May 15, 2017

VIA ONLINE SUBMISSION
Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20581

RE: **Capital Requirements of Swap Dealers and Major Swap Participants Notice of Proposed Rulemaking** – RIN 3038-AD54

Dear Mr. Kirkpatrick,

The National Corn Growers Association ("NCGA") and the Natural Gas Supply Association ("NGSA") submit the following comments in response to the Commodity Futures Trading Commission ("CFTC" or "Commission") December 2, 2016 Notice of Proposed Rulemaking for capital requirements of Swap Dealers and Major Swap Participants ("Proposal"). References made herein to the Commodity Exchange Act (the "CEA") refer to that statute as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act" or the "Act").

The CFTC's capital requirements rules must conform to the Dodd-Frank Act and to Congress's intent in passing the Act. Further, the Act requires that the rules be risk-based—that is, that they "help ensure the safety and soundness" of Swap Dealers ("SDs") and Major Swap Participants ("MSPs") (collectively, "Covered Swap Entities" or "CSEs")[1] while being "appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant."[2]

[1] Bank SDs and MSPs are covered swap entities with respect to the Prudential Regulators' proposed rule. Non-bank SDs and MSPs are covered swap entities with respect to the CFTC's proposed rules. These comments will refer to both groups interchangeably as "covered swap entities" or "CSEs," which should be interpreted in context of the particular rule or rules being discussed.
[2] *See* CEA § 4s(e)(3)(A).

Regulations implementing the Dodd-Frank Act's capital requirements should be drafted consistent with the language of the statute and with congressional intent regarding mitigation of systemic risk and avoidance of unnecessarily tying up capital from beneficial forms of investment.

Overly conservative or poorly-sized capital requirements for non-bank CSEs unnecessarily diverts capital from productive uses, by requiring those dollars to be set-aside and kept out of mainstream circulation. The diversion of capital away from productive investment, such as investments made to produce a commodity, raises commodity costs for consumers. Regulatory-imposed capital requirements are akin to a clearing mandate in that they create a demand for capital and then sideline that capital from productive use. An unnecessary increase in capital requirements would come at the expense of increased investment in the economy and commodity production.

Although very few NGSA members and no NCGA members are non-bank CSEs that would be directly affected by the Commission's Proposal, the indirect impact of capital requirements on end users and commodity markets is significant. **Inappropriately sized capital requirements expose market participants to unforeseen risk if they are too low or they sideline capital away from productive investment and raise risk management costs as well as the cost of capital for *all* market participants if the capital requirements are too high.** In addition, the Swap Dealer *de minimis* threshold adjustment remains outstanding, so while there are few non-bank CSEs today, a change in the *de minimis* threshold or a change in underlying commodity prices could very easily sweep additional entities into regulation by the CFTC as non-bank CSEs. Therefore, assuring the right approach to non-bank CSE capital requirements is of paramount importance to non-bank CSE as well as end users.

The Proposal raises a significant number of questions that must be answered to preserve the flexible use of capital by end users in the corn, natural gas and other industries that drive and sustain our national economy. Diverse portfolios and robust counterparty credit evaluations and collateral requirements are integral to fiscal health. Non-bank SDs and MSPs did not cause the financial crisis, are not supported by the federal treasury and thus do not pose a systemic risk. The policy discussion needs to be about ensuring liquidity so that market participants have a choice in risk management counterparties. Cost-effective hedging must be maintained. Key to that is a process for appropriately sizing regulatory capital requirements for non-bank CSEs that recognizes the unique characteristics they bring to the risk management market.

NCGA and NGSA recognize the dramatic improvements in the Proposal since the Commission's initial capital requirements proposal nearly six years ago. Nevertheless, important changes are still needed to ensure better alignment between the Commission's non-bank CSE capital regulations and the underlying businesses of non-bank CSEs. The Proposal seems to assume that non-bank CSEs rely on elaborate, bank-like models to model risk. Instead, companies in the physical commodity business are very different from banks. For instance, non-bank CSEs generally have significant physical inventory and plant assets, and they generally *do not* hold deposits or make loans. As such, risk management practices are very different for a

non-bank CSE, yet they are tried and true, allowing non-bank CSEs to effectively manage their risk. Bank risk models are not necessarily appropriate for non-bank CSEs.

The proposed rule provides three options for quantifying the capital requirements for a non-bank CSE. One of those options, the tangible net worth approach, is only available to entities that are "predominantly engaged in non-financial activities." This limitation does not consider the role of swap dealers that are primarily involved in financial activities, but that involvement stems from the needs of a predominately physical corporate parent. Central hedging affiliates and treasury affiliates are examples. Centralizing financial functions into a single subsidiary provides efficiencies for some holding companies that are primarily involved in non-financial businesses, such as energy production or agriculture. Thus, if an entity that is a swap dealer and is embedded in a larger holding company that is not financial, it should have the freedom to choose between the full range of means to establish its capital requirements. **Non-bank CSE capital requirements rules should be corporate structure neutral**. Accordingly, NCGA and NGSA recommend that when applying the "predominantly engaged in non-financial activities" criteria, the CFTC should consider the type of business activity (financial vs. physical) conducted by the ultimate parent of the swap dealer, not just the swap dealer itself.

