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# Grandfathered into Commerce: Assessing the Federal Reserve's Proposed Rules Limiting Physical Commodities Activities of Financial Holding Companies

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# Grandfathered into Commerce: Assessing the Federal Reserve’s Proposed Rules Limiting Physical Commodities Activities of Financial Holding Companies

## I. INTRODUCTION

When the Deepwater Horizon’s oil pipe broke open in the Gulf of Mexico, millions of people watched the underwater camera showing BP’s oil pumping into the ocean.<sup>1</sup> BP neither owned, nor operated the rig that exploded and sank after killing eleven people.<sup>2</sup> Still, that oil spill has gone down in history as the “BP Oil Spill.”<sup>3</sup> BP spent nearly \$62 billion to resolve the legal claims associated with the event and to restore goodwill and its reputation.<sup>4</sup> But what if instead of the BP Oil Spill, it had been the Morgan Stanley Oil Spill?<sup>5</sup>

Morgan Stanley and Goldman Sachs are the only two financial holding companies (“FHCs”) who benefit from a provision of the Gramm-Leach-Bliley Act of 1999 (“GLBA”), which allows qualifying FHCs to engage in the extraction and transport of physical commodities.<sup>6</sup> In general, commodities trading by FHCs must be deemed

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1. Michael McCarthy, *BP Fights to Limit the Slick—And the Damage to its Reputation*, INDEPENDENT (Apr. 30, 2010), <http://www.independent.co.uk/news/world/americas/bp-fights-to-limit-the-slick-and-the-damage-to-its-reputation-1959598.html>.

2. *Id.* (explaining that Deepwater Horizon was owned and operated by a Swiss drilling company, Transocean, whereas BP had leased the rig and owned the license to drill in the seabed).

3. *Id.*

4. Michael Amon & Tapan Panchal, *BP Puts Tab for Gulf Disaster at \$62 Billion*, WALL ST. J. (July 14, 2016), <https://www.wsj.com/articles/bp-estimates-remaining-material-deepwater-liabilities-1468517684>.

5. STAFF OF S. COMM. ON INVESTIGATIONS, 113TH CONG., REP. ON WALL STREET BANK INVOLVEMENT WITH PHYSICAL COMMODITIES 284 (Comm. Print 2014) (describing a 2006 Morgan Stanley investment in a company that owned approximately 100 oil tankers) [hereinafter COMMITTEE REPORT].

6. See 12 U.S.C. § 1843(k)(1)(A)-(B) (2016) (outlining the general scope of activities for financial holding companies, namely activities that are financial in nature or incidental to such financial activity, as well as complementary to a financial activity); 12 U.S.C. § 1843(o) (2016); BD. OF GOVERNORS OF THE FED. RESERVE SYS., FED. DEPOSIT INS. CORP., & OFFICE OF THE COMPTROLLER OF THE CURRENCY, REPORT TO THE CONGRESS AND THE FINANCIAL STABILITY OVERSIGHT COUNCIL PURSUANT TO SECTION 620 OF THE DODD-FRANK ACT 16 (2016) [hereinafter SECTION 620 REPORT].

“complementary to a financial activity” by the Federal Reserve Board (“Federal Reserve” or “FRB”),<sup>7</sup> or fall into a Grandfather Provision (“Grandfather Provision” or “Grandfather Authority”) that allows two FHCs—Morgan Stanley and Goldman Sachs—to continue engaging in a broader range of nonbanking activities than would otherwise be allowed under the complementary powers.<sup>8</sup>

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”)<sup>9</sup> Section 620 called on the federal bank regulators to study the activities and investments allowed for bank entities and to examine the risks those activities might create for the safety and soundness of the American financial system.<sup>10</sup> Over six years later, on September 8, 2016, the federal bank regulators<sup>11</sup> released their “Report to the Congress and Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act” (“Section 620 Report”).<sup>12</sup> In that report, the Federal Reserve expressed concerns about FHCs’ ability to engage in physical commodities activities.<sup>13</sup> The Federal Reserve recommended Congress repeal this Grandfather Provision.<sup>14</sup> Specifically, the Federal Reserve called on Congress to repeal the Grandfather Authority that in practice allowed just two FHCs to own physical commodity assets and infrastructure for commodity storage, shipment, and use.<sup>15</sup>

Shortly after releasing the Section 620 Report on September 8, 2016, the Federal Reserve released a notice of proposed rulemaking (“NPR”) to address the concerns about the risks of commodity activities by FHCs.<sup>16</sup> The September 30, 2016 NPR attempted to limit these

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7. 12 U.S.C. § 1843(k)(1)(B) (2016); 12 C.F.R. § 225.28(b)(8)(ii) (2017).

8. 12 U.S.C. § 1843(o); SECTION 620 REPORT, *supra* note 6, at 10.

9. Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) § 620, 12 U.S.C. § 5301 (2016).

10. *Id.*; SECTION 620 REPORT, *supra* note 6, at 1.

11. The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of Currency.

12. SECTION 620 REPORT, *supra* note 6 at 1.

13. SECTION 620 REPORT, *supra* note 6 at 16.

14. SECTION 620 REPORT, *supra* note 6 at 28.

15. SECTION 620 REPORT, *supra* note 6 at 29–30 (including recommendations from the Fed, FDIC and OCC. This note covers only the Fed recommendation to repeal the section 4(o) Grandfather activities).

16. 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 (“September 2016 Proposed Rule

commodity activities through stricter capital requirements, activity limits, and greater required public disclosure of data relating to these activities.<sup>17</sup> Since it would require legislative action to amend this statutory provision, repealing the Grandfather Provision is outside the scope of the Federal Reserve's authority.<sup>18</sup> Therefore, in the NPR the Federal Reserve was limited to increasing safeguards for physical commodities activities, which reflect the Federal Reserve's view of the relative risk of those activities.<sup>19</sup>

Many would argue that all physical commodities activities are fundamentally riskier than traditional bank activities, and engaging in these activities undermines the separation of banking and commerce.<sup>20</sup> This raises the question of whether banks should be involved in these activities at all—an issue the Federal Reserve addressed in its Section 620 Report.<sup>21</sup> The Grandfather Provision allows FHCs to engage in a broader range of activities than permitted under the complementary powers.<sup>22</sup> The activities permitted under the Grandfather Provision—such as transporting physical commodities through a pipeline or an oil tanker—are more prone to a catastrophic event than the activities permitted under the complementary authorities and merchant banking powers, which are more financial in nature.<sup>23</sup> This Note analyzes separation of banking and commerce issues that arise out of the FHCs' authority to engage in physical commodities trading under the Grandfather Provision and whether the Federal Reserve is in the best position to address these issues through a proposed rulemaking or whether it is better left for Congress to remove the Grandfather Provision altogether.<sup>24</sup>

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on Risk-Based Capital and Other Regulatory Requirements”), 81 Fed. Reg. 67220, 67225 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. pt. 217 & 225).

17. *Id.* (proposing several new restrictions on commodity activities. This Note focuses on the proposals relating specifically to grandfathered activities.).

18. SECTION 620 REPORT, *supra* note 6, at 28.

19. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67226–27 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. pt. 217 and 225).

20. *Id.* at 67221.

21. SECTION 620 REPORT, *supra* note 6, at 28.

22. 12 U.S.C. § 1843(k)(1)(A)–(B), (o) (2016); SECTION 620 REPORT, *supra* note 6, at 27.

23. SECTION 620 REPORT, *supra* note 6, at 29.

24. See SECTION 620 REPORT, *supra* note 6, at 28 (discussing that recommendations by the Federal Reserve Board to make statutory changes with regard to special exemptions for FHCs will require congressional action as the changes cannot be accomplished unilaterally by the Board).

This Note proceeds in six parts. Part II examines the current statutory scheme that allows financial holding companies to engage in physical commodities activities.<sup>25</sup> Part III lays out a timeline of public scrutiny of the Grandfather Provision.<sup>26</sup> Part IV discusses the issues raised by grandfathered activities and assesses whether the FRB's proposed rules address those concerns.<sup>27</sup> Part V raises the possibility that repealing the Grandfather Provision would be unfair to firms who converted to FHCs under the impression that they could keep those grandfathered activities as part of their business.<sup>28</sup> Part VI concludes that, while the FRB's proposed rules would be a step in the right direction, Congress should step in and repeal the Grandfather Authority outright.<sup>29</sup>

## II. CURRENT STATUTORY SCHEME AND REGULATION OF GRANDFATHERED COMMODITY ACTIVITIES

### A. *General Authority for Nonbank Activities*

The Bank Holding Company Act of 1956 (“BHCA”)<sup>30</sup> is the primary statutory authority controlling the activities of companies that control an insured depository institution.<sup>31</sup> A “principal purpose” of that Act is to “ensur[e] the separation of banking and commerce.”<sup>32</sup> The BHCA provides limited ways that a bank holding company (“BHC”) may permissibly engage in nonbank activities.<sup>33</sup> However, in 1999, GLBA amended the BHCA and further broadened the range of permissible activities for a new subset to BHCs that meet certain conditions and are called FHCs.<sup>34</sup>

FHCs are permitted to engage in nonbanking activities that are “financial in nature,”<sup>35</sup> while BHCs are restricted to activities “closely

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25. *See infra* Part II.

