

TO EXEMPT INTER-AFFILIATE SWAPS FROM CERTAIN REGULATORY REQUIREMENTS PUT IN PLACE BY THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

FEBRUARY 8, 2012.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. LUCAS, from the Committee on Agriculture,
submitted the following

R E P O R T

[To accompany H.R. 2779]

[Including cost estimate of the Congressional Budget Office]

The Committee on Agriculture, to whom was referred the bill (H.R. 2779) to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. TREATMENT OF AFFILIATE TRANSACTIONS.

(a) **COMMODITY EXCHANGE ACT AMENDMENTS.**—Section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), as added by section 721(a)(21) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following:

“(G) **TREATMENT OF AFFILIATE TRANSACTIONS.**—

“(i) **IN GENERAL.**—For the purposes of any clearing and execution requirements under section 2(h) and any applicable margin and capital requirements of section 4s(e) and for purposes of defining a swap dealer or a major swap participant, and reporting requirements other than those set forth in clause (ii), the term ‘swap’ does not include any agreement, contract, or transaction that—

“(I) would otherwise be included as a ‘swap’ under subparagraph (A); and

“(II) is entered into by parties that report information or prepare financial statements on a consolidated basis, or for which an affiliated company reports information or prepares financial statements on a consolidated basis.

“(ii) **REPORTING.**—All agreements, contracts, or transactions described in clause (i) shall be reported to either a swap data repository, or, if there is no swap data repository that would accept such agreements, contracts or transactions, to the Commission pursuant to section 4r, or to a swap data repository or to the Commission pursuant to section

2(h)(5) within such time period as the Commission may by rule or regulation prescribe. Nothing in this subparagraph shall prohibit a swap data repository from publically reporting the information submitted pursuant to this clause.

“(iii) PROTECTION OF INSURANCE FUNDS.—Nothing in this subparagraph shall be construed to prevent the regulator of a Federal or State insurance fund or guaranty fund from exercising its other existing authority to protect the integrity of such a fund, except that such regulator shall not subject agreements, contracts, or transactions between affiliated companies to clearing and execution requirements under section 2, to any applicable margin and capital requirements of section 4s(e), or to reporting requirements of the Wall Street Transparency and Accountability Act of 2010 other than those set forth in clause (ii).

“(iv) PRESERVATION OF FEDERAL BANKING AGENCIES’ AUTHORITY.—Nothing in this section shall affect the Federal banking agencies’ safety-and-soundness authorities established in law other than title VII of P.L. 111–203, including with respect to the authority of the agencies to impose capital requirements on a bank with regard to swaps. For purposes of this clause, the term ‘bank’ shall be defined pursuant to section 3(6) of the Securities Exchange Act of 1934, and the term ‘swap’ shall be defined pursuant to title VII of P.L. 111–203.”.

(b) SECURITIES EXCHANGE ACT OF 1934 AMENDMENTS.—Section 3(a)(68) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(68)), as added by section 761(a)(6) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is amended by adding at the end the following:

“(F) TREATMENT OF AFFILIATE TRANSACTIONS.—

“(i) IN GENERAL.—The term ‘security-based swap’ does not include any agreement, contract, or transaction that—

“(I) would otherwise be included as a ‘security-based swap’ under subparagraph (A); and

“(II) is entered into by a party that is controlling, controlled by, or under common control with its counterparty.

“(ii) REPORTING.—All agreements, contracts, or transactions described in clause (i) shall be reported to either a security-based swap data repository, or, if there is no security-based swap data repository that would accept such security-based swaps, to the Commission pursuant to section 13A within such time period as the Commission may by rule or regulation prescribe.”.

SEC. 2. IMPLEMENTATION.

The amendments made by this Act shall be implemented—

(1) without regard to—

(A) chapter 35 of title 44, United States Code; and

(B) the notice and comment provisions of section 553 of title 5, United States Code; and

(2) through the promulgation of an interim final rule.

