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March 18, 2019

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

Re: Comments of the IECA on **Standardized Approach for Calculating the Exposure Amount of Derivative Contracts**, as proposed by:

DEPARTMENT OF TREASURY, Office of the Comptroller of the Currency, 12 CFR Parts 3 and 32, Docket ID OCC-2018-0030, RIN 1557-AE44;

FEDERAL RESERVE SYSTEM, 12 CFR Part 217, Docket R-1629, RIN 7100-AF22; and

FEDERAL DEPOSIT INSURANCE CORPORATION, 12 CFR Part 324, RIN 3064-AE80

Dear Ms. Misback, Mr. Feldman and the Comptroller of the Currency:

The International Energy Credit Association ("IECA") respectfully submits these comments to the Board of Governors of the Federal Reserve System ("Board"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency, Treasury ("OCC," collectively with the Board and the FDIC, the

"Prudential Regulators") regarding the above-captioned notice of proposed rulemaking (hereinafter, "NOPR"), published at 83 Fed. Reg. 64,660 (December 17, 2018).[1]

Background. In the NOPR, the Prudential Regulators propose to update their standards for how firms measure counterparty credit risk posed by derivative contracts under the Prudential Regulators' regulatory capital rules ("Capital Rules"),[2] which Capital Rules require a banking organization to hold regulatory capital based on the exposure amount of its derivative contracts. This updated approach for calculating the exposure amount of derivative contracts is called the standardized approach for counterparty credit risk ("SA-CCR") and is "designed to better reflect the current derivatives market and incorporate risks observed during the 2007-2008 financial crisis."

Under the Capital Rules, there are two methods for determining total risk-weighted assets, the standardized approach, which applies to all banking organizations, and the advanced approaches, which apply only to advanced approaches banking organizations ("Advanced Approaches Banking Organizations"). An Advanced Approaches Banking Organization has at least $250 billion in total consolidated assets, or has consolidated on-balance sheet foreign exposures of at least $10 billion, or is a subsidiary of a depository institution, bank holding company, savings and loan holding company, or intermediate holding company that is an Advanced Approaches Banking Organization.

Under this NOPR (the "Proposed Rule"), the SA-CCR would replace the Current Exposure Methodology ("CEM")[3] as an additional method for calculating total risk-weighted assets under the Capital Rules for Advanced Approaches Banking Organizations. Under the Proposed Rule, the use of SA-CCR is mandatory for Advanced Approaches Banking Organizations for certain purposes under the Capital Rules and is optional, as an alternative to the Internal Models Methodology ("IMM"), for other purposes under the Capital Rules. Continued use of the CEM under the Standardized Approach is mandatory under the Capital Rules for all banking organizations that are not Advanced Approaches Banking Organizations ("Non-Advanced Approaches Banking Organizations"), provided, however, that a Non-Advanced Approaches Banking Organization may elect to use the SA-CCR method to determine the exposure amount for derivative contracts. The decision to utilize the SA-CCR, as proposed in the NOPR, will result in increased costs to energy market participants due to, among other things, the non-recognition of alternative forms of collateral and the higher supervisory factors for energy commodity derivative contracts.

On its website, the Board explained that "SA-CCR better reflects the current derivatives market and would provide important improvements to risk sensitivity,

[1] The deadline for submitting comments on this NOPR was extended by the Prudential Regulators from February 15, 2019, to March 18, 2019 (see 84 Fed. Reg. 6107, published on February 26, 2019).
[2] See 12 CFR Part 3 (OCC); 12 CFR Part 217 (Board); and 12 CFR Part 324 (FDIC).
[3] The CEM utilizes specific formulas set forth in the Prudential Regulators' regulations that comprise the Capital Rule.

