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Re: Response of the International Energy Credit Association ("IECA") to Commodity Futures Trading Commission ("CFTC" or "Commission") Notice of Proposed Rule ("NOPR" or "Proposed Rules") respecting Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (17 CFR Part 23, RIN 3038-AC97, Federal Register April 28, 2011) pursuant to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")

Re: Response of the IECA to CFTC Proposed Rules respecting Capital Requirements of Swap Dealers and Major Swap Participants (17 CFR Parts 1, 23 and 140, RIN 3038-AD54, Federal Register May 12, 2011) pursuant to Title VII of the Dodd-Frank Act

Ladies and Gentlemen:

The CFTC by the above-referenced NOPRs requests public comment on the Proposed Rules regarding Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants ("Margin Requirements") and Capital Requirements of Swap Dealers and Major Swap Participants ("Capital Requirements"), including various specific questions set forth in the two NOPRs. This letter responds to the two above-captioned NOPRs.

The IECA respectfully requests that the Commission accept these comments on the Proposed Rules, which are being filed after the Commission's requested filing deadline of July 11, 2011. Good cause exists, the IECA submits, for accepting these comments out of time. The IECA is a volunteer group within the energy industry without a substantial budget for outside legal assistance. For a substantial portion of the Commission's comment period on this NOPR on Margin Requirements and the companion NOPR on Capital Requirements, the IECA's limited resources were directed to analyzing and addressing the impacts of the Effective Date for the Dodd-Frank Act of July 16, 2011, including analyzing the Commission's proposed and final orders addressing the Effective Date for Swap Regulation, and the Commission Staff's No-

Action Letter, the proposed and final versions of which were issued on, respectively, June 17, 2011, June 30, 2011 and July 14, 2011. Based on such good cause, the IECA respectfully requests that its comments be accepted in these proceedings after the filing deadline.

I. **Introduction**.

The IECA, founded in 1923, is the leading global organization focused on credit-related issues in the energy industry. The IECA and its members have wide and deep expertise and 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 ("OTC") 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 to:

- Protect against increases in costs;
- Protect against a decline in the value of inventory;
- Manage cash flow, working capital, and liquidity;
- Maximize the value of assets;
- Meet the needs of customers; and,
- Comply with the terms of financing arrangements, which frequently require hedging of interest rate, foreign exchange, and commodity price risk to ensure the borrower's ability to pay its debt.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") will have an enormous impact on working capital requirements, the costs of hedging, and earnings volatility - all critical credit-related issues.

In view of these concerns, the IECA, for the first time in its almost ninety-year 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. Comments on the Proposed Rules.

The IECA's comments on the Proposed Rules are provided as comments on certain sections of the Proposed Rules regarding Margin Requirements, certain sections of the Proposed Rules regarding Capital Requirements, and responses to specific questions asked by the CFTC in the two NOPRs about these Proposed Rules.

1. Margin Treatment for Uncleared Swaps Between Covered Swap Entities and Non-Financial Entities

First and foremost, the IECA applauds the CFTC for "getting it right" in the Margin Requirements NOPR by not imposing margin requirements on non-financial entities as set forth in Section 23.154 of the Proposed Rules. This aspect of the CFTC's decision recognizes the mandate of the Dodd-Frank Act with respect to end-users of swaps and is consistent with the evidence of Congressional intent found in the Dodd-Lincoln letter of June 30, 2010.

IECA and its members are encouraged by the CFTC's allowance of bilaterally negotiated credit support arrangements, including allowing the parties to negotiate thresholds based on each party's creditworthiness, allowing (but not requiring) both the covered swap entities ("CSEs") and the non-financial entities to agree to provide margin to each other as credit support for their obligations under swaps, and essentially allowing the parties to continue to apply the current credit management practices utilized in the energy industry.

In addition, the IECA applauds the CFTC for allowing covered swap entities ("CSEs") to accept non-cash assets from non-financial entities as acceptable forms of margin under Sections 23.157(a)(3) and (b)(3) of the Margin Requirements NOPR. The Proposed Rule states that each CSE shall accept as margin from non-financial entities only assets for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the bilaterally negotiated credit support arrangements. The IECA believe this decision by the CFTC will allow end-users of swaps (i.e., non-financial entities) in the energy commodity markets to continue to realize significant efficiencies and innovations with respect to the use of scarce capital resources that arise due to the availability of alternative forms of credit support under bilaterally negotiated credit support arrangements.

The IECA notes that many of its members will meet the CFTC's definition of "non-financial entity" in proposed Section 23.150. Such non-financial entities use swaps to hedge commercial risk and pose substantially less risk to covered swap entities ("CSEs") than financial entities. Non-financial entities tend to heavily negotiate and document the OTC swaps they enter into and so should not be viewed with the same level of concern with respect to systemically risky behavior as those financial entities, investors and speculative market participants that, for whatever reasons, failed to document their swap transactions or failed to provide adequate credit support for liabilities they owed to their swap counterparties.