26. *See infra* Part III.

27. *See infra* Part IV.

28. *See infra* Part V.

29. *See infra* Part VI.

30. 12 U.S.C. § 1841, et seq. (2016).

31. *Id.*

32. *See* 12 U.S.C. § 1843(n) (outlining the authority to retain limited nonfinancial activities and affiliations); SECTION 620 REPORT, *supra* note 6, at 1, 3.

33. 12 U.S.C. § 1843(k).

34. SECTION 620 REPORT, *supra* note 6, at 4–5.

35. 12 U.S.C. § 1843(k)(1)–(4) (activities that are “financial in nature” include: underwriting insurance, dealing in securities, etc.).

related to banking.”<sup>36</sup> FHC investments in physical commodities as a principal are included in those permissible “financial in nature” activities.<sup>37</sup> There are three grants of authority for a FHC to engage in physical commodities activities under the BHCA: (1) the “complementary to a financial activity” provision,<sup>38</sup> (2) the merchant banking provision,<sup>39</sup> and (3) the Grandfather Provision.<sup>40</sup>

*B. The “Complementary to a Financial Activity” Authority*

The GLBA allows any FHC to engage in activities that are “complementary to a financial activity.”<sup>41</sup> A FHC must obtain permission from the FRB on a case-by-case basis for these activities.<sup>42</sup> The FRB, which has exclusive authority to grant permission, considers whether the proposed activity is complementary to a financial activity and whether the activity would “pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.”<sup>43</sup> In approving these activities, the FRB typically imposes restrictions on the extent of permitted activity to limit the risk of these activities.<sup>44</sup>

FHCs operating under complementary authority are permitted to buy and sell physical commodities to settle commodities derivatives.<sup>45</sup> They are not permitted to own or operate “facilities for extraction, transportation, storage, or distribution of commodities.”<sup>46</sup> Nor are they permitted to “process, refine, or otherwise alter commodities.”<sup>47</sup> FHCs involved in taking and delivering commodities must use reputable third party companies for storage and transportation of the commodities that they own.<sup>48</sup>

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36. SECTION 620 REPORT, *supra* note 6, at 4.

37. SECTION 620 REPORT, *supra* note 6, at 5, 15.

38. 12 U.S.C. § 1843(k)(1)(B).

39. 12 U.S.C. § 1843(k)(4)(H).

40. 12 U.S.C. § 1843(o).

41. 12 U.S.C. § 1843(k)(1)(B); 12 C.F.R. § 225.28(b)(8)(ii) (2017); SECTION 620 REPORT, *supra* note 6, at 15.

42. SECTION 620 REPORT, *supra* note 6, at 15.

43. SECTION 620 REPORT, *supra* note 6, at 15.

44. SECTION 620 REPORT, *supra* note 6, at 24.

45. SECTION 620 REPORT, *supra* note 6, at 25.

46. SECTION 620 REPORT, *supra* note 6, at 25.

47. SECTION 620 REPORT, *supra* note 6, at 25.

48. SECTION 620 REPORT, *supra* note 6, at 25.

Finally, to keep this line of business from becoming too large, a FHC's involvement in physical commodity trading activities is limited to no more than 5% of the firm's consolidated Tier 1 capital.<sup>49</sup> Essentially, the complementary authority allows a FHC to own and trade physical commodities, but does not give the FHC authority to store or transport those assets in its own facilities.<sup>50</sup>

C. *Merchant Banking Authority*

The GLBA permits any FHC to make equity investments up to 100% of a commercial firm under the merchant banking authority of the GLBA.<sup>51</sup> Banks and BHCs may only own up to 5% of the voting shares in a commercial company.<sup>52</sup> This limit is designed to ensure that bank entities remain passive investors in these commercial companies.<sup>53</sup> Post-GLBA, however, the newly created FHCs were granted authority to purchase and control up to 100% of the voting shares of a commercial company.<sup>54</sup>

The statute forbids the FHC from engaging in the routine management of the company, except as may be necessary to obtain a reasonable return on investment upon resale.<sup>55</sup> This means that the investing FHC cannot insert itself into personnel decisions, provide business advice, or meet with the company's employees.<sup>56</sup> Essentially, the FHC must not intertwine itself with the daily activities of the company.<sup>57</sup> However, the FHC is allowed to elect any or all of the board of directors of a controlled company.<sup>58</sup> These restrictions were put in place to maintain the separation of banking and commerce.<sup>59</sup>

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49. SECTION 620 REPORT, *supra* note 6, at 25.

50. SECTION 620 REPORT, *supra* note 6, at 25.

51. 12 U.S.C. § 1843(k)(4)(H) (2016).

52. Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265, 281 (2013).

53. *Id.*

54. 12 U.S.C. § 1843(k)(4)(H).

55. 12 U.S.C. § 1843(k)(4)(H)(iv).

56. Omarova, *supra* note 52, at 283–84.

57. Omarova, *supra* note 52, at 283–84.

58. 12 C.F.R. § 225.171(d)(1) (2017).

59. Omarova, *supra* note 52, at 283.

Further, the GLBA restricts the purpose of investment to bona fide merchant or investment banking activities.<sup>60</sup> In other words, FHCs may only invest in commercial companies with an eye towards profiting off the eventual resale of stock in that company.<sup>61</sup> Pursuant to that goal, the Federal Reserve established caps on the amount of time a FHC is permitted to hold an investment.<sup>62</sup> Generally, a FHC may hold an investment for a maximum of ten years, though it may petition the FRB for an extension.<sup>63</sup> These limits are meant to enforce the financial—rather than commercial—nature of these activities and to limit risk.<sup>64</sup>

*D. Powers Specific to the Grandfather Provision*

Another route to engaging in nonbanking or nonfinancial activity—and the focus of this Note—is under Section 4(o) of the GLBA, the Grandfather Provision.<sup>65</sup> This section provides that any firm that was not a BHC but became a FHC after November 12, 1999—the date of the GLBA’s enactment—may continue to engage in physical commodities trading or investment in commodities, even though not permissible for BHCs, if the firm was engaged in such activities as of September 30, 1997 in the United States.<sup>66</sup> The Grandfather Provision effectively permits Goldman Sachs and Morgan Stanley to engage in a broader range of physical commodity activities than any other authority allowing such activities.<sup>67</sup>

The Section 4(o) Grandfather Provision offers qualifying FHCs advantages over non-grandfathered FHCs.<sup>68</sup> First, the Grandfather Provision allows a broader range of activities, including transporting, refining, extracting, and storing physical commodity assets, than would

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60. 12 U.S.C. § 1843(k)(4)(H)(ii).

61. *Id.*

62. *See* 12 C.F.R. § 225.172 (mandating the period of time FHCs are generally permitted to hold merchant banking investments).

63. 12 C.F.R. § 225.172(b)(1); 12 C.F.R. § 225.172(b)(4)–(5).

64. Omarova, *supra* note 52, at 283.

65. *See* 12 U.S.C. § 1843(o) (“[A] financial holding company . . . may continue to engage in . . . activities related to the trading, sale, or investment in commodities . . .”).

66. STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 113TH CONG., WRITTEN TESTIMONY OF SAULE T. OMAROVA, PROFESSOR OF LAW, CORNELL UNIVERSITY 10 (Comm. Print 2014).

67. *See* 12 U.S.C. § 1843(o) (providing for the Grandfather Authority of certain financial holding companies); SECTION 620 REPORT, *supra* note 6, at 16.

68. 12 U.S.C. § 1843(o).

be allowed under the complementary powers.<sup>69</sup> Second, the Grandfather Provision does not require the FHC to ask permission from the FRB for those activities.<sup>70</sup> Third, the Grandfather Provision is subject to less restrictive aggregate investment limits than the complementary authority.<sup>71</sup>

Activities under the Grandfather Provision are not vetted by the FRB.<sup>72</sup> Unlike complementary physical commodities activities, which require explicit permission from the FRB,<sup>73</sup> the Section 4(o) Grandfather Authority is automatic and a FHC is not required to seek permission from or notify the FRB of new activities.<sup>74</sup> The GLBA grants permission to any company who becomes a FHC after November 12, 1999, to “continue to engage in . . . activities related to the trading, sale, or investment in commodities and underlying physical properties,”<sup>75</sup> so long as the company, “or any subsidiary of the holding company, lawfully was engaged, directly or indirectly, in any of such activities as of September 30, 1997, in the United States.”<sup>76</sup> There are two possible interpretations of this clause.<sup>77</sup> The first interpretation is that a qualifying FHC may continue to perform *only* the activities that it legally engaged in prior to the grandfather date in 1997.<sup>78</sup> The second interpretation takes the view that the statute should be read expansively, so that if a FHC’s predecessor or subsidiary was engaged in *any* physical commodity activity prior to the 1997 grandfather date, then the FHC is permitted to continue those activities *and* add new activities at any time, subject only to the 5%

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69. *Id.*; SECTION 620 REPORT, *supra* note 6, at 15–16.