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resulting in more appropriate capital requirements for derivative contracts exposure." In the Proposed Rule, the Prudential Regulators explained further that the Proposed Rule "makes several improvements to the recognition of collateral under SA-CCR" because the Proposed Rule "would account for collateral directly within the SA-CCR exposure amount calculation" and "would allow a banking organization to reduce the PFE [potential future exposure] amount through recognition of overcollateralization in the form of both variation margin and independent collateral" and, further, "would differentiate between margined and unmargined derivative contracts such that a netting set that is subject to a variation margin agreement would always have a lower or equal exposure amount than an equivalent netting set that is not subject to a variation margin agreement." (emphasis added.)[4]

Summary of the IECA's Position. The IECA is submitting these comments in support of its many members who are commercial end-users of swaps who enter into uncleared swaps, either pursuant to the end-user exception to clearing under Section 2(h)(7)(A) of the Commodity Exchange Act ("**CEA**") or the hedging affiliate exception to clearing under Section 2(h)(7)(D) of the CEA, solely for the purpose of hedging or mitigating their exposure to commercial risk.

With respect to such uncleared swaps, Congress expressly declared that such swaps should be exempt from clearing and such swaps should be exempt from the obligation to post initial and variation margin, because commercial end-users using swaps to hedge or mitigate their exposure to commercial risk should be encouraged not discouraged.

Such uncleared and unmargined swaps are bilaterally negotiated in order to more accurately address the nuances of the end-user's commercial risk that is being hedged or mitigated by such swap. Such swaps are bilaterally negotiated, typically with Advanced Approaches Banking Organizations, and such swaps are generally supported by various forms of bilaterally-negotiated bona fide credit risk reducing forms of credit support, such as letters of credit, liens on a commercial end-user's physical assets, a corporate guarantee by an investment-grade rated entity, or other forms of alternative credit support other than cash margin.

The IECA does not take issue with whether the application of SA-CCR, which recognizes the value of cash collateral posted as independent margin or variation margin in support of a derivative contract, represents an improvement over CEM for purposes of measuring a banking organization's credit risk exposure under derivative contracts. The IECA does take issue with the limitation of SA-CCR which fails to recognize the bona fide credit-risk reducing value of the alternate forms of collateral provided by commercial end-users.

[4] See NOPR, 83 Fed. Reg. at 64666.

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The IECA submits that the failure of SA-CCR, as set forth in the Proposed Rule, to recognize the credit risk-reducing value of the various forms of collateral, provided by commercial end-users and hedging affiliates in support of such unmargined swaps, which is submitted as an alternative to cash margin, has the adverse impact of artificially increasing the calculation of the exposure amount of Advanced Approaches Banking Organizations entering into such uncleared and unmargined swaps.

We urge the Prudential Regulators to reconsider that shortcoming in the SA-CCR as set forth in the Proposed Rule by modifying the SA-CCR to either: (A) recognize the various alternative forms of bilaterally-negotiated credit risk reducing collateral provided by commercial end-users and hedging affiliates in support of their uncleared and unmargined swaps, or (B) providing an exemption for such swaps from the adverse impacts of the artificially-increased counterparty credit risk exposure determination under the SA-CCR.

We also submit that imposing a Supervisory Factor of 40 for energy commodity derivative contracts is unsupported by any reasoned analysis in the Prudential Regulators' NOPR and does not provide a correct assessment of the counterparty credit risk arising from banking organizations entering into energy commodity derivative contracts.

I. Counterparties Affected by the SA-CCR.

As described in the NOPR, "a firm with a positive exposure on a derivative contract expects to receive a payment from its counterparty and is subject to the credit risk that the counterparty will default on its obligations and fail to pay the amount owed under the derivative contract." (Emphasis added.) The purpose of the proposed SA-CCR is providing a method for determining or measuring this "credit risk" that a counterparty may fail to make a payment when owed to an Advanced Approaches Banking Organization under a "derivatives contract," which is also sometimes referred to as exposure at default or "EAD."

As defined in the Capital Rule,[5] the term "derivative contract" means: "a financial contract whose value is derived from the values of one or more underlying assets, reference rates, or indices of asset values or reference rates. Derivative contracts include interest rate derivative contracts, exchange rate derivative contracts, equity derivative contracts, commodity derivative contracts, credit derivative contracts, and any other instrument that poses similar counterparty credit risks. Derivative contracts also include unsettled securities, commodities, and foreign exchange transactions with a contractual settlement or delivery lag that is longer than the lesser of the market standard for the particular instrument or five business days." (Emphasis added.)

