PUBLIC CITIZEN Protecting Health, Safety and Democracy

April 15, 2014

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

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Docket No. R-1479

RIN 7100 AE-10

Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities

Dear Secretary,

On behalf of more than 350,000 members and supporters of Public Citizen, we submit these comments related to the "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities."

> In **summary**, Public Citizen believes that separating banking from commerce serves as a foundational principle of the American economy. This policy has served the nation well, evinced by harsh history lessons when banks breached the banking/commerce wall. Recent events reinforce this concern. In the past decade, the Board has allowed Morgan Stanley, JP Morgan Chase and Goldman Sachs , among others, to engage in commodities-related business, which has generated real and potential hazards. We therefore welcome the Board's public review of this issue. We also compliment the board for highlighting the safety and soundness elements of commodities ownership. Commodities business can involve catastrophes generating losses well beyond those in traditional banking. At the same time, we are concerned with the focus of the board's review and questions. Foremost, the Board must insure that financial institution ownership of commodities generates public benefits. The Board need not explore methods to accommodate the interests of banking profit.

General Discussion

Since 1787, commercial and agrarian interests have endorsed the need to separate banking from commerce, which became expressed in law.[1] The National Bank Act of 1863 limited nationally chartered banks to "the business of banking."[2] The Banking Act of 1933 further separated loan-making from selling and trading in securities. In 1956, Congress approved the Bank Holding Company Act and declared: "No bank holding company shall...acquire direct or indirect ownership or control of any voting shares of any company which is not a bank."[3]

With these statutes, Congress responded to realized problems when banking spilled into commerce. In the 19th century, JP Morgan monopolized railroads, raising rates. In 1907, an attempt to corner the copper market ignited panic and revealed an asset bubble.[4] In the 1920s, bankers created illusory value in stock pools. In the 1980s, real estate developers found ready access to credit by acquiring savings-and-loans and erected endless "see-through" office buildings void of tenants.[5]

Public Citizen supports the separation of banking and commerce as a foundational principle for the American economy. We recently issued a report addressing this policy.[6] We are joined by numerous other interests, including labor, retailers, and even bankers. Progressive organizations have long championed the separation of banking and commerce. [7] Labor representatives call the separation "bedrock economic policy."[8] The National Grocers Association and the National Association of Convenience Stores support separation,[9] as mixing the two can "lead to systemic problems." [10] The National Association of Realtors observes that banks can become "powerful, concentrated

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[1] Arthur Wilmarth, "The Separation of Banking and Commerce," (May 2007), Connecticut Law Review, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=984103&download=yes

[2] J.B. Walter, "Banking and Commerce," Federal Reserve Bank of Richmond Economic Quarterly Volume 89/2 (Spring 2003), available at: http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.200.1161&rep=rep1&type=pdf

[3] 12 U.S.C. 1841

[4] Hearings of the House Subcommittee of the Committee on Banking and Currency," (1913), available at: /

[5] See list of hearings from Senate Committee on Banking, Housing and Urban Affairs, 1987-1988, available at: http://www.banking.senate.gov/public/_files/Legislativecalendar100th.pdf

[6] "Big Banks, Big Appetites," by Public Citizen (April, 2014), available at: http://www.citizen.org/documents/banking-commodities-consequences-repport.pdf

[7] "The Case for Preserving the Separation between Banking and Commerce," by Jonathan Brown, Multinational Monitor, (April 1997), available at: http://www.multinationalmonitor.org/mm1997/041997/brown.html

[8] Testimony of Bridget Kelly, , UFCW, Senate Banking Committee (October 4, 2007), available at: http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=949c6aa8-bab0-4b71-918b-69ddf7aa915b

[9] Testimony of Thomas Bliley, House Financial Services Committee, (July 12, 2006), available at: http://democrats.financialservices.house.gov/media/pdf/071206sbc.pdf

