INTERNATIONAL ENERGY CREDIT ASSOCIATION

January 16, 2024

Filed by Email or Electronically at: www.federalreserve.gov; www.fdic.gov; and www.regulations.gov

Chief Counsel's Office, Attention Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, DC 20219
Email: regs.comments@occ.treas.gov

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Email: regs.comments@federalreserve.gov

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064-AF29)
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Email: comments@FDIC.gov

Re: Comments of the IECA on: **Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity**, as proposed by: OFFICE OF THE COMPTROLLER OF THE CURRENCY, Treasury, 12 CFR Parts 3, 6 and 32, Docket ID OCC-2023-0008, RIN 1557-AE78; FEDERAL RESERVE SYSTEM, 12 CFR Parts 208, 217, 225, 238, and 252, Docket R-1813, RIN 7100-AG64; and FEDERAL DEPOSIT INSURANCE CORPORATION, 12 CFR Part 324, RIN 3064-AF29; and **Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15),** as proposed by: FEDERAL RESERVE SYSTEM, 12 CFR Part 217, Docket No. R-1814, RIN 7100-AG65

Dear Ms. Misback, Mr. Sheesley 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 notices of proposed rulemaking published at 88 Fed. Reg. 64028

on September 18, 2023[1] (hereinafter, "Basel III Endgame Proposal"),and 88 Fed. Reg. 60385 on September 1, 2023[2] (hereinafter, "GSIB Capital Surcharge Proposal," and collectively with the Basel III Endgame Proposal, the "Proposals").

Background 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 the last 100 years, IECA 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, refined products, hydrogen, ammonia, renewable energy credits, voluntary carbon credits, and numerous other energy-related physical commodities (both tangible and intangible) 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.

I. IECA's Previous Comments to the Prudential Regulators Regarding Proposed Bank Capital Requirements.

The IECA is submitting these comments in support of many of its members who are: commercial end-users of swaps, eligible for either the end-user exception to clearing under Section 2(h)(7)(A) ("End-User Exception") of the Commodity Exchange Act ("CEA") or the hedging affiliate exception to clearing under Section 2(h)(7)(D) ("Hedging Affiliate Exception") of the CEA, and who enter into uncleared bilateral swaps solely for the purpose of hedging or mitigating their exposure to commercial risk. These energy market participants rely on financially-settled uncleared bilateral swaps, with both bank and non-bank swap providers, to hedge such 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.

[1] The deadline for submitting comments on the Basel 3 Endgame Proposal was extended by the Prudential Regulators from November 30, 2023, to January 16, 2024 (see 88 Fed. Reg. 73770, published on October 27, 2023).
[2] The deadline for submitting comments on the GSIB Capital Surcharge Proposal was also extended by the Board from November 30, 2023, to January 16, 2024 (see 88 Fed. Reg. 73772, published on October 27, 2023).

With respect to such uncleared swaps, Congress expressly declared in CEA Sections 2(h)(7)(A) and 2(h)(7)(D) 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 a commercial end-user's exposure to commercial risk that is being hedged or mitigated by such swap.

Such swaps are bilaterally negotiated, typically with large banking organizations, and such swaps are generally supported by various forms of bilaterally-negotiated bona fide forms of credit support, such as letters of credit, liens on a commercial end-user's physical assets (which are typically "right-way risk" assets), a corporate guarantee by an investment-grade rated affiliate, cash margin, or other forms of alternative credit support.

The IECA submitted comments asking the Prudential Regulators to recognize the bona fide credit risk reducing effects of the above "other" forms of credit support in the Prudential Regulators' standardized approach for counterparty credit risk ("SA-CCR") for calculating the exposure amount of derivative contracts under the Prudential Regulators' regulatory capital rule.

On March 18, 2019, the IECA submitted its initial comments ("Initial SA-CCR Comments") to the Prudential Regulators regarding the Prudential Regulators' notice of proposed rulemaking entitled *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64660, published on December 17, 2018 (the "SA-CCR NOPR"). On September 10, 2019, the IECA submitted to the Prudential Regulators a supplemental comment letter ("Supplemental SA-CCR Comments"), as a supplement to its Initial SA-CCR Comments, in order to provide additional comments to the Prudential Regulators in light of the issuance of the related EU CCR Regulation on May 20, 2019, two months after the IECA submitted its Initial SA-CCR Comments.

In its Initial SA-CCR Comments, the IECA acknowledged and applauded the Prudential Regulators' proposed implementation of SA-CCR for appropriately recognizing, in calculating a bank's exposure to counterparty credit risk, the reduction to such a bank's exposure to counterparty credit risk arising from the cash collateral posted by a bank's counterparties to derivative contracts subject to initial and variation margin requirements. The IECA also recognized and appreciated the appropriateness of allowing netting under the Agencies' proposed implementation of SA-CCR as a further recognition of the risk reducing nature of a bank's offsetting obligations under various netting sets of derivative contracts.