While investors, speculators and some financial entities are reported to have engaged in systemically risk behavior with respect to OTC swaps, non-financial entities using swaps to hedge commercial risks facing their businesses did not contribute to the systemically risky behavior that led to the enactment of Dodd-Frank.

Instead, non-financial entities engaged in hedging commercial risks are actually engaged in prudent risk management transactions, which due to the non-financial entity's reliance on such swaps to protect their commercial enterprises from the risks of commodity price volatility, are generally well-documented and subject to extensively negotiated credit support arrangements.

Non-financial entities, as end-users seeking to hedge commercial risks with OTC swaps, are not looking for a free ride when they seek to be exempt from initial and variation margin requirements under the CFTC's Proposed Rules. Instead, they seek only to continue to negotiate bilateral credit support arrangements with CSEs using the credit management practices currently in use in the energy industry to produce credit support arrangements that allow both end-users and CESs to ensure that they are adequately protected from credit risk and market risk exposure.

The IECA notes that CSEs do not have to enter into swaps with non-financial entities; if they feel inadequately protected, they can elect not to enter into a swap with that non-financial entity.

Non-financial entities can and do negotiate various forms of bilaterally negotiated credit support for obligations they owe to the CSEs under such swaps, such as first liens on the non-financial entity's assets, i.e., the same collateral a non-financial entity uses to provide credit support for the financing obligations owed to its senior lenders.

Allowing non-financial entities the optionality to use alternative forms of non-cash margin and bilaterally negotiated credit support arrangements, as opposed to restricting them to use cash margin as utilized for swaps between financial entities, enables and encourages innovation and efficient use of scarce capital by non-financial entities, which is vital to their businesses, while continuing to allow the prudent management of their exposure to commodity price volatility risks through bilaterally negotiated swaps with CSEs.

2. Recognizing the Value of Bilaterally Negotiated Credit Support Arrangements to Protect CSEs

While the IECA applauds the CFTC for not requiring non-financial entities to provide initial and variation margin under Section 23.154 of the Margin Requirements NOPR and for allowing non-financial entities and CSEs to continue to utilize bilaterally negotiated credit support arrangements, the IECA is concerned that the CFTC may not properly recognize the value of such bilaterally negotiated credit support arrangements in assessing the risks to CSEs from entering into uncleared swaps or in setting related capital charge requirements for such CSEs.

For example, the requirement in Sections 23.154(a)(7) and (b)(6) that a CSE calculate daily the initial and variation margin that would otherwise be required for an uncleared swap if the CSE's counterparty were another CSE instead of a non-financial entity is an unnecessary addition to current credit management practices in the energy industry. At best, the calculation of hypothetical margin is duplicative and at worst it provides an understated view of the risk to which the CSE is exposed. Moreover, the required use of a 10-day liquidation timeline in Section 23.155(b)(2)(vi) or multiples of 2.0 and 4.4 in Section 23.155(c)(1)(iv) for calculating the initial margin for uncleared swaps unnecessarily overstates the risk to the CSE of entering into such uncleared swaps, relative to the risks to the CSE of entering into a cleared swap.

3. In the Margin Requirements NOPR: Should there be any limits on the types of collateral accepted by CSEs from non-financial entities?

The IECA submits that CSEs and non-financial entities in the energy industry currently maximize the efficiency and innovation in the use of varied credit resources available to each party in negotiating bilateral credit support arrangements. At this time, the IECA sees no reason to impose limits on the types of collateral accepted by CSEs from non-financial entities.

4. Also In the Margin Requirements NOPR: The proposal states that each covered swap entity shall accept as margin from non-financial entities only assets for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the credit support arrangements. Should the Commission be more specific with regard to how non-traditional collateral should be valued?

The IECA submits that CSEs and non-financial entities in the energy industry currently maximize the efficiency and innovation in the use of varied credit resources available to each party in negotiating bilateral credit support arrangements. Imposing arbitrary limits on how non-traditional collateral should be valued will reduce such efficiency and innovation and will be an unnecessary addition to current credit management practices in the energy industry. Accordingly, the IECA sees no reason for the CFTC to be more specific with regard to how non-traditional collateral should be valued.

5. IECA Recommends Phasing Application of the Margin Requirements and the Capital Requirements in the Proposed Rules, First to Credit Default Swaps, Interest Rate Swaps and other Swaps that Already Tend to be Traded on Exchanges and Cleared, and Later to Physical Commodity Swaps such as Energy to Allow Time for the CFTC and Market Participants to Study the Impact on (i) the Price of the Physical Commodities and (ii) the Costs of Hedging by Using Uncleared Swaps in Energy Commodities, which Result from the Imposition of such Proposed Rules

While the Proposed Rules for Margin Requirements will allow CSEs and non-financial entities to bilaterally negotiate credit support arrangements for their uncleared swaps, the IECA is concerned that the imposition of margin requirements on other uncleared swaps entered into by CSEs with respect to energy commodities and the imposition of capital assessments on CSEs with respect to uncleared swaps involving energy commodities could result in changes in the price of underlying commodities and could increase the costs to non-financial entities of hedging their commercial risks using uncleared swaps.

