BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 17, 2011

Andrew S. Baer, Esq.
Sullivan & Cromwell LLP
1701 Pennsylvania Avenue, NW
Washington, D.C. 20006

Dear Mr. Baer:

This letter concerns the notice that the Bank of Nova Scotia ("Scotiabank"), Toronto, Canada, filed on September 1, 2010, under section 4 of the Bank Holding Company Act ("BHC Act") to engage, on a limited basis, in physical commodity trading activities.[1]

Scotiabank stated in the notice that it currently engages in commodity derivative activities that are permissible for bank holding companies under the BHC Act ("Commodity Derivatives Activities"). These activities include trading in cash-settled swaps, forwards, options, and other derivatives based on commodities.[2] Scotiabank has requested approval to expand its current trading activities to include engaging in physically settled commodity derivatives, taking or making delivery of commodities in settlement of those derivatives, taking inventory positions in physical commodities, and trading activities in the spot market in physical commodities ("Physical Commodity Trading"). Scotiabank has represented that its Physical Commodity Trading

[1] Scotiabank would engage in the proposed activities through its wholly owned subsidiary, Scotia Capital Energy Inc., also of Toronto.

[2] 12 CFR 225.28(b)(8)(ii).

will encompass a variety of commodities, including natural gas, crude oil, and emissions allowances.[3]

The Board has previously determined pursuant to Regulation Y that taking and making delivery of a physical commodity complements the financial activity of engaging regularly as principal in Commodity Derivatives Activities based on that commodity.[4] The Board has delegated to the Director of the Division of Banking Supervision and Regulation ("Director"), with the concurrence of the General Counsel, authority to approve requests by financial holding companies to engage in Physical Commodity Trading as an activity that is complementary to Commodity Derivatives Activities, if the proposal meets the conditions imposed by the Board when it has approved previous requests to engage in Physical Commodity Trading and if it does not raise significant legal, policy, or supervisory issues.[5]

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[3] For purposes of this letter, an "emission allowance" is an intangible right to emit certain pollutants during a given year or any year thereafter that is granted by the U.S. Environmental Protection Agency or comparable foreign regulatory authority to an entity, such as a power plant or other industrial concern, affected by environmental regulation aimed at reducing emission of pollutants.

[4] Royal Bank of Scotland Group plc, 94 Federal Reserve Bulletin C45 (2008); Société Générale, 92 Federal Reserve Bulletin C113 (2006); Deutsche Bank AG, 91 Federal Reserve Bulletin C54 (2005); JPMorgan Chase & Co., 91 Federal Reserve Bulletin C57 (2005); Barclays Bank PLC, 90 Federal Reserve Bulletin 511 (2004); UBS AG, 90 Federal Reserve Bulletin 215 (2004); and Citigroup Inc., 89 Federal Reserve Bulletin 508 (2003).

[5] Scotiabank has indicated that the transactions in which it intends to engage after approval of this notice include, among other things, volumetric production payment transactions ("VPPs") on oil and natural gas. VPPs are considered permissible credit transactions under 12 CFR 225.28(b)(1) if a bank holding company immediately sells any commodities it receives under the VPP to third parties. See Letter from Scott G. Alvarez, Esq., to Elizabeth T. Davy, Esq., dated May 15, 2006, regarding UBS AG. Scotiabank would rely on approval of this notice to permit it to retain ownership of commodities delivered to it under a VPP. The market value of any such commodities retained by Scotiabank would be included in the 5 percent of tier 1 capital limit on the value of its physical commodity inventory to which Scotiabank has committed in connection with this notice, as detailed in the appendix to this letter.

In evaluating the risks posed by the proposal, the Director and the General Counsel have considered that Scotiabank already incurs the price risk of commodities through its Commodity Derivatives Activities. Permitting Scotiabank to engage in the limited amount and types of Physical Commodity Trading described above, within the limits described in the appendix, would not appear to increase significantly its potential exposure to commodity price risk. To minimize the potential for increased risks associated with Physical Commodity Trading (including, but not limited to, storage, transportation, legal, and environmental risks), Scotiabank has committed to the Board that it will not (i) own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or (ii) process, refine, store, or otherwise alter a physical commodity itself. Scotiabank has further committed to the Board that it will limit the aggregate market value of physical commodities that it and any of its subsidiaries hold at any one time to 5 percent of Scotiabank's tier 1 capital.[6] Scotiabank also has established and maintained policies and systems for monitoring and controlling the risks associated with Physical Commodity Trading. Going forward, Scotiabank is expected to continue to maintain effective risk-management policies and systems pertaining to its Physical Commodity Trading. Approval of the proposal would likely benefit Scotiabank's customers by enhancing the bank's ability to provide efficiently a full range of commodity-related services and improving its understanding of the commodity markets.

