September 29, 2017

Via Electronic Submission

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:

I. INTRODUCTION

The Edison Electric Institute ("EEI") and the Electric Power Supply Association ("EPSA") (hereafter "Joint Associations") appreciate the Commodity Futures Trading Commission's ("CFTC" or "Commission") considering the important issue of how the Commission's existing rules, regulations and practices could be applied in a simpler, less burdensome and less costly manner.[1] Joint Associations have been active participants in the Commission's numerous rulemakings implementing the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[2] and have supported the goal of providing greater transparency to the swaps market without unduly burdening end users.

EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for about 220 million Americans, and operate in all 50 states and the District of Columbia. As a whole, the electric power industry supports more than 7 million jobs in communities across the United States. In addition to our U.S. members, EEI has more than 60 international electric companies, with operations in more than 90 countries, as International Members, and hundreds of industry suppliers and related organizations as Associate Members.

EPSA is the national trade association representing leading independent power producers and marketers. EPSA members provide reliable and competitively priced electricity from environmentally responsible facilities using a diverse mix of fuels and technologies. Power

[1] *Project KISS Request for Information*, 82 Fed. Reg. 21494, RIN 3038-AE55 (May 9, 2017); and correction thereto, 82 Fed. Reg. 23765, RIN 3038-AE55 (May 24, 2017).

[2] Pub. L. No. 111203, 124 Stat. 1376 (2010),

supplied on a competitive basis collectively accounts for 40 percent of the U.S. installed generating capacity. EPSA seeks to bring the benefits of competition to all power customers.[3]

Joint Association's members are not financial entities. Rather, they are physical commodity market participants that rely on futures and swaps to hedge and mitigate their commercial risk. Regulations that make effective risk management options more costly for end-users of derivatives, such as Joint Association's members, will likely result in higher and more volatile energy prices for residential, commercial, and industrial electricity customers. As such, Joint Associations and its members have a direct and significant interest in ensuring that the Commission's rules and regulations do not impose additional costs and regulatory burdens on end users.

Energy markets are different from financial markets. As such, the Commission should recognize the unique attributes of energy markets and the standards/practices that have been developed in energy markets over the years and accommodate the differences in these practices in its rules and regulations. Joint Associations request that the Commission provide further definitional clarifications and reduce regulatory burdens as discussed herein.

II. COMMENTS

A. Commission Should Further Clarify the Definition of Swap to Exclude Trade Options

End users, such as Joint Association members, treat commodity trade options and forwards as if they are "physical" or "cash market" contracts. They are essentially transactions that provide for actual delivery of the "physical" commodity or the "cash commodity." This physical attribute distinguishes forward contracts and commodity trade options from financially-settled derivatives contracts.

The Commission, however, has classified physically settling trade options as swaps making them jurisdictional and subjecting them to certain swap-related regulatory requirements.[4] Treating commodity trade options, that are intended to be physically settled, as swaps rather than as excluded forwards creates regulatory confusion and burden for Joint Association's members since certain of their physical contracts are considered swaps while the vast majority are not. This results in Joint Association members having to sort their physical agreements into swap and non-swap categories. Thus, Joint Associations, as well as other end users, have asked the Commission to reconsider the burdens associated with commodity trade options and the decision to classify commodity trade options as swaps.

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[3] This letter represents the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

[4] *Commodity Options*, 77 Fed. Reg. 25320 (Apr. 27, 2012) ("Trade Option IFR"). *Joint Final Rule and Interpretations on Further Definition of "Swap," "Security-Based Swap," "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208 (August 13, 2012) ("Products Release").

Section 1a (47) of the Commodity Exchange Act ("CEA"), added to the CEA by the Dodd-Frank Act, provides in relevant part that:

> "1a (47) SWAP—
> (A) IN GENERAL— Except as provided in subparagraph (B), the term "swap" means any agreement, contract, or transaction—
>
> (i) that is a put, call, cap, floor, collar, or similar option of any kind that is for the purchase or sale, or based on the value, of 1 or more interest or other rates, currencies, commodities, securities, instruments of indebtedness, indices, quantitative measures, or other financial or economic interests or property of any kind;(B) EXCLUSIONS.—The term "swap" does not include—…
> (ii) any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled;"*(emphasis added)*

Despite this language, the Trade Option IFR issued, prior to the Products Release, presumed that the Commission would determine that all commodity options, including commodity trade options were included in the defined term "swap."[5] Based on this initial premise, the Products Release rulemaking issued in August of 2012, contained the Commission's interpretation of DFA Section 721 and CEA 1a(47), that all commodity options are "swaps."