[10] Letter to Sen. Chris Dodd, from Sound Banking Coalition, (Feb 8, 2008), available at: https://www.icba.org/files/ICBASites/PDFs/ltr020808.pdf

conglomerates" that harm small businesses and consumers.[11] Many bankers themselves endorse the policy, including the Independent Community Bankers of America.[12] Paul Volcker, when he chaired the Federal Reserve in 1987, summarized: "Widespread affiliations of commercial firms and banks [carry] the ultimate risk of concentrating banking resources into a very few hands, with decisions affecting these resources influenced by the commercial ownership links, resulting in inevitable conflicts of interest."[13]

In the last decade, however, the Board has permitted a number of bank holding companies to purchase commodities firms using statutes described in the ANPR. In the case of JP Morgan Chase, the board rendered a considered decision in 2005 that the bank's commodities business would yield a public benefit. In the cases of Goldman Sachs and Morgan Stanley, the Board's permissions came as a little-noticed byproduct of an emergency order intended to rescue these firms from crisis in 2008.

In none of these cases have the results been unblemished. The Board's current review provides a venue to repair this record. The Board can apply at least two tests: whether bank ownership of commodities yields a public benefit; and whether commodity ownership poses problems for the safety and soundness of the financial institution.

In the case of JP Morgan, the Federal Reserve can apply a public benefits test to energy and other commercial enterprises the firm owns or proposes to purchase.

Episodes of market abuse hardly argue for a universal public benefit. Even outside such episodes, it is difficult to understand how a profit-maximizing bank will generate public benefits through commodity ownership. On its face, the term means that bank ownership generates better prices or overall economic efficiency. But a bank cannot simultaneously sacrifice prices for the benefit of consumers and oblige its shareholders by maximizing profits. The conflicts between the public and shareholders "are not rare," understated Joshua Rosner, a finance expert with Graham Fisher & Co.[14]

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[11] National Association of Realtors, website, visited Jan. 27, 2014, available at: http://www.realtor.org/banks_and_commerce.nsf; A letter to Congress expanding on the associatons position is available at: letter from realtors to congress opposing banks in real estate: http://www.realtor.org/banks_and_commerce.nsf/docfiles/L_09Jan_s356.pdf/$FILE/L_09Jan_s356.pdf

[12] Chicago Fed Letter, "The Mixing of Banking and Commerce: A conference summary", Nisreen H. Darwish, Douglas D. Evanoff, Essays on Issues, The Federal Reserve Bank of Chicago, Number 244a, November 2007, last accessed July 22, 2013, available at: http://qa.chicagofed.org/digital_assets/publications/chicago_fed_letter/2007/cflno vember2007_244a.pdf

[13] "Business Forum: Does The U.S. Need Superbanks? Why Bigger Isn't Better in Banking", Thomas Olson, The New York Times, June 28,1987 available at: http://www.nytimes.com/1987/06/28/business/business-forum-does-the-us-nee d-superbanks-why-bigger-isn-t-better-in-banking.html

[14] Statement of Joshua Rosner, managing director, Graham Fisher & Co., before the U.S. Senate Committee on Banking, Housing and Urban Affairs, (July 23, 2013); available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=5d268a77-d49f-4807-9edd-de59483aee7f

Nor does bank participation in commodities businesses yield greater economic gain. Identifying empirical evidence for this thesis has proven "difficult," concluded a survey by the FDIC.[15]

Nor is it necessary for commodity firms to have bank parents. Most commodity firms already exist outside of banks. There are also cases where such firms have operated under bank control and then independently, with no apparent detriment. For example, Freeport Commodities has operated under a variety of owners, including JP Morgan (as Sempra Energy [16]) and also independently. The senior management has been the same.[17]

Perhaps most troubling, the Federal Reserve is not positioned to determine the public benefits of bank ownership of commodities. The agency has no direct role in the supervision of the commodities markets generally, acknowledged a Board official. [18] Its determinations, by its own account, are "subjective." [19] The Commodity Futures Trading Commission (CFTC) regulates commodity futures and option markets. The existence of an alphabet soup of financial regulators, marked by overlaps as well as gaps, doesn't help either. In a letter to the Senate Banking Committee, CFTC Commissioner Bart Chilton wrote, "There is zero interest in … information sharing on the part of the professional staff at the CFTC [with the Federal Reserve]."[20]

With the existence of commodity market abuse by banks, the absence of clear public benefits, and the lack even of a rigorous regime to measure these benefits, the Federal Reserve can and should reverse its permissions for commodity ownership by applying a strict public benefits test.

