May 15, 2017

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Capital Requirements for Swap Dealers and Major Swap Participants

Dear Mr. Kirkpatrick:

Please accept these comments from BP Energy Company ("BPEC") in furtherance of the U.S. Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed rule regarding Capital Requirements for Swap Dealers and Major Swap Participants ("Proposed Capital Rule").[1] BPEC, located in Houston, Texas, is a marketer of natural gas, electric power, and natural gas liquids with operations throughout the continental United States, and is a swap dealer ("SD") provisionally registered with the CFTC. Therefore, BPEC would be subject to the CFTC Proposed Capital Rule.

BPEC is committed to constructive dialogue with the CFTC to mitigate systemic risk in a manner that protects market liquidity. It is in this spirit that BPEC requests that the Commission consider certain modifications to the Proposed Capital Rule, many of which also have been recommended by various energy end-user associations, including in prior letters submitted to the Commission.

I. The Commission Should Modify The Proposed Eligibility Requirement For The Tangible Net Worth Approach To Ensure That It Is An Available Option For Commercial SDs

The Commission's proposed capital approach based on tangible net worth acknowledges that not all SDs will be traditional financial firms and a single standardized approach is not

---

[1] *See Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 (Dec. 16, 2016) ("Proposed Capital Rule").

appropriate for all SDs.[2] If BPEC were required to meet a traditional bank-based capital approach or net liquid assets capital approach, it would incur extensive costs and need to devote significant resources to modify its existing risk management program, including its internal models, which governs the ways in which BPEC currently calculates its value at risk and liquidity stress test. The bank-based and net liquidity approaches are based on existing regulatory capital regimes applicable to bank holding companies on the one hand, and futures commission merchants ("FCM") or SEC-regulated broker dealers ("BD") on the other. For commercial SDs that are not bank subsidiaries, FCMs or BDs, the increased cost of these changes creates a competitive disadvantage without any additional protection to the commercial SD or to the health of the financial system.

BPEC appreciates the Commission's acknowledgment of this challenge for commercial SDs like BPEC, and its inclusion of an alternative capital approach.[3] However, BPEC is concerned that most commercial SDs would not be eligible to apply the tangible net worth capital approach as currently proposed. In order to be eligible for this capital approach, an SD must be a non-financial SD. In other contexts establishing that commercial entities are non-financial entities, the Commission looks to whether the entity is "predominantly engaged . . . in activities that are financial in nature."[4] However, without explanation, the Proposed Capital Rule reverses this well-established standard as explained below, with the result being that most commercial SDs likely will not be eligible to use the alternative capital approach.

Pursuant to CEA Section 2(h)(7)(C)(i)(VIII), the term "financial entity" 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 Section 1843(k) of title 12." Under Title 1 of the Dodd-Frank Act, an entity that is "predominantly engaged" in activities that are financial in nature is one with at least **85% of consolidated assets or revenues related to, or derived from, "financial in nature" activities**.[5] However, for purposes of the Proposed Capital Rule, the Commission has reversed this financial in nature test, requiring that the entity have no more than

---

[2] "The Commission is proposing the tangible net worth capital approach in recognition that not all SDs will be principally engaged in traditional dealing and other financial activities. The Commission anticipates that a small number of SDs will be substantially engaged in commercial operations that would make meeting a traditional bank-based capital approach or net liquid assets capital approach extremely challenging, if at all possible, without substantial corporate restructuring." Proposed Capital Rule at 91255-91256.

[3] BPEC agrees that "[t]he Commission's proposed approach of recognizing existing capital requirements on firms that register as SDs and the Commission's further recognition that not all SDs will be traditional financial firms offers potential benefits to swap market participants by encouraging more firms to act as SDs and to make markets in swaps. An approach [that would] require substantial corporate reorganization . . . would increase costs of swap transactions for swap dealers and their counterparties, including commercial end users" Proposed Capital Rule at 91256.

[4] Commodity Exchange Act ("CEA") Section 2(h)(7)(C)(i)(VIII).

[5] *See Definitions of "Predominantly Engaged In Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company*, 78 Fed Reg. 20756 (Apr. 5, 2013).

15% of consolidated assets or revenue related to or derived from "financial in nature" activities.

The Commission should apply the same test here that it uses to determine whether an entity is a financial entity under CEA Section 2(h)(7)(C)(i)(VIII). Just as Congress determined to consider commercial companies non-financial entities when they are not "predominantly engaged . . . in activities that are financial in nature," the CFTC should consider a swap dealer to be a non-financial SD when it is not "predominantly engaged . . . in activities that are financial in nature." As the Commission recognized, "while these entities may engage in dealing activities, they are primarily commercial entities and differ from financial entities in various ways, including the composition of their balance sheet (*e.g.*, the types of assets they hold), the types of transactions they enter into, and the types of market participants and swap counterparties that they deal with. Because of these differences, the Commission believes that application of the bank-based or net liquid assets capital approaches to these SDs could result in inappropriate capital requirements that would not be proportionate to the risk associated with them, and, therefore, these SDs should have the option to apply a tangible net worth approach."[6] In other words, commercial SDs are fundamentally different than SDs that are bank subsidiaries, FCMs or BDs. It is the nature of these differences and not an arbitrary 15% threshold that should drive the availability of the tangible net worth capital approach.

