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Telefacsimile: (202) 418-5521 and
Email to secretary@cftc.gov and electronically to <http://comments.cftc.gov>

Re: Response of the International Energy Credit Association ("IECA") to Commodity Futures Trading Commission ("CFTC") Notice of Proposed Rule ("NOPR") respecting the Further Definition of Swap Dealer and Major Swap Participant (17 CFR Part 1, RIN 3038-AD06, Federal Register December 21, 2010) pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")

Ladies and Gentlemen:

The CFTC by the above-referenced NOPR requests public comment on the proposed rule and other matters. This letter responds to the NOPR.

I. Introduction

IECA is the leading global organization focused on credit-related issues in the energy industry. The IECA and its members have wide and deep experience in developing improved metrics, documentation, and tools to assess, manage, and mitigate credit risk. Its members come from more than 500 companies, representing every facet of the energy complex from producers and processors to generators, transporters and end-users. Most of these companies execute privately negotiated over-the-counter derivatives in commodities, interest rates, or currencies.

Derivatives are essential to the business of many of these companies, as well as their suppliers, customers and counterparties. Among other things, derivatives are used for purposes of:

- Protecting against increases in costs;
- Protecting against a decline in the value of the goods they sell;
- Managing cash flow, working capital, and liquidity;
- Maximizing the value of their assets;

- Meeting the needs of their customers; and,
- Complying with the terms of their financing arrangements, which frequently require the hedging of interest rate and foreign exchange risk.

Dodd-Frank will have an enormous impact on working capital requirements, the costs of hedging, and earnings volatility - all critical credit-related issues. By increasing the cost, reducing the availability, and sometimes mandating the clearing of derivatives, Dodd-Frank will introduce or enhance systemic risk by degrading the creditworthiness of companies in, or heavily dependent on, the energy sector.¹

In view of these concerns, the IECA, for the first time in its history, is commenting in a series of rule-making proceedings. The purpose of these comments is to shape the rules in a way that will achieve more certainty for market participants, maximize the potential for bilateral credit relationships, limit the scope of mandatory clearing, and preserve as much competition and flexibility as possible.

Correspondence with respect to these comments should be directed to the following individuals:

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II. The Commission Should Clarify its Proposed Definition of Swap Dealer, including the Exceptions

Swap Dealer Definition

A key principle behind Dodd Frank is the need to manage the risk presented by entities in a position to affect the financial stability of the United States. Dodd Frank addresses that risk, in part, by imposing registration, capital, margin, reporting and other requirements on significant market participants – those included in the category of Swap Dealer and Major Swap Participant. While IECA agrees that the principles behind Dodd Frank are critical to the proper functioning of the financial markets, we wish to point out that many entities whose swaps activity is predominantly limited to energy commodities and derivatives do not create systemic risk or negatively affect the financial stability of the United States. As the Commission explained in the

¹ See “Evaluating Limits on Participation and Transactions in Markets for Emissions Allowances,” Congressional Budget Office (Dec. 2010), p. 25 (stating that Dodd-Frank “increase[s] the cost of OTC transactions in the hope that participants would shift them to exchanges or clearing houses” and “Historical evidence suggests that higher capital requirements cause [those faced with such requirements] to shift toward riskier investments . . . to compensate for the higher costs imposed by those requirements.”)

NOPR, Swap Dealers are persons who transact swaps as part of their “regular business.”² In addition, the Commission further explained in the NOPR that “persons who do not fulfill this function should not be deemed to enter into swaps as part of a ‘regular business’ and are not likely to be swap dealers.”³

Entities, like the IECA members, who are in the physical energy business and use swaps for hedging, price discovery, or to hold a position, should not be considered Swap Dealers. This view is consistent with, and supported by, the Commission’s proposal, as outlined in the NOPR, which states that a Swap Dealer is someone that accommodates others’ demand for swaps, acts in response to the requests of others, and whose regular business is dealing in swaps.⁴

Although these principles are set forth in the NOPR, IECA believes it is important that the rule itself provide the same clear distinctions to avoid unintended consequences for the physical energy markets and its participants. To accomplish this additional clarity, IECA suggests the following changes to the proposed regulatory text:

- *Amend the definition of “swap dealer” in Section 1.3 (ppp)(1) to include the following blacklined text:*

(1) In general. The term “swap dealer” means any person who:

- (i) Holds itself out as a dealer in swaps;
- (ii) Makes a market in swaps;
- (iii) Regularly enters into swaps with counterparties as an ordinary course of business for its own account; or
- (iv) Engages in any activity causing it to be commonly known in the trade as a dealer or market maker in swaps.

For purposes of this Section 1.3(ppp)(1):

- (a) “Dealer” means a person that makes a market;
- (b) “Makes a market” means standing ready to offer to enter into either side of a transaction; and
- (c) “Market maker” means a person who makes a market.

- *Amend the exception for “swap dealer” in Section 1.3 (ppp)(2) to include the following blacklined text:*

(2) Exception. The term “swap dealer” does not include a person that enters into swaps for such person's own account, either individually or in a fiduciary capacity, but not as a part of regular business.

² 75 Fed. Reg. 80177.

³ Id.

⁴ Id.

- (i) “Regular Business” of a person means the primary business activity of such person is to accommodate demand for swaps from other parties and enter into swaps in response to interest expressed by other parties.
 - (a) “Accommodate demand” means a person enters into swaps to satisfy business needs of counterparties to such person.
 - (b) “Interest expressed by other parties” means requests to a person by other parties to enter into swaps with such person for the purpose of satisfying such other parties’ business purposes.
- (ii) For purposes of this Section 1.3 (ppp)(2), Regular Business shall not include:
 - (a) Entering into swaps for the purpose of hedging or mitigating commercial risk as defined in Section 1.3 (tt);.
 - (b) Entering into swaps for the purpose of benefiting from future market price changes affecting their value; and
 - (c) Entering into exchange-traded cleared swaps.⁵

De Minimis Exception

In addition to these clarifications, the IECA members also recommend certain changes to the NOPR’s proposed *de minimis* exception. The IECA is concerned that entities that routinely enter into commodity swaps with end-users as part of their Regular Business, but which present no systemic risk, would be swept up unintentionally into the definition of Swap Dealer and find it uneconomic to continue their existing Regular Business because of the burdens of becoming a registered Swap Dealer.

