Occupy the SEC
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March 25, 2014

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

Re: Physical Commodities: Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies (Docket No. 1479 AND RIN 7100 AE-10)

Dear Sir:

Occupy the SEC ("OSEC")[1] is pleased that the Federal Reserve ("FRB") is considering taking a narrower view on permitting Bank Holding Companies ("BHC") to engage in currently exempted commodities activities. OSEC shares with members of Congress, other advocates, academics, and regulators alike multiple concerns about the overbroad scope of activities that the FRB has permitted BHCs to engage in, pursuant to contested language in the Graham-Leach-Bliley Act ("GLB").

I. INTRODUCTION

Many members of Congress that voted for GLB were misguided in their understanding of certain provisions of GLB. For instance, many were under the impression that the scope of activities that they were permitting financial institutions to engage in under the "complementary" provisions was limited to innocuous activities such as publishing travel brochures.[2] As Sen. Sherrod Brown said, "nobody knew the reach [GLB] would have into the real economy."[3]

This legislative history is unfortunate, because the reality is that such language has permitted BHCs to dramatically expand their balance sheet exposures by engaging in activities that present risks to the stability of the financial system as a whole, undermine competitiveness, and create the conditions of possibility for expansive market manipulation regimes.[4] And such conditions have been exploited to manipulative ends: see, for instance, the $410 million settlement between Federal Energy Regulatory Commission ("FERC) and JPMorgan Chase over power market manipulation in California and the central U.S. between 2010 and 2012.

The FRB now has an opportunity to reverse certain orders and actions and rein in nefarious financial activity by taking a more conservative position on its application of GLB.

A. Separation of Banking from Commerce

Starting in 2003, the FRB issued Orders that approved physical trading in commodities and other activities for certain well-capitalized Financial Holding Companies ("FHC") – some of which later become BHCs.[5] The FRB posited in those Orders that trading in physical commodities was complementary to financial activities and conducive to market efficiency.[6] The GLB Act gutted standards in the BHC Act, grandfathered certain commodities operations, and permitted passive merchant banking activities. Even so, it did not eliminate the long-standing statutory firewall between financial and commercial activities.[7]

BHCs have long been prohibited from "delivery" or possession of physical commodities as part of a larger separation between banking and non-banking activities, the purpose of which remains current today. (See Appendix A.) This history is relevant because the FRB would not exist had pre-New Deal financial institutions not controlled industries—and government—more perniciously and extensively than any run-of the mill monopolist and triggered financial crises that led our nation's leaders to establish the Federal Reserve System and other salient financial regulation in the first place.[8] Moreover, prior to the founding of the Federal Reserve, frequent crises were the result of booms and busts in commodities markets.[9] Through this historical lens we can see how a liberal application of the provisions being considered here undermines the integrity of the very bedrock upon which the FRB's pillars of responsibility were built.

Today, the exemptions granted under the complementary commodities authority and regulations regarding the grandfathering and merchant banking exemptions threaten both financial stability and the productive economy in new and increasingly devastating ways. Recent scandals show that BHCs have engaged in outright fraud and manipulation of commodities markets as well as risky behavior unrelated to their core banking mission, raising concerns about the manipulation of commodity prices, consumer access, and general inflation.[10] The liberalization of physical commodities dealing raises concerns about economic growth and inflation, anti-competitive practices, resource concentration, and banks' conflicts of interest in extending credit and derivatives transactions. The novel and unpredictable risks involved in physical commodities trading, including catastrophic oil spills, threaten banks' solvency and the stability of financial markets.

We therefore contend that the law requires that the FRB take swift and decisive action in reversing its prior orders and regulations and imposing heightened prudential requirements, including reporting and disclosure, intensive capital and liquidity requirements, and effective examination. The Board's interpretation of GLB is not supported by the law or evidence. Several statutes serve as guideposts to the Board's action, including Title I (Systematic Stability) and Section 619 (The Volcker Rule) of the Dodd-Frank Act, and the Board's dual mandate of restraining price inflation and ensuring full-employment. Other statutory schemes, including FERC market-manipulation enforcement authority, the Commodities Exchange Act, and the subsidiary restriction of the Federal Reserve Act are an inadequate substitute for Board action.

B. Legal and Statutory Analysis

The Board, interpreting the Bank Holding Company Act, fails to apply relevant legal principles and neglects the momentous transformations in risk-taking and manipulation that the financial crisis and the resultant Dodd-Frank Act have initiated (See Appendix B). Other legal principles and structures do not substitute for Board action pursuant to the instant ANPR.

Substantial evidence therefore supports extraordinary restrictions on physical commodities trading coupled with regulatory changes to make effective those restrictions.[11] Those restrictions include reporting and disclosure, capital requirements, and various prudential limitations, including a heightened role for internal bank examiners. We counsel against overreliance on weak capital or liquidity requirements, which are likely to be ineffective in assessing the possibility of rare and severe risks, dissuading conduct during a speculative boom, or ensuring liquidity during an environmental crisis.

1. The Dodd-Frank Act's Requirements and the Dual Mandate of the Federal Reserve Act Guide the Board's Decision

The Dodd-Frank Act is a critical map to chart the Board's course in the turbulent aftermath of the financial crisis, which features unabated and aggressive physical commodity practices that are not limited to ownership of coal mines and petroleum trading facilities. At the outset, it is important to emphasize that Section 603 of the Dodd Frank Act, 12 U.S.C. s. 603(b), reiterates the long-standing separation between commercial and financial activities. The Dodd-Frank Act's requirement that the Board evaluate the systematic risk that Systemically Important Financial Institutions (SIFIs) pose to the financial system for the first time institutes guidelines regarding the scope of BHCs' physical commodities activities, not limited to risk-intensive petroleum commodities trading and energy management agreements.

Restrictions in the Dodd-Frank Act that allow the Financial Stability Oversight Council (FSOC) to review the actions of SIFIs (including non-BHCs) and their contributions to systematic risk permit the Board to engage in more stringent prudential regulation of those institutions.[12] The Dodd-Frank Act's restrictions include risk-based capital requirements, leverage limits, liquidity requirements, resolution plan and credit exposure report requirements, concentration limits, contingent capital requirements, enhanced public disclosures, short-term debt limits, and overall risk management requirements.[13] These requirements supplement other efforts to implement the Act and Basel III standards, including the detailed minimum leverage capital requirements and risk-based capital requirements.[14] The restrictions also empower the Board to regulate non-BHC subsidiaries as if they were BHCs and provide FSOC extensive power to recommend action to agencies and to take action itself on systematic risk concerns.[15] We contend that any such restriction would likely include the largest financial institutions and should deal with systematic risk issues such as commodity trading. These principles militate for a strict regime to limit the activities of FHCs, including extensive examiner monitoring.

Similarly, the covered funds provision of Section 619 of the Dodd-Frank Act ("Volcker Rule") curtails proprietary trading, including hedge-fund type activity, otherwise countenanced under the language of the GLB. The Volcker Rule is designed to limit systematic financial risk from proprietary trading by banking entities, on which it also imposes ownership limits and intensive documentation requirements.[16] This limitation affects day-to-day operations under the complementary and grandfathering provisions of the Bank Holding Company Act. The final rule, indeed, includes commodities forwards and contracts for future delivery of physical commodities as prohibited cash trades or financial instruments. We contend that the Volcker Rule also places limits on certain merchant banking activities that are otherwise permitted under Section 4(k)(4)(H) of the Graham-Leach-Bliley Amendments, 12 U.S.C. s. 1843(k)(4)(H). After all, the Volcker Rule's definition of "banking entities" includes all affiliates of depository institutions, even if those institutions are conducting physical commodity operations.[17]

We concede that there may be some ambiguity in how the Volcker Rule's restrictions on covered funds apply to merchant banking activities that are not specifically defined in the BHCA or in the final rule implementing Dodd-Frank Act Section 619.[18] However, what is clear is that the Dodd-Frank Act was passed after the GLB. Accordingly, Congressional intent can reasonably be interpreted so as to look askance upon risky private equity activities conducted by BHCs, even if in the commodity realm. As a matter of statutory interpretation, a statute passed later in time holds more sway with courts if it more specifically covers a specific issue more concretely.[19] The Volcker Rule addressed the issue of BHC ownership of private equity funds directly, while the GLB did so more obliquely.

The dual mandate of the Federal Reserve Act, moreover, contemplates that concerns with inflation, and the growth of full employment, guide Board action in dealing with market manipulation and speculation.[20] Federal Reserve Bank researchers themselves have analyzed the speculative effects of physical commodities operations and the evidence uniformly supports a finding that speculative patterns not based on market pricing are a hallmark of contemporary physical commodities and related derivative markets.[21] There is no dispute about some BHCs are engaging in fraudulent activities under authority provided to them under the GLB, and that those activities threaten innovation and market competitiveness. The law strongly supports Board efforts to broadly limit market irregularities, and not merely to mitigate the most serious financial market risks.

2. The Board's has Interpreted the Bank Holding Company Act in a Cursory Manner that Merits Reconsideration

The far-reaching activities of Bank Holding Companies pose problems, including thwarting competition and posing systematic risk concerns, which were either not evident or not fully analyzed in the Board's post-2003 Orders permitting complementary activity. The Board has also interpreted the grandfathering provisions of the Bank Holding Company Act in a liberal manner that has effectively left an open door for newly-converted BHCs to engage in the riskiest and most speculative physical commodities trading. The FRB's regulations regarding merchant banking, too, avoid a realistic analysis of managerial control and need to be revisited in light of new legal principles and potential environmental and financial catastrophes.

a. Complementary Activities

At a fundamental level, the Board failed to apply the principles of Section 4(k) and 4(j) of the Graham-Leach-Bliley Act in evaluating and permitting activities complementary to financial activities for certain BHCs. The Bank Holding Company Act generally permits regulated institutions to engage in only financial activities, such as lending, but makes exception for certain well capitalized and financed Financial Holding Companies to engage in incidental and complementary activities.[22] The legislative history demonstrates that the exception was intended to allow innocuous activities that were limited to a small portion of the business of the firms.[23]

Unfortunately, the Post-2003 Complementary Orders failed to demonstrate the connection between physical commodities trading and finance on the one hand, and safety and soundness on the other, as required under Section 4(k). Instead, the orders provided only a cursory explanation relating to FHCs' ability to physically settle transactions.[24] Subsequent orders dramatically lifted even the paucity of restrictions upon FHC action, by permitting exchange-traded derivative instruments and involvement in energy trading. [25] The Orders determined that there were no "safety and soundness concerns" because of the mere facts that derivatives were traded in CFTC-regulated exchanges, and that there existed liquidity and prudential limitations on factors such as insurance, ownership of storage or transportation facilities, and levels of tier-one capital.[26] These moderate limitations have been inadequate in preventing risky activity, and sadly permit trading similar to that of now defunct Enron Corporation. Indeed, the FERC has prosecuted such activities as manipulative of the market, as the ANPR makes clear. The rampant use of stockpiles as a means of influencing derivative prices undermines market function, as does extant energy market fraud. In view of this troubling market reality, the Board's interpretation of complementarity is not entitled to deference.

The licensing requirement in Section 4(j)(2)(A), moreover, was designed to restrain anti-competitive activities, avoid concentration of resources, ensure fair and equitable distribution of credit, and limit risky financial practices; it echoes long-standing legal divisions between commercial and financial activity. The Federal Reserve must take advantage of its role in setting conditions for BHC activities to stem the risks of complementary activities that threaten to overwhelm both the banking and commodities systems.[27] It is not enough for the Board to focus on the perceived benefits of such activities to BHCs and their clients, without adequate consideration of BHCs' vast capital structure and their enjoyment of explicit depository and implicit governmental guarantees.[28] The Board's analysis here, we urge, must establish a connection between permitted financial activities and the actual activities of the FHCs following the financial crisis. Moreover, the Board should remain ever-cognizant of the risk that FHCs pose for catastrophic action in the future and be mindful of their very real and ongoing disruption of commodities and derivatives markets. Further liberalization of commodities and commodities derivative markets already demonstrating market concentration is not the appropriate response.

b. Grandfathering of Existing Activities

The Board has also failed to take action to limit the scope of grandfathered activities under the BHCA. Any emergency rationale for the Board's three years of grace periods, extending the two-year statutory window for converted BHCs Goldman Sachs and Morgan Stanley,[29] has long since ceased to exist. More critically, the plain language and legislative history of the statute indicate that only those physical commodities activities in which the institutions engaged prior to September 30, 1997 should be exempted if they converted to BHCs after September 30, 1999, with limitations on the percentage of trading and cross-marketing.[30] The legislative history indicates that the statutory provision was intended to be part of a larger scheme for firms that converted to BHCs and which would have limited FRB oversight and precluded federal depository insurance.[31] As currently drafted, the statutory language only permits an exemption for existing physical commodity activities, and does not grant an unlimited privilege to converted firms, free of public-policy justifications.

c. Merchant Banking Exemptions

The Board's decision to liberalize passive investment under the merchant banking provisions of the Bank Holding Company Act, 12 U.S.C. s. 1843(k)(4)(H) and (I), merits reconsideration under its own terms as well as under the Dodd-Frank Act. We specifically recommend the application of extraordinary restrictions on active management, heightened bank examination, limiting the term for which an investment is held, and other prudential restrictions.[32] The law has general requirements to ensure the separation of banking and commerce, such as the requirement that an investment be in connection with "bona fide underwriting or merchant banking or investment banking activity." The restrictions on routine management, which allow the appointment of directors, approval of activities outside the ordinary course of business, and various consulting permissions, are ineffective against preventing active involvement and consequent liability and market manipulation.[33] The Board must further restrict its regulatory requirements and allow for heightened involvement of internal bank examiners who have access to granular, portfolio-specific data. Similarly, reporting and disclosure requirements must be heightened to provide the public and the Board with a modicum of information about the risks and details of investments. The Board must also restrict the term for which investments can be held to minimize the potential for abuse. We also recommend that the Board implement additional prudential requirements such as capital requirements, reporting and disclosure requirements, and total banking restrictions.

3. Other Statutory Schemes Do Not Address Core Physical Commodities Trading Concerns

It is important to acknowledge that while other provisions of the Dodd Frank Act, the Federal Reserve Act, and FERC energy-market manipulation enforcement authority provide some protection from systematic risk and market manipulation, these regimes do not obviate Board action on the provisions of the BHCA. Dodd-Frank Act requirements that the CFTC impose position limits and exchange trading requirements on derivative transactions limit incentives for manipulation and over-concentration of the commodities markets. However, many of these requirements are riddled with exceptions and resolve related but orthogonal concerns such as derivative market functioning. Similarly, the civil enforcement provisions granted to the FERC allow the government to police manipulative activities by BHCs,[34] but those policing powers do not address other anti-competitive practices, non-energy industries, or institutional or systematic risk.

The requirement in the Federal Reserve Act that limits the amount and type of transactions with affiliates of depository institutions does not alter the necessity that the Board transform the institutional and systematic risk-taking activities of BHCs.[35] As the ANPR makes clear, the subsidiary structure is vulnerable to exactly the financial contagion implicit in the Financial Crisis of 2008 as well as the consequences of environmental catastrophe under the harsh liability regime of environmental statutes such as CERCLA, which include reputational and systemic risks, and the real likelihood that the corporate veil will be pierced in such actions. The modifications to the subsidiary rules in the Federal Reserve Act, while substantial,[36] do not alter this essential dynamic in which mere corporate formalities and separate institutions are inadequate to silo financial contagion.[37] The Volcker Rule's mandate, in Section 619, that banks' fund activities be parceled out from parent institutions is similarly inadequate because of innumerable statutory loopholes. Most troublingly, these regulatory half-measures demand that regulatory agencies engage in judicious enforcement and banking examination of tail risks that are largely unforeseeable. It is unjustifiable that the public should bear the negative environmental, social, and economic impact of the practices of institutions whose parent corporations receive not only FDIC insurance but the implicit guarantee of federal support that makes these activities possible in the first place.

We recognize but find inadequate the requirement in Title VII of the Dodd-Frank Act, implementing changes to the Commodities Exchange Act, that the CFTC impose position limits and exchange trading requirements on derivative transactions, in an effort to reduce the riskiness of physical commodities trading.[38] The new Title VII regulations follow difficult appellate litigation and represent the CFTC's effort to impose restrictions on speculative behavior in the commodities markets that are as essential for productivity, human survival, and political stability as gasoline and wheat.[39] The limitation on the size of market positions of commodity dealers, including forwards, options, and analogous physical commodity trading, is a necessary response to dramatic shifts in commodities speculation and could shift physical commodities trading and eliminate some of the incentive for cornering derivative markets in order to profit from prices in physical commodities, and vice versa.[40] The large size of allowed positions under the proposed rule, exemptions for end users, and the possibility for continued fraud and market manipulation with regard to smaller positions, however, caution against overconfidence in the effect of the rule on FHC physical commodities trading.

