



April 16, 2014

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Attention: Robert deV. Frierson, Secretary

Re: Merchant Banking Activities (Docket No. 1479; RIN 7100 AE-10)

Ladies and Gentlemen:

The Clearing House Association L.L.C. (“**The Clearing House**”), the American Bankers Association (the “**ABA**”), the Financial Services Forum (the “**FSF**”), the Financial Services Roundtable (the “**FSR**”) and the Institute of International Bankers (the “**IIB**”) (collectively, the “**Associations**”)¹ are writing to comment on a portion of the advance notice of proposed rulemaking by the Board of Governors of the Federal Reserve System (the “**Federal Reserve**”) entitled “Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities” (the “**ANPR**”).² Because of the importance of merchant banking activities to our members, small- and medium-sized businesses throughout the country and the broader economy, we believe it is critical to address specifically the ANPR’s discussion of, and questions regarding, the general risks associated with merchant banking activities.³

¹ See Annex A for a description of each of the Associations.

² Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies related to Physical Commodities, 79 Fed. Reg. 3329 (Jan. 21, 2014).

³ The Associations also participated in the preparation of and endorse the comment letter prepared by the Securities Industry and Financial Markets Association (“**SIFMA**”) and submitted jointly with the ABA, the FSF, the FSR and the IIB (the “**Other Joint Trade Association Letter**”). The Other Joint Trade Association Letter attaches a Joint Memorandum of Law submitted on behalf of SIFMA to the Federal Reserve in response to the ANPR prepared by Covington & Burling LLP, Davis Polk & Wardwell LLP, Sullivan & Cromwell LLP and Vinson & Elkins LLP (the “**Joint Memorandum**”).

As a preliminary matter, we note that although many of the comments in this letter could apply equally to merchant banking activities beyond those related to physical commodities, we understand the focus of the ANPR to be on physical commodity and related merchant banking activities. Accordingly, if the Federal Reserve and the U.S. Department of the Treasury (“**Treasury**”) were to determine that the regulatory restrictions or supervisory framework regarding merchant banking should be reconsidered beyond this limited context, we would urge them to allow further opportunity for comment before issuing a proposed rule.

I. Executive Summary

We submit that financial holding companies’ (“**FHCs**”) successful experience in managing the risk associated with all types of merchant banking activities over a period of almost fifteen years demonstrates that the existing prudential framework for these activities overall is robust and effective. Though these activities do pose risks, including, in a limited number of investments, environmental risks relating to environmentally sensitive commodities, FHCs can manage these risks within the existing supervisory structure by adhering to appropriately designed policies and procedures that are informed by established legal frameworks, such as the principles of corporate separateness and the body of environmental law establishing allocation of liability.

We submit that there is no reason to initiate a fundamental revision of the regulatory restrictions or supervisory framework governing FHCs’ merchant banking activities, whether with respect only to physical commodities investments or all merchant banking investments, because we do not believe that the risks of merchant banking investments have changed or that firms’ ability to manage these risks are more limited today than in the past. There are, however, certain practices, which are described in detail in Appendix C to the Other Joint Trade Association Letter, that FHCs may incorporate into their policies and procedures that should be effective to avoid or substantially mitigate the risk of potential liability arising from physical commodity activities, including related merchant banking investments, to a level consistent with a FHC’s risk tolerance.

The following considerations should be weighed carefully in an evaluation of the risks associated with FHCs’ participation in merchant banking activities:

- The merchant banking authority reflects a considered Congressional determination regarding both the benefits of these activities and the conditions that should govern these activities to assure they are conducted in a safe and sound manner. The risks cited in the ANPR are the same risks that FHCs have appropriately managed since the merchant banking authority was granted in the Gramm-Leach-Bliley Act (the “**GLB**”

Act”) and the merchant banking rules were adopted by the Federal Reserve and Treasury.⁴

- Significant and robust statutory and regulatory requirements already exist that minimize the risk that a FHC would have material exposure to the activities of a merchant banking portfolio company beyond the amount of its investment and that limit the amount of the investment itself that is at risk.
- The doctrine of corporate separateness, which is called into question by the ANPR, in our view unjustifiably, is well established in the law and provides insulation from liability for companies that abide by the contours laid out in the relevant judicial decisions.⁵ The doctrine was specifically contemplated in the adopting release of the final merchant banking rule (the “**Final Rule**”), and the requirements in the Final Rule are designed to help ensure that limited liability will be recognized.⁶
- The doctrine of corporate separateness helps to protect FHCs from possible exposure to liability under environmental statutes, a potential source of risk raised in the ANPR.
- Imposing additional restrictions or requirements, such as capital requirements or further limits on holding periods and routine management, on FHCs’ merchant banking activities is not only unnecessary but could hamper the ability of FHCs to make such investments, reducing the potential benefits of such investments.

In this letter, we discuss the legal, regulatory and supervisory framework within which FHCs conduct merchant banking activities, including the ways FHCs manage the risks associated with such activities. We also address potential Federal Reserve actions regarding merchant banking activities raised in the ANPR.

⁴ Pub. L. No. 106-102, 113 Stat. 1338, § 103(a) (codified at 12 U.S.C. § 1843(k)(4)(H)); 12 C.F.R. parts 225 and 1500.

⁵ See, e.g., Neil A. Helfman, *Establishing Elements for Disregarding Corporate Entity and Piercing Entity’s Veil*, 114 Am. Jur. Proof of Facts 3d 403, § 6 (2013).

⁶ Bank Holding Companies and Change in Bank Control, 66 Fed. Reg. 8466, at 8478–79 (Jan. 31, 2001) (codified at 12 C.F.R. part 225); 12 C.F.R. § 225.175(a)(iv).

II. Management of Risks Posed by Merchant Banking Activities

A. Merchant banking activities are authorized by statute under a governing framework established by Congress after careful consideration of the risks and benefits involved.

