

only avenue available to ensure revenues equal expenses on a sustaining basis.

(2) *Consider the impact total MGC Branch costs on the livestock and meat industry:* The MGC Branch issued recommended staffing guidelines for applicants of beef carcass grading and/or live animal/carcass schedule certification services on August 22, 2002. The recommended staffing guidelines, while increasing the number of Federal meat graders in 4 percent of firms requesting services, were designed to reduce the number of cumulative trauma disorders (CTD) associated with repetitive motions, which is the leading cause of injuries to MGC Branch employees.

Voluntary Federal meat grading and certification services are provided to 450 businesses, including 152 livestock slaughterers, 79 facilities that process federal donated products, 74 meat processors, 46 livestock producers and feeders, 28 brokers, 26 organic certifying companies, 25 trade associations, 17 State and Federal entities, and 3 distributors. Seventy-two percent (*i.e.*, 324) of these businesses are small entities which generate approximately 17 percent of the MGC Branch's revenues. A small entity is defined for the meat packing and processing industry as a company that employs less than 500 employees. AMS estimates that the fee increase will cost small businesses an average of \$68,170 or an additional \$210 per month (\$2,520 per year) per applicant. AMS is very cognizant of the impact that fees charged for meat grading and certification services have over all firms.

(3) *Reevaluate the accuracy of the formula used to estimate the per pound cost of providing services:* In accordance with the AMA, meat grading and certification services are provided on a cost recovery basis. The cost per pound is derived by dividing the total revenue by the total pounds graded and certified within the same time frame. The formula provides an accurate and consistent comparison between the cost of providing service and the tonnage of graded and certified carcasses over time. Since 1993, the amount of product graded and certified per year has increased by 13 billion pounds. Over the same timeframe, the MGC Branch has doubled its revenue hour efficiency and maintained the overall cost per pound of service at \$0.0006. We believe this method of calculating the cost per pound for providing grading and certification services is accurate and provides a meaningful way to evaluate efficiency over time.

(4) *Streamline services through MGC Branch office consolidation and staff reduction:* In the past 10 years, the MGC Branch has closed three area offices, reduced mid-level supervisory staff by over 50 percent, and reduced the number of support staff by 38 percent. As part of the current MGC Branch reorganization, the Branch will close the remaining four area offices, eliminate two levels of supervision, and transfer area office functions to the Office of Field Operations (OFO) in Denver, Colorado, by the end of FY 2003. The MGC Branch reorganization also includes plans to restructure the internal operations to more effectively and efficiently service specific program areas. The MGC Branch will maintain two offices: the OFO in Denver, Colorado, and the Headquarter office in Washington, DC. The Agency has determined that, upon completion of the current reorganization, MGC Branch's operations will be streamlined to the maximum extent possible.

(5) *Explore alternative revenue sources and new technology to decrease user costs and improve the accuracy and efficiency of grading and certification services:* By law, the Agency is required to charge fees that equal the cost of providing services. Accordingly, any "alternative revenue source," if required as suggested by the respondent, would be conducted on a full cost recovery basis. AMS has actively participated with the National Cattlemen's Beef Association (NCBA), the beef packing industry, instrument manufacturers, and academia to develop performance standards that can potentially improve grading accuracy and repeatability through the use of an electronic instrument augmentation system that measures the ribeyes of beef carcasses. This same concept is also being researched for lamb grading augmentations. AMS is also involved with ongoing studies to develop technology that utilizes special equipment to apply environmentally safe yet durable carcass quality and yield grade labels. Additionally, the Agency is working with additional companies to incorporate voice recognition software into this new grade application as well as for general data collection and transmission.

Process Verified Programs such as the Non Hormone Treated Cattle Program and the Pork for the European Union Program provide complete traceability from farm to plate. Additional audit based programs such as the National School Lunch Programs' Canned Meats and Ham Programs are being implemented to improve the overall selection, quality, and cost of the

services provided to the industry. In addition, the MGC Branch has worked with members of the Federal purchase and further processing industry to develop several pilot programs that incorporate audit based principles. These programs, while providing the same or a higher level of assurance, require graders to monitor and verify an applicants' entire production process rather than performing an examination on the end product. These audit and audit based programs also allow greater scheduling flexibility, improve operational efficiencies, reduce costs, and provide value-adding services to applicants. The Agency believes that, to the maximum extent possible technology is being utilized to improve the accuracy and cost-effectiveness of meat grading and certification services.

List of Subjects in 7 CFR Part 54

Food grades and standards, Food labeling, Meat and meat products.

■ For the reasons set forth in the preamble, 7 CFR part 54 is amended as follows:

PART 54—MEATS, PREPARED MEATS, AND MEAT PRODUCTS (GRADING, CERTIFICATION, AND STANDARDS)

■ 1. The authority citation for 7 CFR part 54 continues to read as follows:

Authority: 7 U.S.C. 1621–1627.