The Board cannot rely on these related statutory schemes to resolve the core concerns of risk, anti-competitive practices, credit allocation, and resource concentration that are at the heart of the Bank Holding Company Act. Substantial evidence, including the market-manipulation and risky activities of the BHCs themselves since the passage of the Graham-Leach-Bliley Act, supports strong Board action at this time.

The Board's exceedingly liberal interpretation of complementarity and grandfathering is also not entitled to deference in light of the gross market risks that these exemptions have engendered. Under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), an administrative agency is accorded a modicum of deference as to its interpretation of a statute. However, agency action can be overturned for being "arbitrary and capricious" if the agency entirely fails to consider an important aspect of a relevant issue or its decisions are unsupported by substantial evidence.[41] Here, the Board's determination as to the GLB is not warranted under *Chevron* because it has failed to account for existing market risks and establish any meaningful standard regarding complementarity. The Board's interpretations under 12 U.S.C. s. 1843(k)(2) and 12 U.S.C. s. 1843(j) are therefore not supported by substantial evidence and are otherwise arbitrary, capricious, an abuse of discretion or not in accordance with law.

We therefore recommend that the Board limit or restrict entirely the physical commodity operations of BHCs and SIFIs and improve reporting and disclosure requirements. The Board should at least implement prudential requirements such as heightened examination, limitations on the time period during which a passive investment can be held, trading volume limitations, and strict capital and liquidity requirements. Physical trading operations are also subject to the Dodd-Frank Act's limitations on proprietary trading and systemic risk, which limit private equity investments and impose heightened prudential requirements on risky investments. Absent such restrictions, existing limits on the most risky investments and activities, such as refining, shipping, and storing energy commodities, would mitigate but not prevent serious risks. Further Board action is required.

II. TOPICAL CONSIDERATIONS

The intrusions of BHCs into the domain of physical commodity trading threaten to overwhelm institutional risk management and agency capability with, for instance, environmental risks for which the public may become responsible, as well as market inefficiencies and anti-competitive practices. It is inappropriate for BHCs to engage in activities that could cause pollution impacts that the federal government might be responsible for remediating under CERCLA. Those activities also undermine the effectiveness of physical commodity markets and the function of the larger economy. These complex risks are not ones that a system of additional or revised prudential requirements such as insurance, capital requirements, or trading volume limitation requirements can entirely prevent. Nor can additional or more appropriate liquidity or safety and soundness metrics completely ensure against these interlocking risks. Indeed, these tools may be especially ineffective in times of crisis. We fully endorse effective reporting and disclosure requirements that could alter the current opaque physical commodity operations of large banks. We also recommend that the Board approach environmental, reputational, price, and financial system risks with heightened caution because they are largely beyond the ken of both regulators and internal risk management controls.

A. Environmental Catastrophes

In addition to the problems that the FRB has already pointed out in its ANPR, we have additional concerns that the government and public will bear the initial and ultimate responsibility for cleanup of accidents involving BHC physical commodity trading, providing the BHCs an additional undue subsidy. Every day there appears to be some headline involving a disaster of some variety involving the extraction or transportation of crude resources. "Gas well blows up and incinerates 27 year old man…" "Oil train derails and explodes..." "Fracking boom in Texas results in locals suffering from respiratory illnesses…" The pressing need for environmental protection demands that FHCs and BHCs be pushed out of commodities industry. We also contend that the Board has failed to meet the requirements to generate an Environmental Impact Statement (EIS) under the National Environmental Protection Act (NEPA).

1. Escaped Liability Under CERCLA Forces the General Public to Bear Undue Costs

The government should minimize its responsibility for the various environmental, reputational, financial, and social risks inherently associated with the extraction, transportation, and storage of energy related physical commodities that depository institutions, their affiliates, and subsidiaries hold under the Graham-Leach-Bliley Act. The ANPR highlighted various examples including the Deepwater Horizon oil spill, the Fukushima nuclear disaster, and more recently, various explosions of natural gas wells. Such catastrophes present, as the ANPR underscored, severe and unpredictable liability, reputational costs, and the possibility of systemic financial contagion. All of these accidents take a toll on human lives and well as economies of the surrounding regions. They can disrupt commerce and the ecosystems, including marine life, on which commerce is dependent, and the government often bears the cost of mitigating these significant social costs. Typically, institutions that deal exclusively with energy-related commodities have the proper oversight and regulatory framework which ensures these disasters are dealt with in the most effective and efficient means possible.

When the Board originally began approving FHCs, it acknowledged these risks and prohibited an FHC's ability to "own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities; or process, refine, store, or otherwise alter a physical commodity itself."[42] However, as the Board's approvals became more commonplace and dealing in commodities became a standard throughout the financial industry, the Board began to loosen control over these activities.[43] The increased ability of FHCs to deal with commodities absent any stringent environmental oversight increases the probability that a FHC will be involved with a commodity-related accident. The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), or Superfund, ensures that if accidents do occur, the burden of cleanup is placed the on "parties responsible for creating or worsening an environmental problem." [44] Even so, the government and public are commonly responsible for initial remediation costs even if the polluter and other responsible entities pay the ultimate costs. As with the Deepwater Horizon spill, the initial costs can result in severe economic and social disruption during an extended process of assessing liability.

Pollution or disaster costs can amount to billions of dollars relating to cleanup, often resulting in bankruptcy for a potentially responsible party (PRP). For example, in 2009, Lyondell Chemical Company was implicated in six Superfund sites and simultaneously dealt with bankruptcy proceedings. The federal government sought $5.5 billion for both remedial and cleanup costs. As the ANPR states, insurance is likely inadequate in the event of an environmental pollution catastrophe, similar to the case with Lyondell. The chemical company eventually settled with the U.S Government for $331.5 million, leaving behind $5.2 billion dollars worth of damage.[45] And while Lyondell was not associated with a FHC, the principles of corporate structure and bankruptcy still remain pertinent to the issues at hand. The Government Accountability Office (GAO) discovered that no institution, including the federal government, collected information surrounding the number of businesses that file for bankruptcy and consequently have their liabilities for environmental cleanup discharged.[46] The report did find that the federal government faced significant challenges in holding businesses liable for cleanup costs and ensuring that such companies had the financial means to pay for the environmental obligations they incurred.[47]

FHCs have the ability to escape from liability for environmental accidents by insulating themselves with the use of subsidiaries. As the ANPR states, it is a well founded principle of corporate law that a parent company is not liable for the actions of its subsidiaries. And while may be a variety of ways to pierce the corporate veil, the ANPR goes on to say that "FHCs may not be able to accurately predict whether courts would respect the corporate veil between a top-tier FHC and its subsidiary when the subsidiary is liable for extensive damages caused by its Complementary Commodities Activities." It would be unjust to allow FHCs to continue participating in these activities in light of the potential uncertainty regarding liability for damages. Corporations typically have a better means of undertaking the costs associated with damages. FHCs have the ability to internalize these liability costs through the revenue they create and the implicit and explicit guarantees of federal depository insurance, whereas the federal government does not typically generate revenue from its regulatory activities. Calling on the federal government to foot the bill for cleanups costs is simply an indirect way of asking taxpayers to take responsibility for the irresponsible actions of polluters. Moreover, because bankruptcy law is delegated to Congress under Article I, § 8 of the Constitution, the supremacy clause mandates that federal bankruptcy law take precedence over state tort claims and the rights of creditors and debtors. At this point, it becomes difficult to reconcile the "fresh start" public policy embedded within bankruptcy proceedings with the "polluter pays" principle seen in CERCLA. OSEC argues that Board approval of FHCs dealing with commodities would only perpetuate the burden the general public is often left with in CERCLA cleanup situations.

2. *The Board Circumvents the Requisite NEPA Requirements When Approving FHC Activity*

While remedial statutes such as Superfund attempt to punish those responsible, and common law claims can attempt to redress individuals' injuries, there are few statutes that provide for a proactive approach when attempting to mitigate these disasters. The most useful of these is the National Environmental Policy Act (NEPA).

The most effective tool for implementing NEPA is the environmental impact statement (EIS). NEPA requires that all federal agencies prepare an EIS for every "recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment."[48] Upon performing an EIS, an agency is not mandated to act in the most environmentally responsible way. Rather, NEPA relies on information, both from the public and experts within the agency, to force agencies to consider the environmental impacts of their proposals.

OSEC believes that the Federal Reserve, in allowing FHC to engage in commodity related activities, triggered the necessary elements to require an agency to prepare an EIS.

When considering whether an agency has engaged in a "major federal action," 40 C.F.R 1508.18 provides the pertinent language. A "major federal action" includes "new and continuing activities, including projects and programs entirely or partly financed, assisted, conducted, regulated, or approved by federal agencies…."[49]

In the case of the Federal Reserve, the approval of activities pertaining to commodities does not flounder in the gray area surrounding "contemplation" of a certain action. On the contrary, the agency's actions surpass that of "a proposal for a major federal action" and instead fall into the broad category of "actions includ[ing] new and continuing activities...regulated, or approved by federal agencies" discussed in the regulation above. Moreover, the Federal Reserve is not the sole provider of regulatory oversight for the activities of FHCs. Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides for the establishment of a Financial Stability Oversight Council. The council consists of a slew of members spanning multiple agencies involved in financial regulation.[50] Thus, it follows that FHCs engaged participating in commodity markets are subject to regulatory oversight from the Federal Reserve as well as the Federal Housing Finance Agency, the National Credit Union Administration Board, and the Commodity Futures Trading Commission, to name a few.

When considering whether an agency action "significantly affects the human environment" current regulations state that the "significance of an action must be analyzed in several contexts such as society as a whole (human, national)...."[51] In addition to significance, agencies must determine the potential intensity of their proposed actions. Intensity "refers to the severity of impact. Responsible officials must bear in mind that more than one agency may make decisions about partial aspects of a major action."[52] In pertinent parts, the regulation details specific factors that must be taken into consideration when analyzing intensity: "The degree to which the proposed action affects public health or safety;[53] the degree to which the possible effects on the human environment are highly uncertain or involve unique or unknown risks;[54]

whether the action is related to other actions with individually insignificant but cumulatively significant impacts. Significance exists if it is reasonable to anticipate a cumulatively significant impact on the environment."[55]

As the ANPR points out, while environmental catastrophes may not occur often, the magnitude of damage they produce greatly affects public health and safety. Moreover, because the statutes forces agencies to consider societal as well as environmental impacts, the effects transcend public health and safety. Many of these effects are what the regulations deem to be "highly uncertain or involv[ing] unknown risks." Professor Saule Omarova writes extensively on the risks environmental catastrophes have on the finance world. A disaster "could potentially cause a major systemic disturbance in the financial markets...FHC's expansion into the oil, gas, and other physical commodity business introduces a whole new level of interconnectedness and vulnerabilities into the already fragile financial system." [56] Contributing to this risk is the fact that financial institutions are not adequately equipped to realize the risks associated with energy related commodities.

NEPA does not function retroactively. Thus, at this point it would be impractical to reanalyze the Board's previous decisions that approved commodity-related activities of FHCs and determine if an EIS is necessary. However, if the Board were to continue to approve any sort of commodity-related activity for FHCs, OSEC believes that the Board must first adhere to the proper procedural requirements of NEPA prior to the approval of a FHC-requested activity. Moreover, because the Board's approval authority has been exercised on a case-by-case basis, there is a strong argument that the cumulative impact of the agency's past decisions to allow FHCs to participate in commodities must be considered.

B. Market Manipulation & Anticompetitive Effects

We are concerned about the lack of attention paid in the ANPR to problems concerning market manipulation and the anti-competitive effects of BHC physical commodities trading. The Board's policy runs counter to the dual mandate in the Federal Reserve Act that the Board insure against price inflation and ensure full-employment.[57] Indeed, liberalized physical commodities trading reduces the efficiency of physical commodities and commodities derivative markets on which billions are dependent. (See Appendix B.) They also have adverse social effects on business innovation and competition in related industries and threaten geopolitical instability. (See Appendix C).

There are serious risks, first, that stem from concentrating large swaths of physical commodity-related activities that are deemed "complementary to the business of banking" inside the largest financial institutions. The FRB to date has been liberal, for instance, in its interpretation of the "complementary" and permitting provisions of the Bank Holding Company Action, Sections 4(j) – (k), 12 U.S.C. s. 1843(j) –(k). Congress was fairly clear in its statutory guidance that the FRB had to weigh benefits against costs when the Board utilized its exemptive authority, taking into account considerations such as the anticompetitive effects of concentrating activities in FHCs, resource concentration, and access to credit markets. If the FRB intends to take seriously the call to action to undo Too Big To Fail (TBTF), an implicit goal of Dodd-Frank, then it should recognize that undoing the previous Orders that broadly interpret the complementarity of activities would markedly roll back a measure that has facilitated over-concentration. Moreover, such a rollback would also significantly counterbalance some of the anticompetitive effect produced by over-concentration.

Deregulation of physical commodities and physical commodities derivative markets also has created extraordinary price risks and undermined the ability of end users to hedge risks. [58] These markets deviate from perfect competition in exhibiting indicia suggesting market control such as cross and serial correlation, liquidity constraints, speculative storage, and high persistence and heteroscedasticity. The TBTF institutions' heightened leverage and the extraordinary risks of physical commodities trading and other opaque operations threaten the safety and soundness of financial markets.

In light of the obscene concentration of risk that we have witnessed in the short period of 15 years since the passage of GLB, OSEC contends that it should be overwhelmingly clear that the FRB has failed to use its exemptive authority effectively and that its failure in action to undo its commodities exemption orders will only lead to greater inequality and allow banks to continue buttressing their "fortress" balance sheets. As we analyze in Appendices B & C, the evidence demonstrates increasingly unrestrained physical commodities operations and anti-competitive effects on commodities markets. [59] The prevalence of FERC enforcement actions is but an illustration of the most extraordinary indicia of malfunctioning markets.[60]

In granting certain exemptions, the FRB has facilitated the growth of BHCs that are considered TBTF and made such BHCs even more entrenched in the status of TBTF. These actions are doubly anticompetitive to the degree that many of the largest BHCs that are TBTF have access to public subsidies that are unavailable to competitors. This reality is antithetical to the tenets of free market operations. That is, it is disingenuous to hold the ideals of free markets in one hand and with the other provide a privileged few actors with handouts and exemptions that give them a distinct competitive advantage. Unfortunately, that is exactly the situation that the FRB's exemptive authority, coupled with other forms of subsidization, has produced.

C. The Board Lacks the Expertise to Regulate the Esoteric Instruments and Risks Involved in Physical Commodities Trading

Obscure commodity-trading operations also threaten the safety of individual institutions and cause systematic financial risk that the Board has the jurisdiction and responsibility to prevent under the Dodd-Frank Act, among other laws. Those risks may be unknown and of unpredictable timing and scope. Moreover, financial regulators may be poorly equipped to prevent the worst risks, given that the overall footprint of financial regulation is divided among disparate government agencies.

There can be no doubt that the lack of disclosure of BHCs' and FHCs' commodity operations and the complexity of their operations make risk management difficult for regulators.[61] Physical commodity trading, first, exhibits significant price risks associated with speculative trading patterns. Financial regulators also may have little or no training in the function and organization of specific commodity markets such as those for oil. Even where there are effective regulatory or enforcement efforts, as with recent FERC settlements of energy-market manipulation, the regulatory expertise is diffuse and scattered among unrelated agencies such as the CFTC, SEC, FERC, the Office of Comptroller of the Currency in the Treasury Department, the EPA, and the Board itself. The recent financial crisis and the catastrophic fate of synthetic CDOs illustrate the risks of regulatory division and arbitrage.

The capability of financial firms to deal with risk management concerns is questionable, even given adequate capital structures and appropriate liquidity. The London Whale scandal pointed to difficulties that massive FHCs have with their own risk management practices.[62]

Certain operations such as oil trading pose dramatic risks in the event that there is a pipeline rupture or explosion, one that may be the product of terrorism or unforeseeable events. These risks are not only hidden but pose the possibility of extreme outcomes for which hedging or (re)insurance may be unaffordably expensive or altogether unavailable. A heretofore liquid BHC could discover that its most liquid instruments have transformed, overnight, into ones for which there is no longer a market, as occurred with the Repo market during the Financial Crisis of 2008.