There remains the problem of the "merchant" banking and "grandfather" statutes where banks need not meet a public benefit tests. These are the paths through which Morgan Stanley and Goldman Sachs have retained certain commodities businesses.

In these cases, as well as all Board decisions (including permissions under the "complementary" loophole), the Board must uphold safety and soundness of the institution and the financial system. As a regulator, the Federal Reserve's powers to uphold safety and soundness are broad and potent. Under the statute 12 USC 1818 (b), if "in the opinion of" the Federal Reserve, a firm engages in "an unsafe or

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[15] "The Future of Banking in America," by Christine Blair, FDIC Banking Review, (2004, Vol. 16, No. 4), available at: http://www.fdic.gov/bank/analytical/banking/2005jan/article3.pdf

[16] "JP Morgan will buy Sempra Business from RBS," by Jeffrey McCracken, Wall Street Journal, (Feb. 16, 2010), available at http://online.wsj.com/news/articles/SB10001424052748703562404575067982178809878

[17] See company website at: http://www.freepoint.com/about-us/ Also, "Sempra Reborn as Freeport Commodities," by David Sheppard, Reuters, (Jan 13, 2013) Available at: http://www.reuters.com/article/2012/01/13/us-freepoint-messer-idUSTRE80C2FA20120113

[18] Testimony of Michael Gibson before the Senate Banking Committee, (Jan 15, 2014), available at: http://www.federalreserve.gov/newsevents/testimony/gibson20140114a.htm#f10

[19] Testimony of Michael Gibson before the Senate Banking Committee, (Jan 15, 2014), available at: http://www.federalreserve.gov/newsevents/testimony/gibson20140114a.htm#f10

[20] Letter, from CFTC Commissioner Chilton, to the Honorable Sherrod Brown, chair, Subcommittee on Financial Institutions, (Jan 15, 2014).

unsound practice," the Board may terminate this activity.[21] Under the Federal Reserve's Regulation Y, "Whenever the Board believes an activity . . . . constitutes a serious risk to financial safety, soundness, or stability . . . the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary."[22]

The Board should exercise its broad authority to protect the safety and soundness of the financial system from the potential catastrophes from commodity ownership. The Board appropriately recognizes these risks. The grandfathered firms should be held to a strict safety and soundness test so that catastrophes do not cascade through the system.

In general, we applaud the Board for reviewing its policy. We encourage a thorough examination of the full implications of permitting bank ownership of commodities.

Questions

Question 1. *What criteria should the Board look to when determining whether a physical commodity poses an undue risk to the safety and soundness of a BHC?*

Generally, the Board should adopt a precautionary principle, and a worst-case scenario for proposed commodities ownership; if this worst-case would be lead to safety problems, ownership should be denied.

We recognize that the Board is not well positioned to assess safety and soundness threats associated with commodities ownership. Other regulators such as the CFTC and Federal Energy Regulatory Commission supervise these businesses, and even then, only with respect to rates and market abuse. The agencies do no concern themselves with viability of the commodity-owning firms as prudential banking regulators do with banks. Bank regulators exercise secondary supervision of a bank's basic business of loan making, such as the adequacy of capital, liquidity, or sound underwriting standards. But a bank regulator does not assess the prospects of a specific enterprise to which a bank extends credit. Commodity ownership nevertheless supposes that the regulator will understand the safety, soundness and prospects of a commodity business. The Board should instead reject commodity ownership by banks.

