Previously submitted comments do not need to be resubmitted.

Authority: 50 U.S.C. 1701 *et seq.;* 50 U.S.C. 1601 *et seq.;* and section 301 of Title 3, United States Code.

Wilbur L. Ross,

Secretary of Commerce.

[FR Doc. 2019–27596 Filed 12–19–19; 8:45 am]

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 50

RIN 3038–AE92

Exemption From the Swap Clearing Requirement for Certain Affiliated Entities—Alternative Compliance Frameworks for Anti-Evasionary Measures

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Commodity Futures Trading Commission (Commission or CFTC) is proposing revisions to the Commission regulation that exempts certain affiliated entities within a corporate group from the swap clearing requirement under the applicable provision of the Commodity Exchange Act (CEA or Act). The revisions concern the anti-evasionary condition that swaps subject to the clearing requirement entered into with unaffiliated counterparties either be cleared or be eligible for an exception to or exemption from the clearing requirement. Specifically, the revisions would make permanent certain temporary alternative compliance frameworks intended to make this anti-evasionary condition workable for international corporate groups in the absence of foreign clearing regimes determined to be comparable to U.S. requirements.

DATES: Comments must be received on or before February 21, 2020.

ADDRESSES: You may submit comments, identified by RIN 3038–AE92, by any of the following methods:

- *CFTC Comments Portal: http://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above. Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (FOIA), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *https://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the FOIA.

FOR FURTHER INFORMATION CONTACT: Sarah E. Josephson, Deputy Director, Division of Clearing and Risk, at 202–418–5684 or *sjosephson@cftc.gov;* Melissa A. D'Arcy, Special Counsel, Division of Clearing and Risk, at 202–418–5086 or *mdarcy@cftc.gov;* or Stephen A. Kane, Office of the Chief Economist, at 202–418–5911 or *skane@cftc.gov,* in each case at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

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I. Background

A. Overview of Existing Practice

This proposed rulemaking addresses the compliance requirements for market participants electing not to clear inter-affiliate swaps under Commission regulation 50.52. This regulation permits counterparties to elect not to clear swaps between certain affiliated entities, subject to a set of conditions.[2] These conditions include a general requirement that each eligible affiliate counterparty clear swaps executed with unaffiliated counterparties, if the swaps are covered by the Commission's clearing requirement.[3]

As adopted in 2013, the regulation also included two alternative compliance frameworks (Alternative Compliance Frameworks) that allowed counterparties to pay and collect variation margin in place of swap clearing for certain outward-facing swaps.[4] The Alternative Compliance Frameworks were adopted for a limited time period and expired on March 11, 2014.[5] Since that time, market participants have requested that Commission staff provide relief equivalent to the Alternative Compliance Frameworks through no-action letters. The Division of Clearing and Risk (DCR) first provided no-action relief in 2014. DCR issued CFTC Letter No. 14–25 in response to a request from the International Swaps and Derivatives Association (ISDA) to provide relief equivalent to the expiring Alternative Compliance Frameworks set forth in Commission regulation 50.52.[6] DCR subsequently extended the no-action relief provided under CFTC Letter No. 14–25 and later expanded the relief in a series of five additional no-action letters.[7]

[1] 17 CFR 145.9. Commission regulations referred to herein are found at 17 CFR chapter I.

[2] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750 (Apr. 11, 2013).

[3] Commission regulation 50.52(b)(4)(i).

[4] Commission regulation 50.52(b)(4)(ii) through (iii) (discussed in the **Federal Register** release adopting Commission regulation 50.52, the Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21763–21766 (Apr. 11, 2013)).

[5] 78 FR 21763—21765.

[6] CFTC Letter No. 14–25 (Mar. 6, 2014).

[7] CFTC Letter Nos. 14–135 (Nov. 7, 2014), 15–63 (Nov. 17, 2015), 16–81 (Nov. 28, 2016), 16–84 (Dec. 15, 2016), and 17–66 (Dec. 14, 2017), all available at *https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.* CFTC Letter No. 17–66 expanded relief to parties transacting in Australia, Canada, Hong Kong, Mexico, or Switzerland and extended the relief to the earlier of (i) December 31, 2020 at 11:59 p.m. (Eastern Time); or (ii) the

In response to a 2017 request for information [8] seeking suggestions from the public for simplifying the Commission's regulations and practices, removing unnecessary burdens, and reducing costs, commenters asked the Commission to codify the Alternative Compliance Frameworks.[9] Among the comment letters received by the Commission were six comments discussing the Commission's inter-affiliate exemption, and four of those commenters specifically requested that the Commission extend the availability of, or codify, CFTC Letter No. 16–81.

The Commission preliminarily believes that adopting rules to permit affiliated entities to comply with revised Alternative Compliance Frameworks on a permanent basis (in line with the relief granted in CFTC Letter No. 17–66 and prior letters) will provide legal certainty to swap market participants and increase the flexibility offered to counterparties electing not to clear inter-affiliate swaps, while keeping compliance costs and burdens on market participants low. As a result, the Commission is proposing to adopt regulatory revisions to (i) reinstate the Alternative Compliance Frameworks as a permanent option for certain swaps between affiliated entities in line with the existing no-action relief under CFTC Letter No. 17–66, and (ii) make other minor changes to Commission regulation 50.52. In this proposal, the Commission is not considering any changes with regard to the trade execution requirement because those are the subject of another ongoing rulemaking.[10]

B. Swap Clearing Requirement

Under section 2(h)(1)(A) of the CEA, if the Commission requires a swap to be cleared, then it is unlawful to enter into that swap unless the swap is submitted for clearing to a derivatives clearing organization (DCO) that is registered under the CEA or a DCO that the Commission has exempted from registration under section 5b(h) of the CEA. In 2012, the Commission issued its first clearing requirement determination, pertaining to four classes of interest rate swaps and two classes of credit default swaps.[11] In 2016, the Commission expanded the classes of interest rate swaps subject to the clearing requirement to cover fixed-to-floating interest rate swaps denominated in nine additional currencies, as well as certain additional basis swaps, forward rate agreements, and overnight index swaps.[12] The regulations implementing the clearing requirement are in subpart A to part 50 of the Commission's regulations. Subpart C to part 50 provides for an exception to, as well as two exemptions from, the clearing requirement.

C. Commission Regulation 50.52

One of the exemptions from the clearing requirement, in Commission regulation 50.52, provides an exemption for swaps between certain affiliated entities, subject to specific requirements and conditions (Inter-Affiliate Exemption).[13] Two affiliated entities are eligible to elect the Inter-Affiliate Exemption for a swap if each of the counterparties meets the definition of ''eligible affiliate counterparty'' set forth in Commission regulation 50.52(a). The terms of the exempted swap must comply with a documentation requirement and be subject to a centralized risk management program.[14] The election of the Inter-Affiliate Exemption, as well as how the requirements of the exemption are met, must be reported to a Commission-registered swap data repository (SDR).[15] Finally, as discussed above, the Inter-Affiliate Exemption generally requires each eligible affiliate counterparty to clear swaps executed with unaffiliated counterparties (*i.e.,* outward-facing swaps), if the swaps are covered by the Commission's clearing requirement and do not otherwise qualify for an exception to or exemption from the clearing requirement.[16]

The Commission continues to believe that it is necessary to impose risk-mitigating conditions on inter-affiliate swaps. As the Commission stated in the **Federal Register** adopting release issuing the Inter-Affiliate Exemption, entities that are affiliated with each other are separate legal entities notwithstanding their affiliation.[17] As separate legal entities, affiliates generally are not legally responsible for each other's contractual obligations. This legal reality becomes readily apparent when one or more affiliate(s) become insolvent.[18] Affiliates, as separate legal entities, are managed in bankruptcy as separate estates and the trustee for each debtor estate has a duty to the creditors of the affiliate, not the corporate family, the parent of the affiliates, or the corporate family's creditors.[19]

effective date of amendments to Commission regulation 50.52.

[8] *See* 82 FR 21494 (May 6, 2017) and 82 FR 23765 (May 24, 2017).

[9] *See* the Financial Services Roundtable's comments dated Sept. 30, 2017, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61430* (requesting that the Commission exempt inter-affiliate swaps transactions from the scope of all swaps regulations or, as an alternative, codify the no-action relief provided under CFTC Letter No. 16–81). *See* the Institute of International Bankers' comments dated September 29, 2017, available at: *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61384* (requesting that the Commission codify the no-action relief granted under CFTC Letter Nos. 16–81 and 16–84, as well as provide that market participants can presume that the five percent test (discussed in more detail below) does not apply to swaps with affiliates located in jurisdictions that have adopted a clearing requirement). *See* the Securities Industry and Financial Markets Association's comments dated September 29, 2017, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61360* (requesting that the Commission eliminate the outward-facing swap condition to the inter-affiliate exemption or, as an alternative, codify the no-action relief granted under CFTC Letter No. 16–81, and eliminate the five percent test). *See* the International Swaps and Derivatives Association, Inc.'s comments dated September 29, 2017, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61352* (requesting that the Commission grant relief that is not time-limited that is similar to the no-action relief provided under CFTC Letter Nos. 16–81 and 16–84). *See also* the Commodity Markets Council's comments dated September 29, 2017, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61348* (requesting that the Commission establish a permanent exemption for all inter-affiliate swaps from the clearing requirement). *See also* Credit Suisse Holdings USA's comments dated September 29, 2017, available at *https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61424* (requesting that the Commission exempt all inter-affiliate swaps from the clearing requirement, so long as the transactions are: Reported to a swap data repository; centrally risk-managed; and subject to the exchange of variation margin).

[10] The Commission previously proposed an exemption from the trade execution requirement under section 2(h)(8) of the CEA for swap transactions to which the exceptions or exemptions to the clearing requirement that are specified under part 50 apply. The Commission continues to evaluate this proposal as part of its larger evaluation of the regulatory framework for swap execution facilities. *See* Swap Execution Facilities and Trade Execution Requirement, 83 FR 61946 (Nov. 30, 2018).

[11] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012).

[12] Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016).

[13] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750 (Apr. 11, 2013).

[14] Commission regulation 50.52(b)(2) through (3).

[15] Commission regulation 50.52(c) through (d).

[16] Commission regulation 50.52(b)(4)(i) (the ''Outward-Facing Swaps Condition'').

[17] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21752–21753.

[18] Note, for example, that while Rule 1015 of the Federal Rules of Bankruptcy Procedure (FRBP) permits a court to consolidate bankruptcy cases between a debtor and affiliates, FRBP Rule 2009 provides that, among other things, if the court orders a joint administration of two or more estates under FRBP Rule 1015, the trustee shall keep separate accounts of the property and distribution of each estate. *See* Federal Rules of Bankruptcy Procedure (2011).

[19] *See In re L & S Indus., Inc.,* 122 B.R. 987, 993–994 (Bankr. N.D. Ill. 1991), *aff'd* 133 B.R. 119, *aff'd* 989 F.2d 929 (7th Cir. 1993) (''A trustee in

Continued

D. Outward-Facing Swaps Condition

The Outward-Facing Swaps Condition requires that an eligible affiliate counterparty relying on the Inter-Affiliate Exemption clear any swap covered by the Commission's clearing requirement (*i.e.,* an interest rate or credit default swap identified in Commission regulation 50.4) that is entered into with an unaffiliated counterparty, unless the swap qualifies for an exception or exemption from the clearing requirement under part 50.[20] This provision applies to any eligible affiliate counterparty electing the Inter-Affiliate Exemption, including an eligible affiliate counterparty located outside of the United States.

The Outward-Facing Swaps Condition is intended to prevent swap market participants from using the Inter-Affiliate Exemption to evade the clearing requirement or to transfer risk to U.S. firms by entering into uncleared swaps with non-U.S. affiliates in jurisdictions that do not have mandatory clearing regimes comparable to the Commission's clearing requirement regime.[21] Such evasion could be accomplished if the non-U.S. affiliate enters into a swap with an unaffiliated party also located outside of the U.S. and that swap is related on a back-to-back or matched book basis with the swap executed with the affiliated party located in the U.S.[22] In the adopting release to the Inter-Affiliate Exemption, the Commission noted that section 2(h)(4)(A) of the CEA requires the Commission to prescribe rules to prevent evasion of the clearing requirement.[23]

E. Alternative Compliance Frameworks

1. Background

When the Commission adopted the Inter-Affiliate Exemption, it provided two Alternative Compliance Frameworks with which eligible affiliate counterparties located outside of the United States could comply, until March 11, 2014, instead of complying with the Outward-Facing Swaps Condition.[24] These Alternative Compliance Frameworks were not in the original rule proposal, but the Commission added them to the final rule in order to address concerns raised by commenters about the need to align the Commission's Inter-Affiliate Exemption with clearing regimes in other jurisdictions.[25] In the proposal, the Commission did not identify specific jurisdictions for specially-tailored outward-facing swaps requirements.[26] Rather, the Commission proposed a set of conditions that would have required non-U.S. affiliate counterparties to clear almost all outward-facing swaps.[27] Recognizing the concerns expressed by commenters,[28] the Commission adopted a final rule that gave non-U.S. affiliates more flexibility in complying with the outward-facing swap requirements. At the time the Commission adopted its final rule, the Commission expected other jurisdictions to adopt their own clearing requirements soon thereafter and determined that an alternative compliance framework was needed for only twelve months after required clearing began in the United States.[29] The Outward-Facing Swaps Condition under Commission regulation 50.52 was an attempt to balance flexibility for non-U.S. affiliates with the need to protect against evasion of the Commission's clearing requirement.