The Dodd Frank Act requires that the Commission establish capital requirements that will help ensure the safety and soundness of SDs and be appropriate for the risk associated with the SD's non-cleared swaps.[7] As the Commission noted, "financial firms generally present a higher level of systemic risk than commercial firms as the profitability and viability of financial firms is more tightly linked to the health of the financial system than commercial firms."[8] Furthermore, if commercial SDs are required to apply the same capital structure as financial institutions, this will significantly increase costs for these SDs and may very well lead to further concentration in the market.[9] For these reasons, it is critical that the Commission ensure that all non-financial SDs, not just those with insignificant revenue or assets derived from financial activities, be able to utilize the alternative tangible net worth capital approach.

II. The Capital Model Approval Process Should Be Simplified To Allow For The Efficient Use Of Internal Models By Commercial SDs

In its 2011 Capital Proposal, the Commission recognized that capital requirements based on internal risk measurement models are a "better approach" for entities with significant business

---

6 Proposed Capital Rule at 91263.

7 CEA Section 4s(e)(3)(A).

8 Proposed Capital Rule at 91255.

9 Proposed Capital Rule at 91256.

in commodities.[10] While there is some degree of commonality across SDs, each SD faces its own unique set of risks. For BPEC, those risks are related to the energy commodity markets. The Dodd-Frank Act recognizes the importance of considering these differences and, in fact, requires that the Commission's capital requirements for SDs "be appropriate for the risk associated with Swap Dealers' non-cleared swaps."[11] Allowing for the efficient use of models based on widely accepted risk management practices in the energy industry would align the capital requirement with market risks while also helping to ensure a level playing field for commercial SDs relative to financial SDs.[12]

BPEC appreciates the Commission's decision to provide enhanced flexibility to recognize internal models compared to the 2011 Capital Proposal. That said, BPEC urges the CFTC to further streamline the recognition of internal models. In particular, the Commission should, at a minimum, provisionally approve internal capital models submitted by SDs to the National Futures Association ("NFA") in good faith, subject to further review and final approval as appropriate.[13] Further, any final capital rule should explicitly recognize and approve internal models that are based upon widely accepted and well understood risk management practices, provided such internal models are being used to generate the SD's quarterly risk exposure reports filed with the Commission, as required by existing regulations.[14] Additionally, any final capital rule should acknowledge that to the extent that the NFA has conducted its review of an SD's risk management program and determined that its 4s Submission demonstrated its ability to comply with the applicable CFTC regulations, those internal models already were an integral part of and subject to such review.

III. The Proposed Reporting, Recordkeeping and Notification Requirements Should Be Modified For Commercial SDs Commensurate With The Risks

The proposed timing and other requirements for (i) filing monthly and quarterly financial reports with the CFTC; (ii) providing notice of triggering events; (iii) public disclosure of

---

10 *See Capital Requirements of Swap Dealers and Major Swap Participants*, 76 Fed. Reg. 27802, 27809 (May 12, 2011) ("2011 Capital Proposal").

11 CEA Section 4s(e)(3)(A).

12 *See, e.g.,* Letter from the Natural Gas Supply Association and National Corn Growers Association to the CFTC dated Jan. 12, 2012 ("NGSA/NCGA Letter").

13 These models can be reviewed and evaluated by the Commission in an expeditious, cost-effective, and definitive manner through back-testing to demonstrate that the resulting capital requirements are appropriate. *See also* NGSA/NCGA Letter.

14 CFTC Rule 23.600(c)(2). *See also* NGSA/NCGA Letter (the VaR model approach used by many commercial companies is based on widely accepted and well understood risk management practices).

financial reports;[15] (iv) reporting of position and counterparty information; and (v) reporting relating to internal models, as currently proposed would require significant and costly system changes for commercial SDs that do not have the same financial reporting systems as financial SD entities. Just as the Proposed Capital Rule differentiates between SDs that are bank subsidiaries, FCMs or BDs in order to align their requirements within current applicable frameworks, any final capital rule also should account for differences with commercial SDs, both in terms of their current system capabilities and the relative risks posed to the financial system. While financial SDs that are already subject to capital requirements may have existing processes in place to monitor, track and report the required information as proposed in light of their existing regulatory framework and the risks inherent in their businesses, commercial SDs will need to incur substantial costs to comply with these new requirements.