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[21] The Board's powers are described as those of any relevant banking agency, under 12 USC 1818 (b)-(n), available at: http://www.law.cornell.edu/uscode/text/12/1818

[22] Regulation Y, available at: http://www.law.cornell.edu/cfr/text/12/225.4 . See Sec. 225.4 Corporate practices

Question 2. *What additional conditions, if any, should the Board impose on Complementary Commodities Activities? For example, are the risks of these activities adequately addressed by imposing one or more of the following requirements: (i) enhanced capital requirements for Complementary Commodities Activities, (ii) increased insurance requirements for Complementary Commodities Activities, and (iii) reductions in the amount of assets and revenue attributable to Complementary Commodities Activities, including absolute dollar limits and caps based on a percentage of the BHC's regulatory capital or revenue?*

Determining what additional conditions should be applied to commodities ownership assumes that the Board will be able to adopt safety and soundness criteria. We consider such an endeavor difficult, as discussed under Question 1. Losses from commodities enterprises can far exceed the value of the investment itself. See our discussion under Question 6. Current risk metrics for banking, including those that apply to trading, simply fail to measure risks associated with commodities ownership.

For example, under the Volcker Rule, a bank's ownership of a hedge fund is restricted to 3 percent of its capital, and the capital invested in the hedge fund must be above that of its regulatory minimum. However, such a capital regime applied to commodity ownership may be insufficient to meet liabilities of an environmental or other catastrophic event.

Certain safeguards may provide some relief. Increasing insurance can mitigate routine but not major problems. Reducing the proportion of bank assets or revenue associated with commodities ownership would reduce risk, but even a small ownership position could lead to a major loss. Given the absence of foolproof safeguards, the Board should simply deny commodity ownership.

Question 6. Should the type and scope of limitations on Complementary Commodities Activities differ based on whether the underlying physical commodity may be associated with catastrophic risks? If so, how should limitations differ, and what specific limitations could reduce liability from potential catastrophic events?

The commodities business is indeed prone to costly problems. Examples include the explosion at British Petroleum's Deepwater Horizon oil platform;[23] ruptures in gas transmission pipelines at Pacific Gas and Electric Company (PG&E), which led to $1 billion in penalties and another $1 billion in new investment;[24] an armed attack by "very highly trained individuals" at a PG&E substation near San

[23] "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities," Federal Reserve, (January 2014), available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140114a1.pdf

[24] "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities," Federal Reserve, (January 2014), available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140114a1.pdf

Jose, Ca.;[25] the historic Exxon Valdez oil spill of 1989; and the Three Mile Island nuclear power incident of 1979.

Consider the oil spill from Deepwater Horizon—just one platform. This resulted in cumulative losses of $42.2 billion in clean-up costs and liability to coastal businesses.[26] That's a far larger loss than the value of the platform, which was arguably worth less than $1 billion.[27] In conventional banking, losses can be no more than the value of a loan. Had a bank extended a loan for the construction of the platform that its owner could not repay, the bank's loss would be restricted to the loan value, not the $42 billion in losses due to liability of the platform's owner for the oil spill.

Importantly, when banks do own commodities, they do so largely with borrowed funds. Banks are highly leveraged. Borrowed money from deposits, bonds and other financing accounts for more than 90 percent of the value of the property that banks control. In its latest quarterly report, Goldman reported assets of $923 billion. But its liabilities were $845 billion. Total shareholder equity at Goldman stood at $75 billion.[28] By contrast, British Petroleum reported $300 billion in assets, $181 billion in liabilities, and shareholder equity of $118 billion.[29] In other words, even though BP is smaller than Goldman Sachs in assets, its equity buffer could better withstand the $42 billion loss from the Deepwater disaster than could Goldman.

