XV. The U.S. Chamber Opposes the Federal Reserve Board's New Commodity Rule

In January 2014, the Federal Reserve Board (FRB) published an advance notice of proposed rulemaking informing the public of its intent to review physical commodity and investment activities under Sections 4(k)(1)(B), 4(k)(4)(H), and 4(o) of the Bank Holding Company Act (BHCA).[1529] In April 2014, the U.S. Chamber of Commerce (the U.S. Chamber) along with several trade associations authored a letter to Federal Reserve Secretary Robert deV. Frierson expressing concern that the new restrictions on physical commodities would restrict liquidity and limit hedging options in the market, which would have an adverse effect on end-users.[1530] Also in April 2016, the U.S. Chamber authored a second, more detailed objection to additional restrictions on financial holding companies (FHCs).[1531] After the close of comments for the advance notice of proposed rulemaking, the FRB recommended the repeal of the Merchant Banking Authority and Commodity Activity Grandfather provisions of the BHCA.[1532] Despite the U.S. Chamber's objections, the Federal Reserve proceeded with proposing the new rule in September 2016 and reviewed comments

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[1529] Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities, 79 Fed. Reg. 3329 (Jan. 21, 2014) (inviting comments on the language of the rule that will be proposed to alter how commodity and investment activities are regulated under the BHCA); Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities, 79 Fed. Reg. 12,414 (Mar. 5, 2014) (extending the period during which the FRB would accept comments).

[1530] Letter from U.S. Chamber of Com. to Sec'y Robert deV. Frierson, Bd. of Governors of the Fed. Res. Sys. (Apr. 3, 2014) (on file with author) [hereinafter Letter from U.S. Chamber]; *About Commodity Derivatives*, COMMODITYFACT.ORG, http://www.commodityfact.org/about-commodity-derivatives [https://perma.cc/7VRL-CXXE]. End-users of physical commodities refers to the firms that enter into agreements with FHCs in order to "hedge the prices at which they can purchase commodities." Letter from U.S. Chamber, *supra* note 2.

[1531] Letter from U.S. Chamber, *supra* note 2.

[1532] BD. OF GOVERNORS OF THE FED. RES. SYS., REPORT TO THE CONGRESS AND THE FINANCIAL STABILITY OVERSIGHT COUNCIL PURSUANT TO SECTION 620 OF THE DODD-FRANK ACT 28 (2016) [hereinafter "620 Report"], https://www.occ.treas.gov/news-issuances/news-releases/2016/nr-ia-2016-107a.pdf [https://perma.cc/Y79T-DPM3].

on the new rule until February 20, 2017.[1533] Large FHCs like Goldman Sachs, Morgan Stanley, and JPMorgan reacted to the proposed rule by selling off portions of their physical commodities business over the course of the past three years.[1534] On January 5, 2017, the U.S. Chamber authored a letter to Secretary Frierson explaining their position on the proposed regulation and detailing which parts of the regulation would have an adverse effect on the commodities market.[1535]

First, this article will discuss the proposal put forward by the FRB and discuss the changes that it would bring. Next, Section B will examine the rationale provided by the FRB for making the changes it has suggested. Section C will then discuss the U.S. Chamber's objections to the FRB's proposal. Finally, Section D will provide a brief overview of the positions of other actors whose interests will be affected by the proposed change.

A. Risk-Based Capital and Regulatory Requirements for Physical Commodities Activities

The new rule proposed by the FRB, titled "Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Bank Investments," provides for

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[1533] Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Bank Investments, 81 Fed. Reg. 67,220 [hereinafter "Notice of Proposed Rulemaking"] (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. pts. 217 and 225) (providing the proposed language of the new regulation); Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Bank Investments, 81 Fed. Reg. 94,276 (Dec. 23, 2016) (extending the comment period for the proposed rule).

[1534] *See* Jesse Hamilton, *Fed Seeks Aggressive Limit on Wall Street Commodity Holdings*, BLOOMBERG (Sept. 23, 2016), https://www.bloomberg.com/news/articles/2016-09-23/fed-proposes-aggressive-rule-on-wall-street-commodity-holdings-itfye706 [https://perma.cc/Z9ZS-PF48].

