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Via Electronic Submission
Office of the Comptroller of the Currency ("OCC")
Board of Governors of the Federal Reserve System ("FRB")
Federal Deposit Insurance Corporation ("FDIC")
Federal Housing Finance Agency ("FHFA")
Farm Credit Administration ("FCA") (collectively with the above, the "Prudential Regulators")
Commodity Futures Trading Commission ("CFTC" or "Commission")

RE: The following proposed rulemakings pertaining to margin requirements:

I. **Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564 (May 11, 2011) (the "Prudential Regulators' NPRM")**
   - OCC - Docket No. OCC-2011-0008, RIN 1557-AD43
   - FRB - Docket No. R-1415, RIN 7100 AD74
   - FDIC - RIN 3064-AD79
   - FCA - RIN 3052-AC69
   - FHFA - RIN 2590-AA45

II. **Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (April 28, 2011) (the "CFTC Margin Requirements NPRM")**
   - CFTC - RIN 3038-AC97

Dear Sir/Madam:

The Commodity Markets Council ("CMC") thanks the Prudential Regulators and the CFTC for the opportunity to provide comments on this important topic.

CMC is a trade association bringing together commodity exchanges with their industry counterparts. The activities of our members represent the complete spectrum of commercial users of all futures markets. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange, and New York Mercantile Exchange. CMC is uniquely positioned to provide the consensus views of commercial end-users of derivatives exchanges and the exchange markets. Our comments below represent the collective view of the CMC's members.

These comments address the following two proposed rules, which together implement the capital and margin requirements applicable to Swap Dealers ("SDs") and Major Swap Participants ("MSPs") as defined in the Dodd-Frank Act ("Dodd-Frank" or "the Act"):
I. The Prudential Regulators' proposed margin and capital requirements for covered swap entities; and
II. The CFTC's proposed margin requirements for uncleared swaps for SDs and MSPs.

The Prudential Regulators' proposed rule applies to bank SDs and bank MSPs whereas the CFTC's proposed rule applies to non-bank SDs and non-bank MSPs. While the rules share many similarities, there are significant differences between them. Given that the Prudential Regulators and the CFTC must statutorily make their margin requirements comparable to the greatest extent possible, CMC submits these combined comments on the two proposed rules, though the comments are divided into separate sections that focus on each rule.

At the outset, this letter does *not* address an issue of great importance to CMC - affiliate swaps transactions. The CMC's concerns about the potential impact of proposed rules on affiliate transactions are covered in a separate letter to the CFTC by the CMC, the Commercial Alliance, and the Energy Working Group sent on July 8, 2011. In addition, CMC is a co-signer on two letters with the Coalition for Derivatives End-Users, which were sent respectively to the CFTC and the Prudential Regulators on July 11, 2011 and which pertain to the proposed rules on margin requirements, where this topic is addressed in significant detail. Our deliberate omission of that topic from this letter should not be construed as an indication of the importance - or lack thereof - of this topic to CMC.

In conformance with the Dodd-Frank Act, the proposed rules acknowledge that the margin rules must be risk-based, appropriate for the risk associated with the non-cleared swaps held at SDs and MSP (collectively Covered Swaps Entities, or "CSEs"). To conform to Congressional intent, the rules should protect the stability of the U.S. financial system but at the same time preserve the flexibility of market participants and not unnecessarily tie up capital that drive and sustain job growth and productive investment in the national economy. In this respect, the lack of significant risk to the U.S. financial system attributable to the swaps activities of nonfinancial end users requires that the proposed rules allow for flexibility in the credit arrangements between CSEs and nonfinancial end users with respect to their swaps. The following comments address this broad concern in more detail with respect to each of the proposed rules.

I. COMMENTS ON THE PRUDENTIAL REGULATORS' PROPOSED RULE

A. The Prudential Regulators' Proposed Rule Must be Modified to Allow the Use of Noncash Collateral by Nonfinancial End Users.

