Big banks profit from circular hauling of commodities

In testimony before the US Senate Committee on Banking, Housing, and Urban Affairs (<http://tinyurl.com/mcxk37g>) , Timothy Weiner, Global Risk Manager, Commodities/Metals, for MillerCoors LLC said his company had paid “tens of millions of dollars in excess premiums over the last several years,” as a result of London Metals Exchange (LME) rules that allow warehouses it governs to hold the aluminum it purchases for as much as 18 months before MillerCoors can take delivery. In the meanwhile, MillerCoors has to pay rent on the storage of the aluminum that it takes to produce the cans that hold its beer.

But, it is not only beverage companies that pay that premium; it is every company that uses aluminum. “My company and others estimate that last year alone, the LME warehouse rules have imposed an additional $3 billion expense on companies that purchase aluminum,” Weiner said.

The ownership of a key Detroit warehouse by Metro International Trade Services, a subsidiary of Goldman Sachs, provided the reason why the Banking Committee was listening to Weiner. Though he did not go into the details of the operation of the Metro warehouse, New York Times reporter David Kocieniewski did (<http://tinyurl.com/n3cmp3o>).

In the article titled “A shuffle of aluminum, but to banks, pure gold,” Kocieniewski reports that instead of delivering the aluminum to customers—like MillerCoors—Metro complies with LME rules that set a maximum length of time by moving aluminum bars among the 27 warehouses it owns. At the same time, according to Weiner, “the LME warehouses, such as those in Detroit, use minimum load-out rates as maximums, releasing no more than 3,000 MT/day.” And, until last year, Goldman Sachs was part-owner in the LME which sets those rules.

As a result of the 2008 financial crisis, Saule T. Amarova, Associate Professor of Law, University of North Carolina at Chapel Hill, in written testimony before the Banking Committee (<http://tinyurl.com/o3rawrd>), said, investment banks “Morgan Stanley and Goldman received approval to register as BHCs [Bank Holding Companies] subject to the [Federal Reserve] Board’s regulation and supervision, in a desperate effort to bolster investor confidence and avoid potential creditor runs on their assets.”

While investment banks have traditionally had wide latitude to engage in commodity trading as well as to control power plants, warehouses (like Metro International), and oil refineries, BHCs have not. In becoming BHCs, Amarova writes, the two investment banks, “[have] up to five years from the registration date either to divest [their] impermissible non- banking activities or to bring such activities into compliance with [legislative] requirements.

In addition, JP Morgan Chase which is a BHC was allowed to purchase “the commodity assets of two failing institutions, Bear Stearns and RBS [Royal Bank of Scotland]…. [transforming] it [JP Morgan Chase] into one of the three biggest U.S. banking organizations dominating global commodity markets.” It had previously been permitted to engage in commodity trading as complementary to their trading of commodity derivatives. This activity was subject to compliance in those markets and a limit on how large that activity could become.

With “the statutory five-year grace period for the non-conforming commodity activities of Goldman and Morgan Stanley ends in the fall of 2013, at which point the [Federal Reserve] Board must make a potentially fateful decision whether these firms will be able to continue—and further expand—their commodity and energy merchant businesses,”

The Banking Committee hearing was designed to examine whether or not Financial Holding Companies (FHCs)—a subset of BHCs including Goldman, Morgan Stanley, and JP Morgan Chase that are allowed to “conduct broader activities that are ‘financial in nature’—should control power plants, warehouses, and oil refineries.

But the consequences of allowing FHCs to continue to engage in non-banking activities goes beyond power plants, warehouses and oil refineries. As Kocieniewski writes, “the maneuvering in markets for oil, wheat, cotton, coffee and more have brought billions in profits to investment banks like Goldman, JP Morgan Chase and Morgan Stanley, while forcing consumers to pay more every time they fill up a gas tank, flick on a light switch, open a beer or buy a cellphone.”

Unaddressed in both the testimony before the committee and the Kocieniewski article is what impact allowing Goldman, JP Morgan Chase, and Morgan Stanley to engage in the trade of agricultural commodities has had or will have on agricultural markets.

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