BETTER MARKETS
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VIA ELECTRONIC DELIVERY

April 16, 2014

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

RE: Public Comment Period on the Advance Notice of Proposed Rulemaking, "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities"

Dear Mr. Frierson:

Better Markets, Inc.[1] appreciates the opportunity to comment on the matters identified in the above-captioned Advanced Notice of Proposed Rulemaking ("Release"). The Release addresses key issues relating to physical commodity activities of financial holding companies and the restrictions of those activities. In advance, thank you for your consideration of our views.

OVERVIEW

The issue of physical commodity activities conducted by financial holding companies ("FHCs") is one of the last, and unfortunate, policy vestiges of a decade of deregulation. In this regard, the Board of Governors of the Federal Reserve ("the Board") has an important role in ensuring that those activities are appropriately regulated.

The permissive, deregulatory language of several sections of the Gramm-Leach-Bliley Act of 1999 ("GLB Act") and the equally permissive subsequent interpretation by the Board, has led to an expansion of banking endeavors never envisioned by Congress. Specifically, the provisions governing physical commodities activities of the Bank Holding Company Act of 1956 ("BHC Act"), as amended by the GLB Act, namely, Section 4(k)(4)(H) relating to investment banking activities, Section 4(k)(1)(B) relating to "complementary activities", and Section 4(o) relating to grandfathered activities, have been increasingly used by FHCs in a manner that poses grave risks to FHCs, our financial markets, and our economy.

[1] Better Markets, Inc. is a non-profit organization that promotes the public interest in capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

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The commercial physical commodity activities of FHCs, which have been approved by the Board or grandfathered in, have fostered three dangerous and unacceptable consequences: increased risks to the stability of FHCs, an unfair and anticompetitive environment, and the potential for massive market manipulation. Unless a regulatory or legislative response is undertaken, conditions will grow increasingly unsafe and FHCs will continue to pose significant dangers.

The warehousing of aluminum by Goldman Sachs, revealed last summer, illustrates this point. Through its ownership of warehouses that store aluminum for other banks, traders, and producers, Goldman was reportedly able to increase the delay of its aluminum deliveries (from 6 weeks to 16 months) thereby increasing the costs of storage and allegedly manipulating the price of aluminum. This action resulted in Goldman Sachs, a bank, driving up prices of everyday products for consumers like soda cans and car parts.[2]

Moreover, by owning the warehouses, Goldman has had and continues to have unique, inside information on the future costs of aluminum, which presents a clear conflict of interest with its business as a dealer in the derivatives markets and may lead to further market manipulation. Indeed, JPMorgan Chase, another FHC, was accused last year of such manipulation in the energy markets stemming from its ownership of power plants that the bank acquired from Bear Stearns in 2008.[3]

In the comments below, we urge the Board to take swift and comprehensive action to remedy the increasingly dangerous situation presented by FHCs through their physical commodity holdings. In particular, we suggest the Board take the following actions:

- The Board must reconsider their constricted interpretation of congressional intent behind these provisions, and their limitations, as it relates to the current broad array of non-financial activities engaged in by FHCs.
- The Board must make explicit the precise nature of those activities determined to be "complementary" to financial business, and the specific methodology under which such determinations are performed. This analysis and its results must be made public.
- The Board must actively and meaningfully engage in coordination and, crucially, information sharing among related market regulators.
- The Board must remedy the unnecessary and anti-competitive situation created by the grandfather provision.

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2 *See*: *Goldman Sach's Aluminum Pile*, NY TIMES, July 26, 2013, *available at* http://www.nytimes.com/2013/07/27/opinion/goldman-sachss-aluminum-pile.html?_r=0.

3 *In Re Make-Whole Payments and Related Bidding Strategies*, 144 FERC ¶ 61,068 (July 30, 2013). *See* also Jessica Silver-Greenberg & Ben Protess, *JPMorgan Looks to Pay to Settle U.S. Inquiries*, DEALBOOK NY TIMES, July 30, 2013, *available at* http://dealbook.nytimes.com/2013/07/30/jpmorgan-to-pay-410-million-in-power-market-manipulation-case/.

- The Board must ensure that non-banking businesses are not afforded the unfair advantage of access to federal Discount Window funding, and other implicit and explicit subsidies afforded to the banking system.

