Deutsche Bank quits commodities under regulator pressure

(Reuters, Dec. 5, 2013) – Deutsche Bank pulled the plug on its global commodities trading business on Thursday, cutting 200 jobs as it becomes the first major bank to exit the once lucrative sector due to toughening regulations and diminished profits.

Germany's largest bank, which was one of the top-five financial players in commodities, said in a statement it will cease trading in energy, agriculture, base metals, coal and iron ore, retaining only precious metals and a limited number of financial derivatives traders.

The cuts are expected to largely fall on its main commodity desks in London and New York.

The move comes as the financial sector's role in commodity trading has been squeezed by lower margins, higher capital requirements and growing political and regulatory scrutiny of the role of banks in the natural resources supply chain.

"The decision to refocus our commodities business is based on our identification of more attractive ways to deploy our capital and balance sheet resources," Colin Fan, co-head of Corporate Banking & Securities at Deutsche Bank, said in a statement. "This move responds to industry-wide regulatory change and will also reduce the complexity of our business."

Deutsche Bank's decision will also raise questions for other banks in the sector, after JPMorgan Chase & Co put its physical commodity arm up for sale this summer, while Morgan Stanley has been exploring a sale of its energy trading unit for almost two years.

Deutsche Bank was among the first financial firms a decade ago to challenge the long dominance of Goldman Sachs Group Inc and Morgan Stanley in commodities trading. But it suffered a series of ups and downs and personnel changes over the years, including the departure of global chief David Silbert a year ago.

"Silbert built up Deutsche Bank's commodity group to make it a top five contender in the space of five years and then left rather than pull down the house he built," said George Stein, managing director of New York-based recruiting firm Commodity Talent LLC. "The destruction of the commodities business at Deutsche Bank is one more sign that many of the large global banks no longer see commodities as viable," Stein added.

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Silbert's departure was the first sign the bank was withdrawing from the one-time billion-dollar business, which included a substantial U.S. and European power and gas book, a major market-making operation in oil options, and base metals trading.

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BANKS ROLL BACK

The bank announced the decision to staff at a meeting shortly after lunch on Thursday, with around half the 200 traders affected clearing their desks and leaving immediately, according to a person familiar with the matter.

The remaining traders will be asked to stay and help wind down or sell-off parts of the business as part of a unit called the Special Commodities Group over the next two years, with the process being led by the current co-heads Louise Kitchen and Richard Jefferson.

More than 40 traders are expected to be absorbed by other parts of the bank, including those who will continue trading financial commodity derivatives for clients.

The bank is not expected to try and sell its commodity operations wholesale. The bank's near $10 billion commodity index business, which allows smaller investors to get exposure to commodity price moves, will not be affected by the closure, according to a person familiar with the matter.

The bank's flagship PowerShares DB Commodity Index Tracking Fund has $6 billion invested alone, according to the fund's website, making it one of the biggest in the market.

Deutsche Bank had already closed down most of its electricity, natural gas and carbon trading operations in Europe and North America over the past year as regulation tightened, and as the bank was investigated for an alleged tax scam involving the trading of carbon permits.

The bank also reached a $1.5 million settlement with the U.S. Federal Energy Regulatory Commission in January for manipulation of power markets in California.

The decision to quit commodities is not directly related to the U.S. Federal Reserve's current review of the role of banks in physical commodity trading, but comes as the bank reassesses its overall business as part of a strategic review. The Federal Reserve, which first allowed commercial banks to trade physical commodities in 2003, is expected to announce changes in early 2014 in how it regulates the sector.

Deutsche Bank was an active participant in physical commodity markets, but did not own any major trading infrastructure such as power plants, warehouses or oil storage tanks that it could sell as it winds down the business.

The business struggled to achieve "critical mass" over the past seven years,

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said Seb Walker at research firm Tricumen. "Increased regulatory pressure, competition from commodity trading houses and a shift away from the energy markets have all conspired to make commodities a tough market for the top banks."

WINDS OF CHANGE

While 200 traders is a tiny fraction of Deutsche Bank's overall headcount of almost 100,000, at times the commodities business had provided significant revenues for the bank.

The total commodities market for banks rose as high as $12 billion at the end of the last decade, but has since shrunk to less than half that as prices stabilised and as regulators put strict restrictions on trading with the bank's own money.

In the first nine months of this year, commodities revenues for the largest banks in the sector fell 18 percent to $4 billion, London-based financial industry analytics firm Coalition said in a report last month. Full-year commodity revenues for banks are forecast to decline by 14 percent to $4.7 billion, it said.

"The regulatory environment has gotten extremely cumbersome and expensive for banks," said Jeffrey Christian, managing director of commodities consultant CPM Group, who used to work for Goldman Sachs oil and metals trading arm, J.Aron.

"At a number of banks now, you have more people doing compliance and risk management than you have doing the actual trading."

Not all banks are scaling back, however. London-headquartered Standard Chartered, which does a lot of its business in emerging markets, said this month it plans to double revenues from its commodities business in the next four years and plans to add 10-20 staff to its existing team of 100 in the next six months.

Global commodity merchants such as Vitol SA Glencore Xstrata Plc and Mercuria, which are not as affected by growing regulation, are also looking to step into the vacuum left by the big U.S. and European financial heavyweights. Asian-Pacific and South American banks, including Australia’s Macquarie Bank Ltd and Sao Paulo-based BTG Pactual Banking Ltd are also expanding their commodities businesses.

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