70. 12 U.S.C. § 1843(o); *see* SECTION 620 REPORT, *supra* note 6, at 16 (stating that a company that was not a BHC and becomes an FHC after November 12, 1999, may automatically continue to engage in activities related to commodities, implying that no permission is needed from the FRB).

71. 12 U.S.C. § 1843(o); SECTION 620 REPORT, *supra* note 6, at 30.

72. 12 U.S.C. § 1843(o); SECTION 620 REPORT, *supra* note 6, at 30.

73. 12 U.S.C. § 1843(j)(2)(A) (“In connection with a notice under this subsection, the Board shall consider whether performance of the activity by a bank holding company or a subsidiary of such company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, unsound banking practices, or risk to the stability of the United States banking or financial system.”).

74. 12 U.S.C. § 1843(o); SECTION 620 REPORT, *supra* note 6, at 30.

75. 12 U.S.C. § 1843(o).

76. 12 U.S.C. § 1843(o)(1).

77. COMMITTEE REPORT, *supra* note 5, at 58.

78. COMMITTEE REPORT, *supra* note 5, at 58.

activity cap in the statute.<sup>79</sup> The Federal Reserve, the agency responsible for administering the BHCA, which this provision of the GLBA amended, has not taken a position on this question.<sup>80</sup>

The legislative history of the GLBA tends to support the first, more restrictive interpretation of the grandfather clause.<sup>81</sup> Senator Phil Gramm explained that the purpose of this amendment was to ensure that a securities firm that might become a FHC following GLBA would not be forced to divest parts of its business.<sup>82</sup> Further, the statutory language reads that the provision “grandfathers’ existing commodities activities.”<sup>83</sup> The Senate Banking Committee report on the bill gives no indication that the Grandfather Provision is meant to authorize new activities.<sup>84</sup> Further, the phrase “grandfather clause” is defined in Black’s Law Dictionary as a “provision that creates an exemption from the law’s effect for something that existed before the law’s effective date.”<sup>85</sup> This tends to support a narrow interpretation of the statute to include only those specific activities that the firm was engaged in as of September 30, 1997.<sup>86</sup>

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79. COMMITTEE REPORT, *supra* note 5, at 58.

80. COMMITTEE REPORT, *supra* note 5, at 58.

81. See Amendment #9 Gramm Amendment on Grandfathering Existing Commodities Activities, 106<sup>th</sup> Cong. (1999), <http://banking.senate.gov/docs/reports/fsmod99/gramm9.htm> (showing the legislative history of the GLBA and that Senator Phil Gramm’s amendment enlarges the Act’s grandfather provisions); COMMITTEE REPORT, *supra* note 5, at 58.

82. Amendment #9 Gramm Amendment on Grandfathering Existing Commodities Activities, 106<sup>th</sup> Cong. (1999), <http://banking.senate.gov/docs/reports/fsmod99/gramm9.htm> (“The above amendment assures that a securities firm currently engaged in a broad range of commodities activities as part of its traditional investment banking activities, is not required to divest certain aspects of its business in order to participate in the new authorities granted under the Financial Services Modernization Act. This provision “grandfathers” existing commodities activities.”).

83. *Id.* (emphasis added).

84. See H.R. REP. NO. 104-127, pt. 1, at 97 (1995) (“The Committee intends that activities relating to the trading, sale or investment in commodities and underlying physical properties shall be construed broadly and shall include owning and operating properties and facilities required to extract, process, store and transport commodities.”); COMMITTEE REPORT, *supra* note 5, at 59.

85. *Grandfather Clause*, BLACK’S LAW DICTIONARY (10th ed. 2014) (“A provision that creates an exemption from the law’s effect for something that existed before the law’s effective date; specif., a statutory or regulatory clause that exempts a class of persons or transactions because of circumstances existing before the new rule or regulation takes effect.”).

86. 12 U.S.C. § 1843(o)(1) (2016) (authorizing an FHC to continue engaging in commodity activities which it was engaging in prior to September 30, 1997).

Qualifying FHCs, however, have argued for a more expansive interpretation of the grandfather authority that allows the FHCs to engage in any physical commodity activity, even new activities.<sup>87</sup> In its 2008 application to become a BHC, Goldman Sachs wrote:

The Section 4(o) exemption does not require that a company have been engaged prior to September 30, 1997 in all the activities that it seeks to grandfather under Section 4(o) at the time the company becomes a BHC [Bank Holding Company], rather it only requires that the company have been engaged prior to that date in commodity-related activities that were not permissible for a BHC in the United States on that date.<sup>88</sup>

This self-serving interpretation allows Goldman Sachs to engage in any new commodity activities that it wants—without requiring permission or notification of the FRB—so long as it was engaged in *some* physical commodity activity prior to the grandfather date in 1997.<sup>89</sup> Goldman Sachs argued in a letter to the Federal Reserve that the proposed capital increases would “pre-empt Congressional authority by taking action in direct contravention to the language of Section 4(o).”<sup>90</sup> Without citing any statutory authority, Goldman Sachs claims that Congress passed the Grandfather Provision because of the expertise and risk

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87. COMMITTEE REPORT, *supra* note 5, at 60.

88. COMMITTEE REPORT, *supra* note 5, at 60 (quoting “Confidential Application to the Board of Governors of the Federal Reserve System by The Goldman Sachs Group, Inc. and Goldman Sachs Bank USA Holdings LLC,” prepared by Goldman Sachs, FRB-PSI-303638 - 662, at 648–649, 661).

89. COMMITTEE REPORT, *supra* note 5, at 60

90. Letter from John F.W. Rogers on Behalf of The Goldman Sachs Group, Inc., to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 3–4 (Feb. 21, 2017).

management provided by FHCs in the commodities industry.<sup>91</sup> Morgan Stanley, the other qualifying FHC, has endorsed a similar interpretation.<sup>92</sup>

While the statute restricts these grandfathered activities to comprising no more than 5% of a FHC's total consolidated assets, it is unclear how strict that limit is.<sup>93</sup> The statutory 5% cap could be interpreted as "capping only those physical commodity assets for which a qualifying FHC cannot find an alternative authorization, either under its merchant banking or 'complementary' powers."<sup>94</sup> This means that, if the FHC is able to present a commodity activity as authorized under its merchant banking or complementary powers, the FHC could perhaps have the commodities portion of its assets exceed the 5% of total consolidated assets limit.<sup>95</sup> The current statutory structure is ambiguous and has allowed these two FHCs to engage in expansive commodities activities.<sup>96</sup>

### III. TIMELINE OF SCRUTINY OF COMMODITY ACTIVITIES

After the passage of the GLBA, no firm immediately took advantage of the Grandfather Provision. Investment banks continued to engage in physical commodity activities outside the supervisory authority

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91. *Id.* at 4 ("In enacting Section 4(o), Congress explicitly acknowledged the importance of the expertise and risk management provided by FHC intermediaries in the physical commodities markets."). In fact, the legislative history of the GLBA shows that the Grandfather Provision was included so that FHCs would not have to divest parts of their business in its conversion to an FHC. *See* Amendment #9 Gramm Amendment on Grandfathering Existing Commodities Activities, 106<sup>th</sup> Cong. (1999), <http://banking.senate.gov/docs/reports/fsmod99/gramm9.htm> (providing that FHCs cannot continue to engage in activities related to trading in commodities unless the holding company is predominantly engaged in financial activities).

92. COMMITTEE REPORT, *supra* note 5, at 60 ("[T]he plain language of Section 4(o) authorizes a qualifying financial holding company to continue to engage in any activities related to trading, selling, and investing in any type of commodities and related physical properties or facilities, if certain conditions are satisfied. Section 4(o) does not merely authorize the retention of investments in commodities or related physical properties or facilities made or held on a certain date. Instead, it expressly extends to the *continuation* of any *activities* related to the trading, selling, and investing in any type of commodities and related properties or facilities, if certain conditions are satisfied.") (emphasis in original).

93. 12 U.S.C. § 1843(o) (2016); SECTION 620 REPORT, *supra* note 6, at 1, 16.

94. STAFF OF S. COMM. ON HOMELAND SEC. AND GOVERNMENTAL AFFAIRS, 113TH CONG., WRITTEN TESTIMONY OF SAULE T. OMAROVA, PROFESSOR OF LAW, CORNELL UNIVERSITY 10 (Comm. Print 2014).