Numerous commentators have argued that measurements of capital adequacy such as value-at-risk, stress tests, or measurements of liquidity may only encourage excessive confidence in the risk profile of financial institutions.[63] There are limits on the efficacy of existing techniques because of limited historical price information and innovations in the energy marketplace, including deregulation and new techniques such as hydraulic fracturing. The intersections between existing financial vulnerabilities and those posed by a single multi-billion dollar disaster such as the Deepwater Horizon disaster or the Exxon Valdez collision should be the subject of profound deliberation and concern. Like commentator Mike Konczal, we advocate for strict leverage-based capital requirements as a means of avoiding faulty risk measurement and preventing imprudent banking practices.[64]

At issue are larger realities about how to silo, limit, and mitigate financial sector risk. The recent history, in which FDIC-insured and uninsured institutions alike have received direct and indirect support from the Federal Government, militates for more effective review of bank's risk-taking. As noted above, the Board under Dodd-Frank has the capability to mitigate the systematic risks that SIFIs pose to the economy through an array of prudential regulation. The complexity and specificity of physical commodities operations certainly pose a threat to the governability of regulatory institutions and financial institutions alike. These difficulties give rise to larger questions about the role of financial intermediation. But this debate cannot merely be resolved by putting off fundamental questions. The Board is in a position, after decades of a deregulatory regime that has harmed economies and individuals, to alter some of the speculative practices that have caused price instability. In what has been an increasingly fragile financial system, the Board can take affirmative steps to prevent a concentration of economic power, information, and risk.

III. ANSWERS TO SPECIFIC QUESTIONS

Potential Inadequacies of Current Safeguards and Safety and Soundness Considerations

Question 1. *What criteria should the Board look to when determining whether a physical commodity poses an undue risk to the safety and soundness of a FHC?*

The Board should evaluate considerations such as severity, frequency, predictability, complexity, and plausibility of loss. This is a particularly difficult mission with respect to volatile commodity and commodity derivative markets—particularly those for energy—which display patterns of speculative behavior and problems with liquidity based on storage, production, and physical limits on sales.[65] The risks posed by speculative modern physical commodities markets (and especially energy markets) are different in kind than other financial risks and merit special caution. Commodity markets feature both price risks and risk of environmental catastrophes. Particularly worrisome is the limited data set from which the Board can extrapolate historical patterns or model risk. Existing analytical tools are likely to be of quite limited use in assessing safety or adequate safeguards.

We therefore recommend that the Board adopt a precautionary principle in assessing the risks of particular commodities activities. As numerous commentators have argued, risk management criteria such as value-at-risk have been ineffective at anticipating or preventing the most significant risks, and in fact have played a role in encouraging complacency and heedless financial risk-taking. Indeed, the Long Term Capital Management crisis of 1999 and the Financial Crisis of 2008, which occurred in part because of a problematic derivative market, surprised regulators and industry actors alike despite the presence of complex VAR models. The "safety and soundness" criterion is a qualitative legal guideline for which inexact statistical measurements cannot substitute.

It is similarly difficult to employ capital requirements (whether or not stress-tests are employed) or liquidity measurements to determine with exactitude the dangers to the FHC. We believe that liquidity is an insufficient metric because physical commodities trading may pose severe, immediate, and unpredictable risks to BHC/FHCs and the financial system. The ANPR anticipates this set of problems. A heretofore liquid BHC could discover that its most liquid instruments have transformed, overnight, into ones for which there is no longer a market, as occurred with the Repo market during the Financial Crisis of 2008.

We also recommend that the Board engage in analysis of granular data, portfolio review, and internal bank examination to help it collect data and determine whether a commodity poses risks under the "safety and soundness" criteria of Section 4(k) & (j) of the BHCA or the systemic risk measures of the Title I of the Dodd-Frank Act.

While we encourage the clear and public disclosure of risks associated with commercial operations, the adequacy and possibility of effective disclosure should not be considered in determining acceptable levels of risk. It is often virtually impossible to anticipate environmental catastrophes, like the 2011 Deepwater Horizon Disaster, let alone predict their potential repercussions, which can include deleterious effects on businesses and homeowners. Even if collection efforts under CERCLA are successful, an environmental impact for which the remedy is not immediately forthcoming can have permanent economic and social costs. As the ANPR makes clear, insurance is likely inadequate in the event of an environmental pollution catastrophe, and a severe catastrophe could cause the reinsurance markets to fail.

Question 2. *What additional conditions, if any, should the Board impose on Complementary Commodities Activities? For example, are the risks of these activities adequately addressed by imposing one or more of the following requirements: (i) enhanced capital requirements for Complementary Commodities Activities, (ii) increased insurance requirements for Complementary Commodities Activities, and (iii) reductions in the amount of assets and revenue attributable to Complementary Commodities Activities, including absolute dollar limits and caps based on a percentage of the FHC's regulatory capital or revenue?*

We believe that additional capital, insurance, and holding requirements, although an improvement on the existing faulty regulatory framework, would be less effective than a requirement that BHC and FHC institutions divest their physical commodities holdings in whole or in part. We contend that the Board's existing attempts to institute safeguards such as the limitation on the amount of physical commodities trading, limitations on ownership, storage, transportation and refining facilities and insurance requirements have established very weak barriers to both risk contagion and market manipulation. These measures do nothing to prevent the real potential for an environmental crisis that would impose significant social losses that individuals and the government would be forced to bear, whether in CERCLA costs or bailout funds.

The statutory FHC requirements already impose some restrictions on the percentage of BHC activities attributable to physical commodities activities. The Board has imposed further capital and prudential limitations on those activities, including insurance requirements upon authorization of complementary activities. These requirements have not prevented firms from violating the Energy Policy Act of 2005 and facing FERC enforcement, as detailed in Appendix B. Nor have they lessened the potential for contagion involving the volatile physical commodity and commodities derivative markets.

We have serious concerns that the capital requirements instituted under Basel III or new ones introduced pursuant to the complementary provisions of the Bank Holding Company Act alone will not prevent catastrophic results or dissuade market participation. The very circumstances that lead to the intensification of systemic and firm risk could also create a booming market. Firms may not opt out of market participation even with sizable and conditional capital requirements tied to that participation. The risk management tools available to firms and regulators may not anticipate fat tail events with severe outcomes and consequences that could include the collapse of insurance and financial markets.

The ANPR makes clear that, similarly, existing insurance may not protect against certain types of claims or severe liability under CERCLA or other tort law. A systemic environmental or energy crisis which results in multiple insurance claims also could disrupt the functioning of the insurance market. Subsidiary bankruptcy and firm resolution under Title II of the Dodd-Frank Act are not likely or acceptable options for BHCs to avoid liability because of the concomitant risk of market collapse and socialized environmental costs. We therefore have doubts that any amount of insurance could adequately protect against the costs of a catastrophic event.

While we welcome the above restrictions, especially those related to leverage-based capital requirements, we view this option as an inadequate response to risk conditions. Other concerns about market manipulation and pricing are also decisive, as discussed in Section II.B & Appendix C.

Question 3. *What additional conditions on Complementary Commodities Activities should the Board impose to provide meaningful protections against the legal, reputational and environmental risks associated with physical commodities and how effective would such conditions be?*

We recommend the Board rescind its complementary physical commodity orders and require total divestment of holdings in order to limit legal, reputational, and environmental risks. The ANPR shows how these risks are unpredictable in scope, timing, and severity.

In the alternative, some reduction of risk could also be accomplished by mandating divestment or significant additional restrictions on the most volatile trading subject to fat tail risk (such as oil and energy trading). The restrictions could be complete or limited in scope to refining, storage, and particularly risky instruments such as EMAs. Such a solution would not resolve concerns about systematic stability or market manipulation.

As we make clear elsewhere, there are significant social and governmental costs in the short and long term associated with structuring physical commodities holdings in such a way that FHCs can avoid liability for the environmental costs that they incur.

Question 4. *To what extent does the commitment that a FHC will only hold physical commodities for which a futures contract has been approved by the CFTC or for which the Board has specifically authorized the FHC to hold adequately ensure that physical commodities positions of FHCs are sufficiently liquid? What modifications to this commitment, including additional conditions, should the Board consider to ensure that a FHC maintains adequate liquidity in its commodity positions?*

We contend that this specific requirement fails to establish that physical commodity activities are complementary to financial activities and further contend that any measure to ensure liquidity is flawed on pragmatic grounds. The mere connection between physical commodities and what commentators such as Wallace Turbeville and Saule Omarova have characterized as the highly speculative, inefficient commodities derivative markets is fortuitous rather than meaningful in establishing the required “safety and soundness” pursuant to Section 4(k) of the Bank Holding Company Act. Physical commodity operations coupled with futures trading have instead created less liquid markets in which fewer players control markets and determine prices.

The only solution to a potential crisis of liquidity is divestment of current commodity derivative holdings. In a catastrophe, derivative markets and potentially even the underlying physical commodity holdings could become, overnight, insufficiently liquid, and contagion could again infect the financial system. Absent a complete restriction on complementary commodities activities, the Board should require divestment or limit trading in the most volatile trading such as energy markets and certainly in the most risky energy-related activities, such as refining, storing, and transporting fuel. We also recommend, with some trepidation, that the Board consider severe leverage-based capital requirements as a means to ensure liquidity.

Question 5. *What additional commitments or restrictions are necessary to ensure FHCs engaging in Complementary Commodities Activities do not develop unsafe or unsound concentrations in physical commodities?*

We again recommend total divestment of complementary physical commodities trading or a position-limit or holding regime that prevents industry consolidation. The provisions of the Bank Holding Company Act and the Dodd-Frank Act are critical to this analysis, explicated in more depth in Executive Summary Sections I.B.1, II.C, and Appendix C.

A proposed CFTC rule issued pursuant to the Dodd-Frank Act Sec. 737 (codified at 7 U.S.C. s. 12a(7)) imposes position limits on certain physical commodities derivative trading. That rule might parallel Board regulation on physical commodities activities but does not obviate the need for immediate Board action. It has been troubling to observe BHCs engage in market manipulation and speculation even with the existing limits on their complementary commodities activities. Strict new position limit requirements would help avoid resource concentration, other anti-competitive commodities market practices, restrictions on credit, and social and environmental costs. Still, these half-measures would not match the effectiveness of complete divestment.

Question 6. *Should the type and scope of limitations on Complementary Commodities Activities differ based on whether the underlying physical commodity may be associated with catastrophic risks? If so, how should limitations differ, and what specific limitations could reduce liability from potential catastrophic events?*

We believe that a general repeal of the existing orders on complementary commodities activities is the most appropriate resolution of the relevant legal and policy concerns. Those concerns include not only systematic financial risk but also socialized environmental costs. Significant risk is not only tied to the possibility of catastrophes but also to increased risk in trading portfolios due to highly speculative trading, pre-existing risks and leverage.

Nevertheless, with respect to the most volatile and risky commodity activities, such as oil and energy trading, we contend that limitations on a broader range of trading activities and on involvement in ownership, management, and shipping are necessary to mitigate the possibility of environmental catastrophe causing concurrent institutional and financial market failure. It is inappropriate to conceive of limiting liability without limiting risky activity because there is a significant possibility that the Federal Government will socialize the cost borne by depository institutions whose balance sheets are a testament to Federal support. It is also implausible that the Board will be able to specifically tailor heightened restrictions to match the “risks” because of severe problems with risk measurement in the arena of environmental risk. See Sections II.B – C and Appendix C.

Question 7. *Does the commitment not to own, operate or invest in facilities for the extraction, transportation, storage, or distribution of commodities adequately insulate a FHC from risks associated with such facilities, including financial risk, storage risk, transportation risk, reputation risk, and legal and environmental risks? If not, what restrictions should the Board impose to ensure that such extraction, transportation, storage or distribution facilities do not pose safety and soundness risks?*

The “commitments” referenced in the question serve as inadequate insulation against various types of risks, especially legal risks under such statutory schemes as CERCLA. There is simply no legal or policy justification under Sections 4(k) – (j) of the Bank Holding Company

Act or Title I of the Dodd-Frank Act for the Board to take the unsupportable step of continuing to endorse the operation of federally insured banks in such drastically risky non-core areas of commerce as refining crude oil. Protections against everyday squalls are not likely to safeguard against tsunamis. As the ANPR suggests, the current U.S. environmental legal regime, including the assessment of liability and veil piercing under CERCLA, should counsel against a sanguine perspective on the possibility of mitigating environmental liability or financial contagion.

Again, we counsel that a total restriction on some or all subsidiary activities not closely linked to financial activity (such as extraction, transportation, storage, and refining) is necessary to prevent the most severe risks. It is difficult, if not impossible, for financial regulators and institutions to manage these risks because they are different in kind from traditional banking risks. Indeed, the risk of terrorism or geopolitical disruption could significantly and unpredictably disrupt trading operations. These are risks that no financial regulator or already-overleveraged modern financial institution is equipped to assess.

Question 8. *Do Complementary Commodities Activities pose risks or raise concerns other than those described in this ANPR, and if so, how should those risks or concerns be addressed?*

The ANPR neglects three legal and policy considerations critical to determining whether the physical commodities operations of BHCs are appropriate. We elaborate on these concerns in the Executive Summary and Appendices B-C. The ANPR first neglects the effect of these operations on the prices for critical commodities and commodity derivatives, not to mention such operations' real effect on inflation and adverse economic and social outcomes, including market consolidation and political influence. The Board analyzes the risks to financial firms and the safety and soundness of the financial system, as appropriate, but ignores the role of the government in making these investments possible through depository insurance, implicit guarantees, and potentially even environmental pollution clean-up for firms able to evade their pollution liabilities (pursuant to CERCLA) through the corporate form, bankruptcy, or resolution proceedings. The Board, notably, has failed to perform a required Environmental Impact Statement under NEPA in ordering complementary activities under Sections 4(k) and (j) of the Graham-Leach-Bliley Act. The ANPR, finally, fails to contemplate the difficulties that both regulators and financial institutions face in assessing the risks attendant to trading in physical commodities or the social costs of those activities.

Question 9. *What negative effects, if any, would a FHC's subsidiary depository institution experience if the parent FHC was not able to engage in Complementary Commodities Activities?*

We believe that there are no negative effects for the FHCs and their subsidiaries from restriction on commodities activities. Certainly, these institutions' speculative profits and market manipulation could be eliminated or restricted. The ANPR asserts, and we agree, that recent BHC and FHC decisions to abandon physical commodities trading illustrate a lack of necessity and complementarity between financial activities and physical commodities trading.

We recognize that there are other dominant players in the physical commodities trading marketplace. Although increased competition would be beneficial, giving sanction to highly leveraged financial operators with the ability to affect derivative prices through their control of physical commodities, and vice versa, is not the way to ensure that competition. Allowing individual FHCs to profit, at the cost of marketplace competition and financial sector risk, finds no support under Section 4(j) of the Bank Holding Company Act.

Question 10. *How effective is the current value-at-risk capital framework in addressing the risk arising from holdings of physical commodities? Would additional or different capital requirements better address the potential risks associated with Complementary Commodities Activities?*

As we contend elsewhere in this comment letter, the VAR analytic obscures risks and causes blindness to unpredictable, catastrophic events. We believe that additional or different capital requirements are inadequate because of the unpredictability and severity of tail risk events. VAR models do not discourage risk-taking in the event of accelerating profits and can in fact induce a false sense of security and willingness to take on unrecognized risks. Absent truly effective divestment requirements, however, we would acquiesce to the employment of such risks metrics. We believe that an effective systemic capital requirement must be present to ensure the viability of firms and their adequacy to manage the heightened systemic risk that environmental catastrophes might cause. We also support leverage-based and conditional capital requirements, in line with the requirements of Title I of the Dodd-Frank Act, which increase during periods of heightened leverage or expansion and reduce during other periods. These restrictions are the minimum necessary to mitigate risks for the safety and viability of firms and the safety and soundness of the financial system.

