Natural Gas Supply Association

September 29, 2017

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

RE: Project KISS, RIN 3038-AE55

Dear Mr. Kirkpatrick:

By this letter, the Natural Gas Supply Association ("NGSA") respectfully submits comments in response to the U.S. Commodity Futures Trading Commission's (the "CFTC's" or "Commission's") Request for Information, Project KISS ("Keep it Simple Stupid"), 82 Fed. Reg. 21494 (May 9, 2017), as corrected 82 Fed. Reg. 23765 (May 24, 2017). NGSA welcomes the Commission's agency-wide review of its rules, regulations and practices in connection with Project KISS to make them simpler, less burdensome, and less costly and appreciates this opportunity to respond to the Commission's solicitation for related suggestions from the public.

NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets, thus encouraging increased supply and the reliable and efficient delivery of natural gas to U.S. customers. Founded in 1965, NGSA is the only Washington, D.C.-based trade association that focuses on producer/marketer issues related to the downstream natural gas industry.

As producers and suppliers of natural gas, NGSA members would not invest in the growth of the physical natural gas markets if they did not believe the market exhibited three key principles of health—integrity, transparency, and efficiency. NGSA believes that its suggestions in this response to Project KISS further promote these principles and respectfully requests that the Commission consider and implement these suggestions.

COMMENTS

NGSA has been actively engaged in commenting on the CFTC's many rulemakings implementing the swap regulatory regime under the Dodd-Frank Act and appreciates the many areas in which the CFTC has listened to industry concerns in developing and refining its regulatory requirements to work in a manner that is consistent with and non-detrimental to functioning markets. However, given the size and complexity of the regulatory regime, there remain numerous areas where the Commission can further refine and streamline its rules to better accomplish the requirements of the Act while removing unnecessary regulatory burdens and costs on market participants and improving market and regulatory transparency and efficiency.

I. Swap Reporting Rules Should Be Streamlined to Eliminate or Reduce Requirements That Impose Substantial Burdens But Provide Little or No Benefit.

The various reporting requirements applicable to swaps constitute some of the most significant regulatory obligations under the Commission's swap regulatory regime. Several of these requirements impose substantial compliance burdens and liability risks to market participants with seemingly little or no incremental benefit to the Commission or the public. Therefore, NGSA requests that the Commission consider the following suggestions regarding current swap reporting requirements.

A. The Large Trader Reporting Requirements Are Duplicative of Swap Data Reporting Requirements and Should Be Eliminated With Respect to Swaps.

The large trader reporting ("LTR") requirements under Part 20 of the CFTC's regulations are duplicative of the CFTC's swap data reporting requirements and should therefore be eliminated with respect to swaps—to remove unnecessary compliance burdens. These burdens are significant and include: identifying paired swaps and swaptions in counterparty accounts; consolidating positions across accounts based on ownership and control rules; and daily reporting. Moreover, the reporting involves a set of data elements that essentially replicates data that is already reported to swap data repositories ("SDRs") and therefore available to the Commission. Therefore, the Commission should eliminate the LTR requirements with respect to all swaps and instead obtain the relevant data from swap data reporting.

B. The Swap Data Reporting Requirements Impose Unreasonably Short Deadlines That Should Be Extended.

As for the swap data reporting requirements under Part 45 of the CFTC's regulations, the deadlines that apply to such reporting requirements under the existing regulations are unreasonably short and should be extended. With respect to creation data, primary economic terms and confirmation data must typically be reported within two hours or less by swap dealers ("SDs") and within 24 business hours by non-swap dealers.[1] With respect to continuation data, "life cycle events" such as novations must often be reported on the same day by swap dealers or on the next business day by non-swap dealers.[2]

These short turnaround times are a significant challenge to achieve, even under normal circumstances, but can be virtually impossible to satisfy when technological problems arise, which are unavoidable over the long run. As a result of such technological problems, market participants have been forced at times to delay transactions—simply for the purpose of waiting until technological fixes become available. The prevalence of these problems suggests that the existing deadlines are simply too short, and NGSA questions whether such short turn-around times actually provide any value, particularly when applied to non-bank swap dealers and end users transacting in energy and other physical commodity markets. Therefore, NGSA requests that the Commission work with market participants to implement more reasonable deadlines in connection with its swap data reporting requirements.