Under existing Commission regulation 50.52(b)(4)(ii)(A), which expired on March 11, 2014, if one of the eligible affiliate counterparties to a swap is located in the European Union, Japan, or Singapore, either of the following satisfies the Outward-Facing Swaps Condition:

(1) Each eligible affiliate counterparty, or a third party that directly or indirectly holds a majority interest in both eligible affiliate counterparties, pays and collects full variation margin daily on all swaps entered into between the eligible affiliate counterparty located in the European Union, Japan, or Singapore and an unaffiliated counterparty; or

(2) Each eligible affiliate counterparty, or a third party that directly or indirectly holds a majority interest in both eligible affiliate counterparties, pays and collects full variation margin daily on all of the eligible affiliate counterparties' swaps with other eligible affiliate counterparties.[30]

Under existing Commission regulation 50.52(b)(4)(ii)(B), which expired on March 11, 2014, an eligible affiliate counterparty located in the European Union, Japan, or Singapore is not required to comply with either the Outward-Facing Swaps Condition or the variation margin provisions of Commission regulation 50.52(b)(4)(ii)(A), provided that the one counterparty that directly or indirectly holds a majority ownership interest in the other counterparty or the third party

bankruptcy represents the interests of the debtor's estate and its creditors, not interests of the debtor's principals, other than their interests as creditors of estate.''); *In re New Concept Housing, Inc.,* 951 F.2d 932, 938 (8th Cir. 1991) (quoting *In re L & S Indus., Inc.*). While the concept of ''substantive consolidation'' of affiliates in a business enterprise when they all enter into bankruptcy is sometimes used by a bankruptcy court, substantive consolidation is generally considered an extraordinary remedy to be used in limited circumstances. *See Substantive Consolidation—A Post-Modern Trend,* 14 Am. Bankr. Inst. L. Rev. 527 (Winter 2006).

[20] Commission regulation 50.52(b)(4)(i). The Outward-Facing Swaps condition also permits an eligible affiliate counterparty to clear a swap pursuant to a non-U.S. clearing requirement that the Commission has determined to be ''comparable, and comprehensive but not necessarily identical, to the clearing requirement of section 2(h) of the [CEA]'' and to part 50, or to comply with an exception to or an exemption from a non-U.S. clearing requirement that the Commission has determined to be comparable to an exception or exemption under section 2(h)(7) of the CEA and part 50. The Commission has made no such comparability determination.

[21] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21760–21762.

[22] *Id.* at 21760.

[23] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21761. The Commission also notes that Commission regulation 1.6 makes it unlawful to conduct activities outside the United States, including entering into agreements, contracts, and transactions and structuring entities, to willfully evade or attempt to evade any provision of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, including the swap clearing requirement under section 2(h)(1) of the CEA. Any such evasionary conduct will be subject to the relevant provisions of Title VII. In determining whether a transaction or entity structure is designed to evade, the Commission considers the extent to which there is a legitimate business purpose for such structure. 77 FR 48208, 48301 (Aug. 13, 2012).

[24] Commission regulation 50.52(b)(4)(ii) through (iii) (discussed in the **Federal Register** release adopting Commission regulation 50.52, the Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21763–21766).

[25] *See* Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21764.

[26] *See* Clearing Exemption for Swaps Between Certain Affiliated Entities, 77 FR 50423 (Aug. 21, 2012) (proposing regulation 39.6(g)(2)(v)) hereinafter, the ''Affiliated Entities Proposal'').

[27] The Commission's proposed inter-affiliate exemption would have required all inter-affiliate swaps with non-U.S. persons to satisfy one of three conditions: (i) The non-U.S. person affiliate is domiciled in a jurisdiction with a comparable and comprehensive regulatory regime for swap clearing, (ii) the non-U.S. person affiliate is otherwise required to clear swaps with third parties in compliance with U.S. law, or (iii) the non-U.S. person does not enter into swaps with third parties. *See* Affiliated Entities Proposal, 77 FR 50431 (discussing proposed regulation 39.6(g)(2)(v)).

[28] ''Notwithstanding the progress of other jurisdictions to implement their clearing regimes, as discussed above, the Commission is mindful of commenters' concerns that the compliance timeframe for the clearing requirement in the U.S. is likely to precede the adoption and/or implementation of the clearing regimes of most other jurisdictions.'' Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21764.

[29] ''The Commission believes that a transition period of 12 months after required clearing began in the U.S. is appropriate given its understanding of the progress being made on mandatory clearing in the specified foreign jurisdictions.'' Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR at 21764.

[30] Commission regulation 50.52(b)(4)(ii)(A).

that directly or indirectly holds a majority ownership interest in both counterparties is not a ''financial entity'' under section 2(h)(7)(C)(i) of the CEA and neither eligible affiliate counterparty is affiliated with an entity that is a swap dealer or major swap participant, as defined in Commission regulation 1.3.

In both of these provisions, the Commission determined that eligible affiliate counterparties located in the European Union, Japan, or Singapore were entitled to special flexibility because it had reason to believe that those jurisdictions would be moving forward with their own clearing requirements quickly.[31] Japan implemented a clearing regime and adopted a clearing requirement for certain products that was effective as of November 1, 2012, before the final Inter-Affiliate Exemption rule was published.[32] The European Union's over-the-counter derivatives reform legislation, including a requirement to adopt a clearing obligation, entered into force on August 16, 2012.[33] Later that year, on December 19, 2012, the European Commission adopted regulatory technical standards relating to the clearing obligation.[34] However, the European Securities and Markets Authority's first clearing obligation did not become effective until June 21, 2016. Finally, although Singapore was expected to make steady progress on its clearing requirement, it experienced some delays. The Singapore Parliament passed legislation adopting an over-the-counter derivatives regulatory regime in 2012,[35] and the clearing mandate for certain interest rate swaps became effective on October 1, 2018.[36]

Today, the Commission recognizes that some non-U.S. jurisdictions are still in the process of adopting their domestic clearing regimes, some non-U.S. jurisdictions may never implement clearing for swaps, and a number of non-U.S. regimes vary significantly in terms of product and participant scope from the Commission's clearing requirement. Given this reality, and the fact that relief equivalent to the Alternative Compliance Frameworks has been provided through a series of CFTC staff letters for over six years, the Commission is proposing amendments that would codify the relief provided in the CFTC staff letters, make the Alternative Compliance Frameworks a permanent option for certain swaps between affiliated entities, and make other minor changes to Commission regulation 50.52.

2. CFTC Staff Letters Providing Relief Equivalent to the Alternative Compliance Frameworks

CFTC staff examined and evaluated the swap market's continued reliance on the Alternative Compliance Frameworks each year following the Inter-Affiliate Exemption's adoption.[37] In March 2014, CFTC staff noted that the clearing mandates in the European Union and Singapore were not yet effective, and there was no comparability determination for Japan. CFTC staff issued CFTC Letter No. 14–25 providing relief equivalent to the Alternative Compliance Frameworks to December 31, 2014.[38] Later that year, CFTC staff extended the relief again until December 31, 2015.[39] CFTC staff continued to extend the availability of relief equivalent to the Alternative Compliance Frameworks annually and ultimately issued relief through December 31, 2020.[40]

It also was thought that the Alternative Compliance Frameworks would be needed only until the Commission issued comparability determinations with respect to the Commission's clearing requirement for non-U.S. jurisdictions. However, to date, the CFTC has not issued any comparability determinations.[41] Without a comparability determination, eligible affiliated entities could not elect to comply with their domestic clearing regime instead of the CFTC's requirements for the Outward-Facing Swaps Condition as provided for under Commission regulations 50.52(b)(4)(i)(B) and (D). As a result of this and other difficulties, market participants have continued to seek relief from CFTC staff relating to both of the Alternative Compliance Frameworks.[42]

Aside from providing relief equivalent to the Alternative Compliance Frameworks, CFTC staff also issued relief to market participants that are transacting in swaps subject to the Commission's clearing requirement with eligible affiliates in jurisdictions other than the three identified under regulation 50.52 (the European Union, Japan, and Singapore). As explained above, in issuing Commission regulation 50.52(b)(4)(ii), the Commission limited the provision to swaps with counterparties located in those three jurisdictions because, at that time, they had established legal authority to adopt, and were in the process of implementing, clearing regimes.[43] Once additional jurisdictions started to adopt clearing mandates, the Commission monitored their progress and adopted

[31] The European Union, Japan, and Singapore were included in Commission regulation 50.52(b)(4)(ii) because they were seen as having taken ''significant steps towards further implementation'' of a clearing regime. Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21763.

[32] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21763–21764.

[33] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

[34] Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a central counterparty.

[35] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21763.

[36] *See* the Securities and Futures (Clearing of Derivatives Contracts) Regulations 2018, May 2, 2018, *available at https://sso.agc.gov.sg/SL-Supp/S264-2018. See also* the Monetary Authority of Singapore's press release, May 2, 2018, *available at http://www.mas.gov.sg/News-and-Publications/Media-Releases/2018/MAS-Requires-OTC-Derivatives-to-be-Centrally-Cleared-to-Mitigate-Systemic-Risk.aspx.*

[37] *See* CFTC Letter Nos. 14–25 (Mar. 6, 2014), 14–135 (Nov. 7, 2014), 15–63 (Nov. 17, 2015), 16–81 (Nov. 28, 2016), 16–84 (Dec. 15, 2016), and 17–66 (Dec. 14, 2017).

[38] CFTC Letter No. 14–25 (Mar. 6, 2014). The letter noted that ''extending the alternative compliance frameworks until December 31, 2014 may promote the adoption of comparable and comprehensive clearing requirements. [DCR] also believes that such extensions will allow for a more orderly transition as jurisdictions establish and implement clearing requirements and the Commission issues comparability determinations with regard to those requirements.'' CFTC Letter No. 14–25 (Mar. 6, 2014), at 4.

[39] CFTC Letter No. 14–135 (Nov. 7, 2014).

[40] *See* CFTC Letter Nos. 15–63 (Nov. 17, 2015), 16–81 (Nov. 28, 2016), and 17–66 (Dec. 14, 2017). Pursuant to CFTC Letter No. 17–66, DCR will not recommend that the Commission commence an enforcement action against an entity that uses Commission regulation 50.52(b)(4)(ii) or (iii) to meet the requirements of the Outward-Facing Swaps Condition until the earlier of (i) 11:59 p.m. (Eastern Time), December 31, 2020, or (ii) the effective date of amendments to Commission regulation 50.52.

[41] The CFTC continues to monitor and communicate with regulators in other jurisdictions as they consider and adopt clearing regimes. *See* discussion of non-U.S. jurisdictions' clearing regimes in the Commission's 2016 final rule adopting the expanded interest rate swap clearing requirement. Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71202, 71203–71205 (Oct. 14, 2016). However, each jurisdiction's clearing mandate is unique and tailored to its derivatives markets and its market participants. For example, in many non-U.S. jurisdictions, the scope of entities subject to a clearing mandate and the swaps covered by a clearing mandate varies significantly from the Commission's clearing requirement.

[42] Letter from the International Swaps and Derivatives Association, Inc. (ISDA) to the Commission ''Request for Commission Action—Part 50,'' dated Nov. 14, 2017 (2017 ISDA Letter), (requesting that the Commission make permanent the relief provided in CFTC Letter Nos. 16–81 and 16–84, among other things).

