May 15, 2017

Via Electronic Submission

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Capital Requirements of Swap Dealers and Major Swap Participants
RIN 3038-AD54

Dear Mr. Kirkpatrick:

I. Introduction

The Edison Electric Institute ("EEI") and the National Rural Electric Cooperative Association ("NRECA") (hereafter "Joint Associations") respectfully submit these comments in response to the Notice of Proposed Rulemaking on Capital Requirements of Swap Dealers ("SDs") and Major Swap Participants ("MSPs") (the "Proposed Regulatory Capital Rules") issued by the Commodity Futures Trading Commission ("CFTC" or "Commission").[1]

EEI is the association of U.S. shareholder-owned electric companies. EEI's members comprise approximately 70 percent of the U.S. electric power industry, provide electricity for 220 million Americans, operate in all 50 states and the District of Columbia, and directly employ more than 500,000 workers. With more than $100 billion in annual capital expenditures, the electric power industry is responsible for one million jobs related to the delivery of power.

NRECA is the national service organization for more than 900 not-for-profit rural electric utilities that provide electric energy to more than 42 million people in 47 states or 12 percent of electric customers. Kilowatt-hour sales by rural electric cooperatives account for approximately 11 percent of all electric energy sold in the United States. Because an electric cooperative's electric service customers are also members of the cooperative, the cooperative operates on a not-for-profit basis and all the costs of the cooperative are directly borne by its consumer-members.

[1] Capital Requirements of Swap Dealers and Major Swap Participants, Notice of Proposed Rulemaking, 81 Fed. Reg. 91252 (December 16, 2016) ("Proposed Regulatory Capital Rules").

The Joint Associations' members are not financial companies or derivatives market professionals, but instead are physical commodity market participants that rely on bilateral physical power and natural gas contracts, and enter into energy commodity swaps or buy futures contracts, to supply customers with reliable electric service and to hedge and mitigate commercial risks that arise from ongoing business operations ("commercial end-users"). The Joint Associations have been active participants in the Commission's rulemakings implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and, in particular, rulemakings related to regulatory capital requirements for SDs, to the extent that such requirements impact commercial end-users, including the Joint Associations' members.[2]

Regulations that make effective risk management opportunities more expensive for commercial end-users in the energy industry, such as the Joint Associations' members, will likely lead to higher energy prices if the costs associated with new regulations are passed through to American businesses and residential energy consumers, or will result in more volatile energy prices if commercial end-users decide to hedge a smaller portion of the commercial risks arising from their ongoing business operations.

The Joint Associations are also concerned that the Proposed Regulatory Capital Rules will have serious consequences for our members' ability to find counterparties for physical energy supply and commercial risk hedging transactions. The Joint Associations' members need liquid, efficient, and competitive physical commodity and commodity derivatives markets to hedge exposure to commercial risks arising from ongoing operations, including commodity price risk. The Joint Associations' members rely on bank SDs and non-bank SDs as counterparties to energy commodity forward contracts, commodity trade options and energy commodity swaps. Non-bank SDs (which will be subject to the Commission's Proposed Regulatory Capital Rules) are an important part of this market liquidity, particularly in regional energy markets and for longer-term physical commodity and customized commercial risk hedging swaps. Such non-bank SD counterparties will become more important if bank SDs continue to reduce their participation in particular physical commodity and related derivatives markets, such as natural gas and electricity markets, in light of increased regulatory costs and complexity. Accordingly, the Joint Associations and our members have a direct and significant interest in the NOPR.

Joint Associations respectfully request the Commission to revise the Proposed Regulatory Capital Rules to reflect the lower risk associated with non-cleared swaps with commercial end-user counterparties, as well as to protect the value of the end-user exception to clearing.

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[2] NFP Electric Associations at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission5_121410-0017.pdf, and EEI/EPSA/NFP Electric Associations at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=47753&SearchText=).