Accordingly, when used in the Proposed Rule, the term "derivative contract" includes commodity swap transactions under the term "commodity derivative contracts"

[5] See 12 CFR Section 217.2.

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and appears to include commodity forward contracts for physical sales of commodities (see the underscored text shown above in the immediately preceding paragraph).

As such, under the Proposed Rule, the SA-CCR method of determining the "credit risk" that a counterparty may fail to make a payment under a "derivatives contract" will apply to financially-settled swap transactions and also physically-settled transactions for supplies of commodities between counterparties and Advanced Approaches Banking Organizations.

The IECA's members comprise energy professionals from the full range of energy market participants – both domestic and foreign – including producers, processors, generators, and consumers of energy commodities, investor-owned utilities, municipal utilities and pipelines transporting energy commodities, and investors, equity funds and lenders financing the energy industry. As defined in the Capital Rule and the Proposed Rule, the energy market participants represented by members of the IECA rely on "derivatives contracts" with Advanced Approaches Banking Organizations for financially-settled swap contracts used to hedge these entities' exposure to commercial risk, as well as for physically-settled forward contracts under which supplies of various energy commodities are bought and sold to meet the needs of the energy industry and the US economy.

Accordingly, the IECA is providing these comments ("IECA Comments") on behalf of the counterparties whose "credit risk" will be determined, under the Proposed Rule, by the SA-CCR under "derivative contracts," including both financially-settled commodity swap contracts and physically-settled commodity forward contracts between such counterparties and Advanced Approaches Banking Organizations.

II. Adverse Impacts of the SA-CCR

In the NOPR, the Prudential Regulators explained their motivation for implementing the proposed SA-CCR as follows:

> "As it applies to advanced approaches banking organizations, the proposed implementation of SA–CCR would provide important improvements to risk-sensitivity and calibration relative to CEM, resulting in more appropriate capital requirements for derivative contracts. SA–CCR also would be responsive to concerns raised regarding the current regulatory capital treatment for derivative contracts under CEM. For example, the industry has raised concerns that CEM does not appropriately recognize collateral, including the risk-reducing nature of variation margin, and does not provide sufficient netting for derivative contracts that share similar risk factors. The agencies intend for the proposed implementation of SA–CCR to respond to these concerns, and to be substantially consistent with international standards issued by the Basel Committee on Banking Supervision (Basel Committee). In addition, requiring an advanced approaches banking organization to use SA–CCR or IMM for all purposes under the advanced approaches would facilitate regulatory reporting and the supervisory

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assessment of an advanced approaches banking organization's capital management program." (Emphasis added.)

The IECA does not take issue with the Prudential Regulators' reasons, which appear to be laudable based on the explanations provided by the Prudential Regulators for various types of derivative contracts.

However, a primary component of the Prudential Regulators' application of the SA-CCR to derivatives contracts involves "differentiating between margined and unmargined derivative contracts"[6] as a means of providing recognition of the value of collateral. The IECA applauds the Prudential Regulators for recognizing the credit risk reducing value of the cash collateral provided in support of "margined" derivative contracts, but the IECA objects to the Prudential Regulators failure to recognize the credit risk reducing value of the bilaterally-negotiated alternative forms of collateral that counterparties provide as credit support for "unmargined" derivative contracts.

The IECA submits that the Prudential Regulators simply must modify the SA-CCR method in the Proposed Rule to address this failure to accurately assess the "credit risk" of a counterparty failing to make a payment when owed under an "unmargined" derivative contract.

As stated by the Prudential Regulators, the purpose of the proposed SA-CCR is to provide a method for determining or measuring the "credit risk" that a counterparty may fail to make a payment when owed to an Advanced Approaches Banking Organization under a "derivatives contract." With respect to a "margined" derivatives contract, the SA-CCR recognizes the reduction in such credit risk arising due to the provision of initial margin and variation margin by a counterparty under a "margined" derivatives contract.