The framework established by Congress for engaging in merchant banking activities reflects careful and deliberate Congressional consideration of both the risks and benefits involved in the activities.⁷ The GLB Act was passed as part of a financial modernization process aimed at maintaining the competitiveness of U.S. financial institutions, preserving the safety and soundness of the financial system and ensuring the broadest access to financial services for American consumers.⁸ The GLB Act amended the Bank Holding Company Act (the “**BHC Act**”) to include as a financial activity, among other things, the authority for FHCs to make investments in nonfinancial companies as part of a *bona fide* securities underwriting or merchant or investment banking activity.⁹

In authorizing merchant banking, Congress recognized the “essential role” merchant banking has in the national economy.¹⁰ Merchant banking investments can be an important source of equity financing for companies, including start-ups. Congress was also aware of the potential risks involved with these activities and put in place a framework for that authority to be exercised in a safe and sound manner. The statutory merchant banking provisions reflect a balanced and considered approach to both the risks and benefits involved in merchant banking activities. Of particular importance here, a FHC may not routinely manage or operate the investment, except in limited circumstances.¹¹ This requirement, among others, helps insulate the FHC from legal

⁷ See, e.g., *Merchant Banking Regulations Pursuant to the Gramm-Leach-Bliley Act of 1999: Hearing Before the Subcomm. on Fin. Insts. & the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 106th Cong. 1–2 (2000) (statement of Sen. Robert F. Bennett) (“[T]he incorporation of the merchant banking provisions in [the GLB Act] . . . were perhaps the most significant and long sought-after portions of the entire banking modernization process. . . . Congress was *painstakingly careful* in constructing and passing this legislation. . . . All of us who were part of the financial modernization process know that every legislative word of the [GLB] Act was weighed and must be afforded meaning.”) (emphasis added).

⁸ S. Rep. No. 106-44, at 4 (1999).

⁹ Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338, § 103(a) (codified at 12 U.S.C. § 1843(k)(4)(H)).

¹⁰ H.R. Rep. No. 106-434, at 154 (1999) (“The authorization of merchant banking activities as provided in new section 4(k)(4)(H) of the [BHC Act] is designed to recognize the essential role that these activities play in modern finance . . .”).

¹¹ 12 U.S.C. § 1843(k)(4)(H)(iv).

liability for its portfolio companies by reinforcing the legal doctrine of corporate separateness.

B. The legal, regulatory and supervisory framework within which FHCs conduct merchant banking activities protects against the risks cited in the ANPR.

The ANPR recognizes the importance of the doctrine of corporate separateness and limited liability to ensure the safety and soundness of merchant banking activities but raises the potential that a court may pierce the corporate veil in some circumstances.¹² The ANPR also identifies legal, environmental and reputational risk, as well as market, credit and concentration risk, as risks that may arise from merchant banking investments.¹³ Noting tail risk concerns, the ANPR questions whether the current merchant banking regulations sufficiently protect against these threats.¹⁴ For the reasons we discuss below, we believe that the protections currently in place insulate FHCs sufficiently from the risks described in the ANPR, provided that a FHC has in place effective policies and procedures consistent with the standards described in the Joint Memorandum.

1. The risk of liability through corporate veil piercing is contained, even beyond general legal principles, through the structure of the merchant banking authority itself as well as the policies and procedures instituted by FHCs to guard against this risk.

Under the basic principles of limited liability, a shareholder is not liable for the losses of a corporation beyond the amount of the shareholder's investment except in certain very limited, typically egregious, circumstances.¹⁵ This is the very essence of the modern corporate structure. Although the standards for piercing the corporate veil may vary across jurisdictions, the list of factors leading a court to pierce the veil is limited. It is possible to structure and manage merchant banking investments in a way that avoids those factors that trigger piercing the corporate veil. In general, courts impose a high threshold for piercing the corporate veil and will not easily disregard corporate separateness to hold a shareholder liable for the actions of the corporation.¹⁶

¹² 79 Fed. Reg. at 3335.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Lowendahl v. Baltimore & Ohio R.R. Co.*, 247 A.D. 144, 154 (1st Dep't 1936), *aff'd*, 272 N.Y. 360 (1936).

¹⁶ Please see the Joint Memorandum for an extensive discussion of corporate separateness and limited liability. In New York, courts have generally used a formulation for piercing the

The already low risk of corporate veil piercing under this case law can be further managed and minimized. A FHC that establishes and adheres to appropriate policies and procedures would face very little, if any, risk of being held responsible for the liabilities of its merchant banking portfolio companies under “veil piercing” or similar legal theories.

Moreover, the statutory structure and regulatory requirements governing merchant banking activities further reinforce the doctrine of corporate separateness and limited liability by incorporating many elements that help ensure a merchant banking portfolio company is recognized as a separate corporate entity. In particular:

- A merchant banking investment must be a *bona fide* merchant banking investment. That is, a FHC may only make a merchant banking investment for the purpose of generating an investment return and not to operate the portfolio company.¹⁷ The requirement reinforces the separateness of the FHC and the portfolio company because of the limits it places, by its terms, on the ability of a FHC to operate the company.
- A merchant banking investment may be held only for a period of time that enables the sale or disposition of the investment on a reasonable basis consistent with the financial viability of merchant banking activities. In most cases, this means that a merchant banking investment may not be held for more than ten years.¹⁸
- A FHC’s policies, procedures, records and systems must be reasonably designed to, among other things, ensure the maintenance of corporate separateness between the FHC and each portfolio company and protect the FHC and its

corporate veil requiring a showing that (i) the stockholder exercised complete domination of the corporation with respect to the action involved, and (ii) such domination was used to commit a fraud or wrong against the plaintiff that resulted in the plaintiff’s injury. *Cobalt Partners, L.P. v. GSC Capital Corp.*, 944 N.Y.S.2d 30, 33 (1st Dep’t 2012) (quoting *Matter of Morris v. N.Y. State Dep’t of Taxation & Fin.*, 82 N.Y.2d 135, 141 (1993)). In Delaware, courts generally will not pierce the corporate veil unless (i) fraud in the corporate form is present, or (ii) the parent exerts exclusive domination and control such that the subsidiary becomes a “mere instrumentality” or “alter ego” of the parent. See *Irwin & Leighton, Inc. v. W.M. Anderson Co.*, 532 A.2d 983, 987 (Del. Ch. 1992) (“The paradigm instance [for piercing the corporate veil] involves the use of a corporate form to perpetrate a fraud.”); *Geyer v. Ingersoll Publ’ns Co.*, 621 A.2d 784, 793 (Del. Ch. 1992) (“[A] court can pierce the corporate veil of an entity where there is fraud or where a subsidiary is in fact a mere instrumentality or alter ego of its owner.”).

¹⁷ 12 U.S.C. § 1843(k)(4)(H)(ii); 12 C.F.R. § 225.170.

