**Regulators Should Draw a Line Between Finance and Commerce**

By [Francesco Guerrera](http://topics.wsj.com/person/A/biography/6652)



To be or not to be a bank?



The Federal Reserve, Congress and some of the world’s largest financial institutions are about to tackle the existential issue of what a bank is.

The narrow version of the debate is whether [J.P. Morgan Chase](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=JPM)[JPM +0.67%](http://blogs.wsj.com/public/quotes/main.html?type=djn&symbol=JPM?mod=inlineTicker) & Co., [Goldman Sachs Group](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=GS) Inc.[GS -1.50%](http://blogs.wsj.com/public/quotes/main.html?type=djn&symbol=GS?mod=inlineTicker) and [Morgan Stanley](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=MS)[MS -0.26%](http://blogs.wsj.com/public/quotes/main.html?type=djn&symbol=MS?mod=inlineTicker) should continue to own, store and transport commodities such as oil, copper and electricity. But its ramifications reach into a cornerstone of modern U.S. financial architecture: the separation of finance and commerce.

Decisions taken in coming weeks should determine the boundaries of what banks can and can’t do, as well as affecting other participants in the economy ranging from brewers to Coke drinkers.

As often happens, we got to this point through accidents of history and unintended consequences. To simplify: The Gramm-Leach-Bliley Act of 1999 allows banks to trade physical commodities, subject to Fed approval. But it is unclear on whether they can store and transport materials.

Either way, the rules didn’t apply to investment banks such as Goldman and Morgan Stanley, thus allowing them to keep and expand their warehousing and commodity-transportation units.

The current problems stem from the financial crisis. Five years ago this week, Goldman and Morgan Stanley were transformed from securities firms into bank-holding companies amid fears over their stability.

At the same time, J.P. Morgan gained warehousing and electricity assets from the takeover of Bears Stearns Cos. and the purchase of units of [Royal Bank of Scotland Group](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=RBS.LN)[RBS.LN -1.24%](http://blogs.wsj.com/public/quotes/main.html?type=djn&symbol=RBS.LN?mod=inlineTicker).

All of a sudden, three “banks” were active in markets most rivals had been banned from.

The debate is gaining urgency because of a rule stating that newly minted banks like Goldman and Morgan Stanley have five years to sell businesses not permitted under the law.

To add fuel to the fire, so to speak, are [**accusations from aluminum users such as Miller Coors LLC and**](http://online.wsj.com/article/SB10001424127887323864604579067003311940852.html) [**Coca-Cola**](http://online.wsj.com/public/quotes/main.html?type=djn&symbol=KO) **Co.**[**KO -0.88%**](http://blogs.wsj.com/public/quotes/main.html?type=djn&symbol=KO?mod=inlineTicker) that warehouses controlled by banks have been hoarding metal, pushing up the cost of cans and short-changing consumers. Those criticisms have caught the attention of the U.S. Senate, which has held hearings and is expected to call for more.

[**The recent $410 million settlement between J.P. Morgan and energy regulators**](http://online.wsj.com/article/SB10001424127887324170004578637662037547582.html)over accusations of electricity price manipulation didn’t help Wall Street’s case, even though the bank didn’t admit wrongdoing.

Perhaps not surprisingly, Goldman, Morgan Stanley and J.P. Morgan are all exploring a sale of physical commodities businesses.

This is partly a reaction to public pressure and partly a business decision—warehousing is a much better business in a recession than during periods of economic expansion when commodities fly off the shelves. Indeed, bank executives point out that those units contribute just a few hundred million dollars to revenue.

Divestments or not, a principle is at stake: Should banks be barred from activities that aren’t strictly financial, even though their involvement may be beneficial to the economy and their customers?

Banks’ supporters warn that kicking Wall Street away from these markets would have deleterious effects.

“A retrenchment could lead to increased prices and greater price volatility, among other consequences,” Randall Guynn, a partner at Davis Polk & Wardwell LLP, told the U.S. Senate at hearings in July.

Bank executives argue that a sale of these activities would benefit only large commodity groups that aren’t regulated by either the Fed or Congress.

Opponents point to the pitfalls arising from having financial groups involved in these activities—from the risk that a Deepwater Horizon-style disaster may endanger a bank’s existence, to concerns over price manipulation and consumer protection.

“There is great potential for dangerous conflicts of interest when banks control the supply of physical goods while speculating on their futures,” Sherrod Brown (D.-Ohio), a member of the Senate Banking Committee, said in a statement to me last week. “This is on top of the risks posed to taxpayers when too-big-to-fail banks hold sometimes risky assets like refineries, pipelines, and oil tankers.”

A legitimate argument, but one that could be made for other hard assets banks own either directly or through private-equity funds—buildings, bridges, highways, airports and even data and software.

It is a typical Washington irony: a messy situation created with the participation and acquiescence of the Fed and Congress that is now being “reformed” by the very same agencies.

My hunch is that the Fed will order banks to sell their storing and transportation units but give them a few years to do so. The banks will protest but eventually let go of businesses that have become minor contributors and major headaches.

What regulators should really do is to set a precedent and draw a line where finance ends and commerce begins. To be or not to be a bank? That is the real question.

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