

FEDERAL RESERVE SYSTEM

Société Générale
Paris, France

Order Approving Notice to Engage in Activities Complementary to a Financial Activity

Société Générale, a foreign bank that is treated as a financial holding company (“FHC”) for purposes of the Bank Holding Company Act (“BHC Act”),¹ has requested the Board’s approval under section 4 of the BHC Act and the Board’s Regulation Y to engage in physical commodity trading in the United States.² Société Générale currently conducts physical commodity trading and related activities outside the United States.³

Regulation Y authorizes a bank holding company (“BHC”) to engage as principal in derivative contracts based on financial and nonfinancial assets (“Commodity Derivatives”). Under Regulation Y, a BHC may engage in such activities involving Commodity Derivatives subject to certain restrictions that are designed to limit the BHC’s activity to trading and investing in financial instruments rather than dealing directly in physical nonfinancial commodities (“Permissible Commodity Derivatives Activities”). Under these restrictions, a BHC generally is not allowed to take or make delivery of nonfinancial

¹ 12 U.S.C. section 3106.

² 12 U.S.C. section 1843; 12 CFR Part 225.

³ Société Générale will enter into physical commodity trades in the United States through its indirect, wholly owned nonbanking subsidiary, Société Générale Energie (USA) Corp. (“SGE”), New York, New York. SGE currently engages in some physical commodities activities in the United States, pursuant to authority under Regulation K, that are related to the foreign physical commodities activities of its parent company, Société Générale Energie (S.A.). See 12 CFR 211.23(f)(5).

commodities underlying Commodity Derivatives. In addition, BHCs generally are not permitted to purchase or sell nonfinancial commodities in the spot market.

The BHC Act, as amended by the Gramm-Leach-Bliley Act (“GLB Act”), permits a BHC to engage in activities that the Board had determined were closely related to banking, by regulation or order, prior to November 12, 1999.⁴ The BHC Act permits an FHC to engage in a broad range of activities that are defined in the statute to be financial in nature.⁵ Moreover, the BHC Act allows FHCs to engage in any activity that the Board determines, in consultation with the Secretary of the Treasury, to be financial in nature or incidental to a financial activity.⁶

In addition, the BHC Act permits FHCs to engage in any activity that the Board (in its sole discretion) determines is complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.⁷ This authority is intended to allow the Board to permit FHCs to engage, on a limited basis, in an activity that appears to be commercial rather than financial in nature but that is meaningfully connected to a financial activity in a manner that complements the financial activity.⁸ The BHC Act provides that any FHC seeking to engage in

⁴ 12 U.S.C. section 1843(c)(8).

⁵ The Board determined by regulation before November 12, 1999, that engaging as principal in Commodity Derivatives Activities, subject to certain restrictions, was closely related to banking. Accordingly, engaging as principal in Permissible Commodity Derivatives Activities is a financial activity for purposes of the BHC Act. See 12 U.S.C. section 1843(k)(4)(F).

⁶ 12 U.S.C. section 1843(k)(1)(A).

⁷ 12 U.S.C. section 1843(k)(1)(B).

⁸ See 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (Statement of Chairman Leach) (“It is expected that complementary activities would not be significant relative to the overall financial activities of the organization.”).

a complementary activity must obtain the Board's prior approval under section 4(j) of the BHC Act.⁹

Société Générale regularly engages in Permissible Commodity Derivatives Activities based on a variety of commodities and physical commodity transactions outside the United States and, through SGE, engages in limited physical commodities activities in the United States pursuant to authority under Regulation K.¹⁰ Société Générale plans to expand its physical commodity transactions operations in the United States and, therefore, has requested that the Board permit it to engage in physical commodity trading activities in the United States involving commodities such as natural gas, crude oil, and electricity and to take and make delivery of physical commodities to settle Commodity Derivatives ("Commodity Trading Activities").¹¹ The Board previously has determined that Commodity Trading Activities involving a particular commodity complement the financial activity of engaging regularly as principal in Commodity Derivatives based on that commodity.¹² In light of the foregoing and all other facts of record,

⁹ 12 U.S.C. section 1843(j).

¹⁰ 12 CFR 211.23(f)(5).

¹¹ Société Générale has committed that on receiving approval from the Board to conduct Commodity Trading Activities in the United States as an activity complementary to a financial activity, it will conduct such activities pursuant to section 4 authority only, consistent with the limitations placed by the Board on such activities.

¹² Deutsche Bank AG, 92 Federal Reserve Bulletin C54 (2006); JPMorgan Chase & Co., 92 Federal Reserve Bulletin C57 (2006); Barclays Bank PLC, 90 Federal Reserve Bulletin 511 (2004); UBS AG, 90 Federal Reserve Bulletin 215 (2004); and Citigroup Inc., 89 Federal Reserve Bulletin 508 (2003). For example, Commodity Trading Activities involving all types of crude oil would be complementary to engaging regularly as principal in Commodity Derivatives based on Brent crude oil.

the Board believes that Commodity Trading Activities are complementary to the Permissible Commodity Derivatives Activities of Société Générale.

To authorize Société Générale to engage in Commodity Trading Activities as a complementary activity under the GLB Act, the Board also must determine that the activities do not pose a substantial risk to the safety or soundness of depository institutions or the U.S. financial system generally.¹³ In addition, the Board must determine that the performance of Commodity Trading Activities by Société Générale “can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.”¹⁴

Approval of the proposal would likely benefit Société Générale’s customers by enhancing Société Générale’s ability to provide efficiently a full range of commodity-related services. Approving Commodity Trading Activities for Société Générale also would enable it to improve its understanding of physical commodity and commodity derivatives markets and its ability to serve as an effective competitor in those markets.

