OICU-IOSCO

REGULATION and SUPERVISION of COMMODITY DERIVATIVES MARKETS

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IOSCO : A BRIEF INTRODUCTION

- IOSCO is recognized as the International Standard setter for Securities Regulation
- IOSCO Objectives:
  - ***Protecting investors***
  - ***Ensuring that markets are fair, efficient and transparent***
  - ***Reducing systemic risk***
- 120 + jurisdictions, more than 95% of world capital markets;
- Growth and Emerging Markets (GEM) : 86 members
- IOSCO Principles are one of the 12 key standards and codes recognised as key to sound financial systems
- IOSCO MMOU recognized as a benchmark for international cooperation and enforcement- 100 signatories

Related IOSCO work

- IOSCO Principles for the Regulation and Supervision of Commodities Derivatives Markets
- IOSCO Principles for Oil Price Reporting Agencies
- IOSCO Principles for Financial Benchmarks
- OTC Derivative Markets Reform
- Standing Committee on Commodities Derivatives
- IOSCO Work on Manipulation
  - IOSCO Report on “Investigating and Prosecuting Market Manipulation, May 2000
  - Addendum to the IOSCO Report on “Investigating and Prosecuting Market Manipulation, April 2013
- IOSCO Work on Enforcement and Deterrent Sanctions

Characteristics of Commodity Derivatives

- As the name indicates: Securities derived from short maturity claims on real assets
- Serve as an insurance against future prices
- Do not represent direct exposures to actual commodities
- Futures contracts require to post collateral. Therefore, can involve substantial leverage.

Rise of the Commodity Derivatives as An Asset Class

- Financialization as a new phenomenon.
- Interaction between the physical markets and commodity derivative markets.
- Financial stability concerns related to commodity prices
- Are speculators the ones to be blamed for the increasing commodity prices?
- Do not mix manipulation with speculation !
- Do not mix asset bubbles with manipulation !

Some Important Remarks About the Mechanics of Futures Markets

- Far less than 5% of all traded contracts come to delivery
- Unlike the limited supply of physical commodities, the supply of futures contracts is infinite
- The purchaser of a futures contract does not diminish the stock of available futures and much less the supply of the underlying physical commodity.
- Do not mix **i)** " buying futures" with "buying physical commodities",

  ii) "a demand for futures contracts" with "a demand for actual goods"
- Research shows that volatility in in energy and other commodity prices was caused by fundamental factors such as the increasing global demand, the uncertainty of future supply, etc

IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Market

- Continued price pressures on commodities
- A G-20 Mandate
- The Principles build upon and expand the Tokyo Communique - 1997
- Contract Design, Market Surveillance and Information Sharing for physical commodity futures markets
- Focus: The recent changes and trends in commodity derivatives markets – Novel forms of market abuse – Financialization – Rapidly evolving OTC derivatives markets
- Objective: To ensure that physical commodity derivatives markets serve their fundamental price discovery and hedging functions, while operating free from manipulation and abusive trading schemes.

Contract Design

- Commodity derivative contracts must accurately reflect the characteristics and operation of the underlying physical commodity market
- Divergence between the futures settlement price and the underlying physical market price creates susceptibility to manipulation and disorderly market conditions
- Authorities should be given powers to change contract provisions where necessary
- Certain physical market conditions are needed for successful functioning of commodity futures contracts
- Importance of physical delivery terms and settlement reliability for promotion of price convergence

Surveillance

- Physical commodity derivatives markets are fundamentally different than financial derivative markets
- Physical delivery and cash-settled derivative markets call for different approaches
- Most susceptibility to manipulation when the deliverable supply of contracts is small, relative to the size of the positions held (for physically delivered contracts)
- Advanced real-time monitoring capabilities supported by automated systems to detect trading anomalies
- Identification of build-up of large positions
- Access to market data for effective surveillance (physical, on-exchange , OTC)
- Financialization, and the broadened opportunities for abusive trading and manipulation

Addressing Disorderly Commodity Derivatives Markets

- Disorderly conditions in physical commodity derivatives markets can have significant negative effects on the economy
- What is an orderly/disorderly market?
- Intervention Powers
    - Position management powers (Position Limits)
    - Other discretionary powers
    - Price Limits and Trading Halts

Enforcement and Information Sharing

- Misconduct can extend beyond an individual exchange including OTC markets and the underlying physical market
- Active and coordinated enforcement and information sharing among market regulators is necessary – IOSCO MMoU
- Manipulative activity has been a longstanding concern for IOSCO
- Disciplinary and criminal sanctions

Enhancing Price Discovery on Commodity Derivatives Markets

- Commodity futures markets are price discovery markets
- Market authorities should publish aggregated large trader information of commercial and non-commercial market participants
- OTC Markets Transparency and Trade Repositories
- Understanding prices in the physical commodity markets

IOSCO PRINCIPLES for FINANCIAL BENCHMARKS

- In response to major benchmark scandals and investigations (LIBOR, EURIBOR,TIBOR, ISDAFix, Oil, Gas, Gold, etc)
- The size and importance of the problem
- IOSCO Board Level Task Force on Financial Benchmarks
- IOSCO Principles on Financial Benchmarks (Governance, Quality of the methodology, Benchmark quality, Accountability mechanisms), July 2013
- Endorsed by the G-20 and the FSB as the global standards
- IOSCO Implementation Review of LIBOR, EURIBOR and TIBOR

IOSCO OIL PRA PRINCIPLES

- Published in October 2012 as a response to the G20 Leaders' request
- Intended to enhance the reliability of oil price assessments that are referenced in derivative contracts
- Served as a basis for the Financial Benchmarks Principles
- Interaction with the Financial Benchmarks Principles
- Vulnerabilities in PRA price formation arising from voluntary and selective data submissions and weaknesses in PRA methodologies
- Although developed in the context of PRAs, applicaple to all types of commodities derivatives
- IOSCO implementation review of the Oil PRA Principles

Thank you