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

Re: “Information Management Requirements for Derivatives Clearing Organizations,” 75 *Fed. Reg.* 78185 (Dec. 15, 2010), RIN 3038–AC98

Dear Mr. Stawick:

The Commodity Futures Trading Commission (“CFTC” or “Commission”) recently reopened the comment period<sup>1</sup> in order to provide the public with an opportunity to comment on the mosaic of proposed rules implementing Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) in its entirety.<sup>2</sup> Natural Gas Exchange Inc. (“NGX”) appreciates the Commission inviting comment on the rules as a complete package.

NGX is taking this opportunity to supplement its previously filed comment letters with this comment on the proposed rules entitled “Information Management Requirements for Derivatives Clearing Organizations,” 75 *Fed. Reg.* 78185 (Dec. 15, 2010) (“Proposed Rules”). The Proposed Rules implement section 725(c) of the Dodd-Frank Act. The Commission is proposing rules to implement Core Principles J “Reporting” and L “Public Information,” with which registered derivatives clearing organizations (“DCO”) must comply initially and on a continuing basis. The proposed rules would require, among other things, daily position reporting, event-specific reporting for intraday margin calls and public disclosure of specified information.

NGX’s comments are directed to those aspects of the proposed rules that present particular issues for, or are not readily applied to, NGX’s unique clearing model, which is discussed below.

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<sup>1</sup> Reopening and Extension of Comment Periods for Rulemakings Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 *Fed. Reg.* 25274 (May 4, 2011).

<sup>2</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111-203, 124 Stat. 1376 (2010).

## NGX

NGX operates a trading and clearing system for energy products that provides electronic trading, central counterparty clearing and data services to the North American natural gas, electricity and oil markets. On December 12, 2008, NGX, which is located in Calgary, Alberta, was registered by the Commission as a DCO.<sup>3</sup>

As explained in our prior comment letters, NGX offers a unique 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, nor are they subject to any shared risk of other participants.

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 commercial contracts in the physical commodity. Reflecting its focus on commercial end-user participants, unlike other clearinghouses 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.

NGX also uses a unique system for collateralizing the contracts entered into by participants. NGX requires that participants have sufficient collateral on account at all times to cover their obligations to the clearing house. Accordingly, unlike a typical clearing house, margin calls are made prior to an account falling below a replenishment level, not after.

### **Daily Reporting of Positions and Variation Margin**

As explained above, the majority of NGX’s participants are commercial end-users and the contracts cleared by NGX align with the physically and financially settled contracts or agreements commonly traded in the commercial energy markets. For example, unlike futures trading, a very high percentage of NGX cleared contracts are held until, and go through, the settlement process. Moreover, most NGX cleared products are not off-set by entry into a long contract when holding a short position. Rather both contracts, although netted for collateral purposes, are kept open until expiration.

Proposed rule 39.19(c)(1)(iv) would require daily reporting of end-of-day positions for each clearing member, by customer and house origin. The application of this daily position

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<sup>3</sup> 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.

reporting requirement to NGX is problematic due to the unique aspects of the products cleared by NGX. Specifically, the commercial contracts that NGX clears are far more static than typical futures and a position is not readily determined on an end-of-day basis due to the fact, as discussed above, that long and short contracts are not legally offset. And, contrary to the Commission's assumption that this information would be "readily ascertainable" in the "ordinary course of a DCO conducting its clearing and settlement business," because of these differences in its clearing model, NGX's information systems cannot be adapted readily to meet this new proposed reporting requirement without significant modification.<sup>4</sup>

Moreover, proposed rule 39.19(c)(1)(ii) would require a DCO to report the daily variation margin collected and paid by the DCO. However, as described above, NGX does not make use of daily variation margin in its risk management program. Rather, participants maintain collateral at prescribed levels and add to that collateral as necessary. This margining system closely aligns with collateral practices in the commercial markets in which most NGX participants trade.

The Commission has recognized that daily reporting of variation margin amounts is not appropriately applied to all products. Indeed, the Commission specifically recognized that such reporting is not appropriately required for options that are not subject to futures-style margining.<sup>5</sup> Like options that are not subject to futures-style margining, the majority of the products cleared by NGX do not provide for the collection or payment of daily variation margin, and like such options, NGX products should not be subject to this daily reporting requirement.

For these reasons, NGX requests that the Commission provide a degree of flexibility in the daily position and variation margin reporting requirements. Proposed rules 39.19(c)(1)(ii) and (iv) are readily met by DCOs clearing typical futures contracts without significant modification to their electronic processing systems. And, such information can be readily accepted and used by the Commission in its financial surveillance program. However, the proposed rules on daily position and variation margin reporting are not well-suited to the contracts traded on NGX. NGX does not object to the Commission's goal of receiving useful information relevant to financial surveillance. NGX respectfully suggests, however, that greater flexibility in how this requirement is applied to NGX's contracts will yield more useful information to the Commission and in a manner that can be achieved by NGX using its current data processing systems.

