End of an Era as Banks Eye Commodities Exits

(TheStreet, 7/31/13) - JPMorgan Chase's announcement Friday that it will look to exit the physical commodities business steps up the pressure on rivals to follow suit.

"All the banks with commodity units are watching and waiting to see if regulators will force them out of physical commodity trading completely or [require them to] make a minor modification. There is no panic but there is a high level of anxiety," says George Stein, managing director of recruiting firm Commodity Talent LLC.

Goldman Sachs and Morgan Stanley have owned physical commodities assets to supplement their ownership of paper assets going back as far as the 1980s. They continue to be major players in physical commodities, as do other global banking and securities giants such as Citigroup. Bank of America, Barclays Deutsche Bank and Credit Suisse.

Ongoing scrutiny of banks' size and power by Congress, regulators and the press continues nearly five years after the historic bankruptcy of Lehman Brothers on Sept. 15, 2008, and the spotlight has shifted to commodities of late.

On July 23, the Senate Banking Committee held a hearing entitled "Examining Financial Holding Companies: Should Banks Control Power Plants, Warehouses, and Oil Refineries?"

On Tuesday, meanwhile, JPMorgan settled energy market manipulation charges.

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dozen warehouses in Detroit, or because they're moving the oil in these tankers. They know more about transactions, know more about price, know more about movement of goods, so that means they can trade on inside information, it gives them an advantage in

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proprietary trading, it means they can manipulate markets," said Sen. Sherrod Brown (D., Ohio) during the hearing in a speech from the Senate floor. Brown also expressed concern the banks have access to cheap funding from the Federal Reserve to finance these activities and that they "are exposing themselves and us, the economy, to risks that could threaten our financial system."

Brown's comments came three days after The New York Times published a front page article raising questions about Goldman's aluminum storage activities. Also, the Federal Reserve is reviewing exceptions it made to rules allowing banks it regulates to own physical commodities, according to several news reports.

In an interview with CNBC Wednesday, Goldman Sachs COO and President Gary Cohn, who like CEO Lloyd Blankfein started his career at Goldman commodities trading unit J. Aron, did not appear as resolute as JPMorgan in exiting the physical commodities business.

Discussing Metro, a metal warehousing company Goldman bought in 2010, Cohn noted the bank is permitted to own the asset until 2020 and will sell it "at an appropriate time." He also said "commodity hedging is a core competency. We are staying in the commodity hedging business."

Those statements nonetheless leave most of the big questions unanswered about the future of Goldman's physical commodities trading business as a whole.

Should it and others exit the business "beneficiaries are likely to be the large trading houses moving into the vacuum left in financial services," according to Commodity Talent's Stein.

Some of these include Glencore Xstrata, Mercuria Energy Trading SA, based in Geneva, and Singapore-listed, Hong Kong-based Noble Group.

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