The Prudential Regulators fail to recognize, however, the reduction in such credit risk arising due to the provision of letters of credit, liens on a counterparty's assets, and guarantees provided by investment-grade rated entities within a counterparty's corporate family.

Each of these non-margin forms of credit support have been historically accepted by Advanced Approaches Banking Organizations, both with respect to "derivatives contracts" and with respect to other forms of financial arrangements, including borrowing base credit agreements, project financing, and various other commercial credit agreements.

Energy market participants do not typically post cash as collateral for derivatives contracts or other forms of financial arrangements. Such participants use their cash in their businesses for capital investments, which creates jobs. Moreover, borrowing funds to post cash collateral is expensive.

[6] See, for example, the NOPR, 83 Fed. Reg. 64660, at 64665.

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Not recognizing the counterparty credit risk-reducing impacts of alternative forms of collateral will likely result in the banking organizations requiring energy market participants to post cash or, in lieu of posting cash, the banking organizations will pass along their increased capital costs to the energy market participants, thereby making it much more expensive for energy market participants to hedge their commercial risks. Such an increase may result in energy market participants seeking out less creditworthy counterparties with whom to enter into swaps and other derivative agreements or, worse, electing not to hedge their commercial risks.

The IECA submits that such a result is unjustified when, in fact, energy market participants seldom enter into unsupported uncleared swaps, but instead provide alternate forms of bilaterally-negotiated collateral that genuinely reduces the counterparty credit risk faced by their bank counterparties. Accordingly, implementation of the proposed SA-CCR, as set forth in the NOPR, will cause energy market participants to face an unjustified increase in the cost of hedging, or a reduction in liquidity, based on a false assessment of the counterparty credit risk exposure they present to bank counterparties entering into derivative contracts with such energy market participants.

In addition, entities in the energy industry are less likely to default on payments under unmargined derivative contracts, because such entities are prudently using these derivatives contracts that are financially-settled swap transactions, to hedge their exposure to commercial risk. Put another way, these counterparties are prudently managing their exposure to commercial risk by entering into such derivatives contracts, which makes these counterparties more responsible than other participants in the US economy that choose to ignore commercial risk and not hedge or mitigate those risks.

Moreover, the "right way risk" inherent in the nature of an energy producer or energy consumer hedging its commercial risk generally results in an increase in the value of the energy company's assets at the time that an energy company's bank counterparty is exposed to a payment obligation owed to that bank by its energy company counterparty under a typical swap transaction that properly hedges the energy company's commercial risk. On that basis, a lien on an energy company's assets provided to a bank counterparty in support of a hedging transaction actually increases in value at the time that the energy company owes any amount to its bank counterparty under that hedging transaction.

The "right way risk" of many energy company hedging transactions is often evident from the existence of loan agreements with bank counterparties that require the energy company, as the borrower under such a loan agreement, to enter into hedging swap transactions for a portion of its production or consumption in order to mitigate commercial risks and increase the likelihood that the borrower will have sufficient revenues to make its debt service payments.

Often in such circumstances, the bank counterparties to the derivatives contracts that contain such hedging swap transactions are the same bank counterparties, or their

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affiliates, that are the lender(s) under such loan agreements and the same liens on the energy companies' assets that secure each energy company's obligations under the derivative contracts also secure such energy company's obligations, as a borrower, under its loan agreement with the same bank counterparties.

The fact that such counterparties have provided credit support in the form of letters of credit, liens on a counterparty's physical assets, or a guaranty from an investment-grade rated entity in the counterparty's corporate group should be recognized for the legitimate, bona fide reduction of the Advanced Approaches Banking Organization's "credit risk" arising due to the possible failure by such counterparty to pay an amount when due under a commodity derivative contract.

