September 28, 2012

VIA ONLINE SUBMISSION
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

International Organization of Securities Commissions
C/Oquendo 12
28006 Madrid
Spain

Re: BCBS/IOSCO Margin Requirements for Non-Centrally-Cleared Derivatives

The National Corn Growers Association ("NCGA")[1] and Natural Gas Supply Association ("NGSA")[2] submit the following comments to the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO") regarding the organizations' study on margin requirements for non-centrally-cleared derivatives. For further correspondence, please contact:

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The BCBS and IOSCO consultative report was developed at the request of the Group of Twenty ("G20") in its efforts to launch a larger reform initiative designed to mitigate the systemic risk from over-the-counter ("OTC") derivatives. In addressing margin for non-

[1] Founded in 1957, NCGA is the largest nonprofit organization, representing 37,000 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 48 affiliated state associations and checkoff organizations work together to create and increase opportunities for their members and their industry.
[2] 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

centrally-cleared derivatives, the BCBS and IOSCO call for all covered entities engaging in such swaps to exchange, on a bilateral basis, initial and variation margin in a mandatory minimum amount. NCGA and NGSA believe that regulator-imposed margin requirements may not be necessary for all uncleared derivatives, like those used by natural gas producers and corn growers to hedge. To avoid unnecessarily tying up capital used for investment, NCGA and NGSA urge recognition of differences among market participant balance sheets and other factors that affect overall risk profiles such as the nature of the entity's business, the presence of physical assets and, when applicable, parent company support. Where such differences exist, regulations should allow for significantly lower levels of margin, regardless of whether the swap is cleared or uncleared.

The consultative report also provides a list of suggested eligible collateral categories including cash, high quality government and central bank securities, high quality corporate bonds, equities in major stock indices and gold. While NCGA and NGSA understand that this list is not intended to be exhaustive, it is important that end users be allowed to use noncash collateral for margin purposes. Prohibiting the use of noncash collateral by end users unnecessarily constrains the ability of end users and their counterparties to tailor their credit support arrangements to transactions and counterparty-specific business risks in the most efficient and effective way possible.

As mentioned above, the BCBS and IOSCO report is a part of a larger reform effort by the G20. Within its reform program, the G20 advocates for mandatory clearing of standardized derivatives. NCGA and NGSA have long opposed a clearing mandate for transactions that do not pose systemic risk. Many over-the-counter financial tools, which are used by natural gas producers and corn growers to hedge, do not pose systemic risk as the counterparties are not backed by government funds. Mandatory clearing is unnecessary in these circumstances and would centralize risk while unnecessarily draining the economy of productive capital and increasing the cost consumers pay for energy and agriculture products.

NCGA and NGSA support efforts to strengthen the global financial system. However, a one-size-fits-all approach toward margin requirements is not appropriate. It is crucial that margin requirements for non-centrally-cleared derivatives allow for recognition of credit quality differences among market participants and thus maintain the integrity of the end user and economic protections. The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") recognized the importance of regulations that maintain the availability of cost effective hedging tools for end users through the adoption of a variety of end user protections. NCGA and NGSA comments to the Commodity Futures Trading Commission and Prudential Regulators regarding capital and margin requirements in the Dodd-Frank Act are attached for further reference.

NCGA and NGSA thank the BCBS and IOSCO for considering these comments. Please do not hesitate to contact NCGA and NGSA with any questions or comments.

Sincerely,

National Corn Growers Association
Natural Gas Supply Association

Attachment enclosed

June 23, 2011

VIA E-MAIL/ONLINE SUBMISSION
Office of the Comptroller of the Currency ("OCC")
Board of Governors of the Federal Reserve System ("FRB")
Federal Deposit Insurance Corporation ("FDIC")
Federal Housing Finance Agency ("FHFA")
Farm Credit Administration ("FCA") (collectively with the above, the "Prudential Regulators")
Commodity Futures Trading Commission ("CFTC")

RE: I. Margin and Capital Requirements for Covered Swap Entities, 76 Fed. Reg. 27,564 (May 11, 2011) (the "Prudential Regulators' NPRM")

