

What challenges does  
commodity derivative market  
regulation need to consider?

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# Importance of the issue

- goes much beyond just the safety and efficiency of the financial markets
- affects many people not only in EU but also all over the world whose voice are hardly heard in this kind of meetings

# Impact of EU regulation

on the economy and society e.g.

- how much people pay for their food, and whether more poor people go hungry
- how much people pay for their energy and farmers for their inputs
- whether food producers can rely on stable prices and reliable price formation for their products
- How much inflation and therefore what central bank policies
- Whether the emission allowance systems will really stop climate change

# Challenges & considerations in regulation

- the public interests has priority & that needs to be clearly integrated
- take account the specificities of the physical and financial markets of each commodity
- institutionalised linkages and coherence between regulation and supervision of physical and financial markets of each commodity, at the EU level.

Why ?

# Large inflows by institutional investors and non end-users

- strategies to “**diversify**” investments
- **commodity index funds** (est. \$ 46 bn in 2005, \$ 250 bn in 2008; specific problems: continuous long only positions and rolling over of contracts, mixed commodities influence each others prices, ... )
- commodity Exchange Traded Funds (**ETFs**)

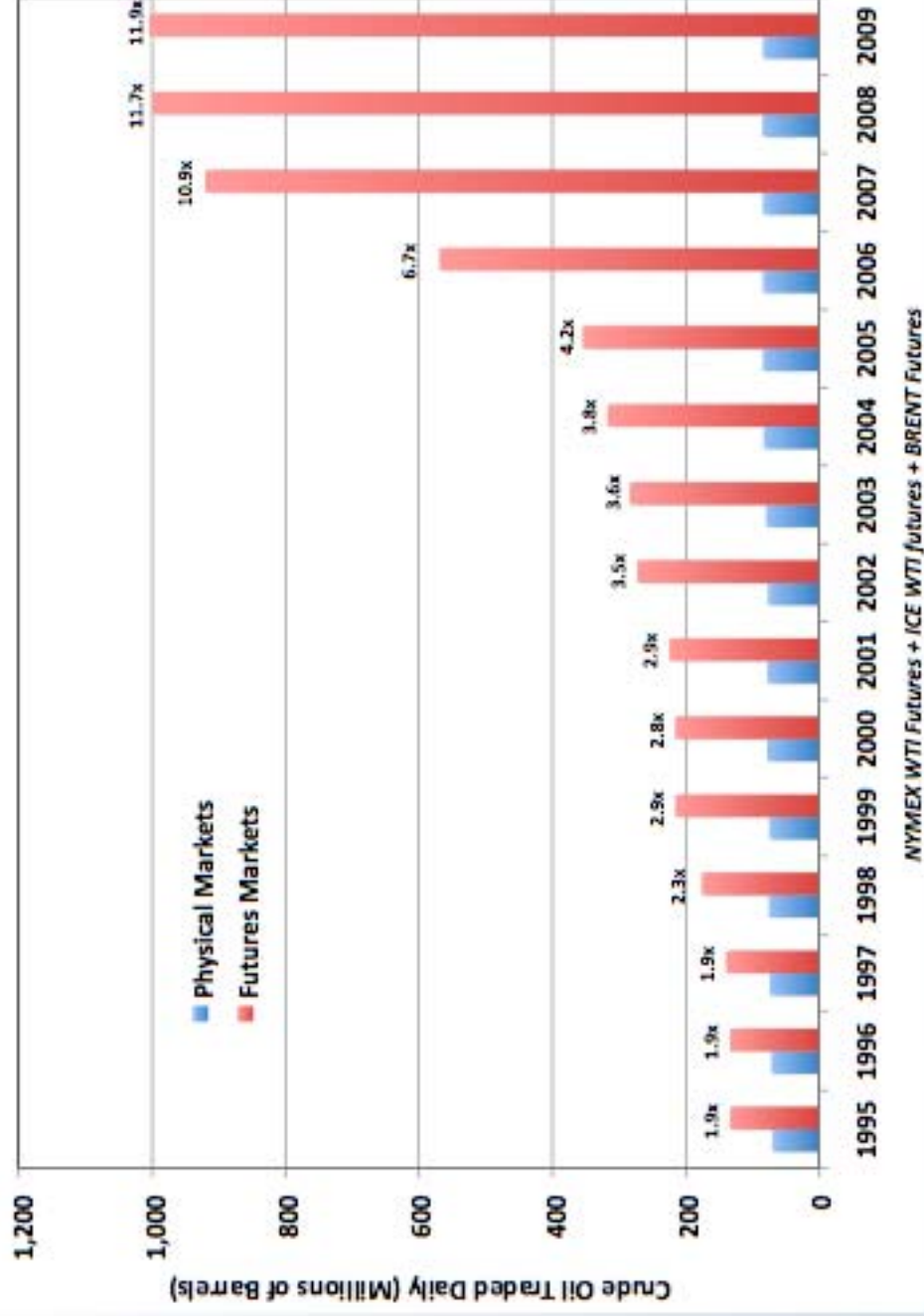
# Result of inflows of financial investors and speculators

- derivative contracts in commodities increased more than 500% between 2002 to mid 2008
  - change in dynamics: much **less end-users active in the commodity derivative markets than financial investors** and speculators (up to 75%) : see example oil prices
  - more investors not deciding on fundamentals of the commodity markets : more offer than demand impacts on prices
  - huge increase in oil prices in 2007-2008, drop in prices when speculators and investors pulled out of derivative markets in the second half of 2008
  - agricultural commodity price spikes and drops e.g. volatility in coffee, cocoa and wheat commodity markets in 2010
- = **affects real food prices** because agricultural commodities future markets are benchmark for spot prices all over the world.