[43] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21764.

an expanded clearing requirement covering additional interest rate swaps that had been, or were expected to be, required to be cleared in other jurisdictions.[44] In the Commission's 2016 clearing requirement determination, the Commission expanded the clearing requirement to cover certain fixed-to-floating interest rate swaps denominated in the Australian dollar, Canadian dollar, Hong Kong dollar, Mexican peso, Norwegian krone, Polish zloty, Singapore dollar, Swedish krona, and Swiss franc, as well as specified other interest rate swaps.[45]

Approximately one month after the Commission adopted the expanded interest rate swap clearing requirement, market participants requested that the Commission broaden the list of jurisdictions included in the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii).[46] In response to ISDA's request, DCR issued CFTC Letter No. 16–84 to provide relief to eligible affiliate counterparties located in Australia and Mexico on the condition that they comply with the Inter-Affiliate Exemption using the Alternative Compliance Frameworks described in Commission regulation 50.52(b)(4)(ii).[47] DCR granted the relief with respect to only Australia and Mexico because the Commission's clearing requirement followed a phase-in compliance schedule and products denominated in Australian dollars and Mexican pesos were the first to be subject to the Commission's expanded clearing requirement.[48]

More recently, ISDA requested that the Commission codify the relief provided under CFTC Letter Nos. 16–81 and 16–84, because market participants continue to rely on the relief equivalent to Alternative Compliance Frameworks under Commission regulation 50.52(b)(4)(ii) and (iii).[49] In addition, ISDA requested that the Commission make the Alternative Compliance Frameworks available in five additional jurisdictions (for a total of eight) instead of limiting relief to the three jurisdictions included in Commission regulation 50.52.[50] The 2017 ISDA Letter requested that both of the Alternative Compliance Frameworks cover the home jurisdictions of the currencies included in the Commission's 2016 expanded clearing requirement determination (Australia, Canada, Hong Kong, Mexico, and Switzerland) because market participants would be increasing their swaps activity in those jurisdictions. For example, U.S. market participants and their affiliated entities would be expected to increase the number and percentage of their swaps in Mexico once the Commission adopted a clearing requirement for the Mexican peso, and a greater percentage of such affiliate's swaps subject to the clearing requirement would be conducted in Mexico as well. As non-U.S. currencies were added to the Commission's clearing requirement, market participants were expected to conduct more inter-affiliate swaps in those currencies and, most importantly, with affiliates located in the home jurisdiction of those currencies.[51]

In CFTC Letter No. 17–66, DCR extended further the availability of relief equivalent to Commission regulation 50.52(b)(4)(ii) to include eligible affiliate counterparties located in Australia, Canada, Hong Kong, Mexico, and Switzerland, so that those counterparties could use the relief equivalent to the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii) as well.[52] Once counterparties were permitted to rely on the Alternative Compliance Framework in Commission regulation 50.52(b)(4)(ii), they could use that Alternative Compliance Framework to satisfy the Outward-Facing Swaps Condition, instead of trying to stay within the limits of the five percent test under Commission regulation 50.52(b)(4)(iii).[53] CFTC Letter No. 17–66 permits eligible affiliates in any of the eight jurisdictions to comply with the Outward-Facing Swaps Condition using relief equivalent to Commission regulation 50.52(b)(4)(ii) until the letter expires on December 31, 2020.

3. Five Percent Limitation for Affiliated Counterparties in Certain Jurisdictions

Under existing Commission regulation 50.52(b)(4)(iii), which expired on March 11, 2014, an eligible affiliate counterparty located in the U.S. could comply with certain variation margin provisions in lieu of clearing, with respect to a swap executed opposite an eligible affiliate counterparty located in a non-U.S. jurisdiction other than the European Union, Japan, or Singapore, so long as a five percent test was met. According to this test, the aggregate notional value of swaps included in a class of swaps identified by Commission regulation 50.4 (classes of swaps covered by the Commission's clearing requirement) executed between an eligible affiliate counterparty located in the U.S. and an eligible affiliate counterparty located in a non-U.S. jurisdiction other than the European Union, Japan, or Singapore may not exceed five percent of the aggregate notional value of all swaps included in a class of swaps identified by Commission regulation 50.4 that are executed by the U.S. eligible affiliate counterparty. If the five percent threshold was exceeded, the Alternative Compliance Framework was unavailable, under existing Commission regulation 50.52(b)(4)(iii), in connection with swaps with eligible affiliate counterparties located in a non-U.S. jurisdiction other than the European Union, Japan, or Singapore.

Eligible affiliates in the jurisdictions discussed above have been granted relief through CFTC staff letters with respect to the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii), but CFTC staff has not issued no-action relief to remove those jurisdictions from the category of ''other jurisdictions'' contemplated by Commission regulation 50.52(b)(4)(iii). In light of the Commission's intent to clarify the application of its rules while maintaining protections against evasion of the clearing requirement, the Commission is proposing to exclude a number of non-U.S. jurisdictions from

[44] Clearing Requirement Determination under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016).

[45] *Id.*

[46] Letter from ISDA to the Commission dated Nov. 16, 2016, (requesting that certain provisions of the inter-affiliate exemption be available for swaps executed between U.S. swap market participants and their affiliated counterparties located in Australia, Canada, Hong Kong, Mexico, Singapore, and Switzerland).

[47] CFTC Letter No. 16–84 (Dec. 15, 2016). Regulators in Australia and Mexico adopted clearing requirements that became effective in their home countries in April 2016.

[48] CFTC Letter No. 16–84 (Dec. 15, 2016). The first compliance date, December 13, 2016, applied to Australian dollar-denominated fixed-to-floating interest rate swap and basis swaps, as well as Mexican peso-denominated fixed-to-floating interest rate swaps.

[49] 2017 ISDA Letter.

[50] *Id.*

[51] *See also* CFTC Letter No. 16–84 (Dec. 15, 2016), at 4 (discussing the effect of the Commission's 2016 expanded interest rate swap clearing determination on entities relying on relief equivalent to the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(iii)).

[52] CFTC Letter No. 17–66 (Dec. 14, 2017). All of the Commission's 2016 expanded interest rate swap clearing requirements have now become effective. The last compliance date for Singapore dollar-denominated fixed-to-floating interest rate swaps and Swiss franc-denominated fixed-to-floating interest rate swaps was on October 15, 2018.

[53] The Commission notes that at this point in time all jurisdictions that are being considered for inclusion in the text of regulation 50.52(b)(4)(ii) have established domestic clearing requirement regimes. Non-U.S. clearing requirements are in force for all of the eight jurisdictions included in proposed amendments to regulation 50.52(b)(4)(ii).

the category of ''other'' by listing them in the text of proposed regulation 50.52(b)(4)(iii), as discussed below.

II. Proposed Amended Regulation 50.52

The Commission proposes to revise the provisions of the expired Alternative Compliance Frameworks under Commission regulation 50.52(b)(4)(ii) through (iii). The proposed revisions would reinstate modified Alternative Compliance Frameworks in a manner substantially similar to the previously adopted provisions. The proposed frameworks will streamline the provision and simplify the manner by which market participants comply with the Outward-Facing Swaps Condition. The proposed regulations are designed to be consistent with the staff no-action relief that has been available since 2014.

The Commission believes that the revised regulations also would continue to prevent swap market participants from using inter-affiliate swaps to evade the clearing requirement or to transfer risk back to U.S. firms by entering into uncleared swaps in non-U.S. jurisdictions. In this proposal, the Commission maintains the Outward-Facing Swaps Condition and is suggesting small revisions to the Alternative Compliance Frameworks.

The Commission is not seeking to weaken the protections against evasion of the clearing requirement. For example, as proposed, there would be no change to the requirement that any swaps that are exempted from the clearing requirement under the Inter-Affiliate Exemption must be subject to a centralized risk management program.[54] All swaps exempted from the clearing requirement pursuant to the Inter-Affiliate Exemption will continue to be subject to the reporting requirements outlined in Commission regulation 50.52(c) through (d) and part 45 of the Commission's regulations. The Commission relies on these reporting requirements to monitor the number of entities electing the Inter-Affiliate Exemption, as well as the number of inter-affiliate swaps for which the exemption is claimed. Data on the election of the Inter-Affiliate Exemption is discussed in more detail below [55] and is presented as support for the Commission's view that this proposal to reinstate the Alternative Compliance Frameworks will not increase opportunities for affiliated entities to evade the clearing requirement.

A. Proposed Revised Alternative Compliance Frameworks

1. Variation Margin for Swaps With Affiliated Counterparties—In General

This proposal to revise the Alternative Compliance Frameworks would permit all non-U.S. eligible affiliate counterparties to comply with one of the Alternative Compliance Frameworks by paying and collecting full variation margin daily on all swaps with other eligible affiliate counterparties. The relevant provisions are in proposed revised regulation 50.52(b)(4). Paragraph (ii) of this proposed section applies if at least one of the eligible affiliate counterparties is located in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, or the United Kingdom, while paragraph (iii) of this proposed section addresses swaps entered into by eligible affiliate counterparties in the remaining jurisdictions.

The Commission preliminarily believes that the variation margin requirement included in both of the revised Alternative Compliance Frameworks, under proposed revised regulation 50.52(b)(4)(ii) and (iii), will mitigate the impact of any potential evasion of the Commission's clearing requirement. Although paying and collecting variation margin daily does not mitigate counterparty credit risk to the same extent that central clearing does, the Commission believes, as stated in the 2013 adopting release for the Inter-Affiliate Exemption, that variation margin is an essential risk management tool.[56] Variation margin requirements may prevent risk-taking that exceeds a party's financial capacity and acts as a limitation on the accumulation of losses when there is a counterparty default or failure to make payments. The process of paying and collecting variation margin accomplishes this by requiring swap counterparties to mark open positions to their current market value each day and to transfer funds between them to reflect any change in value since the previous time the positions were marked to market. This process prevents uncollateralized exposures from accumulating over time, which prevents the accumulation of additional counterparty credit risk on a position, and thereby reduces the size of exposure at default should one occur.

Accordingly, the Commission proposes to reinstate and revise the provision permitting all non-U.S. counterparties to pay and collect full variation margin daily on all of the eligible affiliate counterparties' swaps with other eligible affiliate counterparties.

Request for Comment. The Commission requests comment on the provisions for the collection of variation margin on swaps with affiliated counterparties. The proposed alternative compliance frameworks may produce a permanent residual class of swaps that are not cleared but instead result in the exchange of variation margin between eligible affiliate counterparties. Are there any additional risks to the counterparties or the market that have not been considered in this proposal, or any systemic risk implications for the United States, from the existence of such a class of swaps? If so, please describe such risks.

Are there other alternatives to the provisions for the collection of variation margin that the Commission should consider?

2. Variation Margin for Swaps With Affiliated Counterparties Under Commission Regulation 50.52(b)(4)(ii)

Commission regulation 50.52(b)(4)(ii), as reinstated and revised, would permit each eligible affiliate counterparty, or a third party that directly or indirectly holds a majority interest in both eligible affiliate counterparties, to pay and collect full variation margin daily on all of the eligible affiliate counterparties' swaps with other eligible affiliate counterparties, if at least one of the eligible affiliate counterparties is located in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, or the United Kingdom.[57] This approach is similar to current Commission regulation 50.52(b)(4)(ii)(A)(*2*), but with an expanded list of jurisdictions.

However, the Commission is not proposing to reinstate the provision to permit eligible affiliate counterparties to pay and collect variation margin on all swaps entered into between the eligible affiliate counterparty located outside of the U.S. and an unaffiliated counterparty (current Commission regulation 50.52(b)(4)(ii)(A)(*1*)). The Commission understands that eligible affiliate counterparties electing to comply with the Alternative Compliance Framework as permitted by

[54] Commission regulation 50.52(b)(3).

[55] *See* discussion regarding SDR data on the number of counterparties electing the Inter-Affiliate Exemption below.

[56] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21765 (citing the Affiliated Entities Proposal, 77 FR at 50429).

[57] The Commission is proposing to expand the list of jurisdictions under Commission regulation 50.52(b)(4)(ii) to include the United Kingdom as a separate jurisdiction from the European Union, in order to codify the no-action relief issued in preparation for the United Kingdom's withdrawal from the European Union, commonly referred to as ''Brexit.'' CFTC Letter No. 19–09 (April 5, 2019), *available at https://www.cftc.gov/csl/19-09/download.*

a staff no-action letter currently choose to pay and collect variation margin on swaps with affiliated counterparties rather than with unaffiliated counterparties. Therefore, in order to offer a simplified and streamlined Alterative Compliance Framework, the Commission proposes to reinstate only the provision upon which the Commission preliminarily believes eligible affiliate counterparties have been relying as a matter of market practice.

