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April 16, 2014

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

Submitted via: regs.comments@federalreserve.gov

Docket No. R-1479

RIN 7100 AE-10

Americans for Financial Reform's Public Comment to the Federal Reserve Board Regarding Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities

Dear Mr. Robert deV. Frierson,

On behalf of Americans for Financial Reform (AFR), we thank you for the opportunity to respond to the Federal Reserve Board's (Board's) Request for Comments regarding "Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities." AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups along with prominent independent experts.

In summary, AFR supports the traditional principle of the separation of banking and commerce, and believes that principle, as well as the need to ensure bank safety and soundness, require the elimination or the very significant reduction of commodity ownership from bank portfolios. We believe the Board's statutory requirement to weigh public benefits of commodity ownership, along with its responsibility to ensure the safety and soundness of the financial system, provide grounds to reverse permissions or to substantially alter the conditions under which commodities are owned by Board-supervised firms. Episodes of market abuse raise serious questions as to whether bank participation in commodities provides a clear public benefit, questions that the Board has not adequately answered. Moreover, potential liabilities from commodities-related catastrophes far exceed the asset valuation based metric the Board has used to regulate

permissible levels of commodity ownership, indicating that levels of commodity ownership currently permitted by the Board do threaten bank safety and soundness.

Several AFR member groups and individuals associated with AFR have written long and substantive comments in response to this request, including the Institute for Agriculture and Trade Policy, Public Citizen, and Professor Robert Hockett of Cornell University Law School. We endorse the points made in these comments and recommend them to your attention.

Americans for Financial Reform supports the separation of banking and commerce as a foundational principle, motivated both by considerations of preserving fairness in competition with non-bank firms who do not have access to the prudential safety net, and by considerations of financial safety and soundness. Following enactment of the Gramm Leach Bliley Financial Modernization Act of 1999 and subsequent decisions by the Board, major bank holding companies have been permitted to greatly increase their levels of commodity ownership. However, as the Board itself describes in the Request for Comments, the Gramm Leach Bliley Act did not, as a general matter, overturn the principle of the separation of banking and commerce. Instead, the burden of proof is on banks and their regulators to justify departures from that principle that may be permitted in the cases of complementary activities and merchant banking. For complementary activities, a public benefits test is required, and for merchant banking, there must be a genuine separation between the bank and the outside firm in which it holds an ownership interest.

The post-Gramm Leach Bliley increase in commodity ownership by banks has been associated with several episodes of market abuse, calling into question claims of public benefit.

- JP Morgan Chase was fined $410 million in an energy rate-manipulation case, the largest penalty since Enron.[1]
- British authorities have questioned JP Morgan's control of metals business.[2]
- Goldman Sachs Detroit metals warehouse business prompted considerable media attention and reported federal investigations for price manipulation.[3]
- Morgan Stanley oil ownership drew similar concern over pricing schemes.[4]

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[1] 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.

[2] 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/726/11021602.htm

[3] "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

Of course, non-financial firms with substantial commodities businesses may also engage in manipulative schemes, but firms enjoying federal financial guarantees and the imprimatur of prudential banking oversight will have greater liquidity resources to fuel such schemes. Furthermore, such non-bank firms are not subject to a public benefits test. The Board is ill-positioned to measure the public benefits of commodity ownership as they intersect with the possibility of market manipulation, as it has no role in commodity market regulation.

More broadly, a public benefits test for complementarity requires a detailed assessment of whether locating commodity activities within a bank produces genuine economic complementarities that are not associated with the increased leverage made possible by the public liquidity backstop to banks, and are not associated with anti-competitive tying arrangements in which a bank leverages market power in its financial activities to gain an advantage in commodity markets. We do not believe that the Board has conducted such assessments in sufficient detail. Currently, the Board explains that its judgments as to public benefits are "subjective."[5] Generally, it has proven difficult to identify genuine efficiencies when banking and commerce mix.[6]

We believe that public benefit and safety, not bank profitability should be the Board's exclusive concerns. Some customers may claim to welcome bank participation, but such assertions may be colored by these customers' other banking relationships with these institutions. To the extent that a major bank can indeed offer better terms than non-banks, the Board should also be mindful of the possibility that this is because it has advantages that emerge from implicit public subsidies that may materialize in the case of heavy losses.

Finally, we believe that any weighting of safety and soundness considerations in the context of commodity ownership must assess the potential risk to the bank in terms of possible losses from commodity-related liabilities, not the asset valuation of commodities. The liabilities that may emerge from accidents or mishaps related to commodity ownership can be a significant multiple of the valuation of the commodity itself. We are concerned that in permitting complementary activities, the Board appears to measure safety and soundness risks by comparing commodity asset valuation to bank capital, rather than potential liabilities.

The merchant banking exemption raises a dilemma. While commodities ownership demands careful oversight, the proper implementation of the merchant banking exemption bars the financial holding company from active management of a merchant banking enterprise. Merchant banking involves bank capital investment as opposed to traditional arms-length lending. As the

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[4]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

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

[6] "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

Board points out in its Request for Comment, in the case of significant commodity liabilities due to negligence, those seeking redress may be able to 'pierce the corporate veil' and impose liability on the bank. Any merchant banking investments must be subject to very stringent safety and soundness tests, and must also fulfill the statutory requirement of true independence.

An additional issue created by the Gramm-Leach-Bliley Act is the broad 'grandfathering' clause in Section 4(o) of the Bank Holding Company Act. This clause permits a new financial holding company to continue any commodity-related activities in which it was engaged circa 1997, including the manufacturing and transport of commodities. The clause also permits banks to hold commodity value up to 5 percent of total assets, a level vastly greater than is permitted under the complementary activities provision. Furthermore, this provision is not subject to a public benefits test.

The Section 4(o) grandfathering provision raises significant safety and soundness concerns. Liabilities due to accidents in the transport, storage, or manufacturing of commodities are potentially a multiple of commodity asset valuations. Since the limit in Section 4(o) is measured as a percentage of total assets rather than bank capital, it represents a level of bank asset holdings that could wipe out the total capital of even a bank that is properly meeting minimum regulatory leverage requirements.

We would recommend that the Board aggressively apply its safety and soundness authorities in the case of activities grandfathered under Section 4(o). Furthermore, the statutory injunction that the bank be limited to commodity activities that it was 'engaged in' as of 1997 must be read narrowly and literally. This provision must not become a blank check to engage in any activities that are only generally and vaguely related to its activities as of 1997 (e.g., by permitting the bank a greater level of holdings than it held as of September 1997). Such an interpretation would effectively be a blank check to just two large bank holding companies to engage in practically unlimited commodity activities, activities which would be subject to strict statutory limits if engaged in by any other bank holding company. This cannot be the intent of the statute.

Thank you for the opportunity to comment on this issue. Should you have any questions, please contact Marcus Stanley, AFR's policy director, at 202-466-3672 or marcus@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club

- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

List of State and Local Partners

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- UNET