→ **volatility in the commodity markets and real prices**

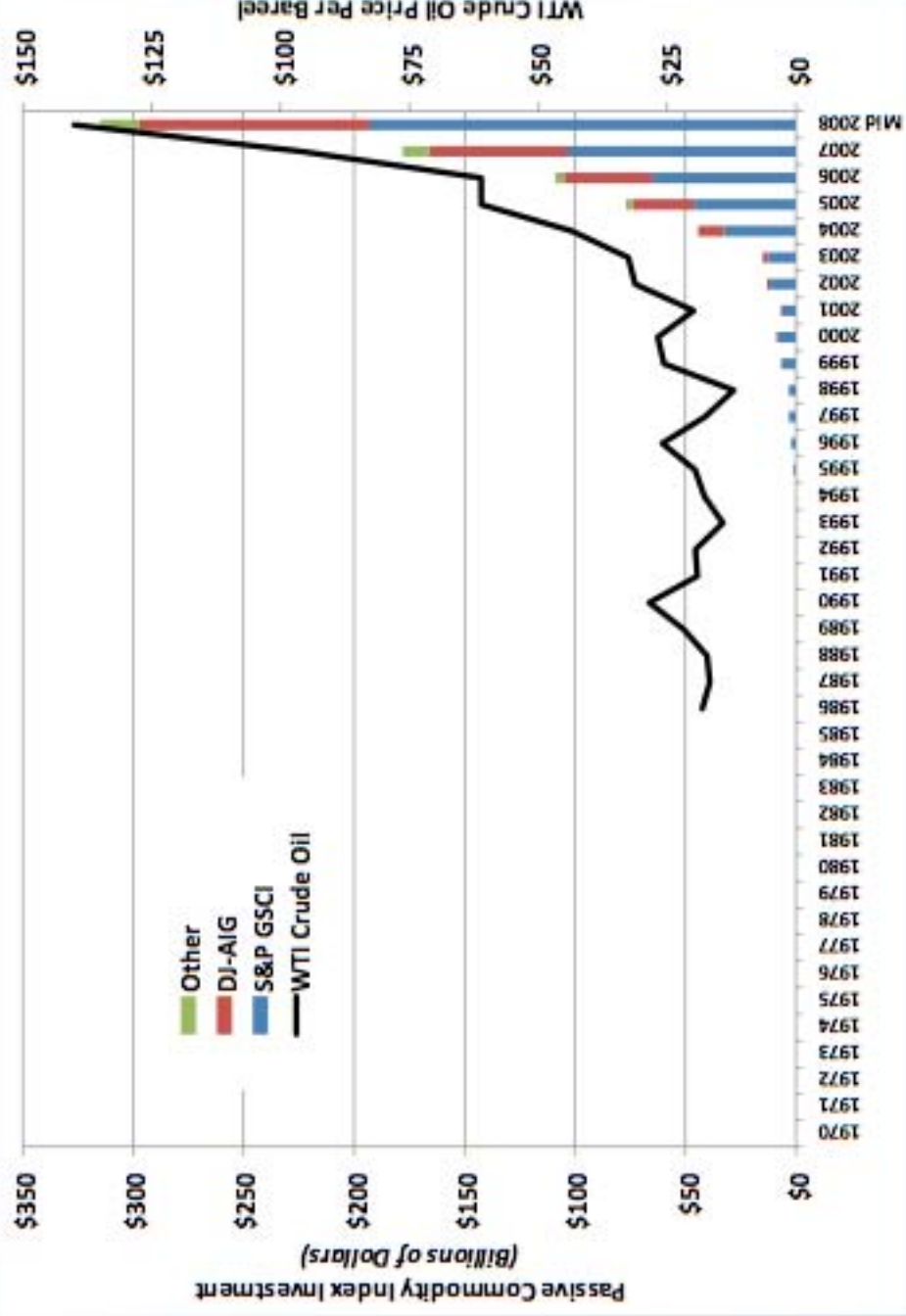
→ **derivative markets are loosing their functions for hedgers and price discovery**

# Paper Dominates Physical



Source: Bloomberg, EIA

# Passive Commodity Index Investment



Source: Goldman Sachs, Standard & Poor's, Dow Jones, calculations based upon CFTC CIT report.  
Mid 2008 figure is as of July 1.

# What regulation of commodity markets is needed

- **very strict and clear position limits** for financial entities (non end-users) and especially for index funds and ETFs
- **clear definition** of financial counterparties or non-end users: what they are (e.g. swap dealers), what activities they do, etc.
- clear definition of commercial end-user or non-financial counterparties and what activities

# The physical and financial commodity markets are susceptible abuses

- e.g. cross market abuses : financial speculators buying up commodities or warehouses
- e.g. emission allowance derivative markets are having huge problems e.g. conflicts of interests (and also abusive valuation, forwards of non-existing offset credits, political interventions that change markets, mixed underlying of emission allowances and offsetting credits whose value is difficult to value)

# Challenges & regulation to improve transparency

- Human and financial resources to supervise, analyse and interact
- Finding all kind of ways to reduce the derivative markets to transparent and safe hedging and price discovery activities

## What regulation of commodity markets need is huge improvement in transparency FOR ALL

- all real time data on trades to be reported to trade repositories (through different means not discussed here);
- All data also to be transferred **immediately to the supervisors**;
- Information given **to the public** very soon after it is given to the regulators: the “public” including farmers e.a. can play an active role in monitoring markets and raising complaints and concerns
- Information on what are the problems in the agricultural markets, and what are **alternatives** outside the derivative markets to deal with volatility more easily available to specific regulators and supervisors