Question 11. *What are the similarities and differences between the risks posed to FHCs by physical commodities activities, as described in this ANPR, and the risks posed to nonbank financial companies supervised by the Board ("nonbank SIFIs")? How do the safety and soundness and financial stability risks posed by physical commodities activities differ, if at all, based on whether the nonbank SIFI controls an IDI?*

We contend that there are substantial risks to both nonbank SIFIs and FHCs and that the risks to both should be restricted pursuant to Title I of the Dodd-Frank Act and Bank Holding Company Act. The FSOC is entitled to regulate SIFIs and IDIs as if they fell under the Bank Holding Company Act and to recommend prudential regulation. Non-bank SIFI control of an IDI could pose additional risks to the safety and soundness of the banking system where there are significant interrelationships with other financial institutions, including unregulated private equity funds, and commercial activities the risks of which are either unclear, unreported, or unascertainable. The collapses of AIG and LTCM, and their attendant effects on the viability of markets generally, illustrate the dangers that non-bank financial sector operators have had on financial markets.

Question 12. *What are the similarities and differences between the risks posed to FHCs by physical commodities activities, as described in the ANPR, and the risks posed to savings and loan holding companies that may conduct such activities? How do the safety and soundness and financial stability risks posed by physical commodities activities differ, if at all, based on whether the savings and loan holding company is or is not affiliated with an insurance company?*

The risk of catastrophes to S&Ls from physical commodities trading disasters are different in scope than those that BHCs face. The latter are generally subject to the systematic stability provisions of Title I of the Dodd Frank Act because of their capital structure and complex investments. This is not to ignore that S&Ls face risk from speculative investments, especially in an era where the performance of commodities derivatives and physical commodities diverges from market fundamentals. But S&Ls typically have lower leverage and possess a limited selection of asset classes than BHCs and other SIFIs. Those facets of their operations could limit not only the risks to the institutions but the threat of contagion. Indeed, S&Ls may engage in physical commodities trading in the service of end users. Although financial innovation has introduced various wrinkles into the equation, there is no doubt that some S&L activity remains critical to actual hedging of agricultural commodity risk. Such activities fall within the purview of an appropriate function for financial intermediaries; they are in contradistinction to those involving large BHCs.

The requirement for heightened prudential control, however, depends on the applicable risks, the existence of reasonable prudential controls, and other requirements. We contend that there may be concurrent risks with insurance companies and we suspect that in an environmental or pollution crisis, the inadequacy of hedging or insurance markets may become clear.

Complementarity of Current Activities

Under current law, a finding of complementarity requires a non-trivial connection to a financial activity. The Board's decisionmaking must strike the appropriate balance between benefits and negative effects on commerce, lending, and financial sector firm and systemic risk. Unfortunately, the Board has failed to perform the appropriate analysis under Section 4(j) in its complementary orders, a deficiency that has become increasingly clear with evidence of market manipulation and risky activity.

The statute's amendment under the Graham Leach Bliley Act did not permit a limitless set of activities to be considered complementary to existing banking activities.[66] The Congressional history shows that these limitations relating to systemic risk were intended to circumscribe the type and scope of BHCs complementary actions.[67] As elaborated in Appendix A, below, Section 4 of the Bank Holding Company Act originally prohibited ownership of non-bank entities, which effectively limited operations for BHCs to those closely linked to traditional banking activities such as lending as well as securities and derivative trading.[68] Regulation Y currently allows for the "delivery of physically settled derivatives that a state member bank is permitted to own," including "corporate debt securities...and certain precious metals."[69] The Regulation, in addition, only allows permissible non-banking activities to include delivery of title to commodities on an instantaneous and pass-through basis, with BHCs making "every reasonable effort to avoid taking or making delivery of the underlying commodity" and requiring assignment, termination, or offset prior to delivery.[70] The Board has declined to find that physical commodities transactions are financial activities by regulation, leaving a case-by-case decision regarding risk management to its permitting process.[71]

Complementarity cannot encompass all activities (like trading commodities derivatives) with tangential relationships to existing financial activities because such a formulation would provide for no practical limitation on financial control of commercial industries. Recent dramatic changes in the safety and perceived riskiness of financial markets must also alter the interpretive heuristic that the Board utilizes to evaluate "safety and soundness." The Graham-

Leach-Bliley Act, indeed, does not provide specific examples of complementarity in its text or legislative history that would guide the determination. The statute lacks that information, although it provides specific examples of what constitutes financial activity, including derivative trading. The statute's definition of what is considered "financial in nature or incidental" is based largely in the rubric of competitiveness and efficiency.[72] The purpose of the provision must therefore be read in context with the foundational principle of the separation of commercial and banking activities, which would require more than a mere felicitous connection with existing approved financial activity that happens to be advantageous to individual BHCs and their customers.

The Board's reliance on moderate limitations on the scope of trading vis-à-vis tier-one capital does not adequately link physical commodities trading with the complementary standard, let alone financial sector safety limitations, or the multi-factor permitting language in Section 4(j). The 2003 Citibank order and those following it mischaracterize the language of the statute in finding that trading in physical commodities is complementary to financial activities and, on balance, benefits the public.[73] The orders starting in 2008 take an increasingly tendentious approach to describing a connection between financial innovation and core banking activities and ignore evidence of risks to the financial sector and the public.

The Board's 2003 order permitted Citigroup, Inc. to directly trade in physical commodities, specifically selling and purchasing energy commodities, agricultural products and other non-financial assets, with limited exceptions.[74] The Board found that the requested physical commodities trading flowed from legitimate financial activities and would improve competition in derivative markets against unregulated non-FHC entities; the FHCs could offer other commodity services and would be better suited to understand the commodity derivative markets. To address the risks of this commercial activity, the Board made the 2003 Citigroup, Inc. Order subject to certain conditions, including that the banks hold no more than 5% of their tier 1 capital in the form of the physical commodities and that the commodities be ones for which CFTC-approved exchange trading exist absent separate Board approval. In recognition of the unique risks associated with energy trading, *inter alia*, the Board also prohibited Citigroup, Inc. from owning energy storage or transportation facilities or refining such products. The 2003 Citigroup, Inc. Order also required the FHC to obtain pollution insurance for both it and third-party storage facilities, ensure the age and adequacy of vessels, and develop spill response and backup plans. The Board's conditions were designed to prevent risks, as analyzed below, which would threaten the institution and the financial system. The Board decided that its orders would present, on balance, benefits to the general public in the form of greater competition.

The additional conditions in the 2003 order, as explored below, have not been adequate to ensure stability or the public interest. Instead, they show the unique risks of physical commodities, which have to be limited and regulated differently than other instruments. The risks of physical commodities are perhaps even less predictable and insurable than those posed by certain complex synthetic derivatives. As Prof. Omarova advocates, a single oil disaster could cause a massive and uninsured financial loss to a key player in the financial market and trigger a catastrophic disruption of financial activity.[75] The volatility of physical commodities markets, a key reason for the entry of financial market players into the trading arena, also cautions against their risks.[76] Existing limitations on quantitative risk and other insurance conditions, while laudable, are unable to ensure against qualitative disruption; nor do they ensure that the FHC activity is properly linked to approved financial activities, including derivative trading, hedging, or investment. Instead, as examined above, the limitations are inadequate to uphold the traditional separation between banking and commercial activity.

The Board's 2003 order has had a negative effect on the very features—market competition—which ostensibly justified the original order. Instead, the orders have exacerbated manipulation in the commodities and derivative markets and may be linked to speculative asset bubbles.[77] The FHCs access insider information about the supply and trading of physical commodities and derivatives, and control of physical assets, and have the market position to fully employ that information.[78] With their incredible capitalization and the guarantees of U.S. Government support, FHCs are well poised to obtain a dominant role. The liberalized orders therefore pose potentially significant risks to competitive physical commodity and derivative markets.[79]

Subsequent orders dramatically lifted even the paucity of restrictions upon FHC action. The RBS Orders that the Board issued in 2008, for the first time removed a key qualitative restriction: derivatives to which the physical commodities must be related need no longer be exchange-traded instruments.[80] These new Orders largely removed even the restrictions, such as requiring that commodities had regulator-approved derivative trading, that were to ensure the safety and soundness of complementary physical commodity operations.[81] The FHCs responded with electricity tolling, oil refining, and energy management agreements that often require active involvement in the administration and contracting of energy plants. The Board found energy tolling, which provides a structure for energy to be provided to or sold to the FHC, to be an outgrowth of permissible commodities derivative trading, with the same benefits as those found in the 2003 Citigroup, Inc. Order.

Evidence does not support the orders' findings that various physical commodity activities are complementary to financial activities through connection with derivative trading and are sufficiently safe through limitations on FHC activity. The risks of energy trading, in particular, is dealt with only in a cursory manner and only by setting restrictions on the amount of trading. There is no evidence that physical commodities trading improves core financial activities such as derivative trading, rather than merely providing inside information to traders. Nor is there evidence that the liberalized requirements allow for improved market function in either the financial or commodities markets. The original findings with regard to complementarity are therefore overly broad and inadequate, and fail to justify an exception to the Bank Holding Company Act.

Question 13. *In what ways are non-BHC participants in the physical commodities markets combining financial and nonfinancial products or services in such markets?*

Whether BHC or non-BHC operations are involved, the increased combination of physical commodities trading and financial operations (e.g. commodities derivatives trading) threatens competition. (See Appendix A.) There are at least two key groups of non-BHC participants: traditional commodity trading operations, such as Glencore, and entities that are SIFIs. We acknowledge that competitors in the physical commodities markets have introduced derivative trading along with physical settlement of commodities operations. These operations, rather than improving competition and market innovation, have resulted in anti-competitive practices, FERC charges, and other evidence of practices that demonstrate physical commodities and derivatives markets that have ceased to operate in a fair and competitive manner. These changes threaten to disrupt the safety and function of the financial industry.

The operations of both types of entities have also exacerbated existing market and resource consolidation and the exploitation of insider information in derivatives trading. SIFIs have used their vast, tax-payer supported balance sheets and operations to engage in physical settlement and warehousing, energy tolling, and energy management agreements. Few other entities are able to engage in these operations. Market consolidation, indeed, is a significant risk where trading commodity trading operations are involved.

As commentators such as Saule Omarova have noted, OCC and Board decisions allowing non end-users to participate in the derivative futures market have created an increasingly speculative arena. The CFTC has used its authority under the Dodd Frank Act to issue proposed rules regarding position limits in the derivative markets, a necessary but insufficient step toward limiting speculation in the commodities markets. We recommend that the FRB also regard the actions of non-BHC operators as a threat to financial stability and competition, and act accordingly to regulate both types of entities.

Question 14. *What are the complementarities or synergies between Complementary Commodities Activities and the financial activities of FHCs? How have these complementarities or synergies changed over time?*

The vast majority, if not all, physical commodity activity has had an attenuated connection with financial activity from a legal and practical standpoint. It is true that trading physical commodities associated with derivatives provides FHC institutions with greater knowledge of market conditions, perhaps allowing them to structure complex EMA deals. These connections, however, are ones that also allow financial institutions to engage in speculation and participate in and corner physical commodity and derivative markets rather than aiding customers or promoting efficient and safe business operations. The Board's prudential limitations on the amount, type, and liability associated with physical commodity operations in the post-2003 orders displayed an understanding of the attenuated connection between trading and banking activity. Those prudential limitations also echo the historical separation between physical commodity trading and financial activity, and between banking and commercial activity. This separation, expressed in the BHCA and other statutes, remains vital today.

Indeed, the history of physical commodity trading since 2003 demonstrates that new activities show a decreasing degree of connection with financial activities, assuming one ever existed. The 2008 Orders allow for trading in commodities for which no CFTC-approved exchange trading exists, based merely on the liquidity of oil and similar commodities. The connection with financial activity is therefore increasingly attenuated. EMAs and energy tolling, problematically, provide an opportunity for BHCs to engage in active management of non-financial operations. Admittedly there are undeniable benefits to the specific customers involved in these deals. These operations have culminated, however, in illegal energy-market manipulation that is today the subject of FERC lawsuits as well as speculative behavior. The recent actions of FHCs to divest themselves of their commodities holdings, as the ANPR makes clear, illustrate that these activities are not truly complementary to financial activities.

Question 15. *What are the competitive effects on commodities markets of FHC engagement in Complementary Commodities Activities?*

We contend that the predicted results of the Board's orders -- greater efficiency, competition, and market innovation -- have no evidentiary support. (See Executive Summary Section II.B and Appendices B & C). At the threshold, FHC engagement in complementary commodities activities benefits from an implicit subsidy against failure and provides an improper competitive advantage. Instead, the effects on commodities markets have included market manipulation and consolidation, and higher and more volatile prices. The effects of speculation on prices and volatility in physical commodities markets for energy and non-precious metals is well established; and there is a temporal connection with increasing prices in grain and other food commodity markets. The FHCs themselves have engaged in directly anti-competitive practices such as isolating warehouse supply and energy-market manipulation. As expressed in recent Congressional testimony, these practices have had a deleterious effect on resource allocation and on end users of commodities.

It is not remarkable that these effects have occurred. The instruments that FHCs have employed to trade physical commodities resemble those that Enron used during its brief and disastrous foray into energy market activity. These types of "financial innovation" have clearly had counterproductive effects within the financial services industry.

Consolidation within the physical commodities market also has likely had a negative impact on innovation in other industries, as explored below. This history of physical commodities trading, including banking crises in the early 20th century, provides evidence that volatility of the markets cannot be contained and that highly leveraged banks, as actors in the non-financial economy, have negative effects on innovation, competition, and economic output.

Question 16. *Does permitting FHCs to engage in Complementary Commodities Activities create material conflicts of interest that are not addressed by existing law? If so, describe such material conflicts and how they may be addressed.*

We believe that existing law provides a means of addressing the conflicts of interest inherent in physical commodities trading. Those laws include the BHCA and Dodd-Frank Act Section 619, with its extensive limitations on proprietary trading.

The history of bank physical commodities trading, indeed, shows the negative effect of FHCs on lending, destruction of confidence in the derivative markets, and limitations on the development of new and productive industries. FHCs, through their vast, government-insured balance sheets, are uniquely poised to foster economic development or serve as gatekeepers and roadblocks to economic progress.

Section 4(j) of the GLB specifically requires the FRB to consider conflicts of interest in determining whether non-financial activities should be approved as complementary. This source of law, although part of a nebulous set of criteria, allows for consideration of various conflicts of interest. The material conflicts of interest include those with respect to the sale of physical commodities when the institution is taking a position with respect to a related commodity derivative or securitized instrument and vice versa. The conflicts also include fair and efficient allocation of credit, with which the multifarious interests of FHC and SIFI institutions alike may not always be in alignment.

Question 17. *What are the potential adverse effects and public benefits of FHCs engaging in Complementary Commodities Activities? Do the potential adverse effects of FHCs engaging in Complementary Commodities Activities, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, unsound banking practices, or risk to the stability of the*

United States banking or financial system, outweigh the public benefits, such as greater convenience, increased competition, or gains in efficiency?

As we contend elsewhere in this comment letter, Complementary Commodities Activities present significant negative effects on competition, credit allocation, and financial system risk, and there is insubstantial evidence of greater benefits such as convenience, competition, or efficiency gains. (See, e.g., Sections II.A & Appendix C.) The balancing test under Section 4(j) therefore must be weighed in favor of revoking the Board's complementary orders. The evidence of anti-competitive and speculative activity, in addition to the potential for environmental and pollution catastrophe, cautions against retaining the existing complementary commodity activity orders. There is no evidence of positive effects in the post-2003 era except for the highly specific customers that have benefited from individual transactions, such as EMAs, and for the FHCs that have been able to engage in largely speculative, non-financial ventures.

Risks that are also at the heart of the CFTC's proposed rule on position limits are unavoidable in speaking about commodity derivative trading. With greater consolidation there are risks not only to institutions and the financial sector but to interests such as the productivity of entire industries, poverty reduction, and geopolitical stability. As the drafters of the Bank Holding Company Act recognized, this concentration of power also allows for BHCs to allocate credit contrary to their other interests. The conclusion that FHCs fail the Section 4(j) balancing test therefore flows inevitably from the evidence of improper activity and price volatility.

Question 18. *In what ways would FHCs be disadvantaged if they did not have authority to engage in Complementary Commodities Activities? How might elimination of the authority affect FHC customers and the relevant markets?*

There is limited evidence that FHCs would be disadvantaged without justification if they did not have authority to engage in Complementary Commodities Activities. In fact, there would likely be significant benefits to marketplaces and customers from such a prohibition. There are, first, existing limitations on physical commodities trading such as volume limitations and other limiting legal frameworks. The FHCs' recent abandonment of physical commodities trading, too, suggests a lack of synergy with financial activity. We acknowledge that the current concentration of physical commodities trading and derivatives activity with non-BHC entities such as Glencore poses genuine questions of fairness. The solution to a systemic crisis in the derivative and physical commodity markets, however, is not to create conditions for oligopolistic and monopolistic firm behavior, as complementary physical commodities trading has made possible. These are also broader questions of antitrust enforcement and derivative position limits that militate against complementarity.

