August 13, 2018

VIA ONLINE SUBMISSION
Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

RE: De Minimis Exception to the Swap Dealer Definition, RIN 3038-AE68

Dear Mr. Kirkpatrick:

By this letter, the Natural Gas Supply Association ("NGSA") respectfully submits comments in response to the U.S. Commodity Futures Trading Commission's (the "CFTC's" or "Commission's") Notice of Proposed Rule Making, De Minimis Exception to the Swap Dealer Definition, 83 Fed. Reg. 27444 (June 12, 2018) (the proposed rule and proposing release therein referred to herein, respectively, as the "Proposed Rule" and the "Proposing Release"). NGSA appreciates the action taken by the CFTC in developing the Proposed Rule, which, if adopted, would significantly reduce the uncertainty associated with the current de minimis exception to the swap dealer definition and the potential end to the current "phase-in" de minimis threshold level. NGSA appreciates this opportunity to provide comments regarding those significant aspects of the Proposed Rule that are workable as proposed and a few others that require certain minor adjustments.

NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. Founded in 1965, NGSA is the only Washington, D.C.-based trade association that focuses on producer/marketer issues related to the downstream natural gas industry.

As producers and suppliers of natural gas, NGSA members would not invest in the growth of the physical natural gas markets if they did not believe the market exhibited three key principles of health—integrity, transparency, and efficiency. NGSA

believes that its comments in response to the Proposed Rule further promote these principles and respectfully requests that the Commission consider and implement them.

COMMENTS

NGSA supports the CFTC's Proposed Rule but recommends that certain changes be made to better provide regulatory certainty and continuity to market participants in the natural gas and other physical commodity-based industries. Overall, the CFTC's Proposed Rule reasonably serves the policy goals behind the de minimis exception (*i.e.*, increasing efficiency, allowing limited swap dealing in connection with other client services, encouraging new participants to enter the market, and focusing regulatory resources) while still achieving the policy goals behind the underlying swap dealer ("SD") registration and related regulatory requirements (*i.e.*, reducing systemic risk, increasing counterparty protections, and increasing market efficiency, orderliness, and transparency). Importantly, the Proposed Rule would provide much-needed regulatory certainty to market participants regarding the level of the de minimis threshold (eliminating the long-running concern about an abrupt shift from an $8 billion to a $3 billion threshold) and the exemption of certain hedges. Similarly, the proposed process for the determination of notional amount calculation methodologies by the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") also has potential to improve the clarity of application of the de minimis exception to market participants. In these ways, the Proposed Rule would maintain or improve the important benefits of the de minimis exception by ensuring a diversity of counterparties, which facilitates affordable hedging by end users.

However, certain changes should be made to various aspects of the Proposed Rule to better provide regulatory certainty and continuity regarding the exception, while preserving appropriate flexibility in the affected physical commodity markets. Ultimately, the de minimis exception must be properly tuned to allow market participants to keep capital productively at work in energy and other physical commodity-based industries and preserve adequate hedging opportunities for end users.

I. The De Minimis Threshold Should Be Fixed at $8 Billion and Not Reduced to $3 Billion.

NGSA agrees with the Commission's proposal to fix the de minimis threshold at $8 billion and not reduce it to $3 billion. As the Proposing Release notes, the $8 billion threshold covers nearly all (typically, 99%) of any given swap market, whether such coverage is determined on the basis of aggregate gross notional amount ("AGNA") or

some other basis.[1] With respect to the market for non-financial commodity ("NFC") swaps, the Commission estimated that the AGNA regulatory coverage is slightly lower—approximately 86%.[2] NGSA agrees with the Commission that this slightly lower SD regulatory coverage is appropriate, given the unique characteristics of the NFC swap market discussed below.

As the Commission has noted, the costs associated with SD registration and compliance are significant and can drive parties that would otherwise provide swap dealing services to industrial and commercial end users from doing so. These costs include, among other things, significant outlays to implement new policies, compliance procedures, technology systems, and training programs and intangible costs related to regulatory risk The imposition of such costs on would-be dealers would be particularly harmful in the natural gas industry, where swap dealing is generally provided by suppliers to their counterparties as an ancillary service to their primary business of supplying physical natural gas. As a result, such dealing constitutes a relatively small portion of the suppliers' overall business.[3] This lower relative importance of swap dealing to physical natural gas suppliers makes it more likely that they will reduce or stop their ancillary swap dealing activities to avoid SD registration if a lower de minimis threshold is established.

