Fed Weighs Surcharge on Banks' Physical Commodity Businesses
Fee Could Spur Firms to Pare Involvement in the Sector

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WASHINGTON—Federal Reserve officials are considering imposing a new capital surcharge on Wall Street banks that own oil pipelines, metals warehouses and other lucrative physical-commodities assets, according to people familiar with the matter.

Such an approach could encourage banks to pare back their involvement in physical commodities, which has increasingly raised concerns among regulators and lawmakers.

While no decision has been made, imposing a surcharge would allow the Fed to sidestep a legal jam caused by existing laws that set Goldman Sachs Group Inc. GS -0.73% and Morgan Stanley MS -0.10% apart from peers and give the former investment banks broad leeway to own commodities.

The Fed has been considering scaling back the ability of banks to own such assets amid concerns that commodities ownership has expanded beyond what regulators originally envisioned. To avoid a regulatory situation where only some banks can own commodities, the Fed is considering a surcharge that would ensure all banks hold more capital to account for potential risks posed by the assets they own or lease.

The Fed could structure such a surcharge in a number of ways, though one possibility would set the charge based on the size and riskiness of affected assets.

It wasn't clear how a surcharge might be calculated or how costly it could be for the banks. High surcharges would crimp returns on commodities businesses, potentially forcing banks to exit and serve as a de facto ban on those activities. "If they're doing it in a way to drive them out, it will be pretty obvious," one bank adviser said.

Fed officials have grown concerned about the evolution of banks' role in commercial ventures such as pipelines in part because of the potential for a catastrophe, such as an oil leak, to put a bank in jeopardy.

But the central bank has run into a legal wall in curtailing the activities of Goldman Sachs and Morgan Stanley, whose commodities ownership is grandfathered under the 1999 Gramm-Leach-Bliley law. The two banks, which converted from investment banks to bank-holding companies during the 2008 financial crisis, are allowed to continue owning or investing in physical commodities as long as they were doing so before October 1997 and the businesses don't total more than 5% of their total assets. Other banks, such as J.P. Morgan Chase & Co. and Citigroup Inc., C +0.31% generally are required to get permission from the Fed to own such assets.

The Fed has broad authority in its role as regulator for the largest banks to set capital levels and address perceived risks. Amid concerns that a handful of banks remain "too big to fail," officials have

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increasingly used that authority to force banks to reduce their size and complexity by increasing capital and leverage limits.

Bank executives and their advisers view the surcharge as a logical outcome since it would bridge the legal dilemma facing the Fed, which has granted waivers to traditional banks that wanted to own commodities, according to people familiar with the approach.

Some banks already have weighed an exit from the commodities business ahead of any Fed decision.

J.P. Morgan announced in July that it would shed its physical-commodity business and in recent weeks began to circulate offering documents valuing the assets at $3.3 billion. The bank expects offers to come in the week of Oct. 21, people familiar with the matter said last week.

Morgan Stanley had held talks to sell all or part of its commodities franchise, including physical assets such as TransMontaigne Inc., a pipeline company, and its stake in Heidmar Inc., which manages a fleet of commercial tankers. Those physical assets remain under review for a possible sale, a person familiar with the matter said.

Goldman Sachs explored a sale of its Metro International Trade Services metal-warehousing unit earlier this year but recently put the matter on hold.

Profits from the business already have dwindled amid a commodities downturn as well as new capital rules that penalize banks for holding riskier assets. Fed surcharges would only increase the internal profit targets banks would need to hit to make keeping the physical-commodities arm worthwhile.

Bank executives and advisers say they are eager to review the details of a possible plan and are hopeful the Fed would tailor the surcharges to the discrete risks of each business. Some commodities—such as oil tankers—come with much greater catastrophic risk than others, they said.

The Fed has been reviewing banks' ownership of physical commodities for more than a year, though the issue gained momentum and scrutiny on Capitol Hill this summer amid complaints from some commercial firms that banks were driving up the price of certain commodities to bolster profits. At a July Senate hearing, Sen. Sherrod Brown (D., Ohio), an outspoken critic of big banks, asked: "What do we want our banks to do, make small-business loans or refine and transport oil?"

—Christian Berthelsen contributed to this article.

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