

standards for cooking products, and submit comments to DOE.

In view of the request for a comment period extension for the September 2016 SNOPR, DOE has determined that a 30-day extension of the public comment period for the September 2016 SNOPR is appropriate. The comment period is extended until November 2, 2016. DOE further notes that any submissions of comments or other information submitted between the original comment end date and the extension of the comment period will be deemed timely filed.

DOE also notes that, in response to the August 2016 TP SNOPR, it received a number of comments pertaining to the test procedure that impact the proposed standard levels from the September 2016 SNOPR.<sup>1</sup> Based on these comments and the extension of the comment period, DOE has identified additional information and data it is seeking that would be beneficial for the analysis in support of the standards rulemaking.

Sub-Zero Group, Inc. commented that the proposed test procedure and standards do not take into account design features associated with commercial-style gas cooking tops that impact efficiency, including:

- High input rate burners with large diameters and high controllability of the flame, for quicker heat-up times as well as the ability to simmer foods such as chocolates and sauces;
- Heavy cast iron grates for better heat distribution and strength to support large loads;
- Greater distance from the burner to the grate for heat distribution and reduction of carbon monoxide; and
- Larger open area for primary and secondary air for combustion and exhaust of combustion byproducts.

DOE welcomes data showing how these design factors affect the measured annual energy consumption relative to the proposed standard levels. As noted in the September 2016 SNOPR, DOE selected the proposed standard level for gas cooking tops to maintain the full functionality of cooking tops marketed as commercial-style and noted that commercial-style gas cooking tops are available on the market that meet the proposed efficiency level. 81 FR 60784, 60817, 60865. As a result, DOE is also seeking data specifically on the efficiency of commercial-style products relative to the proposed standard level and the design changes that would be

needed if these products cannot meet the proposed standard levels. DOE is also seeking test data showing how the design differences for commercial-style cooking tops impact cooking performance relative to residential-style products.

AHAM and GE Appliances, a Haier Company (GE) also objected to the proposed test method for determining the standby power consumption of combined cooking products (*i.e.*, household cooking appliances that combines a conventional cooking top and/or conventional oven with other appliance functionality, which may or may not include another cooking product). GE urged DOE to consider adopting for conventional cooking tops the same prescriptive design requirement for the power supply that was proposed for conventional ovens. DOE welcomes comments on the merits of the approach of adopting a prescriptive standard for the power supply for conventional cooking tops, including data on combined cooking products.

AHAM and GE also expressed concern regarding the proposed requirement to test each unique size setting of multi-ring surface units. AHAM and GE stated that multi-ring elements provide consumers the ability to adjust the element size to the size of the cookware, which in turn saves energy. AHAM and GE noted that because the inner elements of multi-ring surface units operate at lower efficiency, the proposed test procedure could result in the elimination of multi-ring elements. DOE welcomes data comparing available surface element diameters and cooking top energy use for cooking tops with multi-ring surface units and those that do not have this feature.

Issued in Washington, DC, on September 23, 2016.

**Kathleen B. Hogan,**

*Deputy Assistant Secretary for Energy Efficiency, Energy Efficiency and Renewable Energy.*

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## FEDERAL RESERVE SYSTEM

### 12 CFR Parts 217 and 225

[Docket No. R-1547]

RIN 7100 AE-58

#### **Regulations Q and Y; Risk-Based Capital and Other Regulatory Requirements for Activities of Financial Holding Companies Related to Physical Commodities and Risk-Based Capital Requirements for Merchant Banking Investments**

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Board is seeking comment on a proposal to adopt additional limitations on physical commodity trading activities conducted by financial holding companies under complementary authority granted pursuant to section 4(k) of the Bank Holding Company Act and clarify certain existing limitations on those activities; amend the Board's risk-based capital requirements to better reflect the risks associated with a financial holding company's physical commodity activities; rescind the findings underlying the Board orders authorizing certain financial holding companies to engage in energy management services and energy tolling; remove copper from the list of metals that bank holding companies are permitted to own and store as an activity closely related to banking; and increase transparency regarding physical commodity activities of financial holding companies through more comprehensive regulatory reporting.

**DATES:** Comments must be received on or before December 22, 2016.

**ADDRESSES:** You may submit comments, identified by Docket No. R-1547 and RIN 7100 AE-58 by any of the following methods:

- **Agency Web site:** <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.aspx>.
- **Federal eRulemaking Portal:** <http://www.regulations.gov>. Follow the instructions for submitting comments.
- **Email:** [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov). Include the docket number and RIN number in the subject line of the message.
- **Fax:** (202) 452-3819 or (202) 452-3102.
- **Mail:** Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and

<sup>1</sup> These comments are available in the conventional cooking products test procedure docket at <https://www.regulations.gov/docket?D=EERE-2012-BT-TP-0013>.

Constitution Avenue NW., Washington, DC 20551.

All public comments will be made available on the Board's Web site at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.aspx> as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper form in Room 3515, 1801 K Street NW. (between 18th and 19th Streets NW.), Washington, DC 20006 between 9:00 a.m. and 5:00 p.m. on weekdays. For security reasons, the Board requires that visitors make an appointment to inspect comments. You may do so by calling (202) 452-3684. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

#### FOR FURTHER INFORMATION CONTACT:

*Board:* Constance M. Horsley, Assistant Director, (202) 452-5239, Elizabeth MacDonald, Manager, (202) 475-6316, Kevin Tran, Supervisory Financial Analyst, (202) 452-2309, or Vanessa Davis, Supervisory Financial Analyst, (202) 475-6674, Division of Banking Supervision and Regulation; or Laurie Schaffer, Associate General Counsel, (202) 452-2277, Michael Waldron, Special Counsel, (202) 452-2798, Will Giles, Counsel, (202) 452-3351, or Mary Watkins, Attorney, (202) 452-3722, Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets NW., Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf (TDD), (202) 263-4869.

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## I. Introduction

### A. Background

Bank holding companies (BHCs) and their subsidiaries engage in certain types of physical commodity activities under a variety of authorities. Pursuant to the Bank Holding Company Act (BHC Act), BHCs may engage in activities that are “so closely related to banking as to be a proper incident thereto.”<sup>1</sup> This authority allows BHCs to buy, sell, or hold precious metals, such as gold, silver, platinum, and palladium; participate as a principal in cash-settled derivative contracts based on commodities; and trade in commodity derivatives that allow for physical settlement under certain circumstances.

In the Gramm-Leach-Bliley Act (GLB Act) enacted in 1999, Congress expanded the activities in which a BHC may engage.<sup>2</sup> The GLB Act permits BHCs that are well capitalized and well managed to elect to become financial holding companies (FHCs) and engage in a broader range of activities than permitted for BHCs that are not FHCs. Three provisions of the GLB Act permit FHCs to conduct a broader range of physical commodity activities and investments than are otherwise permitted for BHCs. First, the GLB Act permits FHCs to engage in any activity that the Board (in its sole discretion) determines is complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or

the financial system generally.<sup>3</sup> Pursuant to this authority, the Board has authorized certain FHCs to engage in physical commodity trading as well as energy management services and energy tolling. The GLB Act also added a grandfather provision that permits certain FHCs to continue to engage in a broad range of physical commodity activities.<sup>4</sup> Finally, the GLB Act authorizes FHCs to make merchant banking investments in any type of nonfinancial company, including a company engaged in activities involving physical commodities.<sup>5</sup>

### B. Risks Associated With Physical Commodity Activities

There are a number of potential legal, reputational and financial risks associated with the conduct of physical commodity trading activities. Over the past decade, monetary damages associated with an environmental catastrophe involving physical commodities have ranged from hundreds of millions to tens of billions of dollars. These damages can exceed the market value of the physical commodity involved in the catastrophic event, and can exceed the committed capital and insurance policies of the organization. Certain federal environmental laws, including the Oil Pollution Act of 1990 (OPA),<sup>6</sup> the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA),<sup>7</sup> and the Clean Water Act (CWA),<sup>8</sup> generally impose liability on owners and operators of facilities and vessels for the release of physical commodities, such as oil, distillate fuel oil, jet fuel, liquefied petroleum gas, gasoline, fertilizer, natural gas, and propylene.<sup>9</sup> Consequently, a company that directly owns an oil tanker or petroleum refinery that releases crude oil in a navigable waterway or adjoining shoreline in the United States may be liable for removal costs and damages for that release under the OPA.<sup>10</sup>

<sup>3</sup> See Gramm-Leach-Bliley Act § 103, 12 U.S.C. 1843(k)(1)(B).

<sup>4</sup> 12 U.S.C. 1843(o).

<sup>5</sup> 12 U.S.C. 1843(k)(4)(H).

<sup>6</sup> See 33 U.S.C. 2701-02.

<sup>7</sup> See 42 U.S.C. 9607.

<sup>8</sup> See 33 U.S.C. 1321. In general, liability under the OPA, CWA, and CERCLA is subject to limited defenses, including releases caused by an act of God. See, e.g., 33 U.S.C. 2703; 42 U.S.C. 9607.

<sup>9</sup> See 33 U.S.C. 1321, 2701 (defining “oil”), 42 U.S.C. 7412, 9601 (defining “hazardous air pollutant” and “hazardous substance,” respectively).

<sup>10</sup> See 33 U.S.C. 2702. The OPA generally limits liability for spills from facilities to \$350,000,000 and liability from spills from vessels to the greater of \$1,900 per gross ton or \$22,000,000. *Id.* at 2704.

<sup>1</sup> See 12 U.S.C. 1843(c)(8). In addition, national banks owned by BHCs may engage in certain limited types of physical commodity activities pursuant to authority granted under the National Bank Act. State-chartered banks also may be authorized to engage in the same activities under state statutes.

<sup>2</sup> Public Law 106-102, 113 Stat. 1338 (1999).

In addition to Federal environmental law, state environmental laws separately impose liability for the harmful or unauthorized release of an environmentally sensitive commodity.<sup>11</sup> Like Federal environmental law, many states impose strict liability for damages from the unauthorized release of specified harmful substances on the owners and operators of the facility or vessel from which the discharge occurred. Many states also impose liability based on the causal connection between a party's actions and the prohibited release.<sup>12</sup> Some state statutes also impose strict liability directly on owners of the covered substance for damages caused by, and/or cleanup and removal costs incurred as a result of, the release of the substance.<sup>13</sup> State common law tort doctrines may also provide additional bases for liability for environmental harm, such as negligence, trespass, and nuisance.<sup>14</sup>

State laws also allow for the assignment of the liability of one company to its parent and/or another affiliated company even if the affiliated company did not directly participate in the wrongdoing. This concept of "piercing the corporate veil" is an exception to the general rule in corporate law that a parent company is not liable for the acts of its subsidiaries, and may be applied when the affiliated

entity exercises a high degree of control over the liable company.<sup>15</sup> Courts typically require multiple indicia of control before assigning liability to the parent or affiliated company.<sup>16</sup> Common indicia include managing day-to-day operations, undercapitalizing subsidiaries, and commingling of assets, employees, legal advice, accounting, or office space.<sup>17</sup> Courts have also used the concept of veil piercing to assign liability under Federal environmental law.<sup>18</sup>

Further, even if a parent company is not assigned liability through a veil piercing action, the parent company may provide support to affiliated entities involved in an environmental catastrophe to limit reputational damage or as a condition to a settlement agreement. For example, BP p.l.c., the ultimate parent company of BP Exploration & Production, Inc. and BP Corporation North America, Inc., guaranteed the payment of more than \$20 billion as part of a consent decree resolving claims against its subsidiaries resulting from the Deepwater Horizon oil spill.<sup>19</sup>

<sup>15</sup> See, e.g., *See William Passalacqua Builders, Inc. v. Resnick Developers South, Inc.*, 933 F.2d 131, 137–141 (2d Cir. 1991); *Berkey v. Third Avenue Ry. Co.*, 244 N.Y. 84, 155 NE. 58 (1926), (holding that "domination must be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent . . ."); *Fletcher Cyclopedia of the Law of Corporations* 41.30–.60 (rev. ed. 2006). See also Letter from the Securities Industry and Financial Markets Association et al., dated April 16, 2014, Appendix B, pg. 41 (SIFMA Comment Letter). Other courts have articulated the first prong of this inquiry—whether there was domination—as an inquiry into whether the two companies operated as a single economic unit or alter ego. See *Fletcher v. ATEX, Inc.*, 68 F.3d 1451, 1457 (1995); *NetJets Aviation, Inc. v. LHC Communications, LLC*, 537 F.3d 168, 176 (2d Cir. 2008).

<sup>16</sup> See *William Passalacqua Builders, Inc. v. Resnick Developers South, Inc.*, 933 F.2d 131, 137–141 (2d Cir. 1991); *United States v. Golden Acres, Inc.*, 702 F. Supp. 1097, 1104 (D. Del. 1988) aff'd 879 F.2d 860, 1104 (3d Cir. 1989). See also *Harco Nat. Ins. Co. v. Green Farms, Inc.*, 15 Del. J. Corp. L. 1030, 1038–1040 (Del. Ch. 1989).

<sup>17</sup> See, e.g., *United States v. Golden Acres, Inc.*, 702 F. Supp. at 1104; *New York State Elec. and Gas Corp. v. First Energy Corp.*, 766 F.3d 212, 224–227 (2d Cir. 2014); *William Passalacqua Builders, Inc. v. Resnick Developers South, Inc.*, 933 F.2d 131, 137–141 (2d Cir. 1991).

<sup>18</sup> See, e.g., *United States v. Bestfoods*, 524 U.S.C. 51, 63–64 (1998); *AT&T Global Info. Solutions Co. v. Union Tank Car Co.*, 29 F.Supp.2d 857, 869 (S.D. Oh. 1998).

<sup>19</sup> *U.S. v. BP Exploration & Production Inc., et al.*, No. 10–4536 in MDL 2179 (E.D. La.) Consent Decree among defendant BP Exploration & Production Inc., The United States of America, and the States of Alabama, Florida, Louisiana, Mississippi, and Texas, Document 16093, Appendix 9, available at [http://www.laed.uscourts.gov/sites/default/files/OilSpill/4042016ConsentDecree\\_0.pdf](http://www.laed.uscourts.gov/sites/default/files/OilSpill/4042016ConsentDecree_0.pdf). See also <https://www.justice.gov/enrd/deepwater-horizon>.

### C. Limitations on Physical Commodity Activities

To help address these risks, the Board placed a number of limitations, discussed below, on the physical commodity activities it has authorized under the GLB Act.

