



January 15, 2016

Chris Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St, N.W.
Washington, D.C. 20581

Re: CFTC's Swap Dealer *De minimis* Exception Preliminary Report

Dear Mr. Kirkpatrick:

The Natural Gas Supply Association ("NGSA") appreciates the opportunity to submit the following comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") in response to the Swap Dealer *de minimis* Exception Preliminary Report issued by Staff on November 18, 2015.

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.

NGSA urges the CFTC to take immediate action to prevent the automatic termination of the phase-in *de minimis* threshold of \$8 billion in order to give the Commission the time needed to collect adequate data and perform a careful review of the impacts of any change to the threshold, and to provide commercial market participants with the certainty needed to continue to perform important risk management functions.

NGSA supports the CFTC undertaking a thorough review and analysis of the appropriate level for the *de minimis* threshold, including collecting more robust data, but urges the CFTC to first take action to prevent a drop in the automatic *de minimis*

threshold adjustment. Allowing the current *de minimis* threshold to decrease from \$8 billion to \$3 billion could have significant negative impacts on the market in the form of decreased liquidity and fewer counterparties for hedging commercial risk. Therefore, NGSa requests that the CFTC issue an interim final rule removing the automatic termination of the phase-in threshold as currently set forth in Rule 1.3(ggg)(4)(iii), in order to maintain the *de minimis* threshold at \$8 billion gross notional value in swap dealing activity.

As indicated by the CFTC, lowering the *de minimis* threshold would not materially increase the transactions subject to swap dealer regulation.¹ In contrast, lowering the *de minimis* threshold has the potential to significantly harm the markets and may concentrate swap dealing in a few entities and ultimately fewer swaps counterparties for physical commodity companies seeking to hedge.

The result of setting a *de minimis* threshold too low was evident in the case of utility special entities.² For the same reason, the CFTC should pass an interim final rule to ensure that the *de minimis* threshold is not automatically decreased, but rather, that the threshold is only changed (if at all) after careful consideration of robust data.

Importantly, any decrease in the *de minimis* threshold would disproportionately impact physical market participants because of (1) the historically low physical commodity prices since passage of the Dodd-Frank Act, and (2) the costs involved with registering as a swap dealer, which very likely would drive many physical market participants out of the swap markets altogether. Commodity prices have been at historic lows since Rule 1.3 (ggg) became effective. Thus, as commodity prices begin to rise, the notional value of swaps executed by commodity market participants will increase even if activity levels stay the same because notional amount is impacted by the commodity price environment. See the attached September 20, 2012 coalition filing regarding the notional amount calculation methodology.

Because of the high costs associated with registration, commodity market participants may move out of the swaps market instead of register as swap dealers as a result of the reduced *de minimis* threshold. In addition to the known costs of

¹ The Staff's data suggests that decreasing the *de minimis* threshold to \$3 billion or raising it to \$15 billion would impact the number of swap dealers required to register (thus increasing costs substantially for a number of market participants), but only would change the number of transactions subject to swap dealer regulation by less than 1%.

² Ultimately, the CFTC acknowledged the negative effect that the lower special entity *de minimis* threshold had on utility special entities and provided relief to allow entities to exclude from the special entity *de minimis* threshold swaps with utility special entities related to utility operations. Under the amended rule, those swaps now are subject to the higher \$8 billion *de minimis* threshold. The Commission issued the relief to ensure that special entities would have counterparties with which to trade because it recognized that utility operations-related swaps are an integral part in providing electricity and natural gas production and/or distribution continuously and at a manageable cost.

registration, there are others including costs for IT infrastructure to deal with a myriad of dealer requirements as well as significant compliance and legal staffing costs and a number of still significant unknown costs related to capital and margin requirements.

In light of the costs and regulatory uncertainty, commercial commodity companies may choose to refrain from swaps activity altogether, further concentrating dealer activity in the hands of a few, thereby reducing competition and increasing systemic risk. The Staff in fact recognized in the Preliminary Report that physical commodity markets “may have characteristics that make them more sensitive to variations in the *de minimis* exception.”