■ 2. Section 54.27 is amended as follows:

■ a. In paragraph (a), remove "\$52" and add "\$64" in its place, remove "\$57" and add "\$70" in its place, remove "\$90" and add "\$110" in its place.

■ b. In paragraph (b), remove "\$45" and add "\$55" in its place, remove "\$57" and add "\$70" in its place, remove "\$90" and add "\$110" in its place.

Dated: June 27, 2003.

A.J. Yates,

Administrator, Agricultural Marketing Service.

[FR Doc. 03–16828 Filed 7–2–03; 8:45 am]

BILLING CODE 3410–02–M

FEDERAL RESERVE SYSTEM

12 CFR Part 225

[Regulation Y; Docket No. R–1146]

Bank Holding Companies and Change in Bank Control

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board of Governors of the Federal Reserve System is adopting an

amendment to Regulation Y that would permit bank holding companies to (i) take and make delivery of title to commodities underlying commodity derivative contracts on an instantaneous, pass-through basis; and (ii) enter into certain commodity derivative contracts that do not require cash settlement or specifically provide for assignment, termination, or offset prior to delivery.

DATES: The final rule is effective August 4, 2003.

FOR FURTHER INFORMATION CONTACT:

Mark E. Van Der Weide, Counsel (202/452-2263), or Andrew S. Baer, Counsel (202/452-2246), Legal Division. For users of Telecommunications Device for the Deaf (TDD) only, contact 202/263-4869.

SUPPLEMENTARY INFORMATION:

Background

The Board's Regulation Y currently authorizes bank holding companies ("BHCs") to engage as principal in forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on a rate, price, financial asset, nonfinancial asset, or group of assets (other than a bank-ineligible security) ("Commodity Contracts"). A BHC's authority to enter into Commodity Contracts is subject to certain restrictions that are designed to limit the BHC's activity to trading and investing in financial instruments rather than dealing directly in commodities. In particular, Regulation Y provides that a BHC may enter into a Commodity Contract only if (i) the commodity underlying the contract is eligible for investment by a state member bank; or (ii) the contract requires cash settlement; or (iii) the contract allows for assignment, termination, or offset prior to delivery or expiration (the "Contractual Offset Requirement"), and the BHC makes every reasonable effort to avoid taking or making delivery of the underlying commodity (the "Delivery Avoidance Requirement").¹

The effect of these restrictions is to allow a BHC to engage as principal in cash-settled derivative contracts involving any type of commodity (other than certain derivative contracts involving bank-ineligible securities) but to limit the authority of a BHC to engage in physically settled derivative contracts. Under these restrictions, a BHC may take and make delivery on physically settled derivatives involving commodities that a state member bank

is permitted to own.² For all other types of physically settled derivatives,³ a BHC must make reasonable efforts to avoid delivery, and the contract must have assignment, termination, or offset provisions.

The Bank Holding Company Act ("BHC Act"), as amended by the Gramm-Leach-Bliley Act (Pub. L. 106-102, 113 Stat. 1338 (1999)) ("GLB Act"), permits a BHC to engage in activities that the Board had determined were closely related to banking, by regulation or order, prior to November 12, 1999. A BHC must conduct these activities in accordance with the terms and conditions contained in such regulations and orders, unless modified by the Board.

In response to requests by Citigroup Inc., New York, New York ("Citigroup"), and UBS AG, Zurich, Switzerland ("UBS"), the Board issued a proposal in March 2003 that would modify the restrictions in Regulation Y to allow BHCs to enter into derivative contracts that typically result in taking and making delivery of title to, but not physical possession of, commodities on an instantaneous, pass-through basis (regardless of whether the contracts contain specific assignment, termination, or offset provisions).⁴ The Board received six public comments on the proposal: two from banking organizations, three from financial services trade associations, and one from an individual. The five financial services commenters supported the proposal and offered no general or specific criticisms of the proposal. These commenters believed that the Board's proposal would enhance the ability of banking organizations to serve as financial intermediaries and satisfy customer needs and would improve liquidity and competition in a number of commodity markets.

The individual commenter expressed opposition to the proposal. The commenter asserted that the proposal would reduce the stability of the financial system by permitting banking

organizations to engage in risky activities. The commenter also contended that permitting banking organizations to participate in a wider variety of derivatives markets would increase the scope of potential conflicts of interest for banking organizations.

Final Rule

After carefully reviewing the public comments on the proposal, the Board has determined to modify the conditions that the Board imposed in Regulation Y on the permissible derivatives activities of BHCs to permit BHCs to enter into Commodity Contracts that are settled by the BHC receiving and transferring title to the underlying commodity instantaneously, by operation of contract, and without taking physical possession of the commodity. The final rule also modifies the existing condition in Regulation Y that generally prevents BHCs from engaging as principal in a physically settled Commodity Contract unless the contract specifically provides for assignment, termination, or offset prior to delivery.

