

Task Force on Commodity Futures Markets

Report to G-20



OICU-IOSCO

**TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS**

JUNE 2010

On behalf of the Technical Committee of the International Organization of Securities Commissions (IOSCO) and the IOSCO Task Force on Commodity Futures Markets¹ (IOSCO Task Force), we are pleased to report to the G-20 leaders IOSCO's progress in improving the transparency and oversight of oil markets as called for in paragraph 28 of the September 24-25, 2009 Pittsburgh Leaders' Statement (the G-20 Pittsburgh Statement).

The IOSCO Technical Committee created the Task Force in September 2008 as a response to global concerns, including those voiced by the G-8 Finance Ministers, concerning price increases and volatility in oil and food products.² The G-8 Finance Ministers specifically called for "national authorities to examine the functioning of commodity futures markets and to take appropriate measures as needed." Responding to these concerns, the Task Force held meetings in Washington, DC in December 2008 and in London in January 2009. The group focused on the following topics:

- Volatility and the role of new participants in futures markets;
- Transparency and market surveillance;
- Challenges to enforcement; and
- Enhancing global cooperation.

The primary focus of the Task Force was whether supervisory approaches were keeping pace with market developments, including the participation of new categories of traders such as index funds, whether transparency in commodity markets was sufficient in light of current concerns, and whether supervisory and enforcement cooperation could be improved.

The Task Force's March 2009 Report set out the following recommendations:³

¹ The IOSCO Task Force on Commodity Futures Markets is co-chaired by the Commodity Futures Trading Commission (United States) and the Financial Services Authority (United Kingdom) and the following IOSCO members participated in the Task Force: Comissão de Valores Mobiliários (Brazil); Alberta Securities Commission (Canada, Alberta); Ontario Securities Commission (Canada, Ontario); Autorité des marchés financiers (Canada, Quebec); China Securities Regulatory Commission (China); Dubai Financial Services Authority (Dubai); Autorité des marchés financiers (France), Bundesanstalt für Finanzdienstleistungsaufsicht (Germany), Securities and Futures Commission (Hong Kong), Forward Markets Commission (India); Commissione Nazionale per le Società e la Borsa (Italy), Financial Services Agency (Japan); Ministry of Agriculture Forestry and Fisheries (Japan); Ministry of Economy, Trade and Industry (Japan); Kredittilsynet (Norway), Monetary Authority of Singapore (Singapore); Swiss Financial Market Supervisory Authority FINMA (Switzerland).

² The G-8 Finance Ministers also raised strong concerns at their June 2008 Meeting in Osaka, Japan about the sharp rise in oil and food prices and the impact on global macro-economic stability as well as peoples' welfare and development prospects. The G-8 Finance Ministers specifically called for "national authorities to examine the functioning of commodity futures markets and to take appropriate measures as needed." *Statement of the G-8 Finance Ministers Meeting*, June 14, 2008, Osaka, Japan <http://www.mof.go.jp/english/if/su080614.pdf>.

³ IOSCO Technical Committee Task Force on Commodity Futures Markets: Final Report (March 2009) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD285.pdf>

- Continued monitoring of the futures markets in order to improve understanding of futures price formation and the interaction between regulated futures markets and related commodity markets⁴;
- Improvements in transparency with respect to the availability and quantity of information on commodities;
- Greater cooperation and the sharing of information among futures market regulators;
- Ensure that futures market regulators have the necessary legal framework to detect and take enforcement action with respect to manipulation; and
- Meeting regularly for the purpose of informal sharing of concerns on trends and developments in commodity markets as well as the sharing of market surveillance and enforcement approaches.

Subsequent meetings in London in December 2009 and in Washington during March 2010, included discussion with the International Energy Agency (IEA), a roundtable with industry participants, and a meeting with representatives of price reporting agencies (PRA). The work arising from these meetings is outlined below, particularly: prioritization of over-the-counter (OTC) oil derivatives, collaboration with the Commodities Major Dealers (CMD)⁵ and ISDA Commodities Product Steering Committee (COSC)⁶.

