10th Anniversary Conference
of the
Association of Futures Markets AFM

12-13 March, 2007
Buenos Aires, Argentina

The 10th Annual Conference of the Association of Futures Markets (http://www.afmorg.net/) was held in fascinating and enchanting city of Buenos Aires, Argentina.

Welcoming Remarks

The opening remarks were delivered by Hamdi Bagci, CEO of TurkDEX in his role as retiring Chairman of the AFM. After welcoming all participants and the new AFM members to the 10th Anniversary Conference in Buenos Aires, the city where the AFM was founded 10 years before, Hamdi Bagci gave an overview of the latest very positive developments at TurkDex.

Ricardo Marra, incoming president of the AFM and Chairman of Mercado a Termino de Buenos Aires (MATba), succeeded Hamdi and addressed his warmest welcome to all attendees of the 10th anniversary Conference. Ricardo also provided Conference with an overview of the 100th anniversary of MATba that was due in October 2007. Ricardo concluded by wishing conference delegates a very fruitful conference and an enjoyable stay in Buenos Aires and Argentina.

Official Launch of the AFM´s 10th Anniversary Publication

Krisztina Kasza, General Secretary of AFM delivered an introduction to the AFM anniversary publication to Conference, “The Exchange Manifesto”, and explained why the AFM had decided to publish a book.

Patrick L Young, CEO of Derivatives Vision, presented details about the publication, the concept and the overall idea behind it. “The Exchange Manifesto” that was presented in Buenos Aires in a special edition, was to be available in its final version in May 2007. The book outlined the essentials for setting up exchanges in a nutshell, and was aimed at everyone that was interested in obtaining fundamental information in this area. The Exchange Manifesto would be distributed mainly via the AFM but would also be available in shops.

Keynote Address - Luis M Corsiglia, Banco Central of Argentina

Luis M Corsiglia, Director of the Central Bank of Argentina, gave a very comprehensive overview of the Argentinean financial system and monetary policy. Due to the continuous development of the last years, the Argentinean capital markets had grown substantially. Hence derivatives markets were included in this growth process as well.

Roundtable 1: Current Exchange Situation in Central and South America and Expectations for the Near Future

Jorge Alegria, General Manager of the Mexican Derivatives Exchange (MexDer) provided an overview of his exchange which had started in 1998 with pit trading.

In 2000 MexDer had switched to electronic trading and introduced a "market making programme" one year later. Currently the exchange was using MEFF´s platform where financial futures, particularly interest rates contracts, the future on the main Mexican blue chip index and options caould be traded.

MexDer's main member base consisted of local mutual and pension funds as well as remote members from the US and UK. MexDer was permanently seeking to keep up with the latest IT developments and was therefore investing heavily in technology.

Responing to a question from Hamdi Bagci as to what the recipe for success and high volumes in the interest rate futures was, Jorge answered that the design of the MexDer contract was similar to the LIBOR contract. As there was credit in Mexico, banks were heavily using the MexDer products. Furthermore, one of the big advantages of MexDer, this being one that the exchange's participants liked very much, was that it had a clearing house.

As one of the newest members of the AFM, Luis Ossola, Chairman of the Rosario Futures Exchange in Argentina (ROFEX) outlined the current exchange situation in Argentina and expectations for the future.

ROFEX had been founded in 1909. Since 2000, when ROFEX started trading electronically, they had introduced financial derivatives, in 2002, and a clearing house. Speaking about the market share in the Argentinean agricultural derivatives market it could be observed that MatBA (Mercado a Termino de Buenos Aires) had a 75% market share whilst ROFEX was participating with around 25%. One fifth of the crop was traded at Rosario on ROFEX. The exchange was currently working on developing interest rate futures and a stock index future. Nevertheless one of the main challenges of Argentinean Exchanges was to attract foreign participants and investors.

Ricardo Marra followed up by describing the specifics of the Argentinean derivatives exchanges. MATba was founded 1907 as the futures market for agricultural products and had experienced, in those days, dynamic growth. Volumes declined between 1940 and 1990 due to the economic problems that Argentina had gone through. Currently MATba was growing again steadily. A major part of MATba´s work was concentrated on education.

Diego Estevez, Executive Director from Mercado Abierto Electronico (MAE), informed the audience that his exchange, MAE, had been founded in Argentina in 1989. Diego also provided a comprehensive overview of MAE's electronic markets where one of the main products traded were fixed income products.

