

December 2, 2014

Christopher J. Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

Re: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, RIN 3038-AC97

Dear Secretary Kirkpatrick:

On October 3, 2014, the Commodity Futures Trading Commission (“CFTC” or “the Commission”) published in the Federal Register a notice of proposed rulemaking and an advance notice of proposed rulemaking entitled “Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants” (respectively, the “Margin NOPR” and the “Margin ANOPR”, and collectively the “Margin NOPR”, as the context requires).<sup>1</sup> The Margin NOPR addresses margin requirements that will apply to swap dealers and major swap participants in bilateral uncleared swap transactions. These entities are referred to as “covered swap entities” (“CSE”) in the Margin NOPR. The Margin ANOPR addresses the cross-border application of the proposed margin rules and offers three alternatives for comment.

The Coalition of Physical Energy Companies (“COPE”)<sup>2</sup> is hereby providing comments in general support of the Margin NOPR, but also suggesting certain revisions. The members of COPE are physical energy companies in the business of producing, processing, and merchandizing energy commodities at retail and wholesale. COPE had provided comment on the prior proposal Commission margin proposal on July 11, 2011, and again on September 14, 2012.<sup>3</sup> In these prior comments, COPE sought to maintain the long-standing and successful

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<sup>1</sup> *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 79 Fed. Reg. 59898 (Oct. 3, 2014).

<sup>2</sup> The members are: Apache Corporation; EP Energy LLC; Iberdrola Renewables, Inc.; Kinder Morgan; MarkWest Energy Partners, L.P.; Noble Energy, Inc.; Shell Energy North America (US), L.P.; SouthStar Energy Services LLC; and Targa Resources.

<sup>3</sup> Comments of the Coalition of Physical Energy Companies, Margin and Capital Requirements for Covered Swap Entities, RIN No. 2590-AA45 (July 11, 2011); Comments of the Coalition of Physical

credit practices that have been employed by physical energy companies rather than require them to be subjected to mandatory margin.

The Margin NOPR replaces the previous proposal relating to margin made by the CFTC in April 2011.<sup>4</sup> It is designed to be consistent with international standards issued by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions<sup>5</sup> and a similar proposal made by the US Federal banking regulators (the “US Prudential Regulators”).<sup>6</sup> The Margin NOPR specifies entities for which margin collection by CSE’s is required and proposes a comprehensive regulatory scheme to be applied when margin is required. CSEs that are not regulated by the US Prudential Regulators and certain specified financial companies/institutions are subject to this proposed rule.<sup>7</sup>

### **The Margin NOPR Properly Excludes Non-Financial End-Users from Mandatory Margin**

As proposed in the Margin NOPR, CSEs and financial end users with a material swap exposure of at least \$3 billion (on an affiliated group basis) would be subject to margin requirements.<sup>8</sup> Non-financial end users are exempt from regulatory-mandated margin requirements (while certain other aspects of the proposal would apply). COPE members would be considered non-financial end users under the proposal.

The Margin NOPR largely mirrors the US Prudential Regulators’ margin proposal. Both exempt non-financial end users from mandatory margin collection requirements imposed by regulation.

As explained in the Margin NOPR:

The proposal would not require CSEs to exchange margin with non-financial end users. The Commission believes that such entities, which generally are using swaps to hedge commercial risk, pose less risk to CSEs than financial entities.

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Energy Companies, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap - Participants – BCBS / IOSCO Consultative Paper, RIN No. 3038-AC97 (September 14, 2012).

<sup>4</sup> *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 23732 (April 28, 2011).

<sup>5</sup> *Margin Requirements for Non-Centrally-Cleared Derivatives*, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, July 2012.

<sup>6</sup> *Margin and Capital Requirements for Covered Swap Entities*, 79 Fed. Reg. 57348 (Sept. 24, 2014).

<sup>7</sup> Margin NOPR at 59926.

<sup>8</sup> *See id.* at 59904.

This approach is consistent with Congressional intent. Senior Congressional leaders have stated that they do not believe that non-financial end users should be required to post margin for uncleared swaps. In addition, the Dodd-Frank Act generally exempted non-financial end users from the requirement that they submit trades to clearing. If the Commission required them to post margin for uncleared trades, the clearing exemption could be weakened because the costs of clearing are likely to be less than the costs of margining an uncleared position. This approach is also consistent with international standards.<sup>9</sup>

COPE agrees with the Commission that non-financial end users need not be subject to the regulation of the credit component of their relationships with their CSE counterparties. Thus, the issue of whether security is required, the type of security, and the need for margin is properly left to the bilateral determination of the parties. COPE members' CSE counterparties are typically sophisticated institutions that make prudent credit decisions based upon the creditworthiness of their counterparty. As noted by the Commission, there is no need to disrupt this relationship as non-financial end users are commercial entities that pose less risk to CSEs and, accordingly, were exempted from mandatory clearing by Congress.

