November 26, 2012

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

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

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

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

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street NW
Washington, DC 20552

VIA ELECTRONIC MAIL

Re: *Margin and Capital Requirements for Covered Swap Entities; Reopening of Comment Period*

Ladies and Gentlemen:

I. INTRODUCTION AND SUMMARY

Enbridge Inc. and Enbridge Energy Partners, L.P. (together "Enbridge") hereby respectfully submit comments in response to the Prudential Regulators'[1] proposed rule: *Margin and Capital Requirements for Covered Swap Entities* (the "Proposed Rule").[2]

Our comments address – and seek to cure – an unintended consequence of the Proposed Rule in that it would treat certain commercial end-users of swaps as "high-risk financial end-users," based solely on the fact that such end-users have elected to hedge their commercial risk through separately incorporated captive trading entities ("Captive Entities"). Absent a change in the Proposed Rule, these non-financial end-users would be subject to onerous margin

---

[1] The Prudential Regulators as referred to herein are the Office of the Comptroller of the Currency, Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency.

[2] Office of the Comptroller of the Currency, Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency. Notice of Proposed Rulemaking. *Margin and Capital Requirements for Covered Swap Entities.* 76 Fed. Reg. 27,564 (May 11, 2011).

requirements and would not be permitted to post non-cash collateral to satisfy such requirements. In short, the Proposed Rule would treat these commercial end-users like hedge funds.

Enbridge is a transporter of energy, operating the world's longest, most sophisticated crude oil and liquids pipeline system in Canada and the United States that ships more than two million barrels every day. Enbridge's natural gas gathering and transmission system extends from Northern British Columbia to the Gulf of Mexico, moving billions of cubic feet of gas per day. It also operates Canada's largest natural gas distribution company in Ontario and provides distribution services in Quebec, New Brunswick, and New York State.

Enbridge transacts in swaps to hedge the risks associated with its core business of transporting and processing energy commodities, including risks associated with energy commodities as well interest rate and foreign exchange risks. Like many other non-financial end-users, Enbridge engages in its swaps hedging largely through Captive Entities.

As explained more fully in these comments, treating companies like Enbridge as a "financial end-user" for margin and collateral purposes would be contrary to express Congressional intent, would serve no regulatory purpose, and would impose needless economic costs on such companies.

Therefore, Enbridge respectfully requests that the Prudential Regulators revise the Proposed Rule

- to subject non-financial end-users that transact in swaps through Captive Entities to the same margin rules as other non-financial end-users; and
- to permit all non-financial end-users to utilize forms of non-cash collateral, such as parent guarantees, letters of credit, and liens on assets, as credit support for their swaps trading relationships with the swap dealers and major swap participants (together, "Covered Swap Entities") that would be subject to the Proposed Rule.

II. BACKGROUND

A. The Proposed Rule

The Proposed Rule is intended to put in place margin requirements required under Section 731 of the Dodd-Frank Act. Congress adopted this Section in order to help ensure the safety and soundness of Covered Swap Entities and to help offset the greater risk to Covered Swap Entities, and the financial system as a whole, arising from the use of uncleared swaps.[3]

In offering the Proposed Rule, the Prudential Regulators state further that it is intended to "reduce the ability of firms to take on excessive risks through swaps without sufficient financial resources to make good on their contracts."[4] The Prudential Regulators thus have constructed the Proposed Rule so firms "that take significant risks through derivatives will face more

---

[3] Proposed Rule at 27,566.

[4] Proposed Rule at 27,567.

stringent margin requirements with respect to non-cleared derivatives, while firms that take lower risks will face less stringent margin requirements." To effectuate this intent, the Proposed Rule places increasingly stringent margin requirements on transactions between Covered Swap Entities and (i) non-financial end-users, (ii) low-risk financial end-users, (iii) high-risk financial end-users, and (iv) other Covered Swap Entities.

While this general conceptual framework appears to be consistent with Congressional intent, as currently drafted, the Proposed Rule would treat non-financial end-users that transact swaps through Captive Entities not as non-financial end-users, but as high-risk financial end-users. Specifically, the Proposed Rule's definition of "financial end-user" includes any entity that is "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 Bank Holding Company of 1956."[5] The Proposed Rule then further divides financial end-users into two classes: (i) high-risk and (ii) low-risk. Under Proposed Regulation §_.2(n), "low-risk financial end user" means an entity that is a financial end-user and makes the following representations to a Covered Swap Entity in connection with entering into a swap—

(1) The entity does not have a significant swaps exposure;

(2) The entity predominantly uses swaps to hedge or mitigate the risks of its business activities, including balance sheet, interest rate, or other risk arising from the business of the counterparty; and

(3) The counterparty is subject to capital requirements established by a prudential regulator or state insurance regulator.

A high-risk financial end-user is any financial end-user other than a low-risk financial end-user.[6]

Because transacting in derivatives is considered to be financial activity under Section 4(k) of the Bank Holding Company Act, as implemented by Regulation Y, Captive Entities within non-financial end-users would fall within the "financial end-user" definition.[7] Moreover, because Captive Entities within non-financial end-users are generally not subject to any form of capital regulation, under the Proposed Rule such entities would be deemed "high-risk financial end-users."