Since this interpretation was published, the Commission has recognized the physical settlement characteristics of commodity trade options, made changes to the regulatory requirements associated with commodity trade options but has not revisited this initial definitional issue. The Commission issued a Trade Option Final Rule in March 2016 which eliminated the reporting requirements for commodity trade options used by end users and indicated that commodity trade options would not be subject to position limits.[6] While the changes in the Trade Option Final Rule reduced some of the regulatory burdens associated with commodity trade options, regulatory burdens associated with these physically-settled contracts remain. End users are still required to track, document and maintain records on commodity trade options which creates a regulatory burden as it requires end users to treat physically-settled commodity trade options differently from other physically-settled transactions. The Trade Option Final Rule explicitly recognized that commenters had raised this concern but did not address it.[7]

Joint Associations reiterate their request that the Commission further define the term "swap" in CEA 1a(47), or reinterpret the definition of "swap" in CEA 1a(47), to specifically exclude from that defined term any nonfinancial commodity transaction for deferred shipment or delivery, so long as the transaction is intended to be physically settled, including a stand-alone commodity trade option. This will help ensure that end users are not subject to the complexity, burden and additional regulations for physically-settled commodity trade options.

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[5] Office of General Counsel ("OGC") Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy at 2.

[6] Final Rule, Trade Options, 81 Fed. Reg. 14966 (March 21, 2016) ("Trade Option Final Rule").

[7] *Id.* at 14969

B. Commission Should Codify the Existing Guidance on Tolling Agreements, Natural Gas Transmission and Similar Contracts

The Commission should codify the guidance issued by Commission staff to provide regulatory certainty. In the dynamic environment that existed after implementation of the Dodd-Frank Act, the Office of General Counsel, the Office of Market Oversight and the Division of Clearing and Risk (among others) issued guidance and No Action Letters that clarified and revised, as needed, elements of the Commission regulations. While this guidance has been helpful, Commission Staff is not the Commission and cannot speak for the Commission. While it is generally assumed that the clarifications provided by Commission Staff represent the views of the Commission, the Commission should provide regulatory certainty by codifying this guidance. As such, Joint Associations request that the Commission formalize the guidance provided by the Offices of the General Counsel and Market Oversight and the Division of Clearing and Risk (among others) and in No Action Letters on the following issues:

1. The Commission Should Codify Guidance on Facility Contracts

The Products Release issued by the Commission in August 2012 contained a proposed interpretation regarding certain physical commercial agreements, contracts or transactions, such as tolling agreements, natural gas transportation and storage agreements, and firm transmission agreements. This interpretation created a three-factor test to provide guidance on conditions the transaction must meet in order for these transactions not to be classified as an option.[8] Joint Associations filed comments indicating that the interpretation created regulatory uncertainty and should be withdrawn in its entirety as it impacted innumerable transactions that are commonly used in the electric industry for the delivery of nonfinancial commodities.

In response to these and other similar comments, the Commission's Office of General Counsel provided guidance clarifying that the physical energy transactions interpretation "was not intended to apply to agreements, contracts or transactions in which the buyer pays for a commodity in two parts, paying the seller's fixed/known costs upfront and the seller's variable costs associated with that commodity later once those costs are established or incurred."[9] Joint Associations request that the Commission codify this guidance.

2. The Commission Should Codify Guidance on Affiliate Reporting and Treasury Affiliates.

In No Action Letter No. 13-09 re affiliate reporting,[10] the Division of Market Oversight and the Division of Clearing and Risk recognized that intra-group swaps are used only for managing risk within a corporate group, do not increase overall systemic risk or warrant the

[8] Products Release at 48242.

[9] Office of General Counsel ("OGC") Response to Frequently Asked Questions Regarding Certain Physical Commercial Agreements for the Supply and Consumption of Energy at 2.

[10] *No-Action Relief for Swaps Between Affiliated Counterparties That Are Neither Swap Dealers Nor Major Swap Participants from Certain Swap Data Reporting Requirements Under Parts 45, 46, and Regulation 50.50(b) of the Commission's* Regulations, CFTC Letter No. 13-09 (Apr. 5, 2013)

same reporting requirements as external swaps, and granted no-action relief to end users from certain reporting obligations under part 45 and part 46 of the Commission's regulations as well as the reporting requirements related to the end-user exception from required clearing under regulation 50.50(b) with respect to certain intra-group swaps. The no-action relief recognized that transactions between affiliates transfer risk internally and do not present risk to the market. The Commission should provide regulatory certainty to end users and codify this relief.

