AMERICAN PUBLIC GAS ASSOCIATION

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Re: Margin and Capital Requirements for Covered Swap Entities
Office of the Comptroller of the Currency: Docket No. OCC–2011–0008
Board of Governors of the Federal Reserve System: Docket No. R–1415
Federal Deposit Insurance Corporation: RIN 3064–AD79
Farm Credit Administration: RIN 3052–AC69
Federal Housing Finance Agency: RIN 2590–AA45

The American Public Gas Association ("APGA") appreciates the opportunity to comment on the Notice of Proposed Rulemaking on Margin and Capital Requirements for Covered Swap Entities ("Agency Proposal") issued by the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Farm

Credit Administration ("FCA"), and the Federal Housing Finance Agency ("FHFA") (collectively the "Agencies"). The Agency Proposal proposes joint rules to implement the margin and capital requirements under Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[1] which added new Section 4s to the Commodity Exchange Act ("CEA").

I. INTRODUCTION

A. APGA

APGA is the national association for publicly-owned natural gas distribution systems. There are approximately 1,000 public gas systems in 36 states and over 700 of these systems are APGA members. Publicly-owned gas systems are not-for-profit, retail distribution entities owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities.

Public gas systems depend upon both the physical commodity markets as well as the markets in over-the-counter ("OTC") derivatives to help meet the natural gas needs of their consumers. Together, these markets play a critical role in the hedging strategies many systems utilize to ensure a reliable supply of natural gas at a reasonable price to gas consumers. Many natural gas distributors use swaps to hedge very long-term agreements for the physical delivery of natural gas. It is doubtful that gas suppliers would be willing to enter into such very long-term contracts for physical delivery of gas without the ability to convert the pricing mechanism to a floating priced contract. In addition to these hedging uses, many of our members also use exchange-traded or OTC derivatives to hedge their short and medium-term price risk associated with potential price volatility in the markets during each year's heating season, enabling them to provide their customers with more stable rates.

Our members are nonfinancial end users under the Dodd-Frank Act and thus will have available to them the end user exemption from clearing established by Section 731. New Section 4s of the CEA among other things requires the Agencies to adopt joint rules relating to margin and capital requirements for swap entities for which they are the prudential regulator. The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") are, respectively, required to issue margin and capital rules for all other swap and security-based swap entities. All the relevant regulators are required to consult and, "to the extent practicable," establish and maintain "comparable" margin and capital requirements.[2] The CFTC has issued separate Notices of Proposed Rulemaking relating to margin and capital for covered swap entities.[3]

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[1] Public Law No. 111–203, 124 Stat. 1376 (2010).

[2] Dodd-Frank Sections 731 (new CEA Section 4s(e)(3)(D)) and 764 (new Exchange Act Section 15F(e)(3)(D)).

[3] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732 (April 28, 2011) ("CFTC Margin Proposal"); Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27802 (May 12, 2011) ("CFTC Capital Proposal"). The SEC has yet to issue its rule proposal.

B. Proposed Rules

The Agency Proposal generally provides that each covered swap entity must establish minimum thresholds for each counterparty, including nonfinancial end user counterparties exempt from mandatory clearing, based on a determination of the credit-worthiness of the counterparty. The covered swap entity must collect initial and variation margin for all transactions with the counterparty in which the exposure exceeds the threshold, including from nonfinancial end users entering into swaps to hedge risk. In addition, the Agency Proposal requires that each covered swap entity must take a capital charge for all of its uncleared swaps. The CFTC margin proposal, on the other hand, does not mandate that covered swap entities collect initial or variation margin from their nonfinancial end user counterparties. The CFTC approach permits covered swap entities and nonfinancial end users to set the terms of any initial and variation margin requirements in their own discretion pursuant to their credit support agreements.

We believe that the CFTC approach to margin for nonfinancial end users, unlike the Agency Proposal, is consistent with the mandate of and intent behind the Dodd-Frank Act and we strongly support that margin proposal. For the reasons discussed below, we believe that the Agencies should amend their proposal and adopt margin rules for covered swap entities dealing with nonfinancial end users that are consistent with the CFTC margin proposal.

In order to prevent additional costs from being passed along to nonfinancial end users through imposition of capital charges on covered swap entities, we also request that the Agencies modify their rules to ensure that capital charges will not be mandated for swaps entered into between covered swap entities and nonfinancial end users. Such modification would be consistent with Congressional intent and also reflect the minimal risk of swaps used for risk mitigation by nonfinancial end users.