Morgan Stanley acknowledges these risks: "Our commodities business . . . exposes us to the risk of unforeseen and catastrophic events, including natural disasters, leaks, spills, explosions, release of toxic substances, fires, accidents on land and at sea, wars, and terrorist attacks that could result in personal injuries, loss of life, property damage, and suspension of operations. As a result, our financial condition, results of operations and cash flows may be adversely affected by these events. "[30]

Certainly, financial holding companies should be barred from owning commodities that are clearly associated with catastrophic risk. However, we are not aware of commodities that do not pose such risks. Grain or water may sound benign, but each could contain a pathogen leading to human health hazards.

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[25] "Sniper Attack on PG&E," by Steve Johnson, San Jose Mercury News, (Feb. 5, 2014) Available at: http://www.mercurynews.com/crime-courts/ci_25072628/attack-pg-e-substation-sparks-concerns-about-possible

[26] "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities," Federal Reserve, (January 2014), available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140114a1.pdf

27 A list of losses from other oil rigs shows values of $200 million to $1.1 billion. http://www.oilrigdisasters.co.uk/ Exxon reports that it's entire plant and equipment is valued at $226 billion. See Exxon annual report (2012), available at: http://www.sec.gov/Archives/edgar/data/34088/000003408813000011/xom10k2012.htm

[28] Goldman Sachs quarterly report, (fourth quarter, 2013), available at: http://www.sec.gov/Archives/edgar/data/886982/000119312513430752/d590232d10q.htm

[29] British Petroleum, financial statement, contained here: http://finance.yahoo.com/q/bs?s=BP+Balance+Sheet&annual

[30] Morgan Stanley annual report (2012), available at: http://www.sec.gov/Archives/edgar/data/895421/000119312513077191/d484822d10k.htm#rom484822_5

Moreover, a financial firm entering commodities business will look to enterprises that exceed its current return from traditional banking. This will necessarily involve more risk, as risk and return are linked.

Where a bank holding company is unable to meet the liabilities of a catastrophe in its commodities ownership, it will be the taxpayer who suffers the burden. Such a scenario should be a core consideration of any Board regulation that emerges from this process.

Question 7. Does the commitment not to own, operate or invest in facilities for the extraction, transportation, storage, or distribution of commodities adequately insulate a BHC from risks associated with such facilities, including financial risk, storage risk, transportation risk, reputation risk, and legal and environmental risks? If not, what restrictions should the Board impose to ensure that such extraction, transportation, storage or distribution facilities do not pose safety and soundness risks?

Pure commodity ownership, even without simultaneous ownership of the enterprises involved in the chain of custody of that commodity, can present risk. With some commodities such as oil, the risks are clear, such as through spills and the subsequent environmental liability. Even where a court may eventually find a tanker company leased by a financial holding company liable for an oil spill, panicked bank creditors are unlikely to wait for legal deliberations. See also our response to Question 20.

Question 9. What negative effects, if any, would a BHC's subsidiary depository institution experience if the parent BHC was not able to engage in Complementary Commodities Activities?

We are not aware of customers who would avoid a depository institution because it lacked an affiliate owning commodities. On the contrary, such customers may view such a clean bank as free of conflicts. Bank holding companies thrived before engaging in commodities. Several firms that once engaged in commodities are now leaving the field, arguing that these firms do not perceive a disadvantage.

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

Only 12 out of the 4000 bank holding companies currently conduct physical commodities activities under complimentary authority. Two of the largest have signaled they intend to cease such activities. This suggests that the synergies may be limited.

As the Board reviews assertions of synergies and complementarities, we urge careful attention to concrete evidence. We believe the burden should rest with BHCs to demonstrate the synergies. Moreover, if these synergies generate profits for the bank, the BHC should detail how those profits accord with a public benefit and do not increase economic risk. If physical commodity ownership provides an information advantage for trading, this advantage naturally comes as a disadvantage for the counterparty. We do not view this synergy as a public benefit.

