTC 2020-2024 Strategic Plan, 85 Fed. Reg. 29,935 (May 19, 2020), <https://www.govinfo.gov/content/pkg/FR-2020-05-19/pdf/2020-10676.pdf>.

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