THE WALL STREET JOURNAL.

http://www.wsj.com/articles/fed-proposes-limits-on-bank-commodity-trading-1474646400

MARKETS | FINANCIAL REGULATION

Fed Targets Big Bank Commodity Lines

Fed: Banks would need to hold additional capital against commodity-related liabilities

The proposed rules would require banks to hold billions of dollars of extra capital in their physical-commodities businesses. *PHOTO: PRASHANTH VISHWANATHAN/BLOOMBERG NEWS*

By **DONNA BORAK** and **LIZ HOFFMAN**

Updated Sept. 23, 2016 5:58 p.m. ET

WASHINGTON—The Federal Reserve on Friday proposed new rules that could drive banks out of the business of owning, trading and moving commodities—such as oil and aluminum—by making those lines too expensive.

The long-awaited proposal, designed to force banks to do more to protect themselves against environmental disasters that might cause huge liabilities, would require banks to hold billions of dollars of extra capital in their physical commodities businesses. The move also follows congressional investigations probing whether big banks were using their commodities units to wield outsize power over certain markets and inflate prices.

The proposed rules are likely to hit hardest at Goldman Sachs Group Inc., which has held tighter to commodities than rivals that have aggressively scaled back such operations in recent years.

RELATED COVERAGE

- Goldman Tries a New Commodities Play
- Regulators Make New Push, and Goldman Could Take the Brunt
- J.P. Morgan to Sell Commodities Business
- Morgan Stanley to Sell Oil Arm to Castleton

Both Goldman Chief Executive Lloyd Blankfein and his second-in-command, Gary Cohn, came up through the ranks of the commodities business, and while the firm has sold some businesses, including a troubled Colombian mine and a series of metals warehouses, it has forged ahead into others, becoming for example a big player in natural-gas marketing.

“We’ve been in the commodity business forever,” Goldman’s chief financial officer, Harvey Schwartz, said last year.

A Goldman spokesman declined Friday to comment on the Fed’s proposal.

The Fed’s move to constrain these activities through regulation appears to be a bit of an end run around Congress, which through law has given financial institutions more flexibility to operate in these areas. The Fed earlier this month called on lawmakers to tighten rules around commodities trading, but many bankers and industry advisers played down the likelihood that Congress would act, especially in an election year. Friday’s action shows that the Fed isn’t waiting for congressional action and is prepared to take steps on its own.

The Fed said the proposal is driven by its fear that an oil spill, mine explosion or power-plant meltdown at a bank-owned facility could trigger a ripple effect of fines, cleanup costs, and loss of investor confidence that could take down a financial institution.

Regulators have cited disasters such as the 2010 Deepwater Horizon oil spill in the Gulf of Mexico, the 2011 Fukushima Daiichi nuclear-plant meltdown in Japan, and the fatal 2010 Pacific Gas & Electric Co. natural-gas pipeline explosion in San Bruno, Calif., as examples of risks that could potentially destabilize the financial system if a bank were involved and subject to legal action.

“These damages can exceed the market value of the physical commodity involved in the catastrophic events, and can exceed the committed capital and insurance policies of the organization,” according to the Fed’s draft plan.

As part of its proposal, the Fed would impose an unusually steep 1,250% capital charge on Goldman and Morgan Stanley, which had been given extra flexibility by Congress to trade in these areas. That depresses returns in those businesses and could pressure banks to abandon them altogether.

Friday’s proposal also called for imposing a strict, but less onerous, capital charge of 300% on a dozen firms—including Bank of America Corp., J.P. Morgan Chase & Co. and Wells Fargo & Co.—who are permitted by the Fed to engage in physical commodity trading.

The Fed would also revoke firms’ ability to engage in physical commodities tied to power plants and prohibit institutions from owning or storing copper. Bank ownership of commodities has been in political and regulatory crosshairs for years.

The Fed has long telescoped its plans to try to restrict banks’ commodity businesses and, in anticipation, many institutions have pulled back.

J.P. Morgan Chase in 2014 sold its physical commodity business to Mercuria Energy Group Ltd., the Swiss trading house. Morgan Stanley, which once owned a fleet of oil tankers and enough actual oil to supply the entire country for three days, exited those businesses last year. The firm held $321 million in physical commodities on its books at the end of last year, down from $9.6 billion in 2011, according to regulatory filings.

But nearly all financial firms continue to trade commodities. And as banks and external advisers digested the proposal on Friday, much of the discussion focused on how far the Fed would go in restricting that business, which can require banks to, for short periods, take delivery of physical commodities.

Goldman’s Mr. Schwartz last year said the collapse of energy prices made the bank’s role as a market maker more important. ”It really reinforces the need for firms such as Goldman Sachs to be in a position to provide our clients with liquidity, with financing capacity,” he said.

Any additional capital charges would further cripple banks' trading businesses, which are already far less profitable than they used to be.

The public will be given 90 days to comment on the proposal. The deadline is Dec. 22.

Write to Donna Borak at donna.borak@wsj.com and Liz Hoffman at liz.hoffman@wsj.com