In the Release, the Board has unfortunately chosen to restrict the potential remedies for these problems to imposing additional capital requirements and insurance obligations. However, these self-imposed limitations must be rejected as wholly inadequate. Rather, the Board should proceed under its plenary authority and directly disallow unacceptable and inappropriate ownership arrangements.

1. The statutes governing the commodities activities of FHCs are limited and were never intended to permit the wide-ranging commodities activities present today.

When Congress considered the statutes on complementary activities of FHCs, it clearly did not anticipate that they would be used to permit the level of non-banking activities permitted today, either by being grandfathered in or approved by the Board. Indeed, the testimony providing justification for the provision was focused on seemingly uncontroversial ownership such as magazine publications which might augment financial services.[4] However, as applied by the Board to date, those narrow provisions have been dramatically expanded, opening the door for a panoply of diversified commodity ownership activities by FHCs. These activities are an unnatural and inappropriate expansion of FHC activities and purposes and something Congress never approved before or after the law was approved. If the matter had been fully and properly considered by Congress, issues such as anti-competition and market manipulation, among others, would surely have been seen as far too problematic to approve the provisions.

The GLB Act provided three distinct authorities under which BHCs may engage in non-banking endeavors, each with explicit (although often not optimally clear) limitations. In particular,

- Merchant Banking Authority: Under Section 4(k)(4)(H)[5] of the BHC Act as amended, a FHC's non-banking activities, must, among other requirements, be made as part of a "bona fide underwriting or merchant or investment banking activity." Furthermore, the investment must be held "only for a period of time [generally ten years] to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the FHC's merchant banking investment activities." Additionally, the FHC may not "routinely manage or operate" any portfolio company in which it made the investment, except as may be necessary in order to obtain a reasonable return on investment upon resale or disposition.

[4] Testimony of Michael Patterson, Vice Chairman, JPM, before the Banking and Financial Services Committee hearing, February 10, 1999.

[5] Public Law 106-102, the Gramm-Leach-Bliley Act of 1999, amendment to the Public Law 84-511, the Bank Holding Company Act of 1956, Section 4(k)(4)(H).

- Complementary Activity Authority: Section 4(k)(1)(B)[6] allows FHCs to conduct activities, subject to Board approval, that are determined to be "complementary to a financial activity" of the FHC. In making a determination, the Board must weigh the benefits of allowing the activity against the risks posed by such an allowance. Specifically, the Board must consider such things as convenience, competition, and efficiencies that would be promoted if a FHC is granted approval to engage in such complementary investments. At the same time, the Board must consider several potential negative factors, including if such complementary activities may result in undue concentration, decreased or unfair competition, or conflicts of interest.

- Grandfather Authority: Section 4(o)[7] of the BHC Act also provides a narrow safe harbor permitting a non-bank holding company that had commodities operations before 1997 and that becomes a FHC after November 1999 to retain those operations for, under subsection (a) two years, subject to an additional three year extension by the Board.[8]

These statutory limitations seek to generally continue what has been a longstanding restriction on ownership of physical commodities. The primary purpose of the FHC must remain purely "financial" in nature. Indeed, on its face, the law **does not** permit FHCs, whose expertise is (and should be) focused on finance, to engage in indisputably non-financial ventures. This makes sense since FHCs, by their nature, do not have the business expertise required to run such agriculture, energy, or metals-related ventures. The skills and experience of a banker obviously do not translate into those of a gas pipeline operator, for instance.

Similarly, banking analysts, banking auditors, and even investors specializing in FHCs cannot be expected to contain the skillset necessary to effectively monitor and analyze a non-financial commercial endeavor conducted by an otherwise financial or banking institution. Indeed, due to the woefully inadequate reporting and disclosure requirements with respect to such non-financial businesses, it is likely that many investors and analysts are simply unaware of the broad set of risks posed by such extraneous endeavors.

The recent bankruptcy of James River Coal is just one example of the challenges of the physical commodities industry – a leveraged business facing competitive and regulatory pressures as well as logistical, practical challenges unique to a commercial

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6 Public Law 106–102, the Gramm-Leach-Bliley Act of 1999, amendment to the Public Law 84-511, the Bank Holding Company Act of 1956, Section 4(k)(1)(B).

7 Public Law 106–102, the Gramm-Leach-Bliley Act of 1999, amendment to the Public Law 84-511, the Bank Holding Company Act of 1956, Section 4(o).