Implementing the IOSCO Task Force Recommendations

The G-20 Pittsburgh Statement endorsed these recommendations and called for IOSCO members to implement them.

In order to assess compliance with these recommendations, the Task Force conducted a survey of its members. The survey (attached) reveals a high degree of compliance by Task Force members with these recommendations: a majority of all members monitor large concentrations, have the authority to order reductions in positions, and have the authority to collect information on related OTC and cash market positions. In instances where authority is lacking, members are reviewing

⁴ The term “related commodity market” refers broadly to the cash commodity that underlies the futures contract, as well as positions in privately negotiated transactions that are not traded on a regulated exchange (e.g. forward contracts, swaps, options and other structured products) involving the same commodity. The purpose of enhancing the transparency of related information is to assist in determining whether market abuses may be taking place in the regulated futures market. Correspondingly the term “underlying” commodity market refers solely to the physical/cash market.

⁵ The CMD includes Bank of America-Merrill Lynch, Barclays Capital, BNP Paribas, Citigroup, Credit Suisse AG, Deutsche Bank AG, Goldman Sachs & Co, HSBC Bank USA N.A., JP Morgan Chase, Morgan Stanley, RBS Sempra, Société Générale, UBS AG and Wachovia Bank, N.A.

⁶ The COSC is the first level of governance, operating under the auspices of the ISDA Industry Governance Committee (IIGC) which includes representatives from CMD as well as major “buy-side” commodity producers and traders.

steps to request such additional authority. All Task Force members have the authority to share surveillance information and have a compliance program, including the powers to discipline both exchange members and non members that engage in abusive trading.

Prioritizing Work in Oil OTC derivatives

The IOSCO Task Force's 2009 Report recommended greater transparency to enhance the quality of information in the organized futures markets and in the related OTC and cash commodity markets. Because transparency in the organized futures markets is well established, and the physical commodity markets are beyond the jurisdiction of IOSCO's securities and derivatives regulators, the Task Force focused its most recent work on the OTC markets.

The Task Force initiated work on multiple fronts to prompt better transparency of OTC oil derivatives data. The co-chairs contacted the BIS Committee on the Global Financial System (CGFS) to request that OTC energy/oil is reported separately from aggregated quarterly OTC commodity derivative statistics. This work remains under consideration by BIS.

In addition, the Task Force has been working with major OTC derivatives participants who had already made initial commitments to bring greater transparency and standardization to the OTC derivatives markets in a variety of asset classes.⁷ The Task Force's objective has been to determine (1) if work could be expanded and accelerated with respect to transparency in oil OTC derivatives and if so, (2) to broaden the participation in this work to include a geographically diverse group of dealers, producers and end-users.

In this respect, the Task Force is pleased to report commitments from the industry to assist in bringing needed transparency to this marketplace. The CMD and the ISDA COSC, collectively referred to as "major commodity participants" have agreed to:

- Work with and report to the Task Force in pursuing greater transparency in OTC oil derivatives;
- Deliver by the end of May 2010 a timeline for deliverables that will facilitate greater transparency and operational efficiencies in OTC oil derivatives;
- Conduct a survey of the ISDA COSC to assess the size and composition of the OTC oil financial derivatives market, thus informing consideration to introduce existing CMD metrics to non-dealer members of the ISDA COSC and work to understand the extent of electronic confirm matching;

⁷ These major participants include major dealers and buy-side institutions which report to their relevant regulators organized as the OTC Derivatives Supervisors Forum that was organized under the auspices of the New York Federal Reserve Bank. <http://www.newyorkfed.org/newsevents/news/markets/2010/ma100301.html>

- Accelerate work on previous commitments (outlined in the CMD’s December 7, 2009 letter ⁸), which are intended to strengthen the resilience and robustness of the OTC commodity derivatives infrastructure in the global OTC commodity derivatives markets, including increased transparency, electronic processing and standardization;
- Build consensus for a trade repository for OTC oil financial derivatives among dealers and non-dealers; and
- Expanding participation in this work to include a broad, diverse group of dealers, industry groups and buy-side participants (including producers and end-users) in geographic areas where OTC oil derivatives markets exist.

