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TO PRUDENTIAL REGULATORS (filed at http://www.regulations.gov):

Department of the Treasury-Office of the Comptroller of the Currency ("OCC")
Docket No. OCC-2011-0008 (RIN 1557-AD43)

Board of Governors of the Federal Reserve System ("Board")
Docket No. R-1415 (RIN 7100-AD74)

Federal Deposit Insurance Corporation ("FDIC")
(RIN 3064-AE21)

Farm Credit Administration ("FCA")
(RIN 3052-AC69)

Federal Housing Finance Agency ("FHFA")
(RIN 2590-AA45)

Re: Margin and Capital Requirements for Covered Swap Entities, 79 Fed.Reg. 57348, published September 24, 2014, (referred to as the "Proposed Margin Rules")

Dear Prudential Regulators Representatives:

The International Energy Credit Association ("IECA") is an association of over 1,400 credit, risk management, legal and finance professionals that is dedicated to promoting the education and understanding of credit and other risk management-related issues in the energy industry. For over ninety years, IECA members have actively promoted the development of best and industry standard practices that reflect the unique needs and concerns of the energy industry. Our members' concerns regarding the relevant rulemakings that followed the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") have led us to submit to the Commodity Futures Trading Commission ("CFTC" or "Commission") numerous comments on various proposed rulemakings, as well as requests for no action relief and petitions in support of relief requests sought by other energy companies and trade groups. This is the IECA's first time to submit comments to the OCC, Board, FDIC, FCA and

FHFA (collectively, the "Prudential Regulators" or the "Agencies") regarding matters raised by the Dodd-Frank Act.

The IECA seeks to protect the rights and advance the interests of the commercial end-user community that makes up the majority of its membership. IECA membership includes representatives of many small and large energy companies all of whom have a fundamental mission of providing safe, reliable, and reasonably priced energy commodities that American businesses and consumers require for our economy and our livelihood. Most of the IECA's members are representatives of commercial end-users, which rely on swaps to help them mitigate and manage (i.e., hedge) the risks of energy commodity price volatility to their physical energy businesses.

Correspondence with respect to these comments should be directed to the following individuals:

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I. Comments on the Proposed Rules.

A. The IECA Commends Prudential Regulators/CFTC for Not Subjecting Non-Financial End Users to a Mandatory Obligation to Post Initial Margin or Variation Margin for their Uncleared Swaps.

First and foremost, the IECA commends the Prudential Regulators for proposing in section ___.3(d), Initial margin, of their Proposed Margin Rules that:

> "A covered swap entity is not required to collect initial margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user with material swaps exposure nor a swap entity but shall collect initial margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps."[1] (Emphasis added.)

Similarly, the IECA commends the Prudential Regulators for proposing in section ___.4(c), Variation margin, of their Proposed Margin Rules that:

[1] See discussion in Section I.D. of these Comments, the IECA recommends that the Prudential Regulators delete the text in Section ___.3(d) that is not underlined in these comments.

> "A covered swap entity is not required to collect variation margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user nor a swap entity but shall collect variation margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps."[2] (Emphasis added.)

The IECA commends the CFTC for defining "covered counterparty" in its Proposed Margin Rule[3] as a "financial end user with material swaps exposure, a swap dealer, or a major swap participant that enters into a swap with a covered swap entity [i.e., a swap dealer or a major swap participant for which there is no prudential regulator]." By excluding "non-financial end users" from the definition of "covered counterparty" in its Proposed Margin Rule, the CFTC removed "non-financial end users" from the requirement under CFTC Regulation 23.152(a) that covered swap entities collect initial margin ("IM") from "covered counterparties."

Similarly, the IECA commends the CFTC for specifying in CFTC Regulation 23.153(a) of its Proposed Margin Rule that a covered swap entity [i.e., a swap dealer or major swap participant for which there is no prudential regulator] shall collect variation margin ("VM") from "a counterparty that is a swap entity [i.e., a swap dealer or major swap participant] or a financial end user." By excluding "non-financial end users" from CFTC Regulation 23.153(a), the CFTC made clear that covered swap entities are not required to collect VM from non-financial end users.

The CFTC supported the foregoing exclusion of non-financial end users from the obligation to post IM and VM by saying (See the CFTC's Proposed Rule, 79 Fed.Reg. 59898, at 59906):

> "In addition, [Section 2(h)(7) of the Commodity Exchange Act ("CEA"), as amended by] the Dodd-Frank Act generally exempted non-financial end users from the requirement that they submit trades to clearing.[41] If the Commission required them to post margin for uncleared trades, the clearing exemption could be weakened because the costs of clearing are likely to be less than the costs of margining an uncleared position. This approach is also consistent with international standards." (Bracketed text incorporated from footnote 41.)

The IECA agrees with and endorses the CFTC's justification for excluding non-financial end users from the obligation to post IM and VM to covered swap entities, as set forth in the foregoing quotation from the CFTC's Proposed Margin Rule.

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[2] See discussion in Section I.D. of these Comments, the IECA recommends that the Prudential Regulators delete the text in Section ___.4(c) that is not underlined in these comments.

[3] CFTC's Proposed Rule and Advance Notice of Proposed Rulemaking entitled "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants," 79 Fed.Reg. 59898, published October 3, 2014, RIN 3038-AC97 (referred to as the "CFTC's Proposed Margin Rule").