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

By nature, large financial institutions with assets exceeding those of traditional commodities firms, including producers, are positioned to exert anti-competitive practices. As J. Christopher Giancarlo said in his confirmation hearing to serve as a member of the Commodity Futures Trading Commission, "Absolute dominance can lead to absolute abuses." [31]

The market currently is dominated by a relatively small number of participants, suggesting that large financial firms have displaced other would-be competitors through the advantage of their massive balance sheets.

Our discussion under Question 17 explores competitive effects with respect to public harms.

Question 16. *Does permitting BHCs to engage in Complementary Commodities Activities create material conflicts of interest that are not addressed by existing law? If so, describe such material conflicts and how they may be addressed.*

Trading with insider information in commodities markets is not illegal (as it is in securities markets). This allows financial institutions to exploit information gleaned from direct commodities ownership and relationship with non-bank commodities producers and owners.

A firm that owns a metals warehouse under the 4(o) grandfather clause could obtain inside information about supplies that could be used for commodity ownership under the complementary authority.

Generally, existing laws may address some material conflicts, but lack willing enforcers. Communication between regulatory agencies remains imperfect, subject to extensive memoranda of understanding to protect confidentiality. Regulatory purviews both overlap and contain gaps.

Finally, a BHC that doesn't engage in commodities ownership may be more likely to make simple loans to a commodities firm instead of more complex financing arrangements that may be

[31] See comment letter from Sunesis Capital, LLC, (March 2014), available at: http://www.federalreserve.gov/SECRS/2014/March/20140321/R-1479/R-1479_031414_112106_596601797334_1.pdf

influenced by the BHC's other ties to the commodities firm. For example, a BHC that deals in commodities might temporarily purchase the oil from an oil importer through a repurchase agreement instead of simply extending credit to the importer. The importer might feel compelled to accept such an arrangement, even if less advantageous than credit, because of the BHC's other ties to the importer, such as underwriting the importer's stock. Generally, more expensive credit arrangements would drive up the cost of commodities for consumers.

Question 17. *What are the potential adverse effects and public benefits of BHCs engaging in Complementary Commodities Activities? Do the potential adverse effects of BHCs engaging in Complementary Commodities Activities, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, or risk to the stability of the United States banking or financial system, outweigh the public benefits, such as greater convenience, increased competition, or gains in efficiency?*

Adverse affects exist. The full extent of such abuse is difficult to determine in no small part because BHC ownership of commodities itself isn't known. The financial institutions do not detail specific ownership; instead, they list only aggregate ownership. Nor does the Board publish this specific information. A complete determination would require an examination of each of these bank-owned commodities enterprises, and the results.

Further, we believe that the Board calculation of whether public benefits outweigh adverse effects is untenable. If a commodities business performs adequately during 11 months, providing reasonable prices and convenience, but then engages in market manipulation for the 12th month, we don't think this means that the benefits outweigh the adverse effects.

We think history may be a better determinant. Commodities markets performed adequately before the entrance of bank holding companies. The entrance of bank holding companies has led to glaring problems.

Goldman Sachs has drawn criticism for a Detroit metals warehouse it owns. In July 2013, the *New York Times* reported: "Hundreds of millions of times a day, thirsty Americans open a can of soda, beer or juice. And every time they do it, they pay a fraction of a penny more because of a shrewd maneuver by Goldman Sachs and other financial players that ultimately costs consumers billions of dollars." In this case, a Goldman subsidiary owns 27 industrial warehouses in the Detroit area to store customers' aluminum. But it seems that the warehouse workers simply shuffle the metal, without delivering it to customers. "They load in one warehouse. They unload in another. And then they do it again." Since Goldman bought the warehouses, the wait time has grown more than tenfold.[32] U.S. regulators and the

[32] "A Shuffle of Aluminum," by David Kocieniewski, New York Times (July 20, 2013), Available at: http://www.nytimes.com/2013/07/21/business/a-shuffle-of-aluminum-but-to-banks-pure-gold.html

Department of Justice have reportedly launched initial investigations into the metals warehousing business.[33]