[1535] Letter from U.S. Chamber, *supra* note 2; *see* Lisa Lambert, *Possible Fed Limits on Wall Street Energy Bets Will Be 'Harmful': U.S. Chamber*, REUTERS (Jan. 5, 2017), http://www.reuters.com/article/us-usa-fed-regulations-idUSKBN14P2FB [https://perma.cc/56LV-Z6F2].

additional restrictions on covered physical commodity activities, and heightened capital requirements for physical commodity activities and merchant banking investments.[1536] Under current law, the FRB's position is that, pursuant to the complementary authority provision of the BHCA, FHCs may hold physical commodities up to the market value of 5 percent of their tier one capital.[1537] Additionally, FHCs have been permitted to hold physical commodities under other authorities, which have not been considered for purposes of the 5 percent limit.[1538] The proposed rule would account for physical commodities held under both the complementary authority of the BHCA as well as any other authority that allows FHCs to hold physical commodities.[1539]

The new rule would also increase the amount of capital that a FHC must hold to support its covered physical commodity holdings.[1540] Capital regulation requires that in order for a FHC to hold certain assets, the firm must have an amount of capital on its books proportional to the value of those assets.[1541] Currently, physical

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[1536] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,225.

[1537] Interests in Nonbanking Organizations, 12 U.S.C. § 1843(k)(1)(B) (2012) (authorizing FHCs to engage in activity that "is complementary to financial activity and does not pose a substantial risk to the safety and soundness of depository institutions of the financial system generally"); Capital Adequacy Guidelines for Bank Holding Companies: Risk-Based Measure, 12 C.F.R. § 225, App. A (defining tier one capital as the sum of capital provided by common stockholders' equity, noncumulative perpetual preferred stock, and retained earnings); Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,225 (noting the current FRB policy limits physical commodity holdings to 5 percent of an FHC's consolidated tier 1 capital); *see, e.g.* Bd. of Governors of the Fed. Reserve Sys., Order, Citigroup Inc., 2003 WL 22297009 (F.R.B. Oct. 2, 2003) (determining that Citigroup could engage in physical commodity activities, but limiting physical commodity activities to 5 percent of tier 1 capital).

[1538] *See* § 24(7) (granting incidental powers "necessary to carry on the business of banking); *see, e.g.*, OCC Interpretive Letter No. 935, 2002 WL 1483791 (May 12, 2002) (granting authority to hold investments in physical commodities for hedging purposes).

[1539] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,237.

[1540] *Id*. at 67,236, 67,238. Covered commodities are defined as a "hazardous substance" under CERCLA, "oil" under the Oil Pollution Act or the Clean Water Act, a "hazardous air pollutant" under the Clean Air Act or a substance that a state statute or other regulation makes a non-governmental actor responsible for remediation of unauthorized release of such substance. *Id.*

[1541] 12 C.F.R. § 217.10 (2016) (denoting minimum capital requirements commodities have a risk-weight of 100 percent, meaning that in order to be well-capitalized, banks with physical commodity assets on their books must hold 10 percent of the risk-weighted value of those assets as capital, and 8 percent of their risk-weighted value as tier one capital.[1542] The proposed rule would require FHCs that hold investments in covered physical commodities permissible under Section 4(k) of the BHCA to assign those commodities a risk-weight of 300 percent.[1543] Additionally, covered physical commodities held through Section 4(o) grandfather authority would be assigned the highest possible risk-weight of 1,250 percent.[1544]

The FRB's proposed rule would also prevent FHCs from engaging in energy tolling and energy management.[1545] To date, the FRB has authorized just five FHCs to become involved in energy management and tolling: Deutsche Bank, Royal Bank of Scotland, JPMorgan, Fortis, and Barclays.[1546] These authorizations would permit FHCs to engage in energy management within specific parameters outlined by the FRB's orders.[1547] For example, an FRB order would detail what services a FHC would be allowed to provide (e.g., providing market information and entering into transactions to provide the energy facility with fuel) and which activities would be prohibited (e.g., operational management of the facility).[1548] Under the proposed rule, FHCs would rescind the permission for these firms to engage in

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proportional to risk-weighted assets); § 217.32 (setting standards for risk-weights depending on the type of assets held).

