

Board of Governors of the Federal Reserve System
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United States
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Chris Barnard

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

Dear Robert deV. Frierson.

Thank you for giving us the opportunity to comment on your Advance notice of proposed rulemaking (ANPR) on Complimentary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities.

You are issuing this ANPR on various issues related to physical commodity activities conducted by financial holding companies and the restrictions imposed on these activities to ensure they are conducted in a safe and sound manner and consistent with applicable law. The activities under review include physical commodities activities that have been found to be “complementary to a financial activity” under section 4(k)(1)(B) of the Bank Holding Company Act (BHC Act), investment activity under section 4(k)(4)(H) of the BHC Act, and physical commodity activities grandfathered under section 4(o) of the BHC Act. You are considering a review of these activities for the reasons explained in the ANPR, including the unique and significant risks that physical commodities activities may pose to financial holding companies, their insured depository institution affiliates, and U.S. financial stability.

Complementary authority

Section 4(k)(1)(B) of the BHC Act permits financial holding companies to engage in any activity that 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”.

In approving Citigroup's October 2003 application to engage in physical commodities trading, the first such order, the Federal Reserve stated that:

“...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. 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 such that it complements the financial activity.”¹

In this early case, the Federal Reserve has defined a complimentary activity as one that is meaningfully connected to a financial activity. Recent events have cast doubt on whether the relationship between commodities derivatives and physical commodities is as close as expected, or meaningfully connected in a manner signifying complementarity.² For this main reason I support a more complete review of the scope of activities authorised under the complimentary authority in the BHC Act.

Yours sincerely

C.R.B.

Chris Barnard

¹ See Citigroup Order Approving Notice to Engage in Activities Complementary to a Financial Activity, October 2, 2003, available at:

<http://www.federalreserve.gov/boarddocs/press/orders/2003/20031002/attachment.pdf>

² For example: Deutsche Bank and JP Morgan have publicly reported that they intend to cease physical commodities activities; and Morgan Stanley are in the process of selling off several physical commodities units.