¹⁸ 12 U.S.C. § 1843(k)(4)(H)(iii); 12 C.F.R. § 225.172.

depository institution subsidiaries from legal liability for the operations conducted by and financial obligations of any such company.¹⁹

- If a FHC makes an investment in assets rather than an existing company: (i) the assets must be transferred to a portfolio company; (ii) the portfolio company must maintain policies, books and records, accounts and other indicia of corporate, partnership or limited liability organization and operation that are separate from the FHC and limit the legal liability of the FHC for obligations of the portfolio company; and (iii) the portfolio company must have separate management from the FHC.²⁰
- Of perhaps most importance, there are prohibitions against routine management of the portfolio company by the FHC and officer and employee interlocks between the FHC and its affiliate and the portfolio company.²¹ As a result of these prohibitions, the FHC may not be involved with the day-to-day operation of a portfolio company.²²

All these requirements, taken together, further minimize the already low risk that a FHC may be held liable for a portfolio company through corporate veil piercing. Moreover, the Federal Reserve examines FHCs specifically to ensure that a FHC's policies, procedures and systems are designed to maintain corporate separateness between the FHC and its portfolio companies and protect the FHC and its depository institution subsidiaries from legal liability for such companies' operations and obligations.²³

2. FHCs can manage the risks, including tail risk, cited in the ANPR through appropriately tailored risk management frameworks.

Although the ANPR refers to a wide variety of risks relating to merchant banking, only one of these risks—environmental risk—truly involves the potential of “catastrophic loss” or “tail risk” on which the ANPR focuses.²⁴ Accordingly, although each of the other risks—legal, reputational, market, credit and concentration—is

¹⁹ 12 C.F.R. § 225.175.

²⁰ 12 C.F.R. § 225.170(e).

²¹ 12 U.S.C. § 1843(k)(4)(H)(iv); 12 C.F.R. § 225.171.

²² There is a limited exception for circumstances in which the FHC's intervention is necessary to obtain a reasonable return on its investments. 12 C.F.R. § 225.171(e). This exception is discussed below.

²³ Bank Holding Company Supervision Manual § 3907.0.7.1.

²⁴ 79 Fed. Reg. at 3335.

meaningful and must be dealt with thoughtfully and carefully, the focus of this letter is likewise on environmental and other “mass tort” type risks that could exist if the corporate veil is pierced. The ANPR notes that, although the probability of catastrophic loss to a FHC from any of these sources is low, the Federal Reserve is considering whether such low-probability tail risks require stricter restrictions on FHCs’ merchant banking investments.²⁵ FHCs, however, face these sorts of risks in their other activities and have developed management frameworks to address them both generally and in the specific context of merchant banking.

Although the ANPR cites various events involving environmentally sensitive commodities as examples of sources of liability to FHCs from merchant banking activities,²⁶ none of the cited events has occurred in the context of merchant banking activities. Moreover, there is no indication that the level of risk to FHCs has changed since the merchant banking authority was granted by Congress to FHCs over a decade ago. The risks faced by FHCs have been adequately managed by FHCs, and we are not aware of a FHC being the target of a successful veil-piercing claim in the context of environmental claims or for any other reason. As to the specter of tail risk, we recognize that the unprecedented virtually national decline in housing prices in the financial crisis of 2008 is asserted by some as an example of tail risk, but that was a systemic event, not an isolated event, whereas the incurrence of environmental liability through corporate veil piercing or otherwise would be an idiosyncratic occurrence.

- a. *FHCs maintain policies, procedures, records and systems to ensure their merchant banking activities are safely and soundly conducted, and these activities are reviewed through the supervisory process.*

As discussed, FHCs face legal, reputational, market, credit and concentration risks, as well as environmental risks, as a result of their merchant banking activities. In light of these risks and in compliance with Federal Reserve rules and guidance,²⁷ as they do with their lending activities, FHCs have in place policies, procedures, records and systems to ensure that merchant banking activities are safely and soundly conducted. Not only have FHCs continued to enhance their practices, policies and procedures in light of these requirements, but the risk management requirements applicable to

²⁵ *Id.*

²⁶ *Id.* at 3332, 3335.

²⁷ *See, e.g.*, 12 C.F.R. part 225; Supervision and Regulation Letter 00-9, “Supervisory Guidance on Equity Investment and Merchant Banking Activities” (June 22, 2000) (“SR 00-9”); Supervision and Regulation Letter 91-20, “Environmental Liability” (Oct. 11, 1991) (“SR 91-20”); Bank Holding Company Supervision Manual §§ 2010.5, 3907.0, 3909.0.

financial institutions generally have increased markedly in recent years.²⁸ FHCs' compliance with the Federal Reserve's requirements in this area is regularly evaluated by FHCs themselves and in the course of supervisory examinations.²⁹

The Final Rule itself requires that FHCs that engage in merchant banking activities "establish and maintain policies, procedures, records and systems reasonably designed to conduct, monitor and manage such investment activities and the risk associated with such investment activities in a safe and sound manner."³⁰ As has been outlined through Federal Reserve guidance and the supervisory process, sound risk management practices for merchant banking and other equity investments involve oversight by the board of directors and senior management, the adoption of appropriate policies, records, procedures and management systems, and the maintenance of adequate internal controls.³¹

The Federal Reserve's guidance identifies in detail sound investment and risk management practices for merchant banking activities and discusses safety and soundness issues related to these activities.³² FHCs are encouraged to adopt procedures and internal controls to address each element of the investment management process, from initial due diligence to final disposition of the investment.³³ For example, the Federal Reserve expects boards of directors to ensure there is an effective management structure in place and to approve merchant banking objectives and investment strategies and policies that are consistent with the institution's financial condition and risk profile and tolerance.³⁴

In addition, other Federal Reserve guidance considers general policies and procedures that should be adopted to address environmental liability and other specific risks FHCs face, including in the merchant banking context. Specifically, guidance from

²⁸ See, e.g., *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. 111-203, 124 Stat. 1376, § 165 (codified at 12 U.S.C. § 5365) and the enhanced prudential standards of Regulation YY adopted by the Federal Reserve thereto; Supervision and Regulation Letter 08-8, "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles" (Oct. 16, 2008); Bank Holding Company Supervision Manual § 2124.0.

²⁹ See, e.g., Bank Holding Company Supervision Manual §§ 2010.5, 3907.0, 3909.0.

³⁰ 12 C.F.R. § 225.175(a).

³¹ E.g., SR 00-9; Bank Holding Company Supervision Manual § 3909.0.

³² SR 00-9 at 3-12.

³³ *Id.* at 5-10.

