CRAVATH, SWAINE & MOORE LLP

WORLDWIDE PLAZA
825 EIGHTH AVENUE
NEW YORK, NY 10019-7475

TELEPHONE: (212) 474-1000
FACSIMILE: (212) 474-3700

CITYPOINT
ONE ROPEMAKER STREET
LONDON EC2Y 9HR
TELEPHONE: 44-20-7453-1000
FACSIMILE: 44-20-7860-1150

WRITER'S DIRECT DIAL NUMBER

(212) 474-1270

STUART W. GOLD
JOHN W. WHITE
EVAN R. CHESLER
MICHAEL L. SCHLER
RICHARD LEVIN
KRIS F. HEINZELMAN
B. ROBBINS KIESSLING
ROGER D. TURNER
PHILIP A. GELSTON
RORY O. MILLSON
FRANCIS P. BARRON
RICHARD W. CLARY
WILLIAM P. ROGERS, JR.
JAMES D. COOPER
STEPHEN L. GORDON
DANIEL L. MOSLEY
PETER S. WILSON
JAMES C. VARDELL, III
ROBERT H. BARON
KEVIN J. GREHAN
STEPHEN S. MADSEN
C. ALLEN PARKER
MARC S. ROSENBERG
SUSAN WEBSTER
DAVID MERCADO
ROWAN D. WILSON
CHRISTINE A. VARNEY
PETER T. BARBUR
SANDRA C. GOLDSTEIN
THOMAS G. RAFFERTY
MICHAEL S. GOLDMAN
RICHARD HALL
JULIE A. NORTH
ANDREW W. NEEDHAM
STEPHEN L. BURNS
KEITH R. HUMMEL
DANIEL SLIFKIN
ROBERT I. TOWNSEND, III
WILLIAM J. WHELAN, III
SCOTT A. BARSHAY
PHILIP J. BOECKMAN
ROGER G. BROOKS
WILLIAM V. FOGG
FAIZA J. SAEED
RICHARD J. STARK
THOMAS E. DUNN
MARK I. GREENE
SARKIS JEBEJIAN
DAVID R. MARRIOTT
MICHAEL A. PASKIN
ANDREW J. PITTS
MICHAEL T. REYNOLDS
ANTONY L. RYAN
GEORGE E. ZOBITZ
GEORGE A. STEPHANAKIS
DARIN P. MCATEE
GARY A. BORNSTEIN
TIMOTHY G. CAMERON
KARIN A. DEMASI
LIZABETHANN R. EISEN
DAVID S. FINKELSTEIN
DAVID GREENWALD
RACHEL G. SKAISTIS
PAUL H. ZUMBRO
JOEL F. HEROLD
ERIC W. HILFERS
GEORGE F. SCHOEN
ERIK R. TAVZEL
CRAIG F. ARCELLA
TEENA-ANN V. SANKOORIKAL
ANDREW R. THOMPSON
DAMIEN R. ZOUBEK
LAUREN ANGELILLI
TATIANA LAPUSHCHIK
ERIC L. SCHIELE
ALYSSA K. CAPLES
JENNIFER S. CONWAY
MINH VAN NGO
KEVIN J. ORSINI
MATTHEW MORREALE
J. WESLEY EARNHARDT
YONATAN EVEN
BENJAMIN GRUENSTEIN
JOSEPH D. ZAVAGLIA

SPECIAL COUNSEL
SAMUEL C. BUTLER
GEORGE J. GILLESPIE, III

OF COUNSEL
PAUL C. SAUNDERS

COMMENT

September 20, 2012

Received CFTC
2012 SEP 24 PM 4:26
Office of the Secretariat

Proposed Rule for Clearing Exemption for
Swaps between Certain Affiliated Entities

(CFTC File: RIN 3038-AD47)

We appreciate the opportunity to provide comments on the proposed rule under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") recently published by the Commodity Futures Trading Commission (the "CFTC") regarding the exemption of swaps and security-based swaps from mandatory clearing, often referred to as the "inter-affiliate" exemption (the "Proposed Rule").[1]

Although the Dodd-Frank Act does not explicitly provide any specific exemption from the mandatory clearing requirement to swaps entered into by affiliates ("inter-affiliate swaps"), it does provide the CFTC with the ability to "make a determination as to whether [a particular] swap or group, category, type, or class of swaps should be required to be cleared".[2] We believe the CFTC acted properly in proposing an exemption from clearing for inter-affiliate swaps; however we believe the Proposed Rule overstates the risks related to inter-affiliate swaps and the exemption should be broadened such that swaps between wholly-owned or majority-owned affiliates should be entirely exempted from clearing, margining and reporting requirements.

---

[1] Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 Fed. Reg. 50425 (Aug. 21, 2012).
[2] Public Law 111-203, §§ 723(a), 763(a), 124 Stat. at 1676, 1762 (adding Commodity Exchange Act ("CEA") § 2(h)(2)).