For all of the above reasons, rather than increasing the counterparty credit risk exposure of bank counterparties, the various forms of alternative collateral described herein truly reduce the counterparty credit risk faced by a bank counterparty and should be recognized as such under the proposed SA-CCR rule. Accordingly, the SA-CCR method set forth in the NOPR should be revised to recognize the counterparty credit risk reduction value of all of the above forms of alternative credit support that are routinely provided as credit support for unmargined derivative contracts.

III. As Proposed by the Prudential Regulators, the Application of SA-CCR Produces a Result that is Directly Contradictory to the Intent of Congress in Enacting the Dodd-Frank Act and its Amendments to the Commodity Exchange Act.

In addition to overstating the counterparty credit risk exposure of banking organizations under their derivatives contracts, the failure of the SA-CCR method to recognize the risk-reducing value of these alternative forms of collateral provided by energy market participants in support of their unmargined derivatives contracts directly contradicts the intent of Congress as contained in the Dodd-Frank Act (DFA) and its amendments to the Commodity Exchange Act (CEA).

Section 2(h)(7)(A) of the CEA (the "End-User Exception") expressly exempts swap transactions that are used to hedge or mitigate the risk of commercial end-users from the mandatory clearing and mandatory exchange trading requirements. Similarly, Section 2(h)(7)(D) of the CEA (the "Hedging Affiliate Exception") expressly exempts swap transactions that are entered into by certain affiliates in order to hedge or mitigate the risk of affiliated commercial end-users that are eligible for the End-User Exception.

In addition to exempting these swaps from mandatory clearing, such swaps are also exempt from the mandatory obligation of swap dealers and major swap participants to post and collect initial and variation margin from uncleared swaps that are eligible for the End-User Exception or the Hedging Affiliate Exception.

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Congress exempted these swap transactions from mandatory clearing, mandatory exchange trading, and mandatory margin posting requirements, because Congress recognized and sought to encourage the continued use of uncleared bilaterally-negotiated swaps to hedge or mitigate the unique risk profiles of commercial end-users. Not only are such swaps allowed to continue to be bilaterally-negotiated, the credit support arrangements supporting such swaps are also allowed to continue to be bilaterally-negotiated.

By enacting the proposed SA-CCR method for use by banks and by refusing to recognize the counterparty credit risk-reducing value of the alternative forms of collateral provided in support of uncleared and unmargined swaps, the Prudential Regulators will very likely increase the cost to commercial end-users and their hedging affiliates of entering into uncleared and unmargined swaps, either by having bank counterparties pass through the higher cost of the capital required to be set aside in the form of higher prices to enter into uncleared and unmargined swaps, or by pricing creditworthy banks out of the market, thereby forcing commercial end-users and their hedging affiliates to enter into swaps with less-creditworthy counterparties.

The IECA submits that rather than following Congressional intent in the Dodd-Frank Act and encouraging the continued availability of uncleared and unmargined swaps to commercial end-users and hedging affiliates seeking to hedge or mitigate commercial risk, the Prudential Regulators are acting directly contrary to the intent of Congress. Instead of authorizing and encouraging the continued access of commercial end-users to the risk-mitigation benefits of hedging their exposure to commercial risk, the Prudential Regulators are artificially making such swaps more expensive and reducing the pool of creditworthy swap providers that commercial end-users and their hedging affiliates can look to as providers of risk-reducing swaps used to hedge or mitigate their exposure to commercial risk.

On this basis alone, the Prudential Regulators should modify the proposed SA-CCR method to recognize the counterparty credit risk-reducing value of the alternative forms of collateral that are provided by commercial end-users and hedging affiliates in support of uncleared and unmargined swaps.

Alternatively, the Prudential Regulators should exempt uncleared and unmargined swaps entered into pursuant to the End-User Exception or the Hedging Affiliate Exception from the application of the proposed SA-CCR rule, so that Advanced Approaches Banking Organizations are exempt from any obligation to set aside additional capital for their uncleared and unmargined swaps for which the other counterparty has elected the End-User Exception or the Hedging Affiliate Exception.