BRIEF EXPLANATION

Inter-affiliate swaps are swaps that are executed between entities that are under common corporate ownership. H.R. 2779 amends the Commodity Exchange Act to provide an exemption for inter-affiliate swaps from the clearing and execution requirements, margin and capital requirements, real time reporting requirements and from consideration with regard to whether entities are swap dealers or major swap participants under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111–203) (the Dodd-Frank Act). H.R. 2779 does provide, however, that inter-affiliate swaps must be reported to a swap data repository, and therefore be transparent to regulators. The bill provides mirroring exemptions for inter-affiliate security-based swaps under the Securities Exchange Act of 1934.

PURPOSE AND NEED

A common corporate structure is for a parent company to have multiple affiliates within a single corporate group. Individually, these affiliates may seek to offset their business risks through swaps. However, rather than having each affiliate go directly to the market to engage in a swap with a dealer counterparty individually, many companies will employ a business model in which only a single or limited number of corporate entities within the group face dealers. These designated external facing entities will then allocate the transaction and its risk mitigating benefits to the affiliate seeking to mitigate its underlying risk. These transactions are known as “inter-affiliate swaps.”

Companies that use this business model argue that it reduces the overall credit risk a corporate group poses to the market because they can net their positions across affiliates, reducing the number of external facing transactions overall. In addition, it permits a company to enhance its efficiency by centralizing its risk management expertise in a single or limited number of affiliates.

Dodd-Frank is largely silent on the regulatory treatment of inter-affiliate swaps, and the regulators have not provided any further guidance. Should these inter-affiliate transactions be treated as all other swaps, they could be subject to clearing, execution and margin requirements. Companies that use inter-affiliate swaps are concerned that this could substantially increase their costs, without any real reduction in risk in light of the fact that these swaps are purely for internal use. For example, these swaps could be “double-margined”—when the centralized entity faces an external swap dealer, and then again when the same transaction is allocated internally to the affiliate that sought to hedge the risk.

The uncertainty that exists regarding the treatment of inter-affiliate swaps spans multiple rulemakings that have been proposed or that will be proposed pursuant to the Dodd-Frank Act. H.R. 2779 provides certainty and clarification that inter-affiliate transactions, when the parties to the transaction are under common control, are not to be regulated as swaps. The bill does, however, require that all affiliate transactions be reported to a swap data repository to provide transparency to regulators with regard to this activity within corporate groups.

SECTION-BY-SECTION

Section 1(a) amends the Commodity Exchange act to exclude from the definition of the term “swap” swap transactions involving a party that is controlling, controlled by or under common control with its counterparty. These transactions must be reported to a swap data repository or to the CFTC.

Section 1(b) is a similar amendment to the Securities Exchange Act’s definition of a security-based swap.

Section 2 excludes the amendments made by this bill from the requirements of the Paperwork Reduction Act and from notice and comment requirements of the Administrative Procedure Act.

COMMITTEE CONSIDERATION

I. HEARINGS

In the 112th Congress, the Committee has held seven hearings, four Full Committee and two General Farm Commodities and Risk Management Subcommittee hearings to examine the implementation of Title VII of the Dodd-Frank Act and one Full Committee hearing to examine legislative proposals related thereto, including H.R. 2779. The Committee took testimony from witnesses that represented a broad spectrum of participants in the derivatives markets.

For example, on October 12, 2011, in the hearing “To review legislative proposals amending Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act” Ms. Brenda Boulton, witness for Constellation Energy on behalf of the Coalition for Derivatives End-users testified:

“We strongly support the Stivers-Fudge bill, which recognizes that inter-affiliate swaps do not create systemic risk and that consequently, as a category, inter-affiliate swaps should be subject to regulation as if they were outward-facing. The Stivers-Fudge bill would exempt a category of swaps, not a particular type of entity from regulation. That is precisely what the Administration did in exempting foreign exchange swaps and forwards and it is the right approach here as well.”

II. FULL COMMITTEE

The Committee on Agriculture met, pursuant to notice, with a quorum present, on January 25, 2012, to consider H.R. 2779, to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and other pending business. Chairman Lucas offered an opening statement, as did Ranking Member Peterson and Ms. Fudge.

By unanimous consent, the Subcommittee on General Farm Commodities and Risk Management was discharged from further consideration and the bill, H.R. 2779 was placed before the Committee for consideration and without objection a first reading of the bill was waived and it was opened for amendment at any point. The Chairman offered an Amendment in the Nature of a Substitute to the bill, and counsel provided a brief explanation of the amendment.

