

**Gas Mart 2011:  
Dodd Frank Reform  
and What it Could Mean  
for Natural Gas Purchasers**

*May 11, 2011*

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## Nodal Exchange Overview

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- **Cash-settled electric power and natural gas futures exchange**
  - **Launched April 8th, 2009; currently over 60 signed Participants**
  - **All contracts for monthly terms (peak and off-peak power)**
  - **Providing ability to trade power on >1,800 hubs, zones, and nodes across six organized markets: ISO-NE, NYISO, PJM, MISO, ERCOT and CAISO**
  - **Natural gas contract for Henry Hub available over-the counter (OTC)**
  - **Two platforms:**
    - Daily auction
    - OTC negotiated transactions (e.g., broker) submission for clearing
  - **Central counterparty cleared market for all transactions through LCH.Clearnet which is a Derivatives Clearing Organization (DCO)**
    - Only cleared market for over 1,750 locations
    - Value-at-Risk (VaR) based margining methodology
  - **Nodal Exchange is an Exempt Commercial Market (ECM) and will need to transition to be either a registered Swaps Execution Facility (SEF) or a Designated Contract Market (DCM) under the Dodd-Frank Act**
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## **Clearing more derivatives is a global objective coming out of the recent financial crisis**

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The G-20 Leaders in September 2009 concurred that:

- “All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest.”
- “OTC derivative contracts should be reported to trade repositories.”
- “Non-centrally cleared contracts should be subject to higher capital requirements.”

## **Dodd-Frank Wall Street Reform and Consumer Protection Act - enacted July 21, 2010**

- Title VII focuses on “Wall Street Transparency and Accountability” – bringing OTC derivatives under CFTC and SEC oversight
- Draft rules mostly released and final rules expected to be released by the CFTC in three phases: spring, summer & fall of 2011
- The CFTC can phase and specify the timing for when entities must be compliant with new rules
  - Expectation that most rules will require operational compliance by the end of 2012: consistent with G20 statement
  - CFTC considering whether to phase by product



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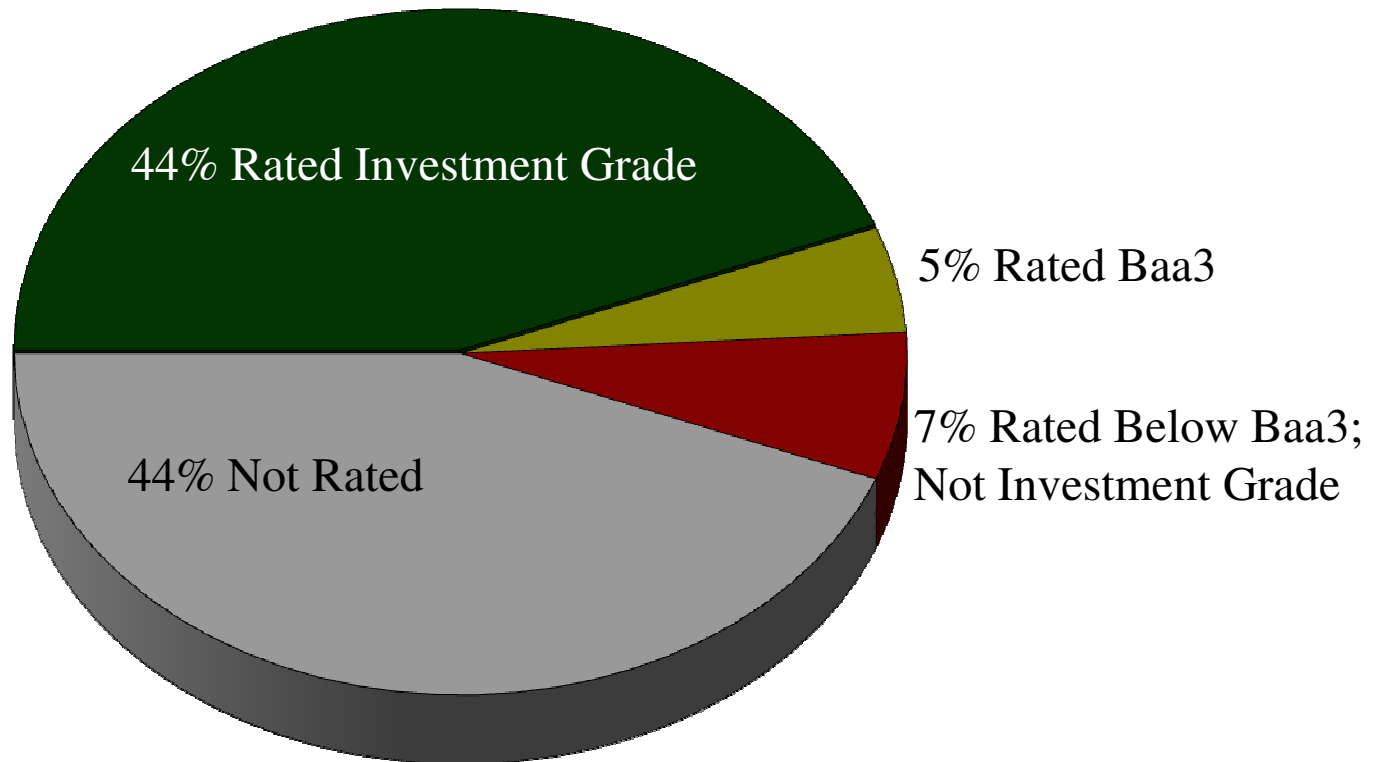
## **Clearing reduces systemic risk (defaulter pays through margining), but also benefits participants**