The situation with respect to customers and marketplaces is more nuanced. Energy tolling and EMA can have positive effects for individual consumers who benefit from an entity with the capital structure and attendant ability to finance the deal. Large FHCs' effect on marketplaces, though, is significantly negative, as FERC enforcement cases and evidence of anti-competitive activity demonstrate.

FHCs are only able to engage in such trading and complex deals because of the FDIC deposit insurance subsidy, among other implicit insurance guarantees that include the Superfund system, and their large capital structure. These privileges should not lead to excessive control over the banking industry and the economy, as such an outcome would be contrary to Bank Holding Company Act policy and principles of competitive marketplaces. If the Board rescinded its complementarity orders and required FHCs to divest their holdings, it would likely benefit market function even if there were real disadvantages to specific customers.

Question 19. *Should the Board's merchant banking rules regarding holding periods, routine management, or prudential requirements be more restrictive for investments in portfolio companies that pose significantly greater risks to the safety and soundness of the investing FHC or its subsidiary depository institution(s)? How could the Board evaluate the types and degrees of risks posed by individual portfolio companies or commercial industries?*

We agree with the premise of the question that merchant banking can "pose significantly greater risks to the safety and soundness of [an] investing FHC or its subsidiary depository institution(s)" Moreover, we believe the requirement referenced in the question should be expanded to account for risk to U.S. financial stability, in accordance with the purpose of Title I of the Dodd Frank Act. In so far as a lending institution in the United States relies on merchant banking authority to make investments in commercial activities (including commodities trading), the tail risk of such activity poses contagion and systemic risk to the wider U.S. banking system.

Neither the banking industry nor financial administrators have adequately demonstrated the benefits physical commodities trading activities provide under merchant banking authority in terms of "benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects," especially in light of tail risks associated with commodities trading and other financial speculation. Absent the existence of outsized benefits that greatly outweigh the potential for wider contagion risk to U.S. financial stability, we would expect the Board to err on the side of financial stability. Moreover, we question the Board's abilities in regard to early detection and mitigation of contagion and tail risk, particularly with respect to designing surveillance for financial risks ("innovations") that are yet-unknown. This is not a competency we believe regulators have. Preparing bank examiners for future financial innovation is not a "routine" task.

The Board has not demonstrated a history of adequate evaluation of risk related to financial innovation and engineering. The failure to detect the buildup of systemic risk from securitizations is a recent example of the difficulty involved in designing "routine" surveillance of a dynamic and innovative marketplace, featuring numerous overlapping regulatory jurisdictions, including foreign ones. The Board cannot presume it has the abilities in this regard or that its surveillance is sufficient to detect and mitigate the build up of contagion and systemic risk. The burgeoning intricacies of the commodity and energy markets may test the resources and capabilities of a limited core of government employees, whose mission to regulate an already complex and overleveraged banking system may resemble a fantastic ordeal rather than a sober administrative task.

In the absence of stricter limits or limitations on trading in specific commodities such as energy and petroleum products, we advocate severe restrictions on routine management and the term for which companies are held. We also recommend the Board employ its authority under the Dodd-Frank Act to engage in prudential restrictions on merchant banking activities. In particular, we counsel for a reduction in the length of time that an investment may be held to maximize returns and an imposition of additional limitations on routine management, including prohibitions against the appointment of executives and directors of portfolio companies and broader restrictions on maintenance of target companies for investment purposes. Greater involvement of bank examiners appointed internally to corporations and more granular, portfolio-specific disclosure and analysis would also mitigate (but not prevent) the most severe catastrophes.

Potential Board Actions Regarding Merchant Banking Investments

The Board must also consider the application of both Title I and Section 619 of the Dodd-Frank Act, which impose prudential regulation on systematically risky activities by BHCs and SIFIs, and restrict and qualify the use of private equity vehicles. The Board also has authority to implement restrictions on the extent of managerial control, duration of holding, reporting and disclosure and other prudential controls under both the BHCA and Dodd-Frank Act.

The Board's decision to tolerate passive investment under the merchant banking provision merits retraction not only under the Dodd-Frank Act but also under the terms of 12 U.S.C. s. 1843(k)(4)(H) and (I) of the BHCA. Banking law contains general requirements to ensure the separation of financial and commercial activities. For instance, merchant banking activities must be part of "bona fide underwriting or merchant banking or investment banking activity." These restrictions also include limitations on an IDI or subsidiary holding the investment, a requirement that a securities affiliate or registered investment advisor for an affiliated insurance company be involved, a corporate separateness requirement, and limitations on the length of time the investment can be held. [82] However, current restrictions on routine management under Regulation Y, involving appointment of directors, restrictions on activities taken outside the ordinary course of business and meeting with officers or employees to monitor, provide advice, and various consulting services, provide little safeguard against abuse.[83] Without meaningful rules and oversight on the degree of control that FHCs exert over their "passive" investments (such as the requirement of internally placed examiners and granular/portfolio level reporting), there is no guarantee that FHCs will limit their manipulative and risky activities. Heightened managerial control poses not only risks of environmental liability, with attendant reputational and systemic dangers, but also threatens to undermine, through market manipulation and speculation, the function of both the physical commodities and commodities derivative markets on which billions of people are dependent.

There are additional and unsupportable risks to be considered. The Board's lengthy term of either 10 years or 15 years for the holding of a portfolio company for investment purposes permits extensive manipulation.[84] Even the existence of limited prudential and capital restrictions, such as risk management policies and use of the corporate subsidiary form,[85] cannot obviate the social and governmental cost of a potentially severe environmental catastrophe. In addition, the Board's capital adequacy or liquidity guidelines would likely be unavailing in the event of a crisis.[86] These risks are as apparent for insurance companies subject to the merchant banking provisions as they are for securities affiliates. The risks of environmental disaster, financial contagion and market concentration demand a panoply of extraordinary restrictions that include limitations on active management, including limitation on appointment of directors and contractual oversight, as well as shortened holding periods.

Question 20. *Do the Board's current routine management restrictions and risk management requirements sufficiently protect against a court piercing the corporate veil of a FHC's portfolio company? If not, what additional restrictions or requirements would better ensure against* *successful veil piercing actions?*

We see the need to protect portfolio companies from veil piercing as dubious. There is little evidence to support the logic that a corporate veil actually exists between portfolio firms and merchant banking owners, despite the legal presumption of limited liability for the parent company. It is our understanding that owners are routinely involved in portfolio firms. It is simply not plausible to accept otherwise given the efficiencies of shared corporate services, the demands of dynamic competition and the requirement for value maximization across an organization.

We do not agree therefore, as the Board seems to suggest, that portfolio firms need greater protection from the courts. Just the opposite is true. We would argue that the courts need greater access to portfolio companies and their merchant banking owners.

Making it easier for courts to pierce the corporate veil of a merchant banking organization would make the risk of contagion less likely to impact the wider U.S. banking system. We would favor weakening limited liability under merchant banking authority to make firms and their merchant banking owners more accessible to the courts and accountable to the public. The courts need to have full access to underlying business relationships in order to properly hold accountable Wall Street and its top dogs.

Under CERCLA and other liability schemes, fraud or injustice can be sufficient to pierce the corporate veil and find a parent corporation liable. The Board must find mechanisms to ensure that liabilities are paid for quickly despite legal machinations, in order to avoid the specter that individuals and the government itself will pay for initial liabilities or remediation costs incurred for environmental pollution. The alternatives are significant costs to the public, human and animal health, and the possibility of a bailout of parent corporations that receive explicit and implicit subsidies in the form of depository and other insurance.

Assuming that the FRB adopts a position that limitations on merchant banking risk are appropriate, our recommendations above on total restriction of physical commodity trading and stronger prudential limitations should be applied.

Question 21. *What are the advantages and disadvantages of the Board raising capital requirements on merchant banking investments or placing limits on the total amount of merchant banking investments made by a FHC? How should the Board formulate any such capital requirements or limits?*

We recommend that the Board adopt a precautionary approach to heightened capital standards and rely more seriously on leverage-based capital requirements. At the outset, we do not oppose serious efforts to implement Basel III or the Dodd Frank Act and endorse the role that capital requirements play in mitigating risk and ameliorating problematic conduct. We agree with commentators such as Mike Konczal that leverage-based capital ratios avoid difficulties associated with the risk-based and conditional models. We question the utility of risk-based capital requirements and limits, though, based on the limited data and difficulties that both regulators and industry actors have faced in anticipating new sources of instability.

Financial emergencies do not occur *ex ante*; they occur in real time and are detected *ex post*. We cannot presume that the Board will conceive of capital standards, or risk testing, in a manner to reduce risk under merchant banking authority *in advance*. This, for one, would require regulators to accurately forecast the trajectory of future financial innovation. The history does not suggest the Board has been able to anticipate risk associated with financial sector innovations and prevented the spread of contagion or systemic risk in the U.S. banking system. Similarly, it is deceptive that no tail risk event has caused financial contagion. The lack of a systemic event in this area is as much a reflection of the small size of the merchant banking niche, as it is a confirmation of capital adequacy. We do not accept the Board's premise that risk-based capital standards *ex ante* are an appropriate safeguard against risks, in light of the fact that many of these risks simply cannot be known in advance.

Moreover, there is emerging evidence that merchant banking activities might grow in response to the recent reform measures of Dodd-Frank. In particular, merchant banking can be viewed as an alternate avenue for banks to pursue private equity investment opportunities that are now prohibited. This possibility further undermines the Board's ability to adequately make assumptions about how much risk merchant banking activity will imbricate in the system.

On April 4, 2001 Governor Laurence H. Meyer provided testimony to the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises and the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services - U.S. House of Representatives. He said "most commentators criticized our proposed capital treatment, and several offered constructive alternative approaches."

Clearly commentators then were wrong, just as those advocating new capital standards now are simply guessing. We reject the premise of stress tests on the basis that they lack real world application. The appropriateness of contingencies cannot be known in advance, particularly in respect of financial innovation that is yet-undeveloped. Capital requirements can also cause overconfidence.

In the absence of better predictive models for future financial innovation, we would urge that regulators formulate severe capital standards for merchant banking authority, given the threat of contagion risk that this activity represents. Moreover, there is limited justification—and no benefit to U.S. consumers—for regulators to have full discretion in setting abstract capital standards and limits. U.S. financial stability is the law under Dodd-Frank and we expect regulators to err in favor of financial stability and not to guess at requirements for supervision of financial innovations that are yet unknown. In this light, leverage-based capital requirements avoid serious inadequacies present in other capital requirements. As Mike Konczal has asserted, a ratio of at least 10% would provide a better model for capital requirements throughout the financial sector. Leverage based capital requirements provide a more trustworthy means of preventing financial contagion. They are not a substitute, as we have advocated, for a thorough prudential regime.

Question 22. *What are the similarities and differences between the risks described above regarding merchant banking investments and the risks regarding investments made under section 4(k)(4)(I) of the BHC Act, which allows insurance companies to make controlling investments in nonfinancial companies (subject to certain restrictions)?*

We recommend that insurance institutions regulated under Title I of the Dodd-Frank Act as SIFIs be subject to similar systemic risk limitations as those on private equity vehicles. A tail-risk event has the potential to spill over into insurance markets that are necessarily connected with the financial system. For insurers with large deposit taking and lending subsidiaries, the risk of contagion is largely the same as for their counterparts operating under the Board's merchant banking authority. Catastrophic risk in underwriting is spread frequently among portfolio firms through reinsurance. Reserves are adjusted annually in consolidated firms to reduce specific perils. In our view the corporate veil (even among firms and their minority owners) hardly exists and communication between owners and operating subsidiaries is frequent. The Board therefore must approach the insurance marketplace with the same precautions.

Section 4(o) Grandfather Authority

We contend that the grandfather authority, whether temporary authority or that under Section 4(o), should be interpreted in a limited fashion in light of the plain language of the bill and the purpose of the BHCA in separating commodity and financial activity. The legislative history of the bill provides significant support for our position that there is no broad exemption for all commodities activities of converting BHCs. Rather, grandfathering is limited only to continuing pre-existing activities.

At the threshold, the language in the September 21, 2008 order that permitted investment banks to continue trading in physical commodities during the financial crisis of 2008 is no longer justified.[87] The Board has granted three grace periods to the institutions involved, Goldman Sachs and Morgan Stanley, in extension of an initial statutory two-year period.[88] There is no adequate connection between banking and the retention of physical commodities and whatever short-term economic necessity that existed in 2008 for allowing grandfathered firms to retain existing physical commodities operations while transitioning to a BHC capital structure has since disappeared. At least two properties of JPMorgan Chase subsidiary Henry Bath which were subject to multiple extensions were involved in the activity that led to a 2013 FERC court filing regarding energy-market manipulation.[89] The Board now must evaluate the fundamental question of whether grandfathered firms are entitled to any exceptions from the general statutory principles for entities which the U.S. Government now insures.

The Act permits entities that become BHCs to retain some commodities operations and underlying physical properties but does not provide for a blanket exception for all physical commodities trading operations. The statute concerns the conversion of non-depository institutions to BHCs following September 30, 1999.[90] It merely allows institutions to continue otherwise legal activities if the BHC and its subsidiaries were lawfully engaged "in any of such activities as of September 30, 1997 in the United States."[91] It also limits the aggregate assets to no more than 5% of total consolidated assets of the BHC and limits cross-marketing of services between depository and commodities subsidiaries.[92] The allowance is limited to specific activities in which the newly-formed BHCs engaged prior to the transition date.

A broader reading of the language would nullify the statute and lead to several implausible results, including an imbalance between the abilities of existing and newly-formed BHCs, and a limitless exemption without policy justification. The legislative history in this respect is instructive as it shows that the grandfathering provision was originally intended to accompany a more comprehensive statutory scheme. Predecessor Congressional bills created a special class of entities that had a holding company structure and were allowed to participate in certain investment bank activities. The entities were able to engage in, for instance, physical commodities trading and were subject to limited Federal Reserve oversight, but would not receive federal depository support.[93] The text was reintroduced during U.S. Congressional debates over the GLB Act but the House text relating to the special entities was dropped in conference while the Senate's broader grandfathering provision was retained.[94] The absence of specific legislative history or demonstrative language explaining the grandfathering provision militates for a cautious reading of the statutory language. Otherwise, a liberal reading would tend to nullify the statutory language prohibiting certain other activities. A broad reading would also create an inexplicable imbalance between the activities in which existing and new BHCs are allowed to engage. We acknowledge that the statute fosters in some part the very financial sector innovations that recently resulted in excessive systematic risk and failing instruments. If the statute was designed to convince non-BHCs to convert, the financial crisis alone appears to have accomplished this goal. Neither the plain language of the statute nor any interpretive guidance, however, leads to the result that the Board is powerless to take decisive action with respect to all existing physical commodities trading.

Question 23. *What are the advantages and disadvantages of the Board instituting additional safety and soundness, capital, liquidity, reporting, or disclosure requirements for BHCs engaging in activities or investments under section 4(o) of the BHC Act? How should the Board formulate such requirements?*

The Board must adopt a precautionary principle in determining which regulatory tools will be effective. We urge the adoption of divestment requirements to the fullest extent possible. As we argue elsewhere in this letter, additional risk-based and conditional capital requirements and limitations may in the most critical instances fail to discourage catastrophic risks or speculation. We also have significant doubts about the ability of safety and soundness metrics and stress testing to adequately predict complex risks, for some of which there may be no reliable past data. We also have concerns that liquidity metrics are of limited effectiveness against unforeseeable catastrophic risk. We do contend that **stringent** leverage-based capital requirements may be less vulnerable to unforeseen risks and could be effective in preserving liquidity and limiting systemic risks.

Reporting and disclosure of complex risks would ameliorate the current opacity of physical commodities trading. We caution that physical trading operations are complicated and even meaningful reform may fail to educate the general public and even sophisticated investors about risks in this highly-leveraged and volatile trading environment. Such disclosure requirements should be formulated in a comprehensive manner, including requiring the listing of all transactions, details of management, insurance, and contracts with third-parties.