- OCC - Docket No. OCC-2011-0008, RIN 1557-AD43
- FRB - Docket No. R-1415, RIN 7100 AD74
- FDIC – RIN 3064-AD79
- FCA – RIN 3052-AC69
- FHFA – RIN 2590-AA45

II. Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (May 12, 2011) (the "CFTC Capital Requirements NPRM")

- CFTC – RIN 3038-AD54

III. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (April 28, 2011) (the "CFTC Margin Requirements NPRM")

- CFTC – RIN 3038-AC97

The National Corn Growers Association ("NCGA") and the Natural Gas Supply Association ("NGSA") submit the following comments in response to the Notices of Proposed Rulemaking ("NPRMs") listed in the subject line above. 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").
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Founded in 1957, NCGA is the largest trade organization in the United States, representing 35,000 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 48 affiliated state associations and checkoff organizations work together to create and increase opportunities for their members and their industry.

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 the Dodd-Frank Act to unnecessarily limit the hedging tools available to corn producers and 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.

COMMENTS

These comments address the following three proposed rules, which together implement the capital and margin requirements applicable to swap dealers ("SDs") and major swap participants ("MSPs") under section 4s of the CEA:

I. The Prudential Regulators' proposed margin and capital requirements for covered swap entities;
II. The CFTC's proposed capital requirements for swap dealers and major swap participants; and
III. The CFTC's proposed margin requirements for uncleared swaps for swap dealers and major swap participants.

The Prudential Regulators' rule applies to bank SDs and bank MSPs. The CFTC's proposed rules apply to non-bank SDs and non-bank MSPs. While the rules share many similarities, there are significant differences between them. Given the statutory requirement that the Prudential Regulators and the CFTC make their capital and margin requirements comparable "to the maximum extent possible," the NCGA and NGSA have combined their comments on the three proposed rules into this one letter for comparative purposes, though the comments are divided into three sections that focus on each of the three rules.

The Prudential Regulators' and the CFTC's proposed rules must conform to the Dodd-Frank Act and to Congress's intent in passing the Act. As both the Prudential Regulators and CFTC acknowledge in their NPRMs, the Act requires that the rules be risk-based—that is, that they "help ensure the safety and soundness" of SDs and MSPs (collectively, "Covered Swap Entities" or "CSEs"[1]) while being "appropriate for the risk associated with the non-cleared swaps

[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

held as [CSEs]."[2] Thus, to conform to Congressional intent, the rules should protect the stability of the U.S. financial system but at the same time preserve the flexibility of market participants and not unnecessarily tie up capital from productive uses that drive and sustain the national economy. In this respect, the lack of significant risk to the U.S. financial system attributable to the swaps activities of nonfinancial end users such as producers in the natural gas and corn industries, and the capital-intensive nature of these businesses, requires that the proposed rules allow for flexibility in the credit arrangements between CSEs and nonfinancial end users with respect to their swaps, such as with respect to their ability to use noncash collateral. The following comments address these and other concerns in more detail with respect to each of the three proposed rules.

I. COMMENTS ON THE PRUDENTIAL REGULATORS' PROPOSED RULE

A. The Prudential Regulators' Proposed Rule Must Be Modified to Allow the Use of Noncash Collateral by Nonfinancial End Users.[3]

The Prudential Regulators' proposed rule contravenes the Act and Congress' clear intent by not allowing the use of noncash collateral by nonfinancial end users to meet initial and variation margin requirements with respect to uncleared swaps with CSEs. The Act expressly requires that:

> In prescribing margin requirements. . . , the prudential regulator[s] . . . and the Commission . . . shall permit the use of noncash collateral as the regulator[s] or the Commission determines to be consistent with—(i) preserving the financial integrity of markets trading swaps; and (ii) preserving the stability of the United States financial system.[4]

However, in spite of their recognition of the "minimal risks that nonfinancial end users pose to the safety and soundness of covered swap entities and U.S. financial stability,"[5] the proposed rule contravenes the Act by not allowing nonfinancial end users to post noncash collateral to satisfy their margin requirements, instead imposing a "one-size-fits-all" requirement requiring that CSEs accept only cash or certain highly liquid debt obligations as collateral.