**Section 4(k)(1)(B) Complementary Authority.** The GLB Act added section 4(k)(1)(B) to the BHC Act to permit an FHC to engage in activities that the Board determines to be complementary to a financial activity (complementary authority). The provision's purpose was to allow the Board to permit FHCs to engage in an activity that appears to be commercial rather than financial in nature, but that is meaningfully connected to a financial activity such that it complements the financial activity.<sup>20</sup> When determining that an activity is complementary to a financial activity for an FHC, the Board must find that the activity does not pose a substantial risk to the safety and soundness of depository institution subsidiaries of the FHC or the financial system generally.<sup>21</sup> In addition, the Board is required to consider whether performance of the activity 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 interest, or unsound banking practices.<sup>22</sup>

Under this authority, the Board has approved the requests of a limited number of FHCs to engage in three complementary activities related to physical commodities: (1) Physical commodity trading involving the purchase and sale of commodities in the spot market, and taking and making delivery of physical commodities to settle commodity derivatives (physical commodity trading);<sup>23</sup> (2) providing transactions and advisory services to power plant owners (energy

<sup>20</sup> *Citigroup Inc.*, 89 Fed. Res. Bull. 508 (2003), note 8 and related text ("2003 Citi Order").

<sup>21</sup> 12 U.S.C. 1843(k)(1)(B).

<sup>22</sup> 12 U.S.C. 1843(j)(2).

<sup>23</sup> See Board orders regarding *Citigroup Inc.*, 89 Fed. Res. Bull. 508 (2003); *Fortis S.A./N.V.*, 94 Fed. Res. Bull. C20 (2008); *Société Générale*, 92 Fed. Res. Bull. C113 (2006); *Deutsche Bank AG*, 91 Fed. Res. Bull. C54 (2005); *JPMorgan Chase & Co.*, 91 Fed. Res. Bull. C57 (2005); *Barclays Bank PLC*, 90 Fed. Res. Bull. 511 (2004); *UBS AG*, 90 Fed. Res. Bull. 215 (2004); and *The Royal Bank of Scotland Group plc*, 94 Fed. Res. Bull. C60 (2008). See also Board letters regarding Bank of America Corporation (April 24, 2007), BNP Paribas (August 31, 2007), Credit Suisse Group (March 27, 2007), Fortis S.A./N.V. (September 29, 2006), Wachovia Corporation (April 13, 2006), Bank of Nova Scotia (February 17, 2011).

However, the OPA liability cap will not apply if the party engaged in certain types of misconduct (e.g., willful misconduct, gross negligence, violation of Federal safety regulation, failure to report incident). *Id.*

<sup>11</sup> The OPA, CERCLA, and CWA explicitly state that the statutes do not preempt state laws imposing additional liability or requirements with respect to the discharge of hazardous substances. 33 U.S.C. 1312(o), 2718(a); 42 U.S.C. 9614(a).

<sup>12</sup> N.J. Admin. Code tit. 7, section 1E:1.6; *State v. Montayne*, 604 N.Y.S.2d 978 (N.Y. App. Div. 1993) (finding an oil broker liable under New York Navigation Law section 181 because the broker was contractually obligated to provide the oil and specify the means of its delivery even though the broker did not own the oil and had used third parties to move and store the oil). See also *N.J. Dep't of Env'tl. Prot. v. Dimant*, 212 N.J. 153, 177, 51 A.3d 816 (2012) (summarizing prior state cases to require some connection between the discharge complained of and the alleged discharger); *Authority of New Brunswick v. Suydam Investors*, 826 A.2d 673, 683 (N.J. 2003) (suggesting that such causal liability under New Jersey law should be read to impose liability on persons responsible for the discharge of the substance).

<sup>13</sup> See, e.g., Alaska Stat. section 46.03.822; Cal. Gov't Code §§ 8670.3, 8670.56.5; Fla. Stat. section 376.12 (imposing liability for cleanup costs on the owner of the covered substance but only if the owner and operator of the facility or vessel do not pay such costs and such parties were not in compliance with the financial security requirements of the statute at the time of the release); Md. Envir. Code Ann. § 4–401; Or. Rev. Stat. § 468B.310; Wash. Rev. Code Ann. section 90.56.370.

<sup>14</sup> Restatement (Second) of Torts sections 158, 165, 390, 822, 825, 826.

management services);<sup>24</sup> and (3) 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 (energy tolling).<sup>25</sup> Together, these three activities are referred to as complementary commodity activities.

The Board placed certain restrictions on each complementary commodity activity to protect against the risks the activity could pose to the safety and soundness of the FHC, any of its insured depository institution (IDI) subsidiaries, and the U.S. financial system. For example, the Board limited the size of these activities by imposing limits on the amount of assets or revenue that an FHC could have committed to complementary commodity activities. Specifically, the aggregate market value of commodities held under physical commodity trading and energy tolling may represent no more than 5 percent of the tier 1 capital of the FHC. The Board also imposed a cap on energy management services of no more than 5 percent of an FHC's consolidated operating revenues. To help protect against dealing in illiquid commodities, the Board also limited the physical commodity trading authority to only physical commodities approved by the Commodity Futures Trading Commission (CFTC) for trading on a U.S. futures exchange (unless specifically excluded by the Board) or commodities the Board otherwise approves.<sup>26</sup>

The Board also prohibited FHCs from owning, operating, or investing in facilities that extract, transport, store, or alter commodities under complementary authority. FHCs also are required to ensure that the third-party contractors hired to store, transport, and otherwise handle the physical commodities of the FHC are reputable.

*Section 4(o) Grandfather Authority.* In the GLB Act, Congress amended the BHC Act to allow certain companies to continue to engage in a broad range of activities involving physical commodities if these companies subsequently became FHCs.<sup>27</sup> Under section 4(o) of the BHC Act, a company that was not a BHC prior to and becomes an FHC after November 12, 1999, may continue to engage in activities related to the trading, sale, or investment in commodities that were not permissible for BHCs as of September 30, 1997, if the company was engaged in the United States in any of such activities as of September 30, 1997 (section 4(o) grandfather authority).<sup>28</sup>

Section 4(o) grandfathered firms are permitted by statute to engage in a broader range of activities than firms that are limited to conducting physical commodity activities under complementary authority. This broader range of activities includes storing, transporting, extracting, and altering commodities. Section 4(o) imposes only two conditions on the conduct of activities: (i) The activities are limited to no more than 5 percent of the total consolidated assets of the FHC, and (ii) the FHC is prohibited from cross-marketing the services of its subsidiary depository institution(s) and subsidiary(ies) engaged in activities under the section 4(o) grandfather authority. The 5 percent of assets limit permits section 4(o) grandfathered FHCs to hold significantly larger amounts of a wider range of commodity-related assets than those FHCs that conduct commodities activities under complementary authority, which does not permit storage, transport, extraction or similar activities and imposes a stricter limit of 5 percent of tier 1 capital on the more limited class of commodity holdings that are permitted under complementary authority.

*Merchant Banking Authority.* The GLB Act also amended the BHC Act to allow FHCs to engage in merchant banking activities. Under section 4(k)(4)(H) of the BHC Act, FHCs may invest in nonfinancial companies as part of a bona fide securities underwriting or merchant or investment banking activity (merchant banking authority).<sup>29</sup> These investments may be made in any type of

ownership interest and in any type of nonfinancial company (portfolio company). The GLB Act imposes conditions on the merchant banking investment activities of FHCs. First, the investment must be part of "a bona fide underwriting or merchant or investment banking activity" and may not be held by an IDI or subsidiary of an IDI.<sup>30</sup> Second, an FHC making merchant banking investments must own or control a securities affiliate or a registered investment adviser that advises an affiliated insurance company.<sup>31</sup> Third, merchant banking investments must be held only "for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities."<sup>32</sup> Finally, an FHC may not routinely manage or operate the portfolio company "except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition."<sup>33</sup>

The Board's rules contain limitations that implement these statutory requirements. For example, Regulation Y prohibits FHCs in most cases from holding merchant banking investments for more than 10 years (or for more than 15 years for investments held in a qualifying private equity fund).<sup>34</sup> Further, Regulation Y limits the duration of routine management to the period necessary to address the cause of the FHC's involvement, to obtain suitable alternative management arrangements, to dispose of the investment, or to otherwise obtain a reasonable return upon the resale or disposition of the investment.<sup>35</sup> Additionally, an FHC must establish risk-management policies and procedures for its merchant banking activities, and policies and procedures that maintain corporate separateness between the FHC and its portfolio companies. Maintaining corporate separateness protects the FHC and its subsidiary IDIs from potential legal liability associated with the operations and financial obligations of the FHC's portfolio companies and private equity funds.<sup>36</sup> The Board's regulatory capital rule (Regulation Q) addresses merchant banking investments through risk-weighting in the equity framework.<sup>37</sup>

<sup>24</sup> See, e.g., *The Royal Bank of Scotland Group plc*, 94 Fed. Res. Bull. C60 (2008) (2008 RBS Order), and *Fortis S.A./N.V.*, 94 Fed. Res. Bull. C20 (2008) (2007 Fortis Order).

<sup>25</sup> Under energy tolling, the toller provides (or pays for) the fuel needed to produce the power that it directs the owner to produce. See, e.g., 2008 RBS Order. The agreements also generally provide that the owner will receive a marginal payment for each megawatt hour produced by the plant to cover the owner's variable costs plus a profit margin. *Id.* The plant owner, however, retains control over the day-to-day operations of the plant and physical plant assets at all times. *Id.*

<sup>26</sup> See 2003 Citi Order. In limited cases, the Board has permitted FHCs to take and make physical delivery of a non-CFTC-approved commodity if the FHC demonstrated that there is a market in financially-settled contracts on that commodity, the commodity is fungible, the commodity is liquid, and the FHC has in place trading limits that address concentration risk and overall exposure. See, e.g., 2008 RBS Order.

<sup>27</sup> See 12 U.S.C. 1843(o).

<sup>28</sup> 12 U.S.C. 1843(o). Two firms are authorized to engage in these activities: The Goldman Sachs Group, Inc. and Morgan Stanley, both of which became bank holding companies in 2008 and made successful elections to become financial holding companies at that time.

<sup>29</sup> *Id.* The statute grants similar authority to insurance companies that are FHCs or subsidiaries of FHCs. *Id.* at 1843(k)(4)(I).

<sup>30</sup> 12 U.S.C. 1843(k)(4)(H)(i), (ii).

<sup>31</sup> *Id.* at 1843(k)(4)(H)(ii).

<sup>32</sup> *Id.* at 1843(k)(4)(H)(iii).

<sup>33</sup> 12 U.S.C. 1843(k)(4)(H)(iv).

<sup>34</sup> See 12 CFR 225.172-173.

<sup>35</sup> 12 CFR 225.171(e). Regulation Y also imposes documentation requirements on these extraordinary management activities. *Id.*

<sup>36</sup> See also *id.* at 225.175(b).

<sup>37</sup> 12 CFR 217.52-53 and 217.153-154.

*D. Summary of the Advance Notice of Proposed Rulemaking (ANPR) and Comments on the ANPR*

Over the last 15 years, a number of FHCs have engaged in physical commodity activities pursuant to these authorities and the Federal Reserve has gained supervisory experience with the implementation of these restrictions. In addition, the Federal Reserve has monitored the connection between authorized physical commodity activities and financial activities, including derivative trading and hedging activities. The Board notes that after an initial growth of physical commodity activities of FHCs, the level of physical commodity activities at FHCs has generally declined.

In January 2014, as part of an ongoing review of the commodities activities of FHCs, the Board sought public comment on a variety of issues related to the unique and significant risks of physical commodity activities through an ANPR.<sup>38</sup> In the ANPR, the Board invited comment on whether additional prudential restrictions or limitations on commodities-related activities were appropriate to further mitigate the risks of those activities.

In light of the potential risks associated with physical commodity activities, the ANPR queried whether the current capital and insurance requirements adequately account for the degree and types of liabilities that would result from physical commodities in the event of an environmental catastrophe. The ANPR also sought comment on whether FHCs' vendor-approval processes and current industry safety policies and procedures are adequate in light of recent environmental disasters.<sup>39</sup>

Apart from direct and indirect financial liability, the ANPR observed that the public confidence in a holding company that was engaged in a physical commodity activity could suddenly and severely be undermined by an environmental disaster, as could the confidence in the company's subsidiary IDI or their access to funding markets. Financial companies, and in particular holding companies of IDIs, are particularly vulnerable to reputational damage in their banking operations. As a result, a catastrophic event involving an FHC could undermine confidence in the FHC's subsidiary bank or may limit its access to funding markets until the extent of the FHC's liability is assessed.

The Board received more than 180 unique comments and more than 16,900

form letters in response to the ANPR from end users of commodities (e.g., non-financial entities that use commodities in their operations or businesses), trade associations, public interest groups, academics, members of Congress, and other individuals. In general, comments from individuals, members of Congress and public interest groups opposed FHC involvement in physical commodity activities or supported additional restrictions on FHC involvement in physical commodities. In contrast, comments from end users, FHCs, and banking trade organizations were generally supportive of FHC involvement in physical commodity activities or opposed additional restrictions on these activities. Comments from insurance companies urged the Board to consider the differences between insurance companies and FHCs in terms of their business models, risks, and regulations.

*Risks of FHC participation in physical commodity activities.* Commenters that opposed FHC participation in physical commodity markets or that favored additional limitations on these activities argued that these activities pose risks to FHCs individually and to the financial system generally. These commenters generally described risks associated with physical commodity activities, including environmental risks, catastrophic risks, geopolitical risks (e.g., commodities activities conducted in regions experiencing political turmoil), compliance risks (e.g., bribery, environmental risks), and supply chain issues. Some of these commenters recommended that the Board prohibit trading in or ownership of commodities associated with catastrophic risk, strengthen prudential safeguards, or require additional capital in connection with such activities.

Many of these commenters expressed concern regarding the ability of FHCs to monitor these risks and questioned the ability of FHCs to insure or hedge against these risks. Some commenters argued that FHCs face a challenge in monitoring commodities risks because of the diverse nature of commodities activities and the number of federal agencies involved in commodities regulation. Some commenters contended that regulators face these same challenges in monitoring commodities risks. Those opposed to FHC participation in physical commodity markets expressed concern that excessive speculation in commodities markets, which they attributed in part to FHC involvement in these markets, causes market distortions.

Commenters that opposed FHCs engaging in physical commodity activities or that favored additional limitations on such activities expressed concern that FHCs have conflicts of interest in dealing with customers and enjoy an unfair competitive advantage. These commenters cited news articles alleging market manipulation by certain FHCs in the aluminum and copper markets. Some commenters also argued that the ability of FHCs to make proprietary trades and purchases of physical commodities may conflict with the interests of their customers. These commenters argued that FHCs may provide less favorable terms on products and services to customers when those customers compete with FHCs in the physical commodity markets. Finally, some commenters stated that the ability of FHCs to trade in physical commodity markets and own physical commodities provides an opportunity for FHCs to use information gleaned from their trading activities to manipulate financial markets.

Commenters in favor of FHC participation in the physical commodity markets or opposed to additional restrictions on these activities argued that FHC participation in these markets provides valuable and hard-to-replace services to end users of commodities. Some commented that FHCs were desirable counterparties in these markets because FHCs are well capitalized, well regulated, and familiar with their customers' businesses. Commenters commonly argued that the ability of FHCs to offer bespoke hedging arrangements to customers would not be possible without their participation in physical commodity activities. Commenters also cautioned that costs for end users would increase if FHCs exited physical commodity markets, including costs to municipalities and retail purchasers of commodities.

