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**M E M O R A N D U M**

July 2, 2003

To Our Clients and Friends

Re: Regulation Y and Derivative Activities

The Federal Reserve Board has issued a final rule that amends Regulation Y to permit bank holding companies (BHCs) to:

- take and make delivery of title to commodities underlying certain commodity derivative contracts on an instantaneous pass-through basis; and
- participate in certain physically-settled derivative markets that do not require cash settlement or specifically provide for assignment, termination or offset prior to delivery.

The amendment is intended to permit BHCs to participate more fully in certain derivative markets. The rule is effective August 4, 2003.

Regulation Y currently authorizes BHCs to engage as principal in cash-settled derivative contracts involving any type of commodity (other than a bank-ineligible security) but limits the authority to engage in physically-settled derivative contracts.

The rule will now permit BHCs to take or make delivery of title to commodities underlying commodity derivative transactions on an instantaneous, pass-through basis. The BHC must take delivery of title to the commodity from a seller and immediately thereafter make delivery of title to the commodity to a buyer. The BHC cannot take physical delivery of the commodity or make physical delivery of commodities out of the inventory of the BHC.

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The rule will also allow BHCs to enter into derivative contracts that do not require cash settlement or specifically provide for assignment, termination, or offset prior to delivery as long as the contracts involve commodities for which futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission.

The final rule can found at [www.schwartzandballen.com/WhatsNew.htm](http://www.schwartzandballen.com/WhatsNew.htm).

If you have any questions concerning the final rule, please call Gilbert Schwartz, Robert Ballen or Tom Fox at (202) 776-0700.