The proposed rule's effective prohibition of the use of noncash collateral by nonfinancial end users unnecessarily constrains the ability of nonfinancial end users and their counterparty CSEs to tailor their credit support arrangements to transaction- and counterparty-specific business risks in the most efficient and effective way possible. As discussed in further detail below, the proposed rule appropriately allows CSEs to establish, based on their informed assessments of credit risk, thresholds for initial and variation margin below which they are not required to collect margin from nonfinancial end users. However, when it comes to what types

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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).

[3] This section specifically addresses questions 1(a) and 59 of the Prudential Regulators' NPRM.

[4] CEA § 4s(e)(3)(C).

[5] *See* Prudential Regulators' NPRM at 27,570.

of collateral to accept from nonfinancial end users, the proposed rule unjustifiably constrains the CSEs' credit decisions by not allowing them to accept noncash collateral. This contravenes Congress's intent to preserve the flexibility of nonfinancial end users to use noncash collateral in individualized credit agreements:

> Congress recognized that the individualized credit arrangements worked out between counterparties in a bilateral transaction can be important components of business risk management. That is why Congress specifically mandates that regulators permit the use of non-cash collateral for counterparty arrangements with Swap Dealers and Major Swap Participants to permit flexibility.[6]

More broadly, Congress provided an end user exception to the mandatory clearing requirement in order to ensure that hedging does not become prohibitively expensive to end users as a tool for managing their commercial risk:

> It is imperative that the regulators do not unnecessarily divert working capital from our economy into margin accounts, in a way that would discourage hedging by end users or impair economic growth.[7]

Accordingly, Congress provided the end user exception from mandatory clearing, partly so that end users in capital-intensive industries like the corn and natural gas industries could enter into uncleared swaps with customized credit support arrangements that allow for the use of letters of credit and other commonly used forms of noncash collateral. However, the proposed rule's prohibition on the use of noncash collateral by nonfinancial end users would erode that flexibility, thereby threatening to unnecessarily tie up working capital from beneficial uses.

In addition, as noted below, the CFTC's rule differs from the Prudential Regulators' rule in that it does *not* prohibit the use of noncash collateral with respect to SDs' and MSPs' uncleared swaps with nonfinancial end users. For the reasons discussed above, the CFTC's treatment is appropriate. By contrast, as recently pointed out in a joint letter by Senator Debbie Stabenow and Representative Frank D. Lucas, the Prudential Regulators' approach does not conform to the statute.[8] Since the Act requires the Prudential Regulators and the Commission to maintain, to the maximum extent practicable, comparable margin requirements, "including the use of noncash collateral,"[9] the Prudential Regulators must modify their proposed rule to also permit the use of noncash collateral by nonfinancial end users.

Finally, the Prudential Regulators' suggested alternative to allowing nonfinancial end users to post noncash collateral does not actually reduce the already-limited risk under the CSE's

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[6] Letter from Sen. Christopher Dodd and Sen. Blanche Lincoln to Rep. Barney Frank and Rep. Colin Peterson 2 (June 30, 2010) (the "Dodd-Lincoln Letter").
[7] *Id.* at 1.
[8] Letter from Sen. Debbie Stabenow and Rep. Frank D. Lucas to Sheila C. Blair, *et al.* 2 (June 20, 2011) (noting the CFTC's and Prudential Regulators' margin and capital requirements NPRMs and stating: "Further, despite a statutory directive to permit the use of noncash collateral, the prudential regulators' proposal is overly restrictive when it comes to requiring and valuing highly liquid assets such as cash, treasuries and GSE securities, and does not provide sufficient clarity that the use of other forms of noncash collateral is permitted.").
[9] *See* CEA § 4s(e)(3)(D)(ii).

