Bond Case Briefs

Municipal Finance Law Since 1971

WSJ: Small Towns Go to Bat for Wall Street Banks.

WASHINGTON—A Federal Reserve plan that could stop big banks from owning oil pipelines, metals warehouses and other physical-commodity assets is sounding alarm bells hundreds of miles from Wall Street.

Small-town officials from Alabama, Louisiana, North Carolina and other states are warning of unintended consequences from the Fed's proposal, telling lawmakers and regulators it could prevent municipalities from delivering natural gas to tens of thousands of customers.

The pushback threatens to complicate an already thorny issue, with mayors and other local officials descending on Capitol Hill to defend the big banks in lawmakers' cross hairs.

At issue is a Fed proposal that could impose restrictions on banks' activities in physical-commodity markets like aluminum and oil. The Fed, pressed by lawmakers, has become concerned that banks' commodities ownership has expanded beyond what regulators originally envisioned and could pose risks to the firms and the financial system.

On Thursday, the Senate Permanent Subcommittee on Investigations begins a two-day hearing on whether banks like Goldman Sachs Group Inc., J.P. Morgan Chase & Co. and Morgan Stanley should be restricted from owning or trading physical commodities. The subcommittee has been investigating whether banks' participation in the market influenced prices and harmed consumers. Democratic lawmakers argue such activity—particularly banks' ownership of power plants, shipping containers and metals warehouses—creates the potential for anticompetitive behavior.

One concern of lawmakers is banks that warehouse aluminum or other metals are inflating prices by holding on to it for longer than necessary. The banks have denied those allegations. The issue is expected to be a focus of Thursday's hearing.

In the past year, some big banks such as J.P. Morgan have retrenched from the physical-commodities business amid tighter regulation and capital constraints.

A coalition led by Sheldon Day, the mayor of Thomasville, Ala., and Al Bean, co-general manager of Alabama's Clarke-Mobile Counties Gas District, is warning that any crackdown will ripple far beyond Wall Street. The group has spent the past few months raising the issue with staff of at least a dozen senators, including Sen. Richard Shelby (R., Ala.), who is expected to be the next chairman of the powerful Banking Committee, and Sens. Sherrod Brown (D., Ohio) and Elizabeth Warren (D., Mass.), whose criticism helped prompt the Fed's proposal.

A spokeswoman for Sen. Mary Landrieu (D., La.), whose staff met with the group this summer, said the senator "has directed her staff to look into the issue."

On Monday, the group met with staff from the Senate Permanent Subcommittee on Investigations to raise concerns. In July, they met with Fed General Counsel Scott Alvarez for 90 minutes, according to those who attended.

“Like everyone else, we want a safe banking system but this has become part of our business over the last 10 to 12 years,” Mr. Day said.

Mr. Bean said the restrictions would “curtail or end our ability to engage in vital natural-gas transactions.” Without Wall Street firms in the market, he said, municipalities would have trouble finding a counterparty that’s regarded as safe by credit-ratings firms and could also handle large contracts.

After Congress deregulated the natural-gas industry in the 1990s, municipalities banded together to create public gas systems to increase their purchasing power. They quickly realized they could save money and hedge against price swings by locking in part of their gas supply in a long-term contract.

Energy companies like Enron Corp. were initially financiers of such deals. After that company’s collapse in 2001, Wall Street banks—freer to engage in commodities markets after another deregulation law passed in 1999—have filled the void.

Municipal gas districts began engaging in prepaid gas transactions, a strategy in which they issue tax-free bonds and use the proceeds to prepay for natural gas that a bank promises to deliver over the long term, typically 20 years or longer. The bank, which profits from the prepayment, will then hedge against its long-term risks, including price fluctuations and supply. There have been more than $20 billion of gas prepayment transactions over the past decade, according to industry lawyers.

People familiar with the matter said the Fed was initially unaware the rule could affect municipalities’ ability to get long-term natural-gas contracts until it was brought to the regulator’s attention.

The proposal also could restrict other types of activities. “Recent disasters involving physical commodities demonstrate that the risks associated with these activities are unique in type, scope and size,” the Fed said in its January proposal.

In particular, the Fed is concerned about disasters like the Deepwater Horizon spill in 2010. BP PLC has paid more than $40 billion in cleanup and legal costs and continues to fight in U.S. courts to limit further payments.

The Fed is trying to determine what risks a bank faces when it finances or trades in commodities like oil and natural gas, and whether it poses any threat to financial stability. The Fed wants to understand whether a bank would be liable if, for example, a pipeline carrying natural gas or oil that it was contractually obligated to deliver exploded or ruptured, causing damage or deaths, according to the proposal.

Congressional aides said lawmakers didn’t intend to prohibit natural-gas trading and financing.

“The ownership of the power plants and the shipping containers and warehouses, those are the things we had the biggest concerns about from a systemic risk and market manipulation perspective,” said a congressional aide to a top Democrat. “The other stuff, the trading and financing deals, we’re not saying banks get out of that stuff entirely.”

THE WALL STREET JOURNAL

By DEBORAH SOLOMON and RYAN TRACY

Nov. 17, 2014 5:49 p.m. ET

Write to Deborah Solomon at deborah.solomon@wsj.com and Ryan Tracy at ryan.tracy@wsj.com