95. *Id.*

96. *Id.* at 11.

of the Federal Reserve.<sup>97</sup> It was not until the 2008 financial crisis when some of these investment banks that were involved in physical commodity activity converted to FHCs—to become eligible for bailout money from the government<sup>98</sup>—that they came under the regulatory authority of the Federal Reserve.<sup>99</sup> In response to this new influx of potentially risky activities, the Federal Reserve Bank of New York created a “Commodities Team” that initiated a two-year investigation into the commodities activities of the ten largest banks under FRB supervision.<sup>100</sup>

In 2011, the issue of FHC involvement began to seep into the mainstream with a widely publicized report of Goldman Sachs hoarding 12% of the world’s aluminum in a warehouse to artificially inflate prices.<sup>101</sup> Coca-Cola filed a complaint with the London Metal Exchange about this practice, as aluminum prices hit record highs.<sup>102</sup> Professor Saule T. Omarova referenced that incident with Goldman in her 2013 *Minnesota Law Review* piece that took an unprecedented look at the extent of physical commodities activities by U.S. banking organizations.<sup>103</sup> Professor Omarova was called to testify at a November 2014 Senate Subcommittee hearing on “Wall Street Bank Involvement in

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97. STAFF OF S. COMM. ON INVESTIGATIONS, 113TH CONG., REP. ON WALL STREET BANK INVOLVEMENT WITH PHYSICAL COMMODITIES 60 (Comm. Print 2014).

98. Kristin Jones, *Why Is Everyone Becoming a Bank Holding Company? It’s All About the Benjamins*, PROPUBLICA, (Nov. 12, 2008), <https://www.propublica.org/article/why-is-everyone-becoming-a-bank-holding-company-1112> (listing eligibility for TARP funding and access to Fed Discount window as key reasons for change); Michael J. de la Merced, et al., *As Goldman and Morgan Shift, a Wall St. Era Ends*, DEALBOOK: N.Y. TIMES (Sept. 21, 2008), <https://dealbook.nytimes.com/2008/09/21/goldman-morgan-to-become-bank-holding-companies> (discussing the rationale behind Goldman Sachs’ and Morgan Stanley’s shift to holding companies, such as the ability to combine investment-banking operations with larger capital cushions).

99. Press Release, Board of Governors of the Federal Reserve System, Board Approves, Pending a Statutory Five-Day Antitrust Waiting Period, the Applications of Goldman Sachs and Morgan Stanley to Become Bank Holding Companies (Sept. 21, 2008) <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20080921a.htm>; COMMITTEE REPORT, *supra* note 5, at 50.

100. Comment Letter from Elise J. Bean & Tyler E. Gellasch to Robert deV. Frierson, Sec’y, Fed. Reserve Sys. Bd. of Governors (Dec. 22, 2016), [https://www.federalreserve.gov/SECRS/2017/May/20170518/R-1547/R-1547\\_122216\\_131639\\_432161420310\\_1.pdf](https://www.federalreserve.gov/SECRS/2017/May/20170518/R-1547/R-1547_122216_131639_432161420310_1.pdf).

101. Dustin Walsh, *Aluminum Bottleneck: Coke’s complaint: 12% of Global Stockpile Held Here, Boosting Prices*, CRAIN’S DETROIT BUS. (Jun. 26, 2011), <http://www.craindetroit.com/article/20110626/FREE/306269994/aluminum>.

102. *Id.*

103. Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265, 266–68 (2013).

Physical Commodities,” along with the heads of Goldman Sachs, Morgan Stanley, and JP Morgan Chase.<sup>104</sup> The subcommittee issued a report authored by Senators Levin and McCain on the extent of FHC physical commodity activities and the potential liability those activities created for FHCs.<sup>105</sup> The subcommittee recommended narrowing the scope of permissible commodities activities, strictly enforcing the size limits imposed by the grandfather clause, and clarifying the scope of the grandfather clause to only permit FHCs to continue engaging in activities in which they had already been engaging before the grandfather date.<sup>106</sup>

Professor Omarova’s work attracted attention from popular media outlets.<sup>107</sup> *The Daily Show* picked up the Goldman Sachs aluminum hoarding story and showed a clip of Professor Omarova’s testimony on the program.<sup>108</sup>

In this environment of public scrutiny, the Federal Reserve issued a September 2016 report pursuant to Section 620 of the Dodd-Frank Act in which the FRB recommended repeal of the Grandfather Authority.<sup>109</sup> That report was quickly followed by a notice of proposed rulemaking.<sup>110</sup> The comments were originally due in December 2016.<sup>111</sup> After the 2016 presidential election, the Federal Reserve announced that it would allow firms an extension on the comment letter deadline, due to the complexity of the issues presented.<sup>112</sup> The extended due date for comments was February 20, 2018.<sup>113</sup>

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104. *Hearing on Wall Street Bank Involvement With Physical Commodities before the Permanent Subcommittee on Investigations*, 113th Cong. (2014).

105. Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 1 (2014).

106. *Id.* at 9–12.

107. *Omarova Article Puts Questionable Banking Practices in National Spotlight*, UNC SCHOOL OF LAW (Aug. 20, 2013), <http://www.law.unc.edu/news/story.aspx?cid=844>.

108. Brent Lang, *John Oliver: Did J.P. Morgan Just Get the Idea to Go Into Sex Trafficking?*, THE WRAP (Oct. 30, 2017, 9:00 AM), <https://www.thewrap.com/john-oliver-did-jp-morgan-just-get-idea-go-sex-trafficking-106186/>.

109. SECTION 620 REPORT, *supra* note 6 at 29.

110. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

111. *Id.*

112. Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Board extends comment period to February 20, 2017, on proposed rule that would strengthen existing requirements and limitations on the physical commodity activities of financial holding companies (Dec. 20, 2016) (on file with author).

113. *Id.*

IV. PHYSICAL COMMODITY ACTIVITIES UNDER THE GRANDFATHER PROVISION

The FHCs have a “significant footprint” in physical commodities markets.<sup>114</sup> Morgan Stanley has an oil storage capacity of 58 million barrels and eighteen natural gas storage facilities in the United States and Europe.<sup>115</sup> In 2009, Morgan Stanley was the ninth largest oil shipping distillate in the world, operating more than 100 ships for oil transport.<sup>116</sup> Goldman Sachs purchased a Colombian coal mine for \$204 million.<sup>117</sup> With such expansive physical operations, it is no wonder that the Federal Reserve has raised concerns about FHC liability in the event of a catastrophic environmental event.<sup>118</sup>

Permitting FHCs to engage directly in a broader range of commercial activities, such as physical commodities activities, cuts against the principle of separating banking and commerce.<sup>119</sup> This section assesses the three concerns that the FRB cited in making this recommendation: (1) safety and soundness, (2) competitive issues presented by the Grandfather Provision, and (3) the potential for conflict of interest.

A. *Safety and Soundness*

Section 4(o) does not prohibit FHCs from owning and operating the infrastructure necessary for physical commodities activities.<sup>120</sup> This power creates safety and soundness concerns because some federal environmental laws impose strict liability on the owners and operators of facilities whose pollution causes damages.<sup>121</sup> Both Morgan Stanley and Goldman Sachs acknowledge the risks that stem from their involvement in physical commodities activities in the Risk Factors section of their

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114. Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 81 (2014).

115. *Id.*

116. *Id.* at 82.

117. *Id.*

118. SECTION 620 REPORT, *supra* note 6 at 27.

119. *Id.* at 30.

120. 12 U.S.C. 1843(o) (2016); SECTION 620 REPORT, *supra* note 6 at 29.

121. SECTION 620 REPORT, *supra* note 6 at 29; *see e.g.*, 33 U.S.C. 1321, 2701–02(f)(1) (2016) (holding the owner and operator of a facility or vessel that discharges oil to be strictly liable).

annual 10-K report to the Securities and Exchange Commission.<sup>122</sup> The liability for an environmental catastrophe creates financial and reputational risk for FHCs beyond the scope of the risks presented by traditional bank activities.<sup>123</sup> As owners and investors in physical facilities for the storage and transport of commodities, FHCs exercising Section 4(o) authority open themselves up to liability for environmental catastrophes.<sup>124</sup> In addition, commodities activity that ends in catastrophe could damage public confidence in the financial institution.<sup>125</sup>

If a catastrophic environmental event occurred in the course of this physical commodities activity, the FHC could incur losses that “greatly exceed the firm’s investments in the physical assets, the market value of the physical commodities involved in the catastrophic event, committed capital, and insurance policies of the organization.”<sup>126</sup> Many federal and state environmental laws impose strict liability on the owners and operators of infrastructure for the transport of certain physical commodities.<sup>127</sup>

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122. Morgan Stanley, *Form 10-K Annual Report Pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934*, 18–19 (Dec. 31, 2016) [https://www.morganstanley.com/about-us-ir/pdf/MS\\_10K\\_December\\_31\\_2016.pdf](https://www.morganstanley.com/about-us-ir/pdf/MS_10K_December_31_2016.pdf) (“Our commodities activities and investments subject us to extensive regulation, and environmental risks and regulation that may expose us to significant costs and liabilities.”); The Goldman Sachs Group, Inc., *Form 10-K Annual Report Pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934*, 39 (Dec. 31, 2016) <http://www.goldmansachs.com/investor-relations/financials/current/10k/2016-10-k.pdf> (“We face enhanced risks . . . in a number of our businesses, including where we make markets, invest and lend, we directly or indirectly own interests in, or otherwise become affiliated with the ownership and operation of public services, such as airports, toll roads and shipping ports, as well as physical commodities and commodities infrastructure components, both within and outside the U.S.”).

