

United States Senate

WASHINGTON, DC 20510

February 9, 2017

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1547 and RIN 7100 AE-58; Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments

Dear Chair Yellen:

We begin by commending the Board of Governors of the Federal Reserve System (the Board) on its efforts in both this Notice of Proposed Rulemaking (NPRM), as well as its recommended legislative changes presented in its report to Congress pursuant to section 620 (Section 620 Report) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). We appreciate the Board's legislative recommendations and believe that Congress has an obligation to consider and act upon them.

Some have suggested that the NPRM, and the recommendations in the Section 620 Report, are unnecessary because financial holding companies' (FHCs) physical commodities activities have never before posed any risks to the financial system as a whole. That view ignores the safety and soundness risks that such businesses can pose to individual institutions, which is one element of the Board's supervisory mandate.¹ It also ignores the policy issues raised by FHCs' involvement in physical commodities activities, including but not limited to, competitive distortions, interference with the efficient functioning of markets, and the traditional separation of banking and commerce.²

Perhaps most importantly, this argument ignores the important lesson from recent history that we should not wait for crises to metastasize before taking action to address their potential consequences. As the Financial Crisis Inquiry Commission (FCIC) found, in the lead-up to the financial crisis of 2008, "many top officials and regulators were reluctant to challenge the profitable and powerful financial industry."³ Regulators and policymakers dismissed as "anecdotal" and "misguided" the concerns raised by

¹ See 12 U.S.C. § 1818(b)(3); see also Michael J. Moore, *How Congress Helped Save Goldman Sachs From Itself*, BLOOMBERG, Sept. 28, 2015, available at: <http://www.bloomberg.com/news/articles/2015-09-29/how-congress-helped-save-goldman-sachs-from-glencore-envy>.

² See Letter from Senator Sherrod Brown & Senator Elizabeth Warren dated April 4, 2014, at 5-8; see also Letter from Professor Saule Omarova dated April 16, 2014, at 4.

³ Fin. Crisis Inquiry Comm'n, THE FIN. CRISIS INQUIRY REPORT 9 (Jan. 2011) available at: <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

academics and community groups about unregulated derivatives and subprime lending.⁴ As observers sounded alarms about practices that were happening in their communities, bank executives viewed the collapse in housing prices prior to the financial crisis as “wholly unanticipated.”⁵ Regulators likewise “underestimated what systemic risk would be in the marketplace.”⁶ Failing to learn from our past shortcomings will almost certainly ensure that we repeat them, potentially with disastrous consequences.

Many of the proposed changes are welcome and overdue. In particular, we support the proposals to rescind the orders allowing FHCs to provide energy management and tolling services, and remove copper from the list of approved precious metals.

The recent exit by certain FHCs from certain commodities markets has undermined the argument that FHCs need to be in the physical markets in order to better understand the commodities whose values underlie financial products like swaps and futures.⁷ In addition, the case for rescinding orders governing commodities activities that present risks is especially strong where there is documented evidence that the benefits to customers are small or nonexistent. For example, airlines have found that FHCs did not provide financial benefits over nonfinancial companies as providers of crude oil.⁸

However, we believe that addressing the following issues could strengthen the proposal:

⁴ *Id.*, at 16; also Justin Lahart, *Mr. Rajan Was Unpopular (But Prescient) at Greenspan Party*, WALL ST. J., Jan. 2, 2009, available at: <http://www.wsj.com/articles/SB123086154114948151>.

⁵ Fin. Crisis Inquiry Comm’n, *supra*, at 3.

⁶ *Id.*, at 308.

⁷ See Neil Hume, *JPMorgan Has Not ‘Exited Physical Commodities’ Despite Sale*, FIN’L TIMES, Nov. 3, 2014 (“Some analysts say that JPMorgan and Morgan Stanley, which is planning to sell its oil merchant trading business to Rosneft of Russia, will damage their commodities franchises by reducing their physical presence. They say banks need to be active in the underlying physical commodities markets in order to properly price risk and make prices. However, Mr. Camacho said there were no reasons why paring back its capabilities around operation and logistics would have a negative impact on the bank’s business. ‘In large liquid markets such as oil, are we really going to be at a disadvantage because we don’t have a logistics business? Not at all,’ said Mr. Camacho.”) available at: <https://www.ft.com/content/00a2ae9e-60e7-11e4-894b-00144feabdc0>.

