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Subject: Physical Commodities-FHCs

Comments:

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Proposal:Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities [R-1479]
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When used responsibly, derivatives can be a legitimate hedge for individual instruments, LIBOR rates, US Treasury rates, commodities, and curriencies. When used irresponsibly, derivatives can manifest into a gross material misstatement of fact. A derivative can extract value out of real things and divert extracted value to private interests effectively when abused.. Derivatives can also be used as a price control grid to set interest rates hindering free market forces.

Yesterday,the FDIC initiated a lawsuit against several primary agents and too-big-to-fail banking insitutions for LIBOR rigging. If LIBOR is manipulated, would not other commodities possibly be manipulated as well? If merchant banks manipulate LIBOR, should be they allowed to hold short positions on a commodity that they serve as a fiduciary custodian in the warehousing business? Derivatives used responsibly should meet requrements specified in Dodd Frank that are "within bounds" of an effective hedge. In other words, the fair value of the item that is hedged should be within proximity of the fair value of the matching derivative. If a commodity is not perfectly hedged, there is said to be a degree of "ineffectiveness." A few years ago, a commodity manager who was employed as a primary agent of the Federal Reserve stated on public television that they were not engaged in manipulating precious metal prices with paper contracts. They stated that they were "running a flat or relatively flat matched book." A short period after this statement, the same bank with the same manager was citationed by the FERC with a fine for manipulating the electricity prices in California.

In today's world, commodity prices continue to be set at the margin with paper derivative contracts. This has resulted in daily exchanges of paper contracts that over a short period represent many times annual physical production of the commodity. The paper contract representations of the physical metal appears to be a far cry from a legitimate hedge.

Merchant banks state that they provide liquidity, assist as market makers, and facilitate protective hedges as custodians for their customers. This said, in the case of silver and gold, custodians appear to have entered the ineffective hedge rhelm without appropriate oversight. Appropriate internal control on derivative activity should require a segregation of duties between fair value measurement and derivative trading activities. Likewise, the custodial warehousing of precious metals should be

segregated from an entity that is betting against its own customers by hedging above and beyond the levels maintained in the warehouse or in the banks name. It seems extreme conflicts of interest would be exhibited where merchant banks can warehouse commodities for others, yet make the market for the commodity they are warehousing.

When a single institution controls 62,000 contracts it represents a corner on a market where few commercially large players participate. If the bank sells 11,000 of these contracts in two weeks, they are not exercising appropriate management of legitimately matched hedges in my view. Note that the head financial regulator of Germany stated recently that the "metals manipulation was worse than LIBOR." Now that the FDIC is suing these insitutions for LIBOR rigging, is any regulator, or even a primary regulator going to look into the documented abuse that is stated to be "worse" than LIBOR?

Limiting bank holding company activities in physical commodity warehousing and related trading is pivotal to control systemic risk. The tiny precious metals markets are actually some of the largest, if not the largest market in the World based on the paper claims for each ounce of metal.