123. SECTION 620 REPORT, *supra* note 6 at 29.

124. SECTION 620 REPORT, *supra* note 6 at 29.

125. SECTION 620 REPORT, *supra* note 6 at 29.

126. SECTION 620 REPORT, *supra* note 6 at 27; Complementary Activities, Merchant Banking Activities, and Other Activities of Financial Holding Companies Related to Physical Commodities, 79 Fed. Reg. 3329 (proposed Jan. 21, 2014) (to be codified at 12 C.F.R. Chapter II).

127. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225) (“Certain federal environmental laws, including the Oil Pollution Act of 1990 (OPA), the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), and the Clean Water Act (CWA), 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. 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.”)

This concern was raised by the FRB in light of recent catastrophic environmental events, like the oil spill involving the Deepwater Horizon, which accounted for cumulative losses at BP of \$53.8 billion as of 2015.<sup>128</sup> BP paid approximately \$4.5 billion to resolve federal criminal claims and federal securities law claims related to the spill. Civil litigation is also ongoing, as the parties are unable to determine the full economic impact of the event.<sup>129</sup> The FRB argues that the costs of preventing accidents like these are high and the costs of liability related to physical commodities activities can be difficult to limit and higher than expected.<sup>130</sup>

Banks argue, however, that environmental liability can be avoided if appropriate safeguards are undertaken.<sup>131</sup> Goldman Sachs describes its involvement in commodities as providing “commodity intermediation” services.<sup>132</sup> Goldman Sachs claims that a bank entity engaging in commodity intermediation can preclude liability by putting in place safeguards designed “to prevent an owner of commodities from assuming the status of ‘operator’ of facilities in which commodities are stored, transported, or processed.”<sup>133</sup> Though Goldman Sachs has publicly claimed it is shielded from liability as an operator, the firm has purchased “contingent, third-party environmental/pollution liability coverage” insurance.<sup>134</sup> Goldman Sachs’ position is that these commodities activities present similar market risks to its financial products like loans or bonds whose risk can be managed and mitigated.<sup>135</sup>

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128. Susan Heavey, Patrick Rucker, Emily Stephenson, *U.S. Says BP to Pay \$20 Billion in Fines for 2010 Oil Spill*, REUTERS (Oct. 5, 2015, 7:46 AM), <https://www.reuters.com/article/us-bp-usa/u-s-says-bp-to-pay-20-billion-in-fines-for-2010-oil-spill-idUSKCN0RZ14A20151005>.

129. *Id.*

130. *Id.*

131. Letter from John F.W. Rogers on behalf of The Goldman Sachs Group, Inc., to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 4 (Apr. 16, 2014).

132. *Id.*

133. *Id.* (“Even with respect to environmentally sensitive commodities, an FHC engaged in intermediation will not be subject to liability under well-settled environmental law by adhering to straight-forward policies and procedures designed to prevent an owner of commodities from assuming the status of ‘operator’ of facilities in which commodities are stored, transported or processed.”)

134. Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 134 (2014).

135. Letter from John F.W. Rogers on behalf of The Goldman Sachs Group, Inc., to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 3 (Apr. 16, 2014).

The Securities Industry and Financial Markets Association (“SIFMA”), a securities industry trade group, wrote in a comment letter to the FRB (“SIFMA Letter”) that FHCs engaged in Section 4(o) commodities business are practicing safe and sound banking so long as those activities are subjected to “appropriate safeguards.”<sup>136</sup> Environmental liability typically attaches to the owner and operator of the facility where the catastrophe occurred.<sup>137</sup> Section 4(o) authority allows FHCs to own and operate facilities that process, store, and

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136. Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 57 (Apr. 16, 2014) (“We do not believe that engaging in Environmentally Sensitive Commodities Handling Activities as a Grandfathered Commodities Activity or making merchant banking investments in portfolio companies engaged in such activities would amount to an unsafe or unsound practice or otherwise be justified, if conducted or made subject to appropriate safeguards when appropriate, such as those described in Appendix C.”); Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys., 57 (Apr. 16, 2014), app. at C-1, Practices for Limiting Environmental Liability and Ensuring that Legal Entity Separateness Will Be Respected (giving a sample procedure that, if followed, would shield a bank from liability for its commodities activities.).

137. Whether FHCs can be held liable as owners/operators of a facility that is part of an environmental catastrophe is outside the scope of this Note. For a more complete discussion of potential liability, see Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys., 54 (Apr. 16, 2014) (“Under these laws, the parties responsible for damages resulting from the release of an environmentally sensitive commodity include the owner and operator of the facility from which the release occurred, as well as parties that directly handle the commodity or arrange for its treatment or disposal. Liability typically does not attach to an entity that merely owns a commodity that is released, or that enters into ordinary course contracts for transportation or storage. Nor does liability typically attach to an entity that merely invests in a business that is engaged in the activity that gives rise to the release.”); see also Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 57 (Apr. 16, 2014), app. at B-4, Joint Memorandum of Law (“Trading or investing in physical commodities, including environmentally sensitive commodities, or engaging in related activities such as extraction, generation, transportation, storage, or processing, may, in certain circumstances, give rise to liability for damages resulting from the release of environmentally sensitive commodities.”).

transport physical commodities.<sup>138</sup> Despite this, FHCs using this authority say they can effectively manage the investment's risk.<sup>139</sup>

The FRB's proposed rule addresses safety and soundness concerns by increasing the required amount of risk-based capital to reflect the increased risk associated with Section 4(o) commodity activities.<sup>140</sup> Specifically, the FRB proposed a 1,250% risk weight—the highest risk weight it can assign—on all commodities assets owned under the Section 4(o) authority.<sup>141</sup>

Some observers speculate that by imposing these new capital requirements the Federal Reserve intends to preclude FHCs from engaging in these Section 4(o) activities altogether.<sup>142</sup> The proposed rule requires banks to keep one dollar of capital for every dollar invested in physical commodities under the Grandfather Authority.<sup>143</sup> The FRB's

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138. 12 U.S.C. 1843(o) (2016); *see e.g.*, Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 295 (2014) (“Morgan Stanley has been participating in physical jet fuel activities since at least 2003. Since then it has stored and transported millions of barrels of jet fuel per year, while participating in financial transactions to hedge volatile jet fuel costs. Over a ten-year period from 2003 to 2013, Morgan Stanley became the primary jet fuel supplier for United Airlines.”); *see e.g.*, Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 146–47 (2014) (“While Goldman has traded coal in financial and physical markets for years, Goldman fundamentally expanded its physical coal activities by purchasing an open pit coal mine in Colombia in 2010, and a neighboring open pit coal mine in 2012. Goldman formed a number of Colombian entities to function as the mine owners, including CNR, while its primary commodities trading arm, J. Aron & Co., became the mines’ exclusive coal marketing and sales agent.”).

139. Letter from John F.W. Rogers on behalf of The Goldman Sachs Group, Inc., to t deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 1 (Apr. 16, 2014).

140. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67225 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 and 225).

141. *Id.* at 67227.

142. Comment Letter from Carter McDowell & Richard Coffman to Robert deV. Frierson, Sec’y, Fed. Reserve Sys. Bd. of Governors 5 (Feb. 17, 2017), [https://www.federalreserve.gov/SECRS/2017/April/20170414/R-1547/R-1547\\_021717\\_131733\\_608227617620\\_1.pdf](https://www.federalreserve.gov/SECRS/2017/April/20170414/R-1547/R-1547_021717_131733_608227617620_1.pdf) (“If implemented, the Proposed Rule inevitably would force domestic FHCs and the U.S. subsidiaries of foreign FHCs to significantly reduce or even terminate their commodities activities, causing adverse effects on competition, end users, the liquidity of commodities markets, small and medium-sized companies in the commodities sector, and thus the real economy.”).

143. SULLIVAN & CROMWELL LLP, PHYSICAL COMMODITY ACTIVITIES CONDUCTED BY FINANCIAL HOLDING COMPANIES 2 (2016), [https://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_Physical\\_Commodity\\_Activities\\_Conducted\\_by\\_Financial\\_Holding\\_Companies.pdf](https://www.sullcrom.com/siteFiles/Publications/SC_Publication_Physical_Commodity_Activities_Conducted_by_Financial_Holding_Companies.pdf); September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67227–28 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225) (imposing a 300% risk weight on merchant banking and commodity activities complementary to a financial activity.).

impact analysis of these rules found that the required amount of capital for all commodities activities in the aggregate across the industry, including Section 4(o) and other authorities, could increase by as much as \$34 billion.<sup>144</sup>

The FRB claims that these new capital requirements capture the risk of a potential environmental catastrophe without making Section 4(o) activities “prohibitively costly.”<sup>145</sup> These increased capital requirements would not disrupt the industry, the FRB says, because the estimated increase in risk-weighted assets would be only 0.7%.<sup>146</sup> Further, the new capital requirements are “not intended to require capital against the full amount of legal liability and reputational harm that might result from a catastrophic event.”<sup>147</sup> The potential costs of a commodity discharge include legal liability as well as potential reputational harm, which is difficult to predict and quantify.<sup>148</sup>

The Federal Reserve has explicitly recommended to Congress that the Section 4(o) authority be repealed, so some observers have claimed that these new requirements are designed to make Section 4(o) activities impracticable.<sup>149</sup> It remains to be seen if these capital requirements will price FHCs out of this business altogether.<sup>150</sup> If FHCs continue their Section 4(o) commodity activities, having extra capital to insure against potential losses could help offset losses in the event of an environmental catastrophe and keep the FHC solvent.<sup>151</sup> On the other hand, ceasing these activities altogether may be the safest and soundest

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144. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67229 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

145. *Id.* at 67227.