Some commenters contended that FHC involvement in physical commodity activities enhances liquidity and efficiency in physical commodity markets. Multiple commenters cited a correlation between recent reductions in wholesale power sales in California with the exit of certain FHCs from those markets. Commenters supportive of FHC participation in physical commodity activities stated that there was not sufficient evidence to substantiate the risks described in the ANPR. They responded by distinguishing events cited in the ANPR, like the Deepwater Horizon oil spill, from the exposures commonly faced by commodity traders both in terms of the extent of potential damages from an incident and the potential to be held financially

<sup>38</sup> See 79 FR 3329 (Jan. 21, 2014).

<sup>39</sup> See 79 FR 3329, 3332 (Jan. 21, 2014).

responsible for such incidents. More specifically, these commenters expressed confidence that adequate insurance generally was available or that the FHC corporate structure offered adequate protection against legal liability. Many FHCs and banking trade organizations argued that FHCs could manage risks arising from physical commodity activities through a robust risk-management framework that is tailored to specific categories of risk. Finally, commenters in favor of FHC participation in these activities regarded the reputational risks associated with physical commodities as being either not substantial or not unique to commodities.

**Complementarity of Complementary Commodity Activities.** Multiple commenters argued that physical commodity activities conducted in connection with derivatives activities are complementary to financial activities for the reasons cited in the Board's orders. For example, commenters argued that physical commodity activities conducted pursuant to the complementary authority better enable FHCs to fulfill their obligations under commodity derivatives contracts and to net physical and financial contracts by allowing physical settlement.<sup>40</sup>

Other commenters believed that physical commodity activities are not complementary to financial activities. These commenters argued that the scope of complementary commodity activities exceeds Congress's intent for complementary authority, which they assert envisioned low-risk activities such as publishing travel magazines. Some commenters argued that FHCs should only be permitted to engage in banking activities.

**Merchant Banking Authority.** Some commenters supported imposing additional restrictions on merchant banking activities, including expanding the range of actions that would constitute routine management and shortening investment holding periods. Commenters supportive of additional restrictions on merchant banking activities argued that these activities pose many of the same risks to safety and soundness and financial stability that are posed by complementary commodity activities and section 4(o) grandfather authority, such as environmental risks, reputational risks, geopolitical risks, compliance risks, and supply chain issues.

In contrast, other commenters urged the Board not to place additional restrictions on merchant banking

investments for several reasons. First, they argued that merchant banking authority reflects a considered Congressional determination that accounted for both the benefits and the risks of these activities and determined the appropriate balance of restrictions on merchant banking activities. Commenters contended that additional restrictions on merchant banking investments would undermine the benefits of merchant banking activities and hamper economic growth by, for example, reducing access to seed capital for some small-to-medium-sized businesses. Some commenters maintained that current regulatory and risk-management safeguards are adequate to prevent or limit risks of merchant banking activities to financial institutions. In support of this position, some pointed to the lack of significant liability resulting from past merchant banking activities. Some commenters argued that imposing further restrictions on merchant banking could increase risks to FHCs by preventing FHCs from taking over routine management functions when necessary to avoid significant loss, and by preventing FHCs from diversifying their investment portfolios through merchant banking investments. Other commenters argued that if FHCs are given an insufficient investment horizon there is a greater likelihood that they will be forced to exit their investments at a loss in order to comply with holding period requirements.

## II. Description of Proposed Rule

Based on its review of comments and additional analysis, the Board invites public comment on a proposal to (i) adopt additional limitations on physical commodity activities conducted pursuant to the complementary activity authority in section 4(k)(1)(B) and clarify certain existing limitations on those activities to reduce potential risks these activities may pose to the safety and soundness of FHCs and their depository institutions; (ii) amend the Board's risk-based capital requirements to increase the requirements associated with physical commodity activities and merchant banking investments in companies engaged in physical commodity activities to better reflect the potential risks of legal liability associated with a catastrophic event involving these physical commodity activities; (iii) rescind the findings underlying the Board orders authorizing certain FHCs to engage in energy management services and energy tolling under complementary authority and provide firms currently authorized to conduct these activities a transition

period to unwind or divest these activities; (iv) remove copper from the list of metals that BHCs are permitted to own and store as an activity closely related to banking under section 4(c)(8) of the BHC Act and Regulation Y; and (v) increase transparency regarding the physical commodity activities of FHCs through more comprehensive regulatory reporting. The Board invites public comment on all aspects of this proposal, including in particular the issues identified below.

### A. Scope of Permissible Physical Commodity Activities

#### 1. Level of Complementary Commodity Activities Permitted

As a condition of approving notices filed by FHCs to engage in physical commodity trading, the Board limited the market value of the commodities an FHC could hold under complementary authority to an aggregate of 5 percent of the FHC's consolidated tier 1 capital. The Board imposed this limit to reduce the safety and soundness risks of holding physical commodities, which include unique risks such as legal and environmental risks described above as well as operational risks associated with the storage and transportation of physical products (e.g., delay of delivery, loss of product).

In addition to complementary authority, FHCs and their subsidiaries may hold physical commodities under other authorities. For example, the Office of the Comptroller of the Currency (OCC) has permitted certain national banks to hold physical commodities to hedge customer driven, bank-permissible derivative transactions<sup>41</sup> and BHCs may take possession of physical commodities provided as collateral in satisfaction of debts previously contracted in good faith.<sup>42</sup> As some commenters argued, holding physical commodities presents unique safety and soundness risks to a banking organization regardless of the authority under which the commodity is held or the entity within the organization that holds the commodities.<sup>43</sup>

<sup>41</sup> See 12 U.S.C. 24(7); see, e.g., OCC Interpretive Letter No. 935 (May 14, 2002).

<sup>42</sup> 12 U.S.C. 1843(c)(2); 12 CFR 225.22(d)(1).

<sup>43</sup> Letter from Senator Carl Levin dated April 16, 2014; Senate Permanent Subcommittee on Investigations, *Wall Street Bank Involvement with Physical Commodities*, 10, 390–396 (Nov. 20, 2014) (PSI Report); see also OCC Banking Circular 277 at 24 (noting the potential additional risks associated with physical hedging activities). In a comment letter on the ANPR dated December 17, 2014, Senator Carl Levin, then-Chairman of the Subcommittee, requested that the PSI Report be added to the administrative record for the ANPR.

<sup>40</sup> SIFMA Comment Letter at 28–30.

To address the potential that the Board's 5 percent limit may be of limited value in addressing the level and risks of physical commodity activities of FHCs because FHCs also rely on other authorities to conduct these activities, the Board is proposing to account for physical commodities held by the consolidated banking organization under a broader range of authorities within the 5 percent limit on physical commodity trading that an FHC may conduct under complementary authority. The proposed tighter limit would better account for the risks that activities involving physical commodities pose to the consolidated organization.<sup>44</sup>

Specifically, the proposal would prohibit an FHC from purchasing, selling, or delivering physical commodities pursuant to its authority to engage in physical commodity trading under section 4(c)(8) or 4(k)(1)(B) if the market value of physical commodities owned by the FHC and its subsidiaries under any authority, other than authority to engage in merchant banking activities, similar investment authority for insurance companies, or authority to acquire assets or voting securities held in satisfaction of debts previously contracted, exceeds 5 percent of the consolidated tier 1 capital of the FHC.<sup>45</sup> The proposal would provide FHCs with two years from the effective date of this rule to conform to the revised 5 percent cap.

Under the proposal, the cap on an FHC's physical commodity trading activities would be calculated based on physical commodities the FHC holds on a consolidated basis. While it would not restrict the ability of a subsidiary to engage in a physical commodity activity pursuant to any authority other than complementary authority, it would limit

the authority of the FHC to expand its physical commodity trading activities based on complementary authority if the FHC already engages in a substantial amount of physical commodity activities under other authorities. The proposal would exclude from the calculation of the cap physical commodity activities of portfolio companies held under merchant banking authority or related to satisfaction of debts previously contracted because activities under these authorities are temporary and, because of other restrictions, may be difficult for an FHC to monitor and control. Finally, because insurance company investments are regulated under state insurance law, companies held under section 4(k)(4)(I) are not a part of the Board's current proposal.<sup>46</sup>

## 2. Clarification of Prohibitions on Certain Operations

As explained above, owners and operators of facilities and vessels that extract, process, store or transport certain physical commodities may be liable for damages and cleanup costs associated with a release of the physical commodity. Because this liability can be substantial, the Board prohibited FHCs from owning, operating, or investing in facilities for the extraction, transportation, storage, or distribution of commodities as part of complementary authority.<sup>47</sup>

The proposal would codify in Regulation Y this limitation and strengthen restrictions designed to ensure that FHCs are not found to "operate" an entity engaged in physical commodity activities for purposes of Federal and state environmental laws. These restrictions prohibit (1) participation in the day-to-day management or operations of the facility, (2) participation in management and operational decisions that occur in the ordinary course of the business of the facility, and (3) managing, directing, conducting or providing advice regarding operations having to do with the leakage or disposal of a physical commodity or hazardous waste or

involvement in decisions related to the facility's compliance with environmental statutes or regulations, including any law or regulation referenced in the proposed definition of covered physical commodity (discussed below). The proposed list of actions is not meant to be exhaustive; an FHC is expected to take other steps as appropriate to limit the types of actions that potentially could impose environmental liability on the FHC or otherwise suggest that the FHC is unduly involved in the activities of third parties.

*Question 1. Does the scope of the proposed list of prohibited actions appropriately protect against an FHC being found to "operate" a facility or vessel under Federal and state environmental law? Please explain your answer. Would it be more or less appropriate for the regulation instead to prohibit any FHC involvement that could subject the FHC to any such liability as operator under environmental law without describing what types of actions could lead to the liability, and why?*

## B. Risk-Based Capital Requirements for Covered Physical Commodities

### 1. Overview

The Board is proposing to amend its risk-based capital rule to better reflect the risk of legal liability that an FHC may incur as a result of its physical commodity activities. The resulting increase in capital requirements would be reflected in both the standardized approach and the advanced approaches risk-based capital ratios, and would be in addition to any existing capital requirements relating to market risk or operational risk applicable to the assets associated with physical commodity activities of an FHC or relating to existing counterparty credit risk applicable to financial transactions associated with such activities.

As described in more detail below, covered physical commodities are those with the highest likelihood of exposing an FHC to legal liability under Federal or state environmental laws. The proposal would not change the risk-based capital treatment of other physical commodities. It would moderately increase the risk weight for covered physical commodities that are held as part of a commodity trading activity that would be permissible under section 4(k) of the BHC Act, and would significantly increase the risk weight for covered physical commodities that an FHC owns as part of an activity authorized solely under section 4(o) of the BHC Act. The Board is proposing a higher risk weight

<sup>44</sup> An increase in the commodity derivatives business of a national bank that is a subsidiary of an FHC may increase the amount of physical commodities the national bank is able to hold as part of its commodity hedging activities as well as the capital requirements of the bank and FHC. See OCC Bulletin 2015-35 (Aug. 4, 2015) (limiting physical hedging activities to 5 percent of the notional value of the bank's derivatives that are in that same particular commodity and allow for physical settlement within 30 days). By including the amount of physical commodities held at the national bank within the proposed 5 percent limit, the proposed limit also would ensure that the amount of physical commodities the FHC is able to hold under complementary authority does not increase along with any increase in the amount of physical commodities held at the national bank.

<sup>45</sup> Consistent with the existing notice requirements of FHCs engaging in physical commodity trading, the proposal also would require an FHC to notify the Board if, on a consolidated basis, the market value of physical commodities owned by the FHC exceeds 4 percent of the consolidated tier 1 capital of the FHC. See, e.g., 2003 Citi Order.

<sup>46</sup> Accord Letter from Teachers Insurance and Annuity Association of America dated April 16, 2014; letter from the American Council of Life Insurers dated April 16, 2014.

<sup>47</sup> For example, an FHC may face liability under certain states' environmental laws based on its ownership of the hazardous substance or on hiring third parties to deliver the substance. See *supra* notes 12-17 and corresponding text.

<sup>48</sup> See, e.g., 2003 Citi Order. The Board's orders also prohibit the FHC from processing, refining, or otherwise altering commodities, and clarify that in conducting its physical commodity trading, the FHC will be expected to use appropriate storage and transportation facilities owned and operated by third parties.



for activities permitted to be conducted solely under section 4(o) because these activities contain the highest legal liability and reputational risks (e.g., storing, refining, extracting, transporting or altering). The proposed risk weight for a merchant banking investment in a company engaged in covered physical commodity activities would depend on the nature of those activities.

The proposed capital requirements would apply only to activities in physical commodities that are substances covered under Federal or relevant state environmental law (covered physical commodities). These physical commodities carry the greatest potential liability under relevant environmental laws. The proposed definition specifically identifies the Federal environmental laws—CERCLA, OPA, CAA, and CWA—likely to impose such liability.<sup>48</sup> However, the proposed definition does not name individual state environmental laws. Rather, an FHC would be required to identify on a state-by-state basis the physical commodities it owns that are not covered substances under the enumerated Federal laws. It would then be required to determine whether the physical commodities it owns in a particular state are subject to liability under that state's environmental laws. This approach is intended to limit an FHC's compliance burden to only those commodities and jurisdictions relevant to the activities actually conducted by the FHC, while helping to ensure the FHC understands the range of its riskiest physical commodity activities and the breadth of state environmental laws to which the FHC may be subject.

FHCs may be subject to legal liability in an amount much greater than the value of the physical commodities they own. An environmental catastrophe linked to an FHC's physical commodity activities could suddenly and severely undermine public confidence in the FHC and any of its subsidiary IDIs, limiting its access to funding markets until the market assesses the extent of the FHC's liability. Both environmental risks and reputational risks are higher for activities permissible only under

section 4(o) grandfather authority than for activities permissible as part of physical commodity trading under complementary authority.<sup>49</sup> As noted above, section 4(o) grandfather authority permits direct ownership or operation of facilities that manage, refine, store, extract, transport, or alter covered physical commodities. These activities increase the potential that an FHC will be held liable for damages from an environmental catastrophe involving covered physical commodities. To help address these risks, as well as the inherent uncertainty in valuing the potential damages associated with a catastrophe, the proposal assigns a 1,250 percent risk weight—the highest risk weight currently specified by the Board under the standardized approach<sup>50</sup>—to the market value of all covered physical commodities permitted to be owned only under section 4(o) grandfather authority.<sup>51</sup> The proposal also assigns a 1,250 percent risk weight to the original cost basis (i.e., cost basis gross of accumulated depreciation and asset impairment) of section 4(o) infrastructure assets, which are any non-commodity on-balance-sheet assets owned pursuant to section 4(o) grandfather authority (e.g., pipelines, refineries). The proposal bases the capital requirement on the original cost basis of a 4(o) infrastructure asset rather than its carrying value because the risk of legal liability does not decline over the life of the infrastructure asset. The proposed capital requirement for 4(o) infrastructure assets is intended to address the risk of legal liability resulting from the unauthorized discharge of a covered substance in

connection with the infrastructure asset. The proposed 1,250 percent risk weight is not intended to require capital against the full amount of legal liability and reputational harm that might result from a catastrophic event, which can vary significantly depending on the nature and extent of the environmental disaster and could be extremely large. Rather, the risk weight is intended to reflect the higher risks of physical commodity activities permissible only under section 4(o) grandfather authority without also making the activities prohibitively costly by attempting to capture the risks of the largest environmental catastrophes.