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.

The Regulation Y derivatives restrictions, however, have impeded the ability of BHCs to participate substantially in certain derivatives markets. Notably, in some over-the-counter forward markets (U.S. energy markets, for example), the physically settled derivative contracts traded by market participants do not specifically provide for assignment, termination, or offset prior to delivery and, thus, do not conform to the Contractual Offset Requirement of Regulation Y. Moreover, participants in these markets generally settle contracts by temporarily taking and making delivery of title to the underlying commodities and, thus, do not comply with the Delivery Avoidance Requirement of Regulation Y.

Financial intermediary participants in these markets generally enter into back-to-back derivative contracts with third parties that effectively offset each other.

² State member banks may own, for example, investment grade corporate debt securities, U.S. government and municipal securities, foreign exchange, and certain precious metals.

³ These would include derivative contracts based on, for example, energy-related commodities and agricultural commodities.

⁴ See 68 FR 12316, March 14, 2003. Citigroup and UBS also have asked the Board to allow financial holding companies to take and make physical delivery of a limited amount of commodities as an activity that is incidental or complementary to engaging as principal in BHC-permissible Commodity Contracts. The Board continues to review these broader requests. Several commenters on the proposed rule expressed support for Board approval of these broader requests by Citigroup and UBS.

¹ 12 CFR 225.28(b)(8)(ii)(B).

That is, financial intermediaries in these markets that enter into a contract to buy, for example, a certain number of barrels of oil from a certain counterparty in a certain future month generally also will enter into another contract, prior to the expiration of the original contract, to sell the same number of barrels of oil to another counterparty in the same future month on substantially identical delivery terms. These market practices typically result in the creation of a chain of contractual relationships that begins with a commodity producer, passes through a number of intermediaries who have entered into matched contracts both to buy and sell the same commodity at the same future time, and 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 believes 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 the BHC 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 currently required by Regulation Y.⁵

The final rule's modifications to Regulation Y will enable BHCs that participate in commodity derivatives markets to provide their customers with

a more comprehensive range of financial intermediation and risk management services. In addition, the final rule should enhance the ability of BHCs to compete effectively with non-BHC participants in the commodity derivatives markets (who currently are able to engage in physically settled derivative transactions with customers). Moreover, by expanding the types of derivative transactions in which BHCs may engage, the final rule should augment the capacity of BHCs to understand commodity markets and to diversify the market, credit, and other risks involved in derivatives trading.

In addition, the Board does not believe that the final rule will materially increase the conflicts of interest faced by BHCs that participate in the commodity derivatives markets or result in any other material adverse effects. Although the final rule will enable derivatives affiliates of BHCs to use a wider variety of transaction formats, the rule will not expand the types of commodities that may serve as the basis for derivative transactions engaged in by BHCs. Importantly, banking organizations are subject to a number of Federal banking laws designed to prevent conflicts of interest, including sections 23A and 23B of the Federal Reserve Act and section 106 of the Bank Holding Company Act Amendments of 1970.⁶ Moreover, banking organizations that engage in derivatives activities, including the commodity derivatives activities newly authorized by the final rule, would remain subject to the general securities, commodities, and energy laws and the rules and regulations of the Securities and Exchange Commission, the Commodity Futures Trading Commission ("CFTC"), and the Federal Energy Regulatory Commission.⁷

For these reasons, the Board's final rule modifies 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. A BHC takes and makes delivery of title to a commodity on an instantaneous, pass-through basis for purposes of the final rule only if the BHC takes delivery of title to the commodity from a seller and immediately thereafter makes delivery

of title to the commodity to a buyer. Accordingly, the revised Delivery Avoidance Requirement would not provide authority for a BHC to take physical delivery of commodities for use or investment or to make physical delivery of commodities out of the inventory of the BHC. In other words, the BHC must not be the original seller of the commodity in the initial position in the delivery chain or the ultimate buyer of the commodity in the last position in the delivery chain.

The Board's final rule also modifies 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 rule 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 CFTC (and the BHC complies with the revised Delivery Avoidance Requirement).⁸

A number of commenters expressed specific support for this modification of the Contractual Offset Requirement. Because derivative contracts based on commodities approved for exchange trading are more likely to have reasonably liquid markets than derivatives based on non-approved commodities, this modified requirement should continue to provide some assurance that BHCs would be able to avoid physical delivery of commodities underlying derivative contracts. 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.⁹

⁸ The CFTC publishes annually a list of the CFTC-approved commodity contracts. See Commodity Futures Trading Commission, *FY 2001 Annual Report to Congress* 126. With respect to granularity, the Board intends this requirement to include all types of a listed commodity. For example, any type of coal or coal derivative contract would satisfy this requirement, even though the CFTC list specifically approves only Central Appalachian coal.