³⁴ *Id.* at 4-5.

the Federal Reserve states that banking organizations should have in place safeguards and controls to protect against potential environmental liability.³⁵ Examiners are expected to verify that FHCs have adopted policies and procedures to minimize environmental liability risk, both with regard to their lending and non-lending activities.³⁶ Moreover, as discussed in the Joint Memorandum, FHCs that invest in companies that own or operate facilities for the extraction, transportation, storage or distribution of commodities or process, refine or otherwise alter commodities (“**Physical Commodities Handling Activities**”) are generally insulated from liability, provided they do not actively participate in the day-to-day operations or environmental affairs of such facilities. In addition, under the Comprehensive Environmental Response, Compensation, and Liability Act (“**CERCLA**”), ordinary oversight and due diligence of an entity that owns or operates a facility that processes commodities is insufficient to deem a FHC the “owner” or “operator” of the facility and thus subject to potential liability.³⁷

In complying with these requirements and guidelines, a FHC develops its own risk management framework that reflects both the particular extent and focus of its merchant banking activities and addresses the risks referenced in the ANPR to the extent such risks are posed by the institution’s specific merchant banking investments. Furthermore, recognizing that effective risk management requires flexibility to adapt, institutions adjust their risk management frameworks over time to respond, for example, to changes in the characteristics of their investments, changes in technology or the economy and feedback from their boards of directors, internal audit departments and, as discussed below, their supervisors.

The FHCs’ risk management frameworks are reviewed by the Federal Reserve on a regular basis as part of its supervisory process to ensure their adequacy by reference to the standards discussed above. Such reviews include a consideration of the strategies a FHC has developed to ensure the risks associated with merchant banking activities are identified and managed and an evaluation of whether the specific merchant banking activities being engaged in would adversely affect the safety and soundness of the FHC or its affiliated depository institutions.³⁸ The Federal Reserve has

³⁵ SR 91-20.

³⁶ *Id.*

³⁷ *See, e.g., United States v. Bestfoods*, 524 U.S. 51, 66–67 (1998) (holding that a parent entity could not be held directly liable as an “operator” under CERCLA for a release of hazardous substances from its subsidiary facility unless the parent “manage[d], direct[ed], or conduct[ed] operations specifically related to pollution, that is, operations having to do with the leakage or disposal of hazardous waste, or decisions about compliance with environmental regulations”). Similar rules apply to liability under the Oil Pollution Act and the Clean Water Act. *See* Joint Memorandum.

³⁸ Bank Holding Company Supervision Manual § 3909.0.5.

a variety of supervisory and, ultimately, enforcement tools to ensure that any deficiencies observed are corrected promptly.

The Federal Reserve's approach toward supervision and examination has been to recognize the differences among FHCs and their particular merchant banking investments while at the same time ensuring that each institution meets the standards set forth in the guidance discussed above. Thus the Federal Reserve examiners "take into account the institution's stated tolerance for risk, the ability of senior management to govern these activities effectively, the materiality of activities in light of the institution's risk profile, and its capital position."³⁹

We believe strongly that the approach to merchant banking risk management should continue to follow the current model. We do not think it is advisable to abandon that model to impose uniform, prescriptive or proscriptive requirements. A "one-size-fits-all" approach will undermine the ability of FHCs to tailor their risk management frameworks to their particular circumstances, including the nature of the particular merchant banking investment, and the ability to refine these tailored risk management frameworks as necessary over time. We believe there are certain practices, based on the well-established legal frameworks regarding allocation of liability under environmental law and limits on secondary liability under principles of corporate separateness, that may be appropriate for a FHC to implement to help protect against such liability arising out of its commodities-related investment activities. These practices are reflected in Appendix C to the Other Joint Trade Association Letter.

- b. FHCs can address the risks of potential conflicts associated with investing in companies engaged in Physical Commodities Handling Activities through appropriately tailored policies and procedures.*

Among the requirements designed to protect the safety and soundness of FHCs and their insured depository institutions, the Federal Reserve's orders authorizing FHCs to engage in certain activities that are complementary to financial activities permit FHCs to engage in physical commodity trading as a complementary activity but prohibit them from using the complementary authority to "(i) own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or (ii) process, refine, or otherwise alter commodities."⁴⁰ This prohibition, however, does not preclude

³⁹ *Id.* § 3909.0.2.2. See also *id.* § 3909.0.2.2.2 ("Supervisors should recognize the potential diversity of practice when conducting reviews of the equity investment process. They should focus on the appropriateness of the process employed relative to the risk of the investments made and the materiality of this business line to the overall soundness of the [banking organization] and the potential impact on affiliated depository institutions.").

⁴⁰ See, e.g., *Société Générale*, 92 Fed. Res. Bull. C113, C115 (2006); *JPMorgan Chase & Co.*, 92 Fed. Res. Bull. C57, C58 (2006); *Deutsche Bank AG*, 92 Fed. Res. Bull. C54, C56 (2006); *Barclays Bank, PLC*, 90 Fed. Res. Bull. 511, 512 (2004); *UBS AG*, 90 Fed. Res. Bull. 215, 217 (2004); *Citigroup Inc.*, 89 Fed.

business relationships between FHCs and companies engaged in Physical Commodities Handling Activities under other authorities under the BHC Act. In addition to being ordinary course commodities trading counterparties, FHCs often provide financial products to these commodities companies, including cash management, custody, clearing, financing (including via loan, repo and tax equity structures) and other types of ordinary course banking and financial services. FHCs have also used merchant banking authority to invest in companies engaged in Physical Commodities Handling Activities.

We understand that the Federal Reserve is concerned about the adequacy of the scope of limitations on commodities activities, including merchant banking investments in commodities-related companies, observing that recent events may “suggest that the risks of conducting these activities are changing and the steps that firms may take to limit these risks” may not be sufficient.⁴¹

The legal risks to FHCs related to merchant banking investments in companies engaged in Physical Commodities Handling Activities can be adequately mitigated by the FHC, and the FHC’s controls related to these risks should continue to be the focus of the Federal Reserve’s supervision of the FHC’s risk management and compliance framework. First and foremost, the key manner by which a FHC mitigates its legal risk arising from merchant banking investments in companies engaged in Physical Commodities Handling Activities is adherence, absent extraordinary circumstances, to the prohibition against day-to-day management of the portfolio company. As previously discussed, the restriction on day-to-day involvement helps to prevent corporate veil piercing or liability based on a “deemed operator” theory, thereby limiting the FHC’s economic exposure to its merchant banking investments. The FHC should also carefully circumscribe, via policies and procedures, its business relationships with the Physical Commodities Handling Activities investee to ensure that its contractual covenants and course of dealing, in combination with the FHC’s role as a merchant banking investor, do not cause it to have *de facto* day-to-day management of the portfolio company.