II. DISCUSSION

A. The Agencies may not mandate margin for nonfinancial end users under the Dodd-Frank Act, nor may they require a capital charge that is likely to be passed on to such end users

The Agencies state that the "plain language" of Section 731 of the Dodd-Frank Act "provides that the Agencies adopt rules for covered swap entities imposing margin requirements on all non-cleared swaps."[4] However, the statute is clear that the Agencies are not authorized to impose margin or capital costs on a nonfinancial end user by imposing such costs on transactions in which that end user is a counterparty. Yet this is precisely what the Agency Proposal does. By imposing mandatory initial and variation margin collection requirements on all transactions, including those with nonfinancial end

[4] Agency Proposal, 76 Fed. Reg. at 27570 (emphasis omitted).

users, and by requiring a capital charge for all uncleared swaps, the Agency Proposal effectively imposes margin and capital costs on nonfinancial end users, directly contrary to the statute's limitation that these costs be imposed only on covered swap entities.

New Section 4s(e)(2)(A) of the CEA requires that the Agencies, in consultation with the CFTC and the SEC, "shall jointly adopt rules [relating to capital and margin] for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant." However, it plainly limits these charges to the swap entity side of the transaction (rules for covered swap entities, with respect to their activities) and does not authorize the regulators to impose margin collection or capital costs on end user counterparties.

It is axiomatic that the plain language of the statute governs and that one should not look beyond the language of the statute unless it is ambiguous or otherwise unclear.[5] Here, the statute does not authorize any of the regulators to impose margin requirements and capital charges on nonfinancial end users.[6]

Even if the statute were deemed to be ambiguous, however, looking at Title VII of the Dodd-Frank Act as a whole, it is clear that Congress did not intend for nonfinancial end users to be caught up by mandatory margin requirements and capital charges.[7]

Most importantly, if the statute were read to allow the Agencies to impose margin and capital charges on nonfinancial end user transactions, the end user exemption from mandatory clearing would be void of meaning and purpose. On this point, Congress again was clear (and the Agencies recognize Congress's intent in this regard): The exemption was designed to ensure that nonfinancial end user hedging transactions would not be subject to additional costs in connection with those transactions.[8]

The clearing exemption simply does not make any sense if the regulators could impose mandatory margin and capital-related costs on nonfinancial end users. Imposing

[5] *See, Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) (*quoting Rubin v. United States*, 449 U.S. 424, 430 (1981) ("When the words of a statute are unambiguous, then, this first canon is also the last: 'judicial inquiry is complete'.").

[6] The record makes clear that the drafters of the Dodd-Frank Act similarly thought the language of the statute to be clear in this regard. *See* Joint Explanatory Statement of the Committee of Conference, H.R. Rep. No. 111-517 (2010)(Conf. Rep.), 111th Cong. ("Regulators have authority to impose margin requirements *only on dealers and major participants* for uncleared swaps") (emphasis supplied); 156 Cong. Rec. H5248 (June 30, 2010) (Rep. Colin Peterson: "[W]e have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or major swap participant….").

[7] *See Brotherhood of Locomotive Engineers v. Atchison, T. & S.F.R.R.*, 516 U.S. 152, 157 (1996); *See also FCC v. NextWave Personal Communications, Inc.*, 537 U.S. 293, 311 (2003) (Breyer, J., dissenting) ("It is dangerous . . . in any case of interpretive difficulty to rely exclusively upon the literal meaning of a statute's words divorced from consideration of the statute's purpose.").

[8] *See,* Letter from Chairmen Christopher Dodd and Blanche Lincoln to Chairmen Barney Frank and Colin Peterson ("Dodd-Lincoln Letter") (June 30, 2010).

these costs would not only negate any of the benefits to the nonfinancial end user of the clearing exemption, it would effectively punish them for using the exemption.[9]

B. There is no doubt that Congress intended nonfinancial end users to be exempt from costs associated with mandatory margin and capital

1. Nonfinancial end users' swap activities pose minimal risk to counterparties or to the U.S. financial system and thus were not intended to be caught up by Title VII of the Dodd-Frank Act

As evidenced by the recent financial crisis (and explicitly recognized by Congress and the Agencies),[10] swap activities of nonfinancial end users, which overwhelmingly use swaps to mitigate their business risk, raise few if any concerns about systemic risk, mitigation of which is the central goal of the Dodd-Frank Act. Imposing additional costs on nonfinancial end users is not related to and will in no way help achieve this statutory goal. Instead, it will significantly hamper the ability of nonfinancial end users to use derivatives to mitigate their own business risk. Any marginal regulatory benefit that may accrue by imposing these costs on nonfinancial end users, which played no role in the financial crisis and which pose no real risk to the U.S. financial system, are clearly outweighed by the devastating impact these costs will have on the end users' ability to manage their own risks prudently.

Recognizing that end users neither caused nor contributed to the financial crisis, Congress made abundantly clear that these entities must be able to continue to hedge effectively against their business risk without having to bear new margin- and capital-related costs. The legislative record leaves no doubt that Congress intended to create an exemption for nonfinancial end users from additional costs associated with their risk-mitigating swap activities.

