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February 15, 2019

VIA E-MAIL

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street SW, Suite 3E-218
Washington, D.C. 20219

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

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Re: Comment to Notice of Proposed Rulemaking – Standardized Approach for Calculating the Exposure Amount of Derivative Contracts [Docket ID OCC-2018-0030; Docket No. R-1629 and RIN 7100-AF22; RIN 3064-AE80]

By notice of proposed rulemaking published in the Federal Register on December 17, 2018, the Office of the Comptroller of the Currency (the “OCC”), the Board of Governors of the Federal Reserve System (the “Board”), and the Federal Deposit Insurance Corporation (the “FDIC”, together with the OCC and the Board, the “Prudential Regulators”) proposed revisions to the required method for calculating counterparty credit risk exposure for certain banks under their derivatives contracts (such notice of proposed rulemaking, the “NOPR”).¹

The Coalition of Physical Energy Companies (“COPE”)² is concerned that if the regulatory changes proposed in the NOPR result in increased capital requirements for banks tied to un-margined derivatives positions with end-users, that would cause the banks to increase transaction fees for end-users and could tighten liquidity in markets that COPE members depend on for hedging and risk mitigation. COPE asks that the Prudential Regulators consider these potential negative and unintended consequences of the NOPR and, if warranted, adjust the proposed regulations in order to mitigate those consequences and avoid unduly burdening derivatives end-users.

¹ *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64,660 (Dec. 17, 2018).

² The members of COPE are: Apache Corporation; Avangrid Renewables, LLC; Kinder Morgan, Inc.; Shell Energy North America (US), L.P.; SouthStar Energy Services LLC; and Targa Resources Partners LP.

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The members of COPE are physical energy companies in the business of producing, processing, transporting, storing, and/or marketing energy commodities at retail and wholesale. COPE members generally use swaps, futures, and other derivatives in conjunction with their physical businesses, most typically for hedging. COPE members routinely enter into derivatives transactions with financial institutions subject to the oversight of the Prudential Regulators in order to hedge risks arising from commodity price, currency, and interest rate fluctuations.

Through the NOPR, the Prudential Regulators have proposed replacing the Current Exposure Method (“CEM”), which is currently used in calculating counterparty credit risk exposure and certain other metrics that factor into the capital requirements of certain regulated financial institutions, with a modified version of the standardized approach for counterparty credit risk (“SA-CCR”) developed by the Basel Committee on Banking Supervision.

COPE members have only recently begun studying this highly complex NOPR and reviewing its potential effects on their bilateral hedging counterparties’ capital requirements. COPE has not fully calculated the likely effects of the proposed shift from the CEM to the modified SA-CCR methodology proposed in the NOPR. However, COPE members have been made aware of concerns (including but not limited to those raised by their hedging counterparties that would be subject to the regulatory changes) that the NOPR could result in significant increases to banks’ capital requirements based on SA-CCR calculations of risk and exposure arising from bilateral derivatives positions that are not offset by cash margin or other cash collateral. If these increased capital requirements are indeed mandated as a consequence of the proposed changes, COPE members are concerned that their bank counterparties would increase transactions costs for derivatives transactions without cash margin and/or limit such trades going forward, thereby reducing much needed liquidity in the commodity, currency, and/or interest rate derivatives markets.

COPE members are engaged in physical businesses that are subject to commodity price volatility as well as interest rate and currency exchange fluctuations. They also typically maintain strong balance sheets and hedge their price and other risks with bilateral swaps that are backed by solid credit and physical assets. COPE members do not typically post cash margin to cover counterparty exposure in hedging transactions, since cash margin ties down capital that is more efficiently used to invest in, develop, and grow their physical business operations. In COPE’s experience, under the CEM method of calculation banks have been able to successfully evaluate potential exposure and risk arising from COPE members’ hedging positions by taking into account the value of non-cash collateral, physical asset liens, and strong balance sheets and credit profiles. COPE believes that any changes to the required method for calculating counterparty credit risk and risk weighted assets for banks must continue to appropriately account for the non-cash assets and credit profiles of derivatives end-users.

To the extent that the NOPR proposals would limit banks’ ability to take these features into account in the calculations relevant to their capital requirements, COPE members are concerned that the proposed changes would have the unintended consequence of limiting physical companies’ ability to hedge risks with derivatives by causing banks to pass through increased capital requirements to counterparties,

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through increased fees and transaction costs and/or pulling back from bilateral derivatives transactions. COPE notes that in crafting their regulations on margin collection requirements for Covered Swap Entities as part of the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Prudential Regulators appropriately exempted transactions with nonfinancial end-users that are hedging risk from mandatory margin collection requirements.³ If implemented as proposed, the changes outlined in the NOPR could undermine that result and cause banks to significantly increase the cost of hedging transactions with end-users.

COPE members are not alone in raising these concerns about the NOPR, and COPE requests that concerns of all derivatives end-users be fully considered by the Prudential Regulators. COPE members and other counterparties of regulated financial institutions require liquid and predictable derivatives markets to hedge risks that arise in the ordinary course of their businesses. Otherwise, the increased costs of those risks would be passed along to consumers of the energy products including power, natural gas, and motor fuel that COPE members help make available to consumers every day. COPE respectfully asks the Prudential Regulators to carefully tailor any changes to the methodology for banks' capital requirement calculations to avoid unintentionally increasing the costs and decreasing the liquidity of the bilateral derivatives market that COPE members depend on to hedge their commercial risks.

Respectfully submitted,

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cc: COPE Members

³ *Margin and Capital Requirements for Covered Swap Entities*, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Farm Credit Administration, and Federal Housing Finance Agency, 80 Fed. Reg. 74,840, 74,844 (Nov. 30, 2015).