In addition, rather than penalizing such entities as increasing the “credit risk” exposure of an Advanced Approaches Banking Organizations, such entities should be seen as more likely to make any payment when owed to an Advanced Approaches Banking Organization under an unmargined derivative contract that involves a

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financially-settled commodity swap transaction, simply because such counterparties are undertaking prudent risk-management practices by hedging and mitigating their exposure to commercial risk.

For the Prudential Regulators to respond to industry comments that CEM "does not appropriately recognize collateral" by simply differentiating between margined and unmargined derivative contracts and then concluding that the Prudential Regulators will recognize the value of the cash collateral posted with respect to "margined" derivative contracts, while ignoring completely the credit risk reducing value of the various forms of credit support provided by counterparties in the form of bilaterally-negotiated credit support arrangements for unmargined derivatives contracts continues the flawed position taken by the Prudential Regulators in their mandate that regulated financial institutions use CEM.

SA-CCR's failure in the Proposed Rule to recognize the legitimate credit risk reducing value provided by counterparties providing letters of credit, liens on physical assets, and other forms of bona fide credit support with respect to unmargined derivative contracts perpetuates many of the flaws of CEM in that the Prudential Regulators continue their previous failure to appropriately recognize legitimate and bona fide collateral.

The IECA submits that ignoring both the bona fide creditworthiness of such hedging swap counterparties, due to their prudent risk-management practices, and ignoring the legitimate "credit risk" reducing impact of the bilaterally-negotiated credit support (e.g., letters of credit, liens on assets, corporate guarantees from investment-grade related entities within a counterparty's corporate group, etc.) provided by counterparties under such unmargined derivative contracts involving energy commodities is completely unjustified by the analysis provided by the Prudential Regulators in the NOPR.

Moreover, in the case of liens on energy assets, as credit support for an unmargined commodity derivative contract, in most instances, in which such a commodity derivative contract would result in that contract being "in the money" for the Advanced Approaches Banking Organization, the value of the energy commodity owned by the counterparty, on which the Advanced Approaches Banking Organization holds a lien, is likely to have increased in value. Such "right way risk" in terms of the value of the lien increasing at the very time that the counterparty owes a payment under the derivative contract to such Advanced Approaches Banking Organization should not be ignored or considered as increasing the bank's exposure to "credit risk" and, therefore, justifying an increase in the capital to be set aside such bank.

Similarly, for unmargined derivative contracts with Advanced Approaches Banking Organizations that involve physically-settled commodity forward contracts, these energy company counterparties are counting on these contracts for the purchase or sale of energy commodities necessary to the functioning of their energy industry businesses. In making any determination about the counterparty credit risk to banking

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organizations arising from entering into such physically-settled energy commodity derivative contracts, the Prudential Regulators must consider the use to which such derivative contracts are put by the counterparties in order to properly recognize the value of credit support and for determining the credit risk that a counterparty may fail to make a payment when owed under such a derivatives contract.

IV. Lack of Justification for Supervisory Factor of 40 for Energy Commodity Derivative Contracts

Energy market participants regularly use energy commodity derivative contracts to hedge or mitigate risks relating to the underlying physical commodity. SA-CCR imposes a very high supervisory factor of 40 across all power, oil and natural gas energy commodity derivative contracts, which does not take into account the fact that energy contracts tend to be more volatile in the spot month, but much less volatile the further out the forward curve or the maturity of the derivative contract.

While spot month volatility in power prices can be substantial because electricity cannot be easily stored, over time such volatility can be reduced by constructing new power plants to reduce shortages, by constructing new transmission lines to reduce congestion-pricing during peak periods, and by improving battery and other technologies to actually store electric energy. Basel recognizes the inherent risk differences between the different energy asset classes and the variations based on maturity and volatility.

Moreover, trading market volatility is not an appropriate proxy for forward credit risk, particularly when, as discussed above, the energy market participant is an energy company experienced in managing such market volatility and using its swaps transactions with banking organizations to hedge or mitigate its exposure to commercial risk.

