Banks Yet to Pull Plug on Commodities

(Montel, March, 2014, excerpt) Investment banks have yet to fully pull the plug on commodities although they are moving away from trading to refocus on prime broking, clearing and asset management.

"As the economy improves the banks are more willing to lend to strengthened counterparties who have projects in the pipeline that they have put off for years," said George Stein, managing director of New York-based recruiting firm Commodity Talent LLC. "Right now the North American hydrocarbon province is the most interesting and the most active on the planet, and project after project, whether it be a shale project or a pipeline project or a refinery, needs capital that only the largest banks can provide," he added. Banks are hoping to link loans that steer commodity offtake, whether it be mining in minerals, or gasoline and diesel, or unrefined oil, to their trading desks where they can turn a profit matching buyer and seller, Stein said. "This is not a market for weak nerves but some say those with the right sense of timing who get in now stand to benefit as the broad commodity sector revives along with the global economy."

In December, BTG Pactual, Latin America's largest independent investment bank, told Montel it planned to start its commodity trading desk in early 2014. While Swiss UBS has scaled back its commodities derivatives business, it has refocused on asset management and is still active in the financing of commodity trade. Citigroup expanded its European energy markets sales and trading team last year in a move to re-address its "under-representation" in these markets, Simon Boughey, vice president of communications at the US bank told Montel in January.

Opportunities

"We see particular opportunities in the areas once inhabited by the European utilities, who are scaling back trading due to financial pressure," said Boughey, adding the bank is focusing on client activities, however, with financial regulation putting restrictions on proprietary trading and physical ownership of assets placing ever greater restraints on capital.

Similarly, rival Morgan Stanley announced in February it will offer its clients contracts in power, coal and emissions on the German EEX power exchange following the bank's direct clearing membership of European Commodity Clearing. "We're happy to be adding to the footprint of the European power markets," said Oliver Wilkinson, executive director at the bank.

Apart from client and prime broking, banks are also more active in the financing

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of infrastructure projects, said players.

"Capital is scarce at the moment, and banks are looking for stable and predictable returns. They will not get these on the trading floor, but more from asset management, and the financing of infrastructure projects," said one former analyst at a major European bank.

Others agree.

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US hydrocarbons

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Large regulatory constraints faced by banks, such as regulatory pressure, and requirements to post more capital against their trading books have seen many banks, including JP Morgan, Deutsche Bank, and Barclays close their energy trading activities over the past year (see related story).

Under pressure

Banks are increasingly under pressure over bonus payments, their risk management systems and a backlash against speculative trading in commodities, he added.

Basel III is a set of reforms to strengthen the regulation, supervision and risk management of the banking sector. The Dodd-Frank Act is a US federal law that places regulation of the financial industry in the hands of the government. The legislation, enacted in July 2010, aims to prevent another significant financial crisis by creating new financial regulatory processes that enforce transparency and accountability while implementing rules for consumer protection.

"Some of the merchant trading firms, which are less restricted by new regulations, are moving into the prop trading business vacated not only by the largest banks but some of the largest hedge funds which are coming under new position limits on speculative trading," said Stein.

Right timing

"This is not a market for weak nerves but some say those with the right sense of timing who get in now stand to benefit as the broad commodity sector revives along with the global economy. A steady stream of highly qualified candidates is making their way through our doors and there is no shortage of clients seeking their skills," Stein added.

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