8 This section currently only applies to Goldman Sachs and Morgan Stanley, who ironically only became FHCs because of their systemic importance as revealed during the financial crisis when they were permitted to convert to a FHC virtually overnight.

enterprise[9]. The company had over 30 operating subsidiaries, each with its own logistical procedures oriented around the mining, warehousing, transportation, and marketing of physical coal, all of which are currently seeking Chapter 11 protection. These commercial challenges are of a nature FHCs have neither the expertise nor the business model to adequately cope with.

Furthermore, the Board, a prudential banking regulator, is ill-equipped to review, determine and opine upon the specific risks associated with the ownership or operation of various commodity businesses, some very complex and interrelated. The Board does not possess the expertise, let alone adequate data, to meaningfully oversee how such businesses operate or the markets in which they trade—markets which can impact virtually every U.S. citizen. Indeed, it cannot be expected that the Federal Reserve System – either as a central bank or prudential banking regulator – would have ever been intended to do so. Nonetheless, the largest banks have capitalized on the weak and poorly designed system of oversight to greatly expand the scope of their industrial footprints. Congress clearly would not have intended for such a result and, on reflection, the Board should so conclude.

2. The Board's approach toward complementary activities has been subject to inadequate constraints and introduces significant conflicts of interest.

The Complementary Activities Authority allows FHCs to conduct certain activities that are not "financial" in and of themselves, but that are determined to be "complementary to a financial activity" of the FHC. While originally stemming from an uncontroversial allowance,[10] this provision has since been unfortunately stretched by the FHCs to the extent that seemingly any activity that generates a profit is argued to be "complementary," even if the activity is clearly unrelated and not "complementary" to the FHC.

While we acknowledge that the statutory limitations on the extent of this authority are not as clear as desirable, they have nevertheless been largely ignored by the Board in its approval of new complementary FHC activities.[11] For example, it is manifestly unfair that those FHCs (including large foreign banking entities) that engage in "complementary" commodity activities can take advantage of unfettered access to cut-rate money from the Federal Reserve's Discount Window while U.S. commodity end-users and other business competitors enjoy no such access.

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9 Swetha Gopinath, *James River Coal files for bankruptcy protection*, Reuters, April 7, 2014, *available at*: http://www.reuters.com/article/2014/04/07/james-river-coal-bankruptcy-idUSL3N0MZ3S220140407.

10 Testimony of Michael Patterson, Vice Chairman, JPM, before the Banking and Financial Services Committee hearing, February 10, 1999.

11 As an example, the 2003 order issued by the Board to allow Citigroup to take physical delivery of commodities (including oil, natural gas, and agricultural products), as a complementary activity to its commodity derivatives trading business, was 9 double -spaced pages that included no quantitative or analytical basis for granting approval. http://www.federalreserve.gov/boarddocs/press/orders/2003/20031002/attachment.pdf.

Indeed, the entire permissive regime adopted by the Board with respect to complementary activities has allowed conflicts of interest, anti-competitive practices, and even manipulation to flourish. As noted in a November 2013 Government Accountability Office report, the government support for many of these institutions has even "raised concerns about moral hazard and the appropriate scope of federal safety nets for the financial sector."[12]

Furthermore, the Board's lenient policy in effectuating the orders approving FHC complementary activities, have created an unacceptable level of risk associated with owning a commodity business. This risk has been concentrated among 12 FHCs—11 of which have been designated as globally systemically important banks.[13] To make matters worse, these FHCs are precisely the same institutions that fueled the 2008 financial crisis and necessitated massive government bailouts because of their tremendous concentration and interconnectedness. The permissive orders of the Board have only exacerbated systemic risk, further placing the economy and the American public at risk of yet another massive government bailout.

Simply put, there are unacceptable risks associated with a FHC's exposure to a commodity business. Should a commodity business fail, let alone be held responsible for some environmental disaster such as an oil spill, it could cause a FHC bankruptcy similar to Lehman Brothers. The resultant repercussions could be calamitous for the FHC and, potentially, our economy.

Compounding these risks is the reality that when FHCs own physical commodity investments, conflicts of interest may run rampant. Markets are supposed to be based, by and large, on the fundamentals of supply and demand. However, if a FHC can impact the supply or demand of a commodity through its investment, ownership, or control of a commodity-related business, it can then take advantage of this position in the commodity and derivatives markets. And, the access to the information gleaned through proprietary knowledge of the supply chain can lead to perverse incentives.

