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**VIA ELECTRONIC SUBMISSION**

Mr. Christopher Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, NW  
Washington, DC 20581

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

Dear Mr. Kirkpatrick:

**I. INTRODUCTION.**

On behalf of The Commercial Energy Working Group (the “**Working Group**”), Sutherland Asbill & Brennan LLP hereby submits this letter in response to the request for public comment set forth in the Interim Final Rule, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* (the “**Interim Margin Rule**”),<sup>1</sup> issued by the Commodity Futures Trading Commission (“the “**CFTC**” or “**Commission**”). Specifically, this comment letter focuses on a particular prong of the definition of “financial end-user,” as further discussed below.

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

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<sup>1</sup> See Final Rule and Interim Final Rule, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (Jan. 6, 2016), available at <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2015-32320a.pdf>.

Since the Interim Margin Rule works in conjunction with the final rule on margin for uncleared swaps (the “**Final Margin Rule**”),<sup>2</sup> the Working Group’s comments contained herein on the definition of “financial end-user,” which is defined in the Final Margin Rule,<sup>3</sup> are appropriate. Specifically, the Final Margin Rule establishes that “financial end-users” are subject to margin requirements, and the Interim Margin Rule provides an exemption from the margin requirements of the Final Margin Rule for certain uncleared swaps. Thus, the need to rely on the exemption provided by the Interim Margin Rule largely is only beneficial for market participants if they are subject to the Final Margin Rule, such as financial end-users.

In conjunction with this letter, the Working Group has also submitted a letter to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (collectively, the “**Prudential Regulators**”) on the Prudential Regulators Joint Interim Final Rule and Request for Comment, *Margin and Capital Requirements for Covered Swap Entities*,<sup>4</sup> containing requests and recommendations consistent with the comments provided herein.

## II. COMMENTS OF THE WORKING GROUP.

The Working Group’s primary concern with the Final Margin Rule’s definition of “financial end-user” is the potential breadth of the following prong of that definition (“**Prong xi**”):

An entity, person or arrangement that is, or holds itself out as being, an entity, person, or arrangement that...uses its own money **primarily** for the purpose of **investing or trading or facilitating the investing or trading** in...swaps...or other assets for resale or other disposition or otherwise trading in...swaps...or **other assets**.<sup>5</sup> (emphasis added).

As discussed herein, the Working Group is seeking clarity with respect to certain aspects of Prong xi and is respectfully offering recommendations. *First*, the Working Group is seeking clarity regarding the phrase “**investing or trading or facilitating the investing or trading**” in Prong xi. *Second*, the Working Group is seeking clarity regarding the phrase “**other assets**” in

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<sup>2</sup> See *id.*

<sup>3</sup> See Final Margin Rule at 696 (defining financial end-user, to be codified at 17 C.F.R. § 23.151).

<sup>4</sup> See Prudential Regulators Joint Interim Final Rule and Request for Comment, *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74,916 (Nov. 30, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28670.pdf>; see also Prudential Regulators Joint Final Rule, *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74,840 (Nov. 30, 2015), available at <https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf>. As used herein, “**PR Final Margin Rule**” refers to the Prudential Regulators’ final rule on margin requirements for uncleared swaps for covered swap entities.

<sup>5</sup> Final Margin Rule at 696 (defining financial end-user, to be codified at 17 C.F.R. § 23.151).

Prong xi. *Third*, the Working Group recommends that the term “primarily” in Prong xi is replaced with the term “predominantly.”

Since the language used in Prong xi of the Final Margin Rule is the same as the language used in Prong xi of the PR Final Margin Rule, the Working Group’s requests and recommendations to the CFTC contained herein are equally applicable to the Prudential Regulators.

**A. The CFTC Should Clarify That “Investing or Trading” Does Not Capture Hedging Transactions.**

The Working Group’s understanding is that transactions that hedge or mitigate commercial risk are not “investing or trading,” but clarity in this respect would provide regulatory certainty. Therefore, the Working Group respectfully requests that the CFTC clarify that the phrase “investing or trading” in Prong xi of the Final Margin Rule’s definition of “financial end-user” does not capture transactions that hedge or mitigate commercial risk. Specifically, any transaction or financial asset (*e.g.*, futures) used to hedge or mitigate commercial risk should not be captured by the phrase “investing or trading.” Providing such clarity would be consistent with (i) positions taken by the CFTC in previous statements and (ii) the approach taken in the Final Margin Rule and the PR Final Margin Rule (collectively, the “**Final Margin Rules**”).

*i. Prior Statements from the CFTC Recognize That Hedging Is Different.*

In both its final rule on the end-user exception from mandatory clearing and its final rule that, among other things, further defined “major swap participant,” the CFTC recognized that hedging or mitigating commercial risk is not “investing or trading.” Specifically, the CFTC recognized the difference between hedging and trading and investing when it noted that “swaps executed for the purpose of speculating, investing, or trading are not being used to hedge or mitigate commercial risk”<sup>6</sup> and the term trading “would not include...entering into...swaps if the swaps are used for the purpose of hedging or mitigating commercial risks.”<sup>7</sup>

*ii. The Final Margin Rules’ Approach of Calculating “Material Swaps Exposure” Supports Treating Hedging Differently.*

The Final Margin Rules’ approach to calculating “material swaps exposure” supports treating hedging differently than “investing or trading.” Specifically, the Final Margin Rules provide that for the purposes of calculating “material swaps exposure,” an entity does not count

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<sup>6</sup> Final Rule, *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42,560, 42,574 (July 19, 2012), available at <http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2012-17291a.pdf>.