Request for Comment. The Commission requests comment as to whether any eligible affiliate counterparty has paid and collected variation margin on swaps with unaffiliated counterparties only under the relief equivalent to current Commission regulation 50.52(b)(4)(ii)(A)(*1*). If an eligible affiliate counterparty has complied with this provision, then the Commission requests comment as to why that provision was preferable to paying and collecting variation margin on all swaps with other eligible affiliate counterparties under the relief equivalent to current Commission regulation 50.52(b)(4)(ii)(A)(*2*). To what extent is compliance with the Outward-Facing Swaps Condition via the Alternative Compliance Frameworks consistent or inconsistent with margin requirements in non-U.S. jurisdictions?

3. Permanent Availability of the Alternative Compliance Framework Under Commission Regulation 50.52(b)(4)(ii)

Unlike Commission regulation 50.52(b)(4)(ii)(A), which expired on March 11, 2014, proposed revised regulation 50.52(b)(4)(ii) would be reinstated without an expiration date. The proposed regulation also would be expanded to include non-U.S. eligible affiliate counterparties located in Australia, Canada, Hong Kong, Mexico, Switzerland, or the United Kingdom, as well as eligible affiliate counterparties located in the European Union, Japan, or Singapore.

Market participants began relying on the Alternative Compliance Frameworks under Commission regulation 50.52(b)(4)(ii)(A) in 2013. The Commission is unaware of any compliance problems during the year-long period the regulation was in effect or under the DCR no-action letters that have provided relief equivalent to the expired Alternative Compliance Frameworks. This includes the period of time during which counterparties from the expanded list of countries have been eligible to use an Alternative Compliance Framework. Accordingly, the Commission preliminarily believes that codifying the current practice sufficiently addresses the risk transfer concerns that the Outward-Facing Swaps Condition was intended to resolve and would be responsive to the clear request from market participants for the staff no-action letters to be codified.[58]

Request for Comment. The Commission requests comment regarding the proposal to make the Alternative Compliance Frameworks a permanent option for non-U.S. eligible affiliate counterparties to comply with the Outward-Facing Swaps Condition of the Inter-Affiliate Exemption. Does codifying the current practice sufficiently address the risk transfer concerns that the Outward-Facing Swaps Condition was intended to resolve?

4. Proposing Not To Reinstate Commission Regulation 50.52(b)(4)(ii)(B)

The proposed reinstated and revised Alternative Compliance Frameworks would not include a provision similar to Commission regulation 50.52(b)(4)(ii)(B). Expired Commission regulation 50.52(b)(4)(ii)(B) permitted an eligible affiliate counterparty located in the European Union, Japan, or Singapore to elect the Inter-Affiliate Exemption without clearing an outward-facing swap or complying with the variation margin requirements currently set forth in subparagraph (b)(4)(ii)(A), provided that the majority owner of the affiliate counterparties, is not a ''financial entity'' under section 2(h)(7)(C)(i) of the CEA and neither eligible affiliate counterparty is affiliated with an entity that is a swap dealer or major swap participant, as defined in Commission regulation 1.3.

Based on a review of swap data, the Commission preliminarily believes that the Inter-Affiliate Exemption has been elected only by financial entities or entities affiliated with a swap dealer. The absence of other entity types electing the Inter-Affiliate Exemption may be due to the existence of the exception to the clearing requirement for non-financial end-users (End-User Exception under Commission regulation 50.50) and the exemption from the clearing requirement for certain cooperative entities (Cooperative Exemption under Commission regulation 50.51). Thus, in order to codify simplified Alternative Compliance Frameworks, the Commission proposes not to reinstate the provision under Commission regulation 50.52(b)(4)(ii)(B).

Request for Comment. The Commission requests comment as to whether an entity has relied on, or intends to rely on, the relief equivalent to the expired Alternative Compliance Framework in Commission regulation 50.52(b)(4)(ii)(B).

5. Proposing To Reinstate and Revise Commission Regulation 50.52(b)(4)(iii)

While proposed revised regulation 50.52(b)(4)(ii) would be available to six additional jurisdictions, the Commission recognizes that eligible affiliate counterparties may be located in other non-U.S. jurisdictions and proposes to reinstate a modified Alternative Compliance Framework under Commission regulation 50.52(b)(4)(iii) to address swaps entered into by eligible affiliate counterparties in the remaining jurisdictions that have not been identified under proposed revised regulation 50.52(b)(4)(ii).

As described above, expired Commission regulation 50.52(b)(4)(iii) permitted an eligible affiliate counterparty located in a non-U.S. jurisdiction (other than the European Union, Japan, or Singapore) to comply with variation margin requirements analogous to those available in Commission regulation 50.52(b)(4)(ii) for uncleared swaps subject to Commission regulation 50.4, provided that the U.S. counterparty's swaps with affiliates in all jurisdictions other than the European Union, Japan, and Singapore did not exceed five percent of the aggregate notional value of all of the U.S. counterparty's swaps subject to Commission regulation 50.4. The provisions of Commission regulation 50.52(b)(4)(iii) (including the ''five percent test'') are intended to apply to the ''other jurisdictions.'' Because the Commission is proposing to expand the jurisdictions eligible for the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii), it is proposing to amend the jurisdictions identified as ''other jurisdictions'' in a corresponding manner.

The five percent test establishes a relative limit on the amount of uncleared swaps activity—activity that would otherwise be subject to the Commission's clearing requirement—that any one U.S. eligible affiliate counterparty may conduct with its affiliated counterparties in certain ''other jurisdictions.'' In other words, the U.S. affiliate cannot enter into swaps that total (in aggregate) more than five percent of all of its swaps that are

[58] As noted above, the Commission received four comment letters in 2017 requesting that the Commission extend the availability of, or codify, CFTC Letter No. 16–81.

subject to the Commission's clearing requirement, with affiliates in the ''other jurisdictions.'' The five percent test has the practical effect of limiting the relative notional amount of uncleared swaps activity that affiliates conduct in jurisdictions that are not identified in Commission regulation 50.52(b)(4)(ii). The Commission continues to believe that limiting the relative notional amount of uncleared swaps executed in jurisdictions that have not established or implemented clearing regimes, along with conditioning relief on the use of variation margin, protects the eligible affiliate counterparty located in the United States from exposure to the risks associated with material swaps exposure in jurisdictions that do not have their own domestic clearing regime. There also exists the possibility that parties may alter their swaps trading in response to the proposed expansion of the number of jurisdictions excluded from the five percent limitation. To the extent that it now applies to fewer countries, a market participant's five percent exposure may be comprised of swaps with counterparties in less sophisticated swaps markets. The Commission invites comment on the market incentives and likely outcomes of its proposal.

The five percent test was adopted by the Commission as a time-limited measure to facilitate compliance with the Outward-Facing Swaps Condition. Before the provisions of the Alternative Compliance Frameworks expired in March 2014, DCR issued no-action letters designed to lengthen the transition period and to permit entities to continue complying with the terms in Commission regulation 50.52(b)(4)(iii). The Commission recognized that there may be affiliated counterparties located outside of the United States, the European Union, Japan, or Singapore, that would be engaging in inter-affiliate swaps and would need an alternative compliance mechanism until the unlisted jurisdictions implemented a clearing regime.

Now, six years after the Commission implemented its first clearing requirement, affiliated entities still face difficulties clearing outward-facing swaps locally, particularly in jurisdictions that have not adopted domestic clearing regimes. For this reason, the Commission is proposing to reinstate the Alternative Compliance Framework included under Commission regulation 50.52(b)(4)(iii), and to redefine the jurisdictions that will be eligible. The Commission is proposing to amend regulation 50.52(b)(4)(iii) to identify jurisdictions other than Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, the United Kingdom, or the United States as the ''other jurisdictions.'' The Commission preliminarily believes that the jurisdictions included in revised regulation 50.52(b)(4)(ii) have all established domestic clearing regimes and requirements that will help to protect against evasion of the Commission's clearing requirement. The list of jurisdictions excluded from ''other'' is the same as the list of jurisdictions eligible for the Alternative Compliance Framework under 50.52(b)(4)(ii), and then it also adds the United States.

Request for Comment. The Commission requests comment as to whether an entity has relied on, or intends to rely on, the relief equivalent to the expired Alternative Compliance Framework provided in Commission regulation 50.52(b)(4)(iii)(B). Additionally, the Commission requests comment as to whether the five percent test outlined in Commission regulation 50.52(b)(4)(iii) should be reinstated and updated as proposed, or whether the Commission should delete the expired provision and eliminate the five percent test.

6. Proposing Not To Reinstate Commission Regulation 50.52(b)(4)(iii)(A)

As the Commission has noted above, it is not aware of any eligible affiliate counterparties that have chosen to comply with the relief equivalent to the expired Alternative Compliance Frameworks using the option to pay and collect variation margin on swaps with all unaffiliated counterparties. The Commission understands that, just as eligible affiliate counterparties elect to comply with the Alternative Compliance Framework under the terms of Commission regulation 50.52(b)(4)(ii)(A)(*2*), any eligible affiliate counterparties complying with Commission regulation 50.52(b)(4)(iii) choose to pay and collect variation margin on swaps with all other eligible affiliate counterparties as contemplated by Commission regulation 50.52(b)(4)(iii)(B). Thus, in order to reinstate a simplified Alternative Compliance Framework and because the Commission preliminarily believes that the relief equivalent to Commission regulation 50.52(b)(4)(iii)(A) has not been relied upon by market participants, the Commission proposes not to reinstate the provision under Commission regulation 50.52(b)(4)(iii)(A).

Request for Comment. The Commission requests comment as to whether a market participant has relied on, or intends to rely on, the relief equivalent to the expired Alternative Compliance Framework provided in Commission regulation 50.52(b)(4)(iii)(A).

7. Additional Revisions to Commission Regulation 50.52

As part of its proposal to reinstate the Alternative Compliance Framework provisions of Commission regulation 50.52(b)(4)(iii), and to make them available to eligible affiliate counterparties located in certain non-U.S. jurisdictions, the Commission is proposing to add a definition of ''United States'' to revised regulation 50.52(a)(2) identical to the one in Commission regulation 23.160(a) (cross-border application of the uncleared margin regulations). This provision defines the United States to mean ''the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.'' The new definition of United States is referenced in proposed revised regulation 50.52(b)(4)(iii).

The Commission preliminarily believes that the proposed revisions to regulation 50.52(b)(4) provide an exemption from the Commission's clearing requirement, in a manner that is demonstrated to be workable, while imposing conditions necessary to ensure that inter-affiliate swaps exempted from required clearing meet certain risk-mitigating conditions. In addition, the Commission preliminarily believes that the proposed revisions would provide more flexibility to eligible affiliate counterparties electing the Inter-Affiliate Exemption and would increase legal certainty for the reasons stated above.

Request for Comment. The Commission requests comment on the proposal to include a definition for the term ''United States'' as it is used in the revised and reinstated regulation 50.52. More broadly, the Commission requests comment as to whether the proposed modified Outward-Facing Swaps Condition and reinstated Alternative Compliance Frameworks will prevent market participants from using the Inter-Affiliate Exemption to evade the Commission's clearing requirement or transfer risk to U.S. firms by entering into uncleared swaps with non-U.S. affiliates.

B. Commission's Section 4(c) Authority

The Commission issued the Inter-Affiliate Exemption pursuant to section 4(c)(1) of the CEA, which grants the Commission the authority to exempt any transaction or class of transactions,

including swaps, from certain provisions of the CEA, including the Commission's clearing requirement, in order to ''promote responsible economic or financial innovation and fair competition.'' Section 4(c)(2) of the CEA further provides that the Commission may not grant exemptive relief unless it determines that: (1) The exemption is appropriate for the transaction and consistent with the public interest; (2) the exemption is consistent with the purposes of the CEA; (3) the transaction will be entered into solely between ''appropriate persons''; and (4) the exemption will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the CEA. In enacting section 4(c), Congress noted that the purpose of the provision is to give the Commission a means of providing certainty and stability to existing and emerging markets so that financial innovation and market development can proceed in an effective and competitive manner.[59]

The Commission preliminarily believes that the exemption, as modified in this proposal, is consistent with the public interest and with the purposes of the CEA. As the Commission noted in the adopting release to the Inter-Affiliate Exemption, inter-affiliate swaps provide an important risk management role within corporate groups.[60] These swaps may be beneficial to the entity as a whole. The proposed revisions to the Outward-Facing Swaps Condition and the Alternative Compliance Frameworks would facilitate use of the Inter-Affiliate Exemption by permitting the variation margin provisions under proposed Commission regulation 50.52(b)(4)(ii) and (iii) to be used in connection with swaps with eligible affiliate counterparties located in any non-U.S. jurisdiction, not only those located in the European Union, Japan, or Singapore. Pursuant to no-action relief issued by DCR, as discussed above, these provisions have been in use since 2013.