C. The Real Time Reporting Requirements Are Unnecessarily Burdensome, and Provide Price Information of Questionable Value, and Should Therefore Be Eliminated.

The real time swap reporting requirements under Part 43 of the CFTC's regulations should, like the LTR requirements with respect to swaps, be eliminated altogether because they impose substantial additional burdens while providing questionable additional value. Although real time swap reporting is intended to provide up-to-date pricing data to the public, the data publicized is of questionable value, and unable to be meaningfully relied upon, because important factors affecting price, such as credit risk premium, are not discernible from reported data. Meanwhile, the "real time" nature of the requirement imposes significant administrative burdens and costs on reporting parties. Therefore, NGSA recommends that the Part 43 real time reporting requirements be eliminated.

D. The Commission's No-Action Relief Regarding the Reporting of Inter-Affiliate Swaps Should Be Clarified and Codified.

In CFTC Letter No. 13-09,[3] the Commission provided no-action relief to non-swap dealers/major swap participants ("non-SDs/MSPs") from the Part 45 and

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[1] 17 C.F.R. § 45.3(c), (d).

[2] 17 C.F.R. § 45.4(d)(1).

[3] CFTC Letter No. 13-09, No-Action Relief for Swaps Between Affiliated Counterparties That Are Neither Swap Dealers Nor Major Swap Participants from

Regulation 50.50(b) reporting requirements for "intra-group swaps" between certain corporate affiliates. NGSA agrees that this relief is warranted and useful. As the Commission acknowledged in the letter, "such intra-group swaps are used only for managing risk within a corporate group, and therefore do not increase overall systemic risk or warrant the same reporting requirements as external swaps."

However, with respect to non-SDs/MSPs that enter into intra-group swaps with foreign affiliates, the sixth condition in the no-action letter undermines the relief granted by arguably requiring such foreign affiliates to report swaps that they enter into with unaffiliated foreign counterparties to an SDR:

> All swaps entered into between either one of the affiliated counterparties and an unaffiliated counterparty (regardless of the location of the affiliated counterparty) must be reported to an SDR registered with the Commission, pursuant to, or as if pursuant to, parts 43, 45, and 46 of the Commission's regulations.

Such swaps would otherwise be non-jurisdictional and outside the scope of the Commission's reporting requirements. To keep all market participants on a level playing field and avoid inadvertently imposing what amount to additional and non-jurisdictional requirements on certain market participants, the Commission should clarify that the sixth condition only applies to swaps that are otherwise reportable under the Commission's reporting requirements.

In addition, the Commission should codify the no-action relief in Letter No. 13-09, as well as Letter No. 14-144[4] and other letters that have been relied upon in the marketplace for long periods of time without ill-effects. Codification into formal rules will provide helpful regulatory certainty to market participants and clean up what has become an archaic hodge-podge of regulations and no-action letters in which market participants must become and remain versed (which represents a daunting learning curve for new end users or those expanding their business into new hedging activities).

Certain Swap Data Reporting Requirements Under Parts 45, 46, and Regulation 50.50(b) of the Commission's Regulations (Apr. 5, 2013).

[4] CFTC Letter No. 14-144, No-Action Relief from the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates (Nov. 26, 2014).

