



February 23, 2017

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

RE: 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

To Whom It May Concern:

Americans for Financial Reform (“AFR”) appreciates this opportunity to comment on the above-referenced Notice of Proposed Rulemaking (the “Proposal”) by the Federal Reserve Board (the “Board”). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. AFR includes consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.<sup>1</sup>

AFR strongly supports the measures laid out in this Proposal to both limit and control risks of physical commodity involvement at financial holding companies. Specifically, we support the new consolidated limits on the total size of commodity holdings, the capital increase to 300 percent risk weights applied to commodities held under 4(k) complementary authority, the capital increase to 1250 percent risk weight applied to certain commodities and commodity infrastructure held under the 4(o) grandfathering and merchant banking exceptions, the clarified prohibitions on ownership or operation of a variety of commodity-related facilities, and the new restrictions on the provision of energy management and tolling services, as well as the reclassification of copper from a precious to an industrial metal.

Taken together, we believe that these restrictions will significantly limit the risks to the banking system created by bank commodity ownership. Just as important, we believe that these changes will help to address the dangers of concentration of economic power and potential market manipulation that occur when the largest banking organizations are permitted to hold large quantities of commodities, play a central role in commodity derivatives markets, and exercise direct control over commodity market supply through mechanisms such as operating extraction and warehouse facilities or managing such facilities indirectly through energy management and tolling agreements.

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<sup>1</sup> A list of AFR member organizations is available at <http://ourfinancialsecurity.org/about/our-coalition/>.

The analytic work and justifications for these measures are extensive and have been conducted over many years. The comment on this Proposed Rule from Elise Bean and Tyler Gellasch, formerly of the U.S. Senate Permanent Subcommittee on Investigations, provides a useful summary of the range of studies of this issue that have taken place over the past five years.<sup>2</sup> These studies include an extensive multi-year review of commodity activities conducted by the Federal Reserve through the Large Institution Supervision Coordinating Committee (LISCC), the joint banking agency report on financial holding company permitted activities conducted in satisfaction of the requirements of Section 620 of the Dodd-Frank Act, an investigation of bank commodity activities by the U.S. Senate Permanent Subcommittee on Investigations, and a hearing by the Banking Committee of the U.S. Senate on the same topic. To this list can be added the thousands of public comments received on the 2014 Advanced Notice of Proposed Rulemaking released by the Board as a result of the LISCC review.

These various studies have thoroughly documented the risks to banks that can arise from liability for commodity-related accidents and disasters, which may far exceed the current market value of the commodity holdings or operations, as well as the ways in which the permissive nature of current rules on commodity activities have been exploited by large bank holding companies to manipulate markets in ways that benefit their bottom lines, but have serious costs for real economy businesses, consumers, and economic stability.

The measures in the Proposed Rule respond directly to these findings and concerns. By rationalizing the rules concerning commodity holdings and restricting total commodity holdings more strictly, the proposed new rules will limit the level of exposure that large banks have to both changes in commodity prices and commodity-related catastrophic events. By increasing capital held against commodity ownership, the Proposed Rule will render financial holding companies more able to survive commodity losses when they do occur.

The higher level of capital demanded for 4(o) and merchant banking commodity activities that exceed pre-set limits is particularly important, as such activities are not subject to Federal Reserve pre-approval as in the case of 4(k) complementary activities. Since their risks are not subject to direct Board oversight due to the scope and breadth of the statutory exemptions that apply, it is reasonable to demand that such risks be backed by a significantly greater level of the company's own capital.

The rules restricting such activities as control of storage and extraction facilities, participation in energy management, and energy tolling agreements, and ownership of an industrial metal such as aluminum target exactly the kind of activities which have been implicated in market abuses such as JP Morgan's energy market manipulation in California and the charges of manipulation of the aluminum market through control of warehousing facilities by Goldman Sachs. However, these

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<sup>2</sup> Bean, Elise and Tyler Gellasch, "Comment Re Proposed Rule on Holding Company Involvement With Physical Commodities", December 22<sup>nd</sup>, 2016.

provisions could be strengthened to cover any contractual arrangements that would have the effect of giving a financial holding company implicit control over commodity production and management.

The elements in the Proposed Rule, while valuable steps forward, still fall well short of the measures recommended in the Section 620 report on bank activities that was jointly conducted by the banking agencies in 2016.<sup>3</sup> The Section 620 report recommends that Congress entirely repeal the 4(o) grandfathering clause in the Gramm-Leach-Bliley (GLB) Act that permits two financial holding companies, Goldman Sachs and Morgan Stanley, to engage in commodity activities with only limited Board oversight. The report points out that this authority creates a non-level playing field between the two companies it benefits and other banking institutions, and more generally undercuts the distinction between banking and commerce. The report further recommends that Congress entirely repeal the ability of financial holding companies to engage in merchant banking activities, which also blur the distinction between banking and commerce. .

As pointed out by Professor Saule Omarova in another comment on this Proposed Rule, it would be possible for the Board, consistent with the statute, to interpret the grandfathering provisions of the GLB Act much more narrowly than it currently does, for example by limiting commodity activities permitted under this authority to those being conducted when the GLB was passed.<sup>4</sup> The fact that the Board considered the risks of grandfathered commodity activities so serious as to recommend significant Congressional actions to eliminate these loopholes shows the urgency of taking all regulatory actions possible to address them. These should include not only the elements in this Proposed Rule but a much narrower interpretation of the grandfathering provisions of the GLB Act.

Thank you for the opportunity to comment on this Proposal. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org) or (202) 466-3672.

Sincerely,  
Americans for Financial Reform

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<sup>3</sup> Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Report to the Congress and The Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act", Washington DC, September 2016.

<sup>4</sup> Omarova, Saule, "Comment Re 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", February 14, 2017.