Based on all the facts of the record, including the commitments made to the Board in connection with the notice and the conditions imposed by the Board in previous cases, the Director, with the concurrence of the General Counsel, has determined that the proposed activities for Physical Commodity Trading are complementary to the Commodities Derivatives Activities conducted by Scotiabank; that the proposal would not appear to pose a substantial risk to Scotiabank, depository institutions operated by Scotiabank, or the financial system generally; and that the proposal can reasonably be expected to produce benefits to the public that outweigh any potential adverse effects.

In making these determinations, the Director and the General Counsel have relied on all the information, representations, and commitments that Scotiabank provided to the Board in connection with the notice and, in particular, the commitments set forth in the appendix and the conditions contained in the previous decisions noted above regarding these activities. These commitments and conditions are critical to the determination that Physical

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[6] See the appendix for a list of Scotiabank's commitments.

Commodity Trading would not pose a substantial risk to the safety and soundness of Scotiabank, other financial institutions, or the financial system generally. These commitments and conditions are deemed to be conditions imposed in writing in connection with this action and, as such, may be enforced in proceedings under applicable law.

This determination is also subject to all the conditions set forth in Regulation Y, including those in section 225.7,[7] to the conditions contained in the Board's previous decisions regarding these activities, and to the Board's authority to require modification or termination of the activities of a bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, or to prevent evasion of, the provisions and purposes of the BHC Act and the Board's regulations and orders issued thereunder.

Sincerely yours,

Robert deV. Frierson

Robert deV. Frierson
Deputy Secretary of the Board

Appendix

cc: Ivan J. Hurwitz, Vice President
Federal Reserve Bank of New York

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[7] 12 CFR 225.7.

Appendix

Commitments by Scotiabank

General

1. Scotiabank will conduct its Physical Commodity Trading exclusively pursuant to the authority of section 4 of the BHC Act and in accordance with the limitations that the Board has placed on the conduct of such activities, and will not conduct such activities in the United States in reliance on section 2(h)(2) of the BHC Act or section 211.23(f)(5) of the Board's Regulation K.

Physical Commodity Trading Activities

2. Scotiabank will limit the aggregate market value of physical commodities that it holds at any one time as a result of Physical Commodity Trading to 5 percent of its tier 1 capital. Scotiabank will include in this 5 percent limit the market value of any physical commodities it holds as a result of a failure of reasonable efforts to avoid taking delivery in commodities transactions conducted pursuant to section 225.28(b)(8)(ii)(B) of Regulation Y. In addition, Scotiabank agrees to notify the Federal Reserve Bank of New York if the aggregate market value of commodities held under this approval exceeds 4 percent of Scotiabank's tier 1 capital.

3. Scotiabank will take and make physical delivery only of physical commodities (i) for which derivative contracts have been authorized for trading on a U.S. futures exchange by the Commodity Futures Trading Commission, (ii) as to which the Board has specifically determined that all financial holding companies with Physical Commodity Trading authority may take or make physical delivery, or (iii) as to which the Board has specifically authorized Scotiabank to take and make physical delivery (collectively, "Approved Commodities").

4. Scotiabank will not use this authority to own, invest in, or operate facilities for the extraction, transportation, storage, or distribution of commodities but will only use storage and transportation facilities owned and operated by third parties. Scotiabank will enter into service agreements only with reputable independent third-party facilities.

5. Scotiabank will act solely as an intermediary in the physical commodities market and will not process, refine, or otherwise alter a physical commodity itself. Scotiabank will contract with a third party for any services it needs in connection with the handling of any commodity. Scotiabank further commits that it will not contract for the exclusive right to use a facility to alter commodities for any period of time. Consistent with the Physical Commodity Trading authority, Scotiabank will contract with third parties (i) to alter only an Approved Commodity and (ii) to alter the commodity only into another Approved Commodity.

Volumetric Production Payment Transactions

6. Scotiabank will include any commodities that Scotiabank receives under a volumetric production payment transaction and does not immediately sell to a third party in calculating its compliance with the limit of 5 percent of tier 1 capital on the aggregate market value of the physical commodities that it and any of its subsidiaries hold at any one time as a result of Physical Commodity Trading.