THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy

By Electronic Mail

September 20, 2012

Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20219
Attention: David A. Stawick, Secretary

Regarding: Clearing Exemption for Swaps Between Certain Affiliated Entities

Dear Mr. Stawick:

The Financial Services Roundtable (the "Roundtable")[1] respectfully submits these comments in response to the proposed Clearing Exemption for Swaps Between Certain Affiliated Entities (the "Proposed Inter-Affiliate Exemption") released by the Commodity Futures Trading Commission (the "Commission").[2] We strongly support the Commission's efforts to exempt swaps between affiliated entities from the Commission's clearing requirements. As we have noted in previous comment letters,[3] swaps between affiliated members of corporate groups provide significant advantages, including streamlining documentation and centralizing risk management and oversight of swaps activities. In general, we believe inter-affiliate swaps should be exempt from clearing and trade execution requirements, and should only be subject to margin requirements to the extent other applicable law, such as Sections 23A and 23B of the Federal Reserve Act, imposes restrictions on affiliate transactions. In addition, we agree that the end-user exemption[4] should be available for inter-affiliate swaps when either party to such swap would independently qualify for such exemption.

Although we generally support the Proposed Inter-Affiliate Exemption, we believe certain conditions to the use of the exemption should be clarified or modified to increase its usefulness for affiliated entities. We discuss our recommended changes below.

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[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[2] 77 Fed. Reg. 50425 (August 21, 2012).

[3] *See e.g.* Letter from The Financial Services Roundtable to Elizabeth M. Murphy, Secretary of the Securities and Exchange Commission and David A. Stawick, Secretary of the Commodity Futures Trading Commission, *Key Definitions in Title VII of the Dodd-Frank Act*, September 20, 2010; Letter from the ABA Securities Association, The Financial Services Roundtable et. al. to David A. Stawick, Secretary of the Commodity Futures Trading Commission, *Treatment of Inter-Affiliate Transactions under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, September 8, 2011.

[4] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42560 (July 19, 2012).

Clarify no requirement to exchange initial margin. We request that the final exemption specifically state that the exchange of initial margin is not required between affiliates. Although this is implied, and we understand it to be the intent of the provision, a clear statement to this effect would be helpful to market participants.

Limit requirement to exchange variation margin to circumstances in which entities are subject to affiliate transaction restrictions under other applicable law. A number of types of regulated entities, including banks, public utility companies, registered investment companies and insurance companies, may be subject to various restrictions on affiliate transactions. For example, Sections 23A & 23B of the Federal Reserve Act and Regulation W provide an existing framework of restrictions, including collateral requirements, which are applicable to transactions between banks and their affiliates. Although many of these transactions are subject to restrictions that limit the ability of unregulated entities to transfer risk to their regulated banking affiliates, certain transactions between banks and their affiliates are not restricted in this way. In particular, subsidiaries of banks (if such subsidiaries are not themselves banks) are generally not treated as "affiliates" under Sections 23A & 23B, and accordingly are not subject to the restrictions of these provisions. The restrictions that have been established for these regulated entities reflect careful deliberations with regard to whether, and in what circumstances, inter-affiliate transactions create risks to the regulated entities that should be subject to regulatory constraint.

Inter-affiliate swaps are often used to allocate risk within a corporate family and to facilitate sound and efficient risk management within the corporate group as a whole. Inter-affiliate swaps are common among corporate end-users, including financial end-users that are not banks and are not currently subject to variation margin requirements. To mandate that variation margin be exchanged for inter-affiliate swaps involving non-bank financial end users will limit the ability of companies to efficiently allocate risk among affiliates and manage that risk centrally. It will discourage sound risk management and make the overall system less safe rather than mitigate risk.

We also believe that the Commission should not expand the requirement to post variation margin to transactions between affiliated entities that are not subject to affiliate transaction requirements by statute or other regulation. In other words, rather than having a stand-alone requirement to post variation margin in certain circumstances, the Commission should require that variation margin be posted only when the primary regulator for one of the entities has imposed such a requirement for affiliate transactions.