The IECA objected, however, to the Agencies' failure to recognize the risk-reducing nature of other bona fide forms of credit support typically provided by a bank's commercial end-user and hedging affiliate (collectively "CEU") counterparties to derivative contracts involving energy commodities that have been given an explicit exemption by Congress and various regulators from the otherwise mandatory initial and variation margin requirements for uncleared over-the-counter swap transactions. The IECA advised the Prudential Regulators that such alternative forms of credit support provided by CEU counterparties produce a no less bona fide reduction of a bank's exposure to counterparty credit risk.

Many CEU counterparties entering into energy commodity derivative contracts with a bank to hedge their exposure to commercial risk, which transactions are therefore exempt from otherwise mandatory clearing and margining requirements, have earned an investment grade ("IG") rating from one or more recognized credit rating agencies. Many times, their direct or indirect parent entities, which are IG-rated, will provide a guaranty of each such CEU counterparty's obligations. In certain situations, an unrated CEU counterparty will be treated by a bank as if it were given an IG-rating by passing a substantial net worth test. In addition, in nearly every energy commodity derivative contract with a bank that is used to hedge a CEU counterparty's exposure to commercial risk, the bank insists on and the CEU counterparty agrees to provide adequate assurance of performance to the bank if the CEU counterparty or its guarantor loses its IG-rating or the CEU counterparty's net worth falls below a substantial level.

Typically, a CEU counterparty lacking an IG-rating (or failing a substantial net worth test) for itself or its guarantor will be required to provide adequate assurance of its performance to a bank in the form of: (i) a replacement guaranty from another IG-rated entity, (ii) a letter of credit from a creditworthy commercial bank, (iii) a lien on "right way risk" assets (i.e., assets that increase in value in proportion to the increase in the amount owed to a bank that is a swap provider, when the bank's position is "in the money" and the bank is exposed to the credit risk of its CEU counterparty defaulting on a payment obligation), or (iv) a cash deposit.

Increasing the costs of hedging will produce adverse impacts on U.S. end-users that rely on such energy commodity derivative contracts to hedge their exposures to commercial risk. Similarly, if one or more banking organizations elected to cease providing energy commodity derivative agreements to CEU counterparties due to the increased capital requirements, that too would adversely affect the liquidity of the markets available for CEU counterparties seeking to hedge their exposure to commercial risk.

Such adverse impacts would include a decline in the financial health of these entities, as financial hedging is a vital component to the health of such U.S. energy commodity derivative contracts end-users. This adverse impact on hedging would lead to liquidity concerns, reduce the ability to do business due to insecurity of commodity prices, and ultimately undermine the capital budget of many U.S. CEU businesses.

We applaud the Prudential Regulators for the following conclusion set forth in the SA-CCR Final Rule:[3]

> "…In addition, and in contrast to derivative contracts with financial end-users, derivative contracts with commercial end-users have heightened potential to present right-way risk.53 The final rule removes the alpha factor from the exposure amount formula for derivative contracts with commercial end-user counterparties. The agencies intend for this treatment to better align with the counterparty credit risk presented by such exposures due to the presence of credit risk mitigants and the potential for right-way risk. In particular, the agencies recognize that derivative exposures to commercial end-user

[3] See *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts,* Final Rule, 85 Fed. Reg. 4362, at 4371, published by the Prudential Regulators on January 24, 2020 ("SA-CCR Final Rule").

counterparties may be less likely to present the types of risks that the alpha factor was designed to address, as discussed previously, and therefore believe that removing the alpha factor for such exposures improves the calibration of SA-CCR. The agencies note that this approach also may mitigate the concerns of commenters regarding the potential effects of the proposal relative to congressional and other regulatory actions designed to mitigate the effect that post-crisis derivatives market reforms have on the ability of these parties to enter into derivative contracts to manage commercial risks." (Emphasis added.)

In sum, the Prudential Regulators agreed in the SA-CCR Final Rule to eliminate any alpha factor for derivative contracts between banks and CEU counterparties (i.e., an alpha factor of 1.0 was applied), which recognized the reduction in a banking organization's credit risk associated with entering into derivative contracts used for hedging or mitigating commercial risk by CEU counterparties. This decision was reasonable and commendable by the Prudential Regulators and for that reason the IECA applauds this portion of the SA-CCR Final Rule.

However, with respect to the commodity supervisory factors, the Prudential Regulators reverted to the Basel Committee Standard (electricity/oil/natural gas: 40/18/18) in the SA-CCR Final Rule. In addition, the Prudential Regulators did not explicitly recognize in the SA-CCR Final Rule the genuine reduction of counterparty credit risk arising from a CEU counterparty's posting of the various forms of bona fide credit support, other than cash margin, provided by CEU counterparties to legitimately mitigate and reduce the credit risk exposure of banking organizations entering into hedging contracts with such CEU counterparties.

In the final sentence of the above-quoted excerpt from the SA-CCR Final Rule, the Prudential Regulators commit to monitoring the implementation of SA-CCR and the effectiveness of the U.S. regulatory capital framework to "determine whether there are opportunities to improve the ability of commercial end-users to enter into derivative contracts with banking organizations in a manner that continues to support the safety and soundness of banking organizations and U.S. financial stability."