Question 24. *Does section 4(o) of the BHC Act create competitive equity or other issues or authorize activities that cannot be conducted in a safe and sound manner by an FHC? If so, describe such issues or activities*

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The grandfathering provision, as we contend above, creates an exemption only for a time-barred class of activities and neither legislative history nor policy supports a broader exemption from limitations on holding company physical commodities trading. We acknowledge that the Act could authorize activities that harm the safety and soundness of financial markets, such as gas trading or mining operations, that could cause a systemic environmental and financial crisis. We describe these activities in detail in *Appendix B*, below.

The Board and FSOC cannot ignore their authority to engage in prudential regulation under the Dodd Frank Act's Title I and Volcker Rule provisions. Only strict regulation and continued oversight will eliminate the risks to the financial system and to consumers from holding companies' physical commodities trading activities.

Thank you for your attention to this matter of grave public concern.

Sincerely,
/s/
Occupy the SEC

Nick Taylor
Ian Hedges
Mike Rhodes
Eric Taylor
Akshat Tewary
et al

APPENDIX A: AMERICAN BANKING LAW HAS LONG LIMITED NON-BANKING ACTIVITIES BY BHCS

A long history of financial crises and bank consolidation led to the passage of New Deal legislation that divided banking from commercial activity. The Glass-Steagall Act limited the scope of banks' operations. The Bank Holding Company Act of 1956 established a general principle forbidding banks from engaging in non-banking commercial activities, and that principle guides agency action even following the amendment of the BHCA statute. Indeed, this principle remains central to modern banking law.

A. The Banks' Rampant Speculation Prior to the Progressive Era Gave Them Excessive Power Over the Economy

Our concerns about banking speculation are not new. History dramatically illustrates the risks attendant to excessive involvement of financial institutions in the commodities markets. As early as 1863, the National Bank Act that provided for the regulation of federally regulated National Banks constrained banks to the "business of banking."[95]

The history of banking crises in the late 19th century and 20th century shows that these crises were triggered in large part by commodities booms and speculation.[96] Booms and busts during in the period from the Civil War to the early 20th Century resulted most often from physical commodities speculation. As Justice Brandeis argued at the time, financial institutions' control over industry can cause not just economic monopolies but also financial crises and severe political corruption.[97] The Congressionally mandated Pujo Report, authored after the 1907 financial crisis, criticized the effect of Banking Trusts on the nation's economy.[98] Banks, the Commission found, held such substantial power that they were dictating the price of commodity goods and the development of entire critical industries such as railroads and oil. The nation's economy was dependent on the whims of a few banking houses. In a situation familiar today, banks held substantial political power through their control of productive enterprises and sometimes outright bribery.

Innovation and product development were less important than the speculative profits of those houses, resulting in a less productive and resilient marketplace. Some commentators have suggested that the market consolidation of the J.P. Morgan-backed Standard Oil and US Steel inhibited enterprise productivity and raised prices to monopolistic levels.[99] The substantial dominance of these industries threatened to cut off the fair supply of credit in the marketplace and prevent new and innovative entities from transforming productive enterprise.

The public found the situation, which had resulted in the second financial crisis in ten years, untenable. The hearings of the Congressionally-mandated Pujo Commission divulged the depths of the crisis and led to the passage of the Clayton Antitrust Act and, with the secret collaboration of industry and congressmen, to the foundation of the Federal Reserve Bank in 1913.[100] The later occurrence allows us to communicate today about the instant, and still quite topical, issue of banks' authority to operate in arenas distant from their core operations.

B. The Bank Holding Company Act & New Deal Legislation Were Designed to Prevent Banking Consolidation & Physical Trading in Commodities

The abuses of the next financial crisis, the Great Depression, led to a series of legislative measures to prevent banks from impeding the productive sectors of the economy through their allocation of credit and control over entire commodities markets. The division between banking and commercial activities, in its modern form, dates back to the New Deal era, when Congress passed the Glass-Steagall Act of 1933 in order to isolate investment activities from ordinary banking and commercial activity. The passage of the Bank Holding Company Act of 1956, however, clarified the principle and significantly altered the scope of activities of federally insured banks.

The Glass-Steagall Act of 1933 was the first modern law to prohibit banks from engaging in commercial activity that extended beyond their role as lending institutions and financial intermediaries. Although the Great Depression was not a commodities crisis, it illustrated problems with the manner in which the system dealt with complex instruments and risk. The Act set clear rules separating commercial banking from such investment activities as securities dealing and underwriting after the catastrophic financial crisis that was the Great Depression. The Act limited the risk that banks' speculation posed to creditors' deposits and the stability of the financial sector.[101] The law also is likely to have prevented abuses in the commodities trading market by limiting the size and control of banks. Institutions that not only were the subject of regulation but received guarantees of public money were required to reward that trust.

The Bank Holding Company Act of 1956 limited BHCs from continuing their speculative activities and had the effect of limiting the corresponding size and influence of financial institutions. BHCs, which own or control U.S. banks, are limited to banking, managing or owning banks, and activities "closely related to banking."[102] There are other restrictions on the manner in which the banks operate and an all-encompassing regulatory regime that includes reporting, capital adequacy and subsidiary support requirements.[103] Section 4(k) of the statute originally forbade bank holding companies and non-bank subsidiaries from engaging in non-banking activity unless the Federal Reserve determined by order or regulation that the activities were incidental to banking activity.[104] Although there were exceptions to the principle of separation in which commercial companies firms could engage in investment operations, they were limited to such unusual cases as unified thrift holding companies or state-chartered industrial banks.[105]

The statute and implementing regulation Y established clear limitations on appropriate activities incidental to banking. The Board exercised its authority cautiously with respect to the handling of physical commodities in derivative transactions. Under Regulation Y, the Board cautiously defined permitted activities to include lending, holding deposits, and trading in financial instruments such as derivatives.[106] The Fed permitted trading in derivatives, which amounted to investment and hedging activities, that included acting as the principal on commodity derivative contracts such as forwards, options, swaps, and futures options.[107] The Fed largely prohibited BHCs from owning physical commodities, with the exception of some products irrelevant to the instant analysis such *as* precious metals.[108] BHCs were even required to make reasonable efforts to avoid physical delivery of the commodities or taking delivery only on a pass-through basis.[109] Incidental activities were defined in a manner that clearly excluded complex physical commodities tolling and energy management agreements in which FHCs have increasingly made a fortune.

The statute was designed to secure the solvency of individual banks against risks and protect the banking sector. Smaller banking institutions themselves played a critical role in pushing for passage of the Bank Holding Company Act.[110] The smaller institutions sought to protect themselves and in the process prevent excessive consolidation of banking and economic power.[111] Prof. Omarova characterizes the bill as one with an explicit anti-trust purpose, rooted in a long-standing American aversion to the power and influence of large institutions.[112] The limitations on commercial banks, significantly, had the purpose of preventing banks' speculation in commodities that had triggered the recurrent financial crises, of which the Great Depression was merely the most recent and severe iteration.[113] The statute, just as critically, prevented banks from again using their central role in the economy to manipulate entire industries and the flow of credit. The prohibition was based in recognition of the dangers that physical possession of commodities could pose to consumers, actors in other industries, and the health of the financial sector and the economy. As intended, the law clarified the critical regulatory principle of separation between banking and non-banking activities in an effort to prevent excessive concentration and economic risk.

C. The Bank Holding Company Act Retains the Conceptual Distinction Between Financial and Non-Financial Activity

Those principles, in altered form, remain in the language of the statute today, with its requirement of regulatory action to approve various types of commercial activity only upon findings of their relatedness to banking action. The Bank Holding Company Act, as amended, limits the scope of banking activity under Section 4 of the Act to activities that are complementary to and not merely coincidental to banking activities. When Congress passed the Graham-Leach-Bliley Act in 1999, it altered the standard regarding non-banking activities for certain BHCs that successfully applied for financial holding company status (FHC). The statute required FHCs to maintain, *inter alia*, well-managed and capitalized subsidiaries with the requisite ratings under the U.S. Community Reinvestment Act.[114] Companies that obtained status as FHCs upon application and determination can engage in financial activities or those activities "incidental to such financial activities."[115] "Financial activities" are specifically defined to include lending, investing, insuring, issuing instruments, underwriting, and underwriting, investment, or merchant banking activity.[116] The statute sets forth specific criteria, based largely on competitiveness concerns, for evaluating whether activities are financial in nature or incidental to financial activities.[117] FHCs can also obtain, upon application, Fed approval to engage in activity that "is complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally."[118] The standard for approval requires a separate weighting of efficiency, competition, and systematic risk concerns that parallels the traditional separation between business and commerce.[119]

APPENDIX B: THE CONDUCT OF FHCS FOLLOWING 2003 AND THE 2008 FINANCIAL CRISIS DEMONSTRATES THE NEED TO SEPARATE BANKING AND COMMODITIES ACTIVITIES

The evidence shows that the conditions that justified the 2003 Citibank Order and subsequent orders, assuming they ever existed, no longer apply. The 2003 Order paved the way for banks to engage in market manipulation in commodity metal and energy markets and take advantage of a commodities boom. Following 2008, the speculative behavior of bank holding companies appears to have intensified. It has taken the form of warehousing and controlling the supply of metals, engaging in complex energy deals tantamount to ownership, and outright fraud. Investigations by Congress and the media show that the banks have used their newfound power to distort and manipulate markets (energy markets in particular) in a manner that also poses risks to the BHCs and the financial sector as a whole. The lack of appropriate disclosure rules, it is true, has prevented complete review of the BHCs' actions. Their behavior, it is nevertheless clear, has failed to comport with the initial expectations of the Board that allowing commodity operations would increase the FHCs' knowledge of commodities trading and derivatives products, and would improve competition by allowing the entities to challenge unregulated entities.

A. Market Manipulation following the 2003 Board Orders

Soon after the Federal Reserve altered its long-standing rules prohibiting BHCs from engaging in many non-banking activities, BHCs began unprecedented commodity trading operations and even energy supply operations. These deals, predicated on Board approval, posed unknowable risks and allowed the institutions to engage in commodities market manipulation. It is especially troubling that information about the scope of these operations and risks other than price risks were not included in Board reporting or SEC mandatory disclosure forms and remains inaccessible to the public.[120]

Although we do not believe that disclosure alone is a panacea for market manipulation concerns, we note the limited information that the public can even obtain about trading risks.[121] The FHCs' activity has not altered traditional patterns of secrecy in a commodities business reliant on access to information for commercial gain.[122] The difficulty in assessing banking institutions' commodities trading activities results from a failure to update financial firms' reporting and disclosure requirements. On a quarterly basis, FHCs report to the Board about the gross market value of physical commodities in their trading inventory. This non-public disclosure relates to limits on the volume of commodities trading relative to tier one capital that the Board's Orders, starting in 2003, have mandated for FHCs. Those measurements have a parallel in the SEC reporting and disclosure requirements for financial firms that are publicly traded corporations. FHCs typically limit themselves to producing a single number relating to commodity-derivative trading and direct trading in physical derivatives and it is difficult, if not impossible, to evaluate FHCs' role and the specific contracts and deals involved. As Prof. Omarova notes, no measurement of volatility beyond exposure to commodities price risk is present in publicly available disclosure reporting.

Prof. Omarova has detailed extensive commodity holdings for all FHCs and in some instances, the amount traded has increased. This increase in trade has accompanied an acknowledged increase in the volatility of commodities markets and evidence of speculative booms. [123]

During the period in question, the information we have indicates that the types of commodities operations also altered significantly. The initial 2003 Citigroup, Inc. Order allowed wide-spread trading in volatile physical commodities such as oil. The 2008 RBS Order and related Board determinations also provide a glimpse of FHCs conducting complex energy management service and tolling operations. Pursuant to the 2008 RBS Order, the bank was allowed to hire third-parties to refine petroleum products at a non-exclusive facility, and enter into long-term electricity supply contracts with large industrial and commercial customers to limit direct effect on consumers. The Order also allowed RBS to engage in energy management services and energy tolling contracts. The EMS involved supplying fuel for the plant from third parties and purchasing and reselling the power generated, with RBS providing credit and liquidity to the plant owner, while hedging risk exposure. RBS was restricted to 5% of total consolidated revenues, was required to obtain owner approval of all purchase and sales, was barred from involvement with day-to-day operations and management, and was requirement to allow owners to retain the right to market and sell power, with FHC first refusal, and to determine power output. The FHC could not guarantee financial performance of the plant or insure the FHC's profitability. The 2008 RBS Order also allowed energy tolling with the FHC making fixed and periodic "capacity payments" for fixed costs in exchange for the right to buy all or part of plant's power output and right to sell excess; it limited FHC administration of the plant. The 2008 RBS Order, issued just before the financial crisis, altered the rules of the game.

FHCs' pervasive role in commodities markets has produced a disruptive, speculative effect on pricing and trading. FHCs engage in operations the risks of which are often invisible to regulators and the public both. This transformation first occurred during the era in which trading in OTC derivatives, often opaque and carrying hidden leverage, became a force of market instability. The FHCs' control of physical commodities gives them access to information regarding the pricing and supply of non-precious metal commodities that they could use in determining how to trade in commodities derivatives. The conduct of FHCs in the commodities trading arena preceding the financial crisis illustrates systematic problems rather than improved market function.

B. Events following the 2008 Financial Crisis: Increasing & Risky "Innovation"

During the period following the financial crisis, some commentators suggest, the banks intensified their speculative activities in order to take advantage of escalating commodities prices during a period of uncertain financial returns. Those operations have included commodities warehousing, supplying commodities pursuant to tolling and energy management agreements, and even performing acts that mimic active ownership of commodities operations. Those deals include tolling agreements and supply and off-take (EMA) deals that mimic ownership of energy storage facilities and shipping. These activities are far different from conventional banking activities and have resulted in violations of market manipulation laws and arguably have contravened antitrust or even criminal laws.

There can be no doubt about the scope of the manipulation in which the banks have engaged. Goldman Sachs, for instance, owns coal mines in Columbia and other energy assets and pipelines even after its conversion to a BHC.[124] The machinations of Goldman Sachs in warehousing aluminum, a widely reported scandal, demonstrate market problems and have led to investigations and public attention. Goldman Sachs stockpiled aluminum at facilities in the upper Midwest, including Detroit, through a deal with subsidiary Metro Int'l Trade Services LLC.[125] The company and its subsidiary invented a system of moving the material between warehouses for months at a time. Customers have been unable to access their metal in a timely fashion. The volume of metal that the company holds has allowed it to limit supply of the metal and take advantage of the resulting higher prices for the metal. The warehousing operation inhibits ordinary market trading, even assuming it does not violate other laws. In that market, the bank's activities have already caused serious additional costs to producers and consumers without benefit to the public. Goldman Sachs, however, has likely earned millions of dollars from its scheme to increase the price of metal. The private London Metal Exchange, of which the FHC is a member, has already changed its rules regarding the period during which a company can warehouse metal. The CFTC, more significantly, has sent letters that request that documents *at the* LME and Chicago Metals Exchange not be destroyed. Even Congressional investigation, however, does not appear to have stymied the costly market scheme.

Some of these operations resemble those which Enron had pioneered, and which only FHCs had adequate capital to carry out: they pose the same problems for energy markets.[126] Ownership of the underlying physical assets or the contracts or instruments that permit control over those assets is not, as discussed above, transparent. As a result, it is difficult or impossible to determine the amount of assets involved or the types of risks that banks face.[127] When an explosion at the Elk Grove refinery in suburban Sacramento occurred in the summer of 2013, few knew or suspected that the asphalt contained in the tanks might belong to Goldman Sachs instead of ostensible owners Paramount Petroleum Corp. or parent company Alon USA Energy.[128] J. Aron, a Goldman trading division, has a "supply and offtake" agreement with Alon USA under which it helped provide and finance the supply of crude oil to the company and market the resultant products. The deal is just one of several complex deals, many unknown, that banks such as Goldman Sachs and Morgan Stanley have signed in the energy markets.