The proposal would assign a risk weight of 300 percent to covered commodities held pursuant to section 4(k) permissible physical commodity trading.<sup>52</sup> The proposed 300 percent risk weight is designed to help ensure that FHCs engaged in commodity trading have a level of capitalization for such activities that is roughly comparable to that of nonbank commodities trading firms. Because the risks of an activity generally are independent of the authority under which an FHC conducts the activity, the proposal would also assign a 300 percent risk weight to physical commodity activities conducted under section 4(o) grandfather authority that would be permissible physical commodity trading under complementary authority.

As part of the conditions for an amount of a covered physical commodity owned by an FHC engaged in physical commodity activities under section 4(o) grandfather authority to be assigned a 300 percent risk weight, the market value of the amount, when aggregated with the market value of almost all of the physical commodities owned by the FHC that the proposal would not already subject to a 1,250 percent risk weight, must not exceed 5 percent of the consolidated tier 1 capital of the FHC. The proposal refers to this aggregate amount as the “section 4(k) cap parity amount” and, like the proposal's modifications to the 5 percent cap on physical commodity trading, the section 4(k) cap parity amount would exclude amounts of physical commodities owned pursuant to merchant banking authority, similar insurance company investment authority, and authority to acquire assets and voting securities in satisfaction of debts previously contracted. The proposal would assign a 1,250 percent risk weight to this excess amount of section 4(k) permissible

<sup>49</sup> The proposal references activities engaged in by the FHC under section 4(o) grandfather authority, including activities of the FHC's subsidiaries. An FHC owning a covered physical commodity under section 4(o) grandfather authority may treat the commodity as a section 4(k) permissible commodity and apply a 300 percent risk weight if it meets certain requirements described below.

<sup>50</sup> See, e.g., 12 CFR 217.38, .41(c)(1), and .42(a)(1).

<sup>51</sup> The Board's regulatory capital rule applies a 1,250 percent risk weight to certain exposures that pose a high degree of risk to the banking organization and regarding which the banking organization may have difficulty determining the extent of the losses. For example, it applies a 1,250 percent risk weight to securitization exposures that raise supervisory concerns with the subjectivity involved in valuation of the exposure and in instances where the institution is not able to demonstrate a comprehensive understanding of the potential losses that could result from a default or partial default of the exposure. Similarly, the proposed 1,250 percent risk weight for section 4(o) permissible commodities and section 4(o) infrastructure assets is intended to address both the risk of those activities and the difficulties in determining the legal liability exposure to an FHC from its section 4(o) permissible commodities. See 12 CFR 217.41(c)(1) and .42(a)(1); see also 78 FR 62018, 62113 and 62117 (Oct. 11, 2013).

<sup>52</sup> Cf. 12 CFR 217.52(b)(5).

<sup>48</sup> A physical commodity would be a covered physical commodity under the proposed definition if the commodity is a covered substance under the identified Federal environmental laws regardless of whether the commodity is held in the United States. Applying the Federal environmental law framework to all physical commodities held outside the United States acknowledges the risk that FHCs may be held liable under similar laws for damages or cleanup costs associated with an environmental catastrophe that occurs outside of the United States without requiring FHCs to identify the physical commodities and activities for which any foreign jurisdiction may impose liability.



commodities for the reasons the Board is proposing to tighten the 5 percent of tier 1 capital limit on physical commodity trading conducted under complementary authority. Physical commodities that are not covered physical commodities or that are held under authorities other than section 4(o) grandfather authority would not receive additional capital requirements.<sup>53</sup>

*Question 2. To the extent the Board's proposed approach to the section 4(k) cap parity amount creates incentives for an FHC to conduct physical commodity activities under authorities that would result in lower capital requirements, should the Board require that an FHC include physical commodity activities conducted under authorities that receive less than a 300 percent risk weight first for purposes of determining the excess amount over the 4(k) cap parity amount?*

FHCs may also own companies under merchant banking authority that are engaged in physical commodity activities, including activities that involve physical commodity trading, storage, transportation, and refining. The proposal refers to investments in portfolio companies engaged in activities involving covered physical commodities as covered commodity merchant banking investments. Because these companies may be subject to similar types and amounts of liability as FHCs engaging in these activities directly, the proposal generally would apply the same risk weights to covered commodity merchant banking investments as the proposal would apply to covered physical commodities used in physical commodity activities under complementary authority and section 4(o) grandfather authority, respectively. Moreover, the proposal would not permit covered commodity merchant banking investments to receive the 100 percent risk weight assigned to non-significant equity exposures.<sup>54</sup>

<sup>53</sup> In addition, in order for an amount of a covered physical commodity owned under section 4(o) grandfather authority to be considered an amount of section 4(k) permissible commodities, the commodity must be one for which a derivative contract has been authorized for trading on a U.S. futures exchange by the CFTC (unless specifically excluded by the Board) or another commodity that has been specifically authorized by the Board under complementary authority (approved physical commodity). The FHC also must have purchased the amount of the commodity in the spot market or own the amount for the purpose of taking or making physical delivery of the commodity to settle a forward, option, swap, or similar contract. Finally, the FHC must have not stored, extracted, produced, transported, or altered that amount while the FHC owned the commodity but instead must have hired reputable third parties to do so.

<sup>54</sup> Under the Board's current standardized approach, merchant banking investments and

Accordingly, the proposal would apply a 1,250 percent risk weight to an FHC's covered commodity merchant banking investment unless all of the physical commodity activities of the portfolio company are physical commodity trading activities permissible under complementary authority (commodity trading portfolio company).<sup>55</sup> If all of the physical commodity activities of the portfolio company are permissible under complementary authority and the securities of the portfolio company are publicly traded, a 300 percent risk weight would be applied to the FHC's covered commodity merchant banking investment in the commodity trading portfolio company. Consistent with the standardized approach to equity investments not subject to a 100 percent risk weight, the proposal would assign a 400 percent risk weight to equity investments in commodity trading portfolio companies that are not publicly traded. If an FHC engages in any other physical commodity activity, including those that would be permissible only under the authority provided in section 4(o), the FHC must apply the 1,250 percent risk weight to that merchant banking investment.

These risk weights are designed to address the risks associated with merchant banking investments generally, the potential reputational risks associated with the investment, and the possibility that the corporate veil may be pierced and the FHC held liable for environmental damage caused by the portfolio company. (A somewhat higher risk weight would be assigned to privately traded portfolio companies in recognition of the risk that an FHC may not be able to gain access to markets for a privately held portfolio company after

certain other types of equity exposures must be assigned a 100 percent risk weight to the extent that the aggregate carrying value of the equity exposures does not exceed 10 percent of the Board-regulated institution's total capital. 12 CFR 217.52(b)(3).

<sup>55</sup> Similar to the proposed restrictions on the 300 percent risk weight for covered physical commodities held under section 4(o) authority, a company would be considered a physical commodity trading company if its activities involving covered physical commodities consisted only of purchasing covered physical commodities (that are approved physical commodities) in the spot market and/or taking or making physical delivery of such commodities to settle forwards, options, swaps, or similar contracts. However, a portfolio company would be considered a commodity trading portfolio company regardless of the amount of covered physical commodities it held; as discussed above, obtaining daily information on the amounts of a portfolio company's commodities holdings or placing limits on the commodities activities of the company may be inconsistent with the more limited, generally-permissible involvement of an FHC in its portfolio companies.

an environmental catastrophe involving the portfolio company).

However, nonfinancial companies use covered physical commodities to operate businesses otherwise unrelated to physical commodities. For example, grocery stores purchase gasoline to transport produce and a business or a warehouse may purchase oil for heating. To ensure the proposal would not apply to all merchant banking investments that own physical commodities but that are not engaged in a physical commodities business, the proposal would attempt to define and exempt activities of commodity end users from physical commodity activities. Under the proposal, a portfolio company would not be subject to these additional capital requirements as a covered commodity merchant banking investment solely because the portfolio company owns or operates a facility or vessel that purchases, stores, or transports a covered physical commodity only as necessary to power or support the facility or vessel. For example, an investment in a company that engages only in one physical commodity activity—oil storage—and does so solely for the purpose of heating its facility and operating machines within the facility would not be a covered commodity merchant banking investment. The Board is seeking comment on whether the proposed exclusion and its scope are appropriate and, if so, whether the proposed definition of the exclusion is workable.

*Question 3. Should investments in certain portfolio companies, such as end users of covered physical commodities, be exempted from additional capital requirements as a covered commodity merchant banking investment? If an exemption is appropriate, what should be the scope of the exemption?*

The Board is also considering the appropriate risk-based capital treatment for all merchant banking investments. For example, the Board is considering whether to continue to include merchant banking investments as "non-significant equity exposures" under the Board's standardized approach to risk-based capital rules.

*Question 4. How are the risks associated with merchant banking investments in companies involved in physical commodity activities different from or similar to other merchant banking investments? Do the Board's current capital requirements adequately capture the risks of merchant banking investments not covered under the proposal? If not, what additional capital requirements should be applied to merchant banking investments*

*generally? For example, is it appropriate to continue to include merchant banking investments as “non-significant equity exposures” under the Board’s risk-based capital rules?*

## 2. Calculation of Exposure Amount for Covered Physical Commodities

Under the proposal, the proposed risk weights would be multiplied by (1) the market value of all section 4(o) permissible commodities; (2) the original cost basis of section 4(o) infrastructure assets; (3) the market value of section 4(k) permissible commodities; and (4) the carrying value of an FHC’s equity investment in companies that engage in covered physical commodity activities to determine an FHC’s risk-based capital requirements for covered physical commodity activities.

An FHC would be required to calculate the market value of its covered physical commodities based on the quantity of each covered physical commodity multiplied by the market price of the covered physical commodity.<sup>56</sup> The proposed measure of exposure is designed to reflect an FHC’s ongoing level of involvement in covered physical commodity activities, and to be relatively stable in the face of market price movements and individual holding amounts, as explained below. The quantity of a covered physical commodity would be measured as a daily average of the amount of each covered physical commodity held by an FHC over the previous calendar quarter.<sup>57</sup> A measurement based on an average should reduce the potential for variations in capital requirements that could result from using a point-in-time measurement. Furthermore, use of a daily, as opposed to a weekly or monthly, average should mitigate fluctuations in the quantities of covered physical commodities held by an FHC that could misrepresent the FHC’s holdings over a longer period.

The calculation of the market price of a covered physical commodity would be determined as a rolling average of the month-end, end-of-day spot prices for

the covered physical commodity over the previous 60-month period. If the market price of a covered physical commodity (e.g., oil) varies based on type, grade, and/or classification, the FHC would calculate the average market price for each classification as a distinct covered physical commodity. The Board notes that FHCs should have mechanisms in place to monitor the prices of the commodities held under complementary authority and grandfather authority.<sup>58</sup>

## 3. Impact Analysis of Proposed Capital Requirements

The proposal would not amend the scope of application of the Board’s capital rules. Therefore, only FHCs conducting complementary, section 4(o) grandfather, or merchant banking activities would be subject to the proposal. Foreign banking organizations conducting such activities in the United States would be subject to the proposal only to the extent the Board’s capital rules apply to the organizations.

The Board conducted an analysis of the impact of the proposed capital requirements on FHCs and physical commodities markets. In doing so, the Board considered the extent of FHC activity in the physical commodity markets, the share of exposure and revenue that physical commodity activities represent at FHCs, and the impact of the proposed capital requirements on an FHC’s physical commodity activities relative to the existing risk-based capital requirements applicable to FHCs.

The Board estimates that, across all FHCs that engage in physical commodity activities, the proposed capital requirements could increase risk-weighted assets as much as \$34.0 billion. Assuming an average risk-based capital ratio of 12 percent, the proposal could increase the amount of capital required to be held to meet regulatory requirements by FHCs that engage in physical commodity activities under any authority by approximately \$4.1 billion in the aggregate. These figures are based on (i) FHC-provided categorizations of their physical commodity holdings; (ii) FHC-provided estimates of their physical commodity holdings that are related to activities

permitted solely under section 4(o) grandfather authority; and (iii) Board estimates of the amount of physical commodity holdings of an FHC that would be considered a covered physical commodity under this proposal. This estimate assumes that all physical commodities of FHCs would be covered physical commodities and therefore subject to the proposed additional risk weights.<sup>59</sup>

The estimated increase in risk-weighted assets resulting from the proposal would be insignificant (0.7 percent) relative to the total risk-weighted assets among FHCs that engage in physical commodity activities. The estimated increase relative to market-risk-weighted assets of these FHCs (that is, risk-weighted assets attributed to trading business) is 7.1 percent. This increase in risk weighting would not cause any FHC to breach the minimum capital requirements, and FHCs could likely absorb the increase in required capital at the firm level if they determine that physical commodity activities are important to the firm’s overall strategy. However, if FHCs consider their physical commodity trading on a standalone basis, the proposed increases in capital requirements could make this activity significantly less attractive based on its return on capital, and could result in decreased activity. Such a reduction in activity is not expected to have a material impact on the broader physical commodity markets.

Information on physical commodity markets, in particular those covered by this proposal, is relatively scarce. Nonetheless, it appears that the bulk of activity and inventory is conducted and held by non-Board-regulated entities (such as energy firms and end users of physical commodities) rather than FHCs. Information available to the Board supports this view, with market participants asserting that, in general, FHCs’ market shares in physical commodity markets are quite low and typically represent less than 1 percent of the market.

FHCs play a larger, but still limited, role in commodity derivatives trading, and a significant portion of FHCs’ physical commodity activity is related to their commodity derivative trading activity. Based on the CFTC Bank Participation Report, the market share of U.S. banks in derivative contracts involving physical commodities typically ranges from 2 percent to 15

<sup>56</sup> An FHC that owns section 4(k) permissible commodities pursuant to section 4(o) grandfather authority would also be required to calculate the market value of other physical commodities as part of the proposed section 4(k) cap parity amount.

<sup>57</sup> To calculate the quantity of a covered physical commodity, an FHC would be required to apply the appropriate unit of measurement customarily used for each covered physical commodity. Customary units of measurement generally are reflected through industry convention and the actions of market participants. For example, physical commodity activities involving oil and oil products typically use barrels as the unit of measurement; transactions involving liquid natural gas would measure quantity in metric tons or gallons.