[1542] § 567.6 (defining risk-weight categories for different types of assets); § 208.43 (setting the standards for the amount of capital that must be maintained by a firm to be considered "well capitalized"). The risk-weighted value of an asset is calculated by multiplying the risk-weight percent by the value of the asset. Then, the amount of capital that a bank must hold is determined by multiplying the risk-weighted value by the percentage of capital the bank must maintain to meet its desired capitalization threshold. § 567.6. For example, an asset valued at $100 million with a risk-weight of 50 percent would have a risk-weighted value of $50 million and the bank would be required to hold 10 percent of that value, or $5 million, in capital to maintain that asset.

[1543] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,237.

[1544] *Id*.

[1545] *Id*. at 67,231–32.

[1546] *Id*. at 67,231; *see id*. at 67,231 nn.67 & 71.

[1547] *See, e.g. Fortis S.A./N.V.*, 94 FED. RES. BULL. C20, 2008 WL 7861883 (F.R.B. Mar. 2008).

[1548] *See, e.g., id.* (detailing Fortis' involvement in energy management).

energy management and tolling activities and FHCs currently engaged in energy management would be given two years to divest following the effective date of the regulation.[1549]

The proposal would also reclassify copper as an industrial metal, alongside nickel, aluminum, and zinc, and remove references to copper from parts of the code that would allow BHCs to trade in contracts that use copper as a derivative.[1550] The FRB has recognized that the Office of the Comptroller of the Currency (OCC) has adopted a new classification of copper as an industrial metal since it has come to be used more in industrial manufacturing than as a store of value.[1551] This recognition prompted the FRB to propose the elimination of copper as a precious metal, which would prohibit bank holding companies (BHCs) from owning and storing copper without limit.[1552] Under current FRB regulations, BHCs have been allowed to store and own copper without limit, as well as to invest in derivatives that used copper as the underlying metal.[1553]

Lastly, the new regulation would require FHCs to report new data with respect to physical commodities and risk-weight reporting of covered physical commodities and Section 4(o) infrastructure assets.[1554] FHCs would be required to report a new schedule, labeled HC–W, which would require specific information on covered physical commodity holdings to be disclosed.[1555] This regulation would require FHCs to disclose: (1) the fair market value of categories of physical commodities, and ownership of any "covered physical commodities, any Section 4(o) infrastructure assets, or investments in covered commodity merchant banking investments";[1556] (2) involvement in the exploration and extraction of covered physical commodities and ownership of any facilities, vessels, or conveyances used in the

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[1549] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,231–32.
[1550] *Id.* at 67,232 n.86, 67,333 & 67,339.
[1551] *Id*. at 67,232.
[1552] *Id*. at 67,233, 67,239.
[1553] 12 C.F.R. § 225.28(b)(8)(ii)(B) (2016) (allowing BHCs to trade in derivative contracts based on copper); Bank Holding Companies and Change in Bank Control (Regulation Y), 62 Fed. Reg. 9290, 9311 (Feb. 18, 1997) (adding copper to the list of precious metals approved by the board for BHCs to own and store).
[1554] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,233.
[1555] *Id*.
[1556] *Id*.

transport of such commodities;[1557] and (3) under Schedule HC-R, the fair market value of the covered physical commodity activity engaged in under either Section 4(k)(1)(B) or Section 4(o) of the BHCA, the cost basis of any Section 4(o) infrastructure activities, and the carrying value of its investments in covered commodity merchant banking investments made under Section 4(k)(4)(H) of the BHCA.[1558]

B. The Federal Reserve Board's Policy Rationale

In its proposal, the FRB highlighted several reasons for its decision to impose new regulatory requirements on physical commodities.[1559] First, the FRB contends that investments in covered physical commodities can, in the event of an environmental catastrophe, expose FHCs to liability that can exceed the fair market value of those held commodities and threaten the stability of the owning financial institution.[1560] Even if a FHC is not directly liable for the activities of its subsidiary, it may still provide financial support to its subsidiary in the event of an environmental catastrophe.[1561] Second, the FRB observed that confidence in an FHC could be severely undermined if it were perceived as being linked to an environmental catastrophe, which in turn could "limit its access to funding markets until the extent of the FHC's liability is assessed."[1562] By applying the new 5 percent cap for physical commodity activities engaged in under any authority, the FRB hopes to more adequately address safety and soundness risks posed by physical commodities.[1563] The FRB also argues that codifying existing prohibitions on FHCs' operating entities engaged in physical commodities activities will reduce the likelihood that an FHC parent company would be exposed to its subsidiary's liabilities.[1564]