Second, as to legal risks, as an equity investor in any portfolio company, the FHC should undertake appropriate due diligence prior to making the investment, evaluating the financial, legal, environmental and other risks of the portfolio company. The FHC should also ensure that it has adequate controls in place to deal with public/private information-sharing issues, as well as any conflicts of interest issues that may arise from having FHC employees serving on the board of directors of the portfolio company.

Res. Bull. 508, 510 (2003). See also *The Royal Bank of Scotland Group plc*, 94 Fed. Res. Bull. C60, C67 (2008).

⁴¹ 79 Fed. Reg. at 3329.

Where the FHC's commodities trading business is engaged in making merchant banking investments in companies engaged in Physical Commodities Handling Activities, the above economic and legal risks may be more acute because of real or perceived risks of improper sharing of non-public information of the portfolio company with the commodities trading business, or the potential to encroach on the prohibition against day-to-day management of the portfolio company. Under such circumstances, the FHC should be vigilant towards having controls adequate to ensure compliance with the merchant banking restrictions and implementing, as appropriate, the practices identified in Appendix C to the Other Joint Trade Association Letter to manage its merchant banking investor interests, while not compromising corporate separateness or the protections on non-operator liability. To address heightened perceptions of conflicts, depending on the circumstances, the FHC may also choose any number of conflicts mitigation controls, such as creating information walls or establishing different levels of business management separation between the investment in companies engaged in Physical Commodities Handling Activities and the traders conducting the FHC's commodities trading activities.

- c. The Federal Reserve's risk-based capital rules help protect against the risks associated with merchant banking investments and other FHC activities.*

The Federal Reserve's risk-based capital rules sufficiently address the risks of FHCs' equity investments. As noted by the ANPR, the recent comprehensive revision to the capital framework implementing Basel III and the Dodd-Frank Act (the "**U.S. Basel III Final Rule**")⁴² included specific risk-weightings for equity exposures under both the standardized and advanced approaches.⁴³

Under the soon to be phased-out U.S. generally applicable Basel I risk-based capital rules, a series of marginal capital charges is imposed that increases with the level of the FHC's overall exposure to equity investment activities relative to its tier 1 capital.⁴⁴ To reflect the risks associated with equity investments, the rule requires a minimum capital requirement that is higher than the charge that applies more broadly to banking assets.⁴⁵ Non-financial equity investments not subject to deduction from tier 1 capital are included in risk-weighted assets at 100%.

⁴² 12 C.F.R. parts 208, 217 and 225.

⁴³ 79 Fed. Reg. at 3335; 12 C.F.R. §§ 217.52–.53, 217.153–.154.

⁴⁴ Capital; Leverage and Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Nonfinancial Equity Investments, 67 Fed. Reg. 3784 (Jan. 25, 2002) (codified at 12 C.F.R. parts 208 and 225).

⁴⁵ *Id.* at 3786.

The U.S. Basel III Final Rule changes that general approach, treating equity investments in unconsolidated non-financial companies as equity exposures and including them in risk-weighted assets. Under the standardized approach, a bank's total risk-weighted assets for equity exposures equals the sum of the risk-weighted amounts for each of its individual equity exposures. To the extent the aggregate adjusted carrying value of certain insignificant equity exposures that in the aggregate do not exceed 10% of an institution's total capital (i.e., CET1, Additional Tier 1 and Tier 2 capital), FHCs using the standardized approach may generally apply a risk weight of 100% to such exposures; beyond that, equity exposures are generally risk weighted at 300% if they are publicly traded and 400% if they are not publicly traded.

So called "advanced approaches"⁴⁶ FHCs generally use internal models, subject to appropriate regulatory review, to estimate potential losses on certain types of equity exposures. The risk-weighted asset is calculated as the greater of the product of estimated potential loss and 12.5 and 200% multiplied by the adjusted carrying value of the FHC's publicly traded equity exposure (or 300% for non-publicly traded).⁴⁷ Advanced approaches FHCs must also account for operational risk, including the risk of legal liability, by calculating a risk-weighted asset that is determined based on internal and external operational loss event data. Among the seven categories of operational loss events included in the rule is "damage to physical assets," which is defined as "the operational loss event type category that comprises operational losses resulting from the loss of or damage to physical assets from natural disasters or other events."⁴⁸

d. FHCs face the risks raised in the ANPR even in their traditional banking activities.

The ANPR notes that merchant banking investments could expose a FHC to various risks—including legal, environmental, reputational, market, credit and concentration risks.⁴⁹ The risks highlighted in the ANPR, however, are not unique to merchant banking activities and may arise even in traditional bank activities, such as lending. Singling out merchant banking investments in this context does not make sense, especially because the limits imposed on FHCs under the merchant banking

⁴⁶ "Advanced approaches" banking organizations are generally those with over \$250 billion in consolidated assets or \$10 billion in foreign exposures.

⁴⁷ Under the Collins Amendment, advanced approaches banking organizations must use the greater of risk-weighted assets as determined under the standardized approach and the advanced internal models based approach for purposes of calculating their regulatory capital ratios. *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. 111-203, 124 Stat. 1376, § 171 (codified at 12 U.S.C. § 5371).

⁴⁸ 12 C.F.R. § 217.101.

⁴⁹ 79 Fed. Reg. at 3335.

authority already reduce the likelihood of liability. FHCs are expected to and do manage these risks in both their merchant banking and traditional bank activities, and the absence of serious losses due to these risks over many years should provide further comfort to the Federal Reserve that no new restrictions are required. For example, environmental risk is a risk that FHCs, and indeed banks, have long faced and been required to manage in extending credit, foreclosing on property, offering asset management services and working out loans, including taking control of companies under the authority of a bank holding company (a “BHC”) or bank, pursuant to the BHC Act and Regulation Y and other federal and state law,⁵⁰ to acquire shares, real estate and other assets in satisfaction of debt previously contracted in good faith (“DPC Authority”).⁵¹

Indeed, DPC Authority provides a particularly useful analogy. A BHC must manage the various risks that such assets present, such as environmental or price risk, during the period that the BHC holds these assets, which may be up to ten years. Maintaining the value of such assets often requires BHCs to actively manage them pending disposition. In doing so, a BHC may, for instance, exercise direct control over the company whose shares it holds, including, in some circumstances, supervising the day-to-day management of such company. Likewise, a BHC may have to actively manage real estate holdings held under the DPC Authority in order to maintain their value and ensure ongoing compliance with state and local law.⁵²

Even more broadly applicable are the market, credit, concentration, reputational and legal risks identified in the ANPR, which FHCs again face in the context of even their core financial activities. For example, the reputational risk a FHC may confront in the context of an event involving an environmentally sensitive commodity could just as well arise from an event at a company to which a bank is the principal lender, and certainly at a DPC property, as at a merchant banking portfolio company.