<sup>58</sup> FHCs engaging in physical commodity trading currently must ensure the market value of commodities held under complementary authority does not exceed 5 percent of the FHC’s consolidated tier 1 capital. FHCs engaging in activities under section 4(o) grandfather authority must ensure that attributed aggregate consolidated assets of the companies held by the FHC pursuant to section 4(o) grandfather authority are not more than 5 percent of the total consolidated assets of the FHC. 12 U.S.C. 1843(o)(2).

<sup>59</sup> The impact on capital would be less to the extent that physical commodities of FHCs would not be covered physical commodities under the proposal.

percent.<sup>60</sup> Derivatives activity related to non-bank subsidiaries of FHCs is estimated to be similar or slightly larger.<sup>61</sup> Thus, any reduction in activity related to financial contracts that may arise from the proposal should not materially impact the overall market for financial commodity contracts.

With respect to FHCs' merchant banking investment activities, the estimated impact of the proposed increased capital requirements appears insignificant. The aggregate value of merchant banking investments among FHCs is approximately \$29 billion.<sup>62</sup> More granular information regarding the proportion of merchant banking investment activity attributable to portfolio companies that engage in physical commodity activities is not available. Nevertheless, given the small market share of FHCs in the physical commodity markets, the Board expects that the value of FHC equity investments in portfolio companies that engage in physical commodity activities would be significantly less than the estimated \$29 billion. Accordingly, the proposed increase in capital requirements for an FHC's merchant banking investment activity would not be expected to have a material impact.

Question 5. *Does the proposed definition of "covered physical commodity" sufficiently cover the commodities that pose the greatest legal, reputational, and financial risks to an FHC? If not, please describe those high-risk commodities that would fall outside the scope of the definition.*

Question 6. *What, if any, other criteria should the Board consider when determining whether a physical commodity poses a risk that the FHC would be liable for a catastrophe involving its physical commodity activities?*

Question 7. *How appropriate are the proposed risk weights for covered physical commodities owned as part of an FHC's physical commodity trading activities or held by FHCs conducting activities solely permitted by section 4(o) grandfather authority and for merchant banking portfolio companies engaged in such activities? If not appropriately calibrated, what are the shortcomings of the capital requirement in capturing catastrophic risk and what other factors should the Board consider to calibrate the capital requirements?*

Question 8. *What are the operational or practical challenges that implementing the proposed formulations for calculating the capital requirement would impose?*

Question 9. *What, if any, alternative methodologies for calculating the quantity of the covered physical commodity should the Board consider?*

Question 10. *Would the proposed capital requirements provide foreign banking organizations engaging in physical commodity activities, to the extent these organizations are not already subject to the Board's capital rules, with a competitive advantage over FHCs organized in the United States that engage in physical commodity activities? If so, what are the nature and amount of the competitive advantages?*

Question 11. *What additional considerations or data should the Board consider to calculate the estimated impact of the proposal?*

#### *D. The Scope of Permitted Complementary Commodity Activities*

##### *1. Background*

In addition to considering whether conduct of the activities by an FHC poses a substantial risk to the safety and soundness of depository institution subsidiaries of the FHC or the financial system generally, in approving each complementary commodity activity, the Board considered whether each activity is "meaningfully connected" to a financial activity such that it complements the financial activity.<sup>63</sup> Currently, twelve FHCs possess authority to engage in physical commodity trading, and five of those FHCs also have authority to engage in energy management services and energy tolling. For the reasons described below, the Board is proposing to rescind the authorization for FHCs to engage in energy tolling and energy management services.

##### *a. Physical Commodity Trading*

In 2003, the Board determined that physical commodity trading—the purchasing and selling of physical commodities in the spot market and the taking and making delivery of physical commodities to settle derivatives that BHCs were authorized to trade (commodity derivatives)—was so meaningfully connected to a financial activity that it complemented the financial activity. The Board cited a number of reasons for its determination. The Board observed that physical commodity trading activities "flow from the existing financial activities of

FHCs"—specifically, commodity derivatives activities, which are permissible financial activities. Permissible financial commodity derivatives trading activities involved derivatives that the FHC could terminate, assign, or cash-settle without taking delivery of the underlying physical commodity.<sup>64</sup> Complementary physical commodity trading allows an FHC to physically settle the derivatives contract.

The Board found physical commodity trading to be a complementary activity to financial commodities derivatives trading for a number of reasons. Physical commodity trading activities would flow from existing commodity derivatives activities. Physical commodity trading would enhance the ability of FHCs to efficiently provide a full range of commodity-related services to their customers; enable FHCs to transact more efficiently with customers in a wider variety of commodity markets and transaction formats; and enable FHCs to acquire more experience in the physical commodity markets and, in turn, improve their understanding of, and profitability in, the commodity derivatives markets. The Board also noted that diversified financial companies that were not at that time BHCs conducted physical commodity trading in connection with their commodity derivatives business. For these reasons, the Board believed that physical commodity trading was complementary to commodity derivatives activities.<sup>65</sup>

The Board has not changed its view on the complementarity of these trading activities. However, as discussed above, the Board believes added limits are appropriate to reduce potential risks to depository institution subsidiaries of FHCs or the financial system generally.

##### *b. Energy Management Services and Energy Tolling*

Following a number of changes to the energy industry, the Board determined that certain activities involving power plants—energy management services and energy tolling—were complementary to a financial

<sup>60</sup> See Bank Participation Reports, available at [www.cftc.gov/MarketReports/BankParticipationReports](http://www.cftc.gov/MarketReports/BankParticipationReports).

<sup>61</sup> See CFTC Commitments of Traders Report, available at [www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm](http://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm).

<sup>62</sup> Data obtained from top-tier domestic holding companies that file the FR Y-12 reporting form.

<sup>63</sup> See, e.g., 2003 Citi Order.

<sup>64</sup> See 12 CFR 225.28(b)(8)(ii)(B)(3)–(4); 2003 Citi Order.

<sup>65</sup> See 2003 Citi Order. Commenters to the ANPR also provided an additional example of the complementarity of physical commodity trading—the ability to net physical and financial contracts under the same master agreement and the ability to take physical delivery of futures to match financial options. SIFMA Comment Letter at 29–30.

activity.<sup>66</sup> The Board permitted six FHCs to engage in one or both of these activities between December 2007 and June 2010.<sup>67</sup>

In January 2014, the ANPR noted that three FHCs that engage in physical commodity activities had announced plans to decrease or discontinue their involvement in the activities.<sup>68</sup> These developments, although potentially caused by a variety of factors,<sup>69</sup> led the Board to reconsider whether complementary commodity activities continued to be so meaningfully connected to a financial activity so as to complement the financial activity. Subsequent to the ANPR, many of these plans were realized and discontinuance of physical commodity activities became more pronounced for FHCs engaging in energy tolling and energy management activities.<sup>70</sup> Of the five FHCs that currently have the authority to engage in either energy management services or energy tolling, at least four have discontinued these activities in the U.S.<sup>71</sup>

**Energy management services.** Under an energy management agreement, an

<sup>66</sup> The approvals to engage in these activities occurred after Federal and state deregulation of the energy industry, the energy crisis in the western United States, the growth of independent power producers, and the enactment of the Energy Policy Act of 2005, which encouraged investment in electricity energy infrastructure. See Public Law 109–58 (Aug. 8, 2005); Timothy P. Duane, *Regulation's Rationale: Learning from the California Energy Crisis*, 19 Yale J. on Reg. 471 (2002).

<sup>67</sup> Only five FHCs are currently permitted to engage in energy management services or energy tolling in the United States. One of the FHCs approved to engage in energy management services and energy tolling—Fortis—was acquired by another FHC after the Board's approvals. See Board letter to Robert L. Tortorelli (Dec. 5, 2008).

<sup>68</sup> 79 FR 3329, 3334 (Jan. 21, 2014).

<sup>69</sup> See *id.*; SIFMA Comment Letter at 29.

<sup>70</sup> See, e.g., Mercuria Closes Acquisition of J.P. Morgan Chase Physical Commodities Business, Mercuria (March 10, 2014), available at <http://www.mercuria.com/media-room/business-news/mercuria-closes-acquisition-jp-morgan-chase-physical-commodities-business>; Morgan Stanley Completes Sale of Global Oil Merchanting Business to Castleon Commodities International LLC, Morgan Stanley (November 2, 2015), available at <https://www.morganstanley.com/press-releases/21e458d2-0231-493b-a95a-5084c3b4c701>.

<sup>71</sup> See, e.g., Ron Bousson, Timeline: Deutsche Bank's Commodities Operations, Reuters (December 5, 2013), available at <http://www.reuters.com/article/us-deutsche-commodities-timeline-idUSBRE9B40UZ20131205?mod=related&channelName=PersonalFinance>; Sempra Energy, RBS Complete Sale of Commodities Joint Venture North American Assets to JP Morgan Unit, Sempra Energy (December 1, 2010), available at <http://investor.shareholder.com/sre/releasedetail.cfm?ReleaseID=534828>; Martin Arnold & Daniel Schafer, Barclays to Wind Down Commodities Trading, Financial Times (April 20, 2014), available at <http://www.ft.com/cms/s/0/5761ec06-c707-11e3-aa73-00144feabdc0.html>; Mercuria Closes Acquisition of J.P. Morgan Chase Physical Commodities Business, Mercuria (March 10, 2014), available at <http://www.mercuria.com/media-room/business-news/mercuria-closes-acquisition-jp-morgan-chase-physical-commodities-business>.

FHC acts as an energy manager that provides transactional, advisory and administrative services to a power plant owner.<sup>72</sup> An energy manager may also provide financial intermediation services. An energy manager performs administrative tasks related to the sale of power and the delivery of fuel to run the plant, and may enter into fuel and power contracts for the owner that satisfy the owner's criteria, including by purchasing fuel from a third party in order to resell it to the power plant owner and by purchasing the energy output of the power plant for release in the market. An FHC, as energy manager, also may enter into hedging transactions with the owner to manage fuel costs and energy prices. The energy manager generally is compensated based on a percentage of the difference between the delivered fuel prices and the realized power revenues (the "spark spread") with a guaranteed minimum compensation amount.

In seeking approval to conduct energy management services, FHCs argued that these services may help a power plant owner develop and refine the power plant's risk-management policies and optimize the plant owner's decisions about when to operate, which are heavily influenced by fuel costs, power prices, and the financing available. FHCs also argued that these activities would improve the FHCs' understanding of energy markets and their ability to serve as an effective competitor in the derivatives markets.

**Energy Tolling.** The FHCs that currently engage in energy management services also engage in energy tolling. A primary difference between energy tolling and energy management is that the former permits the "toller" to act as principal for its own account rather than act as the agent, or otherwise for the benefit, of the power plant owner. Under both energy management and tolling, an FHC generally is responsible for monitoring day-to-day market conditions to determine when to operate the plant and when to provide the necessary fuel. Unlike the typical energy management agreements, pursuant to a tolling agreement, an FHC may direct—rather than advise—the owner to operate the plant so that the toller—rather than the owner—may capture the spark spread.<sup>73</sup> The compensation

<sup>72</sup> These services are typically outlined in an energy management plan and risk-management policy that governs how the power plant should be operated. E.g., 2007 Fortis Order.

<sup>73</sup> The Board compared a tolling agreement to a call option with the strike price being the cost of producing that amount of power. See 2008 RBS Order. A tolling agreement also has been compared to an operating lease agreement because it allows the toller the exclusive right to use the plant during

structure of a tolling agreement reflects the FHC's role as principal: The toller pays the owner a fixed periodic payment in exchange for the right to all or part of the plant's power output and provides the owner with a marginal payment based on the amount of energy produced to compensate for the costs of running the plant.

## 2. Reconsideration of the Approval of Energy Management and Tolling as Complementary Activities

The Board is reconsidering whether energy management services and energy tolling activities are complementary to a financial activity. Over time, these two activities have not appeared to be as directly or meaningfully connected to a financial activity as is physical commodity trading.

Physical commodity trading provides FHCs with an alternative method of settling BHC-permissible commodity derivatives.<sup>74</sup> 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 commodity derivatives activities or other financial activities.

Moreover, the expected benefits of permitting these activities do not appear to have been realized over time. For example, it was originally expected that allowing FHCs to conduct energy management services and energy tolling activities would allow FHCs to gain additional information to help manage commodity-related risks.<sup>75</sup> It is not clear that energy management services or energy tolling significantly improve an FHC's understanding of commodity derivatives markets since—in order to engage in energy management services or energy tolling—an FHC must already have a thorough understanding of commodity derivatives markets. Moreover, FHCs that have divested their physical commodity business lines continue to engage in commodity

the term of the agreement and the benefits of ownership without the capital investment. See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207, 48242 (Aug. 13, 2012) (citing the letter from Mary Anne Mason, Hogan Lovells LLP on behalf of Southern California Edison Company, Pacific Gas and Electric Company and San Diego Gas and Electric Company, dated July 22, 2011 (2011 CA Utilities Letter); Regulating Financial Holding Companies and Physical Commodities: Hearing Before the S. Subcomm. in Fin. Insts. and Consumer Prot. (Jan. 15, 2014) (testimony of Norman Bay, Director, Office of Enforcement, Federal Energy Regulatory Commission at 15), available at <http://www.banking.senate.gov/public/index.cfm/2014/1/regulating-financial-holding-companies-and-physical-commodities>.

<sup>74</sup> See 2003 Citi Order.

<sup>75</sup> See 2007 Fortis Order.

derivatives trading and termination of their energy management and energy tolling activities is not expected to negatively impact their ability to provide commodity derivative services.

The authorizations for energy management services and energy tolling also noted that unregulated financial competitors of FHCs engaged in these activities. However, it is unclear over time what, if any, advantages those financial firms gain from conducting energy management or energy tolling activities over FHCs in the conduct of derivatives and other FHC-permissible physical commodity activities.

Energy tolling was permitted in part to allow an FHC to hedge its own, or to assist its client to hedge, positions in energy.<sup>76</sup> However, there are other effective ways for an FHC to hedge its positions, and an FHC may assist clients to hedge their positions without the FHC engaging in energy tolling.

The proposal would not appear to eliminate the benefits commenters, including energy companies, commonly noted in letters responding to the ANPR.<sup>77</sup> The proposal would affect the actual activity of only one firm and the theoretical authority of five FHCs to engage in complementary commodity activities and would directly limit only certain types of agreements (*i.e.*, energy tolling and energy management services agreements) between FHCs and power plant owners. In addition, the proposal would not affect the authority of FHCs to provide derivatives and related financial products and services to power plants or engage in physical commodities trading. Permissible

activities may include providing inventory and project finance arrangements involving physical commodities,<sup>78</sup> financially- and physically-settled derivatives to hedge fuel costs and energy prices,<sup>79</sup> buying and selling certain physical commodities in the spot market,<sup>80</sup> and derivatives advisory services.<sup>81</sup>

### 3. Conformance Period

The proposal would provide FHCs with a two-year transition period to conform their energy management services and energy tolling agreements following the effective date of the final rule if adopted. This conformance period is intended to reduce the burdens associated with applying the proposal to existing agreements. As noted, the Board invites comments on all aspects of the proposal, including specific questions regarding the appropriate conformance period.