### **The Exclusion of Non-Financial End Users From Mandatory Margin Should Be Included in Regulatory Text**

As noted in the Margin NOPR,

[t]he Commission's proposal is generally consistent with the proposal of the Prudential Regulators but....[t]he Prudential Regulators' proposal contains the following provision:

“A covered swap entity is not required to collect initial margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user with material swaps exposure nor a swap entity but shall collect initial margin at such times and in such forms (if any) that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such noncleared swaps and non-cleared security-based swaps.”<sup>10</sup>

COPE believes that the CFTC should consider following the model of the US Prudential Regulators and make explicit in its regulations what it has said in the preamble: that non-financial end users are not required to post margin under the rule.

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<sup>9</sup> *Id.* at 59906 (internal citations omitted).

<sup>10</sup> *Id.*

## **Non-Financial End Users Should Not Be Subject To Margin-Related Regulatory Documentation Requirements**

Notwithstanding the fact that non-financial end users are not subject to margin requirements under the Margin NOPR, the Commission proposes to require that their documentation with counter parties be made subject to regulation. As a result, the Margin NOPR proposes that, “[f]or uncleared swaps between a covered swap entity and a non-financial entity,<sup>11</sup> the documentation shall specify whether initial and/or variation margin will be exchanged and, if so, the documentation shall comply with” specific regulatory requirements.”<sup>12</sup>

COPE strongly disagrees with this aspect of the proposal. COPE members and their counterparties have been successfully transacting swaps for many years using legally sound and fully effective documentation. There is no need to interfere with this sound process and interject new regulatory requirements that can only be disruptive. COPE notes that the Prudential Regulators’ proposal contains no such requirements.

Under the swap documentation currently used by COPE members and their counterparties, the parties are fully aware of and have documented their duties and obligations. If initial and/or variation margin will be exchanged, the documentation covers those points. However, a new regulatory requirement concerning the existence or non-existence of margin obligations can only raise questions as to whether, beyond the commercial clarity of the documentation, there is a regulatory deficiency. There is no need to impose such regulatory ambiguity into a successful process and relationship. The only result will likely be pointless amendments to documentation that serve no commercial purpose.

Similarly, if margin is required, the parties will have in place the necessary commercial documentation to accomplish the intended result. There is no need for the Commission to prescribe the contents of such documentation. There is a significant body of accepted materials used for addressing the areas covered by the Commission’s language, such as the ISDA Master Agreement, Schedule and Credit Support Annex. These materials and others, both form and bespoke, are used by non-financial end users with their CSE counterparties to fully meet the commercial needs of the marketplace. A new regulatory requirement will only interject ambiguity as to whether these commercially successful documents meet regulatory requirements.

Thus, for the foregoing reasons, the Commission should eliminate the inclusion of non-financial end users from the documentation provisions of any final rule.<sup>13</sup>

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<sup>11</sup> COPE understands that the reference to” non-financial entity” was intended to state “non-financial end user.”

<sup>12</sup> Margin NOPR at 59932

<sup>13</sup> This would be consistent with the “eligible master netting agreement” provisions of the proposal which properly do not apply to non-financial end users.

### **Non-Financial End Users Should Not Be Subject To Hypothetical Margin Calculations**

While non-financial end users are not subject to the margin requirements of the Margin NOPR, “the proposal would require each CSE to calculate hypothetical initial and variation margin amounts each day for positions held by non-financial entities that have material swaps exposure to the covered counterparty.”<sup>14</sup> This requirement is not part of the US Prudential Regulators’ proposal. COPE understands the Commission believes this is a good practice for the CSE’s to perform.

COPE’s concern with this requirement is that it is premised on the identification of non-financial end users that have material swaps exposure to the CSE. Therefore, the CSE will need to understand whether there is material swaps exposure as defined in the Margin NOPR with its non-financial end user counterparty (where the entity and its affiliates have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds \$3 billion, where such amount is calculated only for business days).<sup>15</sup> Since the foregoing definition includes “all counterparties,” the CSE will need to inquire regarding these matters of the non-financial end users.

The indirect requirement that non-financial end users undertake the burdensome process of developing this information so a CSE can undertake a hypothetical exercise should be deleted from any final rule. Currently, a non-financial end user and its CSE counterparty exchange information necessary to inform and implement the credit relationship between the parties. This information ranges from public ratings information and audited financial statements to more granular, more real-time information. However, this information is typically limited to that related to the non-financial end user and its credit support provider, if any. There is no need to involve affiliates to which the CSE is not exposed and that do not provide credit support.

COPE requests that the Commission delete this indirect burden on non-financial end users from any final rule.

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<sup>14</sup> Margin NOPR at 59907 (internal citation omitted).

<sup>15</sup> *Id.* at 59904 (referencing proposed § 23.151).

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## **Conclusion**

For the forgoing reasons, COPE respectfully requests that the Commission issue a final rule that exempts non-financial end users from the regulation of their margin relationships with CSEs. Such a final rule should not include documentation requirements or an indirect obligation to determine material swaps exposure for non-financial end users.

Respectfully Submitted,

/s/ David M. Perlman

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CC: COPE Members