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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]*

Cogentrix, a manager and operator of power generation facilities across the United States, 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 Cogentrix is actively engaged in the power and gas commodity markets for the purpose of managing the commodity exposure associated with the assets it manages.

I. Introduction

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

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) [hereinafter the "Proposed Rule"].

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 these markets while 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

A. 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 BHCA.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. FHC market expertise is particularly important in the case of physically settled OTC 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 Financial Crisis, there has been a 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. 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 \$625 million in total capital for a 10% Total Capital/RWA ratio). By means of comparison, the 1,250% risk-weighting, the highest risk-weighting that can be assigned to an asset, was designed 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). 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

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).

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).

B. As an end-user of commodities derivatives, we rely on sophisticated counterparties that understand our unique commercial risks. 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,



Lisa A. Krueger
Chief Commercial Officer