Another issue is that while the Proposal would allow a non-bank CSE to build a model from scratch, the regulatory process for CFTC approval of the company-specific model makes this approach an arduous task, irrespective of the cost and time commitment involved. For this reason, non-bank CSEs are likely to gravitate to one of the ill-fitting models that will not recognize important differences that non-bank CSEs bring to the market (i.e., end users looking to hedge risk) – differences such as physical inventory, plant assets and strong balance sheets. End users benefit from a market that offers the counterparty diversity provided by the robust participation of non-bank CSEs. Thus, capital requirements for non-bank CSEs need to be based on models that reflect the business risks of companies in the physical commodity business. Applying a bank capital model to a non-bank CSE is likely to overstate the non-bank CSE capital requirement because value of the assets and physical inventory would not be reflected. At a minimum, a bank model would result in an ill-fitting capital requirement that risks sidelining too much capital.

To conform to Congressional intent, **capital rules should protect the stability of the U.S. financial system but, at the same time, preserve the flexibility of market participants without unnecessarily directing capital away from productive uses** that drive and sustain the national economy. The lack of significant risk to the U.S. financial system attributable to the swaps activities of non-bank CSEs, and the capital-intensive nature of these businesses necessitate that the proposed rules allow for flexibility and efficiency in the credit arrangements. Specifically, capital rules for non-bank CSEs must allow the use of unencumbered cash to be considered part of a non-bank CSE's capital base even when the cash is swept up into a corporate omnibus account and held overnight at a financial institution. This is a common practice among commercial firms to optimize the returns on that cash and improves the utilization of capital.

As the costs incurred by swap dealers are likely to be passed through to commercial hedgers and end users in one form or another, NCGA and NGSA members are interested in

ensuring any additional costs that the rule imposes on non-bank CSEs are offset by tangible benefits. Two parts of the proposed rule where benefits may not justify the costs to market participants and consumers are 1) the frequency of the production of financial statements, and 2) the requirements related to the use of U.S. Generally Accepted Accounting Principles (GAAP) for the production of financial statements that are to be submitted to the Commission.

First, the frequency of the production of financial statements provided to the Commission should be commensurate to the non-bank CSE's risk, which in the case of non-bank CSE's is low. NGSA and NCGA recommend that -- 1) the requirement for monthly financial statements be eliminated all together for non-bank CSE, 2) the disclosure deadline for quarterly financial information be extended from 10 to 15 days, and 3) annual audited financial statements should not be required until 90 days after the end of the fiscal year. This aligns the CFTC requirements with standard practices for non-financial companies and Securities and Exchange Commission requirements.

Second, the Proposed Rule's requirement that all CSEs file financial reports using GAAP does not account for the fact that while some CSEs are domiciled in the U.S., they may be a part of an international holding company that uses International Financial Reporting Standards (IFRS) to produce financial statements. The CFTC should permit CSEs that have an ultimate parent that prepares its financial statements under IFRS to meet their CFTC reporting obligations using IFRS. In addition to internationally-held CSEs, privately-held CSEs may not use GAAP. Thus, the Commission should allow privately-held, non-bank CSEs to submit financial statements prepared in accordance with other recognized accounting standards with a public disclosure of the accounting method used. Importantly, the financial statement submission requirements should evolve as global financial reporting standards emerge and must reflect the size, location, operating characteristics and global presence of the non-bank CSEs. **Reporting requirements must not become a barrier to entry into the market for non-bank CSEs.**

Although the Proposal contemplates capital requirements for CSEs, end users and consumers are profoundly impacted by changes in the level of working capital in the economy. The unnecessary sidelining of capital away from productive use in the economy raises commodity costs for consumers. In short, it diverts capital that could otherwise be invested in the production of the commodity, increases the cost of hedging and risk management and decreases market liquidity by raising the cost of participation in the market. Capital requirements that are out-of-step with the risk they seek to mitigate undermine liquidity by elevating a barrier to entry and concentrating risk over a smaller number of market participants.

Industries with physical assets must retain their ability to cost-effectively trade derivatives. Non-bank CSEs offer important counterparty diversity in the market. End users benefit from a variety of choices when selecting a counterparty for risk management transactions. A robust market with diversity among potential counterparties is the most cost-effective way to mitigate systemic risk. The Commission's rules must allow efficiency in risk management markets.

Founded in 1957, the National Corn Growers Association represents more than 40,000 dues-paying corn farmers nationwide and the interests of more than 300,000 growers who

contribute through corn checkoff programs in their states. NCGA and its 49 affiliated state organizations work together to create and increase opportunities for corn growers.

Established in 1965, NGSA represents integrated and independent companies that produce and market approximately 40 percent of the natural gas consumed in the United States. NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. customers.

Because of the potential for regulations implementing the Dodd-Frank Act to unnecessarily limit the hedging tools available to corn producers and participants in the natural gas industry and the potential for the regulations to impede what is and has been a healthy, competitive, and resilient natural gas market, NCGA and NGSA played an active role in the shaping of the Act during its passage and wish to continue this role in ensuring the Act's successful implementation.

NCGA and NGSA appreciate the opportunity to provide these comments. Should you require further information, please do not hesitate to contact NCGA's Sam Willett at 202-628-7001 or NGSA's Jenny Fordham at 202-326-9317. We look forward to working with you.

Sincerely,

National Corn Growers Association
Natural Gas Supply Association