For example, if a FHC can engage in or induce the stockpiling of commodities in a warehouse, thereby limiting the available supply (as Goldman reportedly did with its aluminum warehouses), it could impact if not control the mechanism by which prevailing market prices are determined. It is not difficult to see how that ability to determine the price of an underlying commodity could be a significant competitive advantage when dealing in derivatives based on that commodity.

If an FHC knows, through its vantage point afforded by ownership of the warehouses that timely delivery of the commodity will face challenges in the future, the FHC could place a bet against the price of the commodity through its derivatives desk and profit based on this non-public information. When prices rise, the FHC could simply begin

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12 Government Accountability Office Report, *Government Support for Bank Holding Companies*, Nov. 2013, *available at* http://www.gao.gov/assets/660/659004.pdf.

13 Release 79 Fed. Reg. 3,332.

to sell commodity contracts that were purchased at a lower price prior to the release of the commodity from storage. The FHC could even carefully balance the outflow of the commodity from the warehouse to ensure that prices remain high for some period of time.

It is precisely the coincident ownership of the commodity-related business and derivatives dealing business that creates the significant conflict of interest: FHCs are able to both control the means of determining the price of a commodity and engage in financial transactions dependent on that same commodity. If the FHC did not own the commodity-related business, the scenarios described could not occur.

Currently, the publicly reported commodities ownership activities of the largest FHCs indicate that such conflicts of interest are abundant. As just a few examples:

- Morgan Stanley owns a fuel distributor, as well as a stake in oil tankers, and simultaneously maintains derivatives dealing operations in the very same commodity markets—crude oil and other energy commodities.[14] A recent lawsuit alleges that Morgan Stanley colluded with the oil producer Royal Dutch Shell to manipulate the price of oil.[15]

- Similarly, Citigroup, Goldman Sachs, and Bank of America reportedly all have certain ownership interests in power plants.[16] And, of course, they also all trade energy contracts.

- As noted above, Goldman Sachs owns a network of aluminum warehouses, and, naturally Goldman trades in aluminum in the commodities markets. Some end-users (brewers and soft drink producers, for example) have suggested that their aluminum deliveries have been intentionally delayed by Goldman.[17]

- JPMorgan Chase also has owned aluminum warehouses and has been similarly accused of hoarding the commodity to manipulate prices.[18] Likewise, JPMorgan Chase trades in aluminum in the commodities markets.

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[14] *Wall Street's grandfathers of commodities to survive Fed revamp better than others*, REUTERS, Feb. 12, 2014, *available at* http://www.reuters.com/article/2014/02/12/us-fed-banks-commodities-analysis-idUSBREA1B09720140212.

[15] Bob Van Voris et al., *Brent Crude Traders Claim Proof BFOE Boys Rigged Market*, BLOOMBERG BUSINESSWEEK, Nov. 2013, *available at* http://www.businessweek.com/news/2013-11-06/brent-crude-traders-claim-proof-bfoe-boys-manipulated-oil-market; *see also* Complaint, McDonnell v. Royal Dutch Shell, No. 1:13-cv-07089-UA (filed Oct. 4, 2013), *available at* http://online.wsj.com/public/resources/documents/PlattsLawsuit.pdf.

[16] *Morgan Stanley Oil Tankers Raise Market Power Concern at Hearing*, BLOOMBERG, July 23, 2013, *available at* http://www.bloomberg.com/news/2013-07-23/morgan-stanley-oil-tankers-raise-market-power-concern-at-hearing.html.

[17] *Goldman Sach's Aluminum Pile*, NY TIMES, July 26, 2013, *available at* http://www.nytimes.com/2013/07/27/opinion/goldman-sachss-aluminum-pile.html?_r=0.

[18] Andrew Harris & Margaret Cronin Fisk, *JPMorgan Sued with Goldman in Aluminum Antitrust Case*, BLOOMBERG, Aug. 7, 2013, *available at* http://www.bloomberg.com/news/2013-08-07/jpmorgan-sued-with-goldman-in-aluminum-antitrust-case.html.

Nevertheless, those who profit from the commingling of banking and commerce argue that the FHCs provide an essential service that sustains and complements the commodities industry. This argument, however, is unsupported by history. In fact, FHCs and other financial institutions were clearly able to efficiently and effectively serve their customers prior to the enactment of the GLB Act and the complementary activity provisions just 15 years ago. Conversely, commodity companies were able to hedge their risks and access credit efficiently before their facilitating FHCs entered these markets as competitors.