Given the unique characteristics and particular sensitivity of the physical commodity markets, the CFTC needs to act immediately. NGSa requests that the CFTC amend the language in Rule 1.3(ggg) that ties the CFTC’s hands by automatically terminating the phase-in threshold unless the CFTC takes specific action. Further, the Commission should make clear that any change may only be made through a formal rulemaking wherein the CFTC finds that it is necessary and appropriate in the public interest. Specifically, the CFTC should pass an interim final rule amending Rule 1.3(ggg) by removing language in 1.3(ggg)(4)(ii)(D), which provides that if the CFTC takes no action, the *de minimis* phase-in threshold terminates automatically five years after SDRs began receiving data in accordance with Part 45. The provision should be amended to make permanent the phase-in threshold until such time that the CFTC were to finalize a rule changing the threshold as provided in (ggg)(4)(ii)(C).

NGSA appreciates the opportunity to provide these comments. Should you require further information, please do not hesitate to contact us.

Sincerely,



Jennifer Fordham

Senior Vice President, Government Affairs

Natural Gas Supply Association

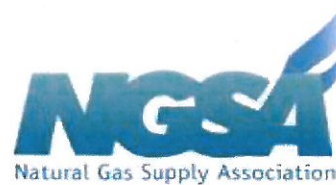
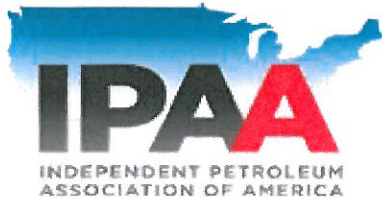
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September 20, 2012

VIA U.S. MAIL

Mr. David Stawick, Secretary
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RE: "Notional Amount" Calculation Methodology under Swap Dealer *De Minimis* Determination (RIN 3235-AK65) and Other CFTC Swap Regulations

The American Petroleum Institute ("API"), Commodity Markets Council ("CMC"), Edison Electric Institute ("EEI"), Electric Power Supply Association ("EPSA"), Independent Petroleum Association of America ("IPAA") and Natural Gas Supply Association ("NGSA"), (collectively, "the coalition") submit the following comments regarding the appropriate methodology for calculating "notional amount" with respect to certain types of commodity swaps, as such term is used in the *de minimis* exception to the definition of "swap dealer" in the Final Rule, Further Definition of "Swap Dealer," *et al.*, 77 Fed. Reg. 30596 (May 23, 2012) (the "Final Entity Definitions Rule") and in other rules issued or currently proposed by the U.S. Commodity Futures Trading Commission (the "CFTC" or "Commission"). 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").

The coalition's members are committed to full compliance with the Commission's swap regulations under the Dodd-Frank Act. The coalition submits these comments out of a desire for regulatory certainty regarding how to comply with the Commission's swap regulations involving

determinations on the “notional amount” of swaps, particularly with respect to the *de minimis* exception to the definition of the term “swap dealer” under the Final Entity Definitions Rule.

API is a national trade association representing more than 500 oil and natural gas companies. API’s members transact in physical and financial, exchange-traded, and over-the-counter markets primarily to hedge or mitigate commercial risks associated with their core business of delivering energy to wholesale and retail consumers. API members enter into futures, options, and swaps to hedge price risk and facilitate physical transactions. API members range from the largest major oil company to the smallest of independents. They are producers, refiners, suppliers, pipeline operators, and marine transporters, as well as service and supply companies that support all segments of the industry.

CMC represents a group of non-bank, commercial participants, each of whom operates in the physical and financial commodities markets and each of whom faces the prospect of potentially having to register its business or a portion of its business as a swap dealer.

EEI is the association of U.S. shareholder-owned electric companies. EEI’s members serve 95 percent of the ultimate customers in the shareholder-owned segment of the U.S. electricity industry, and represent approximately 70 percent of the U.S. electric power industry. EEI also has more than 65 international electric companies as Affiliate members, and more than 170 industry suppliers and related organizations as Associate members. EEI’s members are not financial entities. Rather, the typical EEI member is a medium-sized electric utility with relatively low leverage and a conservative capital structure.

EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers.

IPAA represents the companies that drill 95 percent of America's onshore and offshore oil and natural gas wells. America’s independents produce 54 percent of American oil and produce 85 percent of American natural gas.

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.