⁸ PSI at 304 (“Citing its dealings with United, Morgan Stanley has asserted that its ability to purchase, store, and transport physical jet fuel saved United a significant amount of overhead expenses and the need to obtain expensive financing. Morgan Stanley also claimed that its stronger credit profile enabled it to buy jet fuel at lower prices and pass those savings onto the airline. In reality, those benefits appear to have been limited to the period during which United was experiencing financial distress. Morgan Stanley’s jet fuel supply activities assisted the airline while the parent corporation was going through bankruptcy proceedings. Once the airline emerged from bankruptcy and regained its financial footing, it decided that Morgan Stanley’s fuel assistance, with its fees and financing charges, was actually more expensive than if the airline were to procure its own fuel directly. It began to phase out Morgan Stanley’s role in 2011, and ended it in 2013. United’s action indicates that Morgan Stanley was no longer saving the airline money on its fuel operations.”).

A. The scope of covered physical commodities should be expanded and any loopholes in the 4(k) cap should be eliminated;

1. The scope of covered physical commodities should be expanded

While conventional wisdom has come to view commodities as a standard asset class, they are subject to distinct risks that are of a fundamentally different nature from other assets.⁹ For example, markets can be volatile and prone to sudden swings, including those caused by questionable trading activity.¹⁰ In 2007, the Chief Financial Officer of a large FHC heavily involved in physical commodities said that commodities trading is “a dangerous business to be in even if you are expert.”¹¹ In the past year alone, large commodities trading firms have experienced pressure from funding markets based upon a variety of economic factors.¹²

By trading commodities, FHCs expose themselves to financial, legal, and reputational risk that may be difficult to fully understand, appreciate, and ultimately value, which in turn creates safety and soundness concerns. Unfortunately, the NPRM uses a definition of “covered commodities” focused on the potential catastrophic risk that these holdings and activities could pose to the banks under the Oil Pollution Act of 1990 (OPA), the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), and the Clean Water Act (CWA).

The NPRM fails to account for additional liability concerns related to, for example, reclamation of abandoned mines in the United States,¹³ and such liability could attach for such activities in other countries. It also declines to address considerations like the impact on the environment more generally, the human rights consequences from displacement caused by mining, extraction, and the like, and the international frameworks governing

⁹ See John Fullerton, Update: Commodities are Different (in a “Full World”), Capital Institute Blog, Mar. 5, 2012 (“The notion of commodities as an ‘asset class’ is now accepted conventional wisdom. This concept made sense in the framing of (flawed) modern portfolio theory, given the diversification and correlation benefits. But if any commodity becomes structurally scarce, which I believe is happening, MPT abstraction must be overridden by real-world economy limitations. Indeed, defining ‘commodities as an asset class’ will in the future be seen as an unintentional but immoral error.”) available at: <http://capitalinstitute.org/blog/update-commodities-are-different-full-world/>.

¹⁰ See Andrew Martin, ‘3, 2, 1, Boom’ -- Silver-Fixing Allegations in a Dozen Chats, BLOOMBERG, Dec. 12, 2016 (“‘Avalanche can be triggered by a pebble if u get the timing right,’ the UBS trader wrote. On April 1, 2011, a UBS trader commented on plans to manipulate silver transactions with Deutsche Bank, according to the court filing. ‘If we are correct and do it together, we screw other people hard,’ the trader wrote.”) available at: <https://www.bloomberg.com/news/articles/2016-12-12/3-2-1-boom-silver-fixing-allegations-in-a-dozen-chats>; see also Kate Kelly, *The Secret Club That Runs the World* 120 (Portfolio/Penguin 2014) (“‘In a trading house,’ he says, ‘what you don’t know, you should not ask about.’”).

¹¹ Moore, *supra*.

¹² See Moore, *supra*.