FHCs, of course, are not philanthropic enterprises seeking to merely aid their clients by owning various interests. Far from it. They are profit-driven businesses, and the ability to own "more" business enterprises merely suggests that they can exploit those enterprises for a profit. The Board's allowance of FHCs to enter the business of physical commodity ownership is a clear example of a solution to a problem that did not exist.

In summary, FHCs should not be permitted to own these other businesses because it creates an unacceptable level of risk and market manipulation stemming from a lack of expertise, conflicts of interest, and interconnectedness. Such ownership erodes the traditional and congressionally intended limitations on FHC ownership of physical commodities. The historic separation of banking and other commerce, such as commodities business, has served our nation extremely well. That separation should not be weakened, but fortified.

3. To protect the safety and soundness of our economy the Board must take a more prescriptive and restrictive approach toward "complementary activities" by FHCs.

As detailed above, the Board has taken an unduly permissive approach and permitted commodities activities by FHCs far above and beyond what Congress intended in permitting "complementary" activities in the GLB Act. To protect the safety and soundness of FHCs and our economy, the interpretation by the Board of "complementary activity" must be prescriptive and restrictive.

The Board must comprehensively consider the negative repercussions of any complementary activities, taking an expansive view to include potential consequences outside of the Board's particular interest or area of expertise, such as physical and derivative contracts that can impact our economy and the public. In so doing, the Board should coordinate with other regulators, in particular the Commodities Futures Trading Commission ("CFTC").

Moreover, detailed information about the permitted complementary activities is still deficient in the public domain. Specifically, the Board should release such information to the public on a quarterly basis, consistent with the release of information on the Discount Window—that is: no longer than every two years, but earlier if the Chair determines it to be in the public interest.

4. **The Board must require the FHCs to divest commodities activities upon the expiration of the statutory time limitations.**

As noted above, both the Merchant Banking Authority, under section 4(k)(4)(H), and the Grandfather Authority, under section 4(o), impose statutory limitations consistent with the goal of ensuring that FHCs primarily engage in **financial** activities. As with the Complementary Activity Authority in section 4(k)(1)(B), the Board must revise its permissive stance and take a more prescriptive approach that respects the letter and spirit of the statutory limitations.

Section 4(k)(4)(H) of the Bank Holding Company Act, as amended by the GLB Act, permits certain ownership in non-banking businesses that are "part of a bona fide underwriting or merchant or investment banking activity," **provided** that such ownership interests "are held for a period of time to enable the sale or disposition thereof" and that the FHC "does not routinely manage or operate such company or entity except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition." The Board has interpreted this section in Regulation Y to generally limit non-banking businesses to 10 years and has further qualified management restrictions.[19]

This default "10 year" license to engage in unacceptably risky commodities activities in Regulation Y must be amended. The statute specifically provides that a FHC may only own non-banking business "for a period of time to enable the sale or disposition thereof." The statute says nothing about a 10 year license. To be consistent with the statute and to appropriately address the risk inherent in commodities activities by FHCs, the Board must amend Regulation Y to provide that a FHC may only hold a commodities business to the extent necessary to be able to sell such business, and when such an opportunity to sell arises, the Board must require immediate divesture.

With regard to section 4(o), the Grandfather Authority, two FHCs – Goldman Sachs and Morgan Stanley –have been permitted to engage in complementary activities without Board Order approval, or even so much as a notice. This enormous loophole in the law, added at the "last minute" before the legislation was approved, was almost an "afterthought."[20] The grandfathering clause is so extremely anti-competitive that even other large FHCs (which have won complementary Board Orders) complain that Goldman and Morgan Stanley possess unique unwarranted advantages.[21]

Despite the anticompetitive nature of the provision, Congress expressly created reasonable limits governing non-banking activities of FHCs that were grandfathered in after the statute was enacted. Specifically, subsection (a) states that no FHCs that use the grandfather authority shall retain those non-banking activities for more than two years,

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19 Release 79 Fed. Reg. 3,334.

20 *Wall Street's grandfathers of commodities to survive Fed revamp better than others*, Reuters, Feb. 12, 2014, *available at* http://www.reuters.com/article/2014/02/12/us-fed-banks-commodities-analysis-idUSBREA1B09720140212.