[1557] *Id.*
[1558] *Id.* at 67,233–34.
[1559] *Id.* at 67,220–34.
[1560] *See id.* at 67,221–22 (claiming that covered physical commodities carry significant liability risk "rang[ing] from hundreds of millions to tens of billions of dollars").
[1561] *See, e.g.*, *id.* at 67,222 (highlighting British Petroleum's ultimate parent company's contributions to its affiliates from the Deepwater Horizon oil spill).
[1562] *Id.* at 67,224.
[1563] *Id.* at 67,225–26.
[1564] *Id.* at 67,221–22, 67,226 (noting the potential for liability in veil piercing actions and suggesting new regulation designed to prevent such a finding).

In regards to the new heightened risk weights, the FRB has argued that the risk weights will more accurately reflect the risk posed by holding the assets on an FHC's books.[1565] It claims that heightened capital requirements will require FHCs engaged in commodity trading to build and maintain capitalization levels "roughly comparable to that of nonbank commodities trading firms."[1566]

In its proposal to rescind FHC authority to engage in energy management services and tolling activities, the FRB explained that those activities are not closely connected to financial activities and thus are not permissible FHC activities.[1567] "Unlike physical commodity trading, energy management services and energy tolling do not directly support and are not directly related to engaging in otherwise BHC-permissible [activities]."[1568] Furthermore, the FRB notes that the benefits of such activities do not appear to warrant the extension of FHC authority.[1569]

Removing copper from the list of precious metals is appropriate, the FRB argues, due to its principal use is as an industrial metal.[1570] The primary distinction the FRB makes between metals that are typically classified as "precious metals" and "base" or "industrial" metals is that the former is traditionally used as a store of value and traded internationally for their exchange of value, while the latter is primarily traded for its industrial use.[1571] The FRB also notes that this classification will be consistent with the OCC's classification of copper.[1572]

[1565] *Id*. at 67,226–27.

[1566] *Id*. at 67,227. Capitalization refers to the amount of dollars a bank must set aside in order to hold certain assets on its books. *Id.*

[1567] *Id*. at 67,231. Energy tolling refers to the practice of "paying a power plant owner fixed periodic payments that compensate the owner for its fixed costs in exchange for the right to all or part of the plant's power output." *Id.*

[1568] *Id*. at 67,223, 67,231.

[1569] *See id*. at 67,231 (addressing the fact that FHCs have other options for effectively hedging its client's positions in energy and that involvement in energy does not appear to enhance an FHCs understanding of derivatives markets).

[1570] *Id*. at 67,232.

[1571] *Id*. at 67,232–33 n.88.

[1572] *Id*. at 67,233 (comparing the Federal Reserve's proposed classification with the OCC's classification); Industrial and Commercial Metals, 81 Fed. Reg. 96,353, 96,354 & 96,361 (Dec. 30, 2016) (reclassifying and prohibiting national banks from dealing in copper).

Finally, regarding reporting requirements, the FRB explains that the new schedule requirements would provide both the FRB and the public with information that would help enhance the understanding the effect FHCs have on physical commodity markets.[1573] In addition, the new disclosure requirements in schedules HC–W and HC–R are consistent with other reporting requirements for regulatory capital.[1574]

C. The U.S. Chamber's Objections

1. The Importance of Merchant Banking and Liquid Commodity Markets

In its January 5, 2017 letter to Secretary Frierson, the U.S. Chamber argued that the proposed restrictions on physical commodities would have unintended consequences of reducing competition and market liquidity, and ultimately harming investment in the physical commodities market and "the end-user's ability to efficiently and effectively manage risk."[1575] The U.S. Chamber suggested that these consequences would not only be contained to the physical commodities market, but also would undermine the growth of the real-world economy and threaten the success of "Main Street America."[1576] The U.S. Chamber maintained that before implementing the proposed rule, the FRB needed to consider the its impact on end-users and "commodity-linked derivatives."[1577]

2. GLBA and Congressional Intent

The U.S. Chamber also argued that the proposed rule contradicts the intent of the Gramm-Leach-Bliley Act (GLBA) amendments to the BHCA and would have adverse effects on the commodities market.[1578]

