Global Commodities Forum: Lunch and Networking Activities

16 July 2016

Presentation

The Development of Commodity Derivatives Markets in Africa

by

Selloua Chakri – Head of Market Structure Strategy, MEA, Bloomberg

The views expressed in this document are those of the author(s) and do not necessarily reflect the views of the UNCTAD secretariat.
THE DEVELOPMENT OF COMMODITY DERIVATIVES MARKETS IN AFRICA

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AGENDA

• THE ROLE OF COMMODITY DERIVATIVES IN AFRICA

• OVERVIEW: AFRICAN COMMODITY DERIVATIVES MARKETS

• AFRICA MARKET STRUCTURE

• CHALLENGES AFFECTING DERIVATIVES MARKETS DEVELOPMENT IN AFRICA

• GLOBAL REGULATORY REFORMS POST 2008/2009 FINANCIAL CRISIS
THE ROLE OF COMMODITY DERIVATIVES IN AFRICA
ROLE OF COMMODITY DERIVATIVES MARKETS

- **Hedging** price risk
- **Price discovery**
- **Price risk** management
- Involvement of hedging parties, speculators and banks
- Derivatives instruments: **forwards, futures and options**
- **Facilitate physical deliveries** required for completion of a derivative contract
- Reduce counterparty risk via clearing houses
HISTORICAL COMMODITY PRICES

ENERGY - ICE BRENT CRUDE 1Y

$31.52 on the 16th January 2016
HISTORICAL COMMODITY PRICES

METALS – SPOT GOLD 1Y

Source: Bloomberg
HISTORICAL COMMODITY PRICES

AGRICULTURE – GRAINS - CBOT CORN 1Y

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Current Price</th>
<th>Change</th>
<th>Previous Close</th>
</tr>
</thead>
<tbody>
<tr>
<td>KCU6</td>
<td>140.00</td>
<td>-1.30</td>
<td>141.30</td>
</tr>
</tbody>
</table>

Last Price: 140.00
High: 150.10
Average: 130.47
Low: 117.95

Source: Bloomberg
**DERIVATIVES INSTRUMENTS**

**Forward Contract**
An agreement in which an asset is purchased or sold at its current price, with delivery and settlement set for a specified future date.

**Commodity Futures Contract**
**Definition**
An agreement to buy or sell a set amount of a commodity at a predetermined price and date. Buyers use these to avoid the risks associated with the price fluctuations of the product or raw material, while sellers try to lock in a price for their products. Like in all financial markets, others use such contracts to gamble on price movements.

**Options Contract**
**Definition**
A contract that allows the holder to buy or sell an underlying security at a given price, known as the strike price. The two most common types of options contracts are put and call options, which give the holder-buyer the right to sell or buy respectively, the underlying at the strike if the price of the underlying crosses the strike. Typically each options contract is written on 100 shares of the underlying.

