March 31, 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 American Gas Association (AGA), America's Natural Gas Alliance (ANGA) and The American Exploration & Production Council (AXPC), (the "Associations," or "we") appreciate the opportunity to respond 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 the physical commodities activities conducted by financial holding companies (the "ANPR").

I. Introduction

AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. AGA advocates the interests of its members and their customers, and provides information and services promoting efficient demand and supply growth, and operational excellence, in the safe, reliable and efficient delivery of natural gas. There are more than 71 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 68 million customers — receive their gas from AGA members.

ANGA, Representing North America's leading independent natural gas exploration and production companies, America's Natural Gas Alliance works with industry, government and customer stakeholders to promote increased demand for our nation's abundant natural gas resource for a cleaner and more secure energy future and to ensure its continued availability.

AXPC is a national trade association representing 32 of America's largest and most active independent natural gas and crude oil exploration and production companies. Our members are "independent" in that their operations are limited to the exploration for and production of natural gas and crude oil. Moreover, our members operate autonomously, unlike their fully integrated counterparts, which operate in additional segments of the energy business, such as downstream refining and marketing. AXPC members are leaders in developing and applying the innovative and advanced technologies necessary to explore for and produce crude oil and natural gas, both offshore and onshore from unconventional sources, and that allow our nation to add reasonably priced domestic energy reserves in environmentally responsible ways.

The wellhead or upstream domestic natural gas market, along with the midstream and distribution segment, is dynamic and competitive. It is the envy of the world in terms of innovation, new entry, production, and delivery. But the benefits this brings to the nation and its consumers can only be realized if our members can depend on the efficient operation of a vibrant and robust market for natural gas, including the markets for derivatives based on this important commodity. Our members are engaged in natural gas and oil production; other members in the other segments of the natural gas industry regularly engage in trading of these physical commodities and physical commodities derivatives transactions. Properly functioning commodities and derivatives markets are crucial to our members' ability to manage risk and hedge against normal and expected market volatilities. This enables our members to manage commodity risks, while seeking to maintain the stability of their cash flows, and to serve their customers.

In this highly dynamic and competitive environment, our ability to serve our customers will be hampered if the Board places new restrictions on the commodity activities of financial holding companies (FHCs) and their affiliates. Simply put, limiting the ability of FHCs to participate in physical commodities markets will artificially restrict competition in the markets in which our members participate. We fear that reduced competition will result in lessened market liquidity and inefficient pricing for the commodities and commodity derivatives on which our members depend, hampering our members' ability to compete while diminishing the benefits the nation gets from a robust natural gas market. In addition, we believe that any new restrictions or onerous conditions on FHCs will benefit unregulated market participants and heighten the risk of abusive market practices.

II. Commodity Requirements

As noted earlier, the U.S natural gas market is among the most competitive in the world. As a result, our members are exposed to substantial price volatility and market fluctuations. To manage the risks attendant with these issues, our members routinely enter into physically-settled derivative transactions relating to the price of natural gas (e.g., forward contracts). For these derivative contracts, the ability to elect physical as opposed to mandatory cash settlement is frequently the most economically attractive option, because of the flexibility that the alternative manner of settlement provides. Affiliates of FHCs are among the leading providers of these risk-

mitigating derivatives products and related contracts. Reducing the number of companies that are willing to provide such products and contracts will undermine our ability to participate in the market.

III. The ANPR Threatens Increased Market Concentration and Corresponding Adverse Effects

The ANPR raises questions about whether commodities activities should still be permissible for FHCs and whether the conditions that have been imposed on FHCs that conduct such activities are still sufficient to protect the safety and soundness of FHCs and their subsidiary banks or thrifts. The ANPR contends that, in recent years, "there have been a variety of events and developments involving physical commodities activities that suggest that the risks of conducting these activities are changing and that the steps that firms may take to limit these risks are more limited."[1]

We disagree with the underlying premise of the Board's view. In our view, the commodities markets, like any other competitive market, benefit from a maximum number of stable and creditworthy competitors, offering a wide variety of products and contracts. According to the ANPR, 14 FHCs are currently authorized to engage in physical commodities activities, either under Section 4(k) or Section 4(o) of the Bank Holding Company Act of 1956 (the "BHC Act"). These FHCs are sophisticated participants in the commodities markets, and, with respect to commodity derivative activities, have engaged in cash-settled derivatives transactions well before physical trading activities were approved for FHCs in 2003. As a result, these FHCs participants have substantial market expertise and can structure commodity products efficiently to meet customer needs, including our members' specific physical commodities needs. FHC market expertise is particularly important in the case of physically settled OTC derivative contracts, which are essential for our members' hedging strategies.