The IECA commends the Prudential Regulators for similarly not requiring covered swap entities to collect IM or VM for non-cleared swaps with non-financial end users and, as more fully discussed below in Section I.D of these comments, the IECA urges the Prudential Regulators to consider adopting the justification expressed by the CFTC for its decision to exclude non-financial end users from the obligation to post IM and VM.

B. The IECA Commends the Prudential Regulators for their Logical and Straightforward Legal Analysis in Defining a "Financial End User" in Their Proposed Margin Rules and the IECA Endorses the CFTC's Adoption of the Prudential Regulators' Legal Analysis in the CFTC's Use of the Prudential Regulators' Definition of a "Financial End User" in its Proposed Margin Rule, as a Reasonable Exercise of the CFTC's Discretion in Deferring to the Prudential Regulators' Interpretation and Application of Section 4(k) of the Bank Holding Company Act.

In the Prudential Regulators' legal analysis of the proposed definition of "financial end user," the Prudential Regulators included the following legal analysis (See the Prudential Regulators' Proposed Margin Rules, 79 Fed.Reg. 57348, at 57360):

> "The proposal's definition of financial end user takes a different approach than the 2011 proposal, which, as noted above, was based on the definition of a "financial entity" that is ineligible for the exemption from mandatory clearing requirements of sections 723 and 763 of the Dodd-Frank Act. In order to provide certainty and clarity to counterparties as to whether they would be financial end users for purposes of this proposal, the financial end user definition provides a list of entities that would be financial end users as well as a list of entities excluded from the definition. This approach would mean that covered swap entities would not need to make a determination regarding whether their counterparties are predominantly engaged in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956, as amended (the "BHC Act").[72] In contrast to the 2011 proposal, the Agencies now are proposing to rely, to the greatest extent possible, on the counterparty's legal status as a **regulated** financial entity." (Emphasis added.)

The Prudential Regulators provided a reasoned explanation for their proposing to rely on a counterparty's legal status as a "regulated" financial entity as a reasonable means of interpreting and implementing Congressional intent when it wrote the definition of "financial entity" in the Dodd-Frank Act. As the Prudential Regulators explained in footnote 72 of the Prudential Regulators' Proposed Margin Rules (79 Fed.Reg. at 59903):

> "[72] The financial entity definition in the 2011 proposal includes a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the BHC Act. *See* 7 U.S.C. 2(h)(7); 15 U.S.C. 78c–3(g). The Agencies requested comment on

> how covered swap entities should make this determination, and whether they should use an approach similar to that developed by the Board for purposes of Title I of the Dodd-Frank Act. *See* 68 FR 20756 (April 5, 2013). Section 4(k) of the BHC Act includes conditions that do not define whether an activity is itself financial but were imposed on bank holding companies to ensure that the activity is conducted by bank holding companies in a safe and sound manner or to comply with another provision of law. Staff of the Agencies recognize that by simply choosing not to comply with the conditions imposed on the manner in which those activities must be conducted by bank holding companies, a firm could avoid being considered to be engaged in activities that are financial in nature." (Emphasis added.)

In essence, the Prudential Regulators are saying that Congress' express reliance on Section 4(k) of the BHC Act, in its amendment of Section 2(h)(7) of the CEA under the Dodd-Frank Act, created an unintended ambiguity, which made it essentially impossible for covered swap entities to make the requisite determination "of whether their counterparties are predominantly engaged in activities that are financial in nature, as defined in section 4(k) of the BHC Act."

Accordingly, "in order to provide certainty and clarity to counterparties as to whether they would be financial end users for purposes of this proposal," the Prudential Regulators were exercising their agencies' expertise to interpret and implement the Dodd-Frank Act and the BHC Act to provide operational "certainty and clarity" to entities that would be subject to and obligated to implement the Prudential Regulators' regulations.

In that portion of the CFTC's Proposed Margin Rule adopting the Prudential Regulators' definition of "financial end user," the CFTC has requested the following comment (See CFTC's Proposed Margin Rule, 79 Fed.Reg. at 59904):

> "The Commission also requests comment on whether another approach to defining financial end user (e.g., basing the financial end user definition on the financial entity definition as in the 2011 proposal) would provide more appropriate coverage and clarity, and whether covered swap entities could operationalize such an approach as part of their regular procedures for taking on new counterparties." (Emphasis added.)

In response to this request by the CFTC, the IECA respectfully submits that applying the Prudential Regulators' approach to defining "financial end user," especially when compared to basing any such definition on the "financial entity" definition in the 2011 proposal, provides much "more appropriate coverage and clarity [and greater certainty]" and will ensure that covered swap entities are able to "operationalize" that approach as part of their regular procedures for taking on new counterparties.

As the CFTC said on page 59906 of its Proposed Margin Rule: "Non-financial end users would include any entity that was not an SD [swap dealer], an MSP [major swap participant], or a financial end user." And, as the CFTC concluded in the text quoted from the CFTC's Proposed Margin Rule at the end of the preceding Section II.A of these comments (79 Fed.Reg. at 59906), Section 2(h)(7) of the CEA, as amended by the Dodd-Frank Act, "generally exempted <u>non-financial end users</u> from the requirement that they submit trades to clearing."