¹³ See, e.g., National Wildlife Federation, Natural Resources Defense Council, and the Western Organization of Resource Councils, *Undermined Promise II* (2015) (evaluating mining companies’ compliance with the Federal Surface Mine Control and Reclamation Act) available at: <http://www.underminedpromise.org/UnderminedPromiseII.pdf>.

such issues.¹⁴ Finally, there could be liability under labor laws.¹⁵

Commodities activities present risks that are different from financial market risks, for example:

- political risk;¹⁶
- global supply chain disruptions;¹⁷
- geopolitical turmoil in unstable resource-rich regions;¹⁸
- troubling human rights and labor practices in resource extraction industries and resource-rich regions;¹⁹
- bribery and anticorruption risk;²⁰
- vulnerability to international sanctions laws;²¹ and

¹⁴ See, e.g., Avocats Sans Frontieres, Human Rights Implications of Extractive Industry Activities in Uganda (2014) available at: http://www.asf.be/wp-content/uploads/2014/09/ASF_UG_ExtractiveSectorHRImplications.pdf; see also Caroline Kaeb, *Emerging Issues of Human Rights Responsibility in the Extractive and Manufacturing Industries: Patterns and Liability Risks*, 6 NW. J. INT'L HUM. RTS. 327 (2008).

¹⁵ See Eric Nalder, *Oil Refineries a Risky Business*, S.F. CHRON., Mar. 27, 2013 ("OSHA found more than 1,000 citable violations in refineries during a temporary program that began in 2007.") available at: <http://www.sfgate.com/nation/article/Oil-refineries-a-risky-business-3815770.php>.

¹⁶ For example, banks are being pressured by environmental groups for providing financial support to oil and gas projects like the Dakota Access Pipeline. See Hiroko Tabuchi, *Environmentalists Target Bankers Behind Pipeline*, N.Y. TIMES, Nov. 7, 2016 available at: <http://www.nytimes.com/2016/11/08/business/energy-environment/environmentalists-blast-bankers-behind-dakota-pipeline.html>.

¹⁷ For example, tankers owned by the trading firm Trafigura were intercepted in the Caribbean in 2001 under suspicion of carrying Iraqi oil and spilled toxic waste in the Ivory Coast in 2006. See Joshua Schneyer, *Commodity Traders: The Trillion Dollar Club*, REUTERS, Oct. 28 2011 available at: <http://www.reuters.com/article/2011/10/28/us-commodities-houses-idUSTRE79R4S320111028>. Also, a looming labor strike at the world's largest copper mine in Chile is threatening to squeeze copper supplies, disrupt production, and cause global prices to spike. See Katherine Dunn, *Copper Prices Climb as Workers Set to Strike at Chile Mine*, WALL ST. J., Feb. 8, 2017 available at <https://www.wsj.com/articles/copper-prices-climb-as-workers-set-to-strike-at-chile-mine-1486554159>.

¹⁸ See, e.g., Jeffrey Gettleman, *As President Joseph Kabila Digs in, Tension Rises in Congo*, N.Y. TIMES, Dec. 17, 2016 available at: <http://www.nytimes.com/2016/12/17/world/africa/congo-joseph-kabila-corruption.html>.

¹⁹ For example, the oil company ExxonMobil is being sued in the U.S. under the Alien Tort Statute for acts of torture committed in Indonesia between 1999 and 2001. See Jonathan Stempel, *Indonesia Torture Case vs. Exxon Mobil Revived*, REUTERS, July 8, 2011 available at: <http://www.reuters.com/article/2011/07/08/us-exxonmobil-indonesia-idUSTRE7676I120110708>.

²⁰ Areas rich in extractives such as oil and gas are susceptible to bribery and corruption risks. See EY, *Managing Bribery and Corruption Risks in the Oil and Gas Industry* 5 (2014) ("For example, Africa, Latin America, Asia and the Middle East are all key growth markets for the oil and gas sector. In general, countries in these locations tend to have lower rankings on Transparency International's Corruption Perceptions Index, indicating that there is perceived to be a higher level of corruption.") available at: <http://www.ey.com/Publication/vwLUAssets/EY-Managing-bribery-and-corruption-risk-in-the-oil-and-gas-industry/%24FILE/EY-Managing-bribery-and-corruption-risk-in-the-oil-and-gas-industry.pdf>.