credit processes – it merely shifts it elsewhere within the banking system. The Prudential Regulators' proposed rule applies only to SDs and MSPs that are banks. The NPRM suggests that, in lieu of being able to post noncash assets to such banks as collateral for uncleared swaps, nonfinancial end users should instead pledge such assets to different banks—or perhaps even the same banks but under separate arrangements—as collateral for secured loans and then draw cash from such loans to satisfy the collateral requirements for their uncleared swaps.[10] But this simply moves the potential market and liquidity risk associated with the noncash assets from one bank (*i.e.*, the bank SD or bank MSP counterparty, which is likely to be well-positioned to value the collateral it if regularly transacts swaps in the relevant industry), or one arrangement with a bank, to another. Moreover, such an extra step imposes transaction costs that could be otherwise avoided. As such, the proposed prohibition of noncash collateral with respect to nonfinancial end users does not represent reasoned decision making, does not adhere to the Act or Congressional intent, and does little to nothing to protect U.S. financial stability. Therefore, the Prudential Regulators' proposed rule should be modified to permit the use of noncash collateral by nonfinancial end users.

B. The Prudential Regulators' Proposed Rule Appropriately Allows CSEs to Establish Initial and Variation Margin Thresholds With Respect to Nonfinancial End Users.[11]

NCGA and NGSA support the provisions in the Prudential Regulators' proposed rule that allow for initial and variation margin thresholds below which CSEs are not required to collect margin from counterparties who are nonfinancial end users. The NPRM rightfully recognizes that "the statute requires the Agencies to take a risk-based approach to establishing margin requirements" and that it is appropriate for nonfinancial end users to be "categorized as lower-risk counterparties than financial end users."[12] With respect to thresholds for initial and variation margin, the NPRM recognizes that a threshold-based approach is consistent with current market practices with respect to nonfinancial end users—in which swap dealers view the question of whether and to what extent to require margin from their counterparties as a "credit decision."[13] For example, many nonfinancial end users in the corn, natural gas, and other industries have sound balance sheets characterized by substantial physical assets and low levels of borrowing. Considering the low credit risks such entities pose, their CSE counterparties may find collecting margin to be an unwarranted transaction cost, at least below a certain threshold. As such, and "in light of the minimal risks that nonfinancial end users pose to the safety and soundness of covered swap entities and U.S. financial stability," the NPRM appropriately allows CSEs to establish thresholds for initial and variation margins without preset limits, based on assessments of the credit risks posed by individual counterparties and swaps in accordance with the CSEs' credit processes.[14] Further, the Prudential Regulators should give CSEs broad latitude in determining appropriate risk-based thresholds, to avoid unnecessarily harming liquidity in swap markets in which nonfinancial end users participate.

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[10] *See* Prudential Regulators' NPRM at 27,578.
[11] This section specifically addresses question 23(b) of the Prudential Regulators NPRM.
[12] *See* Prudential Regulators' NPRM at 27,569.
[13] *See id.* at 27,569-70.
[14] *See id.* at 27,570, 27,587-88 §§___.2(m), (bb).

C. The Prudential Regulators' Proposed Rule Has Appropriate Frequency Requirements for the Posting of Variation Margin.

Similarly, NCGA and NGSA support the proposed rule's provisions regarding the required frequency of posting variation margin. "Consistent with the approach of the proposed rule generally, the minimum frequency varies based on the systemic and safety and soundness risk of the counterparty type."[15] The rule requires variation margin to be calculated, and collected if necessary, no less than once per business day for swaps with swap entities and financial end users, but, recognizing the greater flexibility that should be afforded nonfinancial end users and the lower risks they pose to U.S. financial stability, allows for the variation margin requirements to be imposed as infrequently as weekly with respect to nonfinancial end users. As the NPRM recognizes, these are only minimum collection requirements. Importantly, the proposed rule leaves counterparties free to make their own informed credit decisions regarding the actual timing of variation margin calculations and payments within these bounds.

II. COMMENTS ON THE CFTC'S PROPOSED CAPITAL REQUIREMENTS RULE

A. The CFTC's Proposed Capital Requirements Rule Must Be Modified So That the Market and Credit Risk Adders Applicable to Swap Dealers Are Based Only on Swaps Associated with Swap Dealing Activities.

