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

**Re:** ***Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments [Docket No. R-1547; RIN7100 AE58]***

Philadelphia Energy Solutions LLC ("PES", "we," "us," and "our") owns and operates a merchant refinery in Philadelphia, Pennsylvania. The Philadelphia refining complex is a large-scale facility with a combined distillation capacity of 335,000 barrels per day, which makes it the largest refining complex in PADD I and the 10th largest in the United States. PES produces a range of products including gasoline and ultra-low sulfur diesel that are marketed primarily in Pennsylvania and the northeastern United States. PES is pleased to respond to the request for comments by the Board of Governors of the Federal Reserve System (the "Board") on its Notice of Proposed Rulemaking relating to the physical commodities activities conducted by financial holding companies (the "Proposed Rule").[1] PES is actively engaged in the commodities and commodity-based derivatives market as a large purchaser of crude oil and a seller of gasoline and other refined products.

## I. Introduction

End-users employ physical commodities and commodity-based derivatives to manage risks related to their global commercial activities. Accordingly, we believe our use of derivatives mitigates risk, rather than creating it. Hence, we encourage the Board not to make it more difficult or more expensive for firms like PES to achieve risk-mitigation through the careful use of commodities-related derivatives. Although we appreciate the Board's continued oversight of

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[1] Notice of Proposed Rulemaking, *Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments*, 81 Fed. Reg. 67220 (Sept. 30, 2016).

the U.S. financial system, we believe that certain aspects of the Proposed Rule will have unintended consequences on our ability to efficiently and effectively manage risk in our supply and distribution chains.

We are concerned that the Proposed Rule's new restrictions on the commodity activities of financial holding companies ("FHCs") and their affiliates will artificially restrict competition in and sap innovation and creativity from commodities markets while at the same time fueling market instability. We also fear that reduced competition will result in lessened market liquidity and higher prices for the commodities and commodity-related products on which we depend, hampering our ability to compete and threatening higher prices for our customers.

## II. The Proposed Rule Threatens Increased Risks and Costs for End-Users and the Financial Markets

As end-users of physical commodities and commodity-derivatives, we wish to emphasize that, like markets generally, the commodities markets benefit from robust competition. As previously noted in the Advanced Notice of Proposed Rulemaking, 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.[2] 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 FHC participants have substantial market knowledge, and they use their expertise to tailor commodity products efficiently to customer needs, including our specific needs related to the supply of significant volumes of crude oil and the sale of refined products. FHC market expertise is particularly important in the case of physically settled over-the-counter derivative contracts, which are essential to our hedging strategy.

Increased regulation and scrutiny on the activities of FHCs have prompted a reduction in the number of banks willing to transact in this space. Indeed, since the 2008 financial crisis, there has been a significant pullback by banks in the United States from the commodities markets: JPMorgan Chase, Barclays, and Deutsche Bank, for example, have all reduced their commodities activities. As a result, PES has already had to restructure our use of tailored derivative arrangements formerly provided by these entities at significant cost and disruption to our business operations. The Proposed Rule could further encourage the exodus of end-user counterparties and further concentrate risk within the financial markets. In particular, we would point to two aspects of the Proposed Rule that would push FHCs out of the commodities business: (1) increased risk weighting for Section 4(o) FHCs and (2) the restriction of Section 4(k) complementary authority.

The risk weighting assigned by the Board to physical commodities held by FHCs under Section 4(o) authority is unwarranted and unjustified. For example, under the Proposed Rule, if an FHC held $500 million in assets under its Section 4(o) powers, those assets would be subject to the 1,250% risk-weighting and the FHC would be required to hold $625 million in total capital against the assets in order to remain well-capitalized (i.e., the minimum well-capitalized calculations would convert the assets into risk-weighted assets of $6.25 billion, thus requiring

[2] 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).

$625 million in total capital for a 10% Total Capital/RWA ratio). We would note that the 1,250% risk-weighting, the highest risk-weighting that can be assigned to an asset, was designed and intended for only the riskiest of bank exposures (e.g., securitization exposures, where an FHC is not able to demonstrate a comprehensive understanding of the potential losses that could result from a default on the securitization), which we do not believe physical commodities to be.

However, FHCs will likely find little relief under complementary authority provided under Section 4(k) in order to continue to hold physical commodities. To further push out FHCs from commodities activities, the Proposed Rule imposes additional restrictions on Section 4(k). Under the National Bank Act, an FHC's national bank subsidiary can hold physical commodities in amount equal to 5% of its total notional value of its derivatives in that particular commodity. The Proposed Rule would limit an FHC's derivatives activities by now counting it towards the 5% of Tier 1 capital that the Board has imposed under Section 4(k).

As an end-user of commodities derivatives, we rely on sophisticated counterparties that understand the unique commercial risks inherent in the commodity supply and distribution chain that underpins our business model. Moreover, the size and stability of FHCs, coupled with their ability to deal in physical commodities, offer economies of scale that allow for highly tailored and affordable derivatives products. The Proposed Rule would undermine such synergies and add additional challenges to companies that serve the real world economy.

We are concerned that, especially in the markets for customized commodity products, a retreat by FHC affiliates will lead to greater market illiquidity and higher prices. To the detriment of end-users, these FHCs would not be able to maintain their critical intermediary roles in the commodities markets. The lack of competition—with a resulting concentration of risk—would almost assuredly increase costs for end-users as they search for new intermediaries with which to transact.

For the foregoing reasons, imposing additional restrictions or limitations on the physical commodity activities of FHC affiliates would be harmful to end-users and should be reconsidered. We would urge the Board not to proceed with further rulemaking and to maintain the conditions that currently apply to FHC commodity activities.

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Respectfully submitted,

John B. McShane

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