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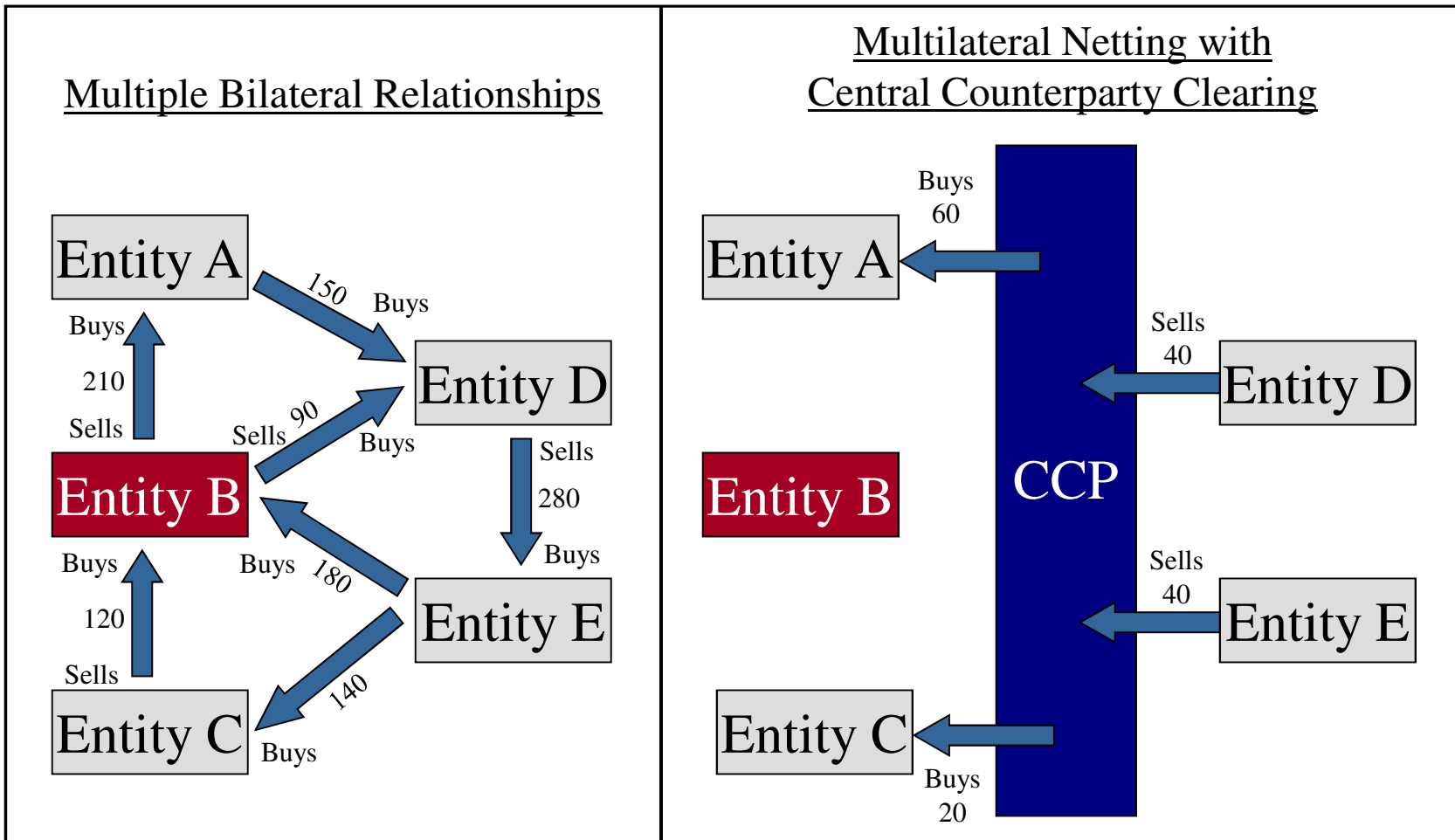
- Access to a wider range of market participants resulting in greater liquidity and better pricing; less than half of the top 50 FTR (Financial Transmission Rights) power traders are rated investment grade
- Very limited default risk and no need to monitor counterparty risk
- Total transaction cost, including default risk, is often lower than bilateral transactions that are not cleared
  - CCRO paper “Market Clearing in the Energy Industry” Feb 2006 estimated default risk for non-cleared trades at 84 basis points
  - Under new regulation, non-cleared OTC trades may have collateral requirements set by CFTC for certain entities (e.g., Swap Dealers, Major Swap Participants)
- Clearing allows netting of positions across the portfolio, lowering margin

## Cleared markets provides access to more counterparties

Top 50 FTR Participants  
(Representing 95% of Volume)



**Clearing allows participants to efficiently net across positions, reducing exposure and required collateral**



1,170 in positions netted to 160: an 86% reduction

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## Key aspects of Dodd Frank and draft rules for natural gas

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- Clearing only required for swaps that the CFTC mandates to be cleared and are able to be cleared
  - Likely to include Henry Hub
- Exemption from clearing for end users who are hedging
- Physical forwards are not swaps
- Swaps subject to the clearing requirement must be traded on a swap execution facility (SEF) or designated contract market (DCM)
- Trading facilities for swaps must be SEFs or DCMs; DCMs can also offer futures contracts

**Thank you!**

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