In its Proposed Margin Rule, the CFTC has essentially adopted the Prudential Regulators' definition of "financial end users" as set forth in the Prudential Regulators' Proposed Margin Rules. In the CFTC's discussion in its Proposed Margin Rule of definition of "financial end users," the CFTC said (79 Fed.Reg. at 59902):

> "As contemplated by the 2013 International Framework, the CFTC proposal, **<u>which is the same as the Prudential Regulator's proposal</u>**, contains greater detail in defining financial end users than the international standards. … In developing the definition, the Commission and the Prudential Regulators sought to provide clarity about whether particular counterparties would be subject to the margin requirements of the proposed rule. The definition is an attempt to strike a balance between the need to capture all financial counterparties that pose significant risk to the financial system and the danger of being overly inclusive. … The list of financial entities is based to a significant extent on Federal statutes that impose registration or chartering requirements on entities that engage in specified financial activities." (Emphasis added.)

The IECA respectfully submits that applying the Prudential Regulators' approach to defining "financial end user," especially when compared to basing any such definition on the "financial entity" definition in the 2011 proposal, provides much more appropriate coverage, clarity and certainty and will ensure that covered swap entities are able to "operationalize" that approach as part of their regular procedures for taking on new counterparties.

In fact, the IECA would endorse the CFTC's adoption and application of the Prudential Regulators' legal reasoning and analysis in the CFTC's determination of the "financial entities" which are not eligible for the exemption to mandatory clearing under Section 2(h)(7) of the CEA. Such deference by the CFTC to the Prudential Regulators' interpretation of the requirements of section 4(k) of the BHC Act would provide greater certainty, coverage and clarity.

C. The IECA Requests that the Prudential Regulators and the CFTC Delete Clause (xiii) of Paragraph (1) of the Definition of "Financial End User" In Order To Ensure that Any Determination that Another Type of Entity, in Addition to the Twelve Types of Entities Enumerated as Financial End Users in Paragraph (1), Will Only Become a Financial End User After (a) Public Notice and Comment under the Administrative Procedures Act, (b) Satisfaction of the Requisite Cost-Benefit Analysis under the OMB

Requirements, and (c) a Collaborative Regulatory Review Process Among the Prudential Regulators, the CFTC and the Securities Exchange Commission ("SEC").

As an important caveat to the IECA's appreciation for the Agencies/CFTC providing clarity and certainty in focusing the definition of "financial end user" on ***regulated*** financial entities, the IECA respectfully request that the Agencies/CFTC delete clause (xiii) of paragraph (1) of the definition of "financial end user" in the proposed rules.

The proposed definition of "financial end user" sets forth 12 clearly-identifiable categories of ***regulated*** financial entities as "financial end users" in paragraph (1) of the definition. In paragraph (2), the proposed definition then sets forth another list of 5 clearly-identifiable categories of entities that are not "financial end users." However, sandwiched between the two clearly-identifiable lists is clause (xiii) of paragraph (1) of the definition. In clause (xiii) of paragraph (1) of the definition, the Agencies/CFTC propose a completely open-ended catch-all provision in the name of regulatory flexibility. Clause (xiii) of paragraph (1) completely obliterates the clarity and certainty of the rest of the definition, and is directly at odds with the rationale provided in general for the proposal, and which the Agencies acknowledge is the underlying Congressional intent.

Clause (xiii) of paragraph (1) of the definition of "financial end user" reads:

> "Notwithstanding paragraph (2) below, any other entity that [Agency or the Commission] has determined should be treated as a financial end user [presumably only for purposes of the Agency's/CFTC's margin rules]."

Clause (xiii) would allow any one of the Agencies or the CFTC to make a unilateral determination that would cause that individual regulator's margin requirements to be mis-aligned with all other regulators' margin rules, both in the United States and in other jurisdictions. That one Agency or the CFTC could seemingly make such a determination for one or all covered swap entities under its jurisdiction. The clause does not provide any standards for such a determination by an individual Agency or the CFTC. There is no explanation as to the criteria that the Agency/CFTC would use for such a determination, or what weight would be given to the other Agencies' or the CFTC's general views on margining end users, or Congressional intent that non-financial (or commercial) end users, as a class, be excluded from margining as they pose a reduced risk to their counterparties and the stability of the U.S. financial system." See 79 Fed. Reg. 57357.

The clause does not anticipate an opportunity for notice or public comment to the Agency of the CFTC making such a determination as to the serious consequences of such a determination for the non-financial (or commercial) end user(s) that might find itself/themselves suddenly designated as "financial end users" and their transactions subject to one Agency's or the CFTC's margin rules. Nor is there an opportunity for the broader notice and public comment on the potential impacts of such an individual Agency's or the CFTC's determination for the local, regional, national and global markets for non-cleared swaps taken as a whole.

The preamble to the Agencies' proposal presumes, but the rule does not require, that an individual Agency would notify ***the covered swap entity*** in writing of the regulator's intention to require treatment of the counterparty as a financial end user, and the date by which such treatment is to be implemented. See 79 Fed.Reg. 57,362. Footnote 77 notes that the Agencies' procedures "would ***generally*** provide the individual covered swap entity notice and an opportunity to respond." This portion of the preamble is especially concerning as it implies that an individual Agency might make such a determination on a covered swap entity-by-covered swap entity basis. If that were to be the case, one prudentially-regulated bank that was registered with the CFTC as a "swap dealer" might be required to margin swaps with a particular counterparty (presumably using the complex calculations as to whether such counterparty was required to post initial and/or variation margin, and subject to the restrictions on types of permissible margin), whereas another bank swap dealer regulated by the same Agency (or a different Agency) might not be required to do so. The proposal does not even consider the effect on the particular non-financial (commercial) end user counterparty attempting to compare swap proposals between two prospective bank swap dealer counterparties.