II. Documentation and Recordkeeping Requirements Should Be Streamlined to Eliminate Unnecessary Burdens.

A. The Commission Should Eliminate the Documentation Requirements for Book-Outs of Excluded Forward Contracts.

The Commission should eliminate the documentation requirements associated with book-outs of excluded forward contracts in physical commodities, to preserve the benefit of the forward contract exclusion that Congress provided to end users in the Dodd-Frank Act. Commercial end users in the natural gas and other physical commodity markets routinely rely on the use of book-outs to simplify the scheduling of physical delivery and other administrative burdens associated with the settlement of physical transactions. The Commission acted appropriately in extending the Brent Interpretation safe harbor to book-outs in this regard, allowing the underlying transactions and related settlements by book-out to remain exempt from swap regulation under the forward contract exclusion. In this regard, the Brent Interpretation includes adequate safeguards to ensure that book-outs are not abused, by requiring that: (i) the booked-out contracts contain binding delivery obligations; and (ii) the applicable counterparties regularly make or take delivery of the referenced commodity in the ordinary course of their business.[5] These requirements effectively ensure that booked-out transactions satisfy the one requirement that Congress established for the forward contract exclusion—that such transactions are "intended to be physically settled."[6]

However, the Commission effectively added a regulatory burden to such excluded contracts by requiring that market participants document the book-out as a subsequent, separately negotiated agreement and follow up any such book-out made orally with a written confirmation (in a commercially reasonable time frame).[7] Such documentation is unnecessary where the underlying physical delivery requirements are binding—in such instances, book-outs can only effectively happen via subsequent, separately negotiated agreements (although the negotiation may obviously be minimal given the routine nature and mutual convenience of book-outs among market participants in liquid markets). Given the relative frequency of book-outs in such markets, the documentation requirement becomes a significant administrative burden. The CFTC should therefore remove such burden by eliminating the documentation requirements imposed on book-outs in its Product Definitions Rule.

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[5] *Further Definition of "Swap," et al.*, 77 Fed. Reg. 48208, 48228-30 (Aug. 13, 2012) (the "Product Definitions Rule").

[6] Commodity Exchange Act § 1a(47)(B)(ii), 7 U.S.C. § 1a(47)(B)(ii).

[7] Product Definitions Rule, 77 Fed. Reg. at 48230.

B. The Commission Should Narrow the Applicability of Its Recordkeeping Requirements Under Regulation 1.35.

The Commission should narrow the applicability of its recordkeeping requirements under Regulation 1.35, which are overbroad and potentially impose onerous recordkeeping requirements on unregistered end users and swap dealers with businesses in physical commodities who execute transactions directly on swap execution facilities ("SEFs") for their own accounts. Regulation 1.35(a)(6) requires an unregistered member of a SEF to keep all "transaction records." This is an expansive requirement, considering that "transaction records" include "full, complete, and systematic records (including all pertinent data and memoranda) of all transactions relating to its business of dealing in commodity interests *and related cash or forward transactions*" as well as all "original source documents" (documents on which trade information is originally recorded).[8] While end users are required to keep "full, complete, and systematic records" with respect to swaps under Part 45 of the Commission's regulations, their physical transactions (which constitute their primary business) are ordinarily not subject to such burdensome requirements. Similarly, Regulation 1.35(a)(2) requires members of SEFs who are registered as swap dealers to also keep all such transaction records, *plus* all written pre-trade communications, which adds substantially to their recordkeeping requirements under Part 45 and Part 23.

The fact that an end user or a swap dealer with a business in physical commodities might execute some swaps for its own account on a SEF, requiring it to become a "member" to enjoy such trading privileges, should not subject it or its otherwise-excluded physical transactions to these additional burdensome requirements under Regulation 1.35. To do so will either unfairly penalize such market participants that choose to execute transactions on SEFs or discourage them from using SEFs altogether (contrary to the Commission's goal of encouraging exchange-traded transactions). The Regulation 1.35 requirements historically focused on entities transacting on exchanges in their roles as registered intermediaries. Therefore, to encourage the use of SEFs and to eliminate unduly burdensome requirements on entities traditionally exempt from the Section 1.35 recordkeeping requirements, such requirements should not apply to SEF members that are unregistered end users or registered swap dealers and are trading on SEFs for their own accounts.

III. Requirements That Affect On-Boarding and New Product Introduction Processes for End User Counterparties Should Be Refined.