The application of this extremely high supervisory factor of 40 to energy commodity derivative contracts will exacerbate the already harmful impacts listed above that arise from the failure of the proposed SA-CCR method to recognize the counterparty credit-risk reducing value of alternative forms of collateral provided in support of uncleared and unmargined swaps.

In addition, we submit that application of this Supervisory Factor of 40 to energy commodity derivative contracts has not been adequately supported by any evidentiary showing or other quantitative analysis by the Prudential Regulators correlating energy commodity derivative contracts, or this Supervisory Factor of 40, to a banking organization's counterparty credit risk arising from energy commodity derivatives contracts.

V. About the IECA.

The 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

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members have actively promoted the development of best practices that reflect the unique needs and concerns of the energy industry.

The IECA seeks to protect the rights and advance the interests of a broad range of domestic and foreign energy market participants, representatives of which make up the IECA's membership. These entities finance, produce, sell, and/or purchase for resale substantial quantities of various physical energy commodities, including electricity, natural gas, oil and other energy-related physical commodities necessary for the healthy functioning of the energy markets and the "real economy". Many of these energy market participants rely on contracts with banking organizations to help them mitigate and manage (i.e., hedge) the risks of physical energy commodity price volatility to their commercial energy businesses, which millions of Americans and the American economy rely on for safe, reliable and reasonably-priced energy supplies.

VI. Communications.

Please direct correspondence concerning these comments to:

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VII. CONCLUSION

The IECA embraces the general premise of all regulatory rulemaking, as embodied in the Administrative Procedures Act, which has been held to require that the agency promulgating a proposed rule must exercise reasoned decision making, supported by substantial record evidence, and an evaluation of the benefits and burdens of a proposed rule to ensure that the benefits of the proposed rule justify its burdens.[7]

The IECA respectfully requests that the Prudential Regulators:

A. With respect to derivatives contracts, recognize not only initial and variation margin, but also recognize the counterparty credit risk reducing value of alternative forms of collateral such as letters of credit, liens on physical assets, and guarantees from investment-grade rated entities in a corporate group that an energy market participant provides to a banking organization in support of uncleared and unmargined derivatives contracts. Revising SA-CCR to recognize such alternative forms of collateral from energy market participants would result in a true determination of the counterparty credit risk exposure to the banking organization.

B. Alternatively, exempt uncleared and unmargined swaps entered into pursuant to the End-User Exception or the Hedging Affiliate Exception from the application of the proposed SA-CCR rule, so that Advanced Approaches Banking Organizations will be exempt from any obligation to set aside additional capital for their uncleared and unmargined swaps in those instances in which the other counterparty has elected the End-User Exception or the Hedging Affiliate Exception.

C. Adjust the Supervisory Factor of 40 for energy commodity derivatives contracts in line with Basel recognition of the inherent risk differences between different energy asset classes and variations based on maturity and volatility and provide a supervisory factor that is truly representative of a banking organization's counterparty credit risk for uncleared and unmargined derivative contracts with commercial end-users and hedging affiliates in the energy industry, as more fully-described above.

[7] Business Roundtable v SEC, 647 F.3d 1144 (D.C. Cir. 2011) (finding the failure of the agency to properly consider the costs and benefits of the rule at issue arbitrary). Although the Board has declined to offer a formal quantitative cost benefit analysis in the Proposed Rule, the IECA believes that such an analysis is appropriate. As noted by Professor Sunstein in a recent paper, "[t]he main virtue of [quantitative cost benefit analysis] is that it focuses attention on the human consequences of regulatory initiatives." Sunstein, Cass R., Cost-Benefit Analysis and Arbitrariness Review (March 20, 2016). Harvard Public Law Working Paper No. 16-12. Available at SSRN: https://ssrn.com/abstract=2752068 (Also noting that "an agency's failure to engage in a degree of quantification, and to show that the benefits justify the costs, will sometimes leave it vulnerable under arbitrariness review.").

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The IECA appreciates the opportunity to provide these Comments to the Prudential Regulators and would welcome the opportunity to discuss these comments further should you require any additional information on any of the topics discussed herein.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

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