

**UNITED STATES OF AMERICA  
BEFORE THE  
COMMODITY FUTURES TRADING COMMISSION**

Protection of Collateral of Counterparties to Uncleared Swaps;     )  
Treatment of Securities in a Portfolio Margining Account in a     )  
Commodity Broker Bankruptcy     )

RIN 3038-AD28

**COMMENTS OF THE  
AMERICAN GAS ASSOCIATION**

Pursuant to the Notice of Proposed Rulemaking (“NOPR”) noticed in the Federal Register on December 3, 2010,<sup>1</sup> by the Commodity Futures Trading Commission (“CFTC” or “Commission”), the American Gas Association (“AGA”) respectfully submits these comments. AGA believes that the Commission’s rulemakings to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>2</sup> should ensure that the financial markets related to energy commodities function efficiently and protect the ability of commercial hedgers to engage in risk management activities at reasonable cost for the benefit of American energy consumers.

**I. COMMUNICATIONS**

All pleadings, correspondence and other communications filed in this proceeding should be served on the following:

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<sup>1</sup> *Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy*, 75 Fed. Reg. 75,432 (Dec. 3, 2010).

<sup>2</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

## **II. IDENTITY AND INTERESTS**

The AGA, founded in 1918, represents 199 local energy companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which 91 percent — more than 64 million customers — receive their gas from AGA members. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.<sup>3</sup> AGA's members engage in financial risk management transactions in markets regulated by the Commission. As such, AGA's members will be directly affected by the Commission's regulations promulgated under the Dodd-Frank Act.<sup>4</sup>

## **III. COMMENTS**

AGA member companies provide natural gas service to retail customers under rates, terms and conditions that are regulated at the local level by a state commission or other regulatory authority with jurisdiction. Many gas utilities use a variety of financial tools, such as futures contracts traded on CFTC-regulated exchanges and over-the-counter energy derivatives, to hedge the commercial risks associated with providing natural gas service, particularly volatility in natural gas commodity costs.

The Dodd-Frank Act requires swap dealers and major swap participants to allow for the segregation and maintenance in a separate account carried by an independent third-party

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<sup>3</sup> For more information, please visit [www.aga.org](http://www.aga.org).

<sup>4</sup> The interests of AGA members may be greatly affected by the Commission's ultimate resolution of the definitions of "swap dealer" and "major swap participant." AGA may file additional comments in this and other proceedings after the definitions of those terms are finalized.

custodian the funds provided by a counterparty to margin, guarantee or secure the obligations associated with an uncleared swap transaction, and to notify such counterparties of the right to request such segregation.<sup>5</sup> In the NOPR in this proceeding, the Commission proposes to require swap dealers and major swap participants to notify a counterparty at the beginning of each swap transaction that is not submitted for clearing of the counterparty's right to require segregation of the initial margin provided by the counterparty.<sup>6</sup> Under the Commission's proposal, the notice must be provided to the Chief Risk Officer, or, if there is no such officer, the Chief Executive Officer, or if none, the highest-level decisionmaker for the counterparty.<sup>7</sup> The proposal specifies that prior to confirming the terms of an uncleared swap, the swap dealer or major swap participant must obtain from the counterparty confirmation of the notice and an election to either require the segregation or not.<sup>8</sup> In addition, the Commission proposes that notification to a particular counterparty by a particular swap dealer or major swap participant need only be made once in any calendar year.<sup>9</sup> Moreover, a counterparty may change its election regarding segregation upon written notice to the swap dealer or major swap participant.<sup>10</sup>

AGA supports efforts that increase the efficiency and transparency of the financial markets to the benefit of consumers. AGA believes that the process of notifying counterparties of their right to segregation of any initial margin should be efficient and cost-effective to allow commercial hedgers such as gas utilities to continue to enter into risk management activities at reasonable cost on behalf of their customers. To that end, AGA offers the following recommendations to clarify the obligations under the proposed regulations.

