

Client Update

Federal Reserve Proposes Changes to Rules Relating to Physical Commodities, Foreshadows Merchant Banking Reforms

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On September 23, 2016, the Federal Reserve Board (the “FRB”) issued a proposed rule (the “NPR”) that would adopt additional limits to the physical commodity activities of financial holding companies (“FHCs”) and bank holding companies (“BHCs”). Comments on the NPR are due by December 22, 2016. Although focused on physical commodities, the NPR could foreshadow additional restrictions on merchant banking activities more broadly.

Below, we provide an overview of the NPR, describe its elements in more detail and then discuss what it may mean for merchant banking. The Appendix illustrates, in redline form, the revisions to regulatory text that the NPR contemplates.

OVERVIEW

The NPR includes five main elements: (1) capital requirements for physical commodity assets and merchant banking investments in portfolio companies that engage in physical commodity activities; (2) tightening of the 5% of tier 1 capital limit that applies to physical commodity activities conducted pursuant to complementary activity authority under section 4(k)(1)(B) of the Bank Holding Company Act (the “BHC Act”); (3) rescission of the orders authorizing energy management and tolling activities as complementary activities; (4) removal of copper from the list of precious metals that BHCs may own and store under section 4(c)(8) of the BHC Act; and (5) an increase of supervisory and public reporting regarding physical commodity activities, including merchant banking investments in companies engaged in physical commodity activities.

The FRB characterizes the NPR as necessary to address policy concerns about the possibility of veil piercing in respect of catastrophic accidents and reputational

harm that could affect the stability of an FHC or require an FHC to guarantee obligations for which it might not otherwise have legal liability.

BACKGROUND

Statutory Authorities

The BHC Act permits FHCs and BHCs to engage in certain physical commodity activities under several authorities.

In particular, section 4(k)(1)(B) of the BHC Act permits FHCs to engage in any activity that the FRB 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 (referred to as “complementary authority”).¹ Pursuant to complementary authority, the FRB has authorized certain FHCs to purchase and sell commodities in the spot market and to take and make delivery of physical commodities to settle commodity derivatives. The FRB also has approved under complementary authority requests of certain FHCs (1) to provide “energy management” services consisting of transactions and advisory services to power plant owners; and (2) to engage in “energy tolling,” whereby an FHC pays 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 power output.

In addition, section 4(o) of the BHC Act is a grandfather provision that permits certain FHCs to engage in a broader range of physical commodity activities that have not been authorized under complementary authority, including storing, refining, extracting, transporting and altering physical commodities.²

Further, section 4(k)(H) of the BHC Act permits FHCs to make merchant banking investments in any type of nonfinancial company. Thus, FHCs may rely on merchant banking authority to make investments in companies that are engaged in physical commodity activities.³

Lastly, under section 4(c)(8) of the BHC Act, BHCs may own and store a range of metals, including gold, silver, platinum, palladium and copper.

¹ See 12 U.S.C. § 1843(k)(1)(B).

² See 12 U.S.C. § 1843(o).

³ See 12 U.S.C. § 1843(k)(4)(H).

The Review of Physical Commodity Activities

The NPR follows a multiyear FRB review of physical commodity activities and broader attention in Washington, D.C. to these activities.

In January 2014, the FRB issued an Advance Notice of Public Rulemaking to seek public comment on issues relating to the risks of physical commodity activities, including whether additional prudential restrictions or limits on physical commodity activities were appropriate to mitigate those risks.⁴

Later that same year, the Senate Permanent Subcommittee on Investigations (the “PSI”) held a two-day hearing examining the extent to which banks and their holding companies own physical commodities as well as own or control businesses like power plants, oil and gas pipelines and commodity warehouses. The PSI investigation culminated in a report titled “Wall Street Bank Involvement with Physical Commodities,” which included recommendations relating to the scope of complementary authority, the grandfather provision and merchant banking authority.⁵ It also encouraged the FRB and other federal banking agencies “to restrict banks and their holding companies from owning or controlling physical commodities in excess of 5% of their Tier 1 capital and consider other appropriate modifications to current practice involving physical commodities.”⁶ Showing its influence, the PSI Report is cited throughout the NPR.

On September 8, 2016, the FRB and other federal banking agencies issued the report required by section 620 of the Dodd-Frank Act.⁷ In the report, the FRB recommended Congress repeal merchant banking authority, among other things. The NPR proposes regulatory changes to address some of the issues raised in the section 620 report and, as noted below, appears to indicate the FRB will propose further revisions to the merchant banking regulations used to invest in companies engaged in activities beyond those involving physical commodities.