Mr. Peterson was recognized to offer and explain an amendment to expedite implementation by excluding the amendments made by the bill from the requirements of the Paperwork Reduction Act and from notice and comment requirements of the Administrative Procedure Act. By a voice vote the Peterson amendment was adopted.

There being no further amendments, the Peterson motion to approve the Amendment in the Nature of a Substitute to H.R. 2779, as amended was adopted by a voice vote.

By a voice vote, the Peterson motion to report the bill favorably to the House with the recommendation that it do pass was adopted.

The Committee then moved onto other pending business, where at the conclusion of the meeting, Chairman Lucas advised Mem-

bers that pursuant to the rules of the House of Representatives that Members have 2 calendar days to file such views with the Committee.

Without objection, staff was given permission to make any necessary clerical, technical or conforming changes to reflect the intent of the Committee.

Chairman Lucas thanked all the Members and adjourned the meeting.

REPORTING THE BILL—ROLL CALL VOTES

In compliance with clause 3(b) of rule XIII of the House of Representatives, H.R. 2779 was reported by voice vote with a majority quorum present. There was no request for a recorded vote.

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee on Agriculture's oversight findings and recommendations are reflected in the body of this report.

BUDGET ACT COMPLIANCE (SECTIONS 308, 402, AND 423)

The provisions of clause 3(c)(2) of rule XIII of the Rules of the House of Representatives and section 308(a)(1) of the Congressional Budget Act of 1974 (relating to estimates of new budget authority, new spending authority, new credit authority, or increased or decreased revenues or tax expenditures) are not considered applicable. The estimate and comparison required to be prepared by the Director of the Congressional Budget Office under clause 3(c)(3) of rule XIII of the Rules of the House of Representatives and sections 402 and 423 of the Congressional Budget Act of 1974 submitted to the Committee prior to the filing of this report are as follows:

FEBRUARY 6, 2012.

Hon. FRANK D. LUCAS,
Chairman, Committee on Agriculture,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2779, a bill to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Susan Willie.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

H.R. 2779—A bill to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111–203) requires that participants in swap transactions meet certain clearing, reporting, and margin requirements as well as certain standards of business conduct. (A swap is a contract that calls for an exchange of cash between two participants

based on an underlying rate or index, or the performance of an asset.) H.R. 2779 would exempt from the definition of a swap those transactions in which the parties are affiliates as defined in the bill; thus, affiliated parties that enter into swap transactions would be exempt from those clearing, reporting, margin, and business conduct requirements.

Neither the Commodity Futures Trading Commission nor the Securities and Exchange Commission (SEC)—the agencies required to develop and enforce regulations related to swap transactions—has finalized regulations related to swap transactions. Based on information from the two agencies, CBO expects that incorporating the provisions of H.R. 2779 at this point in the regulatory process would not require a significant increase in the workload of either agency. Therefore, CBO estimates that any change in discretionary spending to implement the legislation, which would be subject to the availability of appropriated funds, would not be significant. Further, under current law, the SEC is authorized to collect fees sufficient to offset its appropriation each year; CBO expects that the agency would set fee rates each year to offset amounts provided in appropriation acts. Enacting H.R. 2779 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

H.R. 2779 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, and tribal governments.

On December 14, 2011, CBO transmitted an estimate for H.R. 2779, a bill to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act, as ordered reported by the House Committee on Financial Services on November 30, 2011. The Financial Services Committee version of the bill would make similar changes in regulatory requirements for swaps entered into between affiliated parties. CBO estimates that the cost to implement either version of the legislation would be insignificant.

The CBO staff contact for this estimate is Susan Willie. The estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

PERFORMANCE GOALS AND OBJECTIVES

With respect to the requirement of clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the performance goals and objectives of this legislation are to exempt inter-affiliate swaps from certain regulatory requirements put in place by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

CONSTITUTIONAL AUTHORITY STATEMENT

The Committee finds the constitutional authority for this legislation in Article I, section 8, clause 18, that grants Congress the power to make all laws necessary and proper for carrying out the powers vested in Congress by the Constitution of the United States or in any department or officer thereof.