A determination by the Board that physical commodities activities are no longer "complementary" to a financial activity is not supported by the competitive realities of the market place. It is hard to imagine how removing from the market or significantly curtailing the activities of 12 of these 14 FHCs can have anything other than a negative market impact. Imposing additional conditions, such as increased capital requirements, on these FHCs and the two FHCs that conduct physical trading activities pursuant to the grandfather authority contained in Section 4(o) of the BHC Act could well deter these FHCs from pursuing physical commodities activities and thereby reduce market participation as well. In the energy markets (e.g., natural gas) in which our members participate, eliminating, or substantially reducing, FHC participation would result in a sizeable percentage reduction in competition. [Indeed, for certain

[1] Advance Notice of Proposed Rulemaking, Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities, 79 Fed. Reg. 3329 (Jan. 21, 2014).

of the commodity products our members require – such as customized OTC derivatives – FHC affiliates are currently the only major market participants/market participants.]

We are concerned that, especially in the markets for customized commodity derivatives, a retreat by FHC affiliates will lead to greater market illiquidity and inefficient pricing. Market liquidity will suffer because FHC affiliates are frequently the most knowledgeable and active market participants and the most willing to enter into customized trades, and there are few potential new market entrants that can replace them. Reducing the number of market participants threatens higher prices for hedging transactions because end-users like our members will have fewer firms from which to request price quotations. These costs will need to be captured in the market. And if reduced market liquidity harms our members' ability to hedge their commodity risks, their overall financial performance will be adversely affected.

In addition, diminishing competition in the markets in which our members operate will lead to market distortions that will adversely affect our members' businesses. Our members will be required to allocate more of their capital to paying the remaining market participants for needed products and services, and not use that capital for more efficient purposes such as capital investment programs, job creation and acquisitions of additional production capacity.

Restricting the ability of FHCs to engage in physical commodities activities, therefore, will have a real tendency to produce "decreased or unfair competition," and an "undue concentration of resources" in the remaining commodities market participants, and thereby result in a loss of market efficiency.[2]

IV. In Many Cases, FHC Affiliates Are Preferable Counterparties Because They Are Regulated Entities

If, either because of outright activity restrictions or new conditions raising the cost of engaging in physical commodities activities, FHC affiliates reduce their market presence, our members' available counterparties will be entities not subject to Board supervision and regulation. In many cases, our members find FHC affiliates to be preferable counterparties, because their parents are required to meet minimum capital requirements on a consolidated basis, and because FHCs and their affiliates are subject to prudential safety and soundness regulation under the BHC Act and related statutes and regulations. As a credit and risk matter, therefore, it is prudent for our members to trade, and to engage in physically settled commodities derivative transactions, with FHC affiliates rather than unregulated counterparties. This is true even though the trades themselves may be subject to some U.S. regulation.

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[2] Under Section 4(k) of the BHC Act, the Federal Reserve, in determining whether an activity is complementary to a financial activity, is to determine whether performance of the activity by the FHC may reasonably be expected to produce public benefits, "such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or risk to the stability of the U.S. banking or financial system." 12 U.S.C. § 1843(j) (2).

Relatedly, recent developments have shown that certain physical commodities trading activities have migrated to participants headquartered outside the United States. In certain of these jurisdictions, the level of supervision of market participants is different in kind, not merely in degree, from supervision by the Board. In addition, certain of these jurisdictions are not as stable economically as the United States, with concerns being raised, for example, about the stability of banking systems and shadow financial systems. By being required to deal with market participants in those jurisdictions, our members take on country risk in addition to heightened credit and regulatory risk.