2. The legislative history unequivocally supports the drafters' intent that nonfinancial end users be exempt from mandatory margin and capital costs

A Conference Base Text, which ultimately became the Dodd-Frank Act, contained a provision explicitly exempting non-covered swap entities from margin requirements.[11] Apparently because these provisions were viewed as redundant, they were omitted from the text of the base bill that was considered by the Conference

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[9] The Dodd-Lincoln Letter exhorts the regulators to "carefully follow Congressional intent in implementing this bill [so that] these standards are not punitive to the end users[.]".

[10] Agency Proposal, 76 Fed. Reg. at 27570; Letter from Cong. Spencer Bachus and Cong. Frank Lukas to Treasury Secretary Timothy Geithner, et. al. (Dec. 16, 2010) ("Bachus Letter").

[11] Section 731 of the version of the Dodd-Frank Act originally passed in the Senate, at new CEA Section 4s(e)(8), provided that the initial and variation margin requirements would not apply "for swaps in which 1 of the counterparties is not (A) a swap dealer; (B) a major swap participant; or a financial entity as described in section 2(h)(9)(A)(ii), and such counterparty is eligible for and utilizing the commercial end user clearing exemption under section 2(h)(9)."

Committee and finally adopted, with amendments.[12] Numerous statements by the bills' drafters, however, make clear that they believed that these omitted provisions were unnecessary and that end users were adequately protected by the text of the statute.[13] The Dodd-Lincoln Letter (and a similar colloquy on the Senate floor by Senator Lincoln) further make clear the drafters' intent on this point, that the "consistent Congressional directive throughout all the drafts of this legislation, and in Congressional debate, … has been to protect end users from burdensome costs associated with margin requirements and mandatory clearing."

The Dodd-Lincoln Letter also confirms that Congress intended that capital costs also not be imposed on nonfinancial end users. As stated in that letter, "Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end users." In a colloquy on the Senate floor, Senator Lincoln stated: "[I]t is clear in this legislation that regulators only have the authority to set capital and margin requirements on swap dealers and major swap participants for uncleared swaps, not on end users who qualify for the exemption from mandatory clearing."[14]

Unfortunately, the Agency Proposal flies in the face of Congress's unambiguous intention, stated again in the Stabenow and Bachus Letters,[15] sent to the Agencies after enactment of the Dodd-Frank Act. We respectfully urge the Agencies to heed the Congressional directive and ensure that margin and capital costs are not mandated in connection with nonfinancial end user transactions.

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[12] *See* Dodd-Lincoln Letter.

[13] S*ee, e.g.,* 156 Cong. Rec. H5248 (June 30, 2010) (Rep. Barney Frank during colloquy with Rep. Colin Peterson: "[T]he gentleman is absolutely right. We do differentiate between end users and others. The marginal [sic] requirements are not on end users."). See also House-Senate Conference Committee Holds a Meeting on The Wall Street Reform and Consumer Protection Act, Unofficial Transcript, CQ Transcriptions, LLC Copyright 2010 (June 29, 2010)(Senator Dodd: "There is a difference of opinion on how clear the language [on end user margin] is. Our consideration, based on conversations we've had, is that the language is clear…. But I've suggested that a colloquy on the floor of the United States Senate, and it might have had a similar colloquy in the floor of the House. So it's up to the members of the House to decide to clarify what we believe is the clarity of the language." . . . "It was not decided to subject literally all of these individual's organizations to have to – to make margin requirements.").

[14] Senate Report, 156 Cong. Rec. S5907 (July 15, 2010).

[15] Letter from Chairman Debbie Stabenow et. al. to Treasury Secretary Timothy Geithner et. al. ("Stabenow Letter") (Apr. 6, 2011); Bachus Letter.

C. The CFTC's approach to margin for nonfinancial end user transactions follows the statute and Congressional intent

In contrast to the Agency Proposal, the CFTC's proposed margin rules follow Congressional intent and do not mandate any margin in connection with nonfinancial end user transactions. The CFTC's margin proposal as it relates to nonfinancial end users requires that covered swap entities enter into credit support agreements with their end user counterparties and it permits the parties, in their discretion, to negotiate initial and/or variation margin terms, if any, under these agreements. We believe that this is the correct approach and strongly support it.

As noted above, new CEA Section 4s(e) requires the Agencies to consult with the CFTC and to establish and maintain comparable margin and capital requirement to the maximum extent practicable. However, the Agency Proposal and the CFTC margin proposal treat nonfinancial end users quite differently. As we have discussed, we do not believe that the Agency Proposal comports with the language of Section 731 or with the unequivocal intent of Congress. Nor do we think the Agency Proposal fully accounts for the fact that nonfinancial end user hedging transactions raise no systemic risk. Accordingly, we respectfully urge the Agencies to adopt the same approach as in the CFTC's margin proposal.