The Prudential Regulators' proposed rule contravenes the Act and Congress' clear and express intent by not allowing the use of noncash collateral by nonfinancial end users to meet initial and variation margin requirements with respect to uncleared swaps with CSEs. However, in spite of their recognition of the "minimal risks that nonfinancial end users pose to the safety and soundness of covered swap entities and U.S. financial stability," the proposed rule contravenes the Act by not allowing nonfinancial end users to post noncash collateral to satisfy their margin requirements, instead imposing a "one-size-fits-all" requirement requiring that CSEs accept only cash or certain highly liquid debt obligations as collateral. The proposed rule's effective prohibition of the use of noncash collateral by nonfinancial end users unnecessarily constrains the ability of such end users and their counterparty CSEs to tailor their credit support arrangements to transaction- and counterparty-specific business risks in the most efficient way possible. Moreover, limiting the types of allowed collateral will disproportionately affect nonfinancial end users, whose balance sheets are typically comprised of less liquid assets such as physical plants, equipment and property.

An example of a type of collateral that is allowed as margin for futures is warehouse receipts. These negotiable bearer certificates are titles to commodities owned in store at a licensed warehouse. CMC believes that this is one example of a type of collateral that should be allowed as margin for swaps transactions as well, especially because it relates directly to the commodity underlying the swaps position.

More broadly, Congress provided an end user exception to the mandatory clearing requirement in order to ensure that hedging does not become prohibitively expensive to end users as a tool for managing their commercial risk. Accordingly, Congress provided the end user exception from mandatory clearing, partly so that end users could enter into uncleared swaps with customized credit support arrangements that allow for the use of letters of credit and other commonly used forms of noncash collateral. However, the proposed rule's prohibition on the use of noncash collateral by nonfinancial end users would erode that flexibility, thereby threatening to unnecessarily tie up working capital from beneficial uses.

In addition, the CFTC's rule differs from the Prudential Regulators' rule in that the former does *not* prohibit the use of noncash collateral with respect to SDs' and MSPs' uncleared swaps with nonfinancial

end users. This approach appears most consistent with the intent of the Act. We therefore request that the Prudential Regulators modify their proposed rule to also permit the use of noncash collateral by nonfinancial end users.

Finally, the Prudential Regulators' suggested alternative to allowing nonfinancial end users to post noncash collateral does not reduce the already limited risk under the CSE's credit processes - it merely shifts it elsewhere within the banking system. The NPRM suggests that, in lieu of being able to post noncash assets to banks that are SDs or MSPs as collateral for uncleared swaps, nonfinancial end users should instead pledge such assets to different banks - or perhaps even the same banks but under separate arrangements - as collateral for secured loans, and then draw cash from such loans to satisfy the collateral requirements for their uncleared swaps. But this simply moves the potential market and liquidity risk associated with the noncash assets from one bank (*i.e.*, the bank SD or bank MSP counterparty, which is likely to be well-positioned to value the collateral if it regularly transacts swaps in the relevant industry), or one arrangement with a bank, to another. Moreover, such an extra step imposes transaction costs that could be otherwise avoided.

Additionally in this context, in the case of end users that typically pledge real property as collateral for a swap, these entities may be limited in their ability to pledge their property as collateral to a margin lending facility because of the terms of the property's financing. While many lenders are willing to allow a borrower to pledge the same property as collateral on a swap used to hedge the interest rate risk of a loan secured by that property, pledging that property as collateral for a margin lending facility may violate the loan's restrictions against indebtedness.

As such, the proposed prohibition of noncash collateral with respect to nonfinancial end users does not represent reasoned decision making, does not adhere to the Act or Congressional intent, and does little to nothing to protect U.S. financial stability. This is yet another reason the Prudential Regulators' proposed rule should be modified to permit the use of noncash collateral by nonfinancial end users.

B. The Proposed Rule Reduces the International Competitiveness of American Firms.

Imposing margin requirements that are disproportionate to crisis-level loss experience will undermine the ability of American companies to compete effectively with foreign competitors. Senate Agriculture Chairman Stabenow and Ranking Member Roberts acknowledged this when they urged regulators to accept end user concerns, "so that [end users'] costs of risk management allow them to remain competitive."