The Commission should modify or clarify section 23.101 of its proposed capital requirements rule to state that the market and credit risk adders for the tangible net equity requirement applicable to swap dealers should be based on swap and related hedge positions associated with the swap dealers' "swap dealing activities"—instead of their "swap activities," as the proposed rule currently reads. By providing for "limited designations" in its proposed rule defining the term "swap dealer,"[16] the Commission accounted for the fact that Congress, in section 1a(49)(B) of the CEA, provided authority for entities engaging in swap dealing activities to be designated as swap dealers with respect to their swap dealing activities only—*i.e.*, not with respect to their non-dealing swap activities. To impose requirements on swap dealers with respect to their "swap activities" in general, as opposed to their "swap dealing activities," would effectively eviscerate this distinction and place form over function by treating entities differently based on how they choose to combine or separate their swap functions among different corporate entities. Although footnote 23 of the NPRM appears to recognize this distinction, the Commission should clarify the text of section 23.101 of the proposed rule accordingly to eliminate any uncertainty.[17]

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[15] *Id.* at 27,576.

[16] *See* Notice of Proposed Rulemaking, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,212 § 1.3(ppp)(3) (Dec. 21, 2010).

[17] *See* CFTC Capital Requirements NPRM at 27,806 n. 23.

B. The CFTC's Proposed Capital Requirements Rule Must Be Modified to Exclude Hedge Positions from the Calculation of Market Risk Adders and to Recognize and Accommodate the Use of Portfolio Hedging.

Section 23.101(a)(1)(i) and (b)(1)(i) of the proposed capital requirements rule provide that CSEs must maintain a tangible net equity that meets or exceeds $20,000,000 plus certain calculated amounts for market risk and credit risk "associated with [ ] swap positions *and related hedge positions*."[18] NCGA and NGSA support the $20,000,000 baseline as a reasonable minimum capital requirement for CSEs. However, regarding the adders for market risk and credit risk, the Commission is misguided in including hedge positions in the calculation of any market risk adders, as it does in section 23.104(d)(6)(ii) with respect to commodity market risk adders. To the extent that a hedge position directly offsets an underlying speculative or commercial position, there should be no market risk for such position—only credit risk. As such, the final rule must be modified to exclude hedge positions from the calculation of any market risk adders.

Regarding hedge positions in general, the Commission should acknowledge in its final rule that hedging transactions do not always neatly correspond to particular hedged commercial or speculative transactions. Rather, many swap market participants in the corn, natural gas and other industries use broad-based "portfolio hedging" to hedge risk across their entire portfolio of commercial or speculative transactions. To avoid discouraging this efficient and effective means of managing risk, the Commission must give swap dealers who use portfolio hedging flexibility in determining how to assign such hedging transactions to their swap dealing versus non-swap dealing activities for purposes of calculating their tangible net equity requirements, as long as they can provide a basis for such assignment that is consistent with standard accounting practices.

C. The CFTC's Proposed Capital Requirements Rule Should Be Modified to Allow Swap Dealers and Major Swap Participants to Consolidate the Equity of Parent Guarantors in their Computation of Tangible Net Equity.

Consistent with the sort of internal flexibility the CFTC is proposing with respect to limited-purpose swap dealer designations for corporations, the capital requirements rule should allow the tangible net equity of a CSE's parent guarantor to be included, to the extent of any applicable guaranties, in the computation of the CSE's tangible net equity. The purpose of the capital requirements rule is to ensure the safety and soundness of CSEs and the U.S. financial system. Where a parent's guaranty legally binds the parent to fulfill the obligations of a CSE, the parent's tangible net equity subject to the guaranty is as available to fulfill the obligations of the CSE as the CSE's own net equity. As such, the Commission should provide for flexibility in how CSEs provide credit assurances to counterparties—whether through the strength of their own or a parent guarantor's balance sheet—by allowing consolidation of a parent guarantor's tangible net equity in computing a CSE's tangible net equity. Section 23.102(b) of the proposed rule already provides for "downward" consolidation of a CSE's tangible net equity with that of affiliates where the CSE acts as guarantor or is a majority owner and controller of such affiliates, and there is no reason not to similarly allow "upward" consolidation with respect to parental