### **Event-Specific Reporting of Intraday Margin Calls**

Proposed rule 39.19(c)(4)(v) would require a DCO to report to the Commission "[a]ny intraday margin calls to a clearing member," "no later than 1 hour following the margin call."<sup>6</sup> The Commission states that this information would "better position" it "to conduct risk surveillance activities efficiently, to monitor the financial health of the DCO, and to detect any

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<sup>4</sup> Compare, Proposed Rules at 78187.

<sup>5</sup> *Id.* at fn. 21.

<sup>6</sup> This rule is proposed to implement Core Principal J, which provides, "The applicant shall provide to the Commission all information necessary for the Commission to conduct the oversight function of the applicant with respect to the activities of the derivatives clearing organization."

unusual activity in a timely manner.”<sup>7</sup> However, due to its unique margin framework, this requirement if applied to NGX would yield a large amount of information that would not be particularly useful to the Commission’s financial surveillance program, but would nevertheless require significant systems modifications by NGX.

NGX uses a dynamic prepaid margin framework. Participants deposit collateral on account with NGX prior to assuming a position and must maintain a level of collateral that meets or exceeds their risk position at all times. Unlike a typical futures margining system in which routine margin calls are made daily after an account falls below the replenishment level, NGX constantly assesses the level of collateral against the positions participants carry, projects near term requirements based on open positions and physical delivery timelines, and makes frequent calls for collateral during the day to cover such projected positions. These are made prior to the collateral account falling below a replenishment level. Accordingly, unlike a typical futures margining framework, an intraday margin notice by NGX does not indicate an unusual or significant event with risk management implications. To the contrary, it is NGX’s routine practice to call for margin many times throughout the day and well prior to risk positions exceeding collateral holdings. Accordingly, requiring NGX to provide this information would yield little in the way of regulatory benefit. Further, such reporting would require a significant investment in operational infrastructure.

NGX respectfully requests that the Commission clarify in the final rules that where a DCO uses a pre-paid collateral margin model, such as NGX’s, it need not report to the Commission intraday margin calls.<sup>8</sup>

### **Public Information Reporting for Member Fees and Margin Methodology**

Proposed rule 39.21(c)(2)-(3) would require all DCOs to “disclose publicly and to the Commission information concerning” “each clearing and other fee that the derivatives clearing organization charges its clearing members” and the DCO’s “margin-setting methodology.”<sup>9</sup>

The Commission should provide greater flexibility with respect to these disclosure requirements. All NGX clearing participants are provided fee information, but such information is not made generally available. As a non-intermediated market, NGX provides a number of services to participants that are similar to those provided to customers by intermediaries, such as traditional futures commission merchants. NGX includes these intermediary-type fees with the more typical fees associated with clearing services. Requiring that NGX publicly disclose its fees would place NGX at a competitive disadvantage to those providing intermediary services who are not required to disclose publicly their fees.

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<sup>7</sup> Proposed Rules, at 78187.

<sup>8</sup> Some NGX contracts, however, are cleared using a conventional variation-margin model. NGX power contracts, for example, provide for a daily pay and collect with respect to variation adjustment to positions. However the size of this market is very small and NGX requests that the Commission reconsider requiring the build out of system processing capabilities for reporting of clearing offerings of such modest scope.

<sup>9</sup> The Commission is proposing to require these disclosures by DCOs under Core Principal L, which provides, “The applicant shall make information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) available to market participants.”

Moreover, because all clearing participants have a direct relationship with NGX there is no adverse consequence to the public by permitting fees to be disclosed only to participants and the Commission. Unlike an intermediate clearing house, where non-members may depend upon the public availability of information in order to verify information provided to them by their intermediary, all participants will be provided the information as part of their entering into the contracting party's agreement with NGX.


Similarly all clearing participants are provided information on the NGX margin methodology, which NGX treats as proprietary. There are no indirect, customer participants who may require access to the margin methodology. For these reasons, NGX requests that the Commission clarify that disclosure of fees and margin methodology to all participants is sufficient for a non-intermediated DCO. NGX of course would share such information with the Commission.

### **Conclusion**

NGX recognizes the importance of maintaining strong, transparent clearinghouses and does not oppose the Commission's proposals to ensure that DCOs provide accurate, timely and useful reports and disclosure to the Commission and to the public. However, we believe that the greater flexibility we have noted in this comment is necessary in order to address DCOs with unique clearing models. To be sure, NGX is not suggesting that it should not be subject to reporting requirements with respect to participant's positions or collateral amounts collected. NGX merely suggests that a flexible approach will provide the Commission with information better suited to fulfill its regulatory purposes and in a manner that is more readily accessed through NGX's existing processing systems.

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 LLP, at (202) 663-6240, with any questions about these comments.

Respectfully submitted,

  
for: Peter Krenkel, President and CEO