Nor does the Agencies' proposal explain how an Agency would, as a more general matter, determine that all covered swap entities under that particular Agency's jurisdiction should consider an entity or a particular type of entity as a "financial end user." Nor does the proposal explain how the entity that is the object of such a determination (i.e., such entity has been determined to be such a risk to the safety and soundness of an individual covered swap entity or to the financial system) might have notice, an opportunity to comment or an appeal right for such a potentially-costly Agency determination.

The "Notwithstanding" language at the beginning of clause (xiii) is an especially curious provision. It means that an individual Agency or the CFTC could determine that an entity otherwise excluded from the impact of the Agencies'/CFTC's margining rules under the list in paragraph (2) must be margined by one covered swap entity or by all covered swap entities under the jurisdiction of that Agency or the CFTC.

Consider the potential effect on a sovereign, or a particular industry not comprised of otherwise-regulated financial institutions, if such an Agency or the CFTC determination was suddenly announced by certain covered swap entity counterparties. The provision provides none of the administrative procedure rights or due process/appeal provisions that would follow logically from such a potentially broad and burdensome/costly administrative decision. Congress clearly did not intend that the individual Agencies or the CFTC be entitled to make policy that could or may be directly inconsistent with overall policy intent of the swap margining provisions of the Dodd-Frank Act.

For the foregoing reasons, the IECA submits that Clause (xiii) of the definition of "financial end user" in both the Agencies' Proposed Margin Rules and the CFTC's Proposed Margin Rule should be deleted. If the Agencies/CFTC determine, after reviewing public comments solicited in this rulemaking and finalizing the proposed rules, that a particular category of regulated financial entity has been overlooked in the definition of "financial end user," or if an entity or type of entity excluded by paragraph

(2) of the definition is found to be abusing the intent of the exclusion or otherwise threatening the global financial system, then the Agencies/CFTC can and should collectively propose a rule amendment in consultation with each other and in coordination with the global regulators.

D. The IECA Respectfully Requests that the Prudential Regulators Delete Certain Text in Proposed Sections ___.3(d) and ___.4(c), Which Appear to Mandate the Collection of IM and VM by a Covered Swap Entity If and When Determined to be Appropriate by such Covered Swap Entity

While the IECA commends the Prudential Regulators for proposing in section ___.3(d), Initial margin, that a covered swap entity is not required to collect IM with respect to any non-cleared swap from a counterparty that is a non-financial end user, the IECA respectfully submits that the remaining text of section ___.3(d) should be deleted. Specifically, section ___.3(d) should be revised as follows:

> "A covered swap entity is not required to collect initial margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user with material swaps exposure nor a swap entity ~~but shall collect initial margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps~~."

Similarly, while the IECA commends the Prudential Regulators for proposing in section ___.4(c), Variation margin, that a covered swap entity is not required to collect VM with respect to any non-cleared swap from a counterparty that is a non-financial end user, the IECA respectfully submits that the remaining text of section ___.4(c) should be deleted. Specifically, section ___.4(c) should be revised as follows:

> "A covered swap entity is not required to collect variation margin with respect to any non-cleared swap or non-cleared security-based swap with a counterparty that is neither a financial end user nor a swap entity ~~but shall collect variation margin at such times and in such forms and such amounts (if any), that the covered swap entity determines appropriately address the credit risk posed by the counterparty and the risks of such non-cleared swaps and non-cleared security-based swaps~~."

As shown above, the IECA respectfully requests the Agencies to delete certain language in section __.3(d) and section __.4(c) of the proposed rules. The language that should be deleted is inconsistent with both the 2013 International Framework and Congressional intent in enacting the Dodd-Frank Act margin provisions.

In addition, the regulatory "requirement" imposed by the language is ambiguous, and devoid of either substance or process required for either the covered swap entity or its non-financial end user counterparties to operationalize compliance with such a requirement.

Finally, there is no comparable language in the CFTC version of the proposed margin rules, applicable to covered swap entities that are not prudentially-regulated by the Agencies and, as a result, the language appears to make the various regulators' margin rules inconsistent.

The IECA submits that the Prudential Regulators' Proposed Margin Rules should not require, or even imply, that covered swap entities have unilateral discretion to impose margin requirements on swaps to which non-financial end users are party. Instead, covered swap entities and non-financial end users should be free to negotiate bilateral credit support arrangements as part of any uncleared swap between them and the type and amount of margin or other credit support arranged between them should not be limited by the acceptable forms of "eligible collateral" under the Proposed Regulators' Section ___.6.

Accordingly, in each of section __.3(d) and section __.4(c) of the proposed rules, the IECA respectfully requests the Agencies to delete the language beginning with the phrase "...but shall collect..." through the end of each such section.

The 2013 International Framework[4] states: "The BCBS and IOSCO believe that the margin requirements need not apply to non-centrally cleared derivatives to which non-financial entities that are not systemically important are a party, given that (i) such transactions are viewed as posing little or no systemic risk and (ii) such transactions are exempted from central clearing mandates under most national regimes." The 2013 International Framework acknowledges the link between the clearing requirements and the margining rules for derivatives – and that neither is intended to apply to swaps to which non-financial end users are parties (unless the non-financial entity is systemically important).