146. *Id.*

147. *Id.*

148. *Id.*

149. SULLIVAN & CROMWELL LLP, *supra* note 143, at 1; SECTION 620 REPORT, *supra* note 6, at 28 (recommending that Congress repeal the grandfather authority FHCs use to engage in commodities activities); *but see* September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67227 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225) (“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.”).

150. SULLIVAN & CROMWELL LLP, *supra* note 143, at 1.

151. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67227 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

practice for FHCs, given the potential for huge liability.<sup>152</sup> Even if FHCs take steps to avoid liability by refraining from owning or operating commodity infrastructure,<sup>153</sup> the fact remains that the law allows FHCs to be the owners and operators of commodity infrastructure like transport, storage, and distribution facilities.<sup>154</sup> Those activities present the greatest risk of liability and FHCs would still be permitted to engage in those activities, even if the proposed rules are enacted.<sup>155</sup> The FRB took the most drastic action it could to reduce or eliminate these activities, given that those activities are protected by statute.<sup>156</sup> Congress will need to step in and repeal the statutory authority to fully address the safety and soundness issues raised by these Section 4(o) activities.<sup>157</sup>

*B. Anti-Competitive Concerns*

Only Goldman Sachs and Morgan Stanley are authorized to use the Grandfather Provision to engage in physical commodities activities.<sup>158</sup> This authority provides three key advantages for these FHCs: (1) these FHCs are privy to insider information that gives those firms advantages in commodities activities that are unavailable for other firms,<sup>159</sup> (2) the Section 4(o) commodities activities are subject to a less restrictive activity limit than their non-grandfathered counterparts, and

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152. *Id.* at 67221–22.

153. Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Bd. of Governors of the Fed. Reserve Sys. 57 (Apr. 16, 2014) (“We do not believe that engaging in Environmentally Sensitive Commodities Handling Activities as a Grandfathered Commodities Activity or making merchant banking investments in portfolio companies engaged in such activities would amount to an unsafe or unsound practice or otherwise be justified, if conducted or made subject to appropriate safeguards when appropriate, such as those described in Appendix C.”); Letter from Kenneth E. Bensten, Jr. et al. on behalf of SIFMA, to Robert deV. Frierson, Sec’y Board of Governors of the Fed. Reserve Sys. 57 (Apr. 16, 2014), app. at C-1, Practices for Limiting Environmental Liability and Ensuring that Legal Entity Separateness Will Be Respected (giving a sample procedure that, if followed, would shield a bank from liability for its commodities activities.).

154. 12 U.S.C. 1843(o) (2016); SECTION 620 REPORT, *supra* note 6 at 16 (“Specifically, section 4(o) may permit a qualifying FHC to own, operate, or invest in facilities for the extraction, transportation, storage, or distribution of commodities, or to process or refine commodities.”).

155. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67225 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

156. *Id.*

157. 12 U.S.C. 1843(o); SECTION 620 REPORT, *supra* note 6 at 28.

158. SECTION 620 REPORT, *supra* note 6 at 29.

159. *See infra* I.B.1.

(3) grandfathered firms do not need to seek the FRB's permission before beginning a new activity.<sup>160</sup>

The first advantage involves superior information; when a FHC is engaged in the mining, shipping, and storing of physical commodities, it is privy to information that is unavailable to its non-FHC competitors who are not allowed to engage in these activities.<sup>161</sup> Unlike the securities trading market, U.S. commodities trading laws do not restrict the use of non-public information.<sup>162</sup> Examples of useful, non-public information include: information about industry price trends, upcoming large transactions, supply disruptions, and regulatory actions.<sup>163</sup> Banks and regulators acknowledge this advantage. In a 2005 application to the FRB for expanded commodities activities under the complementary authority, JPMorgan Chase suggested that "the information gathered through this increased market participation [in physical commodities] will help improve projections of forward and financial activity and supply vital price and risk management information that JPMorgan Chase can use to improve its financial commodities derivative offerings."<sup>164</sup> This advantage could be even greater for a FHC that actually owns and operates commodities infrastructure.<sup>165</sup> For example, consider a FHC that controls an oil refinery.<sup>166</sup> If the refinery were to experience technical trouble that would affect supply, the controlling FHC would be the first to know.<sup>167</sup> The FHC could use that information to short oil prices, resulting in predictable gains.<sup>168</sup> This insider information gives the FHC an undeniable informational advantage in commodities trading.<sup>169</sup>

FHCs also have a capitalization advantage over non-FHC competitors who do not have access to the Federal Reserve's Discount

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160. *See infra* I.B.2.

161. SECTION 620 REPORT, *supra* note 6 at 29.

162. Staff of S. Comm. on Investigations, 113th Cong., Rep. on Wall Street Bank Involvement with Physical Commodities 35 (2014).

163. *Id.*

164. *Id.*

165. *Id.* at 36.

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

Window.<sup>170</sup> The Discount Window is the lender of last resort for banks and BHCs and is available to relieve liquidity strains and as a backup source of funding for banks and BHCs to meet their reserve requirements.<sup>171</sup> Any bank or BHC that is required to hold reserves at the Federal Reserve is eligible for the FRB's Discount Window lending; non-bank commercial firms are not permitted to borrow from the Discount Window.<sup>172</sup> Though it is uncommon for FHCs to actually take advantage of the Discount Window,<sup>173</sup> the possibility of cheap, easy to access, and federally subsidized credit is unavailable to the non-FHC competitors in the commodities marketplace.<sup>174</sup> This access to funds creates a significant advantage for FHCs who are, under Section 4(o) authority, acting as direct competitors to traditional, commercial commodities firms.<sup>175</sup>

Amongst FHCs, those firms with Section 4(o) authority have a more lenient commodities activity limit than commodities activities conducted by FHCs under other authorities.<sup>176</sup> Commodities activities conducted under the Section 4(o) authority can make up no more than 5% of the FHC's total consolidated assets.<sup>177</sup> While this limit is designed as a "brake" on the purely commercial activities of FHCs, the practical effect of the limit is unclear.<sup>178</sup> First, 5% of the total consolidated assets for a large FHC like Goldman Sachs or Morgan Stanley is no drop in the

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170. 12 U.S.C. § 347b (2016) (outlining the scenarios when the Federal Reserve is permitted to make an advance to member banks through its Discount Window).

171. *Discount Window Lending*, BD. OF GOVERNORS OF THE FED. RESERVE SYS. (Sept. 29, 2017), <https://www.federalreserve.gov/regreform/discount-window.htm>.

172. 12 C.F.R. § 204.1(c) (2017); *Eligibility to Borrow*, FED. RESERVE DISCOUNT WINDOW (June 22, 2015), <https://www.frbdiscountwindow.org/en/Pages/General-Information/The-Discount-Window.aspx#eligibility>.

173. OLIVIER ARMANTIER ET AL., DISCOUNT WINDOW STIGMA DURING THE 2007-2008 FINANCIAL CRISIS, 1-6 (Fed. Reserve Bank of N.Y, Staff Reports) (2015), [https://www.newyorkfed.org/medialibrary/media/research/staff\\_reports/sr483.pdf](https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr483.pdf) (Listing the two primary reasons for member banks to avoid using the Discount Window as (1) a higher interest rate than other available sources of funding, and (2) a perception that taking advantage of the Discount Window is a sign of institutional weakness and instability.).

174. Comment Letter from Dennis M. Kelleher to Robert deV. Frierson, Sec'y, Fed. Reserve Sys. Bd. of Governors 10-11 (Feb. 17, 2017), [https://www.federalreserve.gov/SECRS/2017/May/20170526/R-1547/R-1547\\_021717\\_131726\\_589907666303\\_1.pdf](https://www.federalreserve.gov/SECRS/2017/May/20170526/R-1547/R-1547_021717_131726_589907666303_1.pdf).

175. *Id.*

176. 12 U.S.C. § 1843(o)(2) (2016).