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<sup>5</sup> Dodd-Frank Act § 724(c).

<sup>6</sup> Proposed 17 C.F.R. § 23.601(a).

<sup>7</sup> Proposed 17 C.F.R. § 23.601(c).

<sup>8</sup> Proposed 17 C.F.R. § 23.601(d).

<sup>9</sup> Proposed 17 C.F.R. § 23.601(e).

<sup>10</sup> Proposed 17 C.F.R. § 23.601(f).

In the NOPR, the Commission sought comment on whether the notification should include the cost of segregation, whether such cost would be in the form of fees charged by the third-party custodian if known by the swap dealer or major swap participant or differences in the terms of the swap offered by the swap dealer or major swap participant if the counterparty elects segregation.<sup>11</sup> AGA believes that the notification requirement *must* include the cost of segregation. Counterparties should not be forced to exercise in a vacuum their right to seek segregation of initial margin for an uncleared swap. In order to make an informed decision as to whether to exercise the right of segregation counterparties should fully understand the cost consequences of electing to segregate initial margin or not.

AGA contends that each swap dealer or major swap participant should be required to notify each counterparty of the cost of having a third party hold collateral. Moreover, the cost should be completely transparent and include the cost to establish and maintain the segregated custodial account and provide for the crediting of any interest earned by the custodian on the balances in the account to offset the cost of maintaining the account. In that manner, such cost would represent the explicit cost of reducing risk through the use of segregation. To the extent a swap dealer or major swap participant would offer to a counterparty a difference in the terms of the swap, such as increased collateral that the swap dealer or major swap participant would be willing to offer if the counterparty elects segregation of initial margin, such differences should be clearly specified and explicitly related to the election of segregation. Accordingly, AGA recommends that the Commission revise its proposal and explicitly include in the final rules a requirement that the notification referred to in § 23.601(a) include the cost of segregation.

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<sup>11</sup> 75 Fed. Reg. at p. 75,433.

In the NOPR, the Commission required that the notification be made to the Chief Risk Officer, or the Chief Executive Officer, or the highest-level decisionmaker for the counterparty in descending order of preference. As an alternative to specifying particular designated officers in descending order, AGA suggests that the Commission require that the notification be made to the officer in the counterparty that is responsible for the management of collateral. In many cases, that officer may be designated as the Chief Credit Officer. In some cases, the Chief Risk Officer may have that responsibility. For smaller organizations, decisions regarding management of collateral may be handled directly by the Chief Executive Officer. In all cases, however, an officer of the counterparty would be responsible for the management of collateral. Accordingly, AGA recommends that the Commission revise proposed § 23.601(c) to provide that the notification required by § 23.601(a) shall be made to the officer in the counterparty responsible for the management of collateral.

In the NOPR, the Commission expressed the concern that requiring notification before each and every swap transaction could be redundant and that some periodic reconsideration may be appropriate.<sup>12</sup> The NOPR proposed that notification to a particular counterparty by a particular swap dealer or major swap participant need only be made once in any calendar year.<sup>13</sup> AGA agrees that if a particular swap dealer or major swap participant notifies a particular counterparty of the cost of segregation and such cost would not change, then notification for each swap transaction would not be necessary. AGA emphasizes that the initial notification must be sufficient to fully inform the counterparty of the cost of segregation, and may be effective for the remainder of the year only if the cost of segregation does not change. Accordingly, AGA

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<sup>12</sup> 75 Fed. Reg. at pp. 75,433-34.

<sup>13</sup> Proposed § 23.601(e).

recommends that the Commission revise proposed §23.601(e) to provide that notification need only be made once in any calendar year, unless the cost of segregation is changed.

#### **IV. CONCLUSION**

Wherefore, for the reasons stated above, the American Gas Association respectfully requests that the Commission consider these comments in this proceeding.

Respectfully submitted,

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