34th Bürgenstock Meeting - Friday, September 27, 2013

The 34th FIA/SFOA Bürgenstock Meeting began Friday with a keynote address by Michael Haigh, Managing Director and Global Head of Commodities Research, Sociéte Générale. After an introduction by Walt Lukken, Mr. Haigh, known affectionately as the Elvis Costello of commodities, spoke of the impact of non-fundamental information as a driver of commodities markets.

Sociéte Générale uses a Principal Component Analysis (PCA) modeling approach to assess outside influences including expected inflation, currencies, credit spreads, implied volatility, equity indices and more. The model looks at 23 variables in three main groups: macro factors, currency factors and liquidity.

Ten yeas ago, the fundamentals explained 80-90% market movements, but following the Lehmann Brothers bankruptcy, their explanatory powers dropped. Only after the advent of the Arab Spring in 2011, did the power of fundamentals show signs of returning.

Swans in financial markets these days, rather than being serene creatures, are major mover and shakers of commodities markets, for better or worse. There are so-called potential black swan events, such as hard landing in China, Eurozone debt restructuring, geo-political tensions in places like Syria and Libya and there are also potential while swan events, such as US growth above 3%, the Eurozone emerging from recession and 7%+ growth in China.

A good understanding of how non-fundamentals influence commodity markets is as essential today as ever. It's no longer enough just to count barrels and bushels.

Following the keynote address, Friday morning's first panel discussion, entitled "Update on Position Limits" was moderated by James Proudlock, Managing Director & Global Commodity Product Head, Futures & Options, J.P: Morgan Securities. While speculators traditionally provide valuable liquidity to markets, on both sides of the pond, regulators are now finalizing rules to for position limits in commodity derivatives markets.

Sonia Cattarinussi, Director, Market Regulation Division, Autorité des Marchés Financiers, spoke of the implementation of MiFiD 2, which requires EU member states to establish and apply position limits, based on the size of a position in a commodity over specified period of time. This is intended to prevent market abuse, to support orderly pricing and settlement conditions.

Jonathan Jachym, Executive Director, Government Relations, CME Group, mentioned how Commissioner Michael Dunn said that position limits are a "sideshow," and there's no proof that there is excessive speculation, or that prices will drop once limits are in place. Commissioner Dunn voted for them nonetheless.

Natasha Stromberg, Regulation Manager, Futures & Options Association, spoke of how her organization is working with the industry and banks to determine how position limits will be implemented. The real debate is just beginning, with those inclined to let market operators determine the best implementation versus more draconian approaches which may kill liquidity. What are needed are flexible and dynamic limits.

Chaired by Kathleen Traynor, Executive Director, Regulation, Futures & Options Association, the second panel discussion on Friday was entitled, "Reporting Regulations". In 2009, the G20 leaders responded to the global financial crisis by agreeing to a set of principles to regulate the derivatives markets. Included was the requirement that derivatives contracts should be reported to trade repositories. The panelists looked at the challenges confronted by these new trade repositories (TRs) as they gear up to implement the G20 accords.

David Nowell, Head of Industry Relations and Regulatory Compliance for the UnaVista Division of London Stock Exchange Group, talked about the essential need for the various trade repositories to communicate with one another. Data fields need to pair up, to match. This is rarely the case today, as each TR has its own specifications. It's a catch-up game among the TRs today, which are under pressure by ESMA to get up to speed fast. Reporting always involves a certain amount of risk. There is a great deal of confusion in the market, compounded by delegated reporting. The buy-side community is little aware that it has a reporting obligation at all.

Daniel Corrigan, Executive Director & Chief Executive Officer of European Trade Reporting, CME Group, offered a US perspective, where single-sided reporting requires no pairing or matching and the issue isn't interoperability. He brought up the touchy subject of a clearing house solution, in which the clearing house reports on behalf of the end-client. He called it an elegant solution that gives ESMA what it wants. However, it's the tiny details that make all the difference.

Sara Cresswell, EMEA Head of Clearing Operations at Goldman Sachs, pointed out that there are different challenges confronting different market participants as they adjust and prepare for the new reporting regulations. One challenge lies in reporting consistency. There are also problems with the rules as written. While they are being worked on, companies are forced to make plans and set up structures based on assumptions, which is a risky proposition. Any hopes that reporting would be easy for the market to adapt are proving to be idealistic. It's a multi-year, fundamental change to operations.
Stewart Macbeth, President & Chief Executive Officer, DTCC Derivatives Repository, dashed any hopes raised by other panel members that a delay may be granted for the start date of the new reporting requirements. The commission is driven by the need to finalize and move forward. The level of preparedness among participants is questionable. Not all data may be at the anticipated standard. He sees a paradox in this reform and is concerned about the issue of fragmentation of data and wonders if reform has gotten mired in the details and lost its original intent.
Kanan Barot, Director, ICE Trade Vault Europe, said that his trade repository has a plan forward and is waiting for approval from ESMA. He sees a bit of sticking your head in the sand in the industry in a case of collective denial over the real impact of the new reporting regulations.