⁵⁰ 12 U.S.C. § 1843(c)(2); 12 C.F.R. §§ 225.22(d)(1), 225.140. Similar provisions grant such DPC Authority to banks.

⁵¹ See, e.g., SR 91-20; Bank Holding Company Supervision Manual § 2010.5.

⁵² See, e.g., Supervision and Regulation Letter 12-5, “Policy Statement on Rental of Residential Other Real Estate Owned (OREO) Properties” (Apr. 5, 2012) and Supervision and Regulation Letter 12-10, “Questions and Answers for Federal Reserve-Regulated Institutions Related to the Management of Other Real Estate Owned (OREO)” (June 28, 2012) (highlighting various responsibilities of BHCs and banks, including compliance with the terms of existing leases and other agreements, compliance with laws governing protection of tenants, public health and safety and environmental hazards, and responsibilities to maintain and improve properties in advance of their sale).

III. Potential Federal Reserve Actions Regarding Merchant Banking Investments

In the ANPR, the Federal Reserve identified the following as potential areas for enhancement for all or certain types of merchant banking investments: (i) more restrictive investment holding periods; (ii) additional restrictions on the routine management of investments; (iii) additional capital requirements; and (iv) enhanced reporting to the Federal Reserve or public disclosures.⁵³ For the reasons discussed below, we do not believe that changes in any of these areas are necessary or warranted based on the actual risk posed by merchant banking investments and would likely hamper the ability of FHCs to make such investments.

A. Limited holding periods do not reduce risk, yet shortening them could potentially increase risks to FHCs.

The GLB Act includes in its definition of a *bona fide* merchant banking activity “investment activities engaged in for the purpose of appreciation and ultimate resale or disposition of the investment” and provides that merchant banking investments may be held “for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities.”⁵⁴ The Final Rule provides for a ten-year limitation (or a fifteen-year limitation in the case of certain private equity investments), subject to extension with the approval of the Federal Reserve.⁵⁵ The current holding period limitations reflect careful consideration of the language and purpose of the statute, the Federal Reserve’s supervisory experience and industry practice.

The holding period restrictions on merchant banking investments were imposed to ensure that such investments are made as a *bona fide* merchant banking activity, not in order to reduce the risk of such investments to FHCs. Congress was clear that holding period limitations should not be “arbitrary or unduly restrictive” and that the Federal Reserve “should challenge the exercise of discretion regarding the duration of an investment only if clearly inconsistent with the purposes of [the merchant banking provision].”⁵⁶ The adopting release to the Final Rule states that the holding period

⁵³ 79 Fed. Reg. at 3335.

⁵⁴ 12 U.S.C. § 1843(k)(4)(H)(ii), (iii).

⁵⁵ 12 C.F.R. § 225.172.

⁵⁶ S. Rep. No. 106-44, at 9 (1999). Some members of Congress even expressed skepticism over whether the Federal Reserve and Treasury had authority to set fixed holding periods. See, e.g., *Promotion of Capital Availability to American Businesses, Joint Hearing Before the Subcomm. on Capital Mkts., Ins., & Gov’t Sponsored Enters. & the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 107th Cong. 40 (2001) (statement of Rep. Richard H. Baker, Chairman, Subcomm. on Capital Mkts., Ins., & Gov’t Sponsored Enters.) (“I have before me what the [GLB] provisions are with regard to holding period [sic]. It is, quote, to enable the deposition [sic] thereof on a reasonable basis consistent

limitations were developed after consideration of the purposes and language of the GLB Act and BHC Act, reflection on the Federal Reserve System's experience supervising the equity investment activities of BHCs and consultations with securities firms and BHCs that already made merchant banking and similar equity investments under existing legal authorities.⁵⁷ Although these consultations suggested that the average holding period for these entities was less than ten years, the Final Rule incorporated a longer holding period, recognizing that retention for a ten-year period may be necessary to enable the sale or disposition of some investments on a reasonable basis consistent with the GLB Act.⁵⁸

There is nothing to indicate that the period of time properly associated with "investment activities engaged in for the purpose of appreciation and ultimate resale" should now be shorter than the period originally adopted or that "the period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities" should now be interpreted as being shorter. The economic realities of such investments have not changed in this regard: FHCs still need at least ten years to have sufficient confidence that they will be able to realize the benefit of their investment and exit the investment in a safe and sound manner.

It is difficult to understand how a shorter holding period could reduce risk to a meaningful extent. It is a truism that the risk of some highly unusual and unforeseen event occurring in a portfolio company is greater if the investment is held for a longer period than a shorter period. But that truism applies to any reduced holding period versus, for example, one year (or even, for that matter, one day). Furthermore, if you assume that the FHC maintains a constant level of merchant banking investments, the tail risk will be basically the same whether (i) a FHC invests \$X million for, say, five years in one company and then the same \$X million for a succeeding five years in another company or (ii) the FHC investment of \$X million in the first company is for ten years.

Indeed, more restrictive holding periods could result in an increased risk to FHCs and the financial system. In making merchant banking investments, FHCs often seek to assist companies that have business models with substantial promise but may have difficulty attracting sufficient capital. To be a productive investment for the business,

with financial viability. Now to take that and to translate it into a specific term, as we were repeatedly told earlier that the Congress legislated with regard to these matters, seems to be a bit at contravention with what the language says."); *id.* at 42 (statement of Rep. Spencer Bachus) ("[T]he holding period also concerns Chairman Baker and me. You mentioned the necessity of a forced sale or having to unload the investment when equity markets are depressed. . . . [C]an you see any justification for having a holding period, other than just the broad language of the Act which basically says as long as it is justified?").

⁵⁷ 66 Fed. Reg. at 8473–74.

⁵⁸ *Id.*

the investment must be of a sufficient duration to see the business through multiple cycles. To be a productive investment for the FHC, the investment must be of sufficient duration to earn an appropriate return. FHCs may invest through their merchant banking authority in businesses without liquid, public markets for their securities; as a result, both the FHC making a merchant banking investment and the portfolio company typically require substantial time for the investment to reach its true potential. If FHCs are given an insufficient investment horizon, there is a greater likelihood that they will be forced to exit their investments at a loss in order to comply with the holding period, which would, in fact, increase the risk from these investments.⁵⁹ Alternatively, FHCs faced with such constraints may simply determine that such investments are not worth making or that they are only worth making when transaction and research costs are lowest, i.e., in more established companies with more liquid securities rather than the start-ups and early-stage companies that could most benefit from such investments.