[18] *See id.* at 27,827 §§ 23.101(a)(1)(i), (b)(1)(i) (emphasis added).

guarantors' equity to similarly reflect legal realities regarding the actual availability of capital. Finally, whether equity is consolidated upward with a parent or downward with a subsidiary, the Commission should clarify that such parents and subsidiaries will not themselves be subject to regulation as swap dealers as a result of such consolidation, unless they individually satisfy the definitional criteria with respect to swap dealers under section 1a(49) of the CEA.

D. The CFTC's Proposed Capital Requirements Rule Should Be Modified and/or Clarified to Increase Compatibility With Existing Legal Requirements and Business Practices.

In order to prevent or lessen any unnecessary burdens caused by the proposed capital requirements rule, the capital maintenance, measurement, and reporting requirements should be modified and/or clarified to increase their compatibility with existing legal requirements and business practices. First, the capital maintenance requirements in section 23.105(f)(1) and (2), requiring swap dealers and major swap participants to notify the CFTC within two business days of events causing certain reductions in tangible net equity, should be changed to match the Security and Exchange Commission's ("SEC's") general four-business day period in which publicly traded companies must report various material events on Form 8-K.[19] The SEC has had decades of experience in which to evaluate an appropriate and manageable period for such reporting duties and has found four business days to be an appropriate period.

Second, to accommodate the participation of foreign and multinational companies in U.S. swap markets, the Commission should allow determinations of tangible net equity under section 23.102(a), and recording and recordkeeping under section 23.106, to use International Financial Reporting Standards ("IFRS"), not just U.S. Generally Accepted Accounting Principles ("GAAP") standards. This change will eliminate unnecessary administrative burdens caused by the proposed rule and is consistent with SEC rules.[20]

III. COMMENTS ON THE CFTC'S PROPOSED MARGIN REQUIREMENTS RULE

A. The CFTC's Proposed Margin Requirements Rule Should Be Modified by Deleting the Provisions Requiring CSEs to Hold Initial Margin from Other CSEs at Independent Third-Party Custodians.

The CFTC's proposed margin requirements rule should be modified by deleting the provisions requiring CSEs to hold initial margin from other CSEs at independent third-party custodians because there is no statutory authority for such a requirement. Congress identified and provided for one limited circumstance under which a CSE should be required to hold margin at a third-party custodian, and that is where the CSE's counterparty requests that its margin be held in a segregated account. *See* CEA § 4s(l)(3). Congress could have provided broader circumstances under which collateral must be held with a third-party custodian, but it did not. As such, the Commission should preserve the option of counterparties to avoid the transaction costs resulting from requiring CSEs to identify, monitor, and transfer funds to and from

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[19] *See* Exchange Act Rule 15d-11, 17 C.F.R. § 240.15d-11.

[20] *See* Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, 73 Fed. Reg. 986 (Jan. 4, 2008).

independent third-party custodians. Accordingly, the proposed rule should be modified by deleting the provisions in section 23.158 that require CSEs to hold initial margin from other CSEs at independent third-party custodians.

B. The CFTC's Proposed Margin Requirements Rule Should Be Modified by Decreasing the Proxy Multipliers for Computing the Initial Margin Amounts for Uncleared Swaps.