<sup>7</sup> CFTC and SEC Joint Final Rule, Joint Interim Final Rule, and Interpretations, *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant,” and “Eligible Contract Participant,”* 77 Fed. Reg. 30,596, 30,676 (May 23, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-10562a.pdf>.

uncleared swaps exempted from the margin requirements under the Interim Margin Rule.<sup>8</sup> As a result, uncleared swaps entered into by certain entities that hedge or mitigate commercial risk are not included in the calculation to determine if the \$8 billion material swaps exposure threshold is met.

Since swaps used to hedge or mitigate commercial risk are treated differently in the context of determining whether the material swaps exposure threshold is met, it is reasonable to conclude that such swaps may be excluded with respect to other aspects of the Final Margin Rules. As such, clarifying that transactions that hedge or mitigate commercial risk are not captured by the phrase “investing or trading” would be consistent with the general approach in the Final Margin Rules.

**B. The CFTC Should Clarify That the Phrase “Other Assets” in Prong xi Refers to “Other Financial Assets.”**

The Working Group respectfully requests for the CFTC to clarify that the phrase “other assets” in Prong xi of the Final Margin Rule’s definition of “financial end-user” refers to “**other financial** assets.”

As currently drafted, Prong xi could be read quite broadly. Given the context in which the phrase “other assets” is used, the Working Group believes that the CFTC intended the phrase to capture “other financial assets” since the type of assets specifically listed in Prong xi are all financial in nature. However, without “financial” as an express qualifier, the phrase “other assets” could include not only other financial assets, but also physical commodities and storage and transportation capacity. Inclusion of such assets may cause non-financial commercial entities that are engaged in physical commodity-related businesses to be considered financial end-users, subjecting them to margin requirements.

These entities “were not a source of significant risk in the financial crisis” and should not be subject to regulatory margin requirements.<sup>9</sup> Subjecting them to margin requirements would unnecessarily drain capital from these companies that would be better utilized creating jobs and improving the nation’s energy infrastructure.

To avoid that unintended outcome, the Working Group requests that the CFTC clarify that “other assets” should be read to mean “other financial assets.” Specifically, the Working Group recommends that the Commission amend CFTC Regulation 23.151<sup>10</sup> so that Prong xi specifically states “other financial assets.” However, if the CFTC does not opt to amend the regulation, the Working Group alternatively recommends that the CFTC provide clarity in the

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<sup>8</sup> See Final Margin Rule at 697 (defining material swaps exposure, to be codified at 17 C.F.R. § 23.151); see also PR Final Margin Rule at 74,901 (defining material swaps exposure, to be codified at §\_\_.2).

<sup>9</sup> Statement of Chairman Timothy Massad Regarding the Final Rule on Margin for Uncleared Swaps (Dec. 16, 2015), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement121615d>.

<sup>10</sup> To be codified at 17 C.F.R. § 23.151.

form of guidance by noting that Prong xi refers to “other financial assets.” That guidance should also clarify that transactions that the CFTC has exempted from regulation as swaps are not financial assets.<sup>11</sup>

**C. The CFTC Should Replace the Term “Primarily” in Prong xi with the Term “Predominately.”**

The Working Group respectfully requests that the CFTC replace the term “primarily” in Prong xi with the term “predominately.” The Final Margin Rule’s definition of “financial end-user” should use the term “predominately” instead of “primarily” to be consistent with the terminology in the Commodity Exchange Act’s (“CEA”) definition of “financial entity.”<sup>12</sup> The use of the term “predominately” in the Final Margin Rule will align the threshold for being a financial end-user under such rule with the threshold that Congress established in the CEA for entities to be considered financial entities.

**III. CONCLUSION.**

The Working Group appreciates this opportunity to provide comments on the Interim Margin Rule and respectfully requests that the CFTC consider the comments set forth herein.

If you have any questions, please contact the undersigned.

Respectfully submitted,

/s/ David T. McIndoe

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***Counsel to The Commercial Energy Working Group***

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<sup>11</sup> For example, CEA Section 1a(47)(B) exempts forward contracts for the purchase or sale of physical commodities from the definition of swap. In addition, the CFTC exempted certain forms of electricity-related transactions from regulation as a swap. See Final Order, *Final Order in Response to a Petition from Certain Independent System Operators and Regional Transmission Organizations to Exempt Specified Transactions Authorized by a Tariff or Protocol Approved by the Federal Energy Regulatory Commission or the Public Utility Commission of Texas from Certain Provisions of the Commodity Exchange Act*, 78 Fed. Reg. 19,880 (Apr. 2, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-07634a.pdf>.

<sup>12</sup> See CEA Section 2(h)(7)(C). The last prong of the definition of “financial entity” in the CEA includes “...a person *predominantly* engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in [S]ection 4(k) of the Bank Holding Company Act of 1956.” (emphasis added). CEA Section 2(h)(7)(C)(i)(VIII). However, since the CFTC has not provided guidance on what it means to be “predominantly engaged,” market participants have looked to the definition of “predominantly engaged” in Section 102(a)(6) of Title I the Dodd Frank Act. That definition views an entity to be predominantly engaged in activity that is financial in nature if at least 85% of its assets or revenue are financial in nature.