Based on the Commission's review of data reported to the Depository Trust & Clearing Corporation's (DTCC's) swap data repository, DTCC Data Repository (U.S.) LLC (DDR), the Alternative Compliance Framework provisions under Commission regulation 50.52(b)(4)(ii) appear to be working because the Commission has identified approximately 50 entities located in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, or the United Kingdom that elected the Inter-Affiliate Exemption between January 1, 2018 to December 31, 2018.[61] The Commission preliminarily believes that these entities chose to, or could have, complied with the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii) because of the jurisdiction in which they are organized. Based on the same data set from January 1, 2018 to December 31, 2018, the Commission identified 12 entities located in jurisdictions other than Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, the United Kingdom, or the United States that elected the Inter-Affiliate Exemption and chose to, or could have, complied with the Alternative Compliance Framework under Commission regulation 50.52(b)(4)(iii). During the same time period, the data showed that approximately 70 U.S. entities elected the Inter-Affiliate Exemption.

The Commission preliminarily believes that reinstating the Alternative Compliance Frameworks as permanent provisions, and extending the availability of the first framework under Commission regulation 50.52(b)(4)(ii) to eligible affiliate counterparties located in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, and the United Kingdom while correspondingly narrowing the availability of the second framework under Commission regulation 50.52(b)(4)(iii), would be appropriate for inter-affiliate swap transactions, would promote responsible financial innovation and fair competition, and would be consistent with the public interest.

In this regard, the Commission considered whether the availability of the proposed Alternative Compliance Frameworks might result in fewer affiliated counterparties clearing their outward-facing swaps and the significance of any such reduction in terms of the use of inter-affiliate swaps as a risk management tool. Generally speaking, it is difficult to estimate whether the proposed rule will reduce central clearing of outward-facing swaps. Among other factors, the application of mandatory clearing and the availability of central clearing for particular types of swaps vary by jurisdiction. Also, market participants' response to the proposed rule may depend on which of their swaps are eligible for the Inter-Affiliate Exemption. Despite this uncertainty, the Commission believes that there may be a significant number of affiliated counterparties that will continue to engage in uncleared swaps activity as permitted under the proposed Alternative Compliance Frameworks.[62]

As noted above, swap dealers electing the exemption use inter-affiliate swaps as an important risk management tool within corporate groups and these affiliated groups are subject to a range of regulatory and other controls as part of their swap activities in the United States and in other jurisdictions. In sum, in considering whether the proposed exemption would promote responsible financial innovation and fair competition and would be consistent with the public interest, the Commission took the factors discussed above into account—*i.e.,* the value of inter-affiliate swaps as a risk management tool, the extent to which the Alternative Compliance Frameworks would foster this use of inter-affiliate swaps, and the potential for more elections not to clear outward-facing swaps.

The Commission believes that the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks would be available only to ''appropriate persons.'' Section 4(c)(3) of the CEA includes within the term ''appropriate person'' a number of specified categories of persons, including such other persons that the Commission determines to be appropriate in light of their financial or other qualifications, or the applicability of appropriate regulatory protections. In the 2013 Inter-Affiliate Exemption final rulemaking, the Commission found that eligible contract participants (ECPs) are appropriate persons within the scope of

[59] House Conf. Report No. 102–978, 1992 U.S.C.C.A.N. 3179, 3213.

[60] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21754 (citing to commenters and the proposal 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.'').

[61] The Commission notes that although current Commission regulation 50.52 does not permit entities to comply with either of the Alternative Compliance Frameworks because they have expired, the relief provided by DCR no-action letters means that market participants have continued to use and report swaps activity in compliance with the Alternative Compliance Frameworks.

[62] Based on a review of DDR data reflecting past use of the Inter-affiliate Exemption, the Commission estimates that up to 70 eligible affiliate counterparties located outside of the United States may elect to comply with one of the reinstated Alternative Compliance Frameworks thereby choosing not to clear their outward-facing swaps and rather to pay and collect variation margin on all swaps with other eligible affiliated counterparties instead. These 70 entities include affiliates of swap dealers that are active in multiple jurisdictions.

section 4(c)(3)(K) of the CEA.[63] The Commission noted that the elements of the ECP definition (as set forth in section 1a(18)(A) of the CEA and Commission regulation 1.3(m)) generally are more restrictive than the comparable elements of the enumerated ''appropriate person'' definition. Given that only ECPs are permitted to enter into uncleared swaps, there is no risk that a non-ECP or a person who does not satisfy the requirements for an ''appropriate person'' could enter into an uncleared swap using the Inter-Affiliate Exemption. Therefore, for purposes of this proposal, the Commission reaffirms its finding that the class of persons eligible to rely on the Inter-Affiliate Exemption will be limited to ''appropriate persons'' within the scope of section 4(c)(3) of the CEA.

Finally, the Commission preliminarily finds that the proposed revised Inter-Affiliate Exemption will not have a material effect on the ability of the Commission to discharge its regulatory responsibilities. This exemption continues to be limited in scope and, as described further below, the Commission will continue to have access to information regarding the inter-affiliate swaps subject to this exemption because they will be reported to an SDR pursuant to the conditions of the exemption. In addition to the reporting conditions in the rule, the Commission retains its special call, anti-fraud, and anti-evasion authorities, which will enable it to adequately discharge its regulatory responsibilities under the CEA.

For the reasons described in this proposal, the Commission preliminarily believes it would be appropriate and consistent with the public interest to amend the Outward-Facing Swaps Condition and Alternative Compliance Frameworks as proposed.

Request for Comment. The Commission requests comment as to whether the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks would be an appropriate exercise of the Commission's authority under section 4(c) of the CEA. The Commission also requests comment as to whether the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks would be in the public interest.

III. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires agencies to consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.[64] The proposed revisions to the Inter-Affiliate Exemption contained in this proposed rulemaking will not affect any small entities, as the RFA uses that term. Pursuant to section 2(e) of the CEA, only ECPs may enter into swaps, unless the swap is listed on a DCM. The Commission has previously determined that ECPs are not small entities for purposes of the RFA.[65] The proposed revisions to the Inter-Affiliate Exemption would only affect ECPs because all persons that are not ECPs are required to execute their swaps on a DCM, and all contracts executed on a DCM must be cleared by a DCO, as required by statute and regulation, not by operation of any clearing requirement determination. Therefore, the Chairman, on behalf of the Commission, hereby certifies pursuant to 5 U.S.C. 605(b) that this proposed rulemaking will not have a significant economic impact on a substantial number of small entities.

B. Paperwork Reduction Act

The Paperwork Reduction Act (PRA)[66] imposes certain requirements on federal agencies, including the Commission, in connection with conducting or sponsoring any collection of information as defined by the PRA. This proposed rulemaking will not require a new collection of information from any persons or entities. The Commission is not proposing to amend the reporting requirements of Commission regulations 50.52(c) and (d), for which the Office of Management and Budget has assigned control number 3038–0104.

C. Cost-Benefit Considerations

1. Statutory and Regulatory Background

Section 15(a) of the CEA requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness and financial integrity; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations (collectively referred to herein as the Section 15(a) Factors.) Accordingly, the Commission considers the costs and benefits associated with the proposed amendments to the Inter-Affiliate Exemption in light of the Section 15(a) Factors.

In the sections that follow, the Commission considers: (1) The costs and benefits of reinstating modified Alternative Compliance Frameworks to the Inter-Affiliate Exemption as described in this proposed rule; (2) the alternatives contemplated by the Commission and their costs and benefits; and (3) the impact on the Section 15(a) Factors of reinstating the availability of modified Alternative Compliance Frameworks to the Inter-Affiliate Exemption.

The regulatory baseline for this rulemaking is the current swap clearing requirement and the inter-affiliate exemption codified in Commission regulation 50.52. The Alternative Compliance Frameworks included in Commission regulations 50.52(b)(4)(ii) and (iii) expired as of March 11, 2014. As a practical matter, market participants have continued to use the Alternative Compliance Frameworks because DCR issued a series of no-action letters stating that it would not recommend that the Commission commence an enforcement action against entities using the Alternative Compliance Frameworks. As such, to the extent that market participants have relied upon relevant Commission staff action, the actual costs and benefits of this proposal, as realized in the market, may not be as significant.

However, because the current Alternative Compliance Frameworks have expired, the Commission's regulatory baseline for the costs and benefits consideration is the requirement that all market participants must comply with the Outward-Facing Swaps Condition pursuant to Commission regulation 50.52(b)(4)(i), by either clearing the swap or complying with an exception to or exemption from the clearing requirement. The Commission will assess the costs and benefits of reinstating modified Alternative Compliance Frameworks as if they are not available currently.

Although the Alternative Compliance Frameworks were unavailable according to the text of Commission regulation 50.52, during the 2018 calendar year the Commission was able to monitor the number of entities complying with the Outward-Facing Swaps Condition through the Alterative Compliance Frameworks, as permitted by DCR no-action letters.

The Commission notes that the consideration of costs and benefits

[63] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21754.

[64] 5 U.S.C. 601 *et seq.*

[65] 66 FR 20740, 20743 (Apr. 25, 2001).

[66] 44 U.S.C. 3507(d).

below is based on the understanding that the markets function internationally, with many transactions involving U.S. firms taking place across international boundaries; with some Commission registrants being organized outside of the United States; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. Where the Commission does not specifically refer to matters of location, the below discussion of costs and benefits refers to the effects of the proposed rule on all activity subject to the proposed and amended regulations, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under section 2(i) of the CEA.[67] In particular, the Commission notes that a significant number of entities affected by this proposed rulemaking are located outside of the United States.

2. Considerations of the Costs and Benefits of the Commission's Action

a. Costs

By reinstating modified Alternative Compliance Frameworks to the Outward-Facing Swaps Condition in the Inter-Affiliate Exemption, the proposed rule would permit affiliated entities to elect not to clear swaps with unaffiliated entities that would otherwise be subject to the Commission's clearing requirement. Under current Commission regulation 50.52, all eligible affiliate counterparties must either clear swaps subject to the clearing requirement or qualify for an exception to or exemption from the clearing requirement. This proposal would allow eligible affiliate counterparties to be exposed to greater measures of counterparty credit risk under the Alternative Compliance Frameworks than if they cleared these swaps. Clearing, along with the Commission's requirements related to swap clearing, mitigates counterparty credit risk in the following ways: (1) An FCM guarantees the performance of a customer and in so doing, takes steps to monitor and mitigate the risk of a counterparty default; (2) a clearinghouse collects sufficient initial margin to cover potential future exposures and regularly collects and pays variation margin to cover current exposures; (3) a clearinghouse has rules, and enforcement mechanisms to ensure the rules are followed, to mark a swap to market and to require that margin be posted in a timely fashion; (4) a clearinghouse facilitates netting within portfolios of swaps and among counterparties; and (5) a clearinghouse holds collateral in a guaranty fund in order to mutualize the remaining tail risk not covered by initial margin contributions among clearing members.[68] These risk mitigating factors may be attenuated as parties elect to use the Alternative Compliance Frameworks.

Furthermore, there may be an increased risk of contagion and systemic risk to the financial system that results from permitting additional market participants to use the Alternative Clearing Frameworks to avoid clearing certain swaps subject to the clearing requirement. Swap clearing mitigates risk on a transaction level, as outlined above, and it also provides protection against risk transfer throughout the financial system. As discussed further below, this cost is minimized to the extent that variation margin is an effective risk management tool for swap market participants to prevent the accumulation of uncollateralized risk.

As proposed, reinstating the modified Alternative Compliance Frameworks would permit eligible affiliates that would otherwise be required to clear an outward-facing swap, to instead pay and collect full variation margin daily on all swaps between eligible affiliate counterparties, provided that all other conditions of the Alternative Compliance Frameworks are satisfied. This may result in decreased clearing activity and decreased liquidity in non-U.S. markets and at clearinghouses where eligible affiliate counterparties previously might have cleared such outward-facing swaps, but will now be able to maintain such risk internally through a series of inter-affiliate swaps and variation margining.

Finally, the availability of the modified Alternative Compliance Frameworks may increase the costs to any third party creditor to an entity using an Alternative Compliance Framework instead of clearing its outward-facing swaps. While the variation margin requirement included in this proposal mitigates the buildup of credit risk within a corporate group that uses a centralized risk management structure, it is still possible that using variation margin instead of clearing outward-facing swaps could produce additional counterparty risk to external creditors and/or third parties. In addition, as discussed above, expanding the number of jurisdictions excluded from the five percent limitation may cause market participants to alter their swaps trading behavior. To the extent that it now applies to fewer countries, a market participant's five percent exposure may be comprised of swaps with counterparties located in less sophisticated swaps markets. Such swaps may pose higher risks and overall costs could increase.