Instruments like credit default swaps and interest rate swaps, which had a much greater impact on the systemic risks which gave rise to the economic recession that caused the Dodd-

Frank Act to be enacted, are now largely executed on exchanges and cleared in greater numbers than physical commodity swaps. As a result, these types of costs are priced into the market already to a greater extent than with respect to physical commodity swaps, such as energy. Moreover, since commodity swaps often involve a high degree of customization, the Proposed Rules on Margin Requirements and Capital Requirements may have a greater effect on the physical commodity asset class than asset classes that have a higher degree of standardization.

Accordingly, the IECA believes that the CFTC should conduct an empirical study of the effect of the Proposed Rules on (i) the prices of physical commodities and (ii) the costs of hedging against commodity price risk volatility using uncleared swaps, prior to implementing any of the proposed Margin Requirements and Capital Requirements in the physical commodity space. This could be accomplished by phasing the implementation of the Margin Requirements and Capital Requirements by applying these Proposed Rules to credit default swaps, interest rate swaps and other swaps that are already largely exchange-traded and cleared prior to applying them to physical commodity swaps, thereby giving the CFTC and market participants an opportunity to undertake such studies prior to the CFTC's applying such Proposed Rules on physical commodities in the energy industry.

6. In the Capital Requirements NOPR: The Commission is proposing to amend § 1.17 to specify capital charges for uncleared swap transactions held by an FCM. The Commission requests comment on the appropriateness of the proposed calculations. Furthermore, the Commission requests comment on viable alternative methods to compute capital charges for uncleared swap positions. Specifically, the Commission requests comment on whether capital charges should be based upon the margin calculations that would be required to be conducted under Part 23 of the proposed regulations.

Uncleared swap transactions between a CSE and a non-financial entity, which do not impose a margining obligation on the non-financial entity under Section 23.154, could nevertheless result in the imposition of a capital charge on the CSE to address the risk assumed by the CSE with respect to such uncleared swap. The IECA believes that any such capital charge should account for the broad array of credit worthiness ratings among those non-financial entities who may not choose to clear their swap transactions.

In this regard, the IECA suggests that a credit quality test could be performed by the CSE of any non-financial entity for which the CSE has an uncleared swap with no form of credit support provided by the non-financial entity. Such a credit quality test would be used to determine whether or not an additional capital charge would need to be taken by the CSE. The measure of creditworthiness of that non-financial entity could be based on credit ratings by independent rating agencies or could be based on some measure of (i) cash flow leverage, (ii) fixed charge coverage, and/or (iii) cash flow conversion cycle.

In addition, with respect to uncleared swaps with non-financial entities which provide some form of credit support to the CSE, the capital charges imposed on the CSE for such an uncleared swap should compliment the margin calculations under the credit support arrangement with that non-financial entity similar to the way that DCO capital compliments their collected margin – providing a similar level of coverage. The simplest means would be to deduct posted margin from required capital.

Thus, if a non-financial entity provided some type of non-cash margin to the CSE under the bilaterally negotiated credit support arrangement for an uncleared swap between the non-financial entity and the CSE (in accordance with Sections 23.154 and 23.157(a)(3)), then the IECA submits that a fair valuation of that non-cash margin should be deducted from the CSE's capital charge requirement for any such uncleared swap.

> **7. Also in the Capital Requirements NOPR: The Commission seeks comment on the appropriateness of allowing SDs and MSPs that also are registered as FCMs and have received approval to use internal models to compute their capital requirements to use such models to reduce the 100 percent capital charge for unsecured receivables arising from uncleared OTC swap transactions.**

The IECA wishes to clarify that in this request for comment, if the uncleared OTC swap transaction had been between a non-financial entity and a SD, and such non-financial entity had provided some type of non-cash margin to the SD under the credit support arrangement for this uncleared swap pursuant to Sections 23.154 and 23.157(a)(3), then the SD in the above request for comment (#7) would not have had an "unsecured receivable arising from [such] uncleared OTC swap transaction," but instead would have a "secured receivable arising from [such] uncleared OTC swap."

With a receivable "secured" by non-cash margin allowed under Section 23.154, the IECA submits that such a SD does not hold an "unsecured receivable" and, therefore, such a SD should not be subject to the 100 percent capital charge for unsecured receivables.

III. Conclusion.

The IECA appreciates the opportunity to provide the foregoing comments and information to the CFTC. 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

/s/
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