In the preamble to the proposed rules, the Agencies note that commercial end-users are exempt from the clearing requirements imposed by the Dodd-Frank Act amendments to the CEA for all swaps used to hedge or mitigate commercial risks. (79 Fed. Reg. 57357.) The preamble goes on to acknowledge that comments filed in response to the Agencies' 2011 Proposal argued, persuasively, that it would be inconsistent with the end-user exception to clearing to require cover swap entities to impose margin on non-cleared swaps to which non-financial end users are party. In fact, it would undermine substantially the rights of commercial end-users to be exempt from mandatory clearing of such swaps.

Sections 731 and 764 of the Dodd-Frank Act are applicable on their face to swap dealers and major swap participants, and thus relate to swaps between and among such regulated entities. The Sections direct the Agencies to adopt rules for covered swap entities imposing margin requirements on all non-cleared swaps, and explain the purpose and

[4] The Basel Committee on Banking Supervision (BCBS) and the Board of the International Organization of Securities Commissions (IOSCO), *Margin Requirements for non-centrally cleared derivatives*, (September 2013) *available at http://www.bis.org/publ/bcbs261.pdf.*

scope of such direction. The margin rules are intended to help ensure the safety and soundness of the covered swap entities, and such margin requirements are to reflect a risk-based approach to regulation. If the risk to the covered swap entity is substantially less, as it is for a swap used by a non-financial end user to hedge commercial risks, then a rigid non-cleared swap-by-swap, dollar-for-dollar cash margining regime (similar to that used by central counterparties for standardized swaps trading between and among covered swap entities, and with financial entities as financial investments) would not be consistent with the Congressional intent in the Dodd-Frank Act.

In fact, the clear Congressional intent was not to impose any regulatory margin requirements on commercial (non-financial) end users. The IECA reminds the Agencies that, during the Congressional Conference Committee negotiations in June of 2010, an express prohibition on requiring margin for swaps to which commercial end-users are parties was agreed. Due to what was described by the Conference Committee Chairs as an overnight Congressional staff error, the express prohibition was deleted from the text of the bill being considered by the Conference Committee at its last session. When Republicans on the Conference Committee objected to the deletion, the Conference Committee Chairs, Representative Barney Frank for the House and Senator Chris Dodd for the Senate, stated that if, indeed, the text had been inadvertently deleted (i.e., if the text was not, in fact, redundant of other provisions in the Conference Committee bill), it was an error and would be subsequently fixed. Without a single Republican vote in favor, the Conference Committee passed the bill, based on that promise by the Committee Chairs to implement this important and undisputed Congressional intent.

This was the backdrop for the letter the Agencies cite in the preamble to the proposed rule as suggesting that "some members of Congress" did not intend to impose margin requirements on non-financial end users engaged in hedging activities. These were not just some members – they were the sponsors from each party of the landmark financial reform legislation and, in particular, the derivatives title of that legislation. The Agencies cite the letter by which the Senate sponsors of Title VII of the Dodd-Frank Act (the respective Chairs of the responsible committees in the Senate) explained to the House sponsors that the Act "does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risks ." 156 Cong Rec. S6192 (daily edition July 22, 2010) (the "Lincoln Dodd letter"). In contemporaneous statements by the sponsors in the House, Representatives Frank and Peterson confirmed their understanding of Congressional intent.

> Mr. PETERSON: [W]e have given the regulators no authority to impose margin requirements on anyone who is not a swap dealer or a major swap participant. While the regulators do have authority over the dealer or MSP side of a transaction, we expect the level of margin required will be minimal…I would ask Chairman Frank whether he concurs with my view of the bill.
>
> Mr. FRANK: …[T]he gentleman is absolutely right. We do differentiate between end users and others. The margin[al][sic] requirements are not on end users."

156 Cong. Rec. H5248 June 30, 2010.

Similarly, in the Congressional Record of the House (156 Cong Rec H 523 – June 30, 2010), Congressman Peters said:

> "However, because commercial end users, who are those who use derivatives to hedge legitimate business risks, do not pose systemic risk and because they solely use these contracts as a way to provide consumers with lower cost goods, they are exempted from clearing and margin requirements."

Again in the letter of June 30, 2010, from Senator Christopher Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, and Senator Blanche Lincoln, Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry, to Congressman Barney Frank, Chairman of the House Financial Services Committee, and Congressman Colin Peterson, Chairman of the House Committee on Agriculture (see attached copy), Senators Dodd and Lincoln said:

> "The legislation does not authorize the regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk. If regulators raise the costs of end user transactions, they may create more risk. It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth.
>
> Again, Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end users, nor can the regulators require clearing for end user trades. Regulators are charged with establishing rules for the capital requirements, as well as the margin requirements for all uncleared trades, but rules may not be set in a way that requires the imposition of margin requirements on the end user side of a lawful transaction. In cases where a Swap Dealer enters into an uncleared swap with an end user, margin on the dealer side of the transaction should reflect the counterparty risk of the transaction. Congress strongly encourages regulators to establish margin requirements for such swaps or security-based swaps in a manner that is consistent with Congressional intent to protect end users from burdensome costs." (Emphasis added.)

In testimony before Congress in 2010, then CFTC Chairman Gary Gensler confirmed his understanding that Congress intended to exempt end-users from margining. See Financial Overhaul Law Implementation: Hearing of the Senate Comm. On Banking, Housing and Urban Affairs, CQ Cong Trans (Sept. 30, 2010). More recently, the 2014 Customer Protection and End User Relief Act, HR 4413, that passed the House in the summer of 2014 with numerous important amendments and clarifications to the Dodd-Frank Act, contained the previously-deleted prohibition on margining non-financial end user swaps as Section 311 of that bill.

