November 15, 2010

Mr. Scott D. O'Malia, Commissioner
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Subject: **Segregation of Client Funds for Cleared Swaps under Section 724 of the Wall Street Reform and Consumer Protection Act (the "Act")**

Dear Commissioner O'Malia:

On behalf of the coalition of energy end-users who have signed this letter, thank you for your letter of November 3, 2010 seeking our input on implementation of the Act's collateral segregation provisions. The energy end-users in the coalition make extensive use of swaps to manage the commercial risks associated with their businesses. While our associations do not have sufficient information to respond to all of your questions at this time, based on discussions with members since receiving your letter, the coalition believes the collateral segregation models discussed at the CFTC's October 22, 2010 roundtable could significantly increase end-users' costs of participation in the swaps markets.

As an initial matter, the potential cost increases associated with some of the collateral segregation models discussed at the roundtable underscores the importance of properly exempting energy end-users from the Act's mandatory clearing requirement, as consistent with Congressional intent. In general, because of the physical and illiquid nature of their asset bases, energy end-users can be particularly sensitive to the kind of increased cash margin requirements that may result under some of the proposed segregation models. Congress's goal in providing the end-user exemption to the mandatory clearing requirement was "to protect end-users from burdensome costs associated with margin requirements and mandatory clearing."[1] As such, the increased costs likely to result under some of the collateral segregation models discussed at the roundtable highlights the need for the CFTC to exempt energy end-users from the mandatory clearing requirement. To do so, the CFTC must properly define the terms "swap dealer" and "major swap participant" quickly in upcoming rulemakings.

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[1] Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Colin Peterson 2 (June 30, 2010) (the "Dodd-Lincoln Letter").

With respect to the models discussed at the roundtable and mentioned in your letter, the coalition believes that the existing omnibus model has served the derivatives market well in protecting against both individual and systemic risk while allowing transaction costs to remain at a reasonable level. This model has multiple layers of protection, between the futures commission merchants ("FCMs"), derivatives clearing organizations, capital and margin requirements, credit reviews, existing segregation requirements, default funds, etc. As was pointed out several times at the roundtable, this system performed well in protecting U.S. customers from the effects of the Lehman bankruptcy during the onset of the global financial crisis—a rather severe test. Along those lines, energy end-users—who were not among those responsible for the financial crisis and whom Congress intended to spare from burdensome costs under the Act—should not be subject to the increased costs that might result from switching away from a model with a proven track record.

The energy end-users have reservations with respect to the mandatory individual account model discussed at the roundtable. As you pointed out in your letter, ICE and CME estimated that initial margin costs could increase significantly (rising by approximately 63% and 50-100%, respectively) under this model. As mentioned above, energy end-users can be particularly sensitive to such cash margin requirements because of their relatively illiquid asset base. While the large number of energy end-users that voluntarily clear today might continue to do so in spite of such increased transactional costs, such costs could, in fact, discourage some end-users from clearing or from continuing to participate at the same level in the swaps markets.

That said, the coalition is generally supportive of providing for additional choice in the market. Therefore, all things being equal, the coalition would be supportive of FCM flexibility to offer individual segregated accounts as an option while still allowing market participants to continue to operate under the omnibus model. However, several commenters at the roundtable raised important concerns regarding such an optional individual account model resulting in the same increased costs as the mandatory individual account model. Therefore, the market options mentioned in your letter and at the roundtable, such as clients becoming FCMs themselves or purchasing tailored insurance products, may be more efficient means of offering the additional protection sought by certain market participants. As such, the CFTC should consider the availability of such market options as it seeks to implement a rule that will best serve the market.

To summarize, the coalition of energy end-users views it as essential that the transaction costs associated with the collateral segregation requirements be kept at a reasonable level. The current omnibus model has achieved this goal while protecting against both individual and systemic risks. While the coalition is generally supportive of providing additional choice in the market, including the provision of an individual account option, the coalition is concerned about the cost impacts the individual account model might have, even if implemented only as an option. In that regard, it is worth remembering that the Act was primarily adopted to address systemic, not individual risk, and that other available market tools could address the added individual protections sought by certain market participants. Finally, the potential for cost increases associated with implementation of the various segregation models highlights the importance of the CFTC adhering to Congressional intent in properly exempting end-users from the mandatory clearing requirement, allowing them to retain flexibility to manage their individual risks as best suits their businesses.

Sincerely,

Natural Gas Supply Association
American Gas Association
Edison Electric Institute
Electric Power Supply Association
Independent Petroleum Association of America
Southwestern Energy