

# CONVERSE and COMPANY, INC.

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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**

Converse and Company, Inc. thanks you for the opportunity to respond to the Board of Governors of the Federal Reserve System's (the "Fed") Advance Notice of Proposed Rulemaking regarding the activities of Financial Holding Companies ("FHCs") related to physical commodities (the "ANPRM"). We also appreciate the Fed analyzing this issue for the benefit of all market participants, including end-users like us. To that end, we submit this comment to assist the Fed and to make clear that any additional restrictions on FHCs' ability to trade in physical commodities will negatively impact end-users that rely upon physical commodities and financial instruments derived from commodities, to manage risk.

#### **I. Background**

Converse and Company, Inc. is a coal brokerage and logistics company that is located in Spartanburg, SC.

In the process of buying and selling coal, we transact in physical commodities and commodity derivatives. It is critical for our business to timely access these markets in order to hedge against normal and expected price volatilities while maintaining stable cash flows and serving our customers. For example, if we are in the market to purchase coal we need to have up to the minute pricing so we can transact quickly and be precise.

Accessing these markets, however, could be more difficult, more expensive and less efficient without the presence of FHCs. Although the physical commodities marketplace contains a variety of market participants, generally speaking, the market is dominated by a relatively small number of participants in each commodity sector, so competition and pricing could be affected if companies exit these markets. FHCs provide our businesses with a well-regulated counterparty/market-maker with which we can efficiently transact at the appropriate points in time when such actions are needed to best manage our risk. Further, FHCs' ability to offer a suite services, including funding, financing, and hedging products in different asset classes provides us and other end-users with the ability to manage our business risks conveniently and cost-effectively.

In our experience, FHCs are credit-worthy counterparties with market experience and the ability to handle market volatility. The ANPRM states, "The fact that a FHC has not been involved in such an event to date does not reduce the probability that such an event may occur." But this assertion is not substantiated by empirical data. Moreover, it stands to reason that a FHC, acting as a market maker is at extremely low risk of such an event. In fact, the market events identified by the Fed in its ANPRM and that serve as a basis for the position that additional regulation may be necessary only underscore the ability of FHCs to properly manage these risks and reinforce the importance of FHCs in these markets, particularly to end-users.

## **II. Additional Regulation of FHCs' Physical Commodities Activities Could Result In These Entities Exiting the Marketplace, Negatively Affecting End-Users**

A primary reason we transact with FHCs in [physical commodities and related derivatives]/[commodity derivative] transactions is because FHCs are highly regulated. Under the broad purview of the Fed, FHCs are subject to minimum capital requirements and safety and soundness regulations, among other statutes and regulations. In addition, FHCs are subject to regulation and oversight by the Securities & Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), and the Federal Energy Regulatory Commission ("FERC").

We fear that additional regulation of these activities, including, among other things, the imposition of increased capital requirements, will deter FHCs from participating in the physical commodities space. This fear is not without merit as some FHCs have already begun to withdraw from their physical commodities activities. It would only be reasonable to conclude that more FHCs, and their affiliates, will exit the marketplace if additional restrictions on their physical commodities activities are adopted. This could force end-users to consider transacting with foreign, or other less-regulated counterparties. It also could negatively impact liquidity and increase costs, making it more difficult and expensive for end-users to transact in physical commodities activities necessary to run their businesses and serve their customers.

Reduced liquidity is more than a theoretical concern. It is a likely result of recent decisions by certain FHCs to exit certain physical commodity markets. For example, liquidity in

California's wholesale electricity markets has diminished substantially over the last few years, as evidenced by a 36 percent reduction in total physical wholesale power sales at California's three main delivery points. The additional restrictions that the Fed is contemplating would only exacerbate this exodus and result in additional market harm.

Increased concentration will assuredly have the effect of increasing costs to access these services, which we, as end-users (and ultimately, our customers), will be forced to bear. It is also possible that the hedging transactions we engage in with FHCs will simply be unavailable as a result of the lack of market participants with the relevant type of expertise in the marketplace. Further our profitability may be threatened to the extent we are unable to appropriately and efficiently manage risk.

### **III. Conclusion**

For the foregoing reasons, we believe that the Fed should not impose additional restrictions on FHCs engaging in physical commodities activities. We and other end-users rely on FHCs as reliable, regulated counterparties for physical commodity activities and increased restrictions on FHCs in this space would likely negatively affect our ability to manage risks by unnecessarily increasing costs. Accordingly, we respectfully request that the Fed not proceed with any rulemaking in this area and instead that it continue its successful regulation of these entities within the current regulatory framework. We again appreciate the opportunity to comment and would be pleased to answer any questions the Fed staff may have for us as it continues to analyze these issues.

Yours sincerely,

A handwritten signature in dark ink, appearing to read "Lee Mason", with a long horizontal flourish extending to the right.

Lee Mason  
President  
Converse and Company, Inc.