Speculation in the energy markets, to further trigger a sense of déjà vu, led Congress to grant authority to the Federal Energy Regulatory Commission (FERC) to prosecute energy market manipulation. The FERC has taken advantage of the regulatory authority it was granted to prosecute scores of violations. On July 30, 2013, for example, FERC reached a $410 million settlement with JPMorgan Chase over power market manipulation in California and the central U.S. between 2010 and 2012.[129] The settlement, which contained a non-admissions clause, was not the only settlement of this type and certainly promises not to be the last investigation of conduct made possible largely following the 2003 Order. Barclays Bank, indeed, has also been the target of a FERC enforcement action over similar power-market manipulation in the Western U.S.[130]

It is not clear why the JPMorgan Chase subsidiary involved in the manipulation case, Henry Bath, is still part of the financial conglomerate.[131] JPMorgan has the capacity to withhold copper supplies and inflating prices through SEC approval of a security backed by warehoused copper.[132] There are also allegations that one of the few remaining larger investment banks, Goldman Sachs, engaged in speculation through hedging of commodities, including oil.[133] There is evidence that the speculation resulted in increased poverty and resultant food riots.[134]

The financialization of commodities and resultant speculation has no doubt corrupted the function of several commodities markets involving energy and non-precious metals. There can be no doubt that the BHCs' physical commodities trading has harmed the public through higher prices, reduced access, and illegal practices. The banks' opaque commodities operations trading also pose risks to FHCs, given their highly leveraged status and poor risk-management practices. The inadequacy of the initial orders, following changed circumstances, is clear.

APPENDIX C: THE EVIDENCE OF MARKET MANIPULATION AND ANTI-COMPETITIVE BEHAVIOR SUPPORTS FURTHER REGULATION

The Board can and should act in the interests of the public to limit physical commodities speculation and anti-competitive effects. Its authority to act emerges from the Board's dual statutory mandate to limit inflation and preserve a full-employment economy, as well as its authority under the BHCA to determine whether activities are complementary to financial activities. The Board should ensure that the very institutions that receive federal financing and insurance are not accruing undue economic and political power.

It has long been the mandate of the Board to ensure measures of economic fairness that are under challenge from market manipulation and speculation. The Board has a clear mandate to protect against price inflation and to secure full employment.[135] Those considerations receive support from the unfortunate history of financial speculation in physical commodities and recent market patterns that display multiple indicia of imperfect competition. The organic statute that led to the formation of the Federal Reserve System indeed provides the agency the authority to act to preserve the systematic health and soundness of the system. The banks, as creatures of regulation and federal support, merit scrutiny over their novel operations and not mere acquiescence to their most individually profitable endeavors based on flawed notions of effective competition.

FHCs' physical commodities activities have had real and disastrous consequences on markets and individuals. As numerous commentators have acknowledged in empirical studies and models, firms have employed their large market positions and insider knowledge of physical commodities trading to alter the supply of the goods and profit on the sales of related derivatives as well as the commodities themselves.[136] These speculative actions undermine public confidence in public markets. As Federal Reserve researchers have asserted, BHC and FHC trading in physical commodities threatens inflation and access to markets for basic goods such as oil, non-precious metals, and foodstuffs.[137] The Federal Reserve's mission includes preventing inflation, especially core inflation, and that mission is plainly undermined by the now-real possibility of heightened prices of basic goods on which poor individuals and others in economic distress are especially reliant.[138] As illustrated by the Arab Spring movement that began in the Maghreb during the years following the financial crisis, increased prices on food and other goods is closely linked with political instability.[139] Financial firms' trading in physical commodities can therefore pose a significant risk to the welfare of both ordinary individuals and the geopolitical order.

The incredible concentration of economic power concomitant with the shift toward physical commodities trading represents, as it did at the beginning of the 20th century, a threat to the innovation and productivity of the real economy. Where energy markets are concerned, FHC trading in energy futures and bonds mimics the fraudulent practices of the late Enron Corporation. Such trading has resulted in real settlements and findings of market manipulation in energy markets on which consumers and national economic performance are dependent. In both specific and general ways, the FHCs' "innovations" undermine the purpose of finance in supporting a productive real economy.[140] Instead, financial institutions are cannibalizing existing companies and exploiting their ownership of goods, for instance, for profit rather than facilitating the creation of new industries and investment. FHCs enjoy an undue concentration of power that allows them to deny loans or other financial services to competitors. The concentration of businesses threatens not only to cause all the problems that monopolies and oligopolies pose, including limited innovations and higher prices, but also vast and unaccountable economic and political power. The evidence shows that speculative physical commodities trading has sent millions into poverty and destabilized political systems. There is no easier way to ensure that "Too Big to Fail" is an everyday reality for the public than to permit continued expansion of physical commodities trading.

ENDNOTES

[1] Occupy the SEC (http://occupythesec.org) is a group of concerned citizens, activists, and financial professionals that works to ensure that financial regulators protect the interests of the public, not Wall Street.

[2] H.R. 10—The Financial Services Modernization Act of 1999: Hearings Before the Comm. On Banking and Fin. Servs., 106th Cong. 294-95 (1999) (prepared testimony of Michael E. Patterson, Vice Chairman, J.P. Morgan & Co., Inc., on behalf of the Financial Servs. Council).

[3] Matt Taibbi, *The Vampire Squid Strikes Again: The Mega Banks' Most Devious Scam Yet,* Rolling Stone, Feb. 12, 2014, *avail. at* http://www.rollingstone.com/politics/news/the-vampire-squid-strikes-again-the-mega-banks-most-devious-scam-yet-20140212.

[4] *See, e.g.*, Senate Hearing on Examining Financial Holding Companies: Should Banks Control Power Plants, Warehouses and Oil Refineries? (Senate Committee on Banking, Financial Institutions and Consumer Protections Subcommittee), July 23, 2013, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=cca72cb5-a8fd-427a-978a-a51140a75cb0; Silla Brush, *Fed Should Reverse Commodity Policy, CFTC's Chilton Says*, Bloomberg, Aug. 5, 2013 (referencing Aug. 2, 2013 letter to Fed Chairman and statement at hearing; Saule T. Omarova, *Merchants of Wall Street: Banking Commerce & Commodities*, 98 Minn. L. Rev. 265, *passim,* (2013).

[5] *See, e.g.*, Citigroup, Order Approving Notice to Engage in Activities Complementary to a Financial Activity, 89 Fed. Res. Bull. 508 (2003) ["2003 Citigroup, Inc. Order"]. The status of FHCs is set forth by statute. Financial Services Modernization Act (Gramm-Leach-Bliley Act), Pub. L. No. 106-102, 113 Stat. 1338 (1999) ("GLB Act"), 12 U.S.C. § 1843(k) – (l) (2012).

[6] *See, e.g.*, 2003 Citigroup Order (allowing Citigroup, Inc. to retain voting shares of subsidiary company).

[7] GLB Act, 12 U.S.C. s. 1843(k) (2012).

[8] Lina Khan, *Why Goldman Sachs Has No Business Owning a Coal Mine in Columbia*, Quartz, July 22, 2013; Money Trust Investigation: Investigation of Financial and Monetary Conditions in the United States Under House Resolutions Nos. 429 and 504 (1912), *avail. at* http://fraser.stlouisfed.org/publication/?pid=80 (summarizing conclusions of the Pujo Commission's investigation of then-endemic U.S. financial crises.)

[9] *Id*.

[10] *See, e.g.*, Op-Ed, *Goldman Sachs' Aluminum Pile*, N.Y. Times, July 26, 2013; Erika Eichelberger, *JPMorgan Chase Accused of Manipulating Electricity Prices, Pays Record-Breaking Penalties*, Mother Jones, July 30, 2013; *After Goldman's Oil Burned, Banks Face Day of Reckoning on Commodities*, Reuters, Sept. 11, 2013.

[11] *Universal Camera Corp. v. Nat'l Labor Relations. Bd.*, 340 U.S. 474 (1951).

[12] Dodd-Frank Act, §§ 113, 165 (codified at 12 U.S.C. s. 5323, 5365). Non-bank entities can be designated as SIFIs and become subject to heightened prudential regulation. Dodd-Frank Act, §§ 115, 117 (codified at 12 U.S.C. ss. 5325 & 5327).

[13] 12 U.S.C. s. 5325(a) – (b).

[14] 12 U.S.C. s. 5371.

[15] 12 U.S.C. ss. 5325, 5365.

[16] Dodd-Frank Act, Pub. L. No. 111-203, § 619, 619(h)(4) (defining proprietary trading in terms of trading accounts) 124 Stat. 1376, 1620–31 (2010) (codified at 12 U.S.C. § 1850a–1851).

[17] *See* Dodd-Frank Act § 619(h)(1), 124 Stat. at 1629 (codified at 12 U.S.C. § 1851).

[18] John Cassidy, *Two Cheers for the New Volcker Rule*, New Yorker, Dec. 10, 2013.

[19] *See, e.g.*, *United States v. Estate of Romani*, 523 U.S. 517, 532 (1998) (holding that a later, more specific statute prevails).

[20] 12 U.S.C. § 225A (2012).

[21] Hirbod Assa, Amal Dabbous, and Nikolay Gospodinov, *A Staggered Pricing Approach to Modeling Speculative Storage*, Fed. Rev. Bk. of Atlanta Working Paper 2013-8, Sept. 2013 (examining empirical features of increasingly financialized commodities markets that lead to speculative pricing). If existing players in physical commodities trading also exhibit market consolidation and manipulation, this is an appropriate focus for antitrust action and commodity derivative regulation.
[22] 12 U.S.C. s. 1843(l), (k)(1)(A) (2012).
[23] "It is expected that complementary activities would not be significant relative to the overall financial activities of the organization." (Statement of Chairman Leach.) 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (cited in 2003 Citigroup, Inc. Order, fn 8.)
[24] 12 U.S.C. s. 1843(k)(1).
[25] The Royal Bank of Scotland Group plc., 94 Fed. Res. Bull. C60 (2008) ["2008 RBS Order"]. One commodity in question was nickel, which the Board reasoned was only approved on the major, well-regulated London Metal Exchange for trading, and also oil and petroleum products, deemed sufficiently fungible products with sufficiently liquid OTC trading despite the absence of major exchange trading. *See also* Fortis S.A./N.V., 94 Fed. Res. Bull. C20 (2008) ["2008 Fortis Order"]; Board Letter Regarding Fortis S.A./N.V. (May 21, 2008); Merchants, at 34-36.
[26] 2003 Citigroup, Inc. Order. The order found that Citigroup, Inc. had grandfather rights that expired on October 8, 2003, following the bank's acquisition of Phibro in October 1998 as part of a merger between Travelers and Citicorp. *Id.* at 1 (citing Travelers Group Inc., 84 Federal Reserve Bulletin 985 (1998).
[27] 12 U.S.C. s. 1843(j)(2)(C).
[28] An implicit average guarantee of $20 billion per year, and $100 billion in 2009 may even understate the admittedly intangible insurance by employing balance sheets and bond-credit spreads. Omarova, Merchants, 28 Minnesota L. Rev. 265, fn. 410 (2013) (citing Viral V. Acharya et al., *The End of Market Discipline? Investor Expectations of Implicit State Guarantees*, 3 (Jan. 13, 2013) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1961656.)
[29] 12 U.S.C. s. 1843(a)(2) (2012); Lina Khan, *Why Goldman Sachs Has No Business Owning a Coal Mine in Columbia*, Quartz, July 22, 2013.
[30] 12 U.S.C. s. 1843(o) (2012).
[31] Financial Services Competitiveness Act of 1995,104 H.R. 1062 (Version 1), Sec. 109. Subsequent versions of the bill include 105 H.R. 10 (Version 3), Section 131 (cited in Merchants, at 24.)
[32] 12 U.S.C. s. 1843(k), 12 C.F.R. 225.171-173, 175.
[33] 12 U.S.C. s. 1843(k)(4)(H)(iv); 12 C.F.R. 225.171(b), (d) -(e).
[34] Energy Policy Act of 2005, Pub. L. 109-58 (adding section prohibiting energy market manipulation to both the Federal Power Act and the Natural Gas Act); Testimony of Norman C. Bey (FERC Dir. Off. of Enf.), Regulating Financial Holding Companies and Physical Commodities (Senate Committee on Banking, Financial Institutions and Consumer Protection Subcommittee), Jan. 15, 2014, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=0e55dd8e-8589-4120-8c3e-2c6dc95f7f40; *See In Re Make-Whole Payments and Related Bidding Strategies*, 144 FERC ¶ 61,068 (2013) (FERC enforcement action with J.P. Morgan).
[35] Federal Reserve Act Section 23(A), 12 U.S.C. § 371c (2012)
[36] Dodd Frank Act, ss. 608-609 (codified at 12 U.S.C. s. 371(c)). These provisions limited quantitative exemptions; tightened the applicability of Section 23A to derivatives, securities lending and borrowing transactions that cause a bank to have credit exposure to an affiliate; tightened the collateral requirements, maintaining that banks maintain the appropriate level of collateral at all times for covered transactions subject to collateralization; and limited the granting of exceptions and altered the process for granting exceptions.
[37] *See Merchants*, at 346, fn. 411 (citing Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: the Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N. C. L. Rev.1683 (2011) (noting exemptions to Section 23A during the Financial Crisis of 2008 and prior lax granting of exceptions).
[38] Dodd Frank Act Sec. 737 (codified at 7 U.S.C. s. 12a(7)).
[39] Kevin G. Hall, *Regulator Tries Again to Limit Oil Speculation*, McClatchy DC, Nov. 5, 2013.
[40] CFTC Proposed Rule (17 CFR Pt. 150), 78 Fed. Reg. 68946 (Nov. 15, 2013); CFTC Proposed Rule (17 CFR Pt. 151), 77 Fed. Reg. 31767 (May 30, 2012).
[41] *See Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).
[42] Barclays Bank PLC, Order Approving Notice to Engage in Activities Complementary to a Financial Activity, 90 Fed. Res. Bull. 512 (2004).

[43] 12 U.S.C. § 1843(k)(4)(H); 12 C.F.R. Part 225, Subpart J. Prof. Saule Omarova has criticized the ambiguous restrictions on the active presence of BHCs, such as allowing the hiring of directors without routine management or operation roles, in the implementing regulation, which could allow for informal influence on business decisions. Omarova, *Merchants*, at 283-85, 336-37.
[44] H.R. REP. NO. 96-1016, at 22 (1980).
[45] Press Release, United States Attorney, Southern District of New York, Lyondell Chemical Company to Pay $162 Million in Bankruptcy to Settle Environmental Liabilities (Mar. 31, 2010), http://www.justice.gov/usao/nys/pressreleases/March10/lyondellsettlementagreementpr.pdf.
[46] United States Government Accountability Office, *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Obligations* 17 (2005).
[47] *Id*. at 33
[48] 42 U.S.C. § 4332.
[49] 40 C.F.R 1508.18(a).
[50] These individuals include the "Chairman of the Board of Governors; the Chairperson of the Commodity Futures Trading Commission; the Director of the Federal Housing Finance Agency; the Chairman of the National Credit Union Administration Board; and an independent member appointed by the President." 12 U.S.C. § 5321.
[51] 40 C.F.R 1508.27(a).
[52] 40 C.F.R 1508.27(b).
[53] *Id*. at (2).
[54] *Id*. at (5).
[55] *Id.* at (7).
[56] Omarova, *Merchants*, at 265, 344.
[57] 12 U.S.C. § 225A (2012).
[58] L. Randall Wray, *The Commodities Market Bubble: Money Manager Capitalism and the Financialization of Commodities*, The Levy Economics Institute of Bard College, Public Policy Brief No. 96, 2008; Jayati Ghosh, James Heintz, and Robert Pollin, *Speculation on Commodities Futures Markets and Destabilization of Global Food Prices: Exploring the Connections*, Working Papers wp269, Political Economy Research Institute, Univ. of Mass. at Amherst. Writer Lina Khan references an increase in the price of wheat by 120% between 2005 and 2008 that pushed 250 million additional people into poverty and a spike in prices of oil to a historic $145 per barrel in 2008. Lina Khan, *JP Morgan Gets a Big Holiday Gift From the SEC*, New Republic, Dec. 31, 2012.
[59] *See, e.g.,* Hirbod Assa, Amal Dabbous, and Nikolay Gospodinov, *A Staggered Pricing Approach to Modeling Speculative Storage*, Fed. Rev. Bk. of Atlanta Working Paper 2013-8, Sept. 2013 (examining empirical features of increasingly financialized commodities markets that lead to speculative pricing); David Frenk & Wallace Turbeville, *Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, avail. at http://papers.ssrn.com/sol3/papers.cfn?abstract_id=1945570*
[60] Dietrech Domanski & Alexandra Heath, *Financial Investors and Commodity Markets*, Bank for Int'l Settlements Quarterly Review, p. 53 (March 2007).
[61] We recognize that SIFIs' risks may be detailed in the description of corporate structure and core business activities in resolution plans required pursuant to the Dodd-Frank Act, § 165(d) (codified at 12 U.S.C. s. 5363.)
[62] Omarova, *Merchants*, at 332, fn. 361 (citing Jessica Silver-Greenberg & Suzanne Craig, *JPMorgan Trading Loss May Reach $9 Billion*, N. Y. TIMES, Jun. 28, 2012).
[63] *See, e.g.*, Darryll Hendricks, *Evaluation of Value-at-Risk Models Using Historical Data*, Fed. Res. Bank of New York Economic Policy Review (April 1996) (noting incongruities between VaR modeling and actual conditions). The failures of VaR risk measurements, including non-additive properties and limited usefulness as conditions and market behavior evolve, as especially notable in the context of stress testing. Academics have detailed a substitute for the limited accuracy and indeed dangerous VaR metric or risk-management analytic. Taleb, Nassim Nicholas and Canetti, Elie R.D. and Kinda, Tidiane and Loukoianova, Elena and Schmieder, Christian, *A New Heuristic Measure of Fragility and Tail Risks: Application to Stress Testing* (August 2012) IMF Working Paper No. 12/216, *available at* http://ssrn.com/abstract=2156095.
[64] Mike Konczal, *Capital Requirements: Hitting Six Birds with One Stone*, included in AN UNFINISHED MISSION: MAKING WALL STREET WORK FOR US (Americans for Financial Reform & Roosevelt Institute Report) (2013).
[65] Dietrech Domanski & Alexandra Heath, *Financial Investors and Commodity Markets*, Bank for Int'l Settlements Quarterly Review, 53 (March 2007).