Such reduction or cessation of ancillary swap dealing by natural gas suppliers would harm liquidity in natural gas swap markets, resulting in further harmful effects including increased volatility, higher fees, wider bid/ask spreads, and reduced competitive pricing—all causing harm to industrial and commercial end users of natural gas and reducing their ability to use swaps to manage their business risks. In the natural gas market, the harms caused by the loss of suppliers providing ancillary dealing services is likely to be particularly acute, since end-use customers may not have trading relationships with larger, financial-entity SDs, instead relying solely on their physical natural gas suppliers to access swap markets. Such customers might have difficulty establishing trading lines with, or finding appropriately tailored swap products from, financial entity SDs if their physical suppliers reduce or eliminate their ancillary dealing activities. Further, this might eliminate or undermine significant

[1] *See* Proposing Release at 27451-53. The Proposing Release defines "coverage" in this context as the extent to which a swap market is subject to SD regulation because at least one counterparty to a swap was a registered SD.

[2] *Id.* at 27451.

[3] Many NGSA members are public companies, and this relative primacy of their physical supply business is evidenced in their annual reports. The Oil and Gas Journal estimates 2018 exploration and production ("E&P") spending alone at $132.5 billion and shows 2017 E&P spending at $121.5 billion. Conglin Xu, *US Oil, Gas Industry Capital Spending to Increase in 2018*, 116 Oil & Gas J. 21 (March 5, 2018).

benefits such customers enjoy from having comprehensive services available from supplier-dealers. Ancillary swap dealing in natural gas and other commodity markets provides counterparty diversity to end users, giving market participants useful alternatives to financial entity counterparties. This diversity *decentralizes* physical commodity swap markets and, in doing so, reduces systemic risk.

Other unique factors of the natural gas and other NFC swap markets also justify maintaining the de minimis threshold at the same $8 billion level applicable to swap markets for financial commodities. Because NFC firms are not backed by the U.S. treasury, their provision of SD services generally poses no systemic risk, so it is appropriate that the de minimis threshold for NFC swaps be no lower than it is for financial commodities.[4] NFC markets involve a diverse range of counterparties, products, and business practices, so increased market flexibility is important. Maintaining a reasonable space for non-SD transactions in the NFC market allows participants to innovate and provide new dealing-related products and services on a limited but viable basis, encouraging a robust market.

Importantly, with respect to natural gas, the $8 billion threshold leaves a reasonable amount of "breathing room" for commodity price increases. Since the dramatic growth in natural gas production from shale resources in recent years, the price of natural gas at the Henry Hub is trading in the $2.00-$4.00 per MMBtu range. Thus, as illustrated in the chart below, today's natural gas market conditions more closely resemble the market conditions from more than twenty years ago than those that existed in the years immediately leading up to the passage of the Dodd-Frank Act.[5] The AGNA of swap dealing activity is directly affected by market prices. For this reason, it's vitally important that the de minimis threshold level be adequate to allow for changing market conditions. If the threshold is set too low and market prices rise, an unanticipated number of market participants may be swept into regulation as SDs, negatively impacting commodity consumers. At a time when the market is signaling a need for increased investment in commodity production, increased SD regulation would shift capital away from investment in commodity production by requiring it to be set aside for SD clearing requirements, reducing liquidity and raising hedging costs in affected markets.