As it has for SDs that are bank subsidiaries, FCMs or BDs, the CFTC should provide an approach for commercial SDs that aligns the financial reporting and notification requirements with those already applicable to such SDs. For example, swap dealers already are subject to periodic audits by the NFA in addition to the NFA's detailed review of each SD's policies and procedures to ensure compliance with the rules. Moreover, SDs are required to notify the CFTC of any material non-compliance in the annual report.

The Commission should right-size the requirements for commercial SDs to be commensurate with the applicable risks as it recognized in the Proposed Capital Rule that "financial firms generally present a higher level of systemic risk than commercial firms as the profitability and viability of financial firms is more tightly linked to the health of the financial system than commercial firms."[16] In order to promote competition and a level playing field, the Commission should provide an alternative reporting and notification framework for commercial SDs who are neither part of a bank holding company or dually registered as an FCM or BD.

IV. The Proposed Capital Rules Should Provide US SDs With The Same Accounting Standard Flexibility As Non-US SDs

The Proposed Capital Rule permits a non-U.S. SD to use International Financial Reporting Standards ("IFRS") unless it prepares U.S. GAAP financials as part of its consolidation into a US Parent company. To be consistent, the CFTC also should explicitly allow a U.S. SD to use IFRS to the extent it consolidates into a foreign entity that uses IFRS. IFRS is widely used by non-U.S. companies doing business in the U.S. commodity markets. Requiring an SD to prepare its own financial statements based on U.S. GAAP solely as a

---

[15] The Commission explained that the quarterly public disclosure requirement is "intended to make the frequency of such public disclosure consistent with publicly available information provided by bank entities in call reports." Proposed Capital Rule at 91277. This justification does not apply to commercial SDs who are not already making this information public and who pose less risk to the financial system.

[16] Proposed Capital Rule at 91255.

requirement of being an SD, when it consolidates into a non-U.S. entity who uses other generally accepted accounting principles, will cause the SD to incur additional material costs for its internal and external audit teams at no additional benefit to the market. Furthermore, the SEC does not require financial statements prepared pursuant to IFRS to be reconciled to U.S. GAAP. Accepting IFRS as an alternative to U.S. GAAP would reduce costs for all SDs who currently prepare their financial statements on the basis of IFRS and would be consistent with the requirements and policy direction of the SEC.

V. The Eight Percent Capital Calculation Overstates Needed Capital and May Negatively Impact Liquidity

An SD should be allowed to perform the relevant capital calculations on a portfolio basis.[17] Because an SD would be required to perform the relevant capital calculations on a counterparty-by-counterparty basis, eight percent of the sum of the amount of margin calculated pursuant to Proposed Capital Rule 23.101(a)(2)(ii)(2)(B) would not take into account the likely scenario where an SD has a well-hedged portfolio across multiple counterparties such that, even if they all default, counterparties with positions on one side of the market cannot owe money to the SD at the same time as counterparties with positions on the other side of the market. This aspect of the eight percent calculation could well induce SDs to limit the number of counterparties with whom they deal, thereby impacting liquidity.

VI. The Requirement For An SD To Include Swaps With End Users In Its Eight Percent Capital Calculation Is Inconsistent With The Intent Of Congress

The Proposed Capital Rule obligates an SD to include in its eight percent capital calculation, hypothetical margin from uncleared swaps that are not otherwise subject to the CFTC's Margin Rule. For commercial SDs dealing with significant numbers of end user counterparties, this could result in having to raise significantly more capital because SDs are not required to collect margin from end users under the CFTC's Margin Rule. This has the potential to create an incentive for SDs to require their end user counterparties to post collateral in order to meet heightened capital requirements. Such a result would be contrary to the intent of Title III of the Terrorism Risk Insurance Program Reauthorization Act of 2015, which was designed to exclude end users from margin requirements and could create a competitive disadvantage for SDs who transact with a significant number of end users.

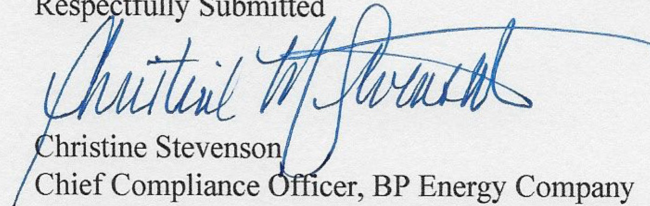
VII. Conclusion

BPEC appreciates the opportunity to comment in this proceeding, and respectfully requests Commission support for the requested modifications, many of which have been advanced by a variety of energy market participants over the course of several years. Please

---

[17] Proposed Capital Rule 23.101(a)(2)(ii)(2)(B).

contact the undersigned, Christine Stevenson at 713-323-0199 if you have any questions or would like further clarification regarding BPEC's submission.


Respectfully Submitted

Christine Stevenson
Chief Compliance Officer, BP Energy Company

cc: Honorable Sharon Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner
John C. Lawton, Deputy Director
Thomas J. Smith, Deputy Director