[66] As explained elsewhere in this letter, there are other requirements on national banks that narrowly define the "business of banking."

[67] "It is expected that complementary activities would not be significant relative to the overall financial activities of the organization." (Statement of Chairman Leach.) 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (cited in 2003 Citigroup, Inc. Order, fn 8.)

[68] 12 U.S.C. § 1843(a).

[69] 12 C.F.R. Pt. 225; 2003 Citigroup, Inc. Order, fn. 2.

[70] 12 C.F.R. § 225.28(b)(8)(ii)(B); 2003 Citigroup, Inc. Order, fn. 2.

[71] 62 Fed. Reg. 9290, 9311-9312 (Feb. 28, 1997).

[72] 12 U.S.C. s. 1843(k) (2012).

[73] 2003 Citigroup, Inc. Order; UBS AG, 90 Fed. Res. Bull. 215 (2004); Barclay's Bank PLC, 90 Fed. Res. Bull. 511 (2004); Deutsche Bank AG, 92 Fed. Res. Bull. C54 (2006); Societe Generale, 92 Fed. Res. Bull. C113 (2006); JPMorgan Chase & Co., 92 Fed. Res. Bull. C57 (2006); Board Letter regarding Wachovia Corp. (Apr. 13, 2006); Board Letter regarding Bank of America Corporation (Apr. 24, 2007). Starting in 2008, as we describe in Appendix B, the Board loosened its requirements on the liquidity of commodities and attached prudential conditions.

[74] 2003 Citigroup, Inc. Order. The order found that Citigroup, Inc. had grandfather rights that expired on October 8, 2003, following the bank's acquisition of Phibro in October 1998 as part of a merger between Travelers and Citicorp. Id. at 1 (citing *Travelers Group Inc.*, 84 Federal Reserve Bulletin 985 (1998).

[75] Omarova, *Merchants*, at 344; Craig Torres & al, *Yellen Says Review of Bank Commodity Activity Could Bring Limits, Bloomberg*, Nov. 14, 2013.

[76] Omarova, *Merchants,* 343, 348-49. The result of increased trading in the physical commodities arena may have inflated asset prices in the manner of a speculative boom. Although there has been a recent downward trend in some commodities, the volatility of certain assets and a general upward trend are likely to continue.

[77] Omarova, *Merchants*, at 349; David Frenk & Wallace Turbeville, *Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, avail. at http://papers.ssrn.com/sol3/papers.cfn?abstract_id=1945570*.

[78] Omarova, *Merchants*, at 312, 341.

[79] Hirbod Assa, Amal Dabbous, and Nikolay Gospodinov, *A Staggered Pricing Approach to Modeling Speculative Storage*, Fed. Rev. Bk. of Atlanta Working Paper 2013-8, Sept. 2013 (examining empirical features of increasingly financialized commodities markets that lead to speculative pricing). If existing players in physical commodities trading also exhibit market consolidation and manipulation, this is an appropriate focus for antitrust action and commodity derivative regulation.

[80] The Royal Bank of Scotland Group plc., 94 Fed. Res. Bull. C60 (2008) ["2008 RBS Order"]. One commodity in question was nickel, which the Board reasoned was only approved on the major, well-regulated London Metal Exchange for trading, and also oil and petroleum products, deemed sufficiently fungible products with sufficiently liquid OTC trading despite the absence of major exchange trading. *See also* Fortis S.A./N.V., 94 Fed. Res. Bull. C20 (2008) ["2008 Fortis Order"]; Board Letter Regarding Fortis S.A./N.V. (May 21, 2008); Omarova, *Merchants*, at 302-04.

[81] 2008 RBS Order.

[82] 12 U.S.C. s. 1843(k)(4)(H), 12 C.F.R. 171-173, 175.

[83] 12 U.S.C. s. 1853(k)(4)(H)(iv), 12 C.F.R. 225.171.

[84] 12 U.S.C. s. 1843(k)(4)(H)(iii), 12 C.F.R. 225.172-173.

[85] 12 CFR 225.175(b), part 225 Appendix A.

[86] 12 CFR 217.52-.53 and 217.153-.154

[87] 94 Fed. Res. Bull. C101 C102 & C103, C105 (2008), available at 2008 WL 7861871 at *2, & 2008 WL 7861872, *5 (Fed. Reserve Bd., Sept. 21, 2008).

[88] 12 U.S.C. s. 1843(a)(2) (2012); Lina Khan, *Why Goldman Sachs Has No Business Owning a Coal Mine in Columbia*, Quartz, July 22, 2013.

[89] Gretchen Morgenson, *Off Limits, but Blessed by the Fed*, N.Y. Times, Dec. 21, 2013. There is evidence that the Board has provided numerous extensions to allow FHCs to relinquish or transform their existing—and quite lucrative—physical commodities subsidiaries.

[90] 12 U.S.C. s. 1843(o) (2012).

[91] 12 U.S.C. s. 1843(o) (2012).

[92] 12 U.S.C. s. 1843(o)(2) – (3) (2012).

[93] Financial Services Competitiveness Act of 1995,104 H.R. 1062 (Version 1), Sec. 109. Subsequent versions of the bill include 105 H.R. 10 (Version 3), Section 131.

[94]Omarova, *Merchants*, at 291, fns. 126-130 (citing Dean Anason, *Capital Briefs: Wholesale Banking Cut From Reform Bill, Am. Banker,* Oct. 28, 1999).
[95] 12 U.S.C. s. 24(Seventh). The U.S. Dept. of Treasury's Office of Comptroller of the Currency has recently interpreted the clause in an increasingly broad manner, but the statute continues to impose substantial restrictions on BHCs engaging in commercial activities in line with the general policy. Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 U. Miami L. Rev. 1041 (2009), Omarova, *Merchants*, passim. Commentator Wallace Turbeville argues that the market innovations of this period have transformed derivatives from an instrument useful for hedging into a costly, opaque tool of extreme financialization that no longer serves its purpose. Wallace C. Turbeville, *Toward an Understanding of the Use of Derivatives by End Users* 100, included in AN UNFINISHED MISSION: MAKING WALL STREET WORK FOR US (Americans for Financial Reform & Roosevelt Institute Report) (2013).
[96] *Id.* The prior banking and economic crisis related to commodities speculation culminated in Congress approving the Pujo Commission to investigate the crisis' cause. Lina Khan, *Why Goldman Sachs Has No Business Owning a Coal Mine in Columbia*, Quartz, July 22, 2013.
[97] Omarova, *Merchants,* 270, 350-51, fn 18 (citing LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 3-4 (1933)).
(1933).
[98] Money Trust Investigation: Investigation of Financial and Monetary Conditions in the United States Under House Resolutions Nos. 429 and 504 (1912), avail. at http://fraser.stlouisfed.org/publication/?pid=80
[99] *See, e.g.,* William Page, *Standard Oil & US Steel Predation and Collusion in the Law of Monopolization & Mergers*, 85 S.C. L. Rev. (2012).
[100] Money Trust Investigation: Investigation of Financial and Monetary Conditions in the United States Under House Resolutions Nos. 429 and 504 (1912), avail. at http://fraser.stlouisfed.org/publication/?pid=80
[101] Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (1933).
[102] 12 U.S.C. s. 1843(c)(8); Omarova, *Merchants*, at 274, fn. 34. As Omarova discusses, the definition of control is set by the statute at a relatively low bar of 25% ownership of a class of voting shares of a bank. 12 U.S.C. s. 1841(a)(1)
[103] 12 U.S.C. s. 1841 *et seq.*
[104] The Federal Reserve was required to determine that the activity was "so closely related to banking as to be a proper incident thereto." 12 U.S.C. s. 1843(c)(8). The language remains in the statute today.
[105] Omarova, *Merchants*, 276-77, fn. 48 (citing Joseph G. Haubrich & Joao A.C. Santos, *Alternative Forms of Mixing Banking with Commerce: Alternative Evidence from American History* (Feb. 2003), at 1, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=305281.)
[106] 12 C.F.R. part 225. The Federal Reserve Board of Governors concedes the extensive and clear system of regulation that governed BHCs prior to the introduction of the 2003 Citigroup Inc., Order. The Office of the Comptroller of the Currency has engaged in a parallel and quixotic mission over several recent decades to alter the meaning of the business of banking to include an array of financial risk-taking and transforming a bank into a general financial intermediary. Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the 'Business of Banking,'* 63 U. Miami L. Rev. 1041 (2009). The broadest vision of a bank as general financial intermediary, while relevant to the larger debates over financial reform and the scope of banks' risk-taking activities, does not alter the concept of a long-standing division between commercial and banking activities.
[107] 12 C.F.R. Pt. 225 (2012).
[108] 12 C.F.R. Pt. 225 (2012).
[109] 12 C.F.R. Pt. 225 (2012).
[110] Omarova, *Merchants*, fn. 42-43 (citing Note, *The Bank Holding Company Act of 1956*, 75 Banking L. J. 277, 293 (1958); MELANIE FEIN, FEDERAL BANK HOLDING COMPANY LAW,§ 7.02[1], AT 7-4 (2011)).
[111] Omarova, *Merchants*, at fn. 28, 44 (citing Saule T. Omarova & Margaret E. Tahyar, *That Which We Call a Bank: Revising the History of Bank Holding Company Regulation in the United States*, 31 REV. BANKING & FIN. L 113, 123-24 (2011, 12); MARK ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994)).
[112] Omarova, *Merchants*, at 277.
[113] Lina Khan, *Why Goldman Sachs Has No Business Owning a Coal Mine in Columbia*, Quartz, Oct. 22, 2013).
[114] 12 U.S.C. s. 1843(l) (2012).
[115] 12 U.S.C. s. 1843(k)(1)(A) (2012).
[116] 12 U.S.C. s. 1843(k)(4) (2012).

[117] 12 U.S.C. s. 1843(k)(3) (2012).
[118] 12 U.S.C. § 1843(k)(1)(B) (2012).
[119] 12 U.S.C. § 1843(j)(2)(A) (2012) ("In connection with a notice under this subsection, the Board shall consider whether performance of the activity by a bank holding company or a subsidiary of such company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or risk to the stability of the United States banking or financial system.")
12 U.S.C. § 1843(j)(2)(A) (2012)
[120] Omarova, *Merchants*, at 25-26.
[121] *Id.*, at 293-99. It may be possible to obtain limited information from news reports, occasional information in SEC filings, and regulatory filings with such other agencies as the FERC, EPA, and CFTC.
[122] *Id.*, fn. 162 (citing Javier Blas, *Trading Houses: Veil Slowly Lifts on a Secretive Profession*, FIN. TIMES, May 23, 2011.
[123] *See, e.g.,* David Frenk & Wallace Turbeville, *Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, avail. at http://papers.ssrn.com/sol3/papers.cfn?abstract_id=1945570*
[124] Cheyenne Hopkins and Michael J. Moore, *Fed Said to Review Commodities at Goldman, Morgan Stanley*, Bloomberg, Oct. 1, 2013; Omarova, *Merchants*, at 310-324 (noting similar strategies of Goldman Sachs and Morgan Stanley).
[125] David Kocieniewski, *A Shuffle of Aluminum, but to Banks, Pure Gold*, N.Y. Times, July 20, 2013; Gretchen Morgenson & David Kocieniewski, *U.S. Weighs Inquiry Into Big Banks' Storage of Commodities,* N.Y. Times, July 22, 2013; Omarova, *Merchants,* at 49-52.
[126] Omarova, *Merchants*, at 343-46.
[127]*After Goldman's Oil Burned, Banks Face Day of Reckoning on Commodities*, Reuters, Sept. 11, 2013.
[128] *Id*.
[129] Erika Eichelberger, *JPMorgan Chase Accused of Manipulating Electricity Prices, Pays Record-Breaking Penalties*, Mother Jones, July 30, 2013; Omarova, *Merchants,* 332-33, fn. 360; News Release, Fed. Energy Regulatory Comm'n, FERC, JP Morgan Unit Agree to $410 Million in Penal-ties, Disgorgement to Ratepayers (July 20, 2013), *available at* http://www.ferc .gov/media/news-releases/2013/2013-3/07-30-13.asp#.Ui1mRRZEO5d.
[130] Alexander Osipovich, *Bank's physical commodity trading comes under scrutiny*, Risk, Aug. 20, 2013.
[131] Gretchen Morgenson, *Off Limits, but Blessed by the Fed*, N.Y. Times, Dec. 21, 2013.
[132] Lina Khan, *JP Morgan Gets a Big Holiday Gift From the SEC*, New Republic, Dec. 31, 2012. The reporter contends that the 1996 actions of Japanese firm Sumitomo, which resulted in $125 million in CFTC penalties would be legal under the decision to legalize an instrument based not on futures but actual supplies.
[133] Matt Taibbi, *The Great American Bubble Machine*, Rolling Stone, July 9-23, 2009. The article focuses on a CFTC hedging exception in 1991 granted to GS and others. It contends that an increasing amount of speculators began to dominate commodities exchanges designed to protect actual producers against fluctuations in value.
[134] *Id.*; Jayati Ghosh, James Heintz, and Robert Pollin, *Speculation on Commodities Futures Markets and Destabilization of Global Food Prices: Exploring the Connections*, Working Papers wp269, Political Economy Research Institute, Univ. of Mass. At Amherst.
[135] 12 U.S.C. § 225A (2012).
[136] L. Randall Wray, *The Commodities Market Bubble: Money Manager Capitalism and the Financialization of Commodities*, The Levy Economics Institute of Bard College, Public Policy Brief No. 96, 2008; Dietrech Domanski & Alexandra Heath, *Financial Investors and Commodity Markets*, Bank for Int'l Settlements Quarterly Review, p. 53 (March 2007).
[137] *See, e.g.,* Hirbod Assa, Amal Dabbous, and Nikolay Gospodinov, *A Staggered Pricing Approach to Modeling Speculative Storage*, Fed. Rev. Bk. of Atlanta Working Paper 2013-8, Sept. 2013 (examining empirical features of increasingly financialized commodities markets that lead to speculative pricing); David Frenk & Wallace Turbeville, *Commodity Index Traders and the Boom/Bust Cycle in Commodities Prices, avail. at http://papers.ssrn.com/sol3/papers.cfn?abstract_id=1945570*
[138] Lina Khan, *JP Morgan Gets a Big Holiday Gift From the SEC*, New Republic, Dec. 31, 2012 (referencing increases in the price of wheat by 120% between 2005 and 2008 that pushed 250 million additional people into poverty and a spike in prices of oil to a historic $145 per barrel in 2008).

[139] Jayati Ghosh, James Heintz, and Robert Pollin, *Speculation on Commodities Futures Markets and Destabilization of Global Food Prices: Exploring the Connections*, Working Papers wp269, Political Economy Research Institute, Univ. of Mass. At Amherst.

[140] Kevin Drum, "The Vampire Squid Has Set Its Sights on Your Beer Can," Mother Jones, July 20, 2013.