Independent Petroleum Association of America

July 11, 2011

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Jennifer J. Johnson
Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

Gary K. Van Meter
Acting Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090

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 Independent Petroleum Association of America (IPAA), the Michigan Oil And Gas Association (MOGA), and the Oklahoma Independent Petroleum Association (OIPA) (collectively, Independent Producers) focus our comments on the above-referenced notice of proposed rulemaking (NOPR), issued collectively by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (collectively, the Prudential Regulators), on the importance of ensuring that commercial end users remain exempt from mandatory margin and capital requirements, either directly or indirectly. As producers of natural gas and crude oil, Independent Producer members rely on the swaps market to mitigate risk, using a strong balance sheet and physical assets to support credit arrangements with counterparties. These arrangements should be allowed to continue so that independent producers can deploy cash resources to find and produce energy.

Independent Petroleum Association of America 1201 15th Street, N.W. Suite 300
Washington, DC 20005
(202) 857 4722 ♦ Fax (202) 857 4799 ♦ www.ipaa.org

I. INTRODUCTION

Independent Producers. IPAA, MOGA, and OIPA represent the thousands of independent oil and natural gas producers and service companies across the United States. Independent producers develop 95 percent of domestic oil and gas wells, produce 54 percent of domestic oil and produce 85 percent of domestic natural gas. A recent Ernst & Young analysis found that the "plowback" percentage of reinvestment increased 170 percent in 2010, for the highest level in the last five years, with producers borrowing funds to enhance their already aggressive efforts to find and produce more energy.

How Independent Producers Hedge. Many energy producers, who own the underlying physical commodities, use hedging as a primary risk-management tool to provide cash-flow certainty. Many independent producers hedge a significant portion of forecasted future natural gas and oil production volumes to reduce revenue risk related to ever-changing commodity prices. Substantial variations in natural gas and oil prices impede our industry's ability to stabilize revenues and prudently manage our cash flow, which we use to fund development activities that produce vital energy resources and maximize value for our stakeholders. For many independent producers, hedging is the primary method of ensuring adequate cash flow is available to meet their financial obligations. They also hedge production to provide security to lenders that base producers' credit on the value of their natural gas and oil reserves, which are pledged as collateral on bank loans. Conscientious hedging programs provide significant protection for creditors. This protection, in turn, helps provide access to capital for the long-term survival of producers.

II. DISCUSSION

Support for the End User Exemption. Independent Producers and other end users fought vigorously for an end user exemption—from mandatory clearing, as well as from margin and capital requirements—as part of financial reform legislation. While the Dodd-Frank legislation was not as clear as end users would have wanted, subsequent and ongoing congressional efforts clarified the intent to exempt end users[1]. Independent Producers urge the Prudential Regulators to implement Dodd-Frank, keeping in mind the need to clarify that "transactions involving nonfinancial end-users that meet the [statutory requirements set forth in the NOPR] are exempt from margin, consistent with congressional intent."[2] Congressional support for an end user exemption would be meaningless if the Prudential Regulators were to impose margin requirements on end users indirectly via counterparties under their jurisdiction. While the Prudential Regulators interpret Dodd-Frank to require them to adopt rules for covered swap entities imposing margin requirements on all non-cleared swaps, the end user exemption is controlling.

Relying on Footnote 37 of the NOPR, it appears that the Prudential Regulators are comfortable in the view that current hedging transactions between "a nonfinancial end user with strong credit profile" and a derivatives dealer "would not require margin—in essence, [the derivatives dealer] would extend unsecured credit to the end user with respect to the underlying exposure." Independent Producers urge the Prudential Regulators to clarify that the NOPR will not disrupt the current practices between nonfinancial energy end users and Swap Dealers and Major Swap Participants. Under current practices, Independent Producer members hedge their production to lessen the volatility in prices to better plan their budgets for finding and producing oil and natural gas, and in turn keep employment levels stable or growing. Under current practices, energy producers and their counterparties can customize hedging transactions, primarily to rely on the

[1] Letter from Senators Christopher Dodd and Blanche Lincoln, to Representatives Barney Frank and Colin Peterson, dated June 30, 2010; floor statements by Sen. Lincoln; colloquy between Reps. Frank and Peterson; letter from Sen. Debbie Stabenow and Rep. Frank Lucas to Prudential Regulators and CFTC, dated Jun 20, 2011.

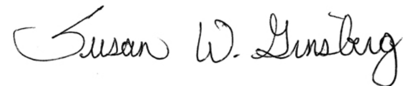
[2] Stabenow-Lucas letter, p. 2.

producers' natural gas and oil reserves as collateral. Banks with loans to producers often require producers to hedge their production. The banks often perform this service for the producer, using the producers' natural gas and oil reserves as collateral.

III. CONCLUSION

Independent producers should continue to be allowed to reinvest in finding and producing energy. Current hedging practices allow for this productive use of capital and recognize that non-financial end users did not contribute to the financial crisis that prompted financial reform efforts. The NOPR appears to acknowledge these principles. Independent Producers urge the Prudential Regulators to confirm congressional design to exempt non-financial end users from margin requirements imposed via covered swap entities.

Respectfully submitted,



Susan Ginsberg
Vice President, Crude Oil &
Natural Gas Regulatory Policy
Independent Petroleum Association of America