*Question 12. Are there reasons that support determining energy management services or energy tolling are complementary to a financial activity that are not discussed above? If so, what are those reasons?*

*Question 13. Are there any potential effects on the safety and soundness of FHCs engaged in energy management services and energy tolling of rescinding such authorities? How would the potential effects differ if only one or the other activity was rescinded?*

*Question 14. What are the average lengths of an energy management services agreement and an energy tolling agreement? Under what circumstances may such agreements be terminated early and what are the contractual consequences of doing so? Are there challenges other than termination of such agreements associated with conformance to the proposed rescission of energy management services and energy tolling orders? To what extent may a conformance period alleviate those challenges? What is an*

*appropriate conformance period for this aspect of the proposal and why?*

### E. Reclassification of Copper as an Industrial Metal

In 1997, the Board amended Regulation Y to provide that BHCs could own and store copper, and engage in related incidental activities, as an activity so closely related to banking as to be proper incident thereto.<sup>82</sup> The Board has previously permitted BHCs to buy, sell, and store gold, silver, platinum and palladium bullion, coins, bars and rounds for their own accounts and the accounts of others. The list of precious metals was expanded to include copper, a metal used in minting coins, after trading in copper became permissible for national banks.<sup>83</sup>

Over time, copper has become most commonly used as a base or industrial metal, and not as a store of value in the same way as gold, silver, platinum and palladium.<sup>84</sup> While gold, silver, platinum and palladium have industrial uses as well, these precious metals have traditionally been traded internationally primarily for their exchange value rather than for industrial uses.<sup>85</sup> Copper, while it has been used in coins, has never been traded as a precious metal and has always been classified and traded as a “base” or “industrial” metal.<sup>86</sup> The

<sup>82</sup> 62 FR 9290, 9336 (Feb. 28, 1997). The authorization also included “any other metal approved by the Board.” No other metals have been approved by the Board under this authority.

<sup>83</sup> *Id.* at 9311.

<sup>84</sup> PSI Report.

<sup>85</sup> PSI Report at 353.

<sup>86</sup> *Id.* The most common benchmark price for copper is the copper futures price established on the London Metals Exchange (LME), the largest financial market for metals. PSI Report at 351. The LME identifies four categories of metals; copper is included in the “non-ferrous” or “base” metal category, which also includes aluminum, nickel, and zinc, rather than the “precious metals” category that includes gold, silver, platinum and palladium. *Id.* at 352. Since the publication of the PSI Report, the LME has ceased certain activities with respect to gold and silver and has initiated activities with respect to platinum and palladium. See <https://www.lme.com/metals/precious-metals/>. COMEX, a division of the New York Mercantile Exchange, also classifies copper as a base metal and gold, silver, platinum and palladium as precious metals. See, e.g., <http://www.cmegroup.com/trading/metals/base.html>. Moreover, standardized copper futures contracts involve large amounts of copper, comparable to the amounts for futures contracts for base metals such as aluminum, lead and zinc. See <https://www.lme.com/metals/non-ferrous/copper/contract-specifications/futures/> (LME copper futures contract specification 25 metric tons); <https://www.lme.com/metals/non-ferrous/aluminium/contract-specifications/futures/> (LME aluminum futures contract specification 25 metric tons); <https://www.lme.com/metals/non-ferrous/lead/contract-specifications/futures/> (LME lead futures contract specification 25 metric tons); <https://www.lme.com/metals/non-ferrous/zinc/contract-specifications/futures/> (LME zinc futures contract specification 25 metric tons).

<sup>76</sup> Physical commodity trading also may be used to hedge positions in energy of FHCs and their clients.

<sup>77</sup> Commenters focused on the benefits of FHC involvement in physical commodity trading activities, rather than the benefits of energy management services or energy tolling. For example, NRG Energy, Inc., a leading competitive power company and major electricity provider, noted a number of activities that would not appear to be affected by the proposed elimination of energy management services or energy tolling, including providing first-lien hedging arrangements, project financing, market making, “customized hedging and risk management solutions like working capital/inventory intermediation facilities and volumetric production payment structures,” and long-term physical commodity transactions. Letter from NRG Energy, Inc. dated April 15, 2014. See also Letter from American Gas Association et al., dated March 31, 2014 (discussing the importance of the ability of FHCs to physically-settle derivatives transactions); Letter from Electric Power Supply Association dated April 16, 2014 (discussing the importance of FHC’s ability to hedge physical power producers’ prices and revenues as well as engage in market making and credit intermediation activities); SIFMA Letter, Appendix G (discussing market making and the provision of market liquidity, efficient price formation, risk-management solutions, project finance, credit extension, and greater competition).

<sup>78</sup> See, e.g., 12 CFR 225.28(b)(1); *Chemical New York Corp.*, 59 Fed. Res. Bull. 698 (1973) (approving as a permissible lending activity for BHCs an arrangement under which a BHC would finance a utility’s coal purchases by purchasing from a third party, and taking title to, a quantity of coal on a monthly basis at the direction of the utility customer); Letter to Mr. Lustgarten dated May 15, 2006 (finding certain commodity purchase and forward sale transactions entered to finance commodity inventories of an FHC’s customers to be a permissible lending activity of the FHC); Letter to Ms. Davy dated May 15, 2006 (finding certain volumetric production payments to be a permissible lending activity).

<sup>79</sup> See 12 CFR 225.28(b)(8) and the Board’s approvals to engage in physical commodity trading.

<sup>80</sup> See, e.g., 2003 Citi Order.

<sup>81</sup> 12 CFR 225.28(b)(6).

most significant uses of copper are for industrial purposes, rather than as a store of value.<sup>87</sup> Further, the OCC has recently proposed a similar reclassification of copper under the National Bank Act.<sup>88</sup>

For these reasons, the Board proposes to treat the purchase and sale of copper in the same manner as the purchase and sale of other non-precious metals; specifically, as an activity requiring FHC status and complementary authority and subject to the restrictions and limitations (including the 5 percent of tier 1 capital cap) imposed on FHCs engaged in complementary commodity activities. Under the proposal, copper would be removed from the list of metals BHCs are permitted to own and store without limit as an activity closely related to banking under section 4(c)(8) of the BHC Act and Regulation Y.

The Board proposes not to authorize services such as arranging for storage, safe custody, assaying, and shipment of copper. The Board is also proposing to make a corresponding change in the language of section 225.28(b)(8)(ii)(B) of Regulation Y to remove copper from the list of metals on which a BHC may enter derivatives contracts that require taking delivery of the underlying metal as principal. Removing copper from this

list will ensure that the metals specifically listed as financial assets for purposes of derivatives trading activities remain consistent with the metals permitted to be bought, sold and stored by BHCs.<sup>89</sup>

The proposal would take effect one year after the rule is finalized to provide BHCs time to conform to this change.

Question 15. *What is the cumulative impact on BHCs of the proposed limitation on physical copper trading authority combined with the proposed additional restrictions on complementary physical commodities trading? What is the cumulative impact of these proposals on copper markets?*

Question 16. *Is a one-year transition period during which BHCs currently engaged in buying, selling, and storing copper would be permitted to wind down their activities with respect to copper under this authority sufficient or appropriate? If not, what is the appropriate transition period and why? What is the appropriate scope of BHCs that should benefit from such a transition period? Should the scope, for example, be limited to BHCs that own copper as of the date of this proposal or BHCs that do not have separate complementary authority to hold copper?*

#### F. New Financial Reporting Data on Physical Commodity Activities

##### 1. General

The Board is proposing to modify the Consolidated Financial Statements for Holding Companies (FR Y–9C) to (i) create a new Schedule HC–W, Physical Commodities and Related Activities, and (ii) add data items to Schedule HC–R, Part II, Risk-Weighted Assets. Schedule HC–W would collect more specific information on the covered physical commodities holdings and activities of FHCs, and the modifications to HC–R, Part II would report the risk-weighted asset amounts associated with an FHC's engagement in activities that involve (1) covered physical commodities, (2) section 4(o) infrastructure assets, or (3) investments in covered commodity merchant banking investments. The proposed reporting requirements would become effective on the same date as the proposed risk-weighted asset requirements.

##### 2. Schedule HC–W

*Part A.* Currently, BHCs report the gross (total) fair value of all physical commodities on Schedule HC–D to the FR Y–9C. On Part A of the proposed

new Schedule HC–W, FHCs would be required to report the total fair value of categories of physical commodities held in inventory as follows:

- (1) Petroleum and petroleum products;
- (2) Natural gas;
- (3) Natural gas liquids;
- (4) Fertilizer;
- (5) Propylene;
- (6) Coal and coal products;
- (7) Uranium; uranium products;
- (8) Other covered physical commodities; and
- (9) All other physical commodities.

The sum of the total fair values of commodities reported on Part A as proposed would continue to be reported as the gross fair value of physical commodities held in inventory in item 9 of Schedule HC–D.

The categories of physical commodities listed in items (1)–(8) above are proposed to be defined in a manner consistent with the proposed definition of “covered physical commodities.” Categories (1)–(7) generally include those covered substances under Federal environmental law. The item “other covered physical commodities” would include all other covered physical commodities held in inventory that would not be included in items (1)–(7) described above and therefore would reflect those covered substances under relevant state environmental law.

*Part B.* On Part B of the proposed new Schedule HC–W, FHCs would be required to indicate affirmatively or negatively whether they are engaged in particular aspects of physical commodity-related activities. Specifically, FHCs would indicate whether they own any covered physical commodities, any section 4(o) infrastructure assets, or investments in covered commodity merchant banking investments. FHCs also would indicate whether they are engaged in the exploration, extraction, production, or refining of physical commodities. FHCs also would indicate whether they own facilities, vessels or conveyances for the storage or transportation of covered physical commodities. Further, FHCs would be required to report (i) the total fair value of section 4(k) permissible commodities and section 4(o) permissible commodities owned; (ii) the original cost basis of any section 4(o) infrastructure assets owned; and (iii) the carrying value of their investments in covered commodity merchant banking investments.

##### 3. Schedule HC–R Modifications

The Board is also proposing to modify Schedule HC–R, Part II to include new

specifications/futures/ (LME zinc futures contract specification 25 metric tons); [http://www.cmegroup.com/trading/metals/base/copper\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/base/copper_contractSpecs_futures.html) (COMEX copper futures contract specification 25,000 pounds); [http://www.cmegroup.com/trading/metals/base/aluminum-mw-us-transaction-premium-platts-swap-futures\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/base/aluminum-mw-us-transaction-premium-platts-swap-futures_contractSpecs_futures.html) (COMEX aluminum MW US transaction premium plats futures contract specification 25 metric tons). Precious metals futures contracts, by contrast, involve much smaller amounts. See, e.g., [http://www.cmegroup.com/trading/metals/precious/gold\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/precious/gold_contractSpecs_futures.html) (COMEX gold futures contract specification 100 troy ounces); [http://www.cmegroup.com/trading/metals/precious/silver\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/precious/silver_contractSpecs_futures.html) (COMEX silver futures contract specification 5,000 troy ounces); [http://www.cmegroup.com/trading/metals/precious/platinum\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/precious/platinum_contractSpecs_futures.html) (COMEX platinum futures contract specification 50 troy ounces); [http://www.cmegroup.com/trading/metals/precious/palladium\\_contractSpecs\\_futures.html](http://www.cmegroup.com/trading/metals/precious/palladium_contractSpecs_futures.html) (COMEX palladium futures contract specification 100 troy ounces).

<sup>87</sup> See, e.g., <http://minerals.usgs.gov/minerals/pubs/commodity/copper/>, “Copper Statistics and Information,” (building construction is the single largest market for copper, followed by electronics and electronic products, transportation, industrial machinery, and consumer and general products), compare <http://minerals.usgs.gov/minerals/pubs/commodity/gold/>, “Gold Statistics and Information,” (“Although gold is important to industry and the arts, it also retains a unique status among all commodities as a long-term store of value”); <http://minerals.usgs.gov/minerals/pubs/commodity/silver/>, “Silver Statistics and Information,” (“Silver has been used for thousands of years as ornaments and utensils, for trade, and as the basis for many monetary systems”).

<sup>88</sup> Available at <http://occ.gov/news-issuances/news-releases/2016/nr-occ-2016-108.html>.

<sup>89</sup> Copper would be treated as a non-financial asset for purposes of 12 CFR 225.28(b)(8)(ii)(B).



items related to the proposed capital requirement described in this proposal for a firm's physical commodity activities conducted under any of the commodity authorities and that involve covered physical commodities. New line items would be added to Column A of Schedule HC–R, Part II to report (1) the market value of an FHC's covered physical commodity activities involving covered physical commodities (calculated as described in this proposal) conducted under section 4(k)(1)(B) of the Bank Holding Company Act or section 4(o) of the Bank Holding Company Act (as applicable); (2) the original cost basis of section 4(o) infrastructure assets owned pursuant to section 4(o) of the Bank Holding Company Act; and (3) the carrying value of an FHC's investments in covered commodity merchant banking investments made under section 4(k)(4)(H) of the BHC Act. Specifically, the following modifications are being proposed:

- New line items would be added to Column L to allocate a 300 percent risk weight to (A) the market value of an FHC's physical commodity activities involving section 4(k) permissible commodities and (B) the carrying value of investments in covered commodity merchant banking investments that are publicly traded commodity trading portfolio companies to the 300 percent risk weight category;

- New line items would be added to Column M to allocate a 400 percent risk weight to the carrying value of investments in covered commodity merchant banking investments that are commodity trading portfolio companies and are not publicly traded to the 400 percent risk weight category; and

- New line items would be added to Column Q to allocate a 1,250 percent risk weight to the (A) the market value of physical commodity activities involving section 4(o) permissible commodities (including section 4(k) permissible commodities in excess of the section 4(k) cap parity amount); (B) the original cost basis of section 4(o) infrastructure assets owned pursuant to section 4(o) of the BHC Act; and (C) the carrying value of investments in covered commodity merchant banking investments that are not commodity trading portfolio companies.

#### 4. Public Disclosure

The Board proposes to make the information reported as described above available to the public. The Board has long supported meaningful public disclosure by banking organizations with the objective of improving market discipline and encouraging sound risk-

management practices. The Board believes that the information that would be collected in Part A of proposed Schedule HC–W would provide the public with important information on the degree to which FHCs are involved in trading covered physical commodities, improving market discipline, and enhancing understanding of the role FHCs play in these markets through their nonfinancial activities. Public disclosure of the new reporting items would also facilitate supervisory monitoring of commodity activities that present particular risks to safety and soundness, as discussed in this proposal. The Board proposes to make the disclosures in Part B of the new proposed Schedule HC–W public for similar reasons. Additionally, the Board believes that public disclosure of the information in Part B will provide market participants, end users, and supervisors with important information that is not captured in inventory reporting about the nature and extent of FHC presence in the physical commodities markets over time. This information would provide additional insight into the potential risks FHCs may bear as part of their commodities activities as well as a more complete picture of their role in the commodity markets.