No Action Letter No. 14-144 re treasury affiliates[11], the Division of Clearing and Risk recognized the role that affiliates play in hedging on behalf of non-financial affiliates within a corporate structure and allowed them to take advantage of the end-user exception from clearing.

Both of these no-action letters recognized the standards and practices used within the energy industry to manage and transfer internal risk. The Commission should provide regulatory certainty by codifying this guidance.

C. Recordkeeping and Reporting Rules Should Be Clarified

1. Definition of Pertinent Data and Memoranda Should be Clarified

Pursuant to §45.2, non-SD/MSP counterparties are required to "keep full, complete, and systematic records, together with all pertinent data and memoranda, with respect to each swap in which they are a counterparty, including, without limitation, all records demonstrating that they are entitled, with respect to any swap, to elect the clearing requirement exception in CEA section 2(h)(7) (Rule 45.2(b)" for a period of five ("5") years in a format that is retrievable within five ("5") business days for inspection. Joint Association members are familiar with complying with recordkeeping requirements. However, such requirements are typically related to their core utility business and are specified in a clear, unambiguous manner. The term "*all pertinent data and memoranda*" relating to a swap is unspecified and requires further clarification by the Commission.

When the Commission issued the Swap Data Recordkeeping and Reporting Requirements rule, energy trade associations requested that the Commission better define "all pertinent data and memoranda."[12] The Commission did not define these terms and indicated that Commission registrants such as DCMs, DCOs, FCMs, IBs and members of DCMs were currently able to comply with such a requirement.[13] While these traditional Commission registrants may have a clear understanding of this recordkeeping requirement, physical end-users need more clarity as to the scope of what is meant by "all pertinent data and memoranda" for their transactions. Joint Association members are physical electric utilities whose core business is not swaps and futures. To the degree Joint Association members transact in swaps and futures, it is as end-users hedging risk. The uncertainty of what is required by this phrase creates a

[11] *No-Action Relief from the Clearing Requirements for Swaps Entered into by Eligible Treasury Affiliates,* CFTC Letter No. 13-22 (June 4, 2013), subsequently amended by CFTC Letter No. 14-144 (Nov. 26, 2014).

[12] *Swap Data Recordkeeping and Reporting Requirements*, 77 Fed. Reg. 2136, 2140 (Jan. 13, 2012); 17 C.F.R. § 45.2 (2017).

[13] *Id.* at 2141

regulatory burden as end users must try to determine what must be preserved for each transaction and systematically record it. The ambiguity also may result in inadvertent non-compliance if the end user makes the wrong determination.

Given the ambiguity and resulting burden coupled with Joint Association member's end-user status, Joint Associations would suggest that the Commission clarify that the records that need to be kept are final confirmations, modifications thereto and related master agreements. These documents are maintained in the regular course of business and will provide the information needed by the Commission while reducing the burden on end users and providing regulatory certainty.

2. Commission Should Eliminate the Requirement to Document Oral Book- Outs

The Products Release appropriately recognized that physical forward contracts in which the parties later agree to book-out their delivery obligations for commercial convenience are excluded forward contracts. Despite this recognition, the Products Release seemed to indicate that oral book-outs would only be permissible if they are followed in a commercially reasonable timeframe by a confirmation in some type of written or electronic form.[14]

Book-outs are a customary commercial practice in the energy industry to optimize economics in the process of scheduling physical energy deliveries and are typically used in bilateral markets to reduce the volume of scheduled transactions. The intent of each transaction is physical delivery or settlement and the book-out is used to simplify the transaction scheduling and checkout process, thus reducing the administrative burden and costs to market participants. As a result, participants in the bilateral markets may utilize the book-out process several times a day and such book-outs are often orally communicated, due to the dynamic nature of the scheduling process. The added step of documenting the book-out in a separate agreement is unduly burdensome and a costly proposition for market participants as it adds another layer of regulatory requirement for transactions that are excluded from Commission jurisdiction.

Joint Associations would request that the Commission withdraw this requirement to create a separate confirmation or other documentation for each oral book-out. Since the book-out documentation has been required, Joint Associations are not aware of any concerns or abuses that validate its continuation. This requirement to maintain documentation for transactions which are excluded from Commission jurisdiction is burdensome and should no longer be required.