As just one example, some independent power plants are owned by private equity funds, which funds do not themselves have an energy trading desk. Various physical energy trading companies offer energy management services agreements to such power plants, pursuant to which the energy trading company agrees to (i) purchase fuel for that power plant, (ii) purchase and resell in the marketplace the power output of that power plant, and (iii) provide swaps to that power plant to hedge against fuel purchase price volatility or power sales price volatility. In order to achieve the efficiencies of payment netting as well as credit support netting among these three types of transactions, the power plant owner, as an end-user of such transactions, wants all three types of transactions (the physical fuel commodity purchase transactions, the physical power commodity sale transactions, and the related power and fuel swaps transactions) to be executed with the same counterparty and under the same master agreement, often in the form of an ISDA Master Agreement.

By simply selling such commodity swaps to the power plant owners (which power plant owner would likely qualify for the end-user exception) which are its customers, this energy management services provider could be subject to CFTC regulation as a Swap Dealer under the proposed regulations. Moreover, the costs to such an entity of registration as a Swap Dealer and

⁵ The IECA’s changes to the regulatory text also propose excluding exchange-traded swaps because such swaps are entered into, like futures, where the market maker is the exchange and the counterparty is the clearinghouse. Therefore, the transacting entity is not accommodating demand or acting in response to requests from others.

compliance with the reporting, margin, capital and clearing requirements for Swap Dealers will likely cause the entity to abandon the provision of commodity swaps to such power plant owners or dramatically increase the cost to power plant owners of such swaps.

The IECA submits that such entities' provision of swaps to end-users do not present systemic risk and such entities should not be forced to dramatically increase their cost of performing their Regular Business, which cost will be borne by the end-users, or to abandon a portion of their Regular Business, that is beneficial to end-users, because they are swept into a Swap Dealer regulatory classification intended to capture large interconnected financial institutions which do present systemic risk.

The *de minimis* exception should exclude from registration swap activity posing no appreciable risk to the financial stability of the United States. The number of counterparties and swap transactions says nothing about the risk associated with a person's swap activity. On the other hand, the value of an entity's positions as compared to the overall market is indicative of whether its activity is *de minimis*.⁶ For this reason, the IECA suggests using a measure that is a proportion of the total gross notional value of the United States swaps market and removing the thresholds related to the number of counterparties and swap transactions. Another way of determining whether the swap positions held by a particular entity pose appreciable risk to the financial stability of the United States is to assess the ability of that entity to absorb the risks associated with the positions it holds.

Accordingly, the IECA members suggest the following changes to the proposed regulatory text:

- *Amend the de minimis exception in Section 1.3 (ppp)(4) to reflect the following blacklined changes:*

(4) *De minimis exception.* A person shall not be deemed to be a swap dealer in either of the following cases:

(i) In connection with such person's Regular Business swap dealing activity, swaps entered into by such person with counterparties that meets each of the following conditions: (i) The swap positions connected with those activities into which the person enters during the immediately preceding 12 months have an aggregate gross notional amount of no more than \$100 million one one-thousandth of one percent of the total estimated gross notional value of all outstanding swaps positions for all types of swaps and have an aggregate gross notional amount of no more than \$25 million one ten-thousandth of one percent with regard to swaps in which the counterparty is a "special entity" (as that term is defined in Section 4s(h)(2)(C) of the Commodity Exchange Act). For purposes of this paragraph, if the stated notional amount of a swap is leveraged or enhanced by the structure of the swap, the calculation shall be based on the effective notional amount of the swap rather than on the stated notional amount, or

⁶ If the Commission decides to use some basis other than the gross notional amount of the entire United States swaps market in determining the *de minimis* level, the Commission should provide its revised concept for public comment.

(ii) the swaps activity of such person constitutes less than twenty percent (20%) of such person's revenues and the net unsecured potential future exposure of such swaps never exceeds on any day more than twenty-five percent (25%) of the net worth of such person.

~~(ii) — The person has not entered into swaps in connection with those activities with more than 15 counterparties, other than swap dealers, over the course of the immediately preceding 12 months. In determining the number of counterparties, all counterparties that are members of a single group of persons under common control shall be considered to be a single counterparty.~~

~~(iii) — The person has not entered into more than 20 swaps in connection with those activities over the course of the immediately preceding 12 months. For purposes of this paragraph, each transaction entered into under a master agreement for swaps shall constitute a distinct swap, but entering into an amendment of an existing swap in which the counterparty to such swap remains the same and the item underlying such swap remains substantially the same shall not constitute entering into a swap.~~

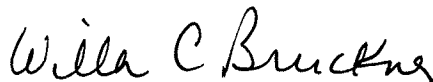
These proposed revisions to the Swap Dealer definition and exceptions in the regulatory text are consistent with the Congressional intent and with the Commission's proposal as set forth in the NOPR. These proposed changes will provide the necessary additional clarity to the regulatory text to ensure that only "real" swap dealers fit within the Commission's definition.

III. Conclusion

The IECA appreciates the opportunity to provide the foregoing comments and information to the Commission. The IECA is pleased to make available to the Commission experienced credit and derivatives professionals for further discussion and information upon request.

This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member thereof.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION



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