B. Significant additional restrictions on already limited permissible routine management of portfolio companies would not mitigate the risks cited in the ANPR and could undermine a safe and sound approach to managing such investments.

The GLB Act provides that FHCs shall not “routinely manage or operate [a portfolio company] except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition.”⁶⁰ Consistent with this statutory mandate, the Final Rule reflects a careful attempt to implement the routine management restriction without impinging on FHCs’ ability to earn a return.⁶¹

⁵⁹ This principle is also recognized by the Federal Reserve in the DPC context, in which the Federal Reserve permits extensions of the initial holding period for DPC assets if, among other things, the “disposal of the shares, real estate or other assets during the initial period would have been detrimental to the company.” 12 C.F.R. § 225.22(d)(1)(ii).

⁶⁰ 12 U.S.C. § 1843(k)(4)(H)(iv).

⁶¹ See 66 Fed. Reg. at 8466; *Merchant Banking Regulations Pursuant to the Gramm-Leach-Bliley Act of 1999: Hearing Before the Subcomm. on Fin. Insts. & the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*, 106th Cong. 12 (2000) (statement of Gary Gensler, Under Sec’y for Domestic Fin., Dep’t of Treasury) (“We took very specifically all those things that were important to be engaged in, to obtain the delivery of a high return or even an adequate return on the investment, but added something so that if there was a problem, for 6 months you could go in and actually day-to-day manage. But we are aware at the same time that the Congress in the legislation said not to be involved in day-to-day management. We are trying to find that balance of being involved through the board and these important covenants to get the return, but recognizing that there was the legislative language about not being there every day.”).

The Final Rule somewhat revised the routine management provisions of the interim rule, after receiving criticism from Congress that certain provisions were too restrictive. See, e.g., *Merchant Banking Regulations Pursuant to the Gramm-Leach-Bliley Act of 1999: Hearing Before the Subcomm. on Fin. Insts. & the Subcomm. on Sec. of the S. Comm. on Banking, Hous., & Urban Affairs*,

Restrictions on routine management only bear on risk to the extent FHC involvement in the management or operation of a portfolio company facilitates veil piercing, a concern that, as discussed above, is adequately addressed through the requirements under the merchant banking authority itself and the policies and procedures FHCs adopt to protect against such risk. Further restrictions on routine management could increase the risk to a FHC's safety and soundness.

We believe that significant tightening of the current restrictions on routine management would be contrary to Congressional intent. Furthermore, as discussed below, additional limits on routine management could actually increase the risk to a FHC from merchant banking investments by narrowing or eliminating the ability of a FHC to take over routine management in situations where it is necessary to try to avoid significant loss, including the type of catastrophic loss that appropriately concerns the Federal Reserve.

The limitations on routine management are already highly restrictive. As a general matter, a FHC is prohibited from engaging in routine management altogether. A FHC may only routinely manage or operate a portfolio company when such intervention "is necessary or required to obtain a reasonable return on the financial holding company's investment in the portfolio company upon resale or other disposition of the investment." The two examples provided in the Final Rule as to when this circumstance might occur are the avoidance of or addressing a "significant" operating loss or the loss of senior management.⁶²

In light of these limitations on routine management, we do not see how routine management could be further restricted in significant ways without potentially increasing the risk to a FHC's safety and soundness. In addition, the risks should be evaluated in terms of both likelihood of occurrence and loss upon occurrence. Under this formulation, the tangible risk of loss on the investment if intervention in management is impermissible, even when a significant operating loss becomes probable, will usually be greater (because of the much higher probability of occurrence) than the risk of loss from some extraordinary and unforeseeable event, and penetration of the corporate veil, that could be attributed to the FHC's involvement in management. Furthermore, just considering tail risk alone, the risk is likely to be greater if the FHC cannot intervene in exceptional circumstances to prevent the precipitating circumstances from arising or minimize the damage if they do.

106th Cong. 11 (2000) (statement of Sen. Robert F. Bennett). *See also Bank Holding Companies and Change in Bank Control*, 65 Fed. Reg. 16460 (Mar. 28, 2000).

⁶² 12 C.F.R. § 225.171(e).

C. Changes to the existing capital framework for merchant banking investments are not necessary, particularly in light of new and enhanced capital requirements.

As discussed in Section II.B.2.c, the treatment of equity exposures was comprehensively reviewed and revised under the U.S. Basel III Final Rule.⁶³ We do not believe that further changes to the regulatory capital framework are needed to account for the risk from any type of merchant banking investment. We are not aware of any evidence that capital requirements for merchant banking investments are inadequate. In the absence of such evidence, we submit that capital requirements should not be increased. Increasing capital requirements would effectively impinge on the clear Congressional mandate in the GLB Act to permit merchant banking as a way for various businesses in the economy to have access to equity capital from FHCs, subject to the effective safeguards discussed elsewhere in this letter.

Furthermore, we note that with respect to statements in the ANPR regarding tail risk faced by FHCs in the context of investments in entities engaged in environmentally sensitive activities, the fact is that no amount of capital can fully protect against a theoretical unlimited catastrophic liability—whether it comes from a merchant banking investment or more traditional bank activities. In constructing capital and other regulatory requirements, there is always a balance to be struck between accounting for risk in an appropriate and conservative, but not unrealistic, way without undermining banks' ability to provide credit and other financial services to their customers.

D. FHCs' merchant banking investments are already subject to an appropriate reporting and disclosure regime.

FHCs are already subject to an array of reporting requirements with respect to their merchant banking investments. We believe these reporting requirements are appropriate and provide sufficient information regarding the scope of FHCs' merchant banking activities. In particular, a FHC must submit the following reports:

- A FHC must disclose on Form FR Y-12 (Consolidated Holding Company Report of Equity Investments in Nonfinancial Companies) aggregate acquisition costs, net unrealized holding gains not recognized as income and the carrying value of all its merchant banking investments. This report allows the Federal Reserve to monitor a FHC's merchant banking investments and other investments in

⁶³ 79 Fed. Reg. at 3335; 12 C.F.R. §§ 217.52–.53, 217.153–.154.

nonfinancial companies and their contributions to the FHC's capital, profitability, risk and volatility.⁶⁴

- A FHC must disclose on Form FR Y-12A (Annual Report of Merchant Banking Investments Held for an Extended Period) information about all merchant banking investments at or approaching the end of their holding periods, on an individual investment basis, including the plan and schedule for disposition of the investment. This report allows the Federal Reserve to monitor compliance with the holding period restrictions and the risks that divestment of these investments may pose to the FHC.⁶⁵
- A FHC that commences large merchant banking activities must disclose on Form FR Y-10 (Report of Changes in Organizational Structure) information about its merchant banking investments if it has not previously engaged in merchant banking activities. This Report allows the Federal Reserve to monitor changes in a FHC's organizational structure.⁶⁶
- A FHC must report on Form FR Y-6 (Annual Report of Holding Companies) all merchant banking investments reportable on Form FR Y-10 as part of its annual report. This Report assists the Federal Reserve in assessing the financial soundness of the FHC and determining its compliance with applicable laws and regulations.⁶⁷
- A FHC must submit a notice, which may be in letter form, if it routinely manages or operates a portfolio company for more than nine months (pursuant to the limited exception, described above, from the prohibition on routine management). This notice includes an explanation of the reason for involvement, the actions that the FHC has taken to address the circumstances

⁶⁴ See Instructions for Preparation of Consolidated Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12), Gen-1 (2013).