COMMITTEE COST ESTIMATE

Pursuant to clause 3(d)(2) of rule XIII of the Rules of the House of Representatives, the Committee report incorporates the cost estimate prepared by the Director of the Congressional Budget Office pursuant to sections 402 and 423 of the Congressional Budget Act of 1974.

ADVISORY COMMITTEE STATEMENT

No advisory committee within the meaning of section 5(b) of the Federal Advisory Committee Act was created by this legislation.

APPLICABILITY TO THE LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of section 102(b)(3) of the Congressional Accountability Act (Public Law 104–1).

FEDERAL MANDATES STATEMENT

The Committee adopted as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates Reform Act (Public Law 104–4).

EARMARK STATEMENT REQUIRED BY CLAUSE 9 OF RULE XXI OF THE RULES OF THE HOUSE OF REPRESENTATIVES

H.R. 2779 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(e), 9(f), or 9(g) of rule XXI of the Rules of the House of Representatives.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in *italic* and existing law in which no change is proposed is shown in roman):

COMMODITY EXCHANGE ACT

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SEC. 1a. DEFINITIONS.

As used in this Act:

(1) * * *

* * * * *

(47) SWAP.—

(A) * * *

* * * * *

(G) *TREATMENT OF AFFILIATE TRANSACTIONS.*—

(i) IN GENERAL.—For the purposes of any clearing and execution requirements under section 2(h) and any applicable margin and capital requirements of section 4s(e) and for purposes of defining a swap dealer or a major swap participant, and reporting requirements

other than those set forth in clause (ii), the term “swap” does not include any agreement, contract, or transaction that—

(I) would otherwise be included as a “swap” under subparagraph (A); and

(II) is entered into by parties that report information or prepare financial statements on a consolidated basis, or for which an affiliated company reports information or prepares financial statements on a consolidated basis.

(ii) **REPORTING.**—All agreements, contracts, or transactions described in clause (i) shall be reported to either a swap data repository, or, if there is no swap data repository that would accept such agreements, contracts or transactions, to the Commission pursuant to section 4r, or to a swap data repository or to the Commission pursuant to section 2(h)(5) within such time period as the Commission may by rule or regulation prescribe. Nothing in this subparagraph shall prohibit a swap data repository from publically reporting the information submitted pursuant to this clause.

(iii) **PROTECTION OF INSURANCE FUNDS.**—Nothing in this subparagraph shall be construed to prevent the regulator of a Federal or State insurance fund or guaranty fund from exercising its other existing authority to protect the integrity of such a fund, except that such regulator shall not subject agreements, contracts, or transactions between affiliated companies to clearing and execution requirements under section 2, to any applicable margin and capital requirements of section 4s(e), or to reporting requirements of the Wall Street Transparency and Accountability Act of 2010 other than those set forth in clause (ii).

(iv) **PRESERVATION OF FEDERAL BANKING AGENCIES’ AUTHORITY.**—Nothing in this section shall affect the Federal banking agencies’ safety-and-soundness authorities established in law other than title VII of P.L. 111–203, including with respect to the authority of the agencies to impose capital requirements on a bank with regard to swaps. For purposes of this clause, the term “bank” shall be defined pursuant to section 3(6) of the Securities Exchange Act of 1934, and the term “swap” shall be defined pursuant to title VII of P.L. 111–203.

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SECURITIES EXCHANGE ACT OF 1934

TITLE I—REGULATION OF SECURITIES EXCHANGES

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DEFINITIONS AND APPLICATION OF TITLE

SEC. 3. (a) When used in this title, unless the context otherwise requires—

(1) * * *

* * * * *

(68) SECURITY-BASED SWAP.—

(A) * * *

* * * * *

(F) TREATMENT OF AFFILIATE TRANSACTIONS.—

(i) *IN GENERAL.*—The term “security-based swap” does not include any agreement, contract, or transaction that—

(I) would otherwise be included as a “security-based swap” under subparagraph (A); and

(II) is entered into by a party that is controlling, controlled by, or under common control with its counterparty.

(ii) *REPORTING.*—All agreements, contracts, or transactions described in clause (i) shall be reported to either a security-based swap data repository, or, if there is no security-based swap data repository that would accept such security-based swaps, to the Commission pursuant to section 13A within such time period as the Commission may by rule or regulation prescribe.

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