⁴ See 79 Fed. Reg. 3329 (Jan. 21, 2014).

⁵ See STAFF OF S. COMM. ON INVESTIGATIONS, 113TH CONG., WALL STREET BANK INVOLVEMENT WITH PHYSICAL COMMODITIES (2014).

⁶ *Id.* at 11, 48, 97-98.

⁷ See Debevoise & Plimpton LLP, “Banking Agencies Issue Dodd-Frank Section 620 Report” (Sept. 12, 2016), available at http://debevoise.com/~media/files/insights/publications/2016/09/20160912_banking_agencies_issue_dfa_section_620_report.pdf

CAPITAL REQUIREMENTS

The NPR proposes various increases in risk weights for “covered” physical commodities, defined as any physical commodity that is specifically named (1) as a “hazardous substance” under section 104 of the Comprehensive Environmental Response, Compensation, and Liability Act; (2) as “oil” under section 1001 of the Oil Pollution Act of 1990 or section 311 of the Clean Water Act; (3) as a “hazardous air pollutant” under section 112 of the Clean Air Act; (4) in regulations interpreting the foregoing terms under the corresponding statute; or (5) in a state statute, or a 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 (5), the FRB-regulated institution owned the commodity in the state that promulgated the law imposing such liability during the last reporting period.

The FRB’s reasoning for including these activities within the proposed capital requirements is that, in an accident or other catastrophic event, liability under the various identified statutes can exceed the market value of the physical commodity involved.

The proposed risk weights are as follows:

- 300% risk weight for: (a) covered physical commodity assets held pursuant to complementary authority; (b) investments in any merchant banking portfolio company engaged in covered physical commodity activities permissible under complementary authority if the company is publicly traded; and (c) covered physical commodity assets held in reliance on section 4(o) that would be permissible under complementary authority.

With respect to (c) above, the covered physical commodity assets held in reliance on section 4(o) may be subject to the 300% risk weight only if they comport with the limits that apply to assets held pursuant to complementary authority, including the proposed, more stringent 5% tier 1 capital limit, discussed below. This limit, referred to in the NPR as the “section 4(k) cap parity amount,” requires that the market value of the assets held pursuant to section 4(o) must not exceed 5% of the consolidated tier 1 capital of the FHC when aggregated with the market value of all physical commodities (subject to certain exceptions) owned by the FHC that the proposed rule would not already subject to a 1,250% risk weight.

- 400% risk weight for investments in any merchant banking portfolio company engaged in covered physical commodity activities permissible under complementary authority if the company is *not* publicly traded.
- 1,250% risk weight for: (a) assets held under section 4(o) of the BHC Act that do not qualify for the 300% risk weight and (b) investments in any merchant banking portfolio company engaged in covered physical commodity activities unless all such activities are permissible under complementary authority.

The 1,250% risk weight effectively is a dollar-for-dollar capital charge under the standardized approach based on the Basel III 8% total capital requirement (*i.e.*, for a \$100 asset, the risk-weighted value would be \$1,250 and 8% of \$1,250 results in a \$100 capital requirement).

To ensure that the proposed rule would not apply to merchant banking investments in companies that hold physical commodities but that are not engaged in a physical commodities business, the proposal includes a carve-out to permit merchant banking portfolio companies to continue to hold physical commodities as an end-user (*e.g.*, a company that purchases gas for its vehicle fleet).

Further, under the current capital rules, merchant banking investments may be subject to a 100% risk weight as non-significant equity exposures. The proposed rule, however, would not permit any such risk weight. Instead, the proposed rule effectively would set a new floor of a 300% risk weight for merchant banking investments in companies engaged in physical commodity activities.

5% TIER 1 CAPITAL LIMIT

As a condition to authorizing physical commodity activities under complementary authority, the FRB has limited the market value of the commodities an FHC may hold under complementary authority to no more than 5% of the FHC's tier 1 capital.

The NPR would subject physical commodities held under a broader range of authorities—no longer just those held under complementary authority—to an aggregate cap of 5% of the FHC's consolidated tier 1 capital. Assets held as debt previously contracted and held under merchant banking or insurance company investment authority would not be included in the limit. The proposal would provide a two-year conformance period for the new, more stringent 5% cap.

By order, the FRB has prohibited FHCs from owning, operating or investing in facilities for the extraction, transportation, storage or distribution of commodities as part of complementary authority. The NPR would codify this restriction and increase the 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. The proposed restrictions would prohibit, among other things, day-to-day management or operations of a facility; participation in the management decisions that occur in the ordinary course of business; and managing or providing advice regarding operations having to do with leakage or disposal of a physical commodity or hazardous waste.