21 *Id*

subject to an additional 3 year extension by the Board having been given the 5 year grace period and the three year extension permitted by section 4(o), Goldman and Morgan Stanley should no longer be able to engage in commodities activities under this provision. Mandated grandfather ownership divestiture is required.

5. The Board must coordinate with other regulators to ensure adequate supervision and oversight.

While the Board approves FHC commodity activities and possesses information relating thereto, other commodity market regulators do not have access to FHC commodity-related ownership information. The information is not shared with the market regulators, primarily the CFTC, but also the Federal Energy Regulatory Commission ("FERC") and the Securities and Exchange Commission ("SEC").

Indeed, there is no formalized mechanism, such as a memorandum of understanding ("MOU"), for accepting or sharing significant ownership and market-related information.[22] This is a major market blind spot that can lead to serious and significant market malfunctions that may impact the FHC, the markets themselves, the economy, and ultimately, the public.

Specifically, the precise nature and percentage of any ownership arising out of these authorities should be detailed with descriptions of any potential impact upon supply and demand fundamentals, and shared with interested oversight and enforcement officials at other financial regulators (CFTC, FERC, SEC, and OCC). Such information determinations should be discussed, considered, and acted upon as part of the coordinated work that Congress expected from the Financial Stability Oversight Council ("FSOC").

Additionally, basic information about a FHC's commodity ownership should be presented in a time-certain manner (as recommended previously) on the Board's website in an easy-to-understand fashion for the benefit of the public and commodity firms, and not privileged.

One of the key criticisms of the "public stewards of our financial system" by the Financial Crisis Inquiry Commission ("FCIC") in its 2011 Report is that leading up to the 2008 financial collapse, "they lacked a full understanding of the risks and interconnectedness in financial markets."[23] Indeed, a nearly complete absence of inter-agency coordination and information sharing ensured that regulators "did not have a clear grasp of the financial system they were charged with overseeing."[24]

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22 See, e.g., Memorandum of Understanding between the Federal Energy Regulatory Commission and the Commodity Futures Trading Commission, available at http://www.ferc.gov/legal/mou/mou-ferc-cftc-jurisdictional.pdf.

23 Financial Crisis Inquiry Commission Report, Conclusions of the Financial Crisis Inquiry Commission, *available at* http://fcic.law.stanford.edu/report.

24 Financial Crisis Inquiry Commission Report, Conclusions of the Financial Crisis Inquiry Commission, *available at* http://fcic.law.stanford.edu/report.

The existing environment, marked by excessive FHC ownership of commodities enterprises coupled with regulatory silos and information gaps, echoes the FCIC's expressed concerns. To remedy this concern, the Board must prioritize the improved coordination among regulators and take a broader view of markets. It is unacceptable to simply suggest that commodity or physical markets are not within the jurisdiction of the Board, and therefore, of marginal interest.

Markets are inter-related and FHCs, which are under the purview of the Board, participate in them. In this respect, we specifically suggest that the Board seek continuous, and formalized, input from other regulators (CFTC, FERC, SEC, and OCC) related to the work of the Board's Large Institution Supervision Coordinating Council ("LISCC"). Coordination among regulators, viewed by some as a pedestrian or insignificant supervisory responsibility, is actually vital, yet it has all too often been ignored. The Board should take the lead, through the LISCC, in ensuring all is being done to protect our economy and the public in this area.

6. The Board must consider the impact of FHCs' commodity activities on other laws.

In amending the currently permissive scheme applicable to commodities activities of FHCs, the Board must also give due weight to other areas of the law that may be thwarted without necessary changes. In particular, the Board must address the new regulatory regime embodied in the Dodd-Frank Act, a law designed to reduce systemic risk to prevent another financial crisis and economic collapse. Moreover, the Board must take into account laws governing anti-trust, insider trading, and anti-manipulation to ensure that it does not provide FHCs with a dangerous and unacceptably risky loophole.

Congress enacted—and late last year financial regulators approved rules related to—the Volcker Rule, a key provision of the Dodd-Frank Act.[25] The law and the regulations thereto guard against bank speculation in markets for proprietary interests. If, however, a FHC has ownership in a commodity-related business, the FHC may claim they have a proprietary business interest that should be hedged in markets. It would claim that the trading would not be on behalf of customers (as is allowed under the Volcker Rule), but rather for their own hedging activity, and therefore, they would argue, would not technically be impermissibly speculative in nature. Consequently, such an expansion of ownership by a FHC could, in essence, be used to game an end-run around the Volcker Rule.

