European Parliament – Economic and Monetary Affairs Committee

Public Hearing: Energy derivatives markets, oversight challenges related to market integrity and financial stability risks

Meeting Room – EP SPAAK 3C50

27 March 2023 | 16h30 – 18h30 CET

Opening Statement of Jean-Paul Servais, IOSCO Board Chair

Dear Madam Chairwoman,

Dear Members of the Economic and Monetary Affairs Committee,

I would like to thank you for the opportunity to take part in this hearing in my capacity as IOSCO Board Chair.

IOSCO is the global organisation in charge of the development and the promotion of adherence to international standards of regulation, oversight and enforcement in the field of financial markets.

With 130 members globally, including more than 90 members from Growth and Emerging Markets, IOSCO members regulate more than 95% of the world's securities markets.

Recently, as a result of the war in Ukraine, there have been concerns with the high prices and high volatility in energy and commodity spot markets, which led in turn to spikes in commodity derivatives markets and on margin requirements. These consequences were singularly acute in Europe and raised questions on the potential impact to financial stability.

Against this backdrop, the scheduled review of IOSCO's principles for the Regulation and Supervision of Commodity Derivatives Markets turned out to be very timely. We published them in January 2023 and are the result of extensive dialogue between IOSCO members and public consultation of stakeholders.

The 2011 Principles were originally requested and endorsed by the G-20 Leaders to provide internationally recognised guardrails that are intended to be used globally for the regulation and supervision of the commodity derivatives markets.

The scope of IOSCO principles is broad in focus. It does not only apply to energy / gas derivative markets, but also to wheat, metals, and other types of commodity derivatives markets.

The revised principles seek to support the commodity derivatives markets in fulfilling their fundamental price discovery and hedging functions, while operating free from manipulation and abusive trading schemes.

In conducting this review, IOSCO was guided by its three main objectives of (1) protecting investors, (2) ensuring fair, efficient and transparent markets, and (3) reducing systemic risks.

Whilst not legally binding, the IOSCO Principles are recognised as the highest global standards for regulation and supervision of commodity derivatives markets. They are designed by and for market authorities and they inform national and regional legislative initiatives.

While the IOSCO implementation reviews in 2012, 2014 and 2018 demonstrate a high level of implementation, further proper implementation of the revised Principles is essential for sound price formation in commodity derivatives markets and the underlying physical energy, metals and food markets, which all are core to the functioning of the global economy.

Most of the 2011 principles are still fit-for-purpose. However, five of the 24 principles were strengthened to reinforce authorities' monitoring and supervision ability.

Let me highlight some of the key guardrails included in the revised Principles:

Principles 2 on "economic utility" and 5 on 'Transparency on Contractual Terms' stipulate that market authorities should have the ability to review contracts to ensure sound risk management practices are in place.

Principle 3 aims at guarantying the adequate correlation with physical markets to guarantee that derivative markets don't deviate from their real economic anchorage such as commodity supply.

Principle 15 on "Intervention Powers" already included the ability for authorities to suspend or to curtail trading through circuit breakers in case of disorderly markets. It recommends implementing maximum price fluctuations and position limits to help mitigate excessive price volatility and provide time for market participants to arrange necessary financing, in addition to allowing time for price movements to be fully understood by all market participants.

This should help mitigate cases of extreme volatility by setting limits on price fluctuations or on position concentration.

We have also introduced a new principle 16 on "Unexpected Market Disruptions" to require authorities to have a process to restore orderly markets in response to unexpected disruptions, such as a war, a natural disaster, or a pandemic.

Principle 16 clarifies that market authorities should (i) protect the rights and interests of market participants, (ii) minimise the adverse impact of the unexpected disruptions, and where possible, (iii) take steps to de-incentivise higher risk-taking to isolate the potential market and contagion risks across different commodity derivatives markets.

By nature, commodities will remain more volatile than other asset classes under extreme stress scenarios. Therefore, the Revised IOSCO Principles are a step forward towards mitigating commodity derivatives prices volatility but cannot insure against a price spike during a war or similar incident.

The principles are designed to contribute to markets functioning properly, including during times of stress, and were referred in the FSB report on the financial stability aspects of commodities markets published in February 2023.

Let my finally add that the Committee on Payments and Market Infrastructures (CPMI), the Basel Committee on Banking Supervision (BCBS) and IOSCO are conducting joint work on margin requirements.

In September 2022, the three bodies published a review of margining practices which identified areas for further work in order to enhance transparency and liquidity preparedness. Adequate risk management is indeed crucial to help market participants manage unexpected liquidity pressure due to margin calls during times of stress.

Honourable members of parliament,

Madam Chairwoman,

I thank you for your attention and look forward to taking questions