In a parallel case, in 2009, Morgan Stanley hired a supertanker to store oil at sea presumably as a means to remove supply and profit from higher prices later. Noted one observer, "Investment banks like Morgan Stanley . . . were the leaders in keeping 80 million barrels of oil in storage in takers at sea—nearly enough oil to supply the world for a day." [34]

Meanwhile, JP Morgan Chase was fined $410 million in an energy rate-manipulation case, the largest penalty since Enron.[35] "JPMorgan's brazen, Enron-style market manipulation cost California ratepayers over $120 million," said Rep. Henry Waxman (D-Calif).[36] British authorities also questioned JP Morgan's control of metals business, calling it "restrictive" and "manipulative."[37]

Mega-banks, of course, aren't the only abusers in commodities markets. Enron's energy manipulations and frauds harmed electricity consumers. Unlike any other industry, bank funding for its assets enjoys the backing of the federal government. Insurance from the FDIC means depositors can be less concerned about management integrity at the bank. The Federal Reserve provides low cost abundant funding, especially in times of peril. These legal backstops exist for no other industry. These bank privileges should be used for specific goals, namely impartial loan-making. These privileges should not be exploited to sprawl into commodities, let alone manipulate these markets.

Finance expert Rosner testified before the Senate Banking Committee that the experiment of allowing banking into commerce "has gone better for the banks than it has for consumers. Electricity users appear to pay more because of Wall Street involvement, aluminum for airplanes and soda cans costs more, and some say gasoline at the pump costs more -- without any measurable benefit to anyone but the banks."[38]

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[33] "It'll Be Way Harder For Goldman Sachs And Morgan Stanley To Get Out Of The Physical Commodities Business Than JP Morgan," Reuters (July 29, 2013), available at: http://www.businessinsider.com/morgan-and-goldman-on-physical-commodities-2013-7

[34] Tyson Slocum, "Testimony, US Senate Permanent Subcommittee on Investigations, (Nov. 3, 2011); and Alaric Nightingale, "Morgan Stanley Hires Supertanker to Store Oil in Gulf," January 19, 2009, www.bloomberg.com/apps/news?pid=newsarchive&sid=aIbVHft2R3SE

[35] Federal Energy Regulatory Commission, "Order Approving Stipulation and Consent Agreement," (July 30, 2013) Available at: http://ferc.gov/EventCalendar/Files/20130730080931-IN11-8-000.pdf. Since this penalty, JP Morgan has said it intends to exit the commodities business

[36] "JP Morgan to pay $410 million in FERC settlement," Bloomberg, (July 30, 2013) Available at: http://www.bloomberg.com/news/2013-07-30/jpmorgan-to-pay-410-million-in-u-s-ferc-settlement.html

[37] House of Commons of the United Kingdom, Select Committee on Science and Technology, "Strategically important metals - Science and Technology Committee", "Examination of Witnesses (Question Numbers 70-107)", February 16, 2011, available at: http://www.publications.0parliament.uk/pa/cm201012/cmselect/cmsctech/726/11 021602.htm

[38] Statement of Joshua Rosner, managing director, Graham Fisher & Co., before the U.S. Senate Committee on Banking, Housing and Urban Affairs, (July 23, 2013); available at

Question 18. *In what ways would BHCs be disadvantaged if they did not have authority to engage in Complementary Commodities Activities? How might elimination of the authority affect BHC customers and the relevant markets.*

The Board should not consider the profitability of a banking enterprise as a criterion for justifying bank participation. Instead, the Board should weigh the public benefits and the threat of systemically risky behavior.

Some customers may assert that they welcome BHC participation. We urge the Board to weigh whether these firms maintain other relationships with the bank that may influence this view. For example, the bank may serve as a creditor or underwriter to the firm. Firms that assert that BHCs make reliable partners as regulated, well capitalized firms may well be expressing a reliance on the subsidies of deposit insurance, Federal Reserve lending, and the hazard of too big to fail credit advantages. We do not believe that such subsidies are an appropriate reason to justify BHC participation in commodity ownership.