3. Commission Should Work With SDRs to Harmonize Data

Joint Associations would suggest that sometimes less is more and one of the ways in which the Commission can meet its objective to ensure that its rules are less costly and burdensome while still providing needed information is to focus on data harmonization efforts in conjunction with the Swap Data Repositories ("SDR"). SDRs are in the best position to evaluate

[14] Product Release at 48228 – 49230.

the data currently being reported to the Commission. At the February 23, 2016 Technology Advisory Committee ("TAC") meeting, the question was asked whether the Data Standards Subcommittee, which allows Commission Staff to work with the SDRs to identify and address data issues, should be re-established. The resounding answer from all of the SDRs was yes. All of the SDRs indicated a willingness to work with Commission Staff to improve and harmonize the data currently being provided to the Commission. This process would help ensure that the data being provided to the Commission is in a form that is most useful to the Commission and will allow the Commission to focus on improving the data quality of the information already being collected rather than imposing new requirements. A data harmonization process would allow the Commission to improve the processes that it already has in place; evaluate what data is not being used by the Commission and therefore may not need to be provided; and access the data that it feels it needs under Part 45 without imposing extra costs on end-users.

Reporting requirements, including any reporting changes arising from harmonization efforts described above, must also recognize that energy markets are different from financial markets. As such, "standardization" cannot apply across all markets because the products are different. The Commission should recognize the unique attributes of energy markets and the standards/practices for reporting and confirming transactions that have been developed in energy markets over the years for uncleared swaps by accommodating these practices in its rules and regulations.

D. Additional Clarifications

1. Commission Should Ensure That the Current *De Minimis* Level is Maintained

Commission Regulation 1.3(ggg) states that a person shall not be deemed a swap dealer unless its swap dealing activity (as defined jointly by the Commission and the U.S. Securities and Exchange Commission) exceeds an aggregate gross notional amount threshold of $3 billion (measured over the prior 12-month period), subject to a phase-in period during which the gross notional amount threshold was set at $8 billion. The phase-in period ends on December 31, 2017 at which time the *de minimis* threshold falls automatically to $3 billion, absent Commission action. On October 13, 2016, the Commission issued a Notice and Order extending the termination date for the *de minimis* threshold phase-in period until December 31, 2018.[15]

Regulations that make effective risk management options more costly for end users of derivatives will likely result in higher and more volatile energy prices for residential, commercial, and industrial customers. Swaps enable end users to *reduce* risk by offsetting their exposure to commodity prices and other unpredictable variables that are an inherent part of operating any commercial business. To offset these risks, commercial end users enter into long-term bilateral transactions with other commodity market participants to hedge their commodity risks. The sudden arbitrary drop in the *de minimis* threshold from $8 billion to $3 billion creates concern as it impacts the ability of utilities and other commercial end users to engage in long-term planning. Energy prices are unstable and vary considerably over time. The certainty of a stable, consistent threshold that is set at a level that considers the needs of commercial end users

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

will assist Joint Associations members in managing risk in the future. The Commission should reduce regulatory uncertainty and issue a rule maintaining the $8 billion *de minimis* threshold and wait until the Commission has better market data before making any decisions to adjust the threshold.

2. Definition of "Predominantly Engaged in Financial Activities" in the Definition of Financial Entity Should be Clarified

The definition of financial entity under Section 723 of the Dodd Frank includes "a person that is predominantly engaged in...activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956." Commission clarification on what is meant by "predominately engaged in financial activities" would provide regulatory certainty. Many energy companies structure their businesses so that a single legal entity within the corporate family acts as a central hedging, trading and marketing entity – allowing companies to centralize functions such as credit and risk management. However, when the banking law definitions are applied in this context, these types of central entities it is unclear whether this hedging activity could be viewed as engaging in activity that is "financial in nature."

Joint Associations members are physical electric utilities. They are not banks or financial companies. Regardless, they may include "market facing" entities in their corporate structure that exist to market physical products and undertake risk management on behalf of the physical business in the affiliated electric utility(-ies). In effect, these "market facing" entities are similar to treasury affiliates with a larger assignment. The manner in which these entities function causes them to transact in derivatives and physical transactions in which they take "transitory title" -- all activities that can meet the test of "financial in nature."

However, these entities are a component of a physical firm organized for efficiency and to assist in regulatory compliance and should be viewed as such. Given their nature, they should not be viewed as "*predominantly engaged in*" activities that are in the business of banking or financial in nature. The Commission has not addressed this issue- leaving ambiguity and regulatory risk. Joint Associations request that the Commission provide clarity and define the words "*predominantly engaged in*" in the statute to relate to the substance of the overall firm and not a market-facing affiliate on a standalone basis if it is functioning as an element of the overall enterprise. The Commission should be clear that such a market-facing affiliate is not a financial entity.