Request for Comment. The Commission requests comment, including any available quantitative data and analysis, on the expected costs resulting from the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks in the Inter-Affiliate Exemption.

b. Benefits

Because the Commission's current regulation does not permit eligible affiliate counterparties to use the Alternative Compliance Frameworks, this proposal is expected to provide a benefit to eligible affiliate counterparties seeking additional flexibility in their inter-affiliate swap risk management. To the extent that complying with the variation margin provisions of the modified Alternative Compliance Frameworks is less expensive than clearing an outward-facing swap, market participants would be able to avail themselves of these cost savings. For example, entities that choose to comply with the Alternative Compliance Frameworks as proposed would not need to pay the costs of posting incremental initial margin to either FCMs or clearinghouses, or paying any additional clearing fees. All of these savings would provide a benefit to eligible affiliate counterparties that choose to comply with the Alternative Compliance Frameworks rather than to clear a swap.

Entities within a corporate group may benefit from better risk transfers between affiliates. Current Commission regulation 50.52 provides little flexibility to market participants and requires them to either clear the outward-facing swap or comply with an exception to or exemption from the clearing requirement. Certain corporate entities might be incentivized by the new availability of the Alternative Compliance Frameworks to increase their inter-affiliate swap activity in order to increase the benefits of centralized risk management because they can use the Alternative Compliance Frameworks rather than clearing outward-facing swaps.

[67] 7 U.S.C. 2(i).

[68] *See* Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 FR 71230.

There are additional benefits this proposal may provide to affiliates by improving and increasing options for the transfer of risk between affiliated entities. Entities most often elect to transact and clear inter-affiliate swaps in the most liquid market (reducing costs). The Commission notes that affiliated entities may choose in which jurisdiction to clear outward-facing swaps under current Commission regulation 50.52. The modified Alternative Compliance Frameworks may increase the number of options that affiliate entities have to comply with the Outward-Facing Swaps Condition, and thus, may increase the number of entities electing the Inter-Affiliate Exemption or even increase the number of inter-affiliate swaps that are entered into to transfer risk between entities. This represents an additional benefit to entities that would be induced to elect the Inter-Affiliate Exemption because of changes to the Alternative Compliance Frameworks that otherwise would not have engaged in any (or would have engaged in less) centralized risk management or risk transfers.

As stated above, the Commission estimates that approximately 50 entities in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, or the United Kingdom have used or potentially would use the modified Alternative Compliance Framework under Commission regulation 50.52(b)(4)(ii), if adopted pursuant to this proposal. Furthermore, the Commission estimates that as many as 12 entities might elect to use the modified Alternative Compliance Framework under Commission regulation 50.52(b)(4)(iii).[69] Besides the difficulty in determining who might use the Alternative Compliance Framework, the estimation of the benefit to each entity is further complicated by the differing costs and capital structures related to each entity. Further, the Commission realizes that there may be more entities in the future that would elect to pay and collect variation margin rather than clear outward-facing swaps if they are electing the Inter-Affiliate Exemption.

Request for Comment. The Commission requests comment on which entities might elect to use the Alternative Compliance Framework.

[69] The Commission would expect use of the Alternative Compliance Framework available under proposed revised regulation 50.52(b)(4)(iii) to increase in additional jurisdictions over time as swaps markets develop. The current estimate of up to 12 entities complying with the Alternative Compliance Framework under proposed revised regulation 50.52(b)(4)(iii) in unlisted jurisdictions may be a low estimate.

The Commission also requests comment on the benefits that would likely result from the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks in the Inter-Affiliate Exemption, and, if any, the expected magnitude of such benefits.

3. Costs and Benefits of the Proposed Rule as Compared to Alternatives

The Commission considered two alternatives to this proposal to adopt modified Alternative Compliance Frameworks.[70] First, the Commission considered adopting new Alternative Compliance Frameworks that include expiration dates, after which point in time non-U.S. eligible affiliate counterparties would be required to clear any outward-facing swaps, or otherwise satisfy the Outward-Facing Swaps Condition. When the Commission adopted the Inter-Affiliate Exemption in 2013 it included an expiration date, March 11, 2014, for the alternative compliance framework because the Commission believed that a one year transition period after the adoption of the Commission's clearing requirement in March 2013 was appropriate. The Commission preliminarily believes that time-limited Alternative Compliance Frameworks would provide little additional benefit to market participants while potentially distorting long-range planning. In general, a regulatory time limit can be useful in focusing attention, but it can also cause distortions as market participants make plans based on an arbitrary date rather than their business needs. The Commission preliminarily believes that adopting modified Alternative Compliance Frameworks without expiration dates would increase planning flexibility for swap market participants, which could be especially beneficial as additional jurisdictions adopt, implement, and change their mandatory clearing regimes in ways that the Commission cannot predict at this time. In view of this uncertainty and the uncertainty regarding clearing requirement comparability determinations described above, the Commission preliminarily does not see the value in setting a new expiration date for the regulation. The Commission notes that it generally retains the authority to modify its regulations as changing conditions warrant.

Second, the Commission considered the alternative of not amending the current Alternative Compliance Frameworks regulations that have expired. Without modified Alternative Compliance Frameworks that permit eligible affiliate counterparties to pay and collect variation margin on certain inter-affiliate swaps, market participants would have to determine whether any alternatives to clearing outward-facing swaps are available. The availability of these alternatives to clearing, if any, would vary in across jurisdictions and may depend on the terms of the transaction in question. Therefore, the Commission cannot predict whether eliminating the Alternative Compliance Frameworks is a viable option. In addition, the potential lack of alternatives to clearing could lead eligible affiliate counterparties to reduce their use of inter-affiliate swaps for risk management purposes, which would not be a positive result because inter-affiliate swaps are an important component of centralized risk management. Finally, eliminating the Alternative Compliance Frameworks could cause market distortions if it leads market participants to conduct their swap-related activities based on the availability of regulatory exemptions rather than their business needs.

Request for Comment. The Commission requests comment on the costs and benefits of reinstating modified Alternative Compliance Frameworks compared to the costs and benefits of (i) adopting modified Alternative Compliance Frameworks that include expiration dates, and (ii) making no amendments to the current Outward-Facing Swaps Condition to the Inter-Affiliate Exemption. The Commission requests quantitative data and analysis where possible.

4. Section 15(a) Factors

a. Protection of Market Participants and the Public

In revising the Outward-Facing Swaps Condition and Alternative Compliance Frameworks, the Commission considered various ways to appropriately protect affiliated entities, third parties in the swaps market, and the public. The Commission seeks to

[70] The Commission acknowledges that the legal framework for establishing a substituted compliance regime could have been an additional component of this proposal. This proposal would have taken into account existing regulation 50.52(b)(4)(i)(B), which provides for compliance with a foreign jurisdiction's clearing mandate that is comparable, and comprehensive, but not necessarily identical to the Commission clearing requirement as a means of satisfying the conditions of the regulation. However, the Commission believes that it is impractical at this time to set up a substituted compliance regime for required clearing that would serve as a meaningful alternative given that the swaps and types of market participants covered by foreign mandatory clearing regimes vary significantly from Part 50 of the Commission's regulations. Accordingly, the Commission is not proposing or considering this alternative at this time.

ensure that the proposal prevents swap market participants from evading the Commission's clearing requirement and/or transferring excessive risk to an affiliated U.S. entity through the use of uncleared inter-affiliate swaps. The Commission proposes to permit eligible affiliate counterparties to elect not to clear an outward-facing swap subject to the clearing requirement, but only if eligible affiliates pay and collect daily variation margin on swaps.

The Commission also considered the potential effects on the public of providing this alternative to clearing outward-facing swaps subject to the clearing requirement. In particular, the Commission considered the extent to which the proposed Alternative Compliance Frameworks might result in fewer affiliated counterparties clearing their outward-facing swaps. One difficulty in estimating the effect of the proposal is the fact that the application of mandatory clearing and the availability of central clearing for particular types of swaps vary by jurisdiction. Also, many market participants enter into swaps and other financial instruments in multiple jurisdictions, which may give them the ability to adjust their financial and risk management activity in response to regulatory requirements.

In the face of this uncertainty, the Commission believes that, even if the change in clearing activity and business for clearinghouses is uncertain, there may be a significant number of affiliated counterparties that will continue to engage in swaps activity permitted under the proposed Alternative Compliance Frameworks.[71] The Commission understands that the swap dealers conduct their swaps activities using affiliates in various jurisdictions. Swap dealers engage in inter-affiliate swaps in order to distribute risk among their affiliates. Thus, inter-affiliate swaps are an important part of prudent risk management and a significant number of swap dealers and other market participants engage in inter-affiliate swaps. This inter-affiliate swaps activity is subject to a range of regulatory and other controls.

In considering how the proposed rule would affect the protection of market participants and the public, the Commission took into account the value of inter-affiliate swaps as a risk management tool and the extent to which the Alternative Compliance Frameworks would foster this use of inter-affiliate swaps. The Commission also considered potential increases in systemic risk if affiliates elect not to clear outward-facing swaps and use the Alternative Compliance Frameworks instead. In view of these factors, the Commission preliminarily believes that the potential increases in systemic risk will be mitigated by the controls on the use of inter-affiliate swaps, their inherent risk management features, and the conditions set out in the proposed Alternative Compliance Frameworks.

The proposed revisions also would create certain costs that would be borne by entities electing the Inter-Affiliate Exemption. Under the proposed revisions, entities that choose to comply with an Alternative Compliance Framework would now be required to pay and collect variation margin on their inter-affiliate swaps, which could be a significant cost for those entities. However, the proposed revisions also provide that an entity may continue to choose to clear an outward-facing swap with an unaffiliated counterparty instead of paying and collecting variation margin on all swaps with other eligible affiliate counterparties. Therefore, affected entities are free to choose which of these alternatives is best for them.

b. Efficiency, Competitiveness, and Financial Integrity of Swap Markets

The Commission preliminarily believes that the proposed revisions to the Inter-Affiliate Exemption may have some, but not a significant, impact on the efficiency or competiveness of swaps markets. As noted above, inter-affiliate swaps are an important risk management tool for affiliated corporate groups. To the extent that swap dealers may participate more extensively in swap markets in non-U.S. jurisdictions because they can use inter-affiliate swaps to manage risk efficiently, the proposed amendments to the Inter-Affiliate Exemption may increase the efficiency, competitiveness, and financial integrity of swap markets by increasing the range of swaps that are available to market participants. The Commission also preliminarily believes that the revised Outward-Facing Swaps Condition and adoption of modified Alternative Compliance Frameworks should discourage misuse of the Inter-Affiliate Exemption. For example, the Commission recognizes that internal calculations and swaps portfolio management is required to comply with the five percent test under Commission regulation 50.52(b)(4)(iii). If the Commission had proposed to reinstate the Alternative Compliance Frameworks, without adjusting the list of non-U.S. jurisdictions in which an affiliated counterparty may be located for purposes of Commission regulation 50.52(b)(4)(ii), entities may have failed to appropriately calculate the permissible limits under the five percent test under Commission regulation 50.52(b)(4)(iii). Aligning the scope of jurisdictions included in the Alternative Compliance Frameworks with the jurisdictions for which the domestic currency is subject to the Commission's clearing requirement may help to make these calculations and compliance with the provisions easier. This should promote the financial integrity of swap markets and financial markets as a whole.

c. Price Discovery

Under Commission regulation 43.2, a ''publicly reportable swap transaction,'' means, among other things, any executed swap that is an arms'-length transaction between two parties that results in a corresponding change in the market risk position between the two parties.[72] The Commission does not consider non-arms'-length swaps as swaps that contribute to price discovery in the markets, as they are not publically reported, generally.[73] Given that inter-affiliate swaps as defined in this proposed rulemaking are usually not arms'-length transactions, the Commission preliminarily believes that the proposed revisions to the Inter-Affiliate Exemption would not have a significant effect on price discovery.[74] However, if the availability of the Alternative Compliance Frameworks reduces the use of outward-facing swaps, which may or may not be publicly reported depending on the jurisdiction, there could be a negative

[71] Based on a review of DDR data reflecting past use of the Inter-affiliate Exemption, the Commission estimates that up to 70 eligible affiliate counterparties located outside of the United States may elect to comply with one of the reinstated Alternative Compliance Frameworks thereby choosing not to clear their outward-facing swaps and rather to pay and collect variation margin on all swaps with other eligible affiliated counterparties instead. These 70 entities include affiliates of swap dealers that are active in multiple jurisdictions.