²¹ According to ExxonMobil, the joint venture that it established with Russian state-owned oil company Rosneft was forced to wind down exploration and research activities involving offshore Russia in the Black Sea, Arctic regions, and onshore western Siberia, and ExxonMobil's "maximum exposure to loss from these joint ventures ... is \$1.0 billion." Exxon Mobil Corporation 2014 10-K filing, at 72. See also Saabira Chaudhuri & Sarah Kent, *J.P. Morgan Commodities Assets Sale to Mercuria Smaller Than Planned*, WALL

- other environmental protection concerns.²²

Even commodities like agricultural commodities that appear vulnerable to fewer of these factors are exposed to the catastrophic macro risks of, for example, climate change.²³

They also contain financial risks that apply whether a bank is engaging in financing, physical asset ownership, and the like, including liquidity risk, stock risk, etc.²⁴ Commodities originating in certain countries may be subject to tariffs, however, a stockpile's country of origin may not always be easily discernible.²⁵ In another notable example, fraud at Chinese metals warehouses undermined copper and aluminum transactions, notwithstanding an "extensive internal review process" of such transactions.²⁶

All of this is not to say that some of these risks are not manageable, merely they are numerous and varied, and cannot necessarily be measured using one uniform risk weighting applicable to either covered or non-covered commodities. The risk weighting regime should better reflect the various levels of risk associated with certain commodities. For example, it could distinguish the risks associated with extractive industries as opposed to those associated with agricultural commodities. Proposed changes to the risk weighting scheme are discussed more below.

2. The risk weighting scheme and the regime for calculating the application of the 4(k) cap should better reflect the risks involved

While FHCs appear to have reduced their commodities holdings and trading activities in recent years, these FHCs still engage in many activities, and may choose to expand again

ST. J., Oct. 2, 2014 ("Morgan Stanley's pact to sell an oil-trading unit to Russian energy company OAO Rosneft remains in limbo as U.S. regulators scrutinize the deal. U.S. tension with Russia over its intervention in Ukraine, and Washington's decision to add Rosneft's chief executive to a sanctions list, have clouded the sale's outlook.") available at: <http://www.wsj.com/articles/j-p-morgan-close-to-sale-of-physical-commodities-assets-to-mercuria-1412266574>.

²² Goldman Sachs' mining subsidiary Colombia Natural Resources was forced to stop exporting coal for more than a year because it failed to comply with environmental laws, and one of its mines was taken out of commission when it flooded. See Peter Murphy, *Goldman Sachs Miner Halts Coal Exports from Colombia*, REUTERS, Jan. 9, 2014 available at: <http://www.reuters.com/article/2014/01/09/us-colombia-coal-cnr-exclusive-idUSBREA081CO20140109>.

²³ See, e.g., Richard Gledhill, Dan Hamza-Goodacre & Lit Ping Low, *Business-Not-As-Usual: Tackling the Impact of Climate Change on Supply Chain Risk*, PwC (2013) available at: http://www.pwc.com/gx/en/governance-risk-compliance-consulting-services/resilience/publications/pdfs/issue3/business_not_as_usual.pdf.

²⁴ See Prajat Samant & Rashaul Bahia, *Repurchase Transactions & Soft Commodities: Trends & Issues 4-5, Commodities Now*, Sept. 2011 available at: <http://files.mwe.com/info/pubs/praj1011.pdf>.

²⁵ See Scott Patterson, Biman Mukherji & Vu Trong Khanh, *Giant Aluminum Stockpile Was Shipped From Mexico to Vietnam*, WALL ST. J., Dec. 1, 2016 available at: <http://www.wsj.com/articles/giant-aluminum-stockpile-was-shipped-from-mexico-to-vietnam-1480588228>.

²⁶ Christian Berthelsen & Sarah Kent, *Citigroup Was Wary of Metals-Backed Loans*, WALL ST. J., Dec. 21, 2014 available at: <http://www.wsj.com/articles/citigroup-was-wary-of-metals-backed-loans-1419194646>.

in the near future.²⁷ The capital rules should be revised, both to properly address the current structure and risks associated with commodities financing, as well as to alter the economics of future physical commodities investments.

For example, FHCs often structure their commodities financing as repo-style transactions.²⁸ The repo structure offers certain legal and regulatory advantages to the lender over a secured loan, including favorable treatment under capital rules.²⁹ Repo-style arrangements also offer the ability to move commodities exposures off-balance sheet in certain circumstances.³⁰ For restrictions, including the 5 percent cap, and capital rules to meaningfully mitigate the risks of 4(k) complementary activities they should ensure that this regime is applied equally, regardless of structure of such transactions.

