January 16, 2024

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219

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

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

Via Agency Website

Re: ***Comment Letter on Proposed Rules: "Large Banking Organizations and Banking Organizations with Significant Trading Activity" (OCC Docket Number OCC-2023-0008 (RIN 1557-1557-AE78); Board Docket No. R-1813 (RIN 7100-AG64); FDIC RIN 3064-AF29); and "Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; System Risk Report (FR Y-15)" (Board Docket No. R-1814 (RIN 7100-AG65))***

Arena Energy, LLC ("Arena Energy" or the "Company") is pleased to respond to the requests for comments in connection with the notice of proposed rulemaking titled "Large Banking Organizations and Banking Organizations with Significant Trading Activity" (the "Basel III Endgame Proposal"); and "Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; System Risk Report (FR Y-15)" (the "GSIB Surcharge Proposal" and, together with the Basel III Endgame Proposal, the "Proposals").[1]

Founded in 1999, Arena Energy quickly became a trusted name in oil operations and management of gas field properties and is one of the largest independent operators in the Gulf of Mexico, focusing on pursuing lower-risk prospect opportunities. The Company invests approximately $250-300 million dollars in capital per year to produce (i) low-emission, (ii) safe, and (iii) low-cost oil and natural gas in the shallow waters of the Gulf of Mexico. Over the past twenty-four years, the Company has safely drilled more than 350 wells, with a success rate exceeding 94 percent. In everything we do, the Company prioritizes the health, safety, and welfare of its

[1] 88 Fed. Reg. 64028 (Sept. 18, 2023) (Basel III Endgame Proposal); 88 Fed. Reg. 60385 (Sept. 1, 2023) (GSIB Surcharge Proposal).

employees and contractors, environmental responsibility, and responsible financial stewardship as our paramount concerns.

Arena Energy, similar to other large oil and gas companies, use derivatives to efficiently manage price risks and ensure consistency and stability in earnings forecasts. Given that producers are unable to determine the price for its products and that oil and gas prices have a historically cyclical nature, the implementation of a successful capital budget can be difficult without the controlled use of derivative products. Arena uses derivatives to help ensure they will be able to meet their business operations and plans, while also reducing earnings volatility from commodity price swings. The advantages of using derivatives as a hedging tool extend beyond the advantages to Arena Energy. Indeed, the benefits of hedging business risks extend to American consumers; this is because hedging fosters increased stability and reduced expenses in the production and provision of goods and services. Further, hedging to manage risk lowers costs of goods and services, drives greater investment in innovation and job creation, and promotes broader market discipline.

We are a signatory to the comment letter submitted by the Coalition for Derivatives End-Users (the "Letter") and share the concerns set forth in that letter. The Proposals fail to consider the harm they will subject to end-users of derivatives and the U.S. economy. Federal Reserve Governor Michelle W. Bowman has raised concerns that the Proposals' increased capital requirements would "have a tangible effect on banking activities and may have a detrimental impact on U.S. market liquidity and lending." Further, an analysis conducted by Oliver Wyman and Morgan Stanley estimates that if the Proposals pass in their current form, there could be "a reduction of up to 23% (~$40 Billion) in wholesale banking revenue."[2] We expect the Proposals will result in two materially adverse impacts on end-users: (i) substantial cost increases flowing to consumers for everyday necessities; and (ii) reduced capacity for end-users like Arena Energy to hedge commercial risks because the costs to hedge those risks will rise, likely significantly, resulting in greater price volatility.

Specifically, Arena Energy is concerned with the following aspects of the Proposals:

Credit Valuation Adjustment ("CVA"). The Basel III Endgame Proposal would mandate the calculation of CVA capital of all counterparties holding CVA-covered positions, without any exemptions. This adds another layer to existing capital requirements and also contradicts current legislative and regulatory measures. As a result, the CVA adjustment will harm end-users because (1) increased capital requirements make it more likely that large banks reduce their offerings of hedging transactions, and (2) there is a lack of options that provide commercial end-users with a bespoke approach to derivative transactions, undermining legislative relief granted to commercial end-users under the final SA-CCR rule and via margin clearing exemptions. Arena Energy urges the Federal Banking Agencies to exempt derivatives transactions with corporates, pension funds, insurance companies, and other commercial end-users (and their associated hedges) from CVA-risk-capital requirements.

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[2] *Into the Great Unknown for Wholesale Banking*, Morgan Stanley and Oliver Wyman at 6, *available at*, https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2023/nov/Morgan-Stanley-Oliver-Wyman-Wholesale-Banking-Report-2023.pdf.

Non-Modellable Risk Factor ("NMRF"). The NMRF component of the Basel III Endgame Proposal raises capital requirements for customized derivative hedging transactions used by commercial end-users—including Arena Energy—to mitigate risks. Arena Energy asks that the Federal Banking Agencies exempt any NMRF requirement for transactions involving commercial end-users and associated hedges.

GSIB Surcharge Proposal. The GSIB Surcharge Proposal poses a significant increase in the capital requirements for the derivatives clearing businesses of large banking organizations. This proposal will create barriers for end-users in accessing cleared OTC derivatives services—running up the cost while cutting the availability. This directly affects end-users, compelling companies to put aside more funds to continue their hedging activities. Given the well-established understanding that hedging by commercial end-users contributes to economic stability in the United States and the broader global financial system, the heightened cost of hedging for these entities ultimately translates into increased expenses for consumers. Arena Energy urges that the Federal Reserve continue to exclude OTC client cleared transactions from the complexity and interconnectedness indicators of the GSIB surcharge.

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The above discussion—along with the points raised in the Coalition for Derivatives End-Users Letter—identifies specific areas of concern, as well as recommendations, with respect to the structure of the Proposals. Arena Energy urges the Federal Banking Agencies to redraft the Proposals in a manner that takes a more holistic approach to market risk and corporate exposure.

Derivatives end-users, like Arena Energy, would be materially harmed due to the heightened costs that large banks would inevitably pass on to end-users. Further, these Proposals would trigger a cascade of unintended consequences. These costs include end-users withdrawing their money from capital markets and their customers withdrawing from capital market activities altogether.

Thus, the Company asks that the Federal Banking Agencies withdraw and rethink the Basel III Endgame Proposal and GSIB Surcharge Proposal, keeping in mind the end-user concerns discussed above.

Sincerely,

J. Michael Vallejo
President & Chief Financial Officer
Arena Energy, LLC