[1573] Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,234.
[1574] *Id.* (recognizing that the public disclosure for these schedules are consistent with international standards under Basel III); *see* 12 C.F.R. § 3.172 (2016) (requiring disclosure of capital levels for national banks and Federal savings associations).
[1575] Letter from U.S. Chamber, *supra* note 2, at 3.
[1576] *Id.* at 4.
[1577] *Id.*
[1578] 12 U.S.C. §1843(k) (2010) (amending the BHCA to allow FHCs to engage in activities that are "complementary to financial activities that do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally"); *see* Letter from U.S. Chamber, *supra* note

The U.S. Chamber contends that the proposed rule is an attempt to implement FRB's suggestion to Congress of repealing merchant banking authority and commodity activities by imposing prohibitive risk-weights on assets acquired under those authorities.[1579] In effect, the U.S. Chamber argues that the FRB is second-guessing Congress' decision to allow FHCs to engage in merchant banking activities by imposing risk-weights that penalize FHCs that engage in "legitimate merchant banking activities."[1580]

Importantly, the U.S. Chamber notes that the FRB has recognized that no risk undertaken pursuant to Section 4(o) authority has ever resulted in a severe loss, and therefore the FRB cannot justify its 1,250 percent risk weight imposed on Section 4(o) activities.[1581] U.S. Chamber argues that the Section 4(o) risk weight is unnecessary because FHCs have responded to the financial crisis by reducing their physical commodity activities and a 1,250 percent risk-weight would serve to force more FHCs out of the physical commodity market.[1582]

The U.S. Chamber maintains that if the rule were finalized without change, the Section 4(o) risk weight would result in more FHCs relying on Section 4(k) authority, but the proposed rule would further restrict FHCs in this regard by accounting for more physical commodities as part of the 5 percent limit of tier one capital.[1583] By both increasing the risk-weight of physical commodities and accounting for a greater range of authorities to transact in physical commodities for purposes of the 5 percent limit, FHCs would be forced to significantly reduce their involvement in the physical commodities markets, resulting in "reduc[ed] end-user access to competitive transaction pricing."[1584] Since there would be less FHC involvement in the

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1579 Letter from U.S. Chamber, *supra* note 2, at 4–5; *see* 620 Report, *supra* note 4, at 28 (suggesting the repeal of section 4(o) and merchant banking authority).

1580 Letter from U.S. Chamber, *supra* 2, at 2.

1581 *Id.* at 5; *c.f.*, Notice of Proposed Rulemaking, 81 Fed. Reg. at 67,222, 67,224–25 (providing the Deepwater Horizon oil spill as an example of significant liability exposure that the FRB is concerned may reach a FHC).

1582 Letter from U.S. Chamber, *supra* note 2, at 5–6.

1583 *Id*. at 6.

1584 *Id*.; *see, e.g.,* Gregory Meyer and Neil Hume, *Morgan Stanley in Talks to Sell Oil Tanker Stake*, FIN. TIMES (Jan. 8, 2017), https://www.ft.com/content/1d8d8af0-d436-11e6-9341-7393bb2e1b51 [https://perma.cc/S4DB-PD6M] (demonstrating the response of large FHCs to the FRB's proposed physical commodities markets, the reduced competition in the market would result in more concentrated risk, leading to higher prices and ultimately a less efficient market.[1585]

In response to the FRB's concerns that FHCs could be held liable in a corporate veil piercing action, the U.S. Chamber responds that no FHC has ever been held liable under such a theory.[1586] Furthermore, the U.S. Chamber responds to the FRB's suggested repeal of merchant banking authority by arguing that such a repeal would adversely affect non-financial companies because it would reduce "access [to] efficient, transparent, liquid markets for managing their day-to-day physical commodity and related hedging needs."[1587] The U.S. Chamber reasons that because the FRB is weighing only a hypothetical, unrealized risk of potential liability from physical commodity activities against the quantifiable benefits of merchant banking activities, the proposed restrictions on Section 4(k) authority are arbitrary and capricious and "fail to take into account factors that can damage the overall economy."[1588]

3. Risks and Costs for End-Users and the Financial Markets

The U.S. Chamber further anticipates that the suggested measures by the FRB would create challenges for end-users of physical commodities by limiting the number of market participants and generating greater market illiquidity.[1589] As a result of the strain on liquidity, the U.S. Chamber predicts end-users that rely on sophisticated counterparties will face more concentrated risk in the commodities market, which will result in higher prices for both the end-users and their customers.[1590] The U.S. Chamber maintains that increased restrictions on physical commodity activities would cause "decreased or unfair competition,' and an 'undue concentration of

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regulation).

