



September 14, 2012

David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

RE: *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23,732 (April 28, 2011).
RIN 3038-AC97

Dear Mr. Stawick:

Pursuant to the notice extending the comment period issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”) on July 12, 2012,¹ the American Gas Association (“AGA”) submits for your consideration the following additional comments regarding margin requirements for uncleared swaps for swap dealers and major swap participants. AGA urges the Commission to establish rules that allow swap dealers and major swap participants to enter into credit-based financial arrangements whereby initial and variation margin would not be required for non-financial end-users, and to ensure that the margin requirements imposed on swap dealers and major swap participants related to uncleared swaps do not operate to decrease liquidity and/or increase the cost of such transactions to the detriment of end-users and American energy consumers.

The AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 71 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 65 million customers — receive their gas from AGA members. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States’ energy needs. For more information, please visit www.aga.org.

AGA member companies provide natural gas service to retail customers under rates, terms and conditions that are regulated at the local level by a state commission or other

¹ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, Extension of Comment Period, 77 Fed. Reg. 41,109 (July 12, 2012).

regulatory authority with jurisdiction. Many gas utilities use a variety of financial tools, including futures contracts traded on CFTC-regulated exchanges and over-the-counter energy derivatives, to hedge the commercial risks associated with providing natural gas service. Some gas utilities are required by their state regulatory agencies to hedge a portion of forecasted demand to manage potential price volatility.

In this proceeding, the Commission proposed to establish margin requirements for swap dealers and major swap participants that are not regulated by the Office of the Comptroller of the Currency, U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the “Prudential Regulators”).² Separately, the Prudential Regulators proposed to establish similar margin requirements for the swap dealers and major swap participants that they regulate.³

On July 11, 2011, AGA filed comments with both the Prudential Regulators and this Commission urging the regulators to work together work to develop a common approach to capital and margin requirements for all swap dealers and major swap participants, particularly as they apply to non-financial end-users. In particular, AGA urged the regulators to adopt rules reflecting that non-financial end-users have lower risk profiles such that swap dealers and major swap participants should be permitted to enter into credit-based financial arrangements whereby initial and variation margin would not be required.

As referenced in the most recent notice in this proceeding, the Working Group on Margin Requirements established by the Basel Commission on Banking Supervision and the International Organization of Securities Commissions published a consultative paper in October 2011, outlining possible margin requirements for non-centrally cleared derivatives.⁴ The report sets forth seven key principles: (1) appropriate margining practices should be in place for all derivatives not centrally cleared; (2) all financial firms and systemically important non-financial entities that engage in non-centrally cleared derivatives must exchange initial and variation margin; (3) the methods for calculating initial and variation margin should be consistent with reducing systemic risk and promoting clearing; (4) assets collected as collateral should be highly liquid; (5) initial margin should be held in a way that ensures that the margin is immediately available in the event of default and protects the posting party in the event of collecting party bankruptcy; (6) transactions among affiliates should be subject to appropriate variation margin arrangements to prevent the accumulation of significant current exposure to any affiliated entity arising out of non-centrally cleared derivatives; and (7) regulatory

² *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, Notice of Proposed Rulemaking, 76 Fed. Reg. 23,732 (April 28, 2011), Extension of Comment Period, 76 Fed. Reg. 27,621 (May 12, 2011).

³ *Margin and Capital Requirements for Covered Swap Entities*, 76 Fed. Reg. 27,564 (May 11, 2011).

⁴ 77 Fed. Reg. at p. 41,109, fn. 2 (“Consultative Paper”).

regimes should interact so as to result in sufficiently consistent and non-duplicative regulatory margin requirements for non-centrally cleared derivatives across jurisdictions. This Commission has sought comments on the Consultative Paper.

As AGA noted in comments to the Prudential Regulators, gas utilities reduce the cost of hedging on behalf of their customers by relying, in part, on their strong financial profiles to obtain unsecured credit for their hedging transactions instead of posting cash collateral. Typically, entities owning gas utilities maintain a capital structure that is approximately 50 percent equity and 50 percent debt, and own large quantities of tangible assets (*i.e.*, gas distribution systems and other energy facilities) that are recorded on their books at historical cost and financed through long-term debt. Gas utilities recover their costs, including the commodity-related costs of providing service, from their retail customers through rates approved by their local regulators. The commodity-related costs are recovered close in time to when the costs are incurred, *i.e.*, on a monthly basis. Moreover, to the extent customers do not pay their bills, utilities may be able to recover such costs through their rates either in the form of an expense included in base rates or through a monthly or quarterly cost recovery mechanism.

As a result of these strong credit profiles, gas utilities are able to negotiate with financial counterparties to take hedging positions up to a specified limit without having to post margin or collateral. Similarly, gas utilities often extend their counterparties a measure of unsecured credit as part of their hedging agreements, if justified by the counterparty's financial profile. Thus, the master agreements used by many gas utilities waive payment of initial margin, specify a minimum transfer amount, and/or permit netting of initial margin postings against margin postings for other transactions. These provisions recognize the strong credit profiles and limited default risk that gas utilities pose to their counterparties. Such credit arrangements benefit consumers by enabling counterparties to offer hedges to gas utilities at lower cost.

The Consultative Paper noted a broad consensus that the margin requirements would not apply to non-centrally cleared derivative transactions where one of the parties was a non-financial entity that is not systemically important because such transactions are viewed as posing little or no systemic risk and because such transactions are typically exempt from central clearing requirements.⁵ AGA agrees that over-the-counter derivative transactions involving non-financial end-users pose little or no systemic risk to the financial system. For this reason, AGA urges this Commission to work with the Prudential Regulators to establish rules that allow swap dealers and major swap participants to enter into credit-based financial arrangements whereby initial and variation margin would not be required for non-financial end-users, nor should additional costs be imposed.

The Consultative Paper also noted that the benefits of margin requirements must be weighed against the impact on liquidity and potential changes to market functioning as a result of increased demand for liquid, high-quality collateral.⁶ AGA, too, remains

⁵ See Consultative Paper at p. 9.

⁶ See *id.* at p. 3.

concerned about the market impact of the margin and collateral requirements proposed by various regulators. AGA believes that not only should the requirements be consistent among the various regulatory authorities – a point echoed by the Consultative Paper,⁷ they should also protect the ability of non-financial end-users to engage in risk management transactions at reasonable cost. The cost of such transactions may rise due to financial counterparties having increased capital cost requirements to fund derivative activities imposed by regulators. The Commission should work with the Prudential Regulators to ensure that the capital and margin requirements imposed on swap dealers and major swap participants related to non-centrally cleared transactions do not operate to decrease liquidity and/or increase the cost of such transactions to the detriment of end-users and American energy consumers.

Respectfully submitted,

/s/ Andrew K. Soto

Andrew K. Soto
Senior Managing Counsel
American Gas Association
400 N. Capitol Street, NW
Washington, DC 20001
202.824.7215
asoto@aga.org

⁷ See *id.* at pp. 4, 28-30.