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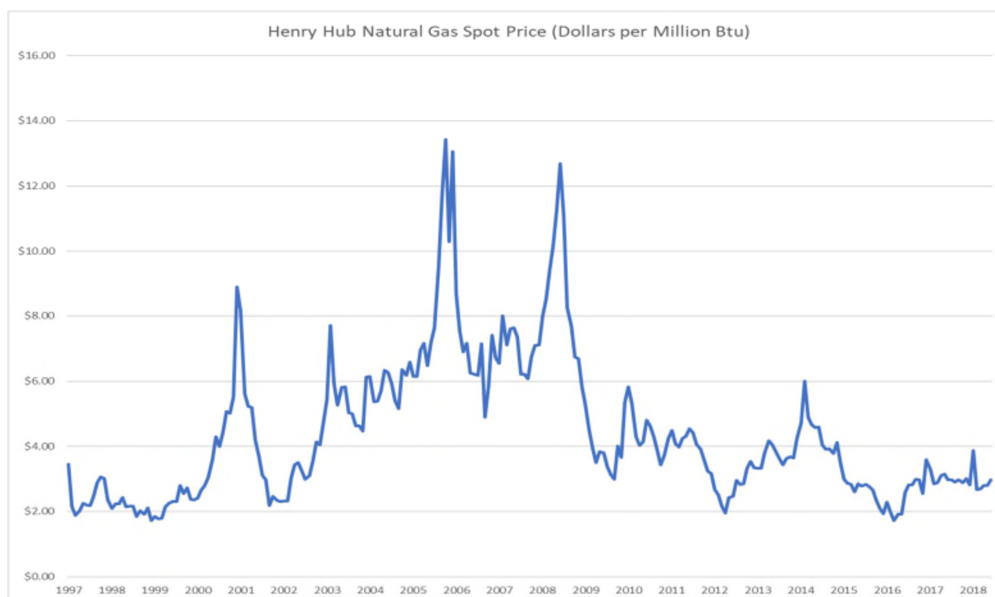
[4] *See* Proposing Release at 27457 (noting that NFC firms providing SD services generally pose less systemic risk than financial commodity SDs).

[5] The price history data is available from the Energy Information Administration ("EIA"), https://www.eia.gov/dnav/ng/hist/rngwhhdM.htm). The chart reflects EIA data with an August 1, 2018 release date. The "Dodd-Frank Act" refers to the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).



Finally, as the Commission suggested in the Proposing Release, maintaining an $8 billion threshold would foster efficiency by providing continuity and eliminating the uncertainty associated with an end of the current phase-in period (which would otherwise require transition from the $8 billion threshold to a $3 billion threshold).[6] Currently, many companies have structured their businesses in connection with the existing $8 billion threshold and changing it could entail significant disruption to their processes and procedures, and significant negative effects on end-user counterparties as a result. In light of this, NGSA agrees that maintaining the status quo with respect to the de minimis threshold signals long-term stability and allows for efficient application and long-term planning. This regulatory certainty benefits end users by facilitating counterparty and risk management cost certainty. The $8 billion threshold has been proven over five years now without issue, as demonstrated by a healthy and well-functioning natural gas swap market over such period, and therefore the de minimis threshold should be fixed and maintained by rule at that level until market changes (such as significant commodity price increases) provide reason for modification.

II. Swaps Entered Into to Hedge Financial or Physical Positions Should Be Excluded From the AGNA Determination Against the De Minimis Threshold, and Such Exclusion Should Not Be Subject to Any Non-Hedging Related Conditions.

NGSA agrees with the CFTC's proposal to exclude swaps entered into to hedge financial or physical positions from the determination against the de minimis threshold,

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[6] Proposing Release at 27450.

but such exclusion should only depend on conditions designed to ensure that such swaps are for legitimate hedging purposes—and not on any other, non-hedging related conditions. The CFTC's primary policy consideration for SD registration is "reducing systemic risk,"[7] and counting any legitimate hedge transactions (which are intended to reduce the hedging party's risk) against the de minimis threshold does nothing to reduce systemic risk and actually undermines such policy if the prospect of such inclusion causes parties to avoid such transactions for that reason. Also, as the Commission has suggested, in light of the already available exclusion for swaps entered into to hedge physical positions, the absence of such an exclusion for swaps entered into to hedge financial positions creates regulatory uncertainty, and such uncertainty causes inefficiencies in compliance efforts and market behavior.[8] Providing an exclusion that extends to both financial and physical positions would significantly reduce such uncertainty and inefficiencies.

As an example, consider a physical commodity transaction that allows for settlement by physical delivery under certain conditions and financial settlement under certain other conditions. It can be unclear whether a swap to hedge such transaction should be counted against the de minimis threshold under the currently available exception limited to hedges of physical positions only. This uncertainty might cause the involved counterparties to: (1) not enter into the transaction, when it might be the most efficient transaction to suit their economic needs and risk tolerance at the time; (2) structure the transaction as a purely physical transaction, which might be less efficient; or (3) out of an abundance of caution, count the transaction against the de minimis threshold and possibly forego other beneficial dealing transactions to remain under the de minimis threshold. Further, in all three cases, one or both counterparties might spend unnecessary resources determining how the contemplated transaction should be treated for regulatory purposes and whether and in what form to enter into the transaction. To avoid such uncertainties and inefficiencies, NGSA supports the provision of an exclusion from the determination against the de minimis threshold for swaps entered into to hedge financial or physical positions.