Several rules that impose direct requirements on swap dealers indirectly create significant compliance-related costs, risks, and uncertainty for end users. These rules,

[8] *See* 17 C.F.R. § 1.35 (a)(1)(i), (ii).

which affect the on-boarding and new product introduction processes of market participants, should be refined to eliminate such burdens.

A. The Commission Should Clarify the Definition of "Financial End User" in the Non-Bank SD/MSP Margin Rule to Eliminate Confusion and Uncertainty and Avoid Sweeping in Commercial End Users.

The Commission should clarify the definition of "financial end user" in its final non-bank SD/MSP margin rule. NGSA members have found that this definition, which is used to determine whether non-SD/MSP counterparties are subject to the margin requirements, creates significant confusion and uncertainty among end users, which results in unnecessary administrative and legal expenses and delays end user onboarding and beneficial hedging activities. In this regard, clause (xi) in the definition of "financial end user" has proven to be particularly troublesome because of the vague and broad terms that it contains:

> (xi) An entity, person, or arrangement that is, or holds itself out as being, an entity, person, or arrangement that raises money from investors, accepts money from clients, or uses its own money primarily for investing or trading or facilitating the investing or trading in loans, securities, swaps, funds, or other assets.

Therefore, NGSA requests that this clause be deleted from the definition.

B. The Commission Should Allow End User Representations to Be Relied Upon.

Furthermore, the Commission should allow end user representations regarding "financial end user" status and other swap-related items to be fully relied upon by swap dealer counterparties. The CFTC has provided safe harbors in this regard, but those safe harbors are undermined by Section 23.402(d), which effectively negates such safe harbors if a swap dealer has any information that might cause it to question the accuracy of a counterparty's representations. Unfortunately, there is always a risk that some statement by a counterparty could be taken out of context after the fact, or that some information should have been discovered or noticed by a swap dealer in the course of its business dealings, to suggest that a swap dealer should have considered such counterparty to have a less-than-complete or less-than-perfect understanding of some aspect of a transaction or to be conducting its business differently than it has represented. NGSA members believe that the safe harbor provisions require (1) a thorough set of disclosures to inform counterparties and (2) a thorough set of representations by counterparties to confirm their understanding and business practices, which should be able to be relied on by swap dealers to provide true "safe harbor." Therefore, the exception in Rule 23.402(d) to a swap dealer's right to rely on counterparty representations should be removed, and the right to rely should be extended to all relevant swap regulatory matters (beyond just the swap dealer business conduct standards), to eliminate the unavoidable uncertainties and unnecessary compliance risks that are otherwise imposed on entities that deal with end user counterparties.

C. The Commission Should Streamline Its New Product Approval Requirements.

The Commission should also modify its requirements for swap dealer approval of new swap product offerings under Rule 23.600(c)(3)(iii), so that end users can obtain new, customized products to meet their ever-changing hedging needs in a timely manner. While the requirement that swap dealers have a risk management unit to evaluate the risks associated with new products is useful, the requirement that any new product that materially alters the overall risk profile of a swap dealer be pre-approved by the governing body of the swap dealer—typically, the board of directors—is overly restrictive and time-consuming. The CFTC should instead allow for such approval to be provided by an appropriate senior manager of a swap dealer, who would have the requisite expertise, authority, and availability to make sound, informed decisions regarding new product offerings on a timely basis. This would better allow swap dealers to respond to evolving end user needs and business developments.

IV. Registration-Related Requirements Should Be Modified to Eliminate Unnecessary Compliance Costs, Risks, and Uncertainty.

A. The Swap Dealer *De Minimis* Threshold Should Be Fixed at the Current $8 Billion Level by Rule Until Reliable Data Justifying an Adjustment is Obtained and Published for Comment.