177. *Id.*

178. Written Testimony of Saule T. Omarova, Professor of Law, Cornell University, before the Before the U.S. Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations 10 (Nov. 21, 2014).

bucket; indeed, with trillion dollar balance sheets, qualifying FHCs have a wide breadth to engage in commodities activities.<sup>179</sup> Compare that with the limit on complementary commodities activities, which can make up no more than 5% of the FHC's Tier 1 capital.<sup>180</sup> Take, for example, Goldman Sachs's balance sheet.<sup>181</sup> As of June 30, 2017, Goldman Sachs reported just under \$907 billion in total assets.<sup>182</sup> With a 5% of total consolidated assets limit on activity, Goldman is able to engage in Section 4(o) activities worth up to \$45.4 billion.<sup>183</sup> On the flip side, Goldman's total Tier 1 capital totals just over \$23 billion.<sup>184</sup> Under complementary authority, which limits commodities activities to no more than 5% of Tier 1 capital, Goldman would be limited to \$1.2 billion.<sup>185</sup> A FHC of Goldman's size is therefore allowed to engage in commodities activities worth up to 97.4% more than their counterparts who were not grandfathered into this authority.<sup>186</sup>

The proposed rules do not address the information advantage that grandfathered FHCs have.<sup>187</sup> Further, the plain language of the statute forbids the FRB from creating tighter activity caps.<sup>188</sup> The proposed rules do not create a requirement for FHCs to notify the FRB about new

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179. *Id.*

180. 12 U.S.C. 1843(k)(1)(B); SECTION 620 REPORT, *supra* note 6 at 30.

181.  *Holding Companies with Assets Greater Than \$10 Billion*, NAT'L INFO. CTR. (June 30, 2017) [hereinafter NAT'L INFO. CTR.], <https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx>.

182. *Id.*

183. *Id.*

184. GOLDMAN SACHS BANK USA AND SUBSIDIARIES, ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 2015 124 (2015), <http://www.goldmansachs.com/investor-relations/financials/current/subsidiary-financial-info/gsbank-usa/gsbank-usa-2015-financial-statements.pdf>.

185. *Id.*

186. NAT'L INFO. CTR., *supra* note 181.

187. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

188. 12 U.S.C. 1843(o)(2) (2016) (“[T]he attributed aggregate consolidated assets of the company held by the holding company pursuant to this subsection, and not otherwise permitted to be held by a financial holding company, are equal to not more than 5% of the total consolidated assets of the bank holding company, except that the Board may *increase* that percentage by such amounts and under such circumstances as the Board considers appropriate, consistent with the purposes of this Act.”) (emphasis added).

activities, nor do the proposed rules create a requirement for permission for those activities.<sup>189</sup>

C. *Conflict of Interest Concerns*

One public policy consideration in favor of separation of banking and commerce is the importance of an objective banking system that allocates credit in an equitable way.<sup>190</sup> In other words, involvement in commercial activities—whether by a bank or a FHC subsidiary—creates a potential conflict of interest when it comes to lending to competitors in that commercial market.<sup>191</sup> Finding reliable data about lending practices in the face of a conflict of interest is difficult, but there is certainly a temptation for self-serving lending practices and other abuse by FHCs.<sup>192</sup>

Consider that in 2011, the Coca-Cola Company filed a complaint with the London Metal Exchange that accused Goldman Sachs of hoarding aluminum to artificially raise the market price.<sup>193</sup> Metro International Trade Services LLC (“Metro International”) was a metal warehousing company in Detroit, wholly owned by Goldman Sachs.<sup>194</sup> At the time of the accusation, Metro International held over 12% of the warehoused aluminum in the world.<sup>195</sup> Metro International’s inventory of aluminum went up from 893,025 tons of aluminum in February 2010 to 1.15 million tons as of June 22, 2011.<sup>196</sup> Goldman Sachs purchased

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189. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

190. 12 U.S.C. 1843(k)(1)(B) (2016); SECTION 620 REPORT, *supra* note 6 at 30.

191. Saule T. Omarova, *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265, 346–47 (2013) (“One of the key policy reasons for separating banking from commerce is the fear of banks unfairly restricting their commercial-market competitors’ access to credit, the lifeblood of the economy.”).

192. *Id.*

193. Dustin Walsh, *Aluminum Bottleneck: Coke’s complaint: 12% of Global Stockpile Held Here, Boosting Prices*, CRAIN’S DETROIT BUS. (June 26, 2011, 12:00 PM), <http://www.crainsdetroit.com/article/20110626/FREE/306269994/aluminum>.

194. *Id.*; Industrial and Commercial Metals, 81 Fed. Reg. 96353, 96353 (Dec. 30, 2016) (to be codified at 7 C.F.R. pt. 7) (responding to the Section 620 Report and a Senate Subcommittee report, the OCC issued a final rule that said the holding of industrial and commercial metals like copper or aluminum is not part of or incident to the business of banking. Since the OCC only regulates national banks and not FHCs, this rule does not affect the activities described in this Note.)

195. Walsh, *supra* note 193.

196. Walsh, *supra* note 193.

Metro International in February 2010.<sup>197</sup> The supply bottleneck in Metro International's Detroit warehouses led to record aluminum prices.<sup>198</sup> Though Coca-Cola complained, Prof. Omarova expressed surprise that more industrial-end aluminum purchasers did not voice complaints about this market manipulation.<sup>199</sup> Prof. Omarova speculated that “[i]t is also possible that commercial companies deliberately avoided an open confrontation with Goldman because it was a Wall Street powerhouse with which they had—or hoped to establish—important credit and financial-advisory relationships.”<sup>200</sup> Though it would be difficult to quantify the impact of Goldman Sachs' credit powers on the behavior of players in the aluminum market, this incident sheds light on the potential for abuse when bank entities enter into the commercial realm.<sup>201</sup>

Similar to the safety and soundness concerns, the proposed rules also do not address potential conflicts of interest in lending raised by FHC involvement in physical commodity transport, storage, and refinement.<sup>202</sup>

#### V. YOU CAN NEVER LEAVE: THE HOTEL CALIFORNIA PROVISION

One complication to the repeal of the Grandfather Provision by statute—or effective repeal through capital charges—is that such a move could be perceived as a bait and switch tactic by lawmakers.<sup>203</sup> This is because of the so-called “Hotel California Provision”<sup>204</sup> of Dodd-Frank,

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197. Walsh, *supra* note 193.

198. Walsh, *supra* note 193.

199. Omarova, *supra* note 191, at 347 (“It is curious, however, that more industrial end-users did not publicly complain—or complain a lot sooner or louder—about this potential conflict-of-interest situation.”).

200. Omarova, *supra* note 191.

201. Omarova, *supra* note 191, at 346–47.

202. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

203. *Bait and Switch*, BLACK'S LAW DICTIONARY (10th ed. 2014) (“A sales practice whereby a merchant advertises a low-priced product to lure customers into the store only to induce them to buy a higher-priced product. Most states prohibit the bait and switch when the original product is not actually available as advertised. . . . The unethical practice of offering an attractive rate or premium to induce a person to apply for a loan or contract, with approval contingent on some condition, and then telling the person that the offered rate is not available but that a higher one can be substituted.”).

204. The Eagles, *Hotel California* (Asylum Records 1976) (“You can check out any time you like, but you can never leave.”); *see also* Jacob Goldstein, *The ‘Hotel California’ Clause: Finance Reform Meets Classic Rock*, Nat'l Pub. Radio (Mar. 15, 2010, 2:57 PM), [http://www.npr.org/sections/money/2010/03/what\\_dodds\\_bill\\_does\\_about\\_too.html](http://www.npr.org/sections/money/2010/03/what_dodds_bill_does_about_too.html) (“So what this part of the bill says is that, even if these institutions get rid of their bank holding companies,

which stipulates that any firm who was classified as a BHC at the time of its passage and accepted money from the Troubled Asset Relief Program would remain under the regulatory supervision of the FRB as a BHC even if the firm no longer meets the definition of a BHC.<sup>205</sup> Morgan Stanley and Goldman Sachs converted to FHCs in the aftermath of the 2008 financial crisis to gain access to the FRB's discount window and future bailout funds.<sup>206</sup> Goldman Sachs and Morgan Stanley made that decision with an understanding that their commodities dealings would be grandfathered in by Section 4(o) and would remain permissible under their new classification as FHCs.<sup>207</sup> If the authority to engage in that line of business was repealed by statute, or regulated to the point of impracticability, these two firms could claim that the continuation of these activities was material to their decision to subject themselves to FRB regulation.<sup>208</sup>

## VI. CONCLUSION

Despite the risks and other issues surrounding the activities permitted to qualifying FHCs by the Grandfather Provision, commodities industry participants and end-users who responded to the Federal Reserve's proposed rule generally support continued FHC involvement in this field.<sup>209</sup> These commenters point to the increased efficiency and

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they'll still be subject to Fed oversight. Or, to paraphrase the Eagles: Goldman Sachs can check out any time it likes, but it can never leave.”).

205. 12 U.S.C. § 5327(b) (2016) (“If an entity described in subsection (a) ceases to be a bank holding company at any time after January 1, 2010, then such entity shall be treated as a nonbank financial company supervised by the Board of Governors, as if the Council had made a determination under section 113 [12 USC § 5323] with respect to that entity.”); 12 U.S.C. § 5327(a)(1)(B) (explaining that the previous section applies to any Bank Holding Company that “received financial assistance under or participated in the Capital Purchase Program established under the Troubled Asset Relief Program authorized by the Emergency Economic Stabilization Act of 2008”).