II. Comments

Congress added new Section 4s(e) to the Commodity Exchange Act ("CEA"), authorizing the Commission to establish regulatory capital rules (and margin rules) for non-bank SDs that enter into swaps "with respect to their activities as a swap dealer." See Section 4s(e)(2)(B). In establishing such regulatory capital rules, CEA Section 4s(e)(2)(C) directs the Commission to take into account activities conducted by the SD other than its swap dealing activity. And, Section 4s(e)(3)(A) of the CEA states that capital requirements for SDs that enter into non-cleared swaps as part of swap dealing activities must "help ensure the safety and soundness of the swap dealer" and must also "be appropriate to the risk associated with the non-cleared swaps" held by the SD.[3]

Section 4s(e)(3)(D) directs the Commission, to the maximum extent practicable, to establish and maintain comparable minimum capital requirements (and margin requirements) for non-cleared swaps with the prudential regulators that supervise bank SDs (the "Prudential Regulators").[4] The Prudential Regulators' regulatory capital rules apply various market and credit risk weightings and categories based on the type of instrument, contract or transaction to which the bank SD is a party, and also provide flexibility based on the counterparty type and the regulated financial institution's overall relationship with the counterparty. There is not a single risk measure, or incremental quantitative regulatory capital risk weighting, applicable to all (or all uncleared) financial and physical commodity swap transactions to which the prudentially-regulated financial institution or holding company is a party, or to all uncleared swaps that are not 100% cash-margined.

In its Final Rule on Margin Requirements for Uncleared Swaps (the "Final Margin Rules"),[5] the Commission established initial and variation margin requirements for SDs and MSPs ("Covered Swap Entities") transacting in non-cleared swaps with other SDs, MSPs or "financial end-users." The Commission did not require SDs to collect cash margin from, or post cash margin to, swap counterparties that are not "financial end-users."[6] Those counterparty credit risk decisions were left to the business judgment of the individual SD.

In the adopting release for its Final Margin Rules, the Commission recognized that counterparties that are not financial end-users are generally using swaps to hedge or mitigate commercial risks. Such counterparties and such commercial risk hedging swaps pose less risk to Covered Swap Entities. The Commission indicated that "under section 4s(e)(3)(A)(ii) of the

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[3] CEA Section 4s(e)(3)(A)(ii).

[4] CEA Section 4s(e)(3)(D).

[5] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, Final Rule and Interim Final Rule, 81 Fed. Reg. 636 (January 6, 2016).

[6] *See* Id. at 648, 678.

CEA, applying a different standard to trades by CSEs with nonfinancial entities than to trades by CSEs with covered counterparties would be "appropriate to the risk."[7]

The Joint Associations respectfully request that the Commission follow this same reasoning in the Proposed Regulatory Capital Rules. Commercial end-users in the energy industry generally enter into energy commodity swaps to reduce risks that arise from ongoing business operations, not to initiate or incur additional risk. The likelihood of a default by a commercial end-user on a swap between a SD and that commercial end-user is low, because any losses associated with the end-user swap will typically be offset by a positive change in the position or commercial risk associated with the end-user's underlying business that is being hedged (*i.e.*, when an end user's swap exposure increases, the hedged exposure usually decreases proportionally). Congress also recognized that such risk-reduction transactions do not pose systemic risk.[8] The Joint Associations support the Commission's proposal in the NOPR to allow each SD under its jurisdiction to choose from three approaches for determining its minimum capital level, based on the characteristics and principal business activities of the non-bank SD.[9] This tailored regulatory approach is consistent with CEA Section 4s(e)(2)(C), which directs the Commission to take into account commercial business activities conducted by the non-bank SD other than its swap dealing activity.

However, the Joint Associations are concerned that the Proposed Regulatory Capital Rules nonetheless continue a one-size-fits-all approach to evaluating and assigning risk weightings to uncleared swap transactions (or positions) being measured against such minimum regulatory capital levels. The NOPR requires SDs to include all uncleared swaps, including swaps that may not be part of the SD's swap dealing activity as part of a single bucket of assets to which risk weightings are to be applied. The proposal also requires SDs to include all uncleared swaps, even those that are excluded or exempt from the scope of the Commission's Final Margin Rules, in a single bucket and to apply a single regulatory risk capital weighting measured by the amount of "uncleared swap margin" (which is defined in Proposed Regulations 23.100) held by the non-bank SD.[10]

A SD may conduct a variety of activities in a particular industry, and enter into swaps as part of the commercial business activity that is not subject to the Commission's regulation of the entity as an SD. For example, an energy commodity merchant that is registered as a SD may also have interest rate, currency and energy commodity swaps that hedge or mitigate risks associated with its ongoing business operations. A SD may also have other business

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[7] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, Proposed Rule, advance notice of proposed rulemaking, 79 Fed. Reg. 59898 (October 3, 2014) at 59906.