Source: Bloomberg
OVERVIEW: AFRICAN COMMODITY DERIVATIVES MARKETS
### OVERVIEW: AFRICAN COMMODITY DERIVATIVES MARKETS

<table>
<thead>
<tr>
<th>South Africa</th>
<th>Botswana</th>
</tr>
</thead>
<tbody>
<tr>
<td>• In 1995, establishment of <strong>SAFEX</strong> following the deregulation by the SA government of the agricultural market and the end of agricultural price controls</td>
<td>• Regulator approved exchange license for Bourse Africa (Mauritius) to operate in the local market</td>
</tr>
<tr>
<td>• In 2001, <strong>Johannesburg Stock Exchange</strong> bought SAFEX, now a division of JSE – SAFEX/JSE is the only fully functional commodity futures exchange in Africa</td>
<td>• PACDEX and the Multi Commodity Exchange of Africa are other commodity exchanges initiatives in Botswana</td>
</tr>
<tr>
<td>• Products traded in the commodity space are agricultural, metal and energy derivatives</td>
<td>• Top 20 largest commodity futures exchange</td>
</tr>
<tr>
<td>• JSE/SAFEX is also used as a price discovery mechanism for the Southern African region.</td>
<td>• <strong>PACDEX</strong> and the Multi Commodity Exchange of Africa are other commodity exchanges initiatives in Botswana</td>
</tr>
<tr>
<td>Country</td>
<td>Details</td>
</tr>
<tr>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>Egypt</td>
<td>In 1861, establishment of Alexandria Cotton Exchange, Africa’s oldest commodity exchange. ACE Exchange ceased to exist in 1961 as the Egyptian state took control. More recently, the Cairo &amp; Alexandria Stock Exchange is looking at launching commodity futures supported by financial sector reforms that will include the use of derivatives.</td>
</tr>
<tr>
<td>Ghana</td>
<td>In 2016, the Ghana Commodity Exchange expected to start operation, it will offer derivatives. GCE will be able to take part in a regional or pan-African network.</td>
</tr>
<tr>
<td>Kenya</td>
<td>In 1994, establishment of the Kenya Agricultural Commodity Exchange (KASE). KASE focused on price information and dissemination. In 1998, the Nairobi Coffee Exchange announced it aspired to offer futures contracts – so far this has not happened. In 2015, the Nairobi Securities Exchange (NSE) was licensed to operate a derivatives market. NSE expected to launch exchange traded derivatives this year. NSE established a CCP to clear derivatives.</td>
</tr>
<tr>
<td>Malawi</td>
<td>In 2006, establishment of the African Commodity Exchange (ACE) a regional exchange. In 2013, announcement of AHCL looking to offer commodity futures trading. The Securities Law has been reviewed to consider derivatives trading. In 2016, the Malawi Securities Exchange announcement to set up a derivatives market.</td>
</tr>
</tbody>
</table>
OVERVIEW: AFRICA COMMODITY DERIVATIVES MARKETS

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| Mauritius | • In 2010, **Bourse Africa** (ex-Global Board of Trade) started to offer commodity and currency derivatives and African equity index derivatives, and has global aspirations  
• Bourse Africa Clear Ltd.– undertakes clearing & settlement for trades done on BA |
| Ethiopia  | • In 2008, establishment of the **Ethiopia Commodity Exchange** (ECEX), a government led initiative  
• All Ethiopian commodities trading must take place on the exchange  
• ECEX aims at offering futures trading |
| Nigeria   | • In 2001, establishment of **Abuja Securities & Commodity Exchange**  
• ASCE failed to develop significant volumes  
• In 2016, the SEC announced that it will be introducing initiatives to help the development of commodities trading in Nigeria  
• ASCE plans on developing a futures market |
| Rwanda    | • In 2014, establishment of the **East Africa Exchange**, trading of commodities in the East African Community  
• In 2014, the government announced that it will allow derivatives trading on the Rwanda Stock Exchange  
• **Rwanda Stock Exchange** announced to offer derivatives trading in the future |
### OVERVIEW: AFRICAN COMMODITY DERIVATIVES MARKETS

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| Tanzania      | - In 2016, the Tanzania Commodity Exchange Market is expecting to be operational  
                 - Kilimanjaro Native Cooperative Union – experimented with hedging in 200-2002                                                  |
| Uganda        | - In 1998, establishment of the Uganda Commodity Exchange, trading has been suspended since  
                 - In 1994, ALTX Exchange Uganda got licensed to operate as a subsidiary of Mauritius based ALTX Africa Group.  
                 - ALTX Exchange plans to launch derivatives markets and set up a CCP for derivatives clearing. |
| Zambia        | - In 1994, establishment of the Zambia Agricultural Commodity Exchange  
                 - In 1997, establishment of the Kapiri Commodity Exchange and the Eastern Agricultural Commodity Exchange  
                 - Exchanges not successful due to government intervention in the grain market.  
                 - In 2007, ZAMACE was re-launched  
                 - In 2011, BaDex (Bond & Derivatives Exchanges) was licenced |
| Zimbabwe      | - In 1994, establishment of ZIMACE, a private-sector owned open outcry exchange  
                 - In 2001, ZIMACE was suspended as the Zimbabwean government took control over grain and wheat trading  
                 - In 2010, the government announced the creation of COMEZ (the commodity exchange of Zimbabwe) |
REGIONAL & SUB-REGIONAL INITIATIVES:

- EAX – launched in 2013 (Rwanda & East Africa)
- ACFEX - Africa Commodities & Futures Exchange
- UEMOA – Bourse Régionale des Produits Vivriers
- ECCAS – Economic Community of Central Africa States (BVMAC market).
- COMESA – Common Market for Eastern & Southern Africa
- PACDEX, Pan-African Commodity & Derivatives Exchange
AFRICA’s MARKET STRUCTURE
AFRICA – MARKET STRUCTURE OVERVIEW

54 COUNTRIES

- About 15 countries with commodities exchanges
- About 10 countries with clearing operations
- About 5 countries with operational commodity derivatives exchanges
- 3 countries with CCPs clearing derivative products
- 1 - Number of CCPs with QCCP status under EMIR

About 6 - Commodity derivatives exchanges initiatives
CHALLENGES AFFECTING DERIVATIVES MARKETS DEVELOPMENTS IN AFRICA
MAIN FACTORS AFFECTING THE DEVELOPMENT OF DERIVATIVES MARKETS IN AFRICA

- Regulatory issues
  - Unfavourable legal environment
    - Enforceability of contracts by a local court
    - Equal treatment for foreign counterparties
    - Insolvency laws & protection against the risk of counterparty’s insolvency
    - Non recognition of use of collateral by local law.
  - Rules & regulations sometimes unclear to market participants
MAIN FACTORS AFFECTING THE DEVELOPMENT OF DERIVATIVES MARKETS IN AFRICA

- **Other issues:**
  - Government control related to prices & the trading of commodities
  - Cost effectiveness/Technology costs
  - Inadequate market infrastructure
  - Education – lack of product understanding
  - Underdevelopment of the underlying commodity market
  - Inadequate risk management
  - Insufficiently large group of speculators (speculators provide liquidity to an exchange)
  - Political instability
GLOBAL REGULATORY REFORMS POST 2008/2009 FINANCIAL CRISIS
PRE 2008/2009 FINANCIAL CRISIS

“Derivatives are financial weapons of mass destruction...”

- Warren Buffett, Chairman & CEO of Berkshire Hathaway Inc.
GLOBAL REGULATORY REFORMS
POST 2008/2009 FINANCIAL CRISIS

• September 2009 Pittsburgh G20 summit

<table>
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<th>COMMITMENTS – OTC Derivatives</th>
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</thead>
<tbody>
<tr>
<td>“All Standardised OTC contracts should be:”</td>
</tr>
<tr>
<td>➢ Traded on an exchange or electronic Trading platforms, where appropriate</td>
</tr>
<tr>
<td>➢ Cleared through a CCP</td>
</tr>
<tr>
<td>➢ If not centrally cleared, subject to higher capital requirements</td>
</tr>
<tr>
<td>➢ Reported to a trade repository”</td>
</tr>
</tbody>
</table>
South Africa – FMA Regulation

• FMA entered into effect in 3 June 2013:
  ❖ Regulates the OTC derivatives markets:
    ➢ Aims to reduce systemic risk
    ➢ Increases transparency in these markets
    ➢ Promotes central clearing – use of a CCP
    ➢ Mandates reporting – establishment of a trade repository
    ➢ Real-time access of trade data by regulators

• Regulation in line with international norms and standards

• JSE Clear recognised as a QCCP
GLOBAL NORMS & STANDARDS

• **IOSCO** recommends trading of OTC derivatives **in African markets** to be moved to securities exchanges (*FSB requested to promote the practice*)

• **Basel III** – Encourages banks to centrally clear their OTC derivatives transactions

• **CPSS-IOSCO** – a benchmark for CCPs, CSDs and trade repositories.
On Bloomberg

Numerous products and solutions:

{GLCO<GO>} {BMAP<GO>} {CMBQ<GO>}

{CMET<GO>} {CDAT<GO>} {MARS<GO>}

{ARB<GO>} {BIP<GO>} and many more....

Bloomberg Market Concept {BMC<GO>
THANK YOU