The Board has evaluated the financial resources of Société Générale and its subsidiaries. Société Générale’s capital levels exceed the minimum levels that would be required under the Basel Capital Accord and are considered equivalent to the capital levels that would be required of a U.S. banking organization.

Based on all the facts of record, the Board believes that Société Générale has the managerial expertise and internal control framework to manage

¹³ 12 U.S.C. section 1843(k)(1)(B).

¹⁴ 12 U.S.C. section 1843(j)(2)(A).

adequately the risks of taking and making delivery of physical commodities as proposed. The Board notes that Société Générale has established and maintained policies for monitoring, measuring, and controlling the credit, market, settlement, reputational, legal, and operational risks involved in its Commodity Trading Activities. These policies address key areas, such as counterparty-credit risk, value-at-risk methodology, and internal limits with respect to commodity trading, new business and new product approvals, and identification of transactions that require higher levels of internal approval. The policies also describe critical internal control elements, such as reporting lines, and the frequency and scope of internal audits of Commodity Trading Activities. Société Générale has integrated the risk management of Commodity Trading Activities into its overall risk-management framework.

As a condition of this order, to limit the potential safety and soundness risks of Commodity Trading Activities, the market value of commodities held by Société Générale as a result of Commodity Trading Activities must not exceed 5 percent of Société Générale's consolidated tier 1 capital (as calculated under its home country standard).¹⁵ Société Générale also must notify the Federal Reserve Bank of New York if the market value of commodities held by Société Générale as a result of its Commodity Trading Activities exceeds 4 percent of its tier 1 capital.

In addition, Société Générale may take and make delivery only of physical commodities for which derivative contracts have been authorized for trading on a U.S. futures exchange by the Commodity Futures Trading

¹⁵ Société Générale would be required to include in this 5 percent limit the market value of any commodities it holds as a result of a failure of reasonable efforts to avoid taking delivery under section 225.28(b)(8)(ii)(B) of Regulation Y. 12 CFR 225.28(b)(8)(ii)(B).

Commission (“CFTC”) (unless specifically excluded by the Board) or that have been specifically approved by the Board.¹⁶ This requirement is designed to prevent Société Générale from becoming involved in dealing in finished goods and other items, such as real estate, that lack the fungibility and liquidity of exchange-traded commodities.

To minimize the exposure of Société Générale to additional risks, including storage, transportation, legal, and environmental risks, Société Générale would not be authorized (i) to own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or (ii) to process, refine, store, or otherwise alter commodities in the United States. In conducting its Commodity Trading Activities, Société Générale has committed to use appropriate storage and transportation facilities owned and operated by third parties.¹⁷

Société Générale and its Commodity Trading Activities also remain subject to the general securities, commodities, and energy laws and the rules and regulations (including the antifraud and antimanipulation rules and regulations)

¹⁶ The particular commodity derivative contract that Société Générale takes to physical settlement need not be exchange traded, but (in the absence of specific Board approval) futures or options on futures on the commodity underlying the derivative contract must have been authorized for exchange trading by the CFTC.

The CFTC publishes annually a list of CFTC-authorized commodity contracts. See Commodity Futures Trading Commission, FY 2004 Annual Report to Congress 109. With respect to granularity, the Board intends this requirement to permit Commodity Trading Activities involving all types of a listed commodity. For example, Commodity Trading Activities involving any type of coal or coal derivative contract would be permitted, even though the CFTC has authorized only Central Appalachian coal.

¹⁷ Approving Commodity Trading Activities as a complementary activity, subject to limits and conditions, would not in any way restrict the existing authority of Société Générale to deal in foreign exchange, precious metals, or any other bank-eligible commodity.

of the Securities and Exchange Commission, the CFTC, and the Federal Energy Regulatory Commission.

Permitting Société Générale to engage in the limited amount and types of Commodity Trading Activities described above, on the terms described in this order, would not appear to pose a substantial risk to Société Générale, depository institutions, or the U.S. financial system generally. Through its existing authority to engage in Permissible Commodity Derivatives Activities, Société Générale already may incur the price risk associated with commodities. Permitting Société Générale to buy and sell commodities in the spot market or physically settle Commodity Derivatives would not appear to increase significantly its potential exposure to commodity-price risk.

For these reasons, and based on Société Générale's policies and procedures for monitoring and controlling the risks of Commodity Trading Activities, the Board concludes that consummation of the proposal would not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally and can reasonably be expected to produce benefits to the public that would outweigh any potential adverse effects.

Based on all the facts of record, including the representations and commitments made to the Board by Société Générale in connection with the notice, and subject to the terms and conditions set forth in this order, the Board has determined that the notice should be, and hereby is, approved. The Board's determination is subject to all the conditions set forth in Regulation Y, including those in section 225.7,¹⁸ and to the Board's authority to require modification or termination of the activities of a BHC or any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder.

¹⁸ 12 CFR 225.7.

The Board's decision is specifically conditioned on compliance with all the commitments made to the Board in connection with the notice, including the commitments and conditions discussed in this order. The commitments and conditions relied on in reaching this decision shall be deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order of the Board of Governors,¹⁹ effective March 15, 2006.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁹ Voting for this action: Chairman Bernanke and Governors Bies, Olson, Kohn, Warsh, and Kroszner. Absent and not voting: Vice Chairman Ferguson.