Question 19. *Should the Board's merchant banking rules regarding holding periods, routine management, or prudential requirements be more restrictive for investments in portfolio companies that pose significantly greater risks to the safety and soundness of the investing BHC or its subsidiary depository institution(s)? How could the Board evaluate the types and degrees of risks posed by individual portfolio companies or commercial industries?*

Merchant banking enterprises in commodities or other industries that pose safety and soundness risks presents an insurmountable problem. BHCs may not participate in active management of a merchant banking enterprise, which reduces the ability of the bank to ensure safe conduct. Since merchant banking involves bank capital investment as opposed to traditional arms-length lending, the BHC is at once more exposed to loss with less ability to manage risk. Using its safety and soundness oversight powers, the Board should restrict any ownership of commodities sought through the merchant banking statute.

Question 20. Do the Board's current routine management restrictions and risk management requirements sufficiently protect against a court piercing the corporate veil of a BHC's portfolio company? If not, what additional restrictions or requirements would better ensure against successful veil piercing actions?

The Board should be mindful that a catastrophic event such as news of an oil spill may lead to panic by BHCs creditors. While litigation exploring this corporate veil might prove a BHC free of liability after the fullness of deliberation, such panicking creditors may not wait. The harm to the financial institution and

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http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=5d268a77-d49f-4807-9edd-de59483aee7f

potential contagion will have long since been suffered. Consequently, the Board should reject commodity ownership.

Question 21. *What are the advantages and disadvantages of the Board raising capital requirements on merchant banking investments or placing limits on the total amount of merchant banking investments made by a BHC? How should the Board formulate any such capital requirements or limits?*

Ordinary capital requirements for merchant banking enterprises that may suffer catastrophic events cannot assure the safety of the BHC, as the liability may be well beyond the value of the asset. Nor does limiting the total amount of merchant banking investments provide complete insulation. Just as one rogue trader brought down Barings Bank, one catastrophic event could fell a major financial institution.

That said, merchant banking should require greater capital than traditional banking. Greater capital serves as a buffer for losses before the financial firm is unable to oblige its creditors. Merchant banking capital should be at levels of a traditional commodity firm, which is many multiples that of a major bank.

Question 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?*

We strongly urge that the Board apply its full suite of authorities to consideration of grandfathered commodities businesses of BHCs. Foremost, the Board should apply safety and soundness standards. Catastrophic events in many types of commodities could jeopardize a large financial institution and release contagion in the system. The Board should reject commodity ownership altogether so as to ensure that taxpayers will not be burdened with to costs of catastrophe.

If the Board elects not to order divestiture based on safety and soundness, the Board should substantially increase capital requirements as a buffer against loss. Ordinary capital increases the Board has recommended for traditional banking safety would be woefully inadequate to address major losses from commodities. Instead, the Board should consider the kind of capitalization of a traditional commodity firm, which is many multiples that of a major bank.

Should the Board not require divestiture of commodity firms, we support better disclosure of ownership. This will help the public, shareholders, other responsible regulatory agencies, and scholars assess the breadth of ownership and vulnerabilities. Such disclosure can also help highlight the presence or absence of public benefits

We are unaware of any meaningful disadvantages of either complete divestiture, or greater capital and disclosure requirements. Greater capital will be welcomed by the bank's current creditors, as it serves as better insulation against creditor loss.

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

The grandfather clause constitutes a clear advantage to the two firms that qualify over the 4,000 bank holding companies that do not. While the other clauses permitting commodity ownership include restrictions on duration, such as with merchant banking, or require a public benefits test, such as with complementary activity, there are no similar restrictions on grandfathered activity.

While all activity must be conducted safely, it is incumbent upon the board to ensure rigorous safety and soundness criteria for grandfathered activity.

We appreciate the opportunity to comment on this issue. For questions, please contact us at bnaylor@citizen.org, or (202) 580-5626

Sincerely,

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