April 21, 2011

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Filed Electronically

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: "Risk Management Requirements for Derivatives Clearing Organizations," 76 *Fed. Reg.* 3698 (January 20, 2011); RIN 3038-AC98.

Dear Mr. Stawick:

Natural Gas Exchange Inc. ("NGX") appreciates the opportunity to supplement its prior comment, on the Commodity Futures Trading Commission's ("Commission") notice in the *Federal Register* entitled, "Risk Management Requirements for Derivatives Clearing Organizations," 76 *Fed. Reg.* 3698 (January 20, 2011) ("Notice"). NGX's prior comment was filed on March 21, 2011 and assigned the identifier by the Commission of Comment Letter No. 32021. As we noted in our prior comment letter, the Notice proposes a comprehensive framework to implement the core principles with which registered Derivatives Clearing Organizations ("DCO") must comply initially and on a continuing basis.[1]

Among these requirements, the Commission is proposing in Rule 39.13(g)(2)(ii) to mandate that, in its initial margin modeling, a DCO must use a liquidation time of at least five days for cleared swaps that are not executed on a Designated Contract Market ("DCM") and at least one day for other products. As discussed in greater detail below, this proposed implementing rule is overly prescriptive. It is in excess of the requirements of the applicable core principle as expressed in the Commodity Exchange Act, 7 U.S.C. § et seq. (the "Act") and through its inflexibility does not take into account the unique attributes of NGX.

NGX

NGX operates a trading and clearing system for energy products that provides electronic trading and central counterparty clearing services to the North American natural gas, electricity and oil markets. On December 12, 2008, NGX was registered by the Commission as a DCO.[2]

[1] This framework implements the requirements found in section 725(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 State. 1376 (2010) ("Dodd-Frank Act").
[2] NGX also operates as an exempt commercial market ("ECM"). NGX notified the Commission on November 5, 2002, of its operation as an ECM and has requested an extension to operate as an ECM for a period of one year following the effective date of the Dodd-Frank Act.

As explained in our prior comment letter, NGX offers a unique, non-intermediated clearing model. All participants on the NGX trading platform self-clear on NGX DCO. Both the NGX market and the DCO are non-intermediated. None of the participants in NGX DCO clear for customers. In addition, NGX is non-mutualized. Accordingly, clearing participants are not required to contribute to the guaranty fund which NGX DCO finances through its proprietary funds.

A significant number of the participants in the NGX market are commercial end-users. These participants typically make or take delivery on a routine basis in the cash markets. Moreover, among the contracts traded on NGX and cleared by NGX DCO are forward contracts in the physical commodity. Reflecting its focus on commercial end-user participants, unlike other clearing houses which may step out of the settlement process, NGX DCO sees its role as central counterparty ("CCP") as including guaranteeing completion of the settlement process. Accordingly, NGX as CCP arranges for deliveries and settlement payments to be made. NGX DCO ultimately stands behind the settlement process, and in case of default, will complete the delivery process to the non-defaulting party.

Proposal for Minimum Liquidation Period for Initial Margin Modeling

Proposed Rule 39.13(g)(ii) mandates that, in its initial margin modeling, "[a] DCO would be required to use a liquidation time that is a minimum of five business days for cleared swaps that are not executed on a DCM … [and] a minimum of one business day for all other products that it clears, though it would be required to use longer liquidation times, if appropriate, based on the unique characteristics of particular products or portfolios." The Commission reasoned that "a minimum of five days is appropriate for cleared swaps that are not executed on a DCM in that such a time period may be necessary to close out swap positions in a cost-effective manner." NGX understands that the Commission's reasoning may be grounded in the belief that in a default scenario, a longer period of time may be necessary to close contracts that are not traded on a DCM. NGX agrees with the Commission that the determining issue on the time necessary to close a portfolio is the liquidity of the market in which such contracts trade. However, the assumption that swaps not traded on a DCM will necessarily require five days to liquidate is not supported by our experience as a DCO.

In our experience, the accurate predictor of the appropriate liquidation period for swaps is not their execution venue, but rather their particular risk characteristics. These include the attributes of the products, the settlement cycle of the underlying cash market, product volumes, and types of participants. We have found that many of the OTC contracts cleared by NGX have very liquid underlying markets. Accordingly, NGX computes its collateral requirements assuming a minimum liquidation period of two days. Starting with this two-day minimum, we evaluate each transaction individually and when appropriate, will use a longer liquidation period based on the unique characteristics of the particular products or portfolios. NGX's regular back tests and stress tests clearly support as adequate a two-day liquidation period for the OTC products that NGX clears. For many products, a five-day liquidation time would be unduly conservative, thereby unnecessarily raising the cost of clearing to NGX's clearing participants.

NGX estimates that the impact of transitioning from our current two-day requirement to a five-day requirement for all products would lead to an approximate 60% increase in initial margins. This would significantly impact the margin required of our clearing participants, entities that generally, as end-users, will have a choice of whether they clear these transactions. Such a result is clearly contrary to the Dodd-Frank Act's public policy of encouraging clearing of OTC transactions.

We agree with the Commission that time to liquidate a portfolio is related to liquidity and other risk characteristics and should be considered in establishing initial margins. However, we believe that rather than arriving at this position through a proscriptive regulation, the Commission should permit each DCO to demonstrate through back testing and stress testing the appropriate liquidation time for the particular type of cleared transaction. The Commission could rely on the 5-day period as a rule-of-thumb where the DCO does not document that an alternative minimum liquidation period is more appropriate. This procedure would be consistent with the Commission's proposal requiring the DCO "to use longer liquidation times, if appropriate, based on the unique characteristics of particular products or portfolios." And requiring that the DCO proffer a demonstration that the liquidation time it uses is appropriate will provide the Commission with assurance that the liquidation periods selected are appropriate to the specific products cleared.

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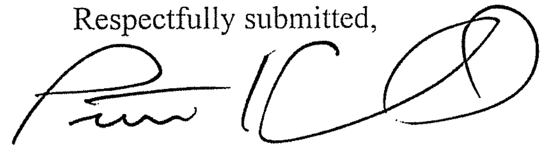
NGX appreciates that the Commission's rule on minimum liquidation periods is based on the assumption that trading on a DCM will be more liquid than in other venues. However, this assumption may not always hold true. Accordingly, we believe that the Commission's objective could be equally achieved by permitting the DCO to offer a demonstration of the appropriate minimum liquidation period that should be used in its margin calculation based on the particular risk characteristics of the instruments cleared. This alternative would benefit our clearing participants by providing that margins are set at an amount that is related to the actual risk of the position and thus further the public policy underlying section 725 of the Dodd-Frank Act.

Please feel free to contact Cheryl Graden, NGX Chief Legal Counsel at (416) 947-4359 or our outside counsel, Paul M. Architzel of Wilmer Cutler Pickering Hale and Dorr, at (202) 663-6240 with any questions.

Respectfully submitted,



Peter Krenkel
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