No other G-20 nation has discussed or proposed a comparable margin requirement on end users, nor did the G-20 leaders mandate an end user margin requirement in Pittsburgh. Notably, in Europe, the European Market Infrastructure Regulation ("EMIR") proposed by the European Commission ("EC") and the current European Parliament and European Council texts do not include a margin requirement for nonfinancial end users, except for end users whose derivatives use poses systemic risk. For example, the EC text states that entities that require central clearing would have to have "appropriate exchange of collateral or capital requirements" for uncleared derivatives. The EU's approach is important in two respects. First, the legislative text focuses on entities that have a mandatory clearing requirement, namely financial entities and non-financial entities with positions that exceed a clearing threshold. Second, the legislative text comports with the CMC's view that capital requirements adequately address the systemic risk related to uncleared derivatives without needing a duplicative margin requirement. In light of the EU's approach, a U.S. margin requirement undoubtedly disadvantages U.S. companies against their European competitors.

C. The Extraterritorial Scope of the Proposed Margin Rule is Detrimental to U.S. Businesses.

As the Prudential Regulators rightly point out, numerous questions surround the extra-territorial reach of the margin regulations. The questions posed by the Prudential Regulators include the following:

- the "permissible territorial scope of the proposed rule;"

- the possibility of subjecting transactions to "multiple, potentially conflicting, margin requirements" established by U.S. and foreign regulators; and
- the potential distortion of "competitive equality among" U.S. and foreign covered swap entities.

To this list, CMC suggests adding several more questions and concerns from end users about extra-territoriality. In particular, we urge the Prudential Regulators to clarify the potential for liquidity, price transparency, and availability of credit to be undermined by the proposed rule. We also believe that more information is needed about the uncertain statutory authority and applicability of the margin rule in foreign jurisdictions.

As proposed, few exceptions exist to the rule's extra-territorial reach. The proposed margin rule could touch almost every transaction, including transactions between entities with extremely tenuous ties or potential to affect the United States. Applying the proposed margin rule in this broad manner to foreign jurisdictions is unnecessary. Foreign covered swap entities will already have foreign capital, regulatory, and governance requirements. Overlapping and potentially conflicting regulations from multiple jurisdictions applying to the same swap may result. The compliance issues could also have a deleterious effect on the ability of end users to administer effective and efficient risk management programs.

U.S. companies that compete globally may have foreign branches, or foreign incorporated subsidiaries that hedge commercial risks. Historically, these foreign branches or subsidiaries have enough dealer counterparties to transact with, including foreign SDs and foreign branches or subsidiaries of U.S. SDs. Having access to a range of dealer counterparties provides multiple benefits - including more liquidity and more competition - which improves the cost of hedging. The extraterritorial application of the proposed margin rule would diminish access to a robust pool of pricing sources and market participants, including U.S. SDs operating a foreign branch or U.S. SDs operating a foreign incorporated subsidiary. This will reduce liquidity and market competition, leading to a potential decrease in price transparency and worse pricing than available today.

II. COMMENTS ON THE CFTC'S PROPOSED MARGIN REQUIREMENTS RULE

A. CSEs Should Not be Required to Hold Initial Margin at Independent Third-Party Custodians.

The CFTC's proposed margin requirements rule should be modified by deleting the provisions requiring CSEs to hold initial margin from other CSEs at independent third-party custodians because there is no statutory authority for such a requirement. Congress identified and provided for one limited circumstance under which a CSE should be required to hold margin at a third-party custodian, and that is where the CSE's counterparty requests that its margin be held in a segregated account. Congress could have provided broader circumstances under which collateral must be held with a third-party custodian, but it did not. As such, the Commission should preserve the option of counterparties to avoid the transaction costs resulting from requiring CSEs to identify, monitor, and transfer funds to and from independent third-party custodians.