However, the CFTC's conditions for use of the financial and physical hedging exclusion should be limited to conditions designed to ensure that the applicable swaps are legitimate hedges. The Commission's proposed conditions in paragraphs (4)(i)(D)(1) and (4)(i)(D)(3) through (5) are limited to such purposes but the following condition in paragraph (4)(i)(D)(2) is not:

> (2) For that swap, the person is not the price maker and does not receive or earn a bid/ask spread, fee, commission, or other compensation for entering into the swap;

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[7] *See* Proposing Release at 27446.
[8] *See* Proposing Release at 27462.

This condition is problematic for a few reasons. First, the term "price maker" is undefined. NGSA understands it to generally mean an entity that can set, *i.e.*, "make," prices—as opposed to a "price taker," who must accept such an offered price or, at best, a prevailing market price. It is unclear whether anyone can be a true "price maker" other than a monopolist, while it could be argued in any transaction between two counterparties that one of them may have more control over price and thus be a "price maker"—though subject to significant uncertainty. Second, with respect to bid/ask spreads, the existence of such a spread may be difficult to determine or control across a large organization with different trading groups and functions. Such an organization may not have an intentional bid/ask spread but could nonetheless have an effective bid/ask spread arising out of the independent and differently-focused activities of its trading groups. This could create the regulatory risk of an apparent but unintended bid/ask spread, undermining the regulatory certainty that should be provided by the hedge exemption. Third, separating out the other potential price components (fees, commissions, and "other compensation") can also be a subjective and uncertain exercise when all that is agreed to between counterparties is an overall contract price.

As described above, these types of regulatory uncertainties create both compliance and market inefficiencies, requiring parties to expend additional resources on analyzing and categorizing transactions and sometime causing them to unnecessarily avoid or alter the most efficient forms of transactions. For these reasons, NGSA requests that the CFTC adopt the proposed exclusion of swaps entered into to hedge both financial and physical positions but eliminate the condition in Section (4)(i)(D)(2) with respect to such exclusion, which is unrelated to ensuring that the excluded swaps are legitimate hedges.

III. The CFTC's Rules and Procedures Regarding Determination of Notional Amount Must Ensure Regulatory Certainty and Continuity for Market Participants.

As the Commission noted in the Proposing Release, it is important to provide certainty to market participants regarding methodologies for calculating notional amount, so that they can be fully aware of whether their activities could lead to (or presently entail) SD regulatory requirements.[9] Given the virtually limitless variety of swaps in the marketplace, the Commission did not prescribe specific calculation methodologies for notional amount in its initial rulemaking with respect to the de minimis exception but, instead, expressly contemplated the use of industry standard practices.[10]

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[9] Proposing Release at 27465.

[10] Further Definition of "Swap Dealer," *et al.*, 77 Fed. Reg. 30596 at 30670 n. 902. (May 23, 2012).

In this regard, the natural gas and other energy industries' long history and extensive use of swaps has resulted in well-developed and widely accepted methodologies for calculating notional amount. On September 20, 2012, a coalition consisting of NGSA and several other energy and commodity market trade associations submitted a comment letter to the CFTC identifying such methodologies with respect to the most commonly used swaps in their respective industries (the "Coalition Letter"). Although no formal safe harbor mechanism was available, the coalition explained its understanding that, based on the CFTC's stated reliance on industry standards, most of the coalition's members planned to continue calculating the notional amounts of their swaps based on the methodologies represented in the Coalition Letter unless they received contrary instructions or guidance from the CFTC. Since that time, these methodologies have been cited approvingly by other well-respected organizations outside of the energy industry itself.[11] Furthermore, in and Ernst & Young Survey of a broad range of companies that trade multiple energy commodities, 69% of survey respondents indicated that they "fully relied" on the established methodologies identified in the Coalition Letter and 25% "somewhat relied" on them (leaving only 6% that did not rely on the methodologies).[12]

The level of reliance on these well-developed methodologies underscores the need for regulatory certainty and continuity with respect to any regulatory changes to such methodologies, and for this reason NGSA requests that the CFTC provide a safe harbor for reliance on a notional amount calculation methodology that is based on standard industry practice unless and until CFTC publishes notice of the invalidity of such methodology or prescribing a different methodology. Many NGSA members have technological systems designed to calculate and track notional amount based on the methodologies noted in the Coalition Letter and have structured their businesses accordingly. As such, any regulatory changes to these methodologies could cause significant disruption, both to natural gas suppliers and to their customers. Therefore, to provide reasonable regulatory certainty and continuity with respect to notional amount determinations, NGSA requests that the CFTC provide, by rule, an explicit safe harbor for reliance on a notional amount calculation methodology based on standard industry practice unless and until the CFTC publishes notice of the invalidity of such methodology or prescribing a different methodology.