The proposed reporting requirements in Schedule HC–W, Part B and proposed modifications to Schedule HC–R, Part II are consistent with other public capital reporting requirements. The Board notes that public disclosure of these proposed items would also be consistent with the international standards regarding public disclosure of regulatory capital under Pillar 3 of the Basel Accord. Such disclosure is designed to complement the minimum capital requirements and the supervisory review process by encouraging market discipline through enhanced and meaningful public disclosure.

For the reasons discussed above, the Board is proposing that the proposed new reporting requirements be released to the public. However, a reporting FHC may request confidential treatment for the proposed reporting items if the company believes that, based on its particular individual circumstances, disclosure of specific commercial or financial information in the report would likely result in substantial harm to its competitive position or that disclosure of the submitted information would result in unwarranted invasion of personal privacy.

Question 17. *To what extent do the proposed regulatory reporting requirements improve transparency of*

*physical commodity activities of FHCs and provide supporting data for assessing the capital requirement?*

Question 18. *How well do the proposed reporting requirements physical commodity activities (both Part A and Part B) capture FHCs' physical commodity activities? What other categorizations should the Board consider for these proposed reporting requirements?*

Question 19. *What other information, if any, should the Board consider collecting from FHCs for public reporting purposes in order to enhance market discipline and public understanding of FHCs' physical commodities or merchant banking activities?*

### III. Regulatory Analysis

#### A. Regulatory Flexibility Act Analysis

The Board is providing an initial regulatory flexibility analysis with respect to this proposed rule. The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), generally requires an agency to assess the impact a rule is expected to have on small entities. The RFA requires an agency either to provide an initial regulatory flexibility analysis with a proposed rule for which a general notice of proposed rulemaking is required or to certify that the proposed rule will not have a significant impact on a substantial number of small entities. Based on its analysis and for the reasons stated below, the Board believes that this proposed rule will not have a significant economic impact on a substantial number of small entities. A final regulatory flexibility analysis will be conducted after comments received during the public comment period have been considered.

Under regulations issued by the Small Business Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with total assets of \$550 million or less. As of June 30, 2016, there were approximately 3,203 small bank holding companies and approximately 162 small savings and loan holding companies. As described above, the Board is proposing to apply risk-based capital and other regulatory requirements for certain physical commodities and merchant banking investment activities conducted by banking organizations. This proposed rule is expected only to apply to banking organizations that (i) conduct physical commodity activities under complementary authority with the Board's approval; (ii) conduct physical commodity activities under section 4(o) grandfather authority; or (iii) engage in



merchant banking investment activities related to physical commodities. Small entities generally will not fall into any of these categories. To date, the Board has granted approvals to 12 FHCs to conduct physical commodity activities under complementary authority, meanwhile, there are two banking organizations that are presently conducting physical commodity activities under section 4(o) grandfather authority. In both cases, the banking organizations all hold total consolidated assets greater than \$50 billion. Further, of the approximately \$29 billion in total merchant banking investment activity engaged in by banking organizations, approximately 99 percent of this activity is conducted by banking organizations with total consolidated assets greater than \$50 billion.

The Board is aware of no other Federal rules that duplicate, overlap, or conflict with this proposal. The Board believes that this proposal will not have a significant economic impact on small banking organizations supervised by the Board and therefore believes that there are no significant alternatives to this proposal that would reduce the economic impact on small banking organizations supervised by the Board.

#### *B. Paperwork Reduction Act*

##### *Request for Comment on Proposed Information Collection*

In accordance with section 3512 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3521) (PRA), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. The Board reviewed the proposed rule under the authority delegated to the Board by OMB.

The proposed rule contains requirements subject to the PRA. The reporting requirements are found in section II.F. To implement the reporting requirement set forth in F, the Board proposes to revise the Consolidated Financial Statements for Holding Companies (FR Y–9C; OMB No. 7100–0128) to create a new Schedule HC–W, Physical Commodities and Related Activities and to add data items to Schedule HC–R, Part II, Risk-Weighted Assets.

Comments are invited on:

(a) Whether the proposed collections of information are necessary for the proper performance of the Board's functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the proposed information

collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or startup costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this proposed rule that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551. A copy of the comments may also be submitted to the OMB desk officer by mail to the Office of Information and Regulatory Affairs, U.S. Office of Management and Budget, New Executive Office Building, Room 10235, 725 17th Street NW., Washington, DC 20503 or by facsimile to 202–395–6974.

Proposed Revision, Without Extension, of the Following Information Collection

##### *Title of Information Collection:*

Consolidated Financial Statements for Holding Companies, Parent Company Only Financial Statements for Large Holding Companies, Parent Company Only Financial Statements for Small Holding Companies, Financial Statement for Employee Stock Ownership Plan Holding Companies, and the Supplemental to the Consolidated Financial Statements for Holding Companies.

*OMB Control Number:* 7100–0128.

*Agency Form Number:* FR Y–9C, FR Y–9LP, FR Y–9SP, FR Y–9ES, and FR Y–9CS.

*Frequency of Response:* Quarterly, semiannually, and annually.

*Affected Public:* Businesses or other for-profit.

*Respondents:* Bank holding companies (BHCs), savings and loan holding companies (SLHCs), securities holding companies (SHCs), and U.S. Intermediate Holding Companies (IHCs) (collectively, holding companies (HCs)).

*Abstract:* The FR Y–9 family of reporting forms continues to be the primary source of financial data on holding companies that examiners rely on in the intervals between on-site inspections. Financial data from these reporting forms are used to detect emerging financial problems, to review

performance and conduct preinspection analysis, to monitor and evaluate capital adequacy, to evaluate holding company mergers and acquisitions, and to analyze a holding company's overall financial condition to ensure the safety and soundness of its operations. The FR Y–9C serves as standardized financial statements for the consolidated holding company. The FR Y–9LP, and FR Y 9SP serve as standardized financial statements for parent holding companies; the FR Y–9ES is a financial statement for holding companies that are Employee Stock Ownership Plans (ESOPs). The Federal Reserve also has the authority to use the FR Y–9CS (a free-form supplement) to collect additional information deemed to be (1) critical and (2) needed in an expedited manner.

*Current Actions:* To implement the reporting requirement set forth in section F, the Board proposes to revise the FR Y–9C to (1) create a new Schedule HC–W, Physical Commodities and Related Activities, which would collect more specific information on the covered physical commodities holdings and activities of FHCs and (2) add data items to Schedule HC–R, Part II, Risk-Weighted Assets, which would report the risk-weighted asset amounts associated with an FHC's engagement in covered physical commodity activities. It is expected that 14 out of the 667 current FR Y–9C respondents would file the new reporting requirements set forth in section F. The Board estimates that proposed revisions to the FR Y–9C would not materially increase the estimated average hours per response or total estimated annual burden. The Board is not proposing to revise the FR Y–9LP, FR Y–9SP, FR Y–9ES, and FR Y–9CS. The draft reporting forms and instructions are available on the Board's public Web site at <http://www.federalreserve.gov/apps/reportforms/review.aspx>.

*Estimated Burden per Response:* FR Y–9C (non advanced approaches holding companies): 50.17 hours; FR Y–9C (advanced approached holding companies HCs): 51.42 hours; FR Y–9LP: 5.25 hours; FR Y–9SP: 5.40 hours; FR Y–9ES: 0.50 hours; FR Y–9CS: 0.50 hours.

*Number of Respondents:* FR Y–9C (non advanced approaches holding companies): 654; FR Y–9C (advanced approached holding companies): 13; FR Y–9LP: 792; FR Y–9SP: 4,122; FR Y–9ES: 88; FR Y–9CS: 236.

*Total Estimated Annual Burden:* FR Y–9C (non advanced approaches holding companies): 131,245 hours; FR Y–9C (advanced approached holding companies): 2,674 hours; FR Y–9LP:

16,632 hours; FR Y–9SP: 44,518 hours; FR Y–9ES: 44 hours; FR Y–9CS: 472 hours.

### C. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act requires the agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies invite comment on how to make this interim final rule easier to understand. For example:

- Have the agencies organized the material to suit your needs? If not, how could the rule be more clearly stated?
- Are the requirements in the rule clearly stated? If not, how could the rule be more clearly stated?
- Does the rule contain technical language or jargon that is not clear? If so, what language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand? If so, what changes would make the rule easier to understand?
- Would more, but shorter, sections be better? If so, which sections should be changed?
- What else could the agencies do to make the rule easier to understand?

### List of Subjects

#### 12 CFR Part 217

Administrative practice and procedure; Banks, banking; Capital; Federal Reserve System; Holding companies; Reporting and recordkeeping requirements; Securities.

#### 12 CFR Part 225

Administrative practice and procedure, Banks, Banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

### Authority and Issuance

For the reasons set forth in the preamble, the Board proposes to amend 12 CFR parts 217 and 225 to as follows:

## PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)

■ 1. The authority citation for part 217 continues to read as follows:

**Authority:** 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371.

■ 2. Section 217.2 is amended by:

- (a) Revising the definition of “Advanced approaches total risk-weighted assets”.

■ (b) Adding the definition of “Approved physical commodity” and “Covered physical commodity”.

■ (c) Revising the definition of “Standardized total risk-weighted assets”.

The revisions and additions are set forth below:

### § 217.2 Definitions

\* \* \* \* \*

*Advanced approaches total risk-weighted assets* means

- (1) The sum of:
  - (i) Credit-risk weighted assets;
  - (ii) Credit valuation adjustment (CVA) risk-weighted assets;
  - (iii) Risk-weighted assets for operational risk;
  - (iv) For a market risk Board-regulated institution only, advanced market risk-weighted assets; and
  - (v) Risk-weighted assets for covered physical commodity activities as calculated under §§ 217.39 through 217.40; minus
- (2) Excess eligible credit reserves not included in the Board-regulated institution’s tier 2 capital.

\* \* \* \* \*

*Approved physical commodity* means a physical commodity for which a derivative contract has been authorized for trading on a U.S. futures exchange by the Commodity Futures Trading Commission (unless specifically excluded by the Board) or other commodities that have been specifically authorized by the Board under section 4(k)(1)(B) of the Bank Holding Company Act 12 (12 U.S.C. 1843(k)(1)(B)).

\* \* \* \* \*

*Covered physical commodity* means any physical commodity that is, or a component of which is, specifically named:

- (1) As a “hazardous substance” under section 104 of the Comprehensive Environmental Response, Compensation, and Liability Act (42 U.S.C. 9601);
- (2) As “oil” under section 1001 of the Oil Pollution Act of 1990 (33 U.S.C. 2701) or section 311 of the Clean Water Act (33 U.S.C. 1321);
- (3) As a “hazardous air pollutant” under section 112 of the Clean Air Act (42 U.S.C. 7412);
- (4) In regulations interpreting the foregoing terms under the corresponding statute; or
- (5) In a state statute, or regulation promulgated thereunder, that makes a party other than a governmental entity or fund responsible for removal or remediation efforts related to the unauthorized release of the substance or for costs incurred as a result of the

unauthorized release; *provided that*, with respect to paragraph (5) of this definition, the Board-regulated institution owned the commodity in the state that promulgated the law imposing such liability during the last reporting period.

\* \* \* \* \*

*Standardized total risk-weighted assets* means:

- (1) The sum of:
  - (i) Total risk-weighted assets for general credit risk as calculated under § 217.31;
  - (ii) Total risk-weighted assets for cleared transactions and default fund contributions as calculated under § 217.35;
  - (iii) Total risk-weighted assets for unsettled transactions as calculated under § 217.38;
  - (iv) Total risk-weighted assets for covered physical commodity activities as calculated under §§ 217.39 through 217.40;
  - (v) Total risk-weighted assets for securitization exposures as calculated under § 217.42;
  - (vi) Total risk-weighted assets for equity exposures as calculated under §§ 217.52 and 217.53; and
  - (vii) For a market risk Board-regulated institution only, standardized market risk-weighted assets; minus
- (2) Any amount of the Board-regulated institution’s allowance for loan and lease losses that is not included in tier 2 capital and any amount of allocated transfer risk reserves.

\* \* \* \* \*

■ 3. Section 217.30 is amended by revising paragraph (b) as follows:

### § 217.30 Applicability.

\* \* \* \* \*

(b) Notwithstanding paragraph (a) of this section, a market risk Board-regulated institution must exclude from its calculation of risk-weighted assets under this subpart the risk-weighted asset amounts of all covered positions, as defined in subpart F of this part (except foreign exchange positions that are not trading positions, OTC derivative positions, cleared transactions, unsettled transactions, and covered physical commodities).

■ 4. Section 217.31 is revised to read as follows:

### § 217.31 Mechanics for calculating risk-weighted assets for general credit risk.

(a) *General risk-weighting requirements.* A Board-regulated institution must apply risk weights to its exposures as follows:

- (1) A Board-regulated institution must determine the exposure amount of each

on-balance sheet exposure, each OTC derivative contract, and each off-balance sheet commitment, trade and transaction-related contingency, guarantee, repo-style transaction, financial standby letter of credit, forward agreement, or other similar transaction that is not:

- (i) An unsettled transaction subject to § 217.38;
- (ii) A cleared transaction subject to § 217.35;
- (iii) A default fund contribution subject to § 217.35;
- (iv) A covered physical commodity, a section 4(o) infrastructure asset, or a covered commodity merchant banking investment subject to §§ 217.39 through 217.40;
- (v) A securitization exposure subject to §§ 217.41 through 217.45; or
- (vi) An equity exposure (other than an equity OTC derivative contract) subject to §§ 217.51 through 217.53.

(2) The Board-regulated institution must multiply each exposure amount by the risk weight appropriate to the exposure based on the exposure type or counterparty, eligible guarantor, or financial collateral to determine the risk-weighted asset amount for each exposure.

(b) Total risk-weighted assets for general credit risk equals the sum of the risk-weighted asset amounts calculated under this section.

■ 5. Section 217.39 is added to read as follows:

**§ 217.39 Covered Physical Commodity Activities.**

(a) *General.* A Board-regulated institution's total risk-weighted assets for covered physical commodity activities equals the sum of the risk-weighted asset amounts for each of its covered physical commodities, each of its equity exposures to covered commodities merchant banking investments, and each of its 4(o) infrastructure assets, each as determined under this section and § 217.40.

(b) *Risk-weighted asset amount for covered physical commodities.* The risk-weighted asset amount for a covered physical commodity equals:

- (1) The exposure amount for a section 4(k) permissible commodity *multiplied* by 300 percent, subject to the limitation in paragraph (c)(3) of this section, *plus*
- (2) The exposure amount for a section 4(o) permissible commodity *multiplied* by 1,250 percent.

(c) *Exposure amounts for covered physical commodities.*

- (1) The exposure amount for a section 4(k) permissible commodity equals the section 4(k) permissible commodity quantity, as determined under

paragraph (d) of this section, *multiplied* by the simple average of the covered physical commodity's month-end, end-of-day spot prices over the previous 60 months.