B. Use of Captive Entities by Enbridge and Certain Other Non-Financial End-Users

Enbridge transacts in swaps to hedge the risks associated with its core business of transporting and processing energy commodities. Those risks include not only the price and basis risk associated with energy commodities, but also risk encountered in the normal course of a commercial business, such as interest rate and foreign exchange risk.

---

[5] Proposed Regulation §_.2(h)(4).

[6] Proposed Regulation §_.2(i).

[7] *See* 12 C.F.R. 225.28(b)(8)(ii).

Like many other non-financial end-users, Enbridge engages in its swaps trading largely through Captive Entities.[8] Specifically, these entities enter into swaps with third parties to hedge the risks of their affiliates. Often, as is the case with Enbridge, the hedges are "sleeved" to their affiliates via inter-affiliate swaps. Enbridge's hedging uses a combination of centrally cleared and exchange executed swaps as well as bespoke bilateral uncleared swaps. Currently, bespoke uncleared swaps are a critical part of Enbridge's and other non-financial end-users' swap trading strategy. They allow parties to tailor swaps to their specific risks, and further, they place significantly less strain on non-financial end-users' working capital and liquidity needs.

Captive Entities generally do not hold any assets other than their trading positions and typically do not conduct activities other than hedging on behalf of their affiliates. Such Captive Entities' counterparties typically rely upon the fact that the Captive Entities are ultimately wholly-owned by creditworthy parents and have the express or implied credit support of their corporate parents including, in some cases, guarantees. In light of those relationships and credit support, and because hedging is generally lower risk than proprietary trading,[9] Captive Entities generally enjoy unsecured credit thresholds, below which they are not obligated to post margin. In the event that Captive Entities do post collateral, it is generally in the form of non-cash collateral such as letters of credit.

There are a variety of genuine commercial reasons why a non-financial end-user would choose to conduct its swaps activity through a Captive Entity – an entity that solely engages in swaps trading. It is often more efficient from a transaction cost and netting perspective for one or a few entities to trade on behalf of a group of affiliated entities rather than having each entity negotiate trading documentation and trade on its own behalf. In addition, it is easier to manage and monitor risk if swaps trading is consolidated into a limited number of entities and done by a handful of traders. Other reasons may include a determination, for example by a company's board of directors, that it is prudent for shareholders to isolate distinct forms of risk in dedicated entities. Said another way, a company may not want to expose its swaps trading relationships to the risks associated with the potential environmental liabilities associated with its pipelines or oil wells and, by the same token, the board of directors may not want to expose its physical assets to risks associated with swaps. In addition, there are often tax and other regulatory reasons as to why a non-financial end-user would elect to trade out of a Captive Entity that has a balance sheet comprised solely of trading positions.

In the case of Enbridge, the FERC Marketing Affiliate Rules necessitated a change in trading structure as commodity derivatives could no longer be traded out of Enbridge Inc. or Enbridge Energy Partners, L.P. The Captive Entities were created to comply with the FERC regulations and also for the above genuine commercial reasons such as capturing efficiencies

---

[8] For additional comments on the use of Captive Entities please see comments submitted by the Commercial Alliance (filed July 21, 2011 – http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47876&SearchText=47876) and Kraft Foods (filed February 11, 2011 – http://comments.cftc.gov/PublicComments/CommentList.aspx?id=933).

[9] Entities that use swaps to hedge are said to have "right way risk." In other words, in the event that they are out of the money on their swaps it would be counterbalanced by the fact that the risk that was being hedged by the entity moved in such entity's favor. That is not the case with speculative trading.

(negotiation of documentation, costs, netting), centralized risk management, and tax considerations.

As discussed further below, the Proposed Rule would have serious economic consequences for Enbridge and other similarly structured non-financial end-users. We interpret the Proposed Rule to classify Captive Entities of non-financial end-users as high-risk financial end-users even though there is nothing to indicate that this was the intent. As such, Captive Entities would be prohibited from enjoying any level of unsecured credit threshold and would be unable to post non-cash collateral to satisfy margin requirements. In short, the Proposed Rule would impose the same margin requirements on Enbridge and similarly structured non-financial end-users that predominantly engage in swaps to hedge as it would on highly-leveraged hedge funds that use swaps as speculative tools. Further, with Enbridge Inc. being a Canadian entity, it operationally avoids the use of cash as margin or collateral given the current state of Canadian case law regarding the inability to create a security interest in cash which is at odds with the legislation and case law in the United States.

IV. ENBRIDGE'S COMMENTS

A. The Proposed Rule as Applied to Enbridge and Certain Other End-Users is Contrary to Congressional Intent

The treatment of trading entities within non-financial end-users as high-risk financial end-users is contrary to Congressional intent. Congress intended to "protect end users from burdensome costs associated with margin requirements and mandatory clearing" and "specifically mandated that regulators permit the use of noncash collateral."[10] Congress "did not authorize the regulators to impose margin on end users."[11] Regulators were "charged with establishing rules for…margin requirements for all uncleared trades, but [such] rules may not be set in a way that requires the imposition of margin requirements on the end-user side of a lawful transaction."[12]

As drafted, however, the Proposed Rule would do exactly what Congress sought to avoid. Non-financial end-users with Captive Entities would be treated as "high-risk financial end-users," required to post margin without credit thresholds and would be precluded from using non-cash collateral.