Background

Wholly-owned or majority-owned affiliates within a corporate group often engage in inter-affiliate swap transactions to allocate the economics of the hedges entered into by the parent company (or other market-facing member of the group) to the particular subsidiary or other affiliate whose operations give rise to the related risks. These transactions are in almost every case intended to address internal accounting and risk management requirements by allocating risks within the corporate group. They do not, in any practical sense, change the risk to the financial system posed by the corporate group or its members. This is true regardless of whether the internal swap transactions are guaranteed (which is neither typical nor necessary). Because the Dodd-Frank Act was enacted for the purpose of reducing systemic risk within the financial system, it is not at all clear that imposing costly clearing, margining, documentation, trade execution and reporting requirements on transactions that do not impact the overall credit risk of a corporate group to the financial system would have any meaningful benefits or serve the purposes of the Dodd-Frank Act. This is particularly true in the case of industrial companies which are not subject to specific regulatory regimes that impose additional risk management or regulatory considerations on internal transfers within the corporate group.

Proposed Margin Requirements

The requirement in the Proposed Rule that affiliated companies which meet the broad definition of "financial entities" must post variation margin to one another to support their inter-affiliate swap transaction is not necessary to protect the financial system. While posting margin is a valid way to reduce systemic risk posed by market-facing swaps with third parties, it does not follow that margin requirements should apply to inter-affiliate swaps which do not create counterparty credit risk. The posting of such margin would unnecessarily tie up capital that could otherwise be used for investment purposes to create jobs and goods and services for the economy. It is not clear why it would be necessary to post variation margin to protect the financial system in the context of inter-affiliate swaps when the back-to-back market-facing swap entered into by an end-user affiliate would not be subject to any such requirement. Additionally, the Proposed Rule would allow an exemption from posting variation margin only in the limited case where the affiliates are 100% commonly-owned and commonly-guaranteed. It seems to be entirely irrelevant whether one or both of the parties' obligations are guaranteed—the fact that the entire risk is carried by two related parties in the same corporate group should be sufficient to eliminate any requirement to post margin.

Reporting Requirements

We believe, based on discussions with our clients, particularly those in businesses outside the financial institution sector, that many companies will have difficulty collecting and producing the detailed information required for historical swap reporting without diverting significant time and resources to the project. Moreover, the level of documentation usually associated with inter-affiliate swap transactions among subsidiaries in an industrial company's corporate group is typically not equivalent to the

documentation associated with a market-facing transaction but instead is quite minimal, which is consistent with the internal risk management purposes served by the swap transactions. Additionally, many companies will need to invest substantial amounts of time and financial resources to develop systems to produce the required documentation and verify the swap information required for new swap transactions among wholly-owned or majority-owned affiliates. There is nothing in the Dodd-Frank Act expressly requiring the reporting of inter-affiliate swaps, and therefore we believe that the Proposed Rule should provide meaningful relief from the reporting requirements of Part 45 and Part 46. The Commission has already determined that the Real-Time Public Reporting requirements contained in Part 43 should not apply to inter-affiliate swaps, on the basis that they are not arm's-length transactions. Such inter-affiliate swap transactions which manage risk among wholly-owned or majority-owned subsidiaries of the same parent without increasing counterparty credit exposure do not require public dissemination to serve the purposes of the Dodd-Frank Act under Part 43. We believe that the same logic applies to Part 45 and Part 46. Moreover, given that all market-facing swaps will be reported by the relevant reporting party, the risk associated with the internal swaps of all end-user groups will already be included in the information provided to the CFTC. The administrative and managerial costs and burdens of applying the same rules to inter-affiliate swaps as are applied to the related market-facing swaps would appear to us to outweigh any regulatory benefit associated with the reporting of these inter-affiliate swaps.

Documentation and Risk Management Requirements

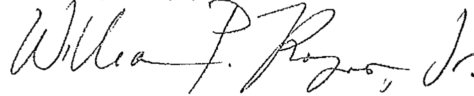
For the reasons outlined above, we believe that the costs associated with the imposition of the documentation requirements and risk management procedural requirements imposed on inter-affiliate swaps significantly outweigh any perceived benefit to the financial system. Particularly in the case of companies outside the financial institution sector, which comprise by far the largest group of companies that will be subject to these requirements, the Proposed Rule will in many cases mandate a substantial change in the processes and procedures currently maintained by these companies. Companies should have the flexibility to engage in prudent risk management for their corporate group in a manner consistent with the overall level of risks to their business. The level of documentation necessary for inter-affiliate swaps should be part of that analysis and should be left to the boards and management of companies to determine in the reasonable exercise of their fiduciary responsibilities.

* * *

We thank you for the opportunity to comment on the Proposed Rule for the inter-affiliate exemption from mandatory clearing of swaps under the Dodd-Frank

Act. We would be pleased to discuss the contents of this letter in greater detail with the CFTC. Please feel free to the undersigned at 212-474-1270 or wrogers@cravath.com with questions you may have regarding the contents of this letter.

Very truly yours,



William P. Rogers, Jr.

David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581