The proxy multipliers for computing the initial margin amounts for uncleared swaps under the proposed rule should be decreased. Under section 23.155(c) of the proposed rule, if a CSE does not use an approved model to compute the initial margin amount for an uncleared swap, it must first identify a cleared swap or futures contract that most closely resembles the uncleared swap (a "proxy"). To compute the initial margin amount for the uncleared swap, the CSE must then multiply the initial margin amount applicable to the proxy (as established by the applicable derivatives clearing organization) by a multiplier of 2.0 if the proxy is a swap or 4.4 if the proxy is a futures contract. These multipliers are excessive and, by raising the cash requirements associated with customized swaps, threaten to limit the ability of end users to use customized swaps to effectively hedge their commercial risks. As Congress recognized:

> End users who hedge their risks may find it challenging to use a standard derivative contract[] to exactly match up their risks. . . . Standardized derivative contracts may not be suitable for every transaction."[21]

Accordingly, the Commission must not make the use of customized swaps prohibitively expensive, effectively drying up liquidity in such markets and chilling the development of important derivative products. Therefore, the Commission should decrease the proxy multipliers in section 23.155(c) of the proposed rule used for computing the initial margin amounts for uncleared swaps.

C. The CFTC's Proposed Margin Requirements Rule Provides Appropriate Flexibility With Respect To Thresholds for Initial and Variation Margin and the Ability to Use Non-Cash Collateral.

NCGA and NGSA support the Commission's proposed margin requirements rule, which does not dictate the terms of margin arrangements between CSEs and non-financial entities other than requiring that any margin accepted by the CSEs under such arrangements consist of assets for which the value is reasonably ascertainable on a periodic basis in a manner agreed to by the parties. The NPRM recognizes that nonfinancial entities using swaps to hedge commercial risk pose less risk to CSEs than do financial entities and that, to be consistent with Congressional intent, margin requirements should not be imposed on such entities.[22] As such, the proposed rule gives CSEs transacting with non-financial entities appropriate flexibility with respect to credit support arrangements, including providing for initial and variation margin thresholds below which the non-financial entity is not required to post initial margin.

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[21] Dodd-Lincoln Letter at 2.
[22] *See* CFTC Margin Requirements NPRM at 23,736.

In addition, the proposed rule provides adequate flexibility with respect to acceptable forms of collateral, accommodating the practical need of many non-financial entities to use noncash collateral as credit support for their swap activities. Given the low risk posed to the U.S. financial system by the use of noncash collateral by non-financial entities, the Commission rightly recognizes that section 4s(3)(3)(C) of the CEA requires that the use of such noncash collateral be allowed. The Commission's limitation that the value of the assets posted be reasonably ascertainable on a periodic basis is acceptable as it is compatible with current business practices. With respect to the Commission's request for comments on how frequently such collateral could and should be valued, NCGA and NGSA suggest that an annual valuation requirement should provide a reasonable balance between the need for accurate valuations and the practical burdens of preparing them.

D. The Commission Must Give CSEs Sufficient Time to Develop and Implement the Models Required to Comply with the Proposed Margin Requirements Rule.

The Commission must give CSEs sufficient time to comply with the proposed rule's modeling requirements for calculating initial margin with respect to uncleared swaps. The Commission's proposed rule requires CSEs to either (1) develop and implement sophisticated models for the calculation of initial margin for such swaps or (2) identify the cleared swaps or futures most closely resembling the uncleared swaps and apply certain multipliers to the derivatives clearing organizations' initial margin amounts for the identified proxies. However, some SDs and MSPs may have tens of thousands of swaps open at any given time. The development and application of the required models, or the identification of cleared products to use as proxies, for such a large number of swaps promises to be a monumental task. In addition, to avoid market disruptions, end users will require adequate lead time to evaluate and consider the effects of the methods selected by the SDs and MSPs before they are applied. For these reasons, the NCGA and NGSA request that the final rule not become effective until at least 12 months after publication in the federal register.

CONCLUSION

NCGA and NGSA respectfully submit that the modifications to the proposed rules described above are necessary to make the rules conform to the text of the Dodd-Frank Act and Congress's intent in passing the Act and to improve their efficiency and effectiveness. The proposed modifications would serve to protect the financial stability of the U.S. financial system while preserving flexible use of capital by end users in the corn, natural gas and other industries that drive and sustain our national economy. NCGA and NGSA appreciate the opportunity to provide these comments. Should you require further information, please do not hesitate to contact us.

Sincerely,

National Corn Growers Association
Natural Gas Supply Association