CHESAPEAKE ENERGY

Nick Dell'Osso
Executive Vice President and
Chief Financial Officer

February 15, 2019

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

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

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

Via Electronic Submission

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

Chesapeake Energy Corporation, one of the nation's largest producers of oil and natural gas, appreciates the opportunity to submit comments in response to the Board of Governors of the Federal Reserve System's, Federal Deposit Insurance Corporation's and the Office of the Comptroller of the Currency's Notice of Proposed Rulemaking regarding the revisions to the standardized approach for calculating the exposure amount (SA-CCR) of derivatives contracts conducted by financial holding companies.

While Chesapeake is not a financial-holding company that would be directly required to comply with the Proposed Rule's requirements, our business relies on the ability to enter into commodity derivative contracts in order to mitigate cash flow risk due to volatile commodity prices. We are very concerned that the Proposed Rule's revisions to SA-CCR risk weighting for derivatives transactions would result in significantly higher capital requirements for our counterparties, costs which would be passed along to us and, ultimately, our customers, and result in more costly and cost-prohibitive hedging for end users like our company that are responsibly trying to manage our commodity-price risk. Therefore, we request that the Prudential Regulators reconsider the proposed changes to the SA-CCR calculation for derivatives transactions with respect to its impact on commercial end users.

Our business

Headquartered in Oklahoma City, Chesapeake is an upstream oil-and-natural gas producer that employs approximately 2,300 people. We are one of the largest producers of oil and natural gas in five states: Oklahoma, Texas, Louisiana, Wyoming and Pennsylvania. No company has drilled more horizontal wells to contribute to today's oil-and-gas renaissance than Chesapeake. We have approximately two billion barrels of oil equivalent in proved reserves and produce approximately 500,000 barrels of oil equivalent per day.

Chesapeake Energy Corporation
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How Chesapeake uses derivatives to mitigate risk

Our operations and cash flow generating capabilities are subject to inherent market price fluctuations. We enter into numerous derivative transactions to help mitigate oil and natural gas price risk, combat volatility and ensure we can continue to invest in future production to meet market demands. Hedging allows us to stabilize our cash flows, protect target returns on investments, and reduce earnings volatility and working capital requirements. Derivatives are a widely used risk-management tool to offset financial risk and, whether selling or buying a commodity, are part of the effort to bridge fluctuations inherent in commodity markets.

Of note, usage of derivatives is not limited to large corporations; many mid-sized and small businesses utilize derivatives as well. It should also be noted that end-users on the "other side", or the buy side, of a derivative transaction are also managing their risk and include businesses like airlines and utilities using natural gas and oil in their provision of products and services. Ultimately, these risk-management activities benefit the American consumer through a more stable supply of commodities and reduced volatility of end-user pricing.

For purposes of illustrating how SA-CCR and the Proposed Rule would disrupt our business, let us use the following example: a one-year oil swap on 365,000 bbls total, struck at $55/bbl, with $0.50/bbl spot exposure. Traditionally, current regulations would impose a 10% potential future exposure risk weighting to the notional value of the contract, equal to $2,190,000. However, under the Proposed Rule, oil contracts would be subject to a 56% potential future exposure risk weighting on the notional value of this contract, equal to $11,497,500, which represents a 425% increase in the exposure amount that our counterparty must retain capital against.

	CEM (Existing)	SA-CCR (Proposed)	Percent Change
Notional	20,075,000	20,075,000	0%
Effective PFE[1] (alpha adjusted)	2,007,500	11,242,000	460%
PFE Percentage	10%	56%	460%
RC[2] (alpha adjusted)	182,500	255,500	40%
Exposure	2,190,000	11,497,500	**425%**

The importance of Congress' end-user exemption

Under the Dodd-Frank law, Congress recognized the importance and reality of end-users' activities. The current statute exempts end users like our company from the clearing and margin requirements imposed on our counterparties. Congress enacted these exemptions in explicit recognition of the importance of end users being able to adequately and efficiently mitigate our commercial risks. The Proposed Rule would most certainly undermine these intended benefits by imposing excessive capital restrictions on our counterparties via the proposed SA-CCR calculations.

While we recognize and share the goal of a stable financial system and the need to ensure that institutions adequately account for counterparty default risk, we believe that the Proposed Rule takes an overly prescriptive approach that will lead to significant cost and liquidity impacts on commercial end users and ignores market practice, which currently accounts for these risks in the pricing terms of contracts.

For instance, the Proposed Rule does not consider the commercial benefits of collateral-based securitization that businesses like ours employ. Our hedging counterparties have mortgages on more than

85% of our assets, which are valued in the billions of dollars. These mortgages collateralize our hedge exposure multiple times over. In addition, the Proposed Rule does not consider the right-way risk inherently underlying the collateral securing our hedges; put simply, when the value of our collateral decreases, our counterparties owe us money. It instead draws a bright-line preference and offset for cash margining. Our industry depends on cash flow to reinvest back into finding and producing oil and gas. Locking up cash for margining that would otherwise be used to find and produce domestic energy, create jobs, and ultimately strengthen the U.S. economy is economically inefficient.

We, therefore, ask that the Prudential Regulators reconsider the metrics and formulation of SA-CCR to ensure that the Proposed Rule will not undermine and circumvent legislatively intended and prescribed benefits for businesses like ours.

Potential for harmful outcomes to the derivatives markets

Our commercial hedging needs are best addressed by deep, competitively priced markets. We are concerned that the Proposed Rule would decrease overall market depth in a sector that has already retracted. Compounding burdens on the activities of our counterparties will serve to only further reduce the number of financial holding companies and their affiliates willing to engage in derivatives transactions with commercial businesses like ours.

In particular, we are concerned that the proposed adjustments under SA-CCR would have the effect of creating an inefficient and uneconomical market place. As illustrated by the example above, a 425-percent increase in the exposure amount borne by our counterparties would inevitably be borne by Chesapeake in the form of higher transaction costs, which we estimate will certainly be in the tens if not hundreds of millions of dollars depending on the level at which we execute our hedging activity. In addition to the possibility of higher pass-through costs necessary to offset SA-CCR calculations, we are concerned that the Proposed Rule also has the potential to create a derivatives marketplace that would mandate cash-margining and, ultimately, may force us or our counterparties out of the market altogether. Any of these outcomes would be harmful to our commercial operations as a result of our inability to properly manage our business risks.

In summary

In conclusion, Chesapeake Energy urges the Prudential Regulators to consider the Proposed Rule's indirect impact on derivatives transactions with commercial end-user entities like our company, as well as generally reconsider the appropriateness of imposing SA-CCR calculations on derivatives transactions that would otherwise qualify for the end-user exception. As currently drafted, we believe the Proposed Rule would directly increase the cost of managing commercial risks.

We appreciate the opportunity to comment on the Proposed Rule and would be happy to answer any questions you may have as you continue to consider these issues. Please contact me at (405) 935-6125 or nick.dellosso@chk.com if you have any questions or if you would like to discuss our comments in greater detail.

Sincerely,

[redacted]

Domenic J. Dell'Osso, Jr.
Executive Vice President and Chief Financial Officer