The CFTC should provide greater certainty to end users trading in swaps in energy and other non-financial commodities, by fixing the swap dealer *de minimis* threshold at the current $8 billion level by rule until such time as the Commission has reliable data and analysis to support a change following public notice and comment. The currently applicable $8 billion *de minimis* threshold (applicable to swap dealing activities over a twelve-month period) is set to automatically decrease to $3 billion on December 31, 2018,[9] which will require entities engaging in swap dealing activities to start tracking such activities for potential registration purposes beginning January 1, 2018. However, this timeline may already be negatively affecting companies providing dealing services that are below but near these levels—potentially causing them to reduce, or plan to limit, such dealing services. This has the potential to harm liquidity

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[9] *Order Establishing De Minimis Threshold Phase-In Termination Date*, 81 Fed. Reg. 71605 (Oct. 18, 2016).

in swap markets, particularly with respect to energy products, for which there can be a broad array of delivery points and other differentiating factors that create diverse markets with numerous products that may be challenged for liquidity. Therefore any reduction to the current *de minimis* level should be considered carefully.

In this regard, the Commission has noted that, at present, "the lack of certain metrics needed for evaluating different *de minimis* thresholds, as well as data validity issues" limit effective analysis of the *de minimis* exception.[10] At the same time, the *de minimis* exception appears to already be low enough such that approximately 90% of all non-financial commodity swaps involve a swap dealer counterparty.[11] Therefore, to avoid making an ill-informed and potentially harmful reduction to the *de minimis* threshold, and to provide greater certainty to market participants for regulatory compliance and planning purposes, the current $8 billion threshold should be fixed by rule until such time as reliable data is obtained and published for comment and any changes to the threshold are determined to be justified.

B. Proposed "Regulation AT" Should Be Modified to Avoid Potentially Sweeping Numerous Market Participants into Unintended and Unwarranted Registration and Compliance Requirements.

NGSA also has significant concerns that the expanded definition of "floor trader" proposed by the Commission in connection with its definition of "AT Person" in proposed "Regulation AT"[12] is overly broad and, as a result, may sweep commercial market participants accessing futures markets in a routine manner into regulation as floor traders. This would subject them to rigorous recordkeeping requirements and compliance reviews that are inappropriate for their commercial businesses—which do not resemble the business of floor traders either in practice or under the statutory definition of "floor trader."[13] Therefore, NGSA requests that the Commission work further with commercial market participants to find a path forward that will meet the Commission's objectives with respect to Regulation AT, while maintaining end user protections and avoiding unnecessarily sweeping commercial market participants into registration and compliance requirements that are intended for more specialized actors in commodity markets.

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[10] *Id.* at 71606 (citing Swap Dealer *De Minimis* Exception Final Staff Report (Aug. 15, 2016)).

[11] Swap Dealer *De Minimis* Exception Final Staff Report at 22, Table 2.

[12] Proposed Rule, *Regulation Automated Trading*, 80 Fed. Reg. 78824 (Dec. 17, 2015), Supplemental Notice of Proposed Rulemaking, 81 Fed. Reg. 85334 (Nov. 25, 2016).

[13] *See* Commodity Exchange Act § 1a(23), 7 U.S.C. § 1a(23).

V. The Commission's Margin and Capital Rules for Non-Bank Swap Dealers Should Be Modified to Improve Certain Ill-Fitting Requirements.

The Commission's margin and capital rules for non-bank swap dealers should be modified to improve certain requirements that are ill-fitted to swap dealers that deal in forward contracts in physical commodities in addition to swaps. With their knowledge, resources, and product offerings with respect to the underlying physical markets, such swap dealers can provide unique synergies and efficiencies to end users that bank swap dealers may not be able to provide. Therefore, the Commission's margin and capital requirements on non-bank swap dealers should not discourage dealers in physical commodities from becoming or remaining registered swap dealers, increase costs by forcing significant corporate or capitalization restructuring, or unnecessarily direct capital away from productive uses, all of which ultimately harms end users by increasing transaction costs and reducing liquidity. For these and other reasons, NGSA requests that the Commission modify its final margin rule and proposed capital rule for non-bank SDs/MSPs as discussed below.