A concurrent panel discussion, entitled "Price Formation in Commodity Markets" was held. Diego Valiante, a policy expert from CEPS, gave a presentation on the main findings from an exceptionally thorough report on all the factors that influence price formation in commodity markets. The report, which is based on two years of research and discussions with market participants and independent experts, examines both physical markets and the related derivatives markets, with a particular emphasis on the "financialization" of the commodity markets. Valiante's presentation gave attendees many useful insights on how this issue will be addressed by policy makers in Europe. After the presentation, Tom Erickson of Bunge and Joe Raia of Goldman Sachs provided commentary from a market participant perspective. Erickson and Raia highlighted the need to analyze each commodity separately and to consider whether weaknesses in the underlying cash market are preventing the related derivatives market from working properly. This was followed by a lively discussion with members of the audience on such topics as the distortions caused by subsidies, the need for infrastructure investments, and the impact of index investors on futures prices and open interest.

After a delicious stand-up lunch that provided plenty of opportunity for networking, the final afternoon session kicked off with a panel entitled, "Regulation and its Effects on Commodity Financing". It was chaired by Stéphane Graber, Secretary General of the GTSA, Switzerland's leading commodity trading and shipping professional organization. The panel discussed the challenges confronting commodity trading houses by the ongoing financial reform regulation.
Physical commodity trading entails bringing raw materials to the consumer from the producer in concert with the imbalanced distribution of commerce and supply throughout the world. The lofty aim of new regulation is to organize and optimize the entire value chain, to manage prices and operational risks.
Natasha Stromberg, Regulation Manager at the Futures & Options Association, spoke of how the commodities industry is being hit from all sides with a plethora of regulations including EMIR, MiFiD, COD4 and REMIT. The industry is challenged to adapt to evolving market demands, and to develop solutions and systems adapted to suit commodity trading activities, which can be applied internationally and multilaterally to all involved participants. The impending position limits have the potential to impact the commercially essential hedging function that commodity trading traditionally provides. One thing is clear; the new regulations will lead to higher costs.
Jean-Yves de Both, Partner at Schellenberg Wittmer, shed light on the situation in Switzerland, which as a non-EU member, tends to go its own way. Here, the market remains relatively unregulated, however, Switzerland will be compelled to adapt rules in line with its counterparts in the US and EU or risk sanction. The chances are that the new Swiss regulation currently being drafted will resemble EMIR, with the usual Swiss finish, of course. One sticking point is the definition of what constitutes a financial company as opposed to a company in the commodities market for pure commercial hedging purposes.
Philippe Berta, General Counsel, BNP Paribas, spoke about the existing legal and regulatory environment in Switzerland. Traders, shipping and banks are all audited. Boards of directors are liable to Swiss law and FINMA, the Swiss Financial Market Supervisory Authority. Swiss regulations are applied very strictly. Transaction flows are monitored carefully to combat money laundering. Transactions to sanctioned people and countries are blocked, including foreign sanctions. Supervision extends to underlying transactions. The new regulations will largely follow those of the UN, EU and US. Traders involved in physical commodity trading, however, will be largely exempted from the impending onslaught of reporting requirements
Guillaume de la Ville, a consultant for commodities trading and finance, is concerned that those formulating the new regulations will be misled by the common tendency to mix and blend traders, brokers and speculators all in one pot. Physical commodity traders are those who move products from point A to point B. They must address challenging logistical issues. The derivatives market supplies price discovery and information about market supply in a highly regulated business. The industry today is challenged by Basel III, cap requirements and difficult access to the US dollar, important drivers leading to consolidation among trading companies. However, it is a

traditionally resilient and relatively low-risk industry that is rapidly adapting and addressing the changes.

The final panel discussion of the 34th Bürgenstock Meeting, entitled, "Commodity Trends: The Big Picture", was affably chaired by Clive Furness, Managing Director of Contango Markets. The panel looked at major trends impacting commodity markets around the world.
When asked what he thought would be the regulation with the greatest impact on commodities trading, Joseph Raia, Managing Director, Head of Global Commodity Futures Sales at Goldman Sachs, mentioned how the advent of clearing extending into additional, traditionally OTC markets, is a game-changer. There is tension between the demand for greater transparency and the bid/offer spread as well as the ability to put a price on what the players are trading. Benchmarks themselves are coming under increasing scrutiny.
He spoke at length about the phenomenal developments in the US oil and gas market. In decline since 1970, the production trend reversed and has grown significantly since 2013. The US shale revolution has taken the industry by surprise and the technology is bound to spread to other countries. This will impact global oil flows, with the major effect being a significant reduction of US imports and growing exports. Nevertheless, further surprises both on the up and downside are to be expected.
Steve Terry, Head of Research at Vitol, led with a disclaimer that he would not make any price forecasts. In recent years, oil has been the great exception in the commodities world. Although it jumped in price from 20 dollars a barrel to well over 100 dollars, unlike other commodities in which price impacts demand, the demand for oil only increased. Only very recently has the market finally worked as intended and high prices led to decreased demand. As the supply side of the business transforms with increasing shale production in the US, it is only a matter of time before this spills over into the world market. At the same time, price also led to greater consumer efficiency in planes, cars, trucks and ships, as well as heating and in industry. Lower oil and gas prices are not at all inconceivable.

Discussion at the 34th Bürgenstock Meeting was dominated by the topic of financial markets regulation and its impact on the industry. The discussions were far-reaching and detailed, providing much-needed clarity on the issues. With the FIA at its side, SFOA has managed to breathe new life into this venerable conference, providing great value in the form of information and top-notch networking in the luxurious setting of the Intercontinental Hotel in Geneva. Proving its essential relevance to the industry once again, participants left knowing that it was not good-bye, only adieu, until we meet again.

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