The Basel III implementing regulations have a risk weighting scheme for physically settled contracts, which serve as a partial basis for the NPRM's framework.³¹ However, this framework excludes repo-style transactions, and the NPRM is not clear how its risk weights would apply to such transactions; how the potential exposure of these transactions returning to the balance sheet should be calculated; and why the risk weights are only 300 percent for these financing arrangements (that are not covered commodities or held under 4(o)), when the Basel III schedule contains weightings for physically settled transactions that are in many ways significantly higher.³² The final rule should account for commodities that are used as repo collateral in FHCs' physical inventories, and use higher risk weights, similar to those in the Basel III physically settled transactions schedule.

Holdings under section 4(o) authority should also not be eligible to be counted against the 4(k) cap for the purposes of calculating risk weighting. As the Board has acknowledged,

²⁷ See Chaudhuri & Kent, *supra* ("After its exit from the commodities business, the bank is expected to continue to be active in commodities financing, derivatives, London Metal Exchange warrant trading, storing and trading of precious metals and liquidity and risk management."). For example, Goldman Sachs states that it continues to "purchase and sell certain physical commodities, [and] arrange for their storage and transport," including "crude oil, oil refined products, natural gas, liquefied natural gas, electric power, agricultural products, metals (base and precious), minerals (including unenriched uranium), emission credits, coal, freight and related products and indices." Goldman Sachs & Co. 2015 form 10-K. Last year alone, it sold 1.2 trillion cubic feet of natural gas – more than Chevron and ExxonMobil – including supplying 22 billion ft³ of gas to plants powering mines owned by Grupo Mexico in the Mexican state of Sonora. See Gregory Meyer, *Goldman Sachs Emerges as Growing Natural Gas Player*, FIN'L TIMES, May 15, 2016 available at: <https://www.ft.com/content/a9e67824-1846-11e6-bb7d-ee563a5a1cc1>.

²⁸ See, e.g., Berthelsen & Kent, *supra* ("Citi's position amounts to about \$270 million of copper and aluminum it bought from Swiss commodities trader Mercuria Energy Group in a series of transactions since May 2013, with an agreement to sell the holdings back later at a higher price, a form of secured low-cost loan that bankers term a repo, according to evidence presented in London's High Court during a December hearing in a lawsuit between the companies.").

²⁹ See, e.g., Mayer Brown, REPOs and Agricultural Commodities – Part I (2012); see also Mayer Brown, REPOs and Agricultural Commodities – Part IV (2012).

³⁰ See, e.g., Cadwalader, Wickersham & Taft LLP, Where Are You Now?: Key Considerations for Commodity Finance and Structured Commodity Transactions (Oct. 28, 2015) at 15, 23, available at: <http://www.energylawresourcecenter.com/blog/wp-content/uploads/2015/10/Panel-2.pdf>.

³¹ See 12 C.F.R. § 217.38.

³² See *id.*

4(k) imposes additional restrictions that are not required under 4(o).³³ Allowing these holdings to be treated as equivalent to 4(k) allows FHCs to receive favorable capital treatment without being subject to more stringent limitations.

In addition, the NPRM fails to account for risks related to FHCs' arrangements to contract the storage, production, transport, and/or alteration of a particular commodity.³⁴ While the specific principal risk involved in operating facilities that engage in, for example, the treatment of crude materials into refined products, is different, there are still risks associated with contracting for these services.³⁵ The NPRM should account for such risks, because they change the nature of the FHCs' potential exposures.

Finally, the risks associated with physical commodity portfolio companies is greater than those associated with non-commodities businesses. FHCs have not had an easy time offloading their commodities holdings in recent years³⁶ – and such sales took place prior to significant declines in certain commodities markets. While many may think that extractive industries are poised for a rebound under new political leadership, there are economic signs that demand may not increase.³⁷ Any final rule should contain a robust framework to account for these potential exposures and their illiquid nature.

B. The Scope of 4(o) Permissible Grandfathered Activities Should Be Narrowed

Notwithstanding our support for your recommendation that Congress repeal section 4(o), we continue to believe that the Board has additional authority to interpret the language of section 4(o) in a manner that more narrowly defines the scope of the grandfathered provision.