206. Press Release, Bd. of Governors of the Fed. Reserve Sys., Board approves, pending a statutory five-day antitrust waiting period, the applications of Goldman Sachs and Morgan Stanley to become bank holding companies (Sept. 21, 2008, 9:30 AM) (on file with author) (announcing the Fed's approval of Goldman Sachs and Morgan Stanley's applications to become BHCs); Michael J. de la Merced et. al., *As Goldman and Morgan Shift, A Wall St. Era Ends*, DEALBOOK: N.Y. TIMES (Sept. 21, 2008, 9:35 PM), <http://dealbook.nytimes.com/2008/09/21/goldman-morgan-to-become-bank-holding-companies>.

207. 12 U.S.C. 1843(o) (2016).

208. Comment letters were due to the Fed by February 20, 2018.

209. Letter from Tom Quaadman, Exec. Vice President, Ctr. for Capital Mkts. Competitiveness, to Robert Frierson, Sec'y, Bd. of Governors of the Fed. Reserve Sys. (Jan. 5, 2017) <https://www.federalreserve.gov/SECRS/2017/February/20170214/R-1547/R->

liquidity offered by the sheer size of FHCs as a benefit for market participants and end-users.<sup>210</sup> These benefits are passed on to consumers in the form of lower prices.<sup>211</sup> These commenters suggest that the Federal Reserve take a closer look at the effect these proposed regulations will have on the commodities industry more generally before implementing these new regulations.<sup>212</sup>

Even if the rule is not adopted, FHCs have been steadily reducing their footprint in the commodities industry over the past several years.<sup>213</sup> Morgan Stanley sold its oil business in 2015 and Goldman Sachs sold its metal warehousing unit that had been the subject of much criticism.<sup>214</sup> During this same time, employees of these qualifying FHCs who have commodities expertise have sought greener pastures in non-FHC commodity trading houses, which can offer traders a greater percentage of the profits they generate.<sup>215</sup> One analyst described efforts to regulate bank entity involvement in physical metals as “closing the barn door after the horse has left,” in response to the reduction in business that took place even before any rule was passed.<sup>216</sup> Though it may be true that FHCs have been reducing their commodities trading activity, there is no indication that they intend to cease this activity; indeed, Goldman Sachs’ Chief Executive Officer Lloyd Blankfein has described commodities trading as a “core” part of his firm’s business.<sup>217</sup> Whether or not Morgan Stanley and Goldman Sachs continue to make Section 4(o) physical commodities trading part of their business plan, the Grandfather Provision is still law and can be used by either of these firms at any time.<sup>218</sup>

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1547\_010517\_131645\_521038067193\_1.pdf; Letter from Jennifer Fordman, Nat. Gas Supply Ass’n, to Bd. of Governors of the Fed. Reserve Sys. (Dec. 15, 2016).

210. Letter from Jennifer Fordman, Senior Vice President, Nat. Gas Supply Ass’n, to Bd. of Governors of the Fed. Reserve Sys. (Dec. 15, 2016).

211. Letter from Tom Quaadman, *supra* note 209.

212. Letter from Tom Quaadman, *supra* note 209, at 3.

213. Jesse Hamilton, *Fed Proposes Aggressive Rule on Wall Street Commodity Holdings*, BNA (Sept. 23, 2016, 12:00 PM) <https://www.bloomber.com/news/articles/2016-09-23/fed-proposes-aggressive-rule-on-wall-street-commodity-holdings-itfy706>.

214. Hamilton, *supra* note 213.

215. Alex Nussbaum & Javier Blas, *Fed Rules Seen Speeding Commodity Trader Exodus From Banks*, BNA (Sept. 26, 2016).

216. Susanne Barton & Joe Deaux, *Wall Street Exit From Physical Metals Formalized Under OCC Ban*, BNA (Dec. 29, 2016).

217. Hamilton, *supra* note 213.

218. 12 U.S.C. § 1843(o) (2016).

The Financial CHOICE Act is the banking reform bill that has the most momentum with the current Congress, but does not repeal the Grandfather Provision and is unlikely to pass in its current form.<sup>219</sup> The bill has passed the House of Representatives and aims to repeal many of the regulations imposed by Dodd-Frank.<sup>220</sup> Section 152 forbids federal banking agencies, like the Federal Reserve, from establishing operational risk capital requirements for banking organizations, unless those requirements are based on the risks posed by a banking organization's current activities and businesses.<sup>221</sup> Neither that section, nor any other provision of the bill mentions grandfathered commodities activities explicitly.<sup>222</sup> Regardless, that bill is not expected to pass the Senate in its current form.<sup>223</sup> In general, Republican Congressional leaders<sup>224</sup> and President Donald Trump<sup>225</sup> have stressed a desire to cut regulation, including on financial institutions.<sup>226</sup> Imposing this new regulation would go against that goal.<sup>227</sup>

As for the new Federal Reserve Chairperson Jerome Powell, most observers do not expect a dramatic change in philosophy from his predecessor, former Chairperson Janet Yellen.<sup>228</sup> Since Yellen was at the

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219. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (2017).

220. Rachel Witkowski & Andrew Ackerman, *What's in the Financial Choice Act?*, WALL ST. J. (June 8, 2017), <https://www.wsj.com/articles/whats-in-the-financial-choice-act-1496955001>.

221. Financial CHOICE Act of 2017, H.R. 10, 115th Cong. § 152 (2017).

222. *Id.*

223. Witkowski, *supra* note 220.

224. Alexander Bolton, *The Hill Interview: McConnell: 2017 a Great Year for GOP*, THE HILL (Dec. 19, 2017), <http://thehill.com/homenews/senate/365715-the-hill-interview-mcconnell-2017-a-great-year-for-gop>.

225. Eric Lipton & Danielle Ivory, *Trump Says His Regulatory Rollback Already is the Most 'Far Reaching'*, N.Y. TIMES (Dec. 14, 2017), <https://www.nytimes.com/2017/12/14/us/politics/trump-federal-regulations.html?mtref=www.google.com>.

226. Ian McKendry, *Senate Votes to Repeal CFPB Arbitration Rule in Win for Financial Institutions*, AM. BANKER, Oct. 24, 2017; Rebecca Floyd, *Populist Conundrum: Big Banks or Plaintiffs' Bar? Banks Win as Congress Overrides the CFPB Rule Banning Class Action Waivers in Arbitration Agreements*, 22 N.C. BANKING INST. 134 (2018).

227. Lydia Wheeler & Lisa Hagen, *Trump Signs '2-for-1' Order to Reduce Regulations*, THE HILL (Jan. 30, 2017), <http://thehill.com/homenews/administration/316839-trump-to-sign-order-reducing-regulations>.

228. Lucinda Shen, *Who Is Jerome Powell, Trump's Pick to Replace Janet Yellen As Fed Chair?*, FORTUNE (Nov. 2, 2017), <http://fortune.com/2017/11/01/donald-trump-jerome-powell-fed-federal-reserve-janet-yellen> ("For starters, Powell is considered by many to be close to a continuation of the Yellen era.")

helm for this proposed rule, nothing indicates that Powell will retract it.<sup>229</sup> Powell has stated that he believes in strict regulation for the biggest banks, with lighter regulation for smaller banks.<sup>230</sup> Morgan Stanley and Goldman Sachs are among the biggest bank holding companies in the country.<sup>231</sup>

Ultimately, the Federal Reserve's proposed capital increases may make Section 4(o) commodities activities prohibitively expensive and FHCs will voluntarily abandon those operations.<sup>232</sup> Still, the FRB does not have authority to unilaterally forbid FHCs from engaging in these activities.<sup>233</sup> Congress should repeal the Grandfather Provision that allows FHCs to transport, store, distribute, and process or refine physical commodities.<sup>234</sup> Those activities present the greatest potential for environmental catastrophe and economic liability, thus presenting the greatest danger to the safety and soundness of the FHC and therefore the greatest risk to the economy as a whole.<sup>235</sup>

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229. September 2016 Proposed Rule on Risk-Based Capital and Other Regulatory Requirements, 81 Fed. Reg. 67220, 67225 (proposed Sept. 30, 2016) (to be codified at 12 C.F.R. Pt. 217 & 225).

230. Jeff Cox, *Fed Nominee Powell: Financial System 'Quite Strong,' Backs 'Tailoring' Regulations to Ease up on Small Banks*, CNBC (Nov. 28, 2017), <https://www.cnbc.com/2017/11/28/fed-nominee-powell-backs-tailoring-regulations-to-ease-up-on-small-banks.html> (quoting Powell: "We want regulations to be the most intense, the most stringent for the very largest, most complex institutions and want it to decrease in intensity and stringency as we move down through the regional banks and the community banks.").

231. NAT'L INFO. CTR., *supra* note 181 (listing Goldman Sachs and Morgan Stanley as the fifth and sixth largest BHCs in the U.S., respectively).

232. SULLIVAN & CROMWELL LLP, *supra* note 143, at 1 (2016).

233. SECTION 620 REPORT, *supra* note 6 at 28.

234. SECTION 620 REPORT, *supra* note 6 at 28.

235. SECTION 620 REPORT, *supra* note 6 at 28.

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