September 14, 2011

Mr. David Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: RIN No. 3038-AD00 -- Comments in Response to Commissioner O'Malia's Letter Requesting Public Comment on Swap Clearing Determinants (July 28, 2011)

Dear Secretary Stawick:

The Agricultural Retailers Association ("ARA"), American Gas Association ("AGA"), American Public Power Association ("APPA"), Commodity Markets Council ("CMC"), Edison

Electric Institute ("EEI"), Electric Power Supply Association ("EPSA"), National Corn Growers Association ("NCGA"), National Rural Electric Cooperative Association ("NRECA"), Natural Gas Supply Association ("NGSA") and The Fertilizer Institute ("TFI") submit the following in response to Commissioner O'Malia's July 28, 2011 letter requesting public comment on the manner in which the Commodity Futures Trading Commission ("CFTC" or "Commission") should determine which swaps to subject to the mandatory clearing requirement.

On July, 26, 2011, the Commission issued the final rule regarding the **Process for Review of Swaps for Mandatory Clearing**. The rule establishes procedures for determining whether a derivatives clearing organization ("DCO") is eligible to clear swaps, as well as the process that DCOs must follow when submitting a swap to the CFTC for determination as to whether the swap is suitable for clearing. Regrettably, NCGA and NGSA's request of June 3, 2011 for regulatory certainty regarding the treatment of illiquid long-term swaps for purposes of the clearing mandate was deemed out of scope by the Commission in the final rule.

Commissioner O'Malia's letter highlights the fact that the way the Commission will interpret the statutory criteria in determining which uncleared swaps it will subject to a clearing mandate remains unresolved, even though the Commission has issued a final rule regarding the process for determining swaps for mandatory clearing. In the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), Congress established several criteria for determining whether a swap is sufficiently standardized to be suitable for clearing, including the central criterion "trading liquidity," i.e., the existence of markets where such swaps can be bought or sold with relative ease.[1] In a previous filing, NCGA and NGSA asked the Commission to clarify that the liquidity test for identifying swaps subject to mandatory clearing should be based on the full term of the swap agreement, rather than a portion of the term. Thus, if sufficient liquidity is not present for the full term of the agreement, the swap should not be subject to mandatory clearing.[2]

A company's ability to efficiently hedge operational and financial risk *increases* the amount of capital the business can use for investment.[3] Efficient hedging is accomplished through a portfolio of hedging tools that may include both cleared and uncleared swaps. The efficiency of a hedge portfolio stems from the cost of the hedge and precision in matching the hedging tool with the risk the tool is intended to offset. Thus, hedging efficiency is diminished if the variety of cost-effective hedging instruments is unnecessarily limited.

Commodity producers and consumers often use long-term uncleared swaps to manage the operational and financial risks in a long-term investment such as an energy infrastructure project that may take years to construct. In the early years of the term of the swap, the market for similar, shorter-term swaps may be very liquid; however, the liquidity can decline significantly in the later years because few entities have need or the ability to enter into long-dated swaps in that particular commodity. Further, a long-term swap will not have the same price as the sum of

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[1] *See* CEA § 2(h)(2)(D)(ii)

[2] NGSA also previously raised this concern in pre-filing comments submitted to the Commission in September 2010.

[3] Kenneth A. Froot, David S. Scharfstein and Jeremy C. Stein, "A Framework for Risk Management," *Harvard Business Review* (November – December 1994):

multiple swaps with shorter terms. Thus, breaking a swap into shorter-term, more liquid pieces will result in an economic outcome that is different than that negotiated by the parties. Market participants are unlikely to enter into transactions if they are uncertain that the prices they negotiate are going to be changed in the clearing process. The Commission could eliminate this uncertainty by adopting a guideline that liquidity will be evaluated based on the full term of the swap.

Congress recognized that required clearing of illiquid swaps would be inefficient and harmful to the market. Likewise, the Federal Reserve Bank of New York January 10, 2010 Staff Report titled *Policy Perspectives on OTC Derivatives Market Infrastructure* acknowledged that a more restrictive menu of exchange-traded derivatives would limit end user ability to obtain derivatives that are customized to specific needs. The report continues by explaining that an end user's inability to hedge effectively can lead businesses to avoid investment in projects with uncertain cash flows. Further, "without the opportunity to use the over-the-counter ("OTC") derivatives market [such as uncleared swaps] as an incubator for new financial products, the development of many new types of derivatives would be stifled, limiting the potential for financial innovation to spur economic growth."[4]

Referring to government investment in infrastructure development, the October 11, 2010 Department of the Treasury and Council of Economic Advisers report on infrastructure investment cited a recent Congressional Budget Office finding that "additional investment in infrastructure is among the most effective policy options for raising output and employment."[5] If government investment in infrastructure is an effective policy option for raising output and employment, it stands to reason that policies that facilitate business investment in infrastructure are also effective policy options for raising economic output and employment.

To make certain long-term investment decisions, market participants need confidence in the availability and cost of risk management tools. Where swaps are illiquid by virtue of their long terms, even greater reason exists to not subject them to mandatory clearing because doing so would create a disincentive for long-term investment in the economy. While the statute is clear that trading liquidity is a factor that the Commission must consider in determining swaps subject to mandatory clearing, regulatory uncertainty regarding the manner in which liquidity will be considered in this process persists and must be resolved.

Agricultural and energy producers and consumers make long-term investment decisions that contribute billions of dollars annually into the U.S. economy. These investment decisions are facilitated by many risk management tools including long-term, uncleared swaps and sound balance sheets. We look forward to working with the Commission to establish guidelines regarding the manner in which the Commission will determine which swaps to subject to the mandatory clearing requirement. Regulatory certainty regarding the treatment of illiquid swaps is crucial and necessary for continued business investment.

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[4] Darrell Duffie, Ada Li and Theo Lubke,"Policy Perspectives on OTC Derivatives Market Infrastructure" *Federal Reserve Bank of New York Staff Report No. 424* (January 2010): 9.
[5] "An Economic Analysis of Infrastructure Investment," A Report Prepared by the Department of the Treasury with the Council of Economic Advisers (October 11, 2010): 5.

Respectfully submitted,

Agricultural Retailers Association
American Gas Association
American Public Power Association
Commodity Markets Council
Edison Electric Institute
Electric Power Supply Association
National Corn Growers Association
National Rural Electric Cooperative Association
Natural Gas Supply Association
The Fertilizer Institute