

BUNKERSPOT

CYBER STORM HOW SECURE ARE YOUR BUNKER DEALS?

INSIDE:
FUEL TESTING
REGULATORY COMPLIANCE
VESSEL MONITORING
ALTERNATIVE FUELS





Information exchange

Innovations in exchange platforms have provided the transparency that is required for commodity derivatives to evolve.

Chris Thorpe takes a closer look at this dynamic and maturing marketplace

Wall Street is most often blamed for taking advantage of the weak, or so called 'main street' businesses that produce basic goods and services in the economy. This belief rests on the fact that financial markets can be opaque to the user who relies on intermediaries to disclose market prices and provide trade execution services. In the wake of market turmoil and financial distress post 2008, commodity derivative exchanges, most notably the Chicago Mercantile Exchange (CME) and its main rival the Intercontinental Exchange (ICE), have sprung into action to provide the platforms to benefit market participants and satisfy increasingly demanding government regulation. But will more transparent market places really be accessible to all users or will intermediaries, such as brokers and banks, continue to dominate the commodity derivative marketplace?

Technology has been slow to advance in commodities derivative markets. It has not been long since these markets involved only two parties, a buyer and a seller meeting by appointment arranged by a mutual broker or financial institution. The arrangement was known as the 'over the counter' or OTC market. These markets were described as opaque because prices traded were often unreported or reported so late that the information was no longer relevant. As time went on and commodity markets grew, derivatives were listed on organised

'Simply put, CME Direct will allow traders to see both their exchange futures trades and positions side by side with their exchange cleared OTC transactions'

exchanges and traded where real flesh and blood humans would bark out orders and fill execution tickets for their clients.

The foundation of organised commodity exchanges is based on 'futures', which are simply standard non-negotiable agreements that obligate the buyer and seller to exchange money for some quantity of product in the future. They are no different than 'forward' contracts aside from their standard specifications, size and fungibility between counterparties.

These futures were the first standardised instrument to stand in place of two party agreements between, for example, a crop producer and a customer who may have previously had a physical supply agreement. Following an initial transaction, futures could be traded freely from one party to the next holding the same obligation to deliver the stated commodity on a fixed date. Though futures markets were arguably created to facilitate the trade of physical commodities in agriculture and metals, financial futures introduced in the 1970s blossomed and eventually dwarfed their predecessors.

The sheer size in the financial markets has served to advance trading platforms. What was once a street corner securities market in New York became a formal exchange as early as 1921. These rapidly burgeoning exchanges were also more heavily scrutinised by government regulators who sought to protect naïve main street investors. Interestingly, after-hour stock markets still have nicknames based on the days when stocks traded outside on the street corner and are still known as 'curb markets'.

The evolution of stock markets, such as the American and New York stock exchanges, stands in stark contrast to the New York Mercantile Exchange (NYMEX) which developed alongside other smaller commodity exchanges throughout the 20th century. It was not until 1978 that oil products were introduced at NYMEX, but oil and its derivatives have made NYMEX one of the most significant

commodity derivative exchanges in the world.

From a technology and management perspective, stock and bond markets deserved more effort and investment in systems early on to provide transparency and liquidity. Though stock markets have developed faster with greater investment in technology, commodity derivative markets have only recently innovated to compete so as to provide greater transparency and liquidity for all clients.

From their beginnings the commodity markets have relied more on a physical presence. After all, most commodity markets were based on a live auction process where buyers and sellers (or their brokers) would meet in a room and find the best price offered for a given size or volume. For products that traded in small quantities, the players would meet at agreed times in the day and complete their business in a matter of hours. For example, small volume or 'thinly traded' futures markets, such as orange juice, would meet for an hour or two whilst larger markets, such as heating oil, would meet for three to four hours.

There was simply no need for trading longer hours based on demand and the minimum market participants needed to provide price discovery and trading liquidity. Outside trading hours, brokers would speak to clients to prepare for trades the following day or discuss current market conditions. However, the amount of time between market trading hours created great market inefficiency and price transparency challenges for those without access to brokers having the best information.

As commodity derivative markets matured and followed other securities market advances, more formalised commodity and commodity derivative exchanges were introduced to increase market transparency.

At CME and its subsidiary NYMEX, hedgers and speculative traders have relied on the open outcry market for over 30 years. Customers would call a phone on the exchange floor and have a clerk relay their order to the 'pit' of the trading floor to a broker

who would then attempt to execute the order. Prior to the technology of hand-held computer tablets and wireless networks, the loudest voice and the largest imposing brokers would often have an advantage. Surprisingly, large light boards that 'printed' the most recent prices traded were once the fastest way to track changing market conditions.

Indeed technology and systems have advanced since the first futures were traded on exchanges. But it has not been long since the NYMEX used a system called 'Access' to facilitate overnight futures trading outside the normal exchange floor hours.

Access was one of the first commodity exchange systems to allow users an on-line tool to see prices and execute futures orders. Still the market for futures in commodities was largely protected by the exchange members who were, by definition, running the exchange from the floor in regular business hours.

NYMEX advanced its clearing of OTC products through the introduction of 'Clearport' in 2003 which aimed to provide existing bi-lateral derivatives transactions with a platform to clear the same way that existing futures cleared on the exchange. The London-based ICE exchange had created a similar mechanism back in 2000, which undoubtedly spurred its slower US competition. Both cleared OTC platforms have grown to include hundreds of commodity derivatives, including swaps and options, once only offered by financial institutions off-exchange ranging from bunker fuels to real estate indices.

The increase in exchange cleared products available has resulted in a more transparent market for fungible oil commodity derivatives that were once unique to banks and major oil companies. Today, open interest, price changes and mark to market information provide invaluable data for traders and the entire financial industry.

Since CME's acquisition of NYMEX in 2008, technology has continued to advance with the goal of creating the most transparent and liquid marketplace in

Even occasional hedgers and traders now have access to professional tools once reserved for only savvy Wall Street brokers

the world. CME has recently introduced CME Direct, which advances the existing Globex live market interface to a new level.

Simply put, CME Direct will allow traders to see both their exchange futures trades and positions side by side with their exchange cleared OTC transactions. This is new for the exchange clearing world and it fills a need that has been magnified by internal and regulatory reporting requirements worldwide.

On Wall Street it is survival of the fittest. Lumbering elephants fall prey to sleek and fast-moving hunters. So what was once a cumbersome process has, by natural

progress, become more seamless and transparent for even the occasional trader and industrial hedger. Even occasional hedgers and traders now have access to professional tools once reserved for only savvy Wall Street brokers. Ease of use is sure to increase exchange volumes, which will result in more price transparency and greater liquidity in the global marketplace. Although brokers and advisors still play an invaluable role, improving exchange platforms will provide the needed transparency for commodity derivatives to evolve in the increasingly complex marketplace.

 Chris Thorpe is a managing partner of Brick Consulting Partners and Brick Investment Partners.

Chris Thorpe co-founded Hudson Capital Energy, an energy risk management firm, and was an investment banker at JP Morgan. He started his career at Methanex and has held positions in Europe, Canada and the United States.

 Email: thorpe@brickipllc.com
Tel: +1 646 790 5777

HAMPTON BUNKERING LTD

Worldwide Bunkers since 1970

999 de Maisonneuve Blvd. West, Suite 615
Montreal, Quebec, H3A 3L4, Canada
Tel: 514-288-2818 Fax: 514-282-9279
bunkers@hamptonmtl.ca

Sylvia Kartanowicz – Susan Cox