3. Definition of Member for Purposes of Commission Regulation 1.35 Should be Clarified

CFTC Regulation 1.35 imposes broad recordkeeping requirements for "members" of a swap execution facility ("SEF") and states in relevant part that:

> "(a)…Each futures commission merchant … and member of a designated contract market or swap execution facility shall keep full, complete, and systematic records, which include all pertinent data and memoranda, of all transactions relating to its business of dealing in commodity interests and related cash or forward transactions."

Under this regulation, a related cash or forward transaction is a purchase or sale for immediate or deferred physical shipment or delivery of an asset related to a commodity interest transaction where the commodity interest transaction and the related cash or forward transaction are used to hedge, mitigate the risk of, or offset one another. As such, CFTC Regulation 1.35(a) imposes broad recordkeeping requirements for such "members." Rather than limiting such requirements to the scope historically covered in the context of the existing regulation (Commission registrants with fiduciary duties to customers), the regulation applies to anyone directly using a SEF. In other words, if a commercial end user received "trading privileges" to execute swaps directly on a SEF, it would become a "member" subject to the requirements of Commission Regulation 1.35(a). This is true even for commercial end users, such as Joint Associations members, who are not required to register with the Commission and who are executing trades for their own account.

The Commission recognized these concerns and excluded members that are not registrants of the Commission from the requirement to keep written communications that lead to the execution of a commodity interest transaction and related cash or forward transactions as well as from the requirements to retain text messages and to maintain records in a particular form and manner.[16] Under this exclusion, the Commission does not explicitly state that end users that are not required to register with the Commission are exempt from SEF membership. The scope of the regulation requires Joint Associations members to maintain extensive records of their non-derivatives physical business for CFTC regulatory purposes. Joint Associations do not believe there is a meaningful regulatory purpose for physical electric utilities end users to maintain CFTC-regulated records of their physical business merely because they traded on a SEF (which required "membership"). No such recordkeeping requirement applies to over-the-counter swaps. As this recordkeeping requirement would only be implicated if a Joint Associations member became a member of a SEF, it is a bar to such membership or trading on a SEF. Unless the Commission can identify a real need for this requirement, it should be eliminated.

Accordingly, the Joint Associations respectfully submit that the Commission clearly exclude persons who are not registered with the Commission and who do not trade on behalf of customers from the requirements of Regulation 1.35(a).

4. The New Requirements for the Form 40 Large Trader Report are Burdensome

In response to special calls from the Commission requesting information about the ownership and control structure of a reportable trader, Joint Associations members have filed paper versions of Form 40 over time and have become familiar with its requirements. After the enactment of the Dodd-Frank Act, the Commission began seeking filings of Form 40S for swaps which requests information about trading in certain physical commodity swaps versus futures trading. The Commission has now replaced the original paper form and moved to an electronic version of Form 40/40S that is submitted via a portal. While similar to the prior paper form, the

[16] Records of Commodity Interest and Related Cash or Forward Transactions, 80 Fed Reg. 80247 (December 24, 2015).

new forms are not identical and have an ongoing reporting requirement. This change was made with little or no public roll-out, instructions, or FAQs

The OCR Rules[17], as amended by the OCR Rule Amendments for Swaps took effect in November 2016 and require that Forms 40/40S be filed using the CFTC's new electronic interface portal or via FTP (an electronic filing format not regularly used in the electric utility industry). After an initial filing, the special-call recipient thereafter has a continuing and ongoing regulatory obligation to update the Form 40/40S data electronically when there is a change in any reported data. The new form also consolidates Form 40/40S into a single form that asks about all derivative activity as well as expanding the amount of data requested about the control of trading decisions. This imposes a new, ongoing regulatory burden on end-users and requires them to invest in new technology. On September 19, 2017, the Commission updated its "online filing portal for submitting CFTC Form 40 [in a manner that] improve[s the functionality of the form and adds new, more user-friendly features, while collecting essentially the same information."[18] While this improvement is appreciated, it does not, however, specifically address the issue of the requirements of the form.

Joint Associations request that the Commission provide transparent clarity as to requirements of the electronic Form 40, including up-to-date instructions and website FAQs.

III. CONCLUSION

Joint Associations appreciate the Commission undertaking this effort and requests that the Commission provide the clarifications described herein.

Respectfully Submitted,

/s/ Richard McMahon

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[17] Ownership and Control Reports, Forms 102/102S, 40/40S, and 71, 78 Fed. Reg. 69178 (Nov. 18, 2013).

[18] http://www.cftc.gov/PressRoom/PressReleases/pr7612-17.

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