RECISSION OF ENERGY MANAGEMENT AND TOLLING AUTHORIZATION

The NPR effectively would rescind orders authorizing certain FHCs to engage in energy management services and energy tolling under complementary authority. The NPR states that these two activities have not appeared to be as directly or meaningfully connected to a financial activity as is physical commodity trading and that the expected benefits of permitting these activities also do not appear to have been realized over time.

The proposal would give FHCs that engage in energy management services and energy tolling a two-year transition period to conform with the final rule, if adopted.

RECLASSIFICATION OF COPPER AS AN INDUSTRIAL METAL

The NPR asserts that unlike gold, silver, platinum and palladium, copper has become most commonly used as a base or industrial metal, rather than a store of value. The FRB thus would treat the purchase and sale of copper in same manner as the purchase and sale of other non-precious metals, *i.e.*, as an activity requiring FHC status and complementary authority. Specifically, the NPR proposes to remove copper from the list of metals that BHCs are permitted to own and store under 4(c)(8) authority. The OCC issued a similar proposal for entities it regulates concurrently with the release of the Dodd-Frank Act section 620 report.⁸

⁸ See OCC, “Industrial and Commercial Metals,” 81 Fed. Reg. 63,428 (Sept. 15, 2016).

SUPERVISORY AND PUBLIC REPORTING REQUIREMENTS

Currently, BHCs are required to report the total fair value of all physical commodities that they hold. The NPR would require additional supervisory and public reporting obligations for physical commodity activities, including reporting the total fair value of physical commodities across different categories of covered physical commodities. In addition, FHCs would be required to indicate whether they own any covered physical commodities; hold infrastructure assets under section 4(o) authority; engage in exploration, extraction, production or refining of physical commodities; or hold investments in merchant banking portfolio companies that engage in physical commodity activities. Further, the new reporting requirements would require information relating to the proposed capital treatment of physical commodity assets described above.

WHAT DOES THIS MEAN FOR MERCHANT BANKING MORE BROADLY?

The NPR notes that the FRB is “considering the appropriate risk-based capital treatment for all merchant banking investments. For example, the FRB is considering whether to include merchant banking investments as ‘non-significant equity exposures’ [i.e., eligible for a 100% risk weight] under the FRB’s standardized approach to risk-based capital.”

This statement indicates that the FRB may propose additional revisions to various regulations applicable to merchant banking investments. Revisions to the merchant banking rules other than capital requirements would need to be proposed jointly by the FRB and the Secretary of the Treasury, per section 4(k)(7)(A) of the BHC Act. Capital requirements could be proposed by the FRB on its own.

* * *

Please do not hesitate to contact us with any questions.

APPENDIX

The below is a redline that shows the NPR's proposed changes to the existing regulatory text.

REGULATION Q

§217.2 Definitions.

As used in this part:

* * *

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; ~~and~~

(iv) For a market risk Board-regulated institution only, advanced market risk-weighted assets; ~~minus~~ 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 (5), 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;

~~(iv)~~ Total risk-weighted assets for securitization exposures as calculated under §217.42;

~~(v)~~ Total risk-weighted assets for equity exposures as calculated under §§217.52 and 217.53; and

~~(vi)~~ 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.

§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, ~~and~~ unsettled transactions, and covered physical commodities).

§ 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;

~~(iv)~~ A securitization exposure subject to §§ 217.41 through 217.45; or

~~(v)~~ 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.

§ 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.

§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

(A) 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

(B) 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

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

(B) 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 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, 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 Purpose, applicability, and principle of conservatism.

(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, ~~and~~ unsettled transactions, [and covered physical commodities](#)).

§ 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, ~~or~~ 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.

§ 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 funds 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 ~~investment funds~~ [covered commodity merchant banking investments](#).

REGULATION Y

§225.28 List of permissible nonbanking activities.

(b) * * *

(8) * * *

(ii) * * *

(B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, ~~copper~~, or any other metal approved by the Board), nonfinancial asset, or group of assets, other than a bank-ineligible security, if:

(1) A state member bank is authorized to invest in the asset underlying the contract;

(2) The contract requires cash settlement;

(3) The contract allows for assignment, termination, or offset prior to delivery or expiration, and the company—

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or

(4) The contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company—

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

(C) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires cash settlement.

(iii) *Buying and selling bullion, and related activities.* Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, ~~copper~~, and any other metal approved by the Board, for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

§ 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).