COMMENTS

Multiple swap regulations issued or currently proposed by the CFTC require the calculation of “notional amounts” of swaps.¹ Nonetheless, as the Commission has recognized,

¹ The swap dealer *de minimis* thresholds are based on “aggregate gross notional amount” and are of the most immediate concern to coalition members, given the substantial difference in regulatory requirements applicable to swap dealers as compared to non-swap dealers. See Final Entity Definitions Rule, 17 C.F.R. § 1.3(ggg)(4). Other

the Commission's rules "do not prescribe any particular methodology for calculating the notional amount or effective notional amount."² Instead, the Commission "contemplate[s] the use of industry standard practices" to calculate notional amounts.³

The Attachment to this letter conveys the predominant view among coalition members regarding the most logical and appropriate methodology for calculating "notional amount" with respect to certain types of commodity swaps in which coalition members regularly trade, *i.e.*, fixed-for-float swaps, float-for-float swaps, and options. Based on the CFTC's stated reliance on industry standards, the coalition understands that most of its members plan to continue calculating the notional amounts of their swaps based on the methodology represented in the Attachment unless they receive contrary instructions or guidance from the CFTC. The coalition would also welcome the opportunity to participate in an industry technical conference if the Commission desires further discussion of the notional amount calculation.

The consensus methodology for calculating "notional amount" in the Attachment is based on three simple concepts:

- (1) a straightforward interpretation based on common definitions of the term "notional value" and "notional;"
- (2) consistency across functionally equivalent transactions; and
- (3) consistency across the Commission's various swap market regulations.

Regarding a straightforward interpretation of the term, Investopedia defines "notional value" as "the total value of a leveraged position's assets."⁴ Merriam-Webster defines "notional" as "conceptual,"⁵ and others use the term "nominal" or "face" interchangeably with "notional."⁶ Accordingly, coalition members believe it is plain that the notional amount of a commodity swap should be the absolute value that results from multiplying the quantity term of a swap by its nominal, *i.e.*, named or facial, price (taking into effect any multipliers, as the Commission has identified).⁷ As an example, the notional amount of a basis swap, for which payments are based on the price differential between two locations, should equal the absolute value of the product of the contract quantity times such price differential.

This approach would be consistent with the Commission's usage of the term "notional amount" across its multiple swap rulemakings. The Commission's definition of the term "major swap participant" and its proposed capital requirements rule (and potentially its margin requirements rule, if it follows the approach of the Prudential Regulators Proposed Margin and

significant regulations dependent on determinations of "notional amount" include: the definition of major swap participant, *id.* § 1.3(hhh)(6)(i)-(ii), (jjj)(3)(ii)(A)(1)-(2); capital requirements applicable to swap dealers and major swap participants, Capital Requirements of Swap Dealers and Major Swap Participants, 17 C.F.R. § 23.104(d)(6), (h)(1); and, potentially, margin requirements applicable to swap dealers and major swap participants. *See* Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 76 Fed. Reg. 27564 at 27568, 27572-73, 27592 Appendix A (May 11, 2011) (the "Prudential Regulators Proposed Margin and Capital Rule").

² Final Entity Definitions Rule, 77 Fed. Reg. at 30670 n. 902.

³ *Id.*

⁴ <http://www.investopedia.com/terms/n/notionalvalue.asp#axzz208YD1ywN>.

⁵ <http://www.merriam-webster.com/dictionary/notional>.

⁶ *See, e.g.*, http://www.proz.com/kudoz/English/investment_securities/1962912-notional.html;
<http://stats.oecd.org/glossary/detail.asp?ID=5984>.

⁷ Final Entity Definitions Rule, 17 C.F.R. §§ 1.3(ggg)(4), (jjj)(3)(iii)(A)(2).

Capital Rule) are based on “notional amount” as a measure of risk or exposure. Taking basis swaps as an example again, the relevant price for determining *exposure* with respect to a basis swap must be the price differential between the two legs, since payments are entirely based on that differential. Similarly, the CFTC’s use of “notional amount” as a measure of market size, *see, e.g.*, the core principles rules for designated contract markets,⁸ would make little sense with respect to basis swaps if it was based on any price other than the price differential between the two legs of such swaps.

Finally, the coalition understands that the total notional amount for a market participant should be determined for purposes of the swap dealer *de minimis* determination as the aggregate value of long and short future equivalent positions “grossed up” at the deal level, without any netting. For Major Swap Participant, however, the coalition understands the rules to allow for netting as provided for under the applicable individual master agreements.