The IECA submits that modifying the Basel III Endgame Proposal and the GSIB Capital Surcharge Proposal in accordance with the comments set forth in Section II of these comments presents the Prudential Regulators with an excellent opportunity to rectify the shortcomings in the SA-CCR Final rule and improve the ability of CEU counterparties to enter into derivative contracts with banking organizations in a manner that "continues to support the safety and soundness of banking organizations and U.S. financial stability."

II. IECA's Comments on Prudential Regulators' Basel III Endgame Proposal and GSIB Capital Surcharge Proposal (the "Proposals").

The IECA has reviewed and endorses the Comment Letter on Proposed Rules submitted to the Prudential Regulators by the Coalition of Derivatives End-Users ("Coalition").

More specifically, the IECA endorses the following "Requested Revisions" to the Basel III Endgame Proposal from the Coalition's comments:

Credit Valuation Adjustment (CVA)

> *Requested Revision*: The Coalition urges the Federal Banking Agencies to exempt from CVA-risk-capital requirements: (i) uncleared derivatives transactions with commercial end-users and their associated hedges (a) because of the undue burden imposed on commercial end-users, (b) because increased CVA-risk-capital requirements would be in contravention of public policy objectives designed to support the ability of commercial end-users to engage in derivative transactions for risk-management purposes and (c) to align U.S. capital requirements with those implemented by other jurisdictions; and (ii) client cleared derivatives transactions because there is no CVA risk to large banks in client clearing.

Fundamental Review of the Trading Book (FRTB)

> *Requested Revision*: The Coalition urges the Federal Banking Agencies to make substantive changes to FRTB to avoid the double counting of market risks under the Basel III Endgame Proposal and the GMS component of CCAR[4] or, failing that, to delay the implementation of FRTB until a holistic review has been performed across FRTB and the GMS component of CCAR. In the absence of such substantive changes or a delay in its implementation, the Coalition urges that derivatives with commercial end-users and their associated hedges should be exempt from FRTB's non-modellable risk factor ("NMRF") requirements to avoid undue burden on derivatives end-users.

Determination of "Investment Grade" for Unlisted Corporate Exposures (the "Public Listing Requirement")

> *Requested Revision*: The Coalition urges the Federal Banking Agencies to remove the Public Listing Requirement because it is likely to negatively affect highly creditworthy corporations, agriculture and food processing entities, energy producers, corporate pensions, mutual funds and small and mid-sized businesses, among others, that are not publicly listed, with no corresponding benefit to large banking organizations, and diverges—materially—from the capital requirements implemented by the EU and the UK.

Similarly, the IECA endorses the following "Requested Revision" to the GSIB Capital Surcharge Proposal from the Coalition's comments:

Addition of OTC Derivatives Clearing under the Agency Model to the Complexity and Interconnectedness Indicators of the GSIB Surcharge

[4] Global Market Shock ("GMS") of the Federal Reserve's Comprehensive Capital Analysis and Review ("CCAR").

Requested Revision: The Coalition urges the Federal Reserve not to add OTC derivatives clearing under the agency model to the complexity and interconnectedness indicators of the GSIB surcharge.

III. Communications.

Please direct correspondence concerning these comments to:

Jeremy Weinstein, Esq.
Law Offices of Jeremy Weinstein, PC
1512 Bonanza Street
Walnut Creek, CA 94596
Phone: 925-943-2708
Email: jweinstein@jweinsteinlaw.com

Phillip G. Lookadoo, Esq.
Haynes and Boone, LLP
800 17th Street, NW, Suite 500
Washington, DC 20006
Phone: 202-654-4510
Email: phil.lookadoo@haynesboone.com

IV. CONCLUSION.

The IECA respectfully requests that the Prudential Regulators reconsider their proposed Basel III Endgame Proposal and the GSIB Capital Surcharge Proposal and make certain modifications to implement the "Requested Revisions" to such Proposals as set forth in Section II of these IECA comments.

The IECA respectfully requests that the Prudential Regulators continue, as was done in the SA-CCR Final Rule, to recognize that a banking organization's exposure to credit risk from its uncleared derivative agreements is significantly less when the bank's counterparty is a commercial end-user whose uncleared OTC derivative trading activity is conducted specifically for hedging the CEU counterparty's exposure to commercial risk and not for speculative purposes.

The IECA also requests that the Prudential Regulators take this opportunity to explicitly recognize that the various forms of credit support, other than cash, provided by CEU counterparties, including letters of credit, guarantees from investment grade entities, and liens on "right-way-risk" assets, all have the very tangible benefit of reducing the credit risk to which bank counterparties are exposed from entering into such uncleared derivative agreements with CEU counterparties as commercial risk hedging transactions.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

/s/ Phillip G. Lookadoo
Phillip G. Lookadoo, Esq.
Haynes and Boone, LLP

/s/ Jeremy D. Weinstein
Jeremy D. Weinstein
Law Offices of Jeremy D. Weinstein