[72] 17 CFR 43.2. *See also* Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182 (Jan. 9, 2012).

[73] Transactions that fall outside the definition of ''publicly reportable swap transaction''—that is, transactions that are not arms-length—''do not serve the price discovery objective of CEA section 2(a)(13)(B).'' Real-Time Public Reporting of Swap Transaction Data, 77 FR at 1195. *See also id.* at 1187 (discussing ''Swaps Between Affiliates and Portfolio Compression Exercises'') and Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR at 21780.

[74] The definition of ''publicly reportable swap transaction'' identifies two examples of transactions that fall outside the definition, including internal swaps between one-hundred percent owned subsidiaries of the same parent entity. 17 CFR 43.2 (adopted by Real-Time Public Reporting of Swap Transaction Data, 77 FR at 1244). The Commission notes that the list of examples is not exhaustive.

impact on price discovery when outward-facing swaps would otherwise be publically reported.

d. Sound Risk Management Practices

The conditions of the Inter-Affiliate Exemption do not eliminate the possibility that risk may impact an entity, its affiliates, and counterparties of those affiliates.[75] Without clearing a swap to mitigate the transmission of risk among affiliates, the risk that any one affiliate takes on through its swap transactions, and any contagion that may result through that risk, increases. This makes the risk mitigation requirements for outward-facing swaps more important as risk can be transferred more easily between affiliates.

Exempting certain inter-affiliate swaps from the clearing requirement creates additional counterparty exposure for affiliates.[76] DCOs have many tools to mitigate risks. This increased counterparty credit risk among affiliates may increase the likelihood that a default of one affiliate could cause significant losses in other affiliated entities. If the default causes other affiliated entities to default, third parties that have entered into uncleared swaps or other agreements with those entities also could be affected.

In 2013, when the Commission finalized the Inter-Affiliate Exemption, it assessed the risks of inter-affiliate swaps and stated that the partial internalization of costs among affiliated entities, combined with the documentation, risk management, reporting, and treatment of outward-facing swaps requirements for electing the exception, would mitigate some of the risks associated with uncleared inter-affiliate swaps.[77] However, the Commission indicated that these mitigants are not a perfect substitute for the protections that would otherwise be provided by clearing, or by a requirement to use more of the risk management tools that a clearinghouse uses to mitigate counterparty credit risk (*i.e.,* both initial and variation margin, FCMs monitoring credit risk of customers, clearing member contributions to default funds, etc.).[78]

e. Other Public Interest Considerations

The Commission has identified no other public interest considerations.

D. General Request for Comment

The Commission invites information regarding whether and the extent to which specific foreign requirement(s) may affect the costs and benefits of the proposal, including information identifying the relevant foreign requirement(s) and any monetary or other quantitative estimates of the potential magnitude of those costs and benefits. The Commission also requests comment on other aspects of the costs and benefits relating to the proposed revisions to the Outward-Facing Swaps Condition and Alternative Compliance Frameworks. The Commission requests that commenters provide any data or other information that would be useful in estimating the quantifiable costs and benefits of this proposed rulemaking.

E. Antitrust Considerations

Section 15(b) of the Act requires the Commission to take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the purposes of the Act, in issuing any order or adopting any Commission rule or regulation (including any exemption under section 4(c) or 4c(b)), or in requiring or approving any bylaw, rule, or regulation of a contract market or registered futures association established pursuant to section 17 of the Act.[79] The Commission believes that the public interest to be protected by the antitrust laws is generally to protect competition. The Commission requests comment on whether the proposal implicates any other specific public interest to be protected by the antitrust laws.

The Commission has considered the proposal to determine whether it is anticompetitive and has preliminarily identified no anticompetitive effects. The Commission requests comment on whether the proposal is anticompetitive and, if it is, what the anticompetitive effects are.

Because the Commission has preliminarily determined that the proposal is not anticompetitive and has no anticompetitive effects, the Commission has not identified any less anticompetitive means of achieving the purposes of the Act. The Commission requests comment on whether there are less anticompetitive means of achieving the relevant purposes of the Act that would otherwise be served by adopting the proposal.

[75] The Commission notes that even in the absence of required clearing or margin requirements for swaps between certain affiliated entities, such entities may choose to use initial and variation margin to manage risks that could otherwise be transferred from one affiliate to another. Similarly, third parties that have entered into swaps with affiliates also may include variation margin requirements in their swap agreements.

[76] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21780–21781.

[77] *Id.*

[78] *Id.* at 21778.

[79] 7 U.S.C. 19(b).

List of Subjects in 17 CFR Part 50

Business and industry, Clearing, Swaps.

For the reasons stated in the preamble, the Commodity Futures Trading Commission proposes to amend 17 CFR part 50 as set forth below:

PART 50—CLEARING REQUIREMENT AND RELATED RULES

■ 1. The authority citation for part 50 is revised to read as follows:

Authority: 7 U.S.C. 2(h), 6(c), and 7a–1 as amended by Pub. L. 111–203, 124 Stat. 1376.

■ 2. Amend § 50.52 as follows:
■ a. Revise paragraphs (a)(2)(i) and (ii);
■ b. Add paragraph (a)(2)(iii); and
■ c. Revise paragraph (b)(4).

The revisions and addition read as follows:

§ 50.52 Exemption for swaps between affiliates.

(a) * * *

(2) * * *

(i) 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;

(ii) The term ''eligible affiliate counterparty'' means an entity that meets the requirements of this paragraph; and

(iii) The term ''United States'' means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

(b) * * *

(4)(i) Subject to paragraphs (b)(4)(ii) and (iii) of this section, each eligible affiliate counterparty that enters into a swap, which is included in a class of swaps identified in § 50.4, with an unaffiliated counterparty shall:

(A) Comply with the requirements for clearing the swap in section 2(h) of the Act and this part;

(B) Comply with the requirements for clearing the swap under a foreign jurisdiction's clearing mandate that is comparable, and comprehensive but not necessarily identical, to the clearing requirement of section 2(h) of the Act and this part, as determined by the Commission;

(C) Comply with an exception or exemption under section 2(h)(7) of the Act or this part;

(D) Comply with an exception or exemption under a foreign jurisdiction's clearing mandate, provided that:

(*1*) The foreign jurisdiction's clearing mandate is comparable, and

comprehensive but not necessarily identical, to the clearing requirement of section 2(h) of the Act and this part, as determined by the Commission; and

(*2*) The foreign jurisdiction's exception or exemption is comparable to an exception or exemption under section 2(h)(7) of the Act or this part, as determined by the Commission; or

(E) Clear such swap through a registered derivatives clearing organization or a clearing organization that is subject to supervision by appropriate government authorities in the home country of the clearing organization and has been assessed to be in compliance with the Principles for Financial Market Infrastructures.

(ii) If one of the eligible affiliate counterparties is located in Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, or the United Kingdom and each eligible affiliate counterparty, or a third party that directly or indirectly holds a majority interest in both eligible affiliate counterparties, pays and collects full variation margin daily on all of the eligible affiliate counterparties' swaps with other eligible affiliate counterparties, the requirements of paragraph (b)(4)(i) of this section shall be satisfied.

(iii) If an eligible affiliate counterparty located in the United States enters into swaps, which are included in a class of swaps identified in § 50.4, with eligible affiliate counterparties located in jurisdictions other than Australia, Canada, the European Union, Hong Kong, Japan, Mexico, Singapore, Switzerland, the United Kingdom, or the United States, and the aggregate notional value of such swaps, which are included in a class of swaps identified in § 50.4, does not exceed five percent of the aggregate notional value of all swaps, which are included in a class of swaps identified in § 50.4, in each instance the notional value as measured in U.S. dollar equivalents and calculated for each calendar quarter, entered into by the eligible affiliate counterparty located in the United States, then the requirements of paragraph (b)(4)(i) of this section shall be satisfied when each eligible affiliate counterparty, or a third party that directly or indirectly holds a majority interest in both eligible affiliate counterparties, pays and collects full variation margin daily on all of the eligible affiliate counterparties' swaps with other eligible affiliate counterparties.

* * * * *

Issued in Washington, DC, on December 12, 2019, by the Commission.

Christopher Kirkpatrick,

Secretary of the Commission.

NOTE: The following appendices will not appear in the Code of Federal Regulations.

Appendices to Exemption From the Swap Clearing Requirement for Certain Affiliated Entities—Alternative Compliance Frameworks for Anti-Evasionary Measures—Commission Voting Summary and Commissioner's Statement

Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Supporting Statement of Commissioner Brian D. Quintenz

I support today's proposal to codify how affiliated swap counterparties have, for the past six years, complied with an important provision of one of the Commission's exemptions from the swap clearing requirement. The Commission's swap clearing requirement has accomplished the important task of requiring financial institutions to centrally clear the overwhelming majority of the most commonly-traded interest rate swaps and credit default swaps through CFTC-supervised clearing organizations. According to a Financial Stability Board (FSB) report published in October, at least 80% of interest rate swaps and credit default swaps executed in the U.S. are now cleared.[1] Central clearing, through the posting of initial and variation margin with a clearinghouse, has greatly reduced counterparty credit risk in the swaps market, helping to support confidence in the financial markets. However, carefully considered exceptions should ensure that uncleared products remain economically viable to provide market participants with flexibility in managing risks. For example, entities belonging to the same corporate group regularly execute swaps for internal risk management purposes, and these swaps do not incur the same risks as those executed with unaffiliated counterparties.[2] The Commission has also created exceptions to the swap clearing requirement for *commercial end-users, financial institutions organized as cooperatives,* and *banks with assets of $10 billion or less.* As an additional point, I look forward to the Commission finalizing last year's proposed exemptions for *bank holding companies* and *savings and loan companies* having consolidated assets of $10 billion or less and for *community development financial institutions.*

I believe the proposal before the Commission today strikes an appropriate balance between guarding against evasion, on the one hand, and providing flexibility for cross-border swaps activity on the other. When affiliated financial counterparties exchange variation margin on all of their swaps with one another, on a worldwide basis, the risk that a U.S. firm can amass a critical amount of uncollateralized exposure abroad is greatly reduced. At the same time, the proposal does not disadvantage U.S.-based institutions competing with foreign institutions located in jurisdictions whose swap clearing requirements are narrower in scope than the Commission's. I believe that today's proposal functions rationally with the Commission's rules for margining uncleared swaps on a cross-border basis, including in the context of inter-affiliate transactions, and I look forward to comments on this topic.

In addition, I note that today's proposal would simplify the existing inter-affiliate exemption to reflect current market practices and eliminate complicated provisions that may never have been relied upon. I hope the Commission's next rulemakings similarly rationalize rules so that industry's compliance becomes less burdensome and costly.

Appendix 3—Concurring Statement of Commissioner Rostin Behnam

I respectfully concur with the Commodity Futures Trading Commission's (the ''Commission'' or ''CFTC'') decision today to issue proposed amendments to the exemption from the swap clearing requirement for certain affiliated entities. The original inter-affiliate exemption rule was issued by the Commission in 2013.[1] Today's proposal reminds us both of how forward thinking the Commission was in implementing the Dodd-Frank Act and the goals envisioned at the 2009 G20 Pittsburgh Summit, and of how we need to be thoughtful and willing to update our rule set when reality differs from what we envisioned.

The impetus for today's proposal boils down to this. In some respects, the world hasn't turned out quite the way the Commission envisioned. When the Commission promulgated the inter-affiliate exemption rule in 2013, the perhaps overly hopeful expectation was that other jurisdictions would quickly follow our lead and adopt swap clearing requirements in short order. While a number of jurisdictions now have clearing mandates for certain swaps, some non-U.S. jurisdictions are still in the process of adopting clearing regimes, and some non-U.S. jurisdictions vary significantly from the Commission's clearing requirement. While the expectation in 2013 was that the Commission would issue comparability determinations for non-U.S. jurisdictions with respect to the clearing requirement, to date the Commission has not issued any comparability determinations.

[1] FSB OTC Derivatives Market Reforms: 2019 Progress Report on Implementation (Oct. 2019), (Appendix C, Table J), *https://www.fsb.org/2019/10/otc-derivatives-market-reforms-2019-progress-report-on-implementation/.*

[2] *See* the Commission's original proposed inter-affiliate exemption, Clearing Exemption for Swaps Between Affiliated Entities, 77 FR 50425, 50426–50427 (Aug. 21, 2012).

[1] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750 (Apr. 11, 2013).