B. Adverse and Unintended Consequences of Proposed Rule for Enbridge and Similar End-Users

As noted above, bilateral uncleared swaps play a significant role in allowing non-financial end-users to manage risk. Chief among the advantages of such swaps is the ability for

---

[10] *See* Letter from Chairman Christopher Dodd, Committee on Banking, Housing, and Urban Affairs, United States Senate, and Chairman Blanche Lincoln, Committee on Agriculture, Nutrition, and Forestry, United States Senate, to Chairman Barney Frank, Financial Services Committee, United States House of Representatives, and Chairman Colin Peterson, Committee on Agriculture, United States House of Representatives (June 30, 2010).

[11] *Id.*

[12] *Id.*

counterparties to structure the credit terms of their trading relationship in a manner that minimizes the impact on non-financial end-users' working capital and liquidity risk. The use of unsecured credit thresholds and forms of non-cash collateral such as parental guarantees, letters of credit, and liens on assets are the mechanisms that allow Enbridge and other non-financial end-users to structure their credit relationships efficiently.

The treatment of Captive Entities within non-financial end-users as high-risk financial end-users would have serious commercial implications for non-financial entities that utilize central trading affiliates. Under the Proposed Rule, such entities, when transacting with swap dealers and major swap participants, will be subject to the same margin rules as hedge funds, which generally do not trade swaps to hedge and pose significantly more risk to the financial system than non-financial end-users.

Specifically, under the Proposed Rule, these Captive Entities of non-financial end-users cannot be afforded unsecured credit thresholds and must post cash or cash equivalents as margin. As noted above, this is not only a significant departure from the safe and efficient trading and credit practices of many of these companies, but it also creates a substantial cost disparity between such companies and their competitors that rely on a different trading structure.

The Proposed Rule would require non-financial end-users with Captive Entities to choose between three undesirable alternatives. *First,* such entities could choose to reduce the degree to which they hedge to avoid the increased costs imposed by the Propose Rule. *Second,* such entities could comply with the Proposed Rule and accept the associated additional costs and liquidity risk. *Third*, non-financial end-users with Captive Entities could restructure the manner in which they trade swaps by trading directly out of the various entities that use swaps rather than the central trading entity, which could be inefficient and, in certain cases, needlessly complex. All of these options would essentially require non-financial end-users to expend resources outside of their core commercial business.

In short, the Proposed Rule would force many non-financial end-users to choose between incurring significant costs and taking on additional risk because of structuring decisions made prior to Dodd-Frank, and in some cases the non-financial end-users may not be able to change their structure without violating other regulators' current regulations. The Proposed Rule, by requiring non-financial end-users that utilize Captive Entities to make that choice, while allowing other non-financial end-users to largely continue to trade swaps as they currently do, would be a triumph of form over substance.

V. ENBRIDGE'S RECOMMENDED CHANGES

As the treatment of Captive Entities within non-financial end-users (i) would impose significant costs on Enbridge and similarly structured non-financial end-users, (ii) would create a competitive disparity between similar companies based solely on the structure of their swaps trading, and (iii) is directly contrary to Congressional intent, Enbridge respectfully requests that the Prudential Regulators do the following.

First, the Proposed Rule should be amended to exclude non-financial end-users' Captive Entities from the definition of "financial end-user" as long as such entities transact in swaps predominantly to hedge commercial risk. In the alternative, such trading entities should be deemed low-risk financial entities, and would therefore be permitted to use unsecured credit

thresholds. The maximum amount of such thresholds should be set the lesser of $45 million or .3% of the end-user's counterparty's capital metric, the higher end of the range of proposed thresholds. Adoption of either of these suggested approaches would avoid imposing a significant burden on effected non-financial end-users and would properly reflect Congressional intent.

Second, the Proposed Rule should be amended to allow non-financial end-users and non-financial end-users' Captive Entities to post non-cash collateral to satisfy margin obligations. Limiting eligible collateral to cash and cash equivalents eliminates forms of collateral currently used widely and safely in swaps markets. There are several forms of non-cash collateral that are accepted in today's markets, such as liens on physical and financial assets and letters of credit. These instruments and legal rights provide the credit support that trading relationships require and help lower costs by reducing funding obligations. So long as the collateral delivered can cover the swaps exposure in the event of a termination of the swaps and the liquidation of the collateral, then the Prudential Regulators should permit delivery of such assets.

VI. CONCLUSION

Enbridge appreciates this opportunity to provide comments on the interpretive guidance in the Proposed Rule and respectfully requests that the Prudential Regulators consider the comments set forth herein as they develop final rules regarding these matters.

If you have any questions, please contact the undersigned at (713) 821-2190.

Respectfully submitted,

/s/ Mollie Merritt

Senior Legal Counsel

Enbridge Energy Partners, L.P.