CONCLUSION

The methodology outlined in the Attachment provides an industry-consensus view of what “notional amount” means with respect to commodity swaps commonly traded by coalition members. Accordingly, given the Commission’s stated intention of relying on “the use of industry standard practices” in determining notional amounts, the coalition invites comment from the Commission should the Commission have a different view on any particular aspects of this methodology. If we can provide any additional information or should the Commission desire further discussion, please do not hesitate to contact us. Correspondence regarding this submission should be directed to:

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Respectfully submitted,

/s/ Kyle Isakower

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/s/ Sanjeev Joshipura

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Commodity Markets Council

⁸ Core Principles and Other Requirements for Designated Contract Markets; Final Rule, 77 Fed. Reg. 36612, 17 C.F.R. § 16.01(a)(2)(iv)(A).

/s/ Richard McMahon

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/s/ Melissa Mitchell

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/s/ Susan Ginsberg

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/s/ Jenny Fordham

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ATTACHMENT

Notional Amount Methodology

General Principles

Notional amount is calculated in US dollars (USD). For purposes of the swap dealer *de minimis* test, the notional amount is the absolute value of the product of the notional quantity of the swap multiplied by the nominal price of the swap at the time of the transaction. These calculations are done per transaction for the swap dealer *de minimis* test, and the notional amount for a portfolio is the sum of the absolute value of the notional amounts of all transactions across the portfolio. For the Major Swap Participant calculations, netting may be applied within a master agreement as provided for in the master agreement, so the absolute value is taken after any such netting.

1. Fixed-for-Float Swaps

Notional amount of a fixed-for-float swap is the absolute value of the product of the notional quantity of the swap multiplied by the transaction price of the swap. Example:

Example Transaction(s)	Transaction Volume	Transaction Price	Notional Amount (\$)
#1: First of Month index for transaction price of \$2.50/MMBtu	10,000 MMBtu	\$2.50/MMBtu	\$25,000
#2: Monthly on-peak electricity swap; day-ahead locational marginal price for transaction price of \$50.00 per MWh	100 MWh	\$50.00/MWh	\$5,000

2. Float-for-Float Swaps

Float-for-float swaps involve exchanging the value of two floating indices. Common examples are an index spread, a basis spread, a time spread and a spark spread. The notional amount is the absolute value of the product of the notional quantity multiplied by the transaction price, which is the differential or price spread between the two floating instruments. This approach presumes that the spread position is created through a single transaction that is executed at this differential (even if the confirmation of the transaction may refer to two legs). Note that a position of equal risk can be created by executing two fixed-for-float transactions. In that case, however, the notional amount should be calculated for each fixed-for-float transaction according to the procedures discussed above for fixed-for-float transactions. As a result, portfolios of equal risk may have very different notional amounts because notional amount is intended to measure activity, not risk.

a. Index spread

A gas index spread is where one party exchanges the variability of one index for another. For instance, one counterparty might pay First of the Month Index price and receive *Gas Daily* price in exchange. Often, the notional amount of an index spread swap is small given the similarity in the market price of both indices in the forward months. The notional amount is the absolute value of the product of the notional quantity times the transaction price, which is the spread or difference between the two indices.

Example Transaction(s)	Transaction Volume	Transaction Price ¹	Notional Amount (\$)
#1: First of Month index in exchange for <i>Gas Daily</i> index	10,000 MMBtu	\$0.02/MMBtu	\$200
#2: <i>Gas Daily</i> index in exchange for First of Month index	10,000 MMBtu	(\$0.02)/MMBtu	\$200

An electric index trade is typically used to manage the price risk difference between the day-ahead and real-time markets. For example, a counterparty might pay the RTO Day Ahead LMP price and receive the RTO Real Time LMP price in exchange. The notional amount is the absolute value of the product of the notional quantity times the transaction price, which is the spread or difference between the two indices.

Example Transaction(s)	Transaction Volume	Transaction Price	Notional Amount (\$)
#3: Monthly on-peak DA/RT swap; day-ahead locational marginal price in exchange for real-time locational marginal price	100 MWh	\$0.50 per MWh	\$50

b. Basis Spread

With a gas basis spread swap, payments are based on the value of the price spread between two locations (for natural gas it is typically the price spread between the Henry Hub and another location).