Furthermore, commodity exchange officials currently establish and enforce "position limits." Such position limits seek to minimize excessive speculation in a commodity contract by setting a cap on concentration levels held by one trader. However, there are exceptions to such limits granted by the exchanges. The exceptions are granted when a trader demonstrates a legitimate business risk needs to be hedged—like owning a commodity or commodity-related business. There is no evidence that an exchange has **ever**

[25] The Volcker Rule is implemented by Title VI of the Dodd-Frank Act, Public Law 111-203.

refused to grant such an exemption. Should a FHC seek such an exemption, due to their commodity-related ownership, precedent indicates it will be granted. The result is that a FHC, already positioned to influence the supply and demand of a commodity, may acquire yet further power to destabilize or manipulate the markets through commodity positions that exceed normally allowable limits. In fact, something similar has already taken place with regard to the energy markets and electricity prices.[26]

As discussed above, FHCs that own such commodity businesses have what amounts to insider information about supply and demand fundamentals of commodities in which they trade. Not only is this anti-competitive, it also can lead to insider trading and manipulation. The environment whereby a FHC may undertake such ownership with the opportunity to engage in potentially abusive market maneuvers should not exist.

The most efficient and effective way to thwart such abuses is to revoke the orders that have been improvidently granted by the Board allowing FHCs to own commodity-related enterprises. In addition, the Board should adopt a new approach, in line with the above comments, to ensure that any commodities-related activities by FHCs are appropriately narrow and limited.

7. FHCs with commodity ownership should not have access to the Discount Window.

Historically, the U.S. banking system has been fashioned to ensure that institutions taking deposits and engaged in commercial lending do not own non-financial interests—preventing concentration of potentially monopolistic economic power, among other undesirable consequences. The effect of maintaining such a separation has been to promote safety and soundness of insured depository institutions, and to enable an efficient and effective flow of credit.

Yet, one consequence of large FHCs owning commodity-related businesses is to do so while having access to the Federal Reserve Discount Window. It is one thing to permit abundant and inexpensive money to be used for financial business activities, but when such cut-rate funds are used as a mechanism to support an otherwise competitive commodity activity, it is manifestly unfair to others who may not access such special, federally-subsidized, low-cost funds. It is antithetical to competition.

Furthermore, we have recently witnessed, from an enforcement perspective, situations where some banks have abused markets while enjoying billions of dollars from the special privilege of being federally-subsidized through access to the Federal Reserve Discount Window.[27] The Discount Window and other Board programs have been used at a

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[26] *Attorney General Kamala D. Harris Announces $300 Million Settlement with JP Morgan Chase*, Department of Justice News Release, Nov. 19, 2013, *available at* https://oag.ca.gov/news/press-releases/attorney-general-kamala-d-harris-announces-300-million-settlement-jp-morgan.

[27] Section 10B of the Federal Reserve Act provides the statutory framework for such Board programs, including the Discount Window.

higher average rate for larger banks and bank holding companies. In fact, unprecedented sums of subsidized aid to financial institutions have been extended in recent years, much of it in the wake of the financial crisis, including more than a trillion dollars in loans and hundreds of billions of dollars in capital and guarantees.[28] To permit such assistance to FHCs that own physical commodity businesses amounts to yet another subsidy, which is unjustifiable. The simple and appropriate response is to deny, or greatly restrict, the ability of FHCs to own commodity businesses.

CONCLUSION

Unless the Board undertakes a full-scale rulemaking to further deny and restrict such ownership, FHCs will continue to be vulnerable to risks due to a lack of expertise, will continue to enjoy grossly unfair advantages, and will continue to threaten market manipulation. Unless the Board takes action, the overall safety and soundness of FHCs, and our economy, remain in jeopardy.

We are hopeful this comment letter aids the Board in preparing, proposing, and ultimately finalizing a rulemaking related to these critical matters. Thank you again for your consideration of our views. We would be pleased to provide further information upon request.

Sincerely,

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[28] *Government Support for Bank Holding Companies*, Government Accountability Office Report, Nov. 2013, *available at* http://www.gao.gov/assets/660/659004.pdf.