

ends with a purchaser that intends to take physical delivery of the commodity. On the maturity date of the derivative contracts, the producer will be responsible for making physical delivery and the ultimate buyer will be responsible for accepting physical delivery, while each intermediate participant in the chain will be deemed, by operation of contract, to have instantaneously received and transferred legal title to the commodity.

The Board adopted the restrictions in Regulation Y on the types of Commodity Contracts that a BHC may enter into as principal to reduce the potential that BHCs would become involved in and bear the risks of physical possession, transport, storage, delivery, and sale of bank-ineligible commodities. The restrictions ensure that the commodity derivatives business of a BHC is largely limited to acting as a financial intermediary that facilitates transactions for customers who use or produce commodities or are otherwise exposed to commodity price risk as part of their regular business.

Citigroup and UBS contend that a BHC that takes title to a commodity on an instantaneous, pass-through basis takes no risk that is greater than or different in kind from the risk that it has as a holder of a commodity derivative contract that meets the current requirements of Regulation Y. Instantaneous receipt and transfer of title to (but not physical possession of) commodities does not appear to involve the usual activities relating to, or risks attendant on, commodity ownership. Instead, such transactions involve the routine operations functions of passing notices, documents, and payments—functions that BHCs regularly perform in their role as financial intermediaries in other markets. Moreover, although BHCs that receive and transfer title to commodities on an instantaneous, pass-through basis face default risks, they are not significantly different than the default risks associated with cash-settled derivative contracts or derivative contracts that include the assignment, termination, or offset provisions required by Regulation Y.

In this light, the Board proposes to modify Regulation Y by changing the Delivery Avoidance Requirement to allow BHCs to take or make delivery of title to commodities underlying commodity derivative transactions on an instantaneous, pass-through basis.

In addition, the Board proposes to modify Regulation Y by changing the Contractual Offset Requirement to permit BHCs to participate in physically settled derivative markets where the standard industry documentation does

not allow for assignment, termination, or offset. In particular, the proposal would allow BHCs to enter into Commodity Contracts that do not require cash settlement or specifically provide for assignment, termination, or offset prior to delivery so long as the contracts involve commodities for which futures contracts have been approved for trading on a U.S. futures exchange by the Commodity Futures Trading Commission (“CFTC”) (and the BHC complies with the revised Delivery Avoidance Requirement). Limiting this relief from the Contractual Offset Requirement to derivative contracts based on commodities approved for exchange trading (which are more likely to have reasonably liquid markets) is intended to provide some assurance that a BHC’s reasonable efforts to avoid delivery would be successful. This requirement would, therefore, serve the same purpose as the current Contractual Offset Requirement, which facilitates the financial settlement of Commodity Contracts by requiring BHCs to have contractual rights to avoid taking or making delivery of the underlying commodities.

The proposed modifications of the derivatives provisions in Regulation Y would apply to all BHCs. Although the GLB Act prohibited the Board from adding to the list of activities permissible for all BHCs after November 11, 1999, the Act preserved the Board’s authority to modify the terms and conditions that applied to such activities before that date.<sup>5</sup> The Board had authorized BHCs to engage as principal in commodity derivative transactions prior to November 11, 1999. The proposed rule would represent a relaxation of the current limitations that apply to a BHC’s commodity derivative activities under Regulation Y and would not create a new permissible activity for BHCs.

The Board invites comment on all aspects of the proposed rule and particularly seeks comment on whether the proposed modifications to Regulation Y would expand the ability of BHCs to participate in commodity derivative markets without exposing them to significant additional risks.

#### Plain Language

Section 722 of the GLB Act requires the Board to use “plain language” in all proposed and final rules published after January 1, 2000. In light of this requirement, the Board has sought to present the proposed rule in a simple and straightforward manner. The Board invites comment on whether the Board

could take additional steps to make the proposed rule easier to understand.

#### Regulatory Flexibility Act

In accordance with section 3(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a)), the Board must publish an initial regulatory flexibility analysis with this proposed rule. The proposed rule, if adopted, would expand the scope of permissible commodity derivatives activities for a bank holding company. A description of the reasons for the Board’s decision to issue the proposed rule and a statement of the objectives of, and legal basis for, the proposed rule are contained in the supplementary material provided above.

The proposed rule would apply to bank holding companies regardless of their size and should enhance the ability of all bank holding companies, including small ones, to compete with other providers of financial services in the United States and to respond to changes in the marketplace in which banking organizations compete. The Board specifically seeks comment on the likely burden the proposed rule would have on bank holding companies, especially small bank holding companies.

#### Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the proposed rule under authority delegated to the Board by the Office of Management and Budget. The proposed rule contains no collections of information pursuant to the Paperwork Reduction Act.

#### List of Subjects in 12 CFR Part 225

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

#### Authority and Issuance

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

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

1. The authority citation for part 225 continues to read as follows:

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

2. Section 225.28 would be amended by revising paragraph (b)(8)(ii)(B) to read as follows:

<sup>5</sup> See 12 U.S.C. 1843(c)(8).