Section 4(o) of the BHC Act provides a statutory exemption for certain eligible institutions to engage in physical commodities activities and asset ownership. Staff at the Federal Reserve Bank of New York has observed that this provision is “widely seen as ambiguous,”³⁸ and the Director of the Board's Bank Supervision and Regulation Division has acknowledged that “there are multiple possible interpretations of section 4(o) of the BHC Act.”³⁹

Board staff told the Senate Banking Committee that “the Board will consider the scope of the grandfather provision in section 4(o)... in connection with its review of physical

³³ See Responses to Written Questions of Chairman Brown from Michael S. Gibson, Regulating Financial Holding Companies and Physical Commodities, S. Hrg. 113-375 (Jan. 15 2014) available at: <https://www.gpo.gov/fdsys/pkg/CHRG-113shrg89605/html/CHRG-113shrg89605.htm>.

³⁴ See 81 Fed. Reg. at 67,228, n. 53.

³⁵ See, e.g., Nalder, *supra*.

³⁶ See Chaudhuri & Kent, *supra*.

³⁷ See, e.g., Georgi Kantchev, *Having Addressed Supply, Oil Markets Face New Threat: Demand*, WALL ST. J., Dec. 14, 2016 available at: <http://www.wsj.com/articles/having-addressed-supply-oil-markets-face-new-threat-demand-1481713086>.

³⁸ Avraham, Selvaggi & Vickery, *supra*, at 68.

³⁹ S. Hrg. 113-375, *supra*.

commodities activities.”⁴⁰ However, the ANPR merely states that the “range of activities includes storing, transporting, extracting, and altering commodities.”⁴¹

While some may argue that the language ties the Board’s hands, the statutory framework appears to provide flexibility.⁴² The language of the statute could limit eligible institutions to only the particular activities that they were engaged in prior to such date. The Board should interpret this provision more explicitly, and in as narrow a manner as possible, permitting grandfathered institutions to only engage in the specific activities in which they were engaged prior to 1997.

In 2013, Morgan Stanley’s CEO reportedly said that the catastrophic risk associated with physical storage and transportation is, “a risk we just can’t take[.]”⁴³ Rather than relying on FHCs to voluntarily determine that it is beyond their ability to prudently manage the risks of such activities, we believe the Board has the ability to further restrict them, including in the interest of safety and soundness.

C. The Limits on Merchant Banking Should Be Expanded, Not Merely Codified

Because FHCs have been found to exercise a high level of control over physical commodity portfolio companies,⁴⁴ the proposal’s strengthened restrictions are necessary and important.

However, the concerns regarding FHCs’ involvement with portfolio companies are not confined to operational decisionmaking. Communications with physical operators provide FHCs with additional market information that can aid their trading operations, notwithstanding the ostensible barriers to these inter-relationships.⁴⁵ FHCs themselves

⁴⁰ *Id.*

⁴¹ 81 Fed. Reg., at 67,223.

⁴² See S. Hrg. 113-67 at 31 (testimony of Professor Saule Omarova) (“So while the text of the Gramm-Leach-Bliley Act that created that grandfathering exemption for newly registered bank holding companies after 1999 technically does not require the Fed to approve the use of this particular exemption—on its face, the statute does not do that. However, the same statute also says that within 5 years at the maximum, right, these institutions have to be, in effect, approved by the Fed as being fully in compliance with the Bank Holding Company Act prohibitions on their activities.”).

⁴³ Christian Berthelsen & Justin Baer, *Morgan Stanley Scales Down Commodities*, WALL ST. J., Dec. 18, 2013, available at: <http://www.wsj.com/articles/SB10001424052702304173704579264452411520552>.

⁴⁴ See PSI at 223 (“Goldman required Metro senior management to clear many business decisions through the Board of Directors, which was composed exclusively of Goldman employees. That included Board review and approval of the merry-go-round deals. Later, when Metro was publicly criticized for its lengthy queues, it was Goldman who announced that it would swap metal with any aluminum end user waiting in Metro’s queue. In addition, Goldman provided significant assistance to Metro’s legal and compliance functions.”).