Another reason that the language should be deleted from section __.3(d) and section __.4(c) of the Agencies' proposed rules is that the language does not include any parameters explaining under what circumstances or using what standards a covered swap entity would impose margin rules unilaterally on swaps to which a non-financial end user is a party. In this way, the language adds ambiguity to the regulations without adding any guidance to, or imposing any standards of conduct on, the covered swap entity. Moreover, the language does not appear in the CFTC's proposed margin rules, and in that way, the language adds inconsistency between the margin rules of the various US agencies, when the Agencies and the CFTC were instructed by Congress in Section 4s(e)(3)(D) of the CEA, as amended by the Dodd-Frank Act, to adopt margin regulations applicable to covered swap entities under their respective jurisdiction that are "comparable" to the maximum extent practicable.

Additionally, this language creates contractual ambiguity and uncertainty between a covered swap entity and its contractual counterparty. For example, when will the covered swap entity have made its determination about whether to require margin? Can that decision be made at any time during the life of the contract in the sole discretion of the covered swap entity? If so, how and when will the non-financial end user know how much margin it will be required to post and under what circumstances?

For all these reasons, the IECA submits that the Agencies should delete from their Proposed Margin Rules this ambiguous and additional requirement, that is not found in the CFTC's Proposed Margin Rule, which were intended to be comparable.

Accordingly, the IECA urges the Prudential Regulators to delete the words in proposed sections ___.3(d) and ____.4(c) that are shown as stricken above in these comments, to ensure that the Prudential Regulators' Proposed Margin Rules comply with the explicit provisions of the Dodd-Frank Act and Congress' explicit intent in enacting the Dodd-Frank Act.

E. The IECA Requests that the Regulators Clarify the Applicability of Custodial Requirements for Collateral in "Non-Financial End User" Swap Transactions

We suggest that the §___.7 of the Prudential Regulators' Proposed Margin Rules regarding segregation of collateral be explicit that it applies only to collateral posted by a covered swap entity to a financial end user with material swaps exposure or by a financial end user with material swaps exposure to a covered swap entity. Non-financial end users should be free to negotiate with their counterparties the arrangements, if any, with respect to segregation of collateral.

The proposed rule's provisions for posting of collateral by a non-financial end user allows covered swap entities to determine the amount of collateral on a counterparty by counterparty basis. As a practical matter, that means a covered swap entity and a non-financial end user will negotiate the amount and type of collateral, or other form of credit support, each of the parties want. There is no universal approach dictated by the

proposed rule for the amount or type of collateral for transactions between those categories of entities. Similarly, any segregation arrangements for collateral posted on transactions between a covered swap entity and a non-financial end user should be determined between the two parties without being subject to universal requirements. As written, the proposed rule would have all collateral posted by a covered swap entity (other than variation margin) be subject to the segregation requirements of the rule. The cross-reference to §___.3 in §___.7(b) suggests that the intention is for the segregation requirements of §___.7 to apply only with respect to collateral posted between a covered swap entity and a financial end user with material swaps exposure. We believe that intention should be made explicit in both §___.7(a) and §___.7(b).

We note that Dodd Frank requires swap dealers and major swap participants to advise their counterparties of the right to have their initial margin segregated (See CEA Section 4s(l) and CFTC Regulation 23.701(a)(1)). In this case, the IECA agrees with the CFTC that segregation is not required for uncleared swaps with non-financial end users, but instead the decision is left to the counterparty to decide whether segregation will apply. A requirement that margin, posted by the non-financial end user to its covered swap entity counterparty, must be segregated would go against these statutory and regulatory provisions of Dodd Frank.

If segregation were required for margin posted by the covered swap entity with a non-financial end user, that would put a substantial burden on the non-financial end user, who is likely using the swap for hedging purposes. It is also likely that a relatively small portion of transactions between a covered swap entity and a non-financial end user would involve posting of initial margin by the covered swap entity. From the perspective of systemic risk management, the minimal gain that might be achieved by requiring segregation of the covered swap entity's initial margin would not justify the burden on the non-financial end user counterparty, including the cost of having to establish and maintain segregated custodial accounts.

F. The IECA Reserves the Right to Address in the CFTC's Yet-To-Be Issued Proposed Capital Requirements Rule Various Issues Raised by Requirement of SDs/MSPs to Calculate Daily the Hypothetical IM and VM that Would Have, but for the Above Exemption, Been Applicable to Uncleared Swaps of Non-Financial End Users

The IECA respectfully reserves the right to submit in its comments to be submitted in response to the CFTC's proposed new rule on Capital Requirements for SDs/MSPs, which has not yet been issued, but which was mentioned in a recent presentation by CFTC Chairman Massad, regarding the impacts (and the likely costs to non-financial end-users) of requiring SDs/MSPs to calculate daily the hypothetical IM and VM that would have been collected had the counterparty not been a "non-financial end user" under the CFTC's proposed CFTC Regulations 23.154(a)(6) and 23.155(a)(3).

Such comments could range from questions about how to calculate this "hypothetical" IM and VM for a non-financial end user (and for its affiliates), including the

determination of whether the non-financial end user has "material swaps exposure to the covered swap entity" as described in proposed CFTC Regulations 23.154(a)(6) and 23.155(a)(3), to whether the covered swap entity must have an exposure to the non-financial end user of at least $3 billion before a hypothetical IM and VM calculation is required under such new proposed regulations.