B. The Commission Must Give CSEs Sufficient Time to Develop and Implement the Models Required to Comply with the Proposed Margin Requirements Rule.

The Commission must give CSEs sufficient time to comply with the proposed rule's modeling requirements for calculating initial margin with respect to uncleared swaps. The Commission's proposed rule requires CSEs to either develop and implement sophisticated models for the calculation of initial margin for such swaps, or identify the cleared swaps or futures most closely resembling the uncleared swaps and apply certain multipliers to the derivatives clearing organizations' (DCOs) initial margin amounts for the identified proxies. However, some SDs and MSPs may have tens of thousands of swaps open at any given time. The development and application of the required models, or the identification of cleared products to use as proxies, for such a large number of swaps promises to be a

monumental task. Moreover, to avoid market disruptions, end users will require adequate lead time to evaluate and consider the effects of the methods selected by the SDs and MSPs before they are applied. For these reasons, the CMC requests that market participants be afforded a necessary adjustment time period before the final rule becomes effective.

C. High Margin Requirements Distort the Incentive to Use Standardized Swaps.

CMC is concerned that the proposed rule will create artificial incentives for companies to use standardized hedges, even if these hedges are not the most effective way to manage underlying commercial risks. Currently, companies weigh the trade-offs between standardized hedges that may be more efficiently priced, and customized hedges that are specifically tailored to address a company's idiosyncratic risks. Economic incentives that deter companies from using tailored products will create at least two adverse consequences. First, companies will be exposed to basis risk between their desired customized hedge and the standardized hedge that they actually use to hedge their commercial risk. Second, companies will realize accounting volatility from the economic mismatch created by the basis risk.

In particular, CMC believes that the proposed margin rule creates an economic incentive for end users to abandon customized hedges in favor of standardized hedges because standardized hedges will have lower margin costs overall. Financial and nonfinancial end users will face higher margin costs for uncleared swaps because the proposed margin rules will lead to increased bilateral transactions costs. For example, the requirement to execute credit support arrangements for every counterparty relationship and the initial margin requirements imposed on swap dealers will each impact end-user costs.

D. The Proposed Rule Attempts to Eliminate Risks in General Instead of Focusing on Systemic Risks.

The Act's margin provisions rightly focus on regulating systemic risk related to SDs and MSPs. The structure of the Act's margin provisions indicate that Congress intended regulators to focus on systemic risk as a primary criterion for establishing margin requirements. By their terms, these sections apply only to entities that pose systemic risk to the financial system: SDs and MSPs.

The financial crisis was closely associated with the failure of systemically significant institutions that had accumulated excessive risks through their transactions with other systemically significant institutions. CMC believes that the Commission should respect Congress's specific focus on systemic risk and should not divert its attention to end-user hedging activities.

Congress correctly recognized that end users' use of derivatives to hedge or mitigate their commercial risks did not cause the financial crisis. Moreover, Chairman Bernanke has commented: "The [Federal Reserve] Board does not believe that end users other than major swap participants pose the systemic risk that [the Dodd-Frank Act] is intended to address." Also, historical evidence and available data simply do not support the contention that commercial end users contribute to systemic risk in the markets. The latest market activity report from the Bank for International Settlements ("BIS") confirms that nonfinancial end-users represent only 8.4 percent of the OTC derivatives market. This small portion of the market is spread across tens of thousands of end users, making any individual end users' exposure very small relative to the overall market and making it extremely unlikely that an end user could cause a CSE to fail.

In light of the evidence, requiring any margin collection from end users would be for the purpose of shoring up the safety and soundness of CSEs whose systemic risks arise from their transactions with other CSEs, not from transactions with end users. This is equivalent to instituting a financial subsidy for CSEs, funded by end users.

CMC thanks the Prudential Regulators and the CFTC in anticipation of your attention to our comments. If you have any questions or would like to discuss further, please do not hesitate to contact me via email at christine.cochran@commoditymkts.org or via phone at (202) 842-0400 - ext. 101.

Regards,

Christine Cochran
President