[1585] *See* Letter from U.S. Chamber, *supra* note 2, at 8–9.

[1586] *Id*. at 7.

[1587] *Id*.

[1588] *Id*. at 6–7.

[1589] *Id*. at 8; *see, e.g.,* Catherine Ngai and Olivia Oran, *Barclay's' Exit from Energy Trading Stirs Concerns Over Liquidity*, REUTERS (Dec. 6, 2016), http://www.reuters.com/article/us-usa-oil-barclays-bk-idUSKBN13U2MW [https://perma.cc/A4MM-99JG] .

[1590] Letter from U.S. Chamber, *supra* note 2, at 8.

resources' in the remaining [firms,] thereby result[ing] in a loss of market efficiency."[1591]

4. Reviewing Regulatory Impact on Business Capital Formation

The U.S. Chamber concludes by suggesting that before enacting new regulations of physical commodities, the FRB should undertake a comprehensive review of the effect current financial regulation has on capital markets.[1592] The aim of the review would be to "(1) [determine] how all of these initiatives will interact and work together; (2) determine the impacts of these initiatives upon the broader macroeconomy; and (3) use modeling techniques to "war-game" these new regulatory structures identify faults and shape comprehensive fixes."[1593] The U.S. Chamber believes that by studying these measures and determining how these regulations impact the macro-economy, the FRB would be able to evade potential negative consequences of new regulations.[1594]

In addition, the U.S. Chamber noted that the FRB ought to comply with a variety of regulations that require the agency to examine the impact of proposed regulation, such as the regulatory burden that small entities will be required to bear as a result of the new regulation and the cost-benefit analysis of the proposed rule.[1595]

D. Other Important Positions

Several trade associations whose members deal in physical commodities, including the National Mining Association, Natural Gas Supply Association, and the American Public Gas Association, have

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[1591] *Id*. at 8–9 n.9.

[1592] *Id*. at 10–11 (suggesting the FRB review the effects that the Leverage Ratio Framework, Net Stable Funding Ratio, Liquidity Coverage Ratio, Globally Systemically Important Bank Capital Surcharge, the Volcker Rule, Money Market Funds reforms, Total Loss Absorbing Capacity proposal, Countercyclical Capital Buffer, and Single Counterparty Credit Limits have on the financial sector and capital formation).

[1593] *Id*. at 11.

[1594] *See id*.

[1595] *Id*. at 11–13 (claiming that the FRB should comply with several regulations including the Regulatory Flexibility Act, the Paperwork Reduction Act, the Small Business Regulatory Enforcement Fairness Act, the Riegle Act, and Executive Order 13563).

concurred with the U.S. Chamber's view that imposing the proposed limits on FHCs in the physical commodities market would harm the end-users of commodities and restrict market liquidity.[1596] Some energy producers have noted that despite the proposed rules concern for environmental liability, by limiting FHC involvement in the physical commodities market, the regulation may have the inadvertent effect of inhibiting the growth of clean energy sources.[1597]

Goldman Sachs and Morgan Stanley have been retreating from the physical commodities business since the rule was first proposed.[1598] In a letter to the FRB, Goldman Sachs Executive Vice President, John F.W. Rogers, made similar arguments to those of the U.S. Chamber—namely that the proposed rule would impose significant costs to end-users of physical commodities and that the rule contradicts Congressional intent with respect to FHC involvement in the physical commodities markets.[1599] Additionally, Mr. Rogers argued that under the current proposal, the risk-weights applied to covered physical commodities created situations that did not consistently reflect the risks associated with holding those commodities.[1600] As a solution, the

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[1596] *See, e.g.*, Letter from Amanda E. Aspatore, Nat'l Mining Assoc'n to Sec'y Robert DeV. Frierson, Bd. of Governors of Fed. Res. Sys. (Dec. 9, 2016) (on file with author) (arguing that the proposed changes would have adverse consequences for "upstream producers such as mining companies"); Letter from Jennifer Fordham, Nat. Gas Supply Ass'n to Sec'y Robert DeV. Frierson, Bd. of Governors of Fed. Res. Sys. (Dec. 15, 2016) (on file with author) (claiming the proposed rule would restrict liquidity and increase hedging costs for end-users, including natural gas market participants); Letter from Dave Schryver, Am. Pub. Gas Ass'n to Sec'y Robert Dev. Frierson, Bd. of Governors of Fed. Res. Sys. (Dec. 19, 2016) (on file with author) (contending that the participation of large banks is critical for public gas systems to have effective counterparties).

