
Energy Sector Alert Series: Federal Reserve Board Seeks New Limits on Bank Activities in Physical Commodities

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As a result of both legislative mandates as well as Congressional and public concern, the Board of Governors of the Federal Reserve System (Board) has been examining whether to impose new restrictions on the activities of banks related to physical commodities. Following these examinations, the Board recently took two actions designed to impose new limits on the activities of banks related to physical commodities: (i) a notice of proposed rulemaking to impose new capital requirements and other limits on such activities of financial holding companies (FHCs) (the “proposed rule”); and (ii) a report, issued pursuant to Section 620 of the Dodd-Frank Act (620 Report), which contains recommendations for legislation to repeal several current authorities for banks to engage in physical commodities activities.

Proposed rule. In brief, the proposed rule would:

- increase the capital requirements for activities of FHCs involving commodities for which existing laws would impose liability if the commodity were released into the environment;
- lower the limit on the amount of physical commodities that may be held by banks that conduct commodity trading activities;
- rescind authority for banks to engage in energy tolling and energy management services;
- delete copper from the list of precious metals that BHCs are permitted to own and store; and
- establish new public reporting requirements on the nature and extent of firms' physical commodities holdings and activities.

620 Report. The 620 Report is divided into three sections, by federal banking regulator. Section I, prepared by the Board, covers state member banks, depository institution holding companies, Edge Act and agreement corporations, and US operations of foreign banking organizations. In its section, with respect to physical commodities, the Board recommends legislative action that would:

- repeal the authority of FHCs to engage in merchant banking activities; and
- repeal the grandfather authority for certain FHCs to engage in commodities activities under section 4(o) of the Bank Holding Company Act (BHCA).

Although participants in energy and other physical commodity markets have commented to the Board that the imposition of new capital requirements and other restrictions on bank participation in physical commodity markets could reduce liquidity and increase costs for end users, the Board has nonetheless proceeded with these proposed rules and legislative recommendations. In the proposed rule, the Board estimates that the proposed rule will not have a significant impact on the physical commodity markets or the related derivative markets.

In this article, we summarize and provide key takeaways from the proposed rule and the 620 Report. [Read the full article.](#)