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[11] *See, e.g.*, Letter from the New York City Bar Association, Committee on Futures and Derivatives to Melissa Jurgens, Secretary of the CFTC, and Elizabeth M. Murphy, Secretary of the Securities and Exchange Commission, March 14, 2013.

[12] *See* Ernst & Young, Notional value under Dodd-Frank: survey of energy commodities participants (2013), *available at* http://www.ey.com/Publication /vwLUAssets/Notional_value_-_under_Dodd-Frank/$FILE/Notional_value_under_ Dodd_Frank.pdf.

With respect to the CFTC's proposed delegation of determining notional amount calculation methodologies to DSIO, NGSA agrees that such delegation may give the Commission and staff appropriate flexibility to promptly respond to future market developments. However, in light of the need for regulatory certainty and continuity discussed above, NGSA requests that the Commission provide a reasonable process for any changes to established methodologies that allows for review and comment by affected market participants. Prior to any adoption or modification of any notional amount calculation methodologies, DSIO should be required to publish their proposed methodology or modification with an explanation showing how their proposal is economically reasonable and analytically supported. Market participants and the public should then have a reasonable period (at least sixty (60) days), to comment on such proposal before it is finalized. This will allow DSIO's proposal to be modified, refined, or verified to ensure reasonable compatibility with the affected markets.

Finally, after the adoption of any new methodology or related modifications, it is essential that market participants have a reasonable period of time to adjust their business practices as necessary before such methodology goes into effect. Such necessary adjustments can include updates to technological systems, training of personnel, modification of business plans, and renegotiation of transactions. To allow for reasonable accommodation of such adjustments, any new rule should guarantee, at a minimum: (1) an implementation date that is at least twelve (12) months after issuance of the final determination; and (2) no retroactive application (*i.e.*, the requested safe harbor for reliance on the existing standard or prescribed methodology should continue to apply to all transactions entered into prior to the implementation date).

IV. Additional Modifications to the De Minimis Exception Are Unnecessary at This Time.

Regarding the "other considerations" identified in the Proposing Release,[13] NGSA does not oppose the suggested additional potential changes to the de minimis exception at this time but does not view them as necessary. With respect to a potential exclusion for cleared swaps from counting against the de minimis threshold, NGSA members' use of cleared swaps is essentially entirely limited to hedging purposes. As such, any cleared swap would likely be covered either by the existing exclusion for swaps used to hedge physical positions or the proposed exclusion for swaps used to hedge financial or physical positions. Therefore, assuming the proposed exclusion for swaps used to hedge financial or physical positions is adopted, an exclusion for cleared swaps seems unlikely to be of practical relevance to NGSA members and may simply be an unnecessary complication to the proposed rule.

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[13] *See* Proposing Release at 27466-70 regarding dealing counterparty count and dealing transaction count thresholds, exchange-traded and/or cleared swaps, and non-deliverable forwards.

Regarding the CFTC's potential introduction of dealing counterparty count and/or dealing transaction count thresholds to the de minimis exception, NGSA has no preference at this time to introduce such measures as additional grounds for use of the exception, though it would oppose any introduction of these measures as new conditions for use of the de minimis exception. In NGSA's view, AGNA is the most relevant measure with respect to the policy goals behind SD registration requirements and is therefore the most appropriate benchmark for the de minimis exception. As such, introducing other measures may simply be an unnecessary complication to the proposed rule. For these reasons, NGSA does not favor introduction of dealing counterparty count or dealing transaction count as new threshold measures for purposes of the de minimis exception at this time.

CONCLUSION

NGSA welcomes the opportunity to further discuss these comments with the Commission. If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,

Jennifer Fordham
Senior Vice President, Government Affairs
Natural Gas Supply Association
1620 Eye Street, NW, Suite 700
Washington, DC 20006
Direct: 202-326-9317
e-mail: jfordham@ngsa.org
Natural Gas Supply Association