[1597] *See, e.g.*, Letter from Tom Vinson, Am. Wind Energy Ass'n to Sec'y Robert DeV. Frierson, Bd. of Governors of Fed. Res. Sys. (Dec. 19, 2016) (on file with author) (explaining that wind energy producers rely on investments by FHCs made pursuant to their merchant banking authority); Letter from Jennifer Fordham, Nat. Gas Supply Ass'n to Sec'y Robert DeV. Frierson, Bd. of Governors of Fed. Res. Sys. 4 (Dec. 15, 2016) (on file with author) (arguing that natural gas is an effective source of carbon emission reduction and an "environmental boon").

[1598] *See* Hamilton, *supra* note 6.

[1599] Letter from John F.W. Rogers, Goldman Sachs Grp., Inc., to Bd. of Governors of the Fed. Res. Sys. (Feb. 21, 2017) (on file with author).

[1600] *Id*. at 5–6.

letter urges the FRB to conduct "in-depth empirical and qualitative studies to assess the potential impacts and to carefully consider the potential loss in the expertise and availability of physical commodities services [by sophisticated FHCs.]"[1601]

However, one environmental organization, Amazon Watch, applauds the FRB's decision to impose limits on FHCs that hold investments in physical commodities and contends that additional limitations need to be added to prevent FHCs from dealing in physical commodities entirely.[1602] A group of U.S. Senators, including Sherrod Brown, Jeff Merkley, and Jack Reed, have also voiced their support of the FRB's proposal for addressing potential risks to the stability of the financial system and suggested additional areas where the regulation could be improved in the future.[1603]

E. Conclusion

The proposed rule would bring new limitations to the FHCs' investments in the physical commodities market and impose new disclosure requirements.[1604] While some commentators have contended that the rule will push FHCs out of the business of physical commodities and lead to a liquidity shortage,[1605] others have contended that the benefits of restricting FHCs would outweigh the costs to the market.[1606] Though some FHCs have responded by retreating from physical commodities investments, it is unclear whether the implementation of the proposed rule would significantly limit access to physical commodities for end-users.[1607] It is also unclear whether

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[1601] *Id*. at 3.

[1602] Letter from Leila Salazar-Lopez, Amazon Watch to Sec'y Robert DeV. Frierson, Bd. of Governors of Fed. Res. Sys. (Dec. 20, 2016) (on file with author).

[1603] Letter from Senators Sherrod Brown, Jeff Merkley, and Jack Reed to Chair Janet L. Yellen, Bd. of Governors of Fed. Res. Sys. (Feb. 9, 2017) (on file with author).

[1604] *See* discussion *supra* Section A (outlining the provisions of the proposed rule).

[1605] *See* discussion *supra* Sections C, D (detailing on the U.S. Chamber's position and summarizing positions opposing the proposed rule).

[1606] *See* discussion *supra* Sections B, D (discussing both environmental benefits and benefits to the financial system generally).

[1607] *Compare* Neil Hume, *JP Morgan Has Not 'Exited Physical Commodities' Despite Sale*, FIN. TIMES (Nov. 3, 2014), https://www.ft.com/content/00a2ae9e-60e7-11e4-894b-00144feabdc0 [https://perma.cc/5EGT-3T3J] (indicating the rule will be finalized under the Trump administration, which has pushed for reduced regulation in the financial sector.[1608]

John Ayers-Mann[1609]

that despite reducing certain aspects of JP Morgan's physical commodities trade, it is not exiting the market); *with* Meyer, *supra*, note 45 (discussing Morgan Stanley's potential sale of an oil tanker).

1608 *See* Gregory Meyer, *Goldman Warns Federal Reserve Over Commodity Trading Rules Fallout*, FIN. TIMES (Feb. 22, 2017), https://www.ft.com/content/8f345610-f91c-11e6-bd4e-68d53499ed71 [https://perma.cc/QQ48-MG4U].

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