⁶⁵ See Instructions for Preparation of Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A), Gen-1 (2013).

⁶⁶ See Instructions for Preparation of Report of Changes in Organizational Structure (FR Y-10), Gen-1 (2012). Large merchant banking activities are defined in the instructions to Form FR Y-10 as investments (1) by which the FHC directly or indirectly acquires more than five percent of the portfolio company's voting shares, assets or total equity and (2) the cost of which exceeds the lesser of \$200 million and five percent of the FHC's tier 1 capital. *Id.* at 4(k)-2.

⁶⁷ See Instruction for Preparation of Annual Report of Holding Companies (FR Y-6), Gen-3 (2012).

giving rise to the intervention and an estimate of when the FHC anticipates ceasing routine management.⁶⁸

The current disclosure regime provides the Federal Reserve with appropriate and adequate information about a FHC's merchant banking activities both to assess the economic impact of the activities on the FHC and to monitor the FHC's compliance with legal and regulatory requirements. It makes sense for initial reporting of merchant banking investments to be made (as on Form FR Y-12) in the aggregate in order to avoid an unnecessary level of detail and to allow this information to be shared publicly. As a particular investment nears the end of the holding period, however, the requirement to disclose specific information about the particular investment (as on Form FR Y-12A) is justified given the increased risk to the institution that the requirement to exit the investment poses. Similarly, the obligation to provide notice to the Federal Reserve if a FHC routinely manages or operates a portfolio company for more than nine months provides the Federal Reserve with a way to ensure that the exception from the general prohibition on such involvement is permissible in the particular case and that this involvement (or the circumstances that required it) does not impose undue risks on the institution.

We also believe that the current regime provides adequate public disclosure of a FHC's merchant banking investments, including to allow market discipline to help control risk and allow markets to assess FHCs' risk profiles and performance in their equity investment business lines.⁶⁹ Federal Reserve guidance provides that adequate disclosure of equity investment activities, including information necessary for the markets to assess risk profiles and performance, is expected.⁷⁰ The guidance encourages, among other things, disclosure of the size, type and nature of investments, portfolio concentrations, returns, accounting valuations and their contributions to reported earnings and capital.⁷¹ It acknowledges, however, that "disclosures regarding each of these topics may not be appropriate, relevant, or sufficient in every case," given the particularities of an institution's investments and their relation to the institution's overall business.⁷² We believe that such a standards-based approach to disclosure is appropriate because it maintains the focus on material activities and investments. Under this approach, should the characteristics or materiality of the merchant banking

⁶⁸ 12 C.F.R. § 171(e)(3); 66 Fed. Reg. at 8473.

⁶⁹ SR 00-9 at 12.

⁷⁰ *Id.*

⁷¹ *Id.* at 12–13.

⁷² *Id.* at 12.

activities conducted or the information investors deem relevant for their review change, FHCs will modify the disclosure of the activities accordingly.

Additional information regarding these activities is available to the public on request. There is a presumption that most of these completed forms are available to the public upon request unless confidential treatment is given.⁷³ The Federal Reserve, however, generally accords confidential treatment to Form FR Y-12A because “disclosure of specific commercial or financial information relating to investments held for extended periods of time could result in substantial harm to the competitive position of the FHC.”⁷⁴

* * *

⁷³ Instructions for Preparation of Consolidated Holding Company Report of Equity Investments in Nonfinancial Companies (FR Y-12), Gen-2–3 (2013) (“The completed version of this report generally is available to the public upon request on an individual basis. However, a reporting holding company may request confidential treatment for certain portions of the FR Y-12”); Instructions for Preparation of Report of Changes in Organizational Structure (FR Y-10), Gen-5 (2012) (“Once submitted, a FR Y-10 report becomes a Federal Reserve Board (Board) record and may be requested by any member of the public pursuant to the Freedom of Information Act (the “FOIA”). Under the FOIA, Board records generally must be disclosed unless they are determined to fall, in whole or in part, within the scope of one or more of the FOIA exemptions from disclosure.” (citations omitted)); Instruction for Preparation of Annual Report of Holding Companies (FR Y-6), Gen-2 (2012) (same as for FR Y-10).

⁷⁴ Instructions for Preparation of Annual Report of Merchant Banking Investments Held for an Extended Period (FR Y-12A), Gen-3 (2013).

The Associations appreciate the opportunity to comment on the ANPR. If you have any questions, please do not hesitate to contact John Court at (202) 649-4628 (email: john.court@theclearinghouse.org).

Respectfully Submitted,



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cc: The Honorable Janet Yellen
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The Honorable Daniel Tarullo
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Annex A

The Clearing House. Established in 1853, The Clearing House Association L.L.C. is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively hold more than half of all U.S. deposits. The Association is a nonpartisan advocacy organization representing through regulatory comment letters, amicus briefs and white papers the interests of its owner banks on a variety of issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its owner banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer and check-image payments made in the United States. For more information, visit www.theclearinghouse.org.

The American Bankers Association. The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$14 trillion banking industry and its two million employees. Learn more at www.aba.com.

The Financial Services Forum. The Financial Services Forum is a non-partisan financial and economic policy organization comprising the CEOs of eighteen of the largest and most diversified financial services institutions with business operations in the United States. The purpose of the FSF is to pursue policies that encourage savings and investment, promote an open and competitive global marketplace, and ensure the opportunity of people everywhere to participate fully and productively in the 21st-century global economy.

The Financial Services Roundtable. *As advocates for a strong financial future™*, the Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for \$98.4 trillion in managed assets, \$1.1 trillion in revenue and 2.4 million jobs.

The Institute of International Bankers. The Institute of International Bankers is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over thirty-five countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions. Further information is available at www.iib.org.