National Association of Corporate Treasurers
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February 15, 2019

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Robert E. Feldman, Executive Secretary
Attention: Comments/RIN 3064–AE80
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Via Agency Website

Re: Docket No. R–1629 and RIN 7100–AF22; RIN 3064–AE80; Docket ID OCC–2018–0030: *Comment Letter re Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, Notice of Proposed Rulemaking

The National Association of Corporate Treasurers ("NACT") represents Main Street companies across the country that are prime movers in our economic activity, employing many thousands of our fellow Americans. Our members and their financial intermediaries use derivatives, including commodity-related derivatives, to manage their business risks and serve their customers' day-to-day needs. We submit this letter in connection with the Board of Governors of the Federal Reserve System's (the "Board"), Federal Deposit Insurance Corporation's (the "FDIC"), and the Office of the Comptroller of the Currency's (the "OCC"), together with the Board and FDIC, the "Prudential Regulators") Notice of Proposed Rulemaking (the "NOPR") regarding revisions to the standardized approach for calculating counterparty credit risk ("SA-CCR").

Here are extracts from my most recent Congressional testimony on how excessive capital requirements adversely affect end-users' ability to manage, in a cost-effective way, their day-to-day business risks using derivatives. It was delivered before the Subcommittee on Capital Markets and Government Sponsored Enterprises of the U.S. House Committee on Financial Services on February 14, 2018.[1]

> For example, **U.S. prudential regulators, acting in accordance with their Dodd-Frank mandates, have continued to issue rules that have resulted in increased costs for end-users' risk mitigation activities. The cumulative effects of these burdens and costs have threatened the ability of American businesses to affordably protect against risks associated with their day-to-day commercial operations.**
> …
> OTC derivatives activity reduces business risk for thousands of end-user companies ... From an end-user company's point of view, **the OTC derivatives market should allow the efficient transmittal of risk from where it is incurred to where it can be matched and offset. Undue regulatory costs along the way, including those placed on its financial intermediaries, are ultimately borne by the end-user**. This hedging activity does not create meaningful system risk and did not roil markets during the 2008 financial crisis. For perspective, end-users comprise less than 10 percent of the notional amount of the OTC derivatives market. [**emphasis added**]

NACT along with other end-user companies and organizations were successful in obtaining Congressional reaffirmation that the legislative intent of the Dodd-Frank Act was to exempt Main Street companies using the derivatives markets to engage in risk-reducing activities from excessive capital requirements through mandatory margining. Requiring the NOPR's proposed level of additional capital on end-users' derivatives counterparties in our view is contrary to the bipartisan position clearly expressed in legislative action since passage of Dodd-Frank[2].

Large financial intermediaries that would be subject to SA-CCR, unlike other counterparties in these markets, are uniquely situated to serve the distinct needs of end-users and likely cannot be replaced by other market participants. The NOPR ignores the many benefits that these entities provide to our members: economies of scale, market-making functions, willingness to enter into derivatives transactions tailored to match specific business risks, financings matching a capital markets transaction with a derivative, market depth, and sophistication and expertise.

As financial counterparties continue to face increased regulatory pressures and additional capital costs imposed by Basel III implementation, increased capital requirements either force these entities out of the market or, alternatively, are passed on to our constituency in the form of higher transaction pricing. Further regulation could hasten this retreat in market making activity, leaving NACT members with a less liquid and more costly market. Indeed, as the NOPR notes, entities subject to SA-CCR will face increased exposure amounts for unmargined derivatives transactions by approximately 90%. Consequently, a departure of institutions falling under the SA-CCR from the derivatives hedging market will create a

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[1] Thomas C. Deas, Jr., Testimony before the US House of Representatives' Committee on Financial Services – Subcommittee on Capital Markets and Government Sponsored Enterprises (February 14, 2018), *available at* https://financialservices.house.gov/uploadedfiles/02.14.2018_thomas_deas_testimony.pdf.

[2] 7 U.S.C. 2(h)(1)(A); 7 U.S. Code § 6s(e)(4).

more concentrated, illiquid market, which will make it very difficult for our constituency to manage their business risks efficiently.

Fears of a retreat in derivatives market activity and increased transaction costs stemming from Basel III regulations are not unfounded and have been a cause for concern by market participants for more than ten years. NACT and its membership have been active in this debate since the beginning and our messaging has remained the same: the regulation of derivatives markets should better account for the impacts on U.S. business and their treasury needs.

As mentioned above, in recognition of the potential real-world detriments that would be caused by an illiquid, expensive derivatives market, Congress specifically enacted legislation to exempt certain derivatives hedging transactions from margin and clearing requirements. These exemptions set forth an explicit recognition by Congress that prudent derivatives risk management strategies should be an encouraged business practice as it ensures stable pricing, commercial growth and US job creation. However, the NOPR threatens to undermine this relief, as it would likely replace the exempted costs of margining and clearing with pass-through costs required by banks in order to offset the significant increased capital requirements imposed by SA-CCR on unmargined derivatives. Further, the current SA-CCR formulation would ignore pledged asset collateral and letters of credit, which are often posted as collateral for commodity and other derivatives. Accordingly, banks would still face the increased capital requirements of SA-CCR without any offset for such posted collateral, thereby likely leading to increased derivatives pricing for corporate end-users.

We appreciate that the Prudential Regulators are taking the time to consider the appropriateness of the NOPR; however, as proposed, we do not see the systemic risk reducing benefits of SA-CCR, especially with respect to its treatment of end-user derivatives transactions. The NOPR would, much to our detriment, make it more difficult for our constituents to manage their business risks.

End-users of derivatives have been transacting with large financial institutions in financial derivatives markets and have done so safely and to the benefit of their businesses for years. We fear that additional regulation in this area will negatively impact our businesses by making it more difficult for us to hedge our risks and serve our customers. As the rising interest rate environment and price volatility we are currently experiencing shows, now more than ever end-users need sophisticated and well-run entities to help manage risk. Robust market participation in providing cost-effective risk management products and services is essential to achieving that goal.

We thank you for your consideration.

Sincerely,

Thomas C. Deas, Jr.
Chairman
National Association of Corporate Treasurers