Such comments by the IECA will also address whether and how the CFTC's new proposed rule addressing Capital Requirements for SDs/MSPs will recognize the beneficial credit impacts of various alternative forms of credit support (other than IM or VM) provided by non-financial end users to their SD/MSP counterparties in such bilaterally negotiated non-cleared swap transactions and whether such other forms of credit support will be recognized by the CFTC in determining the level of capital required to be held by SDs/MSPs entering into uncleared swaps with non-financial end-users.

G. The IECA Requests that the CFTC and the Prudential Regulators Include Letters of Credit, Parent Company Guarantees, and Liens on Assets as Acceptable Forms of Margin under Proposed CFTC Regulation 23.156 and as Eligible Collateral under Proposed Prudential Regulators' Section __.6.

The IECA supports a standard that would allow non-financial end users to continue to negotiate forms of collateral appropriate to the risks of each particular swap transaction. Recognition in the final regulations that non-financial end users may post any form of collateral for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties in the credit support arrangements would go a long way to meeting this goal. Such a standard would also fulfill Congress' direction in Section 731 of the Dodd-Frank Act (Section 4s(e)(3)(C) of the CEA) that regulators "shall permit the use of noncash collateral."

In energy markets, one common form of collateral is a letter of credit from a creditworthy bank or other financial institution. Not only is there an established practice of using letters of credit, but recent market events suggest that continuing such use may actually further the goal of collateralizing with assets that "hold their value in times of financial stress", as stated on page 59912 of the CFTC's Proposed Margin Rule.

On October 15, 2014, participants in the U.S. Treasury market were stunned[5] by a massive plunge and then reversion in a matter of minutes in the yield on the 10-year U.S. Treasury note. The unusual move was described as being "seven standard deviations away from its intraday norm",[6] and has been blamed on various reported news events (including the spread of Ebola, war in the Middle East, and a decline in retail sales) as

[5] Tom Lauricella and Katy Burne, *Bond Swings Draw Scrutiny*, The New York Times (November 9, 2014).

[6] Tracy Alloway and Michael MacKenzie, *Bonds: Anatomy of a market meltdown*, Financial Times (November 17, 2014).

well as algorithmic electronic trading[7]. The ultimate cause of the rapid swing in U.S. Treasury yields has not yet been determined, but the expectation of liquidity in the U.S. Treasury market for such instruments has already been questioned. In remarks to the Financial Times, James Angel, an associate professor at Georgetown University said that "When people use computers to provide prices across markets it [liquidity] can be withdrawn in a heartbeat".[8] In the year prior to this market fluctuation, according to minutes of a meeting of the Treasury Borrowing Advisory Committee of the Securities Industry and Financial Markets Association on November 5, 2013, some members of such committee "suggested that the liquidity provided to the market through electronic trading was small on a relative basis and unlikely to persist during periods of market turbulence."[9]

Letters of credit are not subject to the same rapidly moving forces, which caused the October 15 volatility in the U.S. Treasury market. Letters of credit are generally not transferable like debt securities, so they are not subject to the same kind of liquidation risk that U.S. Treasuries are. Additionally, in order to realize the value of a letter of credit, it must be drawn upon, which requires more than just the pressing of a button (e.g., certain administrative steps must be taken, such as presentation to an issuer), which makes it less likely that such drawing would contribute to a selling panic caused by a widespread liquidation of other forms of collateral due to algorithmic trading or some other market turbulence.

Other common forms of collateral used by non-financial end users in the energy industry include parent company guarantees and liens on assets like oil and natural gas reserves and power generation facilities. The IECA requests that the Prudential Regulators' and the CFTC's final margin requirements rules should clarify that these longstanding collateral practices will satisfy the requirements for eligible collateral under the Prudential Regulators' Section ____.6 and eligible forms of margin under the CFTC's Regulation 23.156.

[7] Susanne Walker and Lisa Abramowicz, *Flash Boys Raise Volatility in Wild New Treasury Market*, Bloomberg (November 17, 2014) *at* *http://www.bloomberg.com/news/2014-11-18/flash-boys-invade-treasury-bond-market-in-new-era-of-volatility.html*.

[8] Tracy Alloway and Michael MacKenzie, *Bonds: Anatomy of a market meltdown*, Financial Times (November 17, 2014).

[9] Minutes of the Meeting of the Treasury Borrowing Advisory Committee Of the Securities Industry and Financial Markets Association November 5th, 2013 *available at* *http://www.treasury.gov/press-center/press-releases/Pages/jl2209.aspx*

H. The IECA Requests that the Prudential Regulators and the CFTC Clarify their Proposed Margin Rules, Including their Respective Definitions of "Eligible Master Netting Agreement," to Permit Netting Across Swap Transactions and Physical Commodity Forward Transactions Entered into Pursuant to an ISDA Master Agreement with One or More Physical Annexes.

Neither the Prudential Regulators' Proposed Margin Rules nor the CFTC's Proposed Margin Rule is explicit regarding how the Commission will treat ISDA Master Agreements with physical annexes, under which unregulated physical commodity forward transactions are entered into under the same ISDA Master Agreement with regulated swap transactions.

In its Proposed Margin Rule, the CFTC said with respect to VM (79 Fed.Reg. 59898 at 59908):

> "The proposal would permit netting of variation margin across swaps.[55] Any netting would have to be done pursuant to an eligible master netting agreement.[56] The agreement would create a single legal obligation for all individual transactions covered by the agreement upon an event of default. It would specify the rights and obligations of the parties under various circumstances.[57]" (Emphasis added.)

