

L'AGEFI

(Translated by Calyon)

From September 17th to 23rd 2009

Corporate and Investment Banks enter the commodities business

While they may not be replacing traditional brokers, banks are gaining a significant foothold in this market.

By Amélie Laurin

Calyon has shifted into high gear for the commodities brokerage business. Two former EDF Trading executives were recently appointed to manage the joint venture announced in May by EDF and Crédit Agricole S.A.'s corporate and investment bank (CIB). By year-end, the new unit is expected to have 10 employees based at Calyon's London office, where many of its 120 commodities specialists already work. Their mission will be to offer hedging products for the European gas and electricity market and the global coal market. "To provide Calyon clients with optimal execution, it is necessary to understand and do business in both the financial and physical energy markets," explains Martin Kreuzberg, formerly of EDF Trading and recently appointed Chief Executive Officer of the new joint venture. "Liquidity, in particular in the European energy sector, is concentrated in those markets where the physical trading occurs. At Calyon, EDF Trading will be responsible for the basics of this business through its expertise and infrastructure, which enable it to manage physical flows in energy-related markets." Although each partner owns 50% of the joint venture, it will operate under the Calyon name, which will be the single contact for clients (see the interview on page 20). "In a partnership of this nature, the bank has a competitive advantage through its greater proximity to the physical markets," says Joseph Florentin, a partner at Eurogroup. According to Marjorie Nadal, a Managing Director at Exocet Advisory and a consultant with First Finance, "This type of transaction remains exceptional, because the leading players such as Total can afford to remain independent and therefore avoid having to share their knowledge of the markets."

A 10-person staff for the Calyon-EDF Trading joint venture, in addition to the bank's 120 commodities specialists.

Massive recruiting

Société Générale, meanwhile, chose to create investor service joint ventures separate from its CIB. "Their trading and sales teams are independent of the parent companies and do business under their own name," emphasizes Edouard Neviaski, global head of commodities at Société Générale. His bank therefore founded Gaselys with GDF in 2001 and Orbeo with chemicals manufacturer Rhodia in 2006. Gaselys, which had 200 employees last year, is active in the European gas and electricity market as well as in the oil sector and CO₂ emissions and coal allowances. Orbeo, which had 40 employees before the acquisition of OneCarbon this summer, offers solutions for the carbon market such as hedging instruments for reductions in greenhouse gas emissions. "We firmly believe that these alliances are a strength in our markets," says Neviaski. Along with our joint ventures with industrial companies, we have also forged commercial agreements with the Japanese bank Mizuho and Kookmin Bank in South Korea to provide them with our

research and solutions, especially in the area of IT systems. Following up on our successful initiatives, we are still looking for more alliances in this area.” Société Générale has not specified its goals, but according to Bloomberg the bank would like to double its business volume in this area by end-2010. It plans to recruit some 60 carbon trading professionals by the end of this year, who would join some 100 commodities salesmen and traders at its CIB.

Crédit Suisse is following the same course. In 2005, it entered into partnership with the brokerage firm Glencore in the oil sector, which was then expanded to include metals and agricultural commodities. The Swiss bank's commodities unit, which had a total of 130 employees at end-2008, intends to recruit another 100 staff over the next 18 months. Meanwhile, Bank of America-Merrill Lynch hopes to increase the size of its team by one-fourth over the next two to three years. This race to bulk up appears to be a necessity for the banks. “One cannot simply rely on a desk of 15 people to handle all the commodities and serve clients effectively for all commodities, unless one opts for a broker approach,” says Benoît de Vitry, the Managing Director in charge of commodities at Barclays Capital, currently ranked third behind Goldman Sachs and Morgan Stanley. “Client requests are increasingly technical, and making sense of commodity price trends remains challenging. Crude oil price trends, for example, vary significantly from one market to the next. To succeed, one must be a global player like the leading CIBs, which are seeking to add market share, or a local specialist for a product segment, like some North American banks.” Barclays Capital, which increased the size of its team from 50 to 320 in 10 years, plans to hire 20 new traders next year.

To succeed, “the banks are looking to further structure their commodities business lines by recruiting analysts, traders and salesmen,” notes Joseph Florentin. Since the collapse of Lehman Brothers and the difficulties encountered by several banks such as UBS, the main investment banks are competing for the best clients. They are also moving into the territory held by the traditional brokerages. “Some banks, not many, have been active in this market for a long time,” says the head of a trading room of an industrial company. “Those that entered the business recently or are looking to do so must create teams by hiring away traders, including from energy suppliers. They offer attractive compensation, but also require a higher degree of risk-taking.”

CIBs hold 40% of the market

Today, all the CIBs want their share of the pie. “They have invested heavily in this niche for the past three or four years, in the wake of the run-up in oil prices and the rise of green finance with CO₂ contracts,” notes Joseph Florentin. “The financial crisis did not affect these activities, which appear to be less risky than the capital markets and benefit from the appeal of hedging products. Next to credit derivatives, they have the highest growth rates” (see graph on page 18). BNP Paribas demonstrates this trend. “For 25 years, we have been present in the commodities market to offer hedging solutions accompanying the financing solutions offered to our clients,” says Amine Bel Hadj Soulami, the bank's global head of commodities derivatives. “Over the past three years, we have grown our business by a factor of three by expanding our client base. Our clientele now includes not only companies involved in the production, transformation or consumption of commodities that are keen to hedge their risks, but also institutional investors drawn by the considerable volatility of this asset class.” BNP Paribas would like to reduce the relative share of corporates in its client base from 90% to 60%-65% while increasing that of institutional investors such as asset managers and pension funds.

Nevertheless, the financialization of commodities is not without limits (see box). Moreover, banks do not yet dominate this market, where traditional brokers and producers have been active for a long time. The banks account for only 40% of revenues in the sector, estimated at USD 23 billion by Crédit Suisse in 2008. “The banks complement the brokerage companies, which do not want to invest more in the commodities derivatives niche,” says Marjorie Nadal. “However, financial institutions have taken a pass on purchasing production capacity, a niche that several banks had successfully sought to enter before their risk management departments determined that these activities were contrary to their business purpose.”

Interview with



Martin Fraenkel, global head of commodities at Calyon

“EDF Trading provides us with its expertise in the physical energy market”

Why did you create a joint venture with EDF Trading?

This partnership is guided by the needs of our clients, mainly European companies in the gas and electricity sectors. It will enable us to round out our positions in this region, where Calyon is currently the leader in terms of the number of electric project financing transactions. EDF Trading, which is heavily involved in the physical energy market, provides its expertise, for example in monitoring market supply. This market knowledge, combined with our own expertise in the areas of structured products and hedging, will enable us to offer our clients innovative solutions.

In what way is this partnership unique?

By year-end, our joint venture will comprise a staff of 10 professionals from EDF Trading — notably the two managers — and Calyon. While the team includes members from both companies, Calyon will be the sole contact for our clients. Our bank will in effect be their only counterpart. We therefore provide them with the security of a highly rated intermediary. Clearly banks are not the only players in the commodity markets, but their role differs from that of energy suppliers, which do not have the same regulatory framework and have not made financial transactions their core business.

Where do you rank in commodities brokerage?

We are among the 10 most active banks in this market, with a global presence. London is our main business center, followed by New York, Hong Kong and Paris. We have grown steadily and plan to take advantage of new opportunities, especially in China, where Calyon was recently awarded a banking license.