OPENING STATEMENT OF SENATOR CARL LEVIN

BEFORE

U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

ON

WALL STREET BANK INVOLVEMENT WITH PHYSICAL COMMODITIES, DAY TWO

November 21, 2014

Today is the second day of our hearings on Wall Street bank involvement in physical commodities. Yesterday, we explored the physical commodity activities of three banks – Goldman Sachs, JPMorgan Chase, and Morgan Stanley – and heard from bank executives and also from experts who helped put those activities in context. Today we will explore the implications of our findings and how to get stronger protections against the abuses, real and potential, that could damage the banking industry, commodity markets, and in a worst case scenario, the U.S. economy and U.S. taxpayers. We will also focus on how to build stronger protections against market manipulation and unfair trading by financial institutions with easy access to capital provided by the Federal Reserve, that is, by the American taxpayer.

Yesterday's hearing showed that, in recent years, Goldman, JPMorgan, and Morgan Stanley have been heavily involved in a wide range of physical commodity activities and businesses, including building multi-billion-dollar stockpiles of aluminum, copper, oil, and natural gas, and running businesses like power plants, oil and gas storage and pipeline companies, and commodity warehouses. When I say "banks" by the way, it is shorthand to cover both federally insured banks and their holding companies.

The evidence presented yesterday showed those Wall Street banks engaging in vast, complex commercial enterprises that are eroding the longstanding U.S. principle of separating banking from commerce. Yesterday's hearing also showed that at the same time the Wall Street banks were stockpiling commodities and running commodity-related businesses, they were engaging in massive transactions to buy and sell those same physical commodities, and were also trading commodity-related financial instruments like futures and swaps.

The simultaneous trading of commodities in the physical and financial markets raises concerns related to market manipulation and unfair trading. In 2013, the Federal Energy Regulatory Commission fined JPMorgan $410 million after finding that JPMorgan commodity traders used power plants to execute manipulative bidding strategies that produced profits for the bank at the expense of electricity customers. We will hear more about that and other electricity manipulation cases today.

Yesterday we heard about a warehouse company, purchased by Goldman Sachs and overseen by a board consisting entirely of Goldman employees, that manipulated its warehouse operations in a way that impacted the price of aluminum for consumers, while at the same time Goldman was trading aluminum-related financial products. The Goldman-controlled board of directors approved the merry-go-round transactions that have done much harm to consumers and aluminum markets.

Yesterday's hearing also disclosed that Goldman employees were given access to valuable nonpublic information from the warehouse company related to aluminum, information that could have been used to benefit Goldman's aluminum trading. Both the warehouse company and Goldman had information barrier policies in place at the time, but given the recent history of banks improperly sharing information to manipulate electricity, LIBOR, and foreign exchange rates, reliance on voluntary policies at banks that have an economic interest in ignoring those policies is simply not enough protection for consumers.

Finally, yesterday's hearing disclosed the extent to which physical commodity activities like uranium trading, coal mining, and oil and gas activities exposed Wall Street banks to wide-ranging and unpredictable risks, from natural disasters to mechanical malfunctions to labor unrest to volatile commodity prices.

The Subcommittee's investigation and report are not the first to expose the problems associated with Wall Street bank involvement with physical commodities. In 2010, the Federal Reserve formed its own Commodities Team to conduct a multi-year special review of the physical commodity activities of ten large banks. That special review found that the ten banks were heavily involved in a wide ranging and expanding set of physical commodity activities and generally had insufficient capital reserves and insurance coverage. In fact, the review determined that four of the banks with the largest physical commodity activities, including the three examined by the Subcommittee, had shortfalls ranging from $1 billion to $15 billion to cover potential losses from a catastrophic event. Should even one of those banks, embedded in every corner of our economy, experience a catastrophic event for which it is unprepared, the U.S. banking system could be affected and U.S. taxpayers be forced to face another bailout.

All this activity has been occurring despite, as I've mentioned, a longstanding separation of banking and commercial activities and despite the potential threats to the safety and soundness of bank holding companies. The legal arguments advanced by the banks to minimize their liability risk are questionable and likely to be of little comfort in the event of a natural disaster or catastrophic accident. The Federal Reserve should approach those arguments with skepticism and make sure that its responsibility to protect the financial system from 2008-style shocks remains paramount. Beyond the issue of risk, it is urgent that the Federal Reserve also consider the implications of these activities for the integrity of U.S. commodity markets and the prevention of market manipulation and unfair trading by Wall Street banks.

To address these problems, we will hear today that the Federal Reserve has made a commitment to issue a new proposed rule in the first quarter of 2015. That's good news, although the 2012 findings of the Federal Reserve's own special review, together with our findings, make that rulemaking long overdue.

The Federal Reserve is considering arguments that Wall Street banks provide hard-to-replace services in these areas. But the separation between banking and commerce has served markets and our economy quite well for decades. And the erosion of that barrier is clearly doing harm today. Any discussion of these physical commodities activities must begin and end with the need to protect our economy from risk, our markets from abuse, and our consumers from the effects of both. Wall Street banks with near-zero borrowing costs, thanks to easy access to Fed-provided capital, have used that advantage to elbow their way into commodities markets. Bad enough that this competitive advantage hurts traditional commercial businesses; worse that it opens the door to price and market manipulation and abusive trading based on nonpublic information.

Today's hearing will receive testimony from Governor Daniel Tarullo, a member of the Board of Governors of the Federal Reserve. We will also hear from Larry Gasteiger, the acting director of enforcement at the Federal Energy Regulatory Commission who has had to deal directly with bank manipulation of the electricity market. Before that, on our first panel, we will hear from Professor Saule Omarova of Cornell University, one of the first legal experts to chronicle the rapid and largely under-appreciated breakdown of the barrier between commercial activity and banking; and from Chiara Trabucci of Industrial Economics Inc., an expert in the area of financial responsibility and liability risk.

The Subcommittee, based on two years of investigation, has recommended a series of actions to rein in excessive risk and conflicts of interest stemming from Wall Street bank involvement in physical commodities. Those recommendations include issuing a single, comprehensive limit on bank holding companies' exposure to physical commodities, no matter what authority is used to accumulate those holdings. They also include narrowing the scope of the Gramm-Leach-Bliley authorities that allowed the explosion of Wall Street involvement in these activities to begin with; and instituting new safeguards to prevent Wall Street banks from using commercially valuable, nonpublic information obtained from their physical commodity activities to manipulate markets or gain unfair trading advantages. The report released by the Subcommittee and these two days of hearings will help provide a factual foundation for those and other reforms as the Federal Reserve, FERC, and other regulators consider new rules to protect businesses, consumers and the economy.

I want to end my remarks on a brief personal note. It has been a privilege for me to work with a staff that not only consistently displays knowledge, tenacity and dedication, but that represents a true example of bipartisan cooperation. The staff of this Subcommittee, majority and minority, have done important and lasting work on behalf of the American people, and I am grateful for all they have done. I can think of no better partner than Senator John McCain. His dedication to energetic, effective oversight is just one of his major contributions to the Senate and our country that make working with him so rewarding. Senator McCain.

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