Diego continued his speech by explaining why fixed income products had developed so well within the last couple of years. This was mainly due to the change from fixed to floating exchange rate for the Argentinean Peso. Another very important factor was the very quickly developing IT environment.

Leonela Santana-Boado, Coordinator for the Commodity Exchanges at the United Nations Conference on Trade and Development (UNCTAD) rounded up the roundtable by focussing on the role of South America within the global context.
Leonela emphasised that, in comparison to the Asian countries like China and India, the development in South America looked relatively small. Having an in-depth look at South America, however, it had to be said that countries like Mexico, Argentina and Brazil had experienced very a significant growth in recent years. This, in turn, was due to a solid banking system that had established itself during the last years.

Leonela focussed as an example on the MexDer. In 2005 MexDer had experienced a catastrophic situation that changed in 2006 when several political changes came through and resulted in fast growth.

Another observation was that exchanges in emerging markets, especially when they did not represent the unique exchange in a specific country, worked together to try to cooperate with other local exchanges, especially when having to represent the exchange interests with respect to government and supervisory authorities.

Roundtable 2: Can Technological leadership of Asian exchanges be Exported to Emerging Markets?

Lamon Rutten, Joint Managing Director of the Multi Commodity Exchange India (MCX), outlined that MCX was founded in 2003 by a financial technology company who was still the major shareholder, followed by the Indian National Bank as the second biggest shareholder. MCX also held 50% of the Dubai Gold Exchange (DGCX) which was also an exchange heavily focussed on technology.

What makes technology easier asked Lamon? The answers of the roundtable participants were performance, lower costs due to the abolition of mainframe systems and the IT environment like trading via the internet or leased lines. All these reasons led to technological superiority.

What was the best technology to choose for Emerging Markets? Was more expensive technology always better, or was cheaper technology not sometimes better?

Allegations:
- Exchange technology creates new markets: look at the example in India: MCX
- on a busy trading day MCX has 20,000 terminals linked into the system from all over India.

Richard Hoo, Senior Vice President, Taiwan Futures Exchange (TAIFEX), provided an overview of his exchange.

TAIFEX was 10 years old and was currently most successful in options on the index products, this product segment was generating 85% of TAIFEX total volume. One of their success factors was high participation (90%) of domestic clients that were trading at the exchange. Retail members were responsible for trading approximately 40% of volume while the remaining 60% of volume was generated by institutional clients.

TAIFEX was using a proprietary system which they were convinced was adequate and met the expectations of their markets. During the past period TAIFEX had sped up their system by a factor three. They ran a pre-margin system which was relatively uncommon compared to other exchanges.

A significant future challenge that they saw was the coming liberalization that would bring more internalization. Hence there was education to be done. TAIFEX was also working together with the Thai Exchange.

Kazuaki Takabatake, Sales Executive from Patsystems, spoke in his role as a software vendor and a software provider for trading solutions. Amognst other clients, Patsystems provided the technology for the Thai Grain Exchange, the Pakistani National Exchange and an exchange in China. Patsystems had a long tradition of successful business in Asia, particularly in the Japanese markets.

Kaz pointed out that whilst European exchanges mostly developed their trading system software internally, in Asia, particularly in Japan, it was more usual for exchanges to outsource their IT and software provision to third party companies.

Martin (Chip) Dempsey, independent consultant based in the US, explained to the audience about the experience he had had as a consultant whilst working with his client "Communicating Limited".

Until now Chip had not detected that the promise of electronic trading being "better, faster and cheaper" had been fulfilled. Considering option trading, Chip was sceptical about electronic trading. In his opinion there were still challenges for electronic option markets when one compared them to their pit counter parties.

The advantage of trading in the pit was that a higher lot size was possible while in electronic markets market makers had to quote mamy more strikes but with a smaller lot sizes. In some electronic markets there were 5000 matches per second. Looking at these factors it had to be questioned if emerging markets needed such high parameters.

The goal, in Chip's understanding, was to create liquid markets with high volumes. Due to problems and issues with technology several exchanges, Chip was not convinced that the current technology was good enough for options trading.

Interjecting from the floor, Alan van Griethuysen from Euronext.LIFFE replied to Chip that in his eyes electronic trading improved options trading and made it more efficient. This could be observed at the Euronext exchanges.

Dr Jonathan Butler, Project