D. The Agency Proposal should ensure that the capital rules do not impose additional costs on nonfinancial end users

As discussed more fully above, Congress has been clear that capital costs must not be imposed on nonfinancial end users and that there is "substantial public interest in keeping [end user derivatives] costs low." [16] The Dodd-Lincoln letter is explicit in this regard: "Congress clearly stated in this bill that the margin *and capital* requirements are not to be imposed on end users" (emphasis supplied). The Dodd-Lincoln Letter continues: "[C]hanges made in Conference to the section of the bill regulating *capital and* margin requirements for Swap Dealers and Major Swap Participants should not be construed as changing this important Congressional interest in protecting end users," (emphasis supplied), and "[c]apital and margin standards should be set to mitigate risk in our financial system, not punish those who are trying to hedge their own commercial risk."[17]

The Agency Proposal requires a covered swap entity to comply with regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. To the extent that covered swap entities will be required to take a capital charge for uncleared swaps with nonfinancial end user counterparties, we expect that such costs will be passed along to the end user. Moreover, as stated in the Agency Proposal, these charges are expected to be even higher when amended in the future to conform to the new Basel III framework. The result will be patently inconsistent with

[16] Dodd-Lincoln Letter.
[17] Id.

the purposes of the statute and the clear directive in the Dodd-Lincoln letter, *i.e.,* that nonfinancial end users not be penalized through increased capital costs.

Basel I with added market risk rules will likely govern most covered swap entities that are either banks or subsidiaries of bank holding companies. In addition, a number of the larger banks also will be subject to Basel II if and when it becomes applicable to U.S. banks. The current capital rules generally establish the required minimum amount of regulatory capital as a "minimum ratio of qualifying total capital to weighted risk assets of 8 percent, of which at least 4.0 percentage points should be in the form of Tier 1 capital."[18] Assets and off-balance sheet items are weighted relative to their risk with greater weighting for greater risk, and with adjustments made for certain market risks.

Under these applicable rules, most covered swap entities for which the Agencies are the prudential regulators will calculate their capital using internal models approved by the Agencies. Cleared swaps will generally be risk-rated at zero in these internal models. For uncleared transactions, however, such as those entered into by APGA's members, internal modeling of risk ratings will depend on a number of factors, including the amount and type of margin and the nature of the counterparty. Ironically, bank counterparties will be risk-weighted more advantageously than will nonbanks, such as nonfinancial end users.

While the Agency Proposal applies to the covered swap entity and not the nonfinancial end user, if the covered swap entity does not collect margin from the end user, it will need to take a higher capital charge. To the extent these costs will be passed along to the nonfinancial end user counterparties, as we fully expect, this will not only eliminate any benefits to the end users from the clearing exemption (forcing many to clear their transactions despite the hard-fought clearing exemption), but will also reduce the benefits of any lower margin requirements nonfinancial end user transactions are accorded under the Agency Proposal. Moreover, because nonbank counterparties are treated less well for capital purposes than banks, nonfinancial end users may well face capital-related costs that are higher than those faced by entities deemed to have more potential for systemic risk.

We believe that the Agencies must modify both their margin proposal and their capital rules to ensure that nonfinancial end users are not adversely affected through either or both the mandatory imposition of margin or capital on transactions in which they are counterparties. We fear that if the Agencies amend only the margin rules but not the capital rules, the increased mandatory capital charge for an unmargined transaction would ultimately result in a higher cost to the nonfinancial end user, thus negating any benefits from the margin rule amendment. These rules must be internally consistent and work in tandem so the protections that Congress sought for nonfinancial end users may in fact be realized. It is clear that imposing increased costs on uncleared nonfinancial end user transactions (or forcing these swaps into central clearing) as the Agency Proposal would do, not only violates the clear intent of Congress but would severely hamstring the prudent risk mitigation alternatives for nonfinancial end users. Punishing nonfinancial

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[18] 12 CFR part 225, Appendix A, Sec. II.A.

end users for availing themselves of the clearing exemption cannot possibly have been what Congress intended.

Accordingly we urge the Agencies to modify their capital rules as needed to ensure that uncleared nonfinancial end user transactions with covered swap entities do not face increased capital costs, whether directly or indirectly.

III. Conclusion

Natural gas is a lifeblood of our economy and millions of consumers depend on natural gas every day to meet their daily needs. It is critical that public gas systems that use swaps to hedge against price fluctuations and other business risks be allowed to continue these crucial risk mitigating activities without the imposition of prohibitive costs. We thank the Agencies for the opportunity to comment on an issue so central to the continued viability of our members.

We would be happy to discuss our comments or any of the issues raised by the proposed rules at greater length with the staff. Please feel free to contact Bert Kalisch, President and CEO of APGA, or David Schryver, Executive Vice President of APGA.

Respectfully submitted,

Bert Kalisch
President and CEO