From: James D. Hanson

Proposal: 1547 (AE58) Regs Q & Y- Risk-based Capital and Other Regulatory Requirements for Activities of FHC's

Subject: Regulations Q and Y

Comments:

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Proposal: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 [R-1547]
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Your comment:Merchant Banking Activities: Proposal to clarify the rule on Permissible Banking Activities and Investments.
The following Fed and OCC proposals to clarify regulatory limits on physical hedging, address national banks' authority to hold and trade copper, and incorporate the Volcker Rule into investment securities regulations are valid and pivotal safeguards to enhance safety and soundness.
If the rule on permissible banking activities for national banks and bank holding companies is to be revised at the OCC and the Fed, why is silver defined as a permissible activity given central banks typically do not hold silver, silver coinage ended in 1964, and silver is no longer considered a monetary metal for currency, but rather is classified as a collectable by the Internal Revenue Service? Secondly, how do the banking regulators define "precious metals"? Do beaver pelts qualify?
The OCC regulation on permissible banking activities states, "A national bank may use derivatives tied to interest rates, foreign exchange and currency, credit, precious metals, and investment securities. National banks may invest in coin and bullion indirectly, via an ETF or other investment company that invests only in bank-permissible precious metals. 12CFR 1.3(h); OCC IL 1013
Currently, precious metals can be defined as an exchanged traded fund (ETF) in which shares of the ETF satisfy physical delivery requirements where the custodian also warehouses the actual physical metal and serves as market maker. If precious metals are deemed a store of value, what are the implications if the "value" is represented by paper supply? What if the true paper supply accurately represents the physical supply in existence? What it only 30% of the physical supply represents a store of value? What if 70% of the physical supply represents industrial use of the metal? Also, what if the value is highly volatile? Activities in gold appear to have substance (although the United States has been off the gold standard since 1971) given that gold is a Basel III Tier 1 asset under international capital rules and Central Banks hold gold. But what of silver? Central banks do not hold silver as in the past and silver is largely an industrial metal, similar to copper. The solar, medical, and technology industries are dependent on silver, yet silver is deemed a precious metal. If silver, in fact, is a precious metal, and retains a store of value somewhere between $9 and $50 in the last five years, is it appropriate for banks to retain, and or serve as custodians in a store of value that retains or loses five times its value in a five year period? This gives new meaning to the term safety and soundness, yet only copper comes into question as an industrial or precious metal. In fact, market-making in

permissible activities provide badly needed liquidity exclusive of considerations for price. Given the activities are permissible banking activities, what are the implications if the banks have the ability to set the price? Should activities that are deemed permissible, be excluded from the same regulatory oversight that is proposed for impermissible banking activities? Why are position limits deemed appropriate for base metals, but not precious metals?

Most of the comment letters to the Fed concerning Merchant Banking Activities several years ago (exclusive of comments noted on physical aluminum cans), argued the Fed should not curtail the authority of Financial Holding Companies to engage in physical commodity activities. Reasons provided were, substantial public benefits, less risk than implied, and the assertion merchant banks facilitate liquidity in markets. It was asserted that there is no evidence of harm to a financial institution. No harm resulted in regards to a financial institution, but the harm to industry and consumers has been extreme. Apparently, the harm has been significant enough that the regulators would consider such a proposal. Per American Banker, "These damages can exceed the market value of the physical commodity involved in the catastrophic event, and can exceed the committed capital and insurance policies of the organization". Higher regulatory capital reserves through higher risk weighting requirements might deter the activity, but not if the activity is highly profitable.

So where do the federal banking regulators draw the line between impermissible proprietary trading and permissible market-making? Where is the place for permissible market-making where bank holding companies neither produce nor consume these metals? Why are they there? Bank holding companies have pushed down risk from merchant banking activities to FDIC insured national banks. To date, there has been no harm to banks in terms of income but the risk is significant to the FDIC insurance fund. Likewise, the risk is significant relative to industry and consumers through products and services exclusive of the implications of FDIC insurance. The aluminum shuffle, airlines hedging fuel costs, and the warehousing yet market-making in metals. Merchant banks can warehouse commodities for others, yet make the market for the commodity they are warehousing. This activity is a gross conflict of interest and the proposed solution should not be limited to copper. This said, copper had no place as a precious metal when regulators defined copper as such in 1995, and silver certainly is a candidate given the price is somewhere between $9 and $50 per ounce depending on how paper supply alchemists feel that day. If silver is a store of value (precious metal), then precious metals have no place in the banking world for safety and soundness. However, if paper representations are a fraudulent representation of physical supply specifically controlled through permissible banking activities, then maybe silver has a place as a profit activity, but not as a moral standard. Price setting in merchant banking activities is not limited to precious metals. Per Scott Kirby, former president of American Airlines, "Hedging is a rigged game that enriches Wall Street." Per the New York Times, "The back-and-forth lengthens the storage time, and that adds many millions a year to the coffers, of Xxxxxx which owns the warehouses and charges rent to store the metal". As one commentator noted, "If the truth be known, it is not a question of liquidity, but a question of price. The question of price is illegal, so the subject changes to liquidity".

If the OCC and Fed definition of "permissible banking activities" is to be revised, then the banking regulators should consider whether banking profits or legal moral authority takes precedent. If liquidity and profits are the primary drivers for short term financial stability, regulators might consider how the costs will be manifested in long term volatility. Busts and bubbles, hurt both banks and consumers. Where will the Fed, OCC, Treasury, FSOC, ESF, and primary agents draw the line relative to interventions that facilitate short term financial stability, versus interventions that facilitate long term busts and bubbles? Should interventions be public information? Which is more important, liquidity or price, stability or transparency, illicit profits or fair price discovery?

Respectfully,

James Hanson

Ref:

The Federal Reserve requests public comment on physical commodity activities.

https ://www. federalreserve.gov/newsevents/press/bcreg/20160923a.htm

The Fed:

Require firms to hold additional capital in connection with activities involving commodities for which existing laws would impose liability if the commodity were released into the environment;

Tighten the quantitative limit on the amount of physical commodity trading activity firms may conduct;

Rescind authorizations that allow firms to engage in physical commodity activities involving power

plants;
Remove copper from the list of precious metals that all bank holding companies are permitted to own and store;
andEstablish new public reporting requirements on the nature and extent of firms; physical commodity holdings and activities.
OCC:
issue a proposed rule to prohibit federal banking entities from holding asset-backed securities that hold bank-impermissible assets. • address concentrations of mark-to-model assets and liabilities with a rulemaking or guidance. • clarify minimum prudential standards for certain national bank swap dealing activities. • consider providing guidance on clearinghouse memberships;clarify regulatory limits on physical hedging; address national banks' authority to hold and trade copper; incorporate the Volcker Rule into the OCC's investment securities regulations. The OCC's regulatory initiatives therefore build upon the many statutory reforms to enhance federal banking entities' safety and soundness.