Example Transaction(s)	Transaction Volume	Transaction Price ²	Notional Amount (\$)
#1: Henry Hub to Transco Z6 NY basis swap	10,000 MMBtu	\$0.235/MMBtu	\$2,350
#2: Henry Hub to El Paso, San Juan	10,000 MMBtu	(\$0.07)/MMBtu	\$700

For electric basis trades, the payments are based on the price differential between two locations. It is typically used in the electricity market to manage the price risk between two locations. For example, a counterparty might pay the fixed price for the difference between AEP Dayton Hub (ADHUB) and Northern Illinois Hub (NIHUB) and receive

¹For the index spread float-for-float swap, the transaction price example is the difference between First of the Month index \$2.32/MMBtu and *Gas Daily* index \$2.30/MMBtu.

²For the basis spread float-for-float swap, the transaction price is, in the first example, the difference between Henry Hub \$2.990/MMBtu and Transco Z6 NY \$3.225/MMBtu and, in the second example, the difference between Henry Hub \$2.990/MMBtu and El Paso, San Juan \$2.920/MMBtu.

the floating price difference between those two locations. The notional amount is the absolute value of the product of the notional quantity times the transaction price, which is the spread or difference between the two price locations.

Example Transaction(s)	Transaction Volume	Transaction Price	Notional Amount (\$)
#3: Monthly on-peak basis swap; PJM AD Hub to PJM NiHub	100 MWh	\$5.00/MWh	\$500

c. Time Spread

In this type of swap, the payments are based on the spread value between two different delivery periods or points in time (such as natural gas or agricultural seasonal winter/summer spreads). For instance, a market participant could buy a summer month while simultaneously selling a winter month, hedging or locking in the value of the summer-winter spread. For time spread swaps, the notional amount is the absolute value of the product of the notional quantity of the swap multiplied by the transaction price, which is based on the difference between the price for two different delivery months.

Example Transaction(s)	Transaction Volume	Transaction Price ³	Notional Amount (\$)
#1: December to April time spread swap	10,000 MMBtu	\$0.40/MMBtu	\$4,000

d. Spark Spread

An electric heat rate trade is typically used to manage price risk by using two commodities: electricity and natural gas. For example, a counterparty would pay the heat rate multiplied by NYMEX Gas and receive the power index. The notional amount is the absolute value of the product of the notional quantity times the transaction price, which is the spark spread.

Product	Location	Term	Fixed Heat rate (BTU/KWH)	NYMEX Gas (MMBTU)	ERCOT North (\$/MWH)	Spark Spread Abs (\$/MW)	Side 1 Notional Abs Volume (MWH)	Notional Amount(\$)
Electricity Peak	ERCOT North Hub	Sept 12	9.50	3.00	30.00	1.50	100	\$150

Note: Fixed Heat Rate [9.50 BTU/KWH]*NYMEX Gas [3.00\$/MMBTU]=28.50 \$/MWH
 >Spark Spread ERCOT North [30.00 \$/MWH]-[28.50 \$/MWH]=1.50 \$/MWH

³For the time spread float-for-float swap, the transaction price is the difference between the December contract price of \$2.70/MMBtu and the April contract price of \$2.30/MMBtu.

3. Options

The notional amount for options should be based on the absolute value of the product of the notional quantity of the option (without adjustment for the option delta) multiplied by the transaction value for the option (*i.e.*, the premium) making the calculation consistent with the calculation for notional amount for swaps. Example:

Example Transaction(s)	Transaction Volume	Option Premium	Notional Amount (\$)
#1: Call Option with \$2.09/MMBtu strike price at a \$0.05/MMBtu premium	10,000 MMBtu	\$0.05/MMBtu	\$500
#2: Monthly on-peak call option on day-ahead locational marginal price with \$50.00 per MWh strike price at a \$5.00 per MWh premium	100 MWh	\$5.00/MWh	\$500

It is important to note that this approach is inconsistent with the calculation of notional amount set forth in the Large Trader Reporting for Physical Commodity Swaps: Division of Market Oversight Guidebook for Part 20 Reports (the "LTR Guidebook") for swaptions. However, the LTR Guidebook is internally inconsistent in that its guidelines for calculating notional amounts for options are inconsistent with its guidelines for calculating the notional amounts for other deal types, such as swaps.⁴

⁴ The LTR Guidebook calculates notional amount for options as follows: Notional Volume x Option Delta x Price Underlying Swap (Page 41 LTR Guidebook – <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/ltrguidebook120711.pdf>). Using the example above, the LTR Guidebook notional value methodology would result in a notional amount of \$10,450 instead of \$500 which is notional amount that would result from the common practice.