(2) The exposure amount for a section 4(o) permissible commodity equals the section 4(o) permissible commodity quantity, as determined under paragraph (d) of this section, *multiplied* by the simple average of the covered physical commodity's month-end, end-of-day spot prices over the previous 60 months.

(3)(i) If the section 4(k) cap parity amount of the Board-regulated institution exceeds 5 percent of the tier 1 capital of the Board-regulated institution, then such excess (up to the sum of the exposure amounts for each section 4(k) permissible commodity owned by the Board-regulated institution pursuant to section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(o))) must be risk weighted at 1,250 percent.

(ii) For purposes of paragraph (c)(3) of this section, section 4(k) cap parity amount equals:

(A) The sum of the exposure amounts for each section 4(k) permissible commodity that is owned by the Board-regulated institution pursuant to section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(o)); *plus*

(B) The sum of the market value of each physical commodity (calculated as the average of the amounts of the physical commodity owned by the Board-regulated institution recorded as of the close of business on each day of the previous calendar quarter *multiplied* by the simple average of the physical commodity's month-end, end-of-day spot prices over the previous 60 months) that is owned by the Board-regulated institution pursuant to:

(1) Any authority other than sections 4(c)(2), 4(k)(4)(H), 4(k)(4)(I), and 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(c)(2), (k)(4)(H), (k)(4)(I), and (o)); *or*

(2) Section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(o)), but only with respect to a physical commodity that is not a covered physical commodity.

(iii) A Board-regulated institution that owns one or more covered physical commodities pursuant to section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(o)) must determine the market value of each covered physical commodity described in paragraph (c)(ii)(B) of this section pursuant to the calculation method described therein.

(d) *Quantity of a covered physical commodity.* (1) A Board-regulated institution must determine the section

4(k) permissible commodity quantity and the section 4(o) permissible commodity quantity of each covered physical commodity the Board-regulated institution owns pursuant to section 4(k)(1)(B) or section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(k)(1)(B) or (o)).

(2) For a covered physical commodity that the Board-regulated institution owns pursuant to section 4(o) of the Bank Holding Company Act (12 U.S.C. 1843(o)):

(i) The section 4(o) permissible commodity quantity of a covered physical commodity equals the average of the amounts of the covered physical commodity owned by the Board-regulated institution recorded as of the close of business on each day of the previous calendar quarter *minus* any section 4(k) permissible commodity quantity;

(ii) If the covered physical commodity is an approved physical commodity, the section 4(k) permissible commodity quantity of the covered physical commodity equals the average of the amounts of the covered physical commodity owned by the Board-regulated institution as of the close of business on each day of the previous calendar quarter, if the daily quantity of the covered physical commodity:

(A) Was purchased by the Board-regulated institution in the spot market or is owned for the purpose of the Board-regulated institution taking or making physical delivery of the commodity to settle a forward contract, option, future, option on future, swap, or a similar contract in which a Board-regulated institution is authorized to engage under section 225.28(b)(8)(ii) of the Board's Regulation Y (12 CFR 225.28(b)(8)(ii)); and

(B) Was stored, extracted, produced, transported, or altered (including by processing or refining) only by reputable, third-party facilities during that day; and

(iii) If the covered physical commodity is not an approved physical commodity, the section 4(k) permissible commodity quantity of the covered physical commodity equals zero.

(3) For a covered physical commodity that the Board-regulated institution owns pursuant to section 4(k)(1)(B) of the Bank Holding Company Act (12 U.S.C. 1843(k)(1)(B)):

(i) The section 4(o) permissible commodity quantity equals zero; and

(ii) The section 4(k) permissible commodity quantity equals the average of the amounts of the covered physical commodity owned by the Board-regulated institution recorded as of the

close of business on each day of the previous calendar quarter.

(e) *Covered commodity merchant banking investments risk weights.* (1) The risk-weighted asset amount for a covered commodity merchant banking investment, as the term is defined in § 217.40, is the exposure amount for the investment multiplied by the appropriate risk weight, each as calculated according to this section.

(2) A Board-regulated institution must assign a 1,250 percent risk weight to an exposure amount for a covered commodity merchant banking investment except as provided in paragraphs (e)(3) and (e)(4) of this section.

(3) A Board-regulated institution must assign a 300 percent risk weight to an exposure amount for a covered commodity merchant banking investment that is a publicly traded commodity trading portfolio company, as the term is defined in § 217.40.

(4) A Board-regulated institution must assign a 400 percent risk weight to an exposure amount for a covered commodity merchant investment that is a commodity trading portfolio company, as the term is defined in § 217.40, that is not publicly traded.

(f) *4(o) infrastructure assets risk weights.* (1) The risk-weighted asset amount for a 4(o) infrastructure asset equals the original cost basis (cost basis gross of accumulated depreciation and asset impairment) of the 4(o) infrastructure asset multiplied by 1,250 percent.

(2) For purposes of this section, a 4(o) infrastructure asset is an on-balance sheet exposure owned pursuant to section 4(o) of the Bank Holding Company Act that is not a physical commodity.

■ 6. Section 217.40 is added to read as follows:

**§ 217.40 Covered Commodity Merchant Banking Investments.**

(a) *Definition of covered commodity merchant banking investment and commodity trading portfolio company.* For purposes of this part,

(1) A covered commodity merchant banking investment is a company

(i) The shares, assets, or ownership interests of which are owned or controlled by the Board-regulated institution pursuant to section 4(k)(4)(H) of the Bank Holding Company Act (12 U.S.C. 1843(k)(4)(H)); and

(ii) Is engaged in covered physical commodity activities.

(2) A commodity trading portfolio company is a covered commodity merchant banking investment that engages in covered physical commodity

activities that are only the purchasing and selling of one or more covered physical commodities (each of which is an approved physical commodity) in the spot market and the taking and making physical delivery of one or more covered physical commodities (each of which is an approved physical commodity) to settle forward contracts, options, futures, options on futures, swaps, or similar contracts.

(b) *Covered physical commodity activities.* For purposes of this section, covered physical commodity activities include, but are not limited to,

(1) Storing, producing, transporting, or altering (including by processing or refining) a covered physical commodity;

(2) Buying or selling a covered physical commodity in the spot market;

(3) Taking or making physical delivery of a covered physical commodity to settle a contract; and

(4) Owning or operating a facility or vessel that holds or uses a covered physical commodity.

(c) *End-user exception.*

Notwithstanding paragraph (b) of this section, covered physical commodity activities do not include

(1) Owning or operating an end-user facility or vessel; or

(2) Buying, owning or storing a covered physical commodity solely for purposes of powering or supporting an end-user facility or vessel that is owned or operated by the portfolio company.

(d) *Definition of end-user facility or vessel.* For purposes of paragraph (c)(2) of this section, end-user facility or vessel means a facility or vessel that does not store, produce, transport, or alter a covered physical commodity except as necessary to power or support the facility or vessel. An end-user facility or vessel does not include a power plant.

**217.51 [Amended]**

■ 7. Section 217.51(a)(1) is revised to read as follows:

(a) *General.* (1) To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to an investment fund, a covered commodity merchant banking investment, as defined in § 217.40, a Board-regulated institution must use the Simple Risk-Weight Approach (SRWA) provided in § 217.52. A Board-regulated institution must use the look-through approaches provided in § 217.53 to calculate its risk-weighted asset amounts for equity exposures to investment funds and use the approach provided in §§ 217.39 and 217.40 for equity exposures to covered commodity merchant banking investments.

\* \* \* \* \*

**217.100 [Amended]**

■ 8. Section 217.100(b)(3) is revised to read as follows:

\* \* \* \* \*

(b) \* \* \*

(3) A market risk Board-regulated institution must exclude from its calculation of risk-weighted assets under this subpart the risk-weighted asset amounts of all covered positions, as defined in subpart F of this part (except foreign exchange positions that are not trading positions, over-the-counter derivative positions, cleared transactions, unsettled transactions, and covered physical commodities).

\* \* \* \* \*

■ 9. Section 217.131 is amended by revising the section heading and revising paragraph (e)(3)(vii) to read as follows:

**§ 217.131 Introduction and exposure measurement.**

\* \* \* \* \*

(e) \* \* \*

(3) \* \* \*

(vii). The risk-weighted asset amount for any other on-balance-sheet asset that does not meet the definition of a wholesale, retail, securitization, IMM, equity exposure, covered commodity merchant banking investment, cleared transaction, or default fund contribution and is not subject to deduction under § 217.22(a), (c), or (d) equals the carrying value of the asset.

\* \* \* \* \*

■ 10. Section 217.151(a)(1) is revised to read as follows:

**§ 217.151 Introduction and exposure measurement.**

(a) *General.* (1) To calculate its risk-weighted asset amounts for equity exposures that are not equity exposures to an investment fund or a covered commodity merchant banking investment, as defined in § 217.40, a Board-regulated institution may apply either the Simple Risk-Weight Approach (SRWA) provided in § 217.152 or, if it qualifies to do so, the Internal Models Approach (IMA) in § 217.153. A Board-regulated institution must use the look-through approaches provided in § 217.154 to calculate its risk-weighted asset amounts for equity funds and use the approach provided in §§ 217.39 through 217.40 for equity exposures to covered commodity merchant banking investments.

\* \* \* \* \*

## PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

■ 11. The authority citation to part 225 continues to read as follows:

**Authority:** 12 U.S.C. 1817(j)(13), 1818, 1828(o), 1831i, 1831p–1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331–3351, 3906, 3907, and 3909; 15 U.S.C. 1681s, 1681w, 6801 and 6805.

### § 225.28 [Amended]

■ 12. § 225.28 is amended by removing the term “copper” from paragraphs (b)(8)(ii)(B) and (b)(8)(iii).

■ 13. Section 225.95 is added to read as follows:

### § 225.95 What are some of the requirements to engage in complementary activities?

(a) Paragraphs (b)–(e) of this section apply to financial holding companies that the Board has approved to purchase and sell physical commodities in the spot market and to take and make delivery of physical commodities to settle contracts identified in section 225.28(b)(8)(B) of this part (12 CFR 225.28(b)(8)(B)) as an activity that is complementary to a financial activity under section 4(k)(1)(B) of the BHC Act (12 U.S.C. 1843(k)(1)(B)).

(b) A financial holding company may not purchase or sell physical commodities in the spot market or take or make delivery of physical commodities pursuant to sections 4(c)(8) or 4(k)(1)(B) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8), (k)(1)(B)) if the market value of physical commodities owned by the financial holding company and its subsidiaries (other than through ownership or control of assets or subsidiaries pursuant to sections 4(c)(2), 4(k)(4)(H), or 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(c)(2), (k)(4)(H), (k)(4)(I))) exceeds 5 percent of the consolidated tier 1 capital of the financial holding company, as determined under the Board’s Regulation Q (12 CFR part 217).

(c) A financial holding company must notify the Board if the aggregate market value of physical commodities owned by the financial holding company and its subsidiaries (other than through ownership or control of assets or subsidiaries pursuant to sections 4(c)(2), 4(k)(4)(H) or 4(k)(4)(I) of the Bank Holding Company Act (12 U.S.C. 1843(c)(2), (k)(4)(H), (k)(4)(I))) exceeds 4 percent of the consolidated tier 1 capital of the financial holding company, as determined under the Board’s Regulation Q (12 CFR part 217).

(d) A financial holding company may not own operate, or invest in facilities

or vessels for the extraction, transportation, storage, or distribution of physical commodities pursuant to section 4(k)(1)(B) of the Bank Holding Company Act (12 U.S.C. 1843(k)(1)(B)).

(e) For purposes of paragraph (d) of this section, the term *operate* includes

(1) Participation in the day-to-day management or operations of the facility;

(2) Participation in management and operational decisions that occur in the ordinary course of the business of the facility; and

(3) Managing, directing, conducting, or providing advice regarding operations having to do with the leakage or disposal of a physical commodity or hazardous waste or decisions about the facility’s compliance with environmental statutes or regulations, including any law or regulation referenced in the definition of covered physical commodity in section 217.2 of the Board’s Regulation Q (12 CFR 217.2).

By order of the Board of Governors of the Federal Reserve System, September 23, 2016.

**Robert deV. Frierson,**

*Secretary of the Board.*

[FR Doc. 2016–23349 Filed 9–29–16; 8:45 am]

**BILLING CODE P**

## FEDERAL RESERVE SYSTEM

### 12 CFR Parts 225 and 252

[Regulations Y and YY; Docket No. R–1548; RIN 7100 AE–59]

### Amendments to the Capital Plan and Stress Test Rules

**AGENCY:** Board of Governors of the Federal Reserve System (Board).

**ACTION:** Notice of proposed rulemaking with request for comment.

**SUMMARY:** The Board is inviting comment on a notice of proposed rulemaking to revise the capital plan and stress test rules for bank holding companies with \$50 billion or more in total consolidated assets and U.S. intermediate holding companies of foreign banks. Under the proposal, large and noncomplex firms, defined below, would no longer be subject to the provisions of the Board’s capital plan rule whereby the Board may object to a capital plan on the basis of qualitative deficiencies in the firm’s capital planning process. In connection with this modification, large and noncomplex firms would no longer be subject to the qualitative assessment in Comprehensive Capital Analysis and Review (CCAR), but would remain subject to a quantitative assessment in

CCAR. The qualitative assessment of the capital plans of large and noncomplex firms instead would be conducted outside of CCAR through the supervisory review process. For purposes of the proposal, a bank holding company or U.S. intermediate holding company with total consolidated assets of \$50 billion or greater but less than \$250 billion, on-balance sheet foreign exposure of less than \$10 billion, and nonbank assets of less than \$75 billion would be considered a large and noncomplex firm. The proposal would also modify reporting requirements for large and noncomplex firms to reduce burdens by raising materiality thresholds, reducing the scope of the data collection on these firms’ stress test results, and reducing supporting documentation requirements. For all bank holding companies subject to the capital plan rule, the proposal would simplify the initial applicability provisions for the capital plan and stress test rules, reduce the amount of additional capital distributions that a bank holding company may make during a capital plan cycle without seeking the Board’s prior approval, and extend the range of potential as-of dates for the trading and counterparty scenario component used in the stress test rules. The proposal would also amend the Parent Company Only Financial Statements for Large Holding Companies (FR Y–9LP) to include new line item 17 of PC–B Memoranda (Total nonbank assets of a holding company that is subject to the Federal Reserve Board’s capital plan rule) for purposes of identifying the large and noncomplex firms. All other bank holding companies subject to the capital plan rule that are not large and noncomplex firms would remain subject to objection to their capital plan based on qualitative deficiencies under the rule.

The proposal would not apply to bank holding companies with total consolidated assets of less than \$50 billion or to any state member bank or savings and loan holding company.

**DATES:** Comments must be received by November 25, 2016.

**ADDRESSES:** You may submit comments, identified by Docket No. R–1548 and RIN 7100 AE–59 by any of the following methods:

- *Agency Web site:* <http://www.federalreserve.gov>. Follow the instructions for submitting comments at <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.aspx>.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.