Publication of Exchange-Traded Energy Derivatives Data

In order to advance the publication of large futures concentration information to the public as a means to enhance oil futures market transparency, the Commodity Futures Trading Commission (CFTC), is holding a seminar for interested regulators. The CFTC, which has published “commitments of trader” (COT) reports for many years, is arranging a meeting in June at which it will share its large trader and COT report procedures with interested Task Force members. Through such sharing of experiences the Task Force hopes to facilitate greater publication of aggregated large trader information in oil futures markets.

Continuing Challenge of Transparency of Underlying Physical Commodity Market Transactions

As noted in the Task Force’s Report:

Commodity futures markets are price discovery markets, in which the futures price tracks the prices of and signals information and expectations about the direction of the underlying markets.

The quality of the price which the futures market discovers reflects the extent of the market’s understanding of the available underlying data, and the quality of that data. If data is inadequate or of poor quality it makes it difficult for futures market regulators to determine accurately whether or not certain activity or price movements are unusual. *Accordingly, information about the underlying commodity is key for the satisfactory functioning of the futures market and reliable price discovery.* ⁹ [Emphasis added]

⁸ The commodities commitments are set out in a letter dated December 7, 2009 to the Supervisors Forum http://www.isda.org/c_and_a/pdf/CMD-CommoditiesSupervisoryLetter.pdf

⁹ Examples of underlying cash market data include published prices and indexes of cash market transactions, inventory and storage reports, crop reports, government data (e.g. cattle data in the US) and all other market information on a particular commodity. The cash market data are available either publicly or privately, usually through third party vendors. The cash market data is used by both market participants and regulators to assess both current and prospective economic conditions.

The securities and derivatives regulators who comprise the IOSCO Task Force regulate the *financial markets* and have limited ability to influence physical market transparency other than to engage in educational efforts that help publicize the need for greater transparency. A February 2010 seminar co-sponsored by the IEA and the Institute of Energy Economics of Japan, with the support of Japan's Ministry of Economy, Trade and Industry (METI), and in cooperation with the IOSCO Task Force illustrates such efforts. That meeting concluded, among other things, that:¹⁰

The issue of data transparency is paramount for a better understanding of oil market dynamics. Improved data on demand, supply and stocks are key to a better grasp on market fundamentals, notably in the emerging markets that are now playing an increasing role, such as Asia. However, equally important is greater granularity on financial market information..."

As described above, the IOSCO Task Force is making concrete progress in increasing the granularity on financial market information (*i.e.*, futures and OTC derivatives). However, Task Force members have no authority to mandate greater transparency in the cash markets. Notwithstanding this, following discussions with PRA, the Task Force recommends that further effort to assess their role in the form of an impact study, which would inform any decision to address their influence in physical markets, would be beneficial. The Task Force considers that this work could be most appropriately undertaken by an international body with involvement in physical energy markets with collaboration from appropriate interested parties.

Efforts are required by relevant authorities with regard to the enhancement of data on underlying cash market (physical) commodity market transactions. We do not underestimate the barriers to achieving greater transparency in the cash markets. However, unless such transparency is achieved, it will remain difficult for national authorities to understand the relationships between transactions in the financial markets and transactions in the cash markets. Moreover, the relative imbalance in the degree of transparency between financial markets versus physical markets leads to greater scrutiny of financial markets -- which are, ironically, by far, the most transparent markets -- and obscures analysis of the many complex inputs into commodity prices.

The Task Force is continuing its work and looks forward to reporting further progress this year.

¹⁰ "Event Notice" on IEA/IEEJ Joint Oil Price Formation Workshop" (February 25, 2010) available at: http://www.iea.org/journalists/events/price_formation_workshop.pdf