Again under the caption "b. Applicability to Multiple Swaps," the CFTC said with respect to IM (Id. At 59909):

> "b. Applicability to Multiple Swaps
> To the extent that more than one uncleared swap is executed pursuant to an eligible master netting agreement (''EMNA'')[72] between a CSE and a covered counterparty, the CSE would be permitted to calculate initial margin on an aggregate basis with respect to all uncleared swaps governed by such agreement.[73] As explained below, however, only exposures in certain asset classes could be offset. If the agreement covered uncleared swaps entered into before the applicable compliance date, those swaps would have to be included in the calculation.[74]
>
> The proposal defines EMNA as any written, legally enforceable netting agreement that creates a single legal obligation for all individual transactions covered by the agreement upon an event of default (including receivership, insolvency, liquidation, or similar proceeding) provided that certain conditions are met. These conditions include requirements with respect to the covered swap entity's right to terminate the contract and to liquidate collateral and certain standards with respect to legal review of the agreement to ensure that it meets the criteria in the definition.

> The Commission requests comment on all aspects of the proposed definition of EMNA."

While the Prudential Regulators and the CFTC both recognize netting across multiple swaps under an "eligible master netting agreement" (or EMNA), unfortunately, there is no mention of netting across swaps and physical commodity forward transactions under an "eligible master netting agreement." Similarly, there is no mention of physical commodity forward transactions in either the CFTC's or the Prudential Regulators' proposed definitions of "eligible master netting agreement" in, respectively, the CFTC's proposed Regulation 23.151 nor in the Prudential Regulators' proposed Section ___.2.

Many energy companies utilize the Power Annex, the Natural Gas Annex, and other physical commodity annexes under the ISDA Master Agreement to incorporate various physical commodity forward transactions entered into with a counterparty under the same master agreement with the swap transactions entered into with that same counterparty. As a result, the same legal and credit terms and conditions that govern the energy company's swap transactions with a counterparty also govern the energy company's physical commodity forward transactions with that same counterparty. This allows netting of exposures under all these bilateral transactions, including both physical commodity forward transactions and swap transactions.

As a result, each counterparty's net exposure to the other counterparty under such ISDA Master Agreements is often netted across physical commodity forward transactions and swap transactions. Under such ISDA Master Agreements, the counterparties' bilaterally negotiated credit support addresses the counterparties' exposure netted across physical transactions and financial transactions and requires the posting of collateral (margin) or other forms of bilaterally negotiated credit support at levels determined by the counterparties' exposure netted across both physical transactions and financial transactions. Through such netting and offset rights, this contractually reduces the counterparties' exposure to each other under such master agreements.

These netting and set-off rights allow counterparties to calculate exposure and exchange collateral based on a single net amount for all transactions, including physical commodity forward transactions that are not swap transactions.

Calculating exposure and margin separately on swap transactions and physical commodity forward transactions could have the adverse consequence of potentially requiring both counterparties to post larger amounts of margin (collateral or other credit support) to the other party under their ISDA Master Agreement, in lieu of margining the counterparties' actual exposure netted across physical commodity forward transactions and swap transactions as the parties have agreed under such master agreement. Obligating both counterparties to post collateral separately in such a manner could, therefore, result in an increase in the dollar amount of collateral (margin) required to be posted and set aside by both counterparties.

And yet the counterparties' actual exposure to each other under such an ISDA Master Agreement with physical annexes, as a result of the netting and offset rights of the counterparties to that master agreement, would not match the required margin but would be a lesser amount. No justification is provided for needlessly increasing the cost of such transactions.

As a result, the IECA requests that the Prudential Regulators and the CFTC acknowledge that counterparties to an ISDA Master Agreement with physical annexes[10] may agree to calculate their exposure to each other by netting across physical forward transactions and swap transactions and then calculating the necessary margin, collateral or other credit support obligations based on such netting across physical forward transactions and swap transactions under their ISDA Master Agreement with physical annexes.

The IECA also requests that the Prudential Regulators and the CFTC allow the counterparties to such ISDA Master Agreements with physical annexes to calculate any required margin based on their exposure calculated by netting across physical forward transactions and swaps transactions so that the applicable margin required to be posted by one of the counterparties recognizes that the physical transactions, as well as the swap transactions, contribute directly to the actual exposure of each counterparty to the other counterparty under such master agreements.

The IECA believes that such clarifications would permit the continuation of the current, prudent and efficient practice among energy industry counterparties to ISDA Master Agreements with physical annexes by allowing the counterparties to agree to (i) calculate their exposure netted across physical forward transactions and swap transactions under such ISDA Master Agreements and to (ii) determine whether and how much collateral (margin) or other credit support may be required by a counterparty based on such calculations of exposure netted across physical forward transactions and swap transactions.

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[10] An ISDA Master Agreement with physical annexes would appear to be capable of satisfying the relevant requirements of the Prudential Regulators' definition of "eligible master netting agreement" under proposed Section ___.2 and the CFTC's definition of "eligible master netter agreement" under proposed Section 23.151.

III. Conclusion.

The IECA appreciates the opportunity to provide the foregoing comments and information to the Prudential Regulators. This letter represents a submission of the IECA, and does not necessarily represent the opinion of any particular member. If you would like for us to expand our discussion of any of the above-listed discussion points, please let us know.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

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