⁴⁵ See Kelly, *supra*, at 142-43 (“In addition to the revenues those investments offered it, they presented Goldman with the possibility of a free look at what was happening on the physical side of commodities through ground-level operations. Tweaking existing contract trades in a commodity based on feedback from colleagues who worked in the physical aluminum markets was by then commonplace in banking. ‘We had pipeline capacity all over the place and we would call up and say, ‘How’s gas flowing this morning?’’ remembers a trading manager who worked for years at one of Goldman’s competitors. If flows were weak, he added, ‘We’d go, ‘Oh, we’re not going to get the pop we thought, so let’s reposition.’”).

have also acknowledged that their customers believe their physical operations create potential conflicts of interest.⁴⁶ Access to board presentations and participation in business strategy decisions provides problematic openings for such information sharing and creates additional possibilities for conflicts of interest.

As a result, FHCs should be removed from business strategy formulation and decisionmaking as well, including placing employees on the boards of portfolio companies.⁴⁷

D. Disclosures

More and better disclosure of these activities will enhance the public's understanding of these activities.

However, the proposal would not give observers a sense of the full range and scope of these activities. How the spot, futures, swaps, loan, and other components of an FHC's portfolio fit together may provide a picture that is not readily apparent by looking at each activity in isolation.⁴⁸ These markets are often interrelated, and access to information about just one market may obscure actions being taken, and strategies towards, other markets.

A more comprehensive narrative description by each FHC of its full range of activities, how they fit together – for example, how physical trading is actually “complementing” derivatives trading and vice versa. More robust information, along the lines of a management discussion and analysis, would better inform observers as to the views of FHCs, their business practices, and the associated risks and values therein.

E. Conclusion

Thank you again for your proposal. While some FHCs are exiting certain business lines, they are remaining in others, demonstrating the need for these rules to be finalized and implemented.⁴⁹ We were disappointed in the long delay between the ANPR and the

⁴⁶ See Hume, *supra* (Quoting the co-head of JPMorgan's commodities division that, “If anything, merchants are more comfortable talking to us than ever before. We are not in the logistics business any more, and we are not competing with them in that respect.”).

⁴⁷ As previously noted, JPMorgan placed the head of its commodities trading unit, as well as other executives, on the board of its Henry Bath warehouse company subsidiary. See David Sheppard, *Insight: Wall Street Reshapes Commodities Business to Fend Off Regulation*, REUTERS, July 22, 2103 available at: <http://www.reuters.com/article/2013/07/22/us-commodities-banks-insight-idUSBRE96L0BY20130722>.

⁴⁸ See Testimony of Norman C. Bay, Director, Office of Enforcement, Federal Energy Regulatory Commission before the Committee on Banking Financial Institutions and Consumer Protection Subcommittee, United States Senate, Jan. 15, 2014 at 4-6, available at: <https://www.ferc.gov/CalendarFiles/20140115143216-Bay-testimony-01-15-2014.pdf>.

⁴⁹ See Gregory Meyer, *Morgan Stanley in Talks to Sell Oil Tanker Stake*, FIN'L TIMES, Jan. 8, 2017 (“[Morgan Stanley] is in advanced negotiations to sell its stake in Heidmar, an oil tanker operator. A deal could be announced within weeks, industry executives said... Last year, Morgan Stanley sold a 100mW gas-fired power plant in Lee County, Alabama and an 80-mW oil-fired plant in Bainbridge, Georgia to Walton Electric Membership Corp, a rural co-operative in Monroe, Georgia. The bank still has long-term

NPRM, as well as the decision to extend the NPRM comment period an additional 60 days, and we hope that you will move forward in finalizing your rules without any further undue delay.

Sincerely,



Sherrod Brown
United States Senator



Jeff Merkley
United States Senator



Jack Reed
United States Senator

Cc: Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System

power supply obligations in the region and has contracted to purchase power from the plants until the 2030s, records show... Morgan Stanley's remaining physical commodities holdings include a 30 per cent stake in Global Energy International of Singapore, which supplies marine fuel and operates tankers, and Pioneer Energy Holdings, which owns a diesel terminal in Queensland, Australia, according to securities filings and executives.") available at <https://www.ft.com/content/1d8d8af0-d436-11e6-9341-7393bb2e1b51>.