⁹ One commenter asked whether the rule would authorize BHCs to engage in activities incidental to engaging in the derivative transaction types newly authorized by the rule, such as entering into service arrangements with operators of pipelines, power grids, and similar facilities. A BHC may engage in any incidental activities that are necessary to allow the BHC to engage in the derivative transaction

⁵ Although one commenter expressed concern that the rule would facilitate excessive risk taking by BHCs, the commenter provided no evidence in support of this position. For the reasons discussed above, the Board does not believe that the rule will expose BHCs to different types or heightened levels of risk.

⁶ See 12 U.S.C. 371c, 371c-1, 1972.

⁷ Although one commenter asserted that the rule would result in increased conflicts of interest for BHCs, the Board is not aware of, and the commenter has not presented, any evidence in support of this position. For the reasons discussed above, the Board does not believe that the rule will materially increase the conflicts of interest faced by BHCs that trade commodity derivatives.

These modifications to the derivatives provisions in Regulation Y would be effective for all BHCs. The GLB Act preserved the Board's authority to modify the terms and conditions that apply to any BHC activity approved by the Board before November 11, 1999.¹⁰ The Board had authorized BHCs to engage as principal in commodity derivative transactions prior to November 11, 1999. The final rule would represent a relaxation of the current limitations that apply to the conduct of a derivatives activity already approved by the Board under Regulation Y, and would not create a new permissible activity for BHCs.¹¹

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 final rule in a simple and straightforward manner. No commenter on the proposed rule asked the Board to take additional steps to make the 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 a final regulatory flexibility analysis with this final rule. The final rule expands 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 final rule and a statement of the objectives of, and legal basis for, the rule are contained in the supplementary material provided above. The final rule applies 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 comments received by the Board on the proposed rule did not indicate that the rule would impose burden on bank holding companies of any size.

types newly authorized by the rule. 12 CFR 225.21(a)(2).

¹⁰ See 12 U.S.C. 1843(c)(8).

¹¹ The Board notes that, subsequent to the Board's issuance of the proposed rule, the Office of the Comptroller of the Currency ("OCC") approved a request by Bank of America, N.A., to engage in customer-driven electricity derivative transactions that involve the transitory transfer of title to electricity. See OCC Interpretive Letter No. 962 (April 21, 2003).

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 final rule under authority delegated to the Board by the Office of Management and Budget. The 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 amends 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 is amended by revising paragraph (b)(8)(ii)(B) to read as follows:

§ 225.28 List of permissible nonbanking activities

* * * * *

(b) * * *

(8) * * *

(ii) * * *

(B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal approved by the Board), nonfinancial asset, or group of assets, other than a bank-ineligible security,¹² if:

(1) A state member bank is authorized to invest in the asset underlying the contract;

(2) The contract requires cash settlement;

(3) The contract allows for assignment, termination, or offset prior to delivery or expiration, and the company—

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

¹² A bank-ineligible security is any security that a state member bank is not permitted to underwrite or deal in under 12 U.S.C. 24 and 335.

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset; or

(4) The contract does not allow for assignment, termination, or offset prior to delivery or expiration and is based on an asset for which futures contracts or options on futures contracts have been approved for trading on a U.S. contract market by the Commodity Futures Trading Commission, and the company—

(i) Makes every reasonable effort to avoid taking or making delivery of the asset underlying the contract; or

(ii) Receives and instantaneously transfers title to the underlying asset, by operation of contract and without taking or making physical delivery of the asset.

* * * * *

By order of the Board of Governors of the Federal Reserve System, June 27, 2003.

Jennifer J. Johnson,
Secretary of the Board.

[FR Doc. 03-16835 Filed 7-2-03; 8:45 am]

BILLING CODE 6210-01-P

FEDERAL HOUSING FINANCE BOARD

12 CFR Parts 910 and 913

[No. 2003-08]

RIN 3069-AB07

Privacy Act and Freedom of Information Act; Implementation

AGENCY: Federal Housing Finance Board.

ACTION: Interim final rule with request for comments.

SUMMARY: The Federal Housing Finance Board (Finance Board) is revising its Privacy Act regulation to reflect an agency reorganization. The responsibilities of the Secretary to the Board of Directors, including administration of the Finance Board's Privacy Act program, have been transferred to the Office of General Counsel (OGC) and an OGC staff member is acting as the Finance Board's Privacy Act Official. The Finance Board also is revising the rule to make it more "user-friendly" by using plain language and where appropriate, a question-and-answer format.

Elsewhere in this issue of the **Federal Register**, the Finance Board is publishing a notice that makes corresponding changes to the agency's Privacy Act systems of records. The notice also adds a new system of records covering Office of Inspector General investigative files.