energy API

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March 16, 2012

Submitted Electronically

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (RIN 3038-AC97); Capital Requirements of Swap Dealers and Major Swap Participants (RIN 3038-AD54)

Dear Mr. Stawick:

The American Petroleum Institute ("API") appreciates the opportunity to submit these further comments to the Commodity Futures Trading Commission regarding the Commission's proposed capital and margin requirements for swap dealers and major swap participants.[1]

I. Introduction

API is a national trade association representing more than 450 oil and natural gas companies. API's members transact in physical and financial, exchange-traded, and over-the-counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy to wholesale and retail consumers. Associated with the hedging of physical exposures, API members enter into swap transactions to offset credit risks and to

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1 *See* Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (proposed May 12, 2011) (to be codified at 17 C.F.R. pts. 1, 23 & 140) (hereinafter, "Proposed Capital Requirements"); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (proposed Apr. 28, 2011) (to be codified at 17 C.F.R. pt. 23) (hereinafter, "Proposed Margin Requirements").

facilitate physical transactions. API members range from the largest major oil company to the smallest of independents. They are producers, refiners, suppliers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry. Because API members rely on the integrity of markets under the Commission's jurisdiction, we appreciate the opportunity to comment.

As the Commission finalizes rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[2] it is important to recognize that onerous new requirements for capital and margin related to energy transactions could tie up money that could be used more productively to invest in and explore for new sources of energy, to lower energy prices, and to create jobs. To avoid negative effects on the energy markets and the larger economy, API respectfully requests that (1) the final margin requirements clarify that, among other things, letters of credit are an appropriate form of collateral that may be posted by non-financial entities; and (2) the final capital requirements clarify that, with respect to commercial firms that are not part of bank holding companies, guarantees by parent or affiliated companies will count toward the "tangible net equity" requirement. These clarifications would recognize the reality of how market participants interact with parent and affiliated companies to manage risk and help to preserve market participants' access to cost-effective hedging transactions.

II. Margin

API previously urged the Commission to implement final margin rules that would preserve the ability of commercial end users to negotiate appropriate forms of collateral and valuation timeframes with their counterparties. In this regard, API supports a standard that would allow counterparties to continue to negotiate forms of collateral appropriate to the risks of each particular transaction. If flexibly interpreted, the Commission's proposed requirement that non-financial entities may post *any* form of collateral "for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the credit support arrangements"[3] goes a long way to meeting this goal and fulfilling Congress's direction that regulators "shall permit the use of noncash collateral."[4] In energy markets, one common form of collateral is a letter of credit from a parent or affiliated company. Other common forms of collateral include liens on assets like commodity reserves and production facilities. API requests

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2 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 Proposed Margin Requirements, 76 Fed. Reg. at 23,747 (proposed 17 C.F.R. § 23.157).

4 Dodd-Frank § 731 (CEA § 4s(e)(3)(C)).

that the Commission's final margin requirements clarify that these longstanding collateral practices will satisfy the final standard for eligible forms of margin.[5]

III. Capital

As explained previously in response to the Commission's proposed entity definition rules, API believes that its members generally are not swap dealers. Although some API members are large traders of swaps, they do so to manage portfolio and enterprise risks associated with commercial energy assets and obligations, not to serve an intermediary function. Accordingly, API has urged the Commission to differentiate between true swap dealers and swap traders.

In the event that the Commission's entity definition rules will treat some commercial energy firms as swap dealers, API supports the Commission's proposal to treat these firms differently from financial entities for purposes of capital requirements. As the Commission has recognized, "it may . . . be the case that significant portions of their equity is comprised of physical and other noncurrent assets, which would preclude the firms from meeting FCM capital requirements without engaging in significant corporate restructuring and incurring potentially undue costs."[6]

Although API supports this principle, API agrees with others submitting comments, including the Working Group of Commercial Energy Firms, that market participants need greater clarity with respect to the definition of "tangible net equity." As the Working Group has observed, in many cases, the entity that trades swaps may not be the same entity where most of the corporation's assets reside. As noted above, many companies find it more efficient for the swap trading entity's transactions to be backed by the guarantee of a parent or affiliated company. Among other things, this allows the parent company more precisely to determine its overall exposure to swap-related risk.

Accordingly, API respectfully requests that the Commission clarify that parent company guarantees will be considered as "assets" for purposes of the "tangible net equity" calculation. In other words, tangible net equity should account for the financial standing of the

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5 In this regard, API notes that the CFTC's end-user exception rulemaking contemplates that guarantees by parent companies, affiliated companies, or others are one way that end users typically meet their obligations associated with entering into uncleared swaps. *See* End-User Exception to Mandatory Clearing of Swaps, 75 Fed. Reg. 80,747, 80,749 & n.12 (proposed Dec. 23, 2010) (to be codified at 17 C.F.R. pt. 39).

6 Proposed Capital Requirements, 76 Fed. Reg. at 27,807.

parent company and for parent guarantees and other forms of support backing swaps entered into by a swap-trading subsidiary or affiliate.

IV. Conclusion

For the foregoing reasons, API respectfully requests that (1) the Commission's final margin requirements clarify that, among other things, letters of credit are an appropriate form of collateral that may be posted by non-financial entities; and (2) the Commission's final capital requirements clarify that, with respect to commercial firms that are not part of bank holding companies, guarantees by parent or affiliated companies will count toward the "tangible net equity" requirement. In accounting for the reality of how participants in energy markets interact with parent or affiliated companies to hedge risk, these clarifications would help to preserve access to cost-efficient hedging transactions and limit the potentially disruptive effects that onerous new capital and margin requirements could have on energy markets and the larger economy.

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Brian Knapp

Policy Advisor,
American Petroleum Institute

cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner
Honorable Mark P. Wetjen, Commissioner