Although there has not been to date a significant commodity-related event that has caused FHCs the sort of "tail risk" that the ANPR describes, or indeed, any such event in which an FHC affiliate has been involved, recent history is filled with examples of the dangers of unregulated, shadow institutions taking on a large role in the financial system. Indeed, the growth of the shadow banking industry is almost always identified as one of the leading causes of the Financial Crisis of 2008 and the Great Recession that followed. Although there is considerable uncertainty that an FHC affiliate will be adversely affected by one-time environmental events like those mentioned in the ANPR, there is unquestioned certainty that if FHC affiliates leave the commodities markets, they will not be replaced by similarly regulated entities. [Moreover, as noted above, the "tail risks" associated with physical commodity purchase/sales and 3rd party storage and transport are limited and manageable.]

V. Commodity Activities Are Engaged in by the Largest, Most Highly Regulated FHCs and Are Subject to Limits on Their Size

Not only are the FHC affiliates that engage in physical commodities activities subject to comprehensive consolidated supervision, but the FHCs themselves are among the largest, most highly regulated FHCs in the world, as the ANPR itself notes. The supervision and regulation of globally systemically significant financial institutions has increased markedly both in the United States and abroad since the Financial Crisis. In addition, under both Section 4(k) and Section 4(o) of the BHC Act, physical commodities activities are subject to hard limits on the size of those activities – they may not grow beyond 5 percent of the FHC's consolidated Tier 1 capital or consolidated assets, depending on the legal authority.

In our view, the current overall regulatory scheme affecting the largest FHCs – heightened prudential regulation combined with the size limits mentioned above – is a better protection against the risks of "interconnectedness" and contagion than anything that exists in the unregulated space. The most obvious alternative providers of physical commodities services are undiversified commodity trading houses. It is far more likely that a "tail risk" event affecting the commodities industry would call into question the stability of firms highly concentrated in that industry, rather than diversified financial institutions where commodities activities are only one of many business lines.

VI. Certain FHC Affiliates Are Reducing Their Physical Commodities Activities As a Result of Other Concerns and Thereby Already Narrowing Market Participation

As the ANPR itself notes, certain FHCs have publicly announced their withdrawals from the physical commodities markets or curtailment of commodity-related activities. Contrary to the ANPR's suggestion, we do not believe that these announcements suggest anything about the continued linkage of commodities activities to financial activities – as the number of FHC participants in the industry will nonetheless remain high, and the withdrawals seem to be responses to overall conditions in the financial industry, such as higher general capital requirements and a perceived need to focus on certain business lines. As we note in the appendix to this letter, the linkage between financial and commodity products is as close as it was when complementary physical commodities activities were first authorized.

What these developments do indicate, however, is that as a result of market forces and business decisions, the commodities markets are losing FHC participants even in the absence of further Board regulation. As we have argued above, a reduction in the number of sophisticated participants – for whatever reason – adversely affects market liquidity and pricing, and therefore the interests of end-users like our members. In view of these market developments, we would urge the Board not to impose new additional and artificial restrictions on the activities of FHC affiliates.

VII. Conclusion

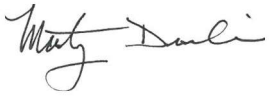
For the foregoing reasons, we believe that imposing additional restrictions or limitations on the physical commodities activities of FHC affiliates is unnecessary at this time and would be harmful to our members. We would urge the Board not to proceed with further rulemaking and to maintain the conditions that currently apply to FHC commodity activities.

[We have addressed certain specific questions posed by the Board in an appendix to this letter. We very much appreciate the opportunity to comment.]

Yours sincerely,

V. Bruce Thompson
President
American Exploration & Production Council

Dave McCurdy
President & CEO
American Gas Association



Marty Durbin
President & CEO
America's Natural Gas Alliance

Appendix – Answers to Specific Questions

2. What additional conditions, if any, should the Board impose on Complementary Commodities Activities?

For the reasons set forth above, we believe that the Board should not impose any additional conditions, including but not limited to enhanced capital requirements, increased insurance requirements, and new absolute dollar limits and caps based on a percentage of the FHC's regulatory capital or revenue.