Because the Commission in 2013 expected the world to quickly follow with clearing mandates, it established a temporary Alternative Compliance Framework for compliance with the Outward-Facing Swaps Condition of the Inter-Affiliate Exemption.[2] Since that temporary Alternative Compliance Framework expired in 2014, the Division of Clearing and Risk staff has issued a series of no-action letters extending the Alternative Compliance Framework to provide more time for global harmonization.[3] Today, because the global regulatory landscape has not turned out quite like we expected, the Commission proposes to codify and make permanent the Alternative Compliance Framework.

While I support today's proposal and believe that it represents the best path forward to provide legal certainty to market participants regarding the Outward-Facing Swaps Condition of the Inter-Affiliate Exemption, there is one significant aspect of the proposal that gives me pause. In the preamble to the 2013 rule, the Commission stated that the Alternative Compliance Framework provided for the Outward-Facing Swaps Condition is ''not equivalent to clearing and would not mitigate potential losses between swap counterparties in the same manner that clearing would.'' [4] We reiterate this in today's preamble, stating that ''[a]lthough paying and collecting variation margin daily does not mitigate counterparty credit risk to the same extent that central clearing does, the Commission believes, as stated in the 2013 adopting release for the Inter-Affiliate Exemption, that variation margin is an essential risk management tool.'' Despite clearly stating that variation margin does not mitigate counterparty credit risk to the same extent as central clearing, we nonetheless are proposing to exempt certain transactions from central clearing under the theory that variation margin mitigates counterparty credit risk. This may be the right result, but I want to be absolutely certain that we are not injecting unnecessary risk into the system by exempting these transactions from central clearing in the name of focusing on the easiest, cheapest risk management tool. I encourage interested parties to comment on whether the alternative compliance framework that we propose to codify effectively mitigates counterparty credit risk, and the differences in risk mitigation between the alternative compliance framework and central clearing.

In part, I am comfortable with the proposal because the existing rule provides the Commission with the ability to monitor how the exemption is working. Under Regulation 50.52(c) through (d), the election of the Inter-Affiliate Exemption, as well as how the requirements of the exemption are met, must be reported to a Commission-registered swap data repository.[5] Accordingly, the Commission will have a window into which entities elect the exemption, how many swaps are exempted, and how the requirements of the exemption are met. In addition, the Commission retains its special call, anti-fraud, and anti-evasion authorities, which should enable it to discharge its regulatory responsibilities under the CEA. I believe that the Commission should closely monitor SDR data regarding the Inter-Affiliate Exemption going forward in order to be certain that the exemption is not being used to evade central clearing, and to ensure that the exemption is not adding unnecessary and preventable risk to the system.

I thank staff for their thoughtful responses to my questions, and for making edits that reflected comments and suggestions made by me and my staff.

Appendix 4—Statement of Commissioner Dan M. Berkovitz

I support the proposed rule to make permanent the alternative compliance frameworks for certain swaps between the foreign affiliates of U.S. firms and their non-U.S. counterparties.[1] The proposed rule would make permanent, with modifications, anti-evasion provisions for inter-affiliate swaps that the Commission originally adopted in 2013, and then extended through staff no-action letters that remain in effect today. The no-action letters require U.S. firms and their foreign affiliates to exchange variation margin in connection with swaps entered into by the foreign affiliate with non-U.S. counterparties, where such swaps are subject to the Commission's clearing requirement and there is no comparable and comprehensive clearing regime in the foreign jurisdiction. The proposed rule upholds the Dodd-Frank Act's clearing mandate, deters evasion, and helps to protect against systemic risk to the U.S. from swaps executed overseas by foreign affiliates.

The Commission's rules provide a limited, conditional exemption from clearing for swaps between certain affiliate counterparties, including U.S. firms and their foreign affiliates (''Inter-Affiliate Exemption'').[2] At the same time, through both regulation and no-action relief, the Commission has implemented measures designed to prevent U.S. firms from routing swaps through their foreign affiliates to evade the Commission's clearing requirement for such swaps. These anti-evasion provisions condition the Inter-Affiliate Exemption such that foreign affiliates of U.S. firms must clear their outward-facing swaps if such swaps are: (1) Subject to the Commission's clearing requirement and (2) entered into with unaffiliated counterparties in foreign jurisdictions (''Outward-Facing Swaps Condition''). The Outward-Facing Swaps Condition allows outward-facing swaps to be cleared pursuant to a comparable and comprehensive foreign clearing regime, if available.

In jurisdictions where the Commission has not made a comparability determination, the alternative compliance frameworks permit the foreign affiliate to exchange full, daily variation margin for the swap with its U.S. affiliate or its non-U.S. counterparty, rather than clearing the outward-facing swap. The alternative compliance frameworks permit the foreign affiliate to enter into swaps with non-U.S. counterparties in foreign jurisdictions under the same terms and conditions as other non-U.S. persons in those jurisdictions. They preserve the competitiveness of the foreign affiliates of U.S. firms without presenting significant risks to the U.S. affiliate or importing significant risks into the U.S. Today's proposed rule would make the alternative compliance frameworks permanent, with certain modifications.[3]

I support the proposed rule's emphasis on clearing, anti-evasion, and systemic risk by preserving the Outward-Facing Swaps Condition and making permanent the alternative compliance frameworks. The proposed rule would also expand the jurisdictions subject to one of the alternative compliance frameworks to include additional jurisdictions that have adopted and implemented their respective domestic clearing mandates.[4] By extending and making permanent the alternative compliance frameworks, the proposed rule would address the lack of comparability determinations for foreign clearing regimes, while ensuring the continued operation of anti-evasion and anti-systemic risk provisions in the Commission's rules.

The proposed rule seeks public comment on whether the alternative compliance frameworks are sufficient to address potential

[2] The Outward-Facing Swaps Condition requires an eligible affiliate counterparty relying on the Inter-Affiliate Exemption to clear any swap covered by the CFTC's clearing requirement that is entered into with an unaffiliated counterparty, unless the swap qualifies for an exception or exemption from the clearing requirement. Commission regulation 50.52(b)(4)(i).

[3] CFTC Letter Nos. 14–25 (Mar. 6, 2014), 14–135 (Nov. 7, 2014), 15–63 (Nov. 17, 2015), 16–81 (Nov. 28, 2016), 16–84 (Dec. 15, 2016), and 17–66 (Dec. 14, 2017), all available at *https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.*

[4] *Id.* at 21765.

[5] Commission regulation 50.52(c) through (d).

[1] *See* 7 U.S.C. 2(h)(1), which provides that if the Commission requires a swap to be cleared, then it shall be unlawful for a person to enter into such swap unless it is submitted to a registered derivatives clearing organization (''DCO'') or to a DCO that is exempt from registration. Part 50 of the Commission's regulations sets forth the classes of swaps required to be cleared, as well as certain conditional exemptions to the clearing requirement, including the exemption and conditions under consideration in this proposal.

[2] The Commission has previously found that ''inter-affiliate transactions provide an important risk management role within corporate groups'' and that they may be beneficial to the group as a whole if properly risk managed. *See* Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21750, 21754 (Apr. 11, 2013).

[3] The original alternative compliance frameworks expired in 2014, but have been repeatedly extended through no-action letters that expire in December 2020.

[4] The proposed alternative compliance frameworks consist of two distinct but similar sets of requirements. Both would require the exchange of full, daily variation margin. However, the first framework, in proposed § 50.52(b)(4)(ii) would apply to eight enumerated jurisdictions that have adopted domestic clearing mandates. The second framework, in proposed § 50.52(b)(4)(iii), would apply in all other jurisdictions. Swaps in this second framework would be limited to the ''five percent test,'' which limits the uncleared swaps activity that a U.S. eligible affiliate counterparty can transact with its affiliates in non-enumerated jurisdictions. The five percent test was also present in the alternative compliance frameworks when they were adopted in 2013.

systemic risk to the U.S. and whether they may produce a permanent residual class of swaps that are not cleared but instead result in the exchange of variation margin between eligible affiliate counterparties (and the risks associated with those swaps). I look forward to public comments on these questions and other aspects of the proposal.

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BILLING CODE 6351–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG–116163–19]

RIN 1545–BP41

Misdirected Direct Deposit Refunds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: These proposed regulations provide guidance on section 6402(n) of the Internal Revenue Code (Code), concerning the procedures for identification and recovery of a misdirected direct deposit refund. The regulations reflect changes to the law made by the Taxpayer First Act. The proposed regulations affect taxpayers who have made a claim for refund, requested the refund be issued as a direct deposit, but did not receive a refund in the account designated on the claim for refund.

DATES: Comments and requests for a public hearing must be received by February 21, 2020.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–116163–19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG–116163–19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–116163–19), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed amendments to the regulations, Mary C. King at (202) 317–5433; concerning submissions of comments, or requests for a public hearing, Regina L. Johnson, at (202) 317–6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 301 under section 6402(n) of the Code and provides guidance on the procedures used to identify and recover tax refunds issued by electronic funds transfer (direct deposit) that were not delivered to the account designated to receive the direct deposit refund on the federal tax return or other claim for refund. These proposed regulations implement section 6402(n) of the Code, a new provision added by section 1407 of the Taxpayer First Act, Public Law 116–25, 133 Stat. 981 (2019) (TFA).

Section 6402(a) provides the Secretary of the Treasury or his delegate (Secretary) with the authority to refund the balance of an overpayment after first crediting the overpayment amount against any tax liability of the person who made the overpayment. Before any refund is issued, the balance must also be offset against certain nontax liabilities. Sections 6402(a), (c), (d), (e), and (f) require a taxpayer's overpayment to be applied to any outstanding Federal tax debt, past-due child support, Federal agency non-tax debt, State income tax obligation, or certain unemployment compensation debts owed to a state prior to crediting the overpayment to a future tax or issuing a refund. This application of a tax overpayment is called a refund offset. An offset occurs after a refund is certified by the IRS but prior to the issuance of the refund.

The procedures for making a claim for refund are set out in § 301.6402–2 of the Procedure and Administration Regulations. Those regulations include procedures for the mailing of a check in payment of allowed claims for refund. See § 301.6402–2(f). The procedures for sending a refund by direct deposit are set out in the Treasury Financial Manual, the Bureau of the Fiscal Service Green Book, and the regulations under 31 CFR part 210. The Treasury Financial Manual is available for downloading at the Bureau of the Fiscal Service's website at *https://tfm.fiscal.treasury.gov/home.html.* The Green Book is available for downloading at the Bureau of the Fiscal Service's website at *https://www.fiscal.treasury.gov/reference-guidance/green-book/.*

The IRS generally issues a refund in the manner requested on the claim for refund. This includes splitting a refund by authorizing direct deposits into multiple accounts using Form 8888, ''Allocation of Refund (Including Savings Bond Purchases).'' Under current procedures, if a taxpayer requests that the refund be issued as a direct deposit on a current year tax return, the IRS will generally issue the refund it determines to the account number and routing number designated on the claim. A direct deposit may be stopped or unable to be delivered for a number of reasons, including, but not limited to, an invalid routing number, rejection by a financial institution, or a processing error. If the direct deposit is stopped or returned prior to the delivery of the refund to the account designated on the claim for refund, the IRS will generally issue the refund in the form of a paper check.

Under current procedures, set out in Internal Revenue Manual (I.R.M.) sections 21.4.1, 21.4.2, and 21.4.3 and available at *https://www.irs.gov/irm,* a taxpayer or authorized representative may report a missing refund to the IRS by using an IRS customer service line or filing a Form 3911, ''Taxpayer Statement Regarding Refund.'' A taxpayer or authorized representative may also report a missing refund to the IRS through the Office of the Taxpayer Advocate (commonly referred to as the Taxpayer Advocate Service (TAS)). When a missing refund is reported, the IRS will first determine if a refund was issued to the taxpayer and whether a direct deposit transaction was made. If the refund was issued as a direct deposit, the IRS will verify the accuracy of the taxpayer's account number and routing number.

If the taxpayer reports a missing refund and the IRS confirms a refund was issued, the IRS will generally conduct a refund trace to determine why the refund was not delivered to the account of the taxpayer. A refund trace is the process by which the IRS tracks stolen, lost, or misplaced refund checks or verifies a financial institution received direct deposits and may replace an authorized refund to the taxpayer if warranted. A refund trace will be initiated when a taxpayer reports a missing refund and the IRS confirms a refund was issued as a direct deposit, even if the taxpayer reports that the account information designated on the claim for refund was incorrect. A refund trace is initiated by inputting a trace code into the IRS's Integrated Data Retrieval System (IDRS), which sends a request to the Treasury Department's Bureau of the Fiscal Service (BFS) for