A. The Commission Should Modify the Final Margin Requirements.

The Commission's final margin rule[14] for non-bank SDs/MSPs includes several requirements that are ill-fitting and unnecessarily burdensome with respect to swap dealers transacting in both financial and physical markets, which ultimately harm not only such swap dealers but also their end user counterparties. For instance, the netting provisions set forth in sections 23.142(c)(1) and 23.153(d)(1) of the margin rule indicate that netting, for purposes of calculating margin requirements, is limited to netting across *uncleared swaps* only. However, eligible master netting agreements typically provide for netting across all commodity and derivative transactions between counterparties, which allows counterparties to more comprehensively manage their credit risk. The Commission's margin requirements should allow for such broader netting, so that market participants can fully realize the benefits that netting is intended to provide under such agreements.

The posting, collecting, and holding mechanics under the final margin rule are also overly constraining. The rule largely requires initial and variation margin to be posted on a T+1 timeframe and, further, requires all margin to be posted in the form of cash and certain high-quality securities. This may be appropriate in purely financial markets between financial entities, but swap dealers and their end user counterparties in the energy and other physical commodity industries have a well-established history of using longer timelines for posting of margin and of allowing margin to be posted in the form of letters of credit from highly creditworthy financial entities. These practices

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[14] Final Rule, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 636 (Jan. 6, 2016).

allow for efficient use of capital and administrative resources and have proven to be sound. Therefore, the Commission's margin requirements should allow swap dealers in energy and other physical commodity industries to maintain such practices.

Lastly with respect to the margin rule, the exclusion of "margin affiliates" from the margin requirements under Rule 23.159 should be broadened to exclude all affiliates that meet the definition of "margin affiliate," without having to satisfy the various other conditions of Rule 23.159. Affiliated entities have ample knowledge and incentive to manage the credit risks across their corporate structures and should not be subject to artificial regulatory restraints that limit their flexibility to do so and impose unnecessary administrative costs.

B. The Commission Should Modify Its Proposed Capital Requirements.

The Commission's proposed capital requirements for non-bank swap dealers and major swap participants are also ill-fitted for swap dealers engaged in physical commodity businesses in addition to swap dealing.[15] The proposed "tangible net worth" method in Section 23.101(a)(2) of the proposed rule is only available for entities that qualify as being "predominantly engaged in non-financial activities." However, it is not unusual for a corporate family predominantly engaged in non-financial activities to use a "central hedging affiliate" or "treasury affiliate" to efficiently manage financial transactions and risks among their corporate family members. Such affiliate may likely be a swap dealer and, due to the segregated nature of its business, not technically qualify as being "predominantly engaged in non-financial activities" despite its essential connection to such activities in connection with its broader corporate family. The Commission's rules should not unfairly penalize holding companies that use such structures or force them to restructure their operations simply to receive equivalent regulatory treatment to other market participants. Instead, the Commission should make provision for considering the type of business activities (physical versus financial) conducted by the ultimate parent of a non-bank SD/MSP in determining whether such SD/MSP is "predominantly engaged in non-financial activities"—so that its final rule on capital requirements is neutral with respect to corporate structure.

Similarly, because non-bank SDs/MSPs that are predominantly engaged in non-financial activities are less equipped and less likely to develop company-specific credit models allowed under the rule, the Commission should ensure that its standard methods for determining capital requirements are appropriate for companies engaging in the energy and other physical commodity industries. In particular, such methods should give adequate weight to the strong balance sheets, backed up by substantial physical inventory and plant assets, that such companies typically carry. Simply put,

[15] *Capital Requirements of Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 91252 (Dec. 16, 2016).

the CFTC should ensure that any final rule on capital requirements preserves flexibility with respect to capital structures and allow the use of credit monitoring mechanisms that are typically used in the energy industry.

CONCLUSION

NGSA welcomes the opportunity to further discuss these comments with the Commission. If we can provide any additional information, please do not hesitate to contact us.

Respectfully submitted,

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