12. What are the similarities and differences between the risks posed to FHCs by physical commodities activities, as described in the ANPR, and the risks posed to savings and loan holding companies that may conduct such activities?

We do not believe that the risks that the Board has identified in the ANPR support a change in existing regulation of physical commodities activities by FHCs. We note our understanding that Congress has made a judgment that so-called "grandfathered" unitary savings and loan holding companies are not subject to any activities restrictions as a matter of law as long as they comply with the conditions to the grandfather. We believe that having as many experienced participants in the relevant markets for commodities as possible is beneficial for end-users and their customers.

13. In what ways are non-BHC participants in the physical commodities markets combining financial and nonfinancial products or services in such markets.

In our experience, non-BHC participants conduct financial activities with respect to commodities, including by making commodity-related loans and equity investments.

14. What are the complementarities or synergies between Complementary Commodities Activities and the financial activities of FHCs? How have these complementarities or synergies changed over time?

We believe that there are the same complementarities between the financial activities of FHCs and Complementary Commodities Activities as when the Board first authorized the Complementary Commodities Activities. For example, FHC affiliates still make loans to companies engaged in commodity activities, which gives those affiliates expertise about the nature of those companies' businesses; this allows the FHC affiliates the ability to offer commodity derivative products – for which physical settlement is often the end-user's preferred option. By trading in the physical commodities markets, FHC affiliates are better able to customize and price physically-settled commodity derivatives. [This relationship may more pronounced for less liquid commodities. In light of this, it is possible for an FHC (or any other

market participant) to be active on a financial-only basis for certain highly liquid products (such as Henry Hub natural gas). At the same time, not having access to physical markets for other commodities (such as natural gas delivered at less liquid trading points) would substantially restrict the ability of a market participant (whether an FHC or otherwise) from being active in the market for such less liquid commodities.]

15. What are the competitive effects on commodities markets of FHC engagement in Complementary Commodities Activities?

As described above, FHC engagement has resulted in beneficial competitive effects by increasing the number of sophisticated participants in the commodities markets. This has resulted in efficiently-tailored end-user specific commodity products, greater market liquidity, and more efficient pricing for end-users and their customers.

16. Does permitting FHCs to engage in Complementary Commodities Activities create material conflicts of interest that are not addressed by existing law?

We have seen no material conflicts of interest created since Complementary Commodities Activities were authorized by the Board. As described above, we believe that there is a greater potential for material conflicts of interest being created by companies not subject to comprehensive regulation.

17. What are the potential adverse effects and public benefits of FHCs engaging in Complementary Commodities Activities?

As we have discussed in the body of our comment letter, we believe that it is the imposition of new restrictions on FHC commodity activities that will result in "undue concentration of resources, decreased or unfair competition," and losses, rather than gains, in efficiency.

18. How might elimination of the [Complementary Commodities] authority affect FHC customers and the relevant markets?

This question is answered at length in the body of our comment letter.

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? How should the Board formulate such requirements?

For the reasons discussed above, additional prudential requirements have the tendency to have the same adverse effects on competition, liquidity, and pricing as activity restrictions.

In addition, in enacting section 4(o) of the BHC Act, Congress made a judgment as to the appropriate manner of constraining risks from grandfathered activities, by imposing a percentage of total consolidated assets limitation. It therefore must be said to have taken the position that existing prudential standards were sufficient to protect FHC safety and soundness. Such existing standards have become stricter since the Financial Crisis and are sufficient, in our view, to protect 4(o) FHCs and the financial system.

24. Does section 4(o) of the BHC Act create competitive equity other issues or authorize activities that cannot be conducted in a safe and sound manner by an FHC?

As an end-user, we have seen no competitive equity or other issues created by Section 4(o)'s grandfather provision. Section 4(o) companies have conducted their 4(o) activities in a safe and sound manner both before and after Congress explicitly permitted grandfathered FHCs to conduct such activities in 1999.