U.S. CHAMBER OF COMMERCE

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April 16, 2014

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Via Agency Website
Re: Docket No. 1479 and RIN 7100 AE-10: Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities, Advance Notice of Proposed Rulemaking

The U.S. Chamber of Commerce (the "Chamber") is the world's largest business organization, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. In 2007, the Chamber established the Center on Capital Markets Competitiveness ("CCMC") to advocate for the replacement of the existing early twentieth century era financial regulatory system with one that more effectively reflects and regulates a globally competitive twenty-first century economy. The mission of the Chamber's Institute for 21st Century Energy ("Energy Institute") is to unify policymakers, regulators, business leaders, and the American public behind a common sense energy strategy to help keep America secure, prosperous, and clean. Through policy development, education, and advocacy, the Energy Institute is building support for meaningful action at the local, state, national, and international levels.

CCMC and the Energy Institute respectfully submit this letter in response to the request for comments by the Board of Governors of the Federal Reserve System (the "Board") in its Advance Notice of Proposed Rulemaking relating to physical commodities activities conducted by financial holding companies (the "ANPR").

Many of our non-financial Members transact in the physical commodity and the commodity-linked derivatives markets on a daily basis to operate their businesses efficiently, hedge their underlying business risks, and serve the needs of their customers, and many use Financial Holding Companies ("FHCs") as counterparties. The methods by which each Member transacts in these markets can differ depending on their physical commodity needs. Yet across the physical commodity and related derivatives markets, a consistent theme is the importance to commercial end-users of FHC participation.

Many of our Members use physical commodities as the raw materials or the fuel for their businesses, and use financial instruments like derivatives to hedge against volatility in the markets for those essential commodities. Hedging allows manufacturers, energy companies, and agricultural companies, for example, to ensure stable prices for their inputs, so they can deliver value to their consumers through stable prices. Certain entities that sell physical commodities and engage in long-term contracts for those commodities, for example, often use swaps to hedge these long-term agreements. Many of our Members that are reliant on fuel in the operation of their businesses enter into hedging transactions to manage the price volatility associated with refined fuels. Transacting with FHCs for these purposes is essential for our Members because FHCs are well-regulated, well-capitalized, highly liquid counterparties that have the capacity to enter into highly customized transactions, designed specifically to match the size and duration of a company's exposure to a particular commodity. For some global end users, their ability to hedge their fuel costs with precision using an FHC gives them a critical pricing advantage over foreign competition.

FHCs are sophisticated market participants that use their expertise in the physical commodities and related derivatives markets to tailor commodity products to meet customer needs. Our Members rely on FHCs to provide more competition, more liquidity and better pricing in the physical commodity and related derivatives markets. Given the crucial role of FHCs in the physical commodity markets, a determination by the Board that restricts, deters or eliminates FHCs' participation in the physical commodities markets could cause these markets to unravel, leading to decreased competition, greater market illiquidity and inefficient pricing as the financial instruments end users rely upon to hedge become less tethered to the underlying commodities markets.

In the energy markets, in which many of our Members participate, eliminating, or substantially reducing FHCs' participation would result in a decrease in competition, as FHCs are currently the only market participants that offer customized OTC derivatives products for certain of the physical commodities our Members require to operate their businesses. Further, a retreat by FHCs, on whom our Members rely to make markets and meet customized needs, from the physical commodity markets also would lead to greater market illiquidity and inefficient pricing. Reducing the number of market participants threatens higher prices for hedging transactions for our Members since they will have fewer firms from which they can request price quotes. Without FHCs in the physical commodities and commodity-linked derivatives marketplace, our Members would face reduced liquidity and would be forced to search for alternatives – and it is not clear to what extent alternatives could be found – to satisfy their hedging needs.

In addition, if certain physical commodity exposures cannot be efficiently hedged, the increased costs and risks will adversely affect our Members' overall financial performance. Our Members will therefore be required to set aside more capital to account for these increased costs, rather than using the capital for more efficient purposes such as business investment, R&D and job creation.

It is in this context that CCMC and the Energy Institute submits this letter, in response to ANPR Questions Nos. 18 and 23, to explain to the Board why we believe additional regulation of FHCs' physical commodities activities will adversely affect FHCs, our Members, and their customers.

Question No. 18: How might elimination of the authority affect FHC customers and the relevant markets?

Question No. 23 What are the advantages and disadvantages of the Board instituting additional safety and soundness, capital, liquidity, reporting, or disclosure requirements for BHCs engaging in activities or investments under section 4(o) of the BHC Act?

Although ANPR Question No. 18 assumes a scenario in which FHCs do not have the authority to engage in Complementary Commodities Activities, we wish to first caution that even additional regulation of FHCs physical commodities activities short of prohibiting FHCs from engaging in these activities could lead to FHCs exiting the marketplace. For this reason, we address both the elimination of FHC authority and the imposition of additional regulation, as noted in ANPR Question No. 23, in this response.

We also wish to caution that one cannot restrict FHC involvement in physical commodity markets without impacting their ability to serve the needs of end-users in markets for commodity-related derivatives. Our Members rely on both types of services provided by FHCs and believe that participation in physicals markets is necessary to correctly price and make markets in related derivatives. Just as our counterparties transact in "physical" markets like US Treasuries to balance their positions and price their interest rate derivative offerings, swap dealers that make markets in commodity derivatives rely on their ability to transact in physical commodities to offer those hedging products to end users.

To the extent FHCs are no longer allowed to engage in Complementary Commodities Activities—or choose to cease these activities—our Members will be adversely affected and forced to seek alternative counterparties with which they can meet their business needs.

It is unlikely that all Members will be able to find a single alternative counterparty to serve their customized needs and, hence, they may have to rely on multiple counterparties. For example, those of our Members that rely on the same FHCs to assist with financing their businesses and hedging commodity risk—with the FHCs' ability to retain title to physical commodities a necessary complement to the hedging transactions—will be unlikely to find a single non-FHC counterparty to meet these needs, because non-FHCs, like foreign trading houses, do not have sufficient experience with financing transactions.

Further, the exit of FHCs from the physical commodity markets may compel our Members to transact with less-regulated, or even unregulated, entities. Such "replacement" entities will not be subject to robust regulatory requirements in the same manner as FHCs and likely will not be as creditworthy, or offer the same range of services, making them less preferable counterparties. Unlike FHCs, which are in the business of making markets, it is very possible that these "replacement" entities will accept only specific types of trades, leaving our Members with unmet business needs. In these cases, our Members will bear increased business costs, which will likely have to be passed on to their customers.

Finally, a mass FHC exit from the market would mean that those Members that rely on FHCs to purchase their physical commodities will lose very significant customers. These Members will be forced to try to find new customers to purchase their physical commodities and will be required to adapt their businesses to make up for lost revenue.

Restricting FHCs from engaging in physical commodities or imposing additional regulations that force them to depart from the physical commodities markets will have a significant adverse effect on our Members and their customers. The Board is considering additional regulations, in part, to ensure the safety of the financial system generally. We submit, however, that additional regulation in this area could harm many businesses and consumers, a result that also would burden the financial markets.

For the foregoing reasons, the Board should not impose additional regulation on FHCs with respect to their physical commodities activities. We appreciate the opportunity to comment on this issue and are available at your convenience to discuss this letter.

Sincerely,

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