Requirements for variation margin for inter-affiliate swaps should be clarified. Financial entities that have in place credit support annexes with their affiliates and that require the exchange of variation margin may nonetheless have minimum transfer amounts, thresholds and other arrangements that would be inconsistent with the Commission's proposed margin rules, but that are consistent with the regulatory requirements of the primary regulator. We believe that such arrangements should be permitted in connection with inter-affiliate swaps relying on the clearing exemption, and ask the Commission for further clarification of this point.

Financial entities with 100% common ownership should not be required to post margin to each other, even if they do not have a common guarantor. Section 39.6(g)(2)(iv) indicates that the margin requirements for transactions between financial entities will not apply in the case

of "100% commonly-owned and commonly-guaranteed affiliates where the common guarantor is also 100% commonly-owned." We believe that 100% common ownership creates a sufficient alignment of interests between the swap counterparties, and sufficiently places the risk of the swap on the ultimate parent entity, so that the exchange of variation margin would do little to mitigate intercompany risk. Moreover, there are a number of circumstances in which the common guarantee proposed by the Commission would be unworkable, but the general economic effect would be identical to that in the proposal. For example, if parent X enters into a swap with third party T and concurrently enters into a back-to-back swap with its wholly owned subsidiary S, there is no clear entity to act as guarantor. However, we see no reason to treat this situation differently in terms of variation margin than in the example provided by the Commission, in which the Commission concluded that the risk was borne by the enterprise as a whole.[5] Subject to our previous comments about circumstances in which the posting of variation margin is consistent with other existing statutory or regulatory restrictions on affiliate transactions for regulated entities, we believe that the margin requirements should not be applicable for 100% commonly owned affiliates even if they do not have a shared guarantor.

The inter-affiliate exemption should apply to swaps between two non-U.S. affiliates, even if such non-U.S. affiliates are not located in countries with clearing regimes comparable to the U.S. regime. Under the Commission's proposed guidance on the extraterritorial application of Title VII,[6] some non-U.S. entities may be subject to regulation by the Commission as swap dealers or major swap participants to the extent they transact with U.S. persons. These non-U.S. entities would not be subject to the Commission's transaction level requirements for swaps to the extent they are not transacting with U.S. persons. However, the extraterritorial guidance is not yet final and may be complicated by the presence of U.S. guarantees and other U.S. connections. Regardless of the complexities of the extraterritorial guidance, we believe that a swap between two non-U.S. affiliates, even if they are financial entities, should not require either the clearing or exchange of margin.

Eliminate requirements for integrated risk management. We understand that integrated risk management systems are generally not established across international boundaries and are not considered to be consistent with general practices for the management of risk in multinational organizations. We therefore believe that requiring such systems would make the inter-affiliate swap exemption unavailable in one of the circumstances in which it is most needed, namely for large multinational organizations. As long as each entity makes its own evaluations of the risk associated with an inter-affiliate position, we see no reason that integrated risk management should be required.

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[5] The example in the preamble to the Proposed Inter-Affiliate Exemption reads as follows:

> To provide an example, assume that A and B are guaranteed wholly-owned subsidiaries of X. B enters into a swap with nonaffiliated third party T. B then enters into a back-to-back swap (mirroring the risk created in the swap with T) with A (i.e., an inter-affiliate swap). In this scenario, the risk associated with the swap with T is effectively borne by X and therefore ultimately borne by the enterprise. In such circumstances therefore the inter-affiliate swap does not create new risks for the enterprise, rather, it allocates the risk from one wholly-owned subsidiary to another. The posting of variation margin here would not substantially mitigate the risk of the inter-affiliate swap because the inter-affiliate swap itself does not create new risks for the enterprise.

Proposed Inter-Affiliate Exemption at 50430.

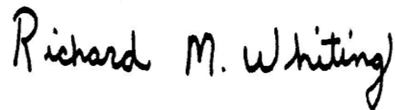
[6] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41214 (July 12, 2012)

Clarify accounting standards for consolidation. To the extent the Commission requires that the entities relying on the inter-affiliate exemption be consolidated for financial reporting purposes, we ask that the Commission clarify that alternatives to GAAP (such as RAP or IFRS) may be used in preparing the financial statements evidencing such consolidation.

Conclusion

We appreciate your consideration of our comments regarding this important topic. If you have any questions, please do not hesitate to call me or Richard Foster, the Roundtable's Senior Regulatory Counsel, at (202) 589-2424 or RFoster@fsround.org.

Sincerely,



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