[8] 156 Cong. Rec. H5244-45 (daily ed. Jun. 30, 2010) (statement of Rep. Peters) ("[B]ecause 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.")

[9] Proposed Regulatory Capital Rules at 91245.

[10] Id. at 91310.

relationships with a commercial end-user in the energy industry that is a counterparty to the SD's swap dealing activities, and for which the SD (and its counterparty) has no requirement to hold (or post) cash margin. For example, the SD may be primarily a natural gas producer or an electricity generator in a particular region, and sell the commodity underlying the swap to, purchase it from or ship it for the commercial end-user counterparty. The two entities may have assets located in the same or adjacent geographic areas, and therefore share other commercial contract or credit or market risk mitigating relationships. Just as a Prudential Regulator allows a bank under its regulatory jurisdiction to assign different regulatory capital risk weightings to classes or categories of transactions with a particular group or type of counterparties, non-bank SDs should have the flexibility to assign different risk weightings to different types or particular commercial counterparties, or to specific classes of swaps or types of commercial risk hedging transactions.[11] The Commission's Proposed Regulatory Capital Rules should protect commercial end users from higher direct *and indirect* costs, and from losing access to non-bank SD counterparties for commercial risk hedging transactions, particularly in illiquid, regional energy markets for long-term, customized swap transactions. Congress did not intend rules promulgated under the Dodd-Frank Act to be a burden or impose costs on commercial end-users of swaps, particularly those entitled to exercise an end-user (or other) exception to clearing swaps used for commercial risk management purposes.[12] It follows that Congress did not intend commercial end-user swap counterparties to bear the same, or even a portion of, the regulatory costs of Dodd-Frank Act rules by ***indirectly*** requiring SDs to maintain the same regulatory capital levels for all uncleared swaps, or for all such swaps for which the SD does not hold margin. The Proposed Regulatory Capital Rules should be tailored to measure only swaps that comprise part of the SD's swap dealing activity (as contemplated by CEA Section 4s(e)(2)), to exclude uncleared swaps for which margin is not required under the Final Margin Rules from the swaps for which a single risk weighting is assigned, and to allow SDs (and MSPs) to assign significantly lower risk factors to commercial end users and commercial risk hedging transactions where the SD or MSP has other commercial relationships with such end-user.

III. Conclusion

Joint Associations appreciate the opportunity to submit comments in response to the Proposed Regulatory Capital Rules, and encourage the Commission not to apply a single incremental risk weighting to all swaps held by the SD or MSP, or to all unmargined swaps. Accordingly, in determining compliance with regulatory capital requirements, the Commission should allow SDs and MSPs to apply lower risk factors for swaps with commercial end user counterparties for which an exclusion or exception to clearing and cash margining rules are available. This flexibility would be consistent with the tailored, risk-based regulatory capital

[11] Each non-bank SD's credit and market risk-weighting model will be unique to its industry, its commercial business activities and assets owned in addition to its swap dealing activities, and its overall commercial enterprise risk tolerances.

[12] As Senator Dodd emphasized, "[i]t is…the intent of this bill to distinguish between commercial end users hedging their risk and larger, riskier market participants. Regulators should distinguish between these types of companies when implementing new regulatory requirements." 156 Cong. Rec. S5901 (daily ed. Jul. 15, 2010)(statement of Sen. Dodd).

requirements applicable to SDs regulated by the various Prudential Regulators for swaps and other financial and commercial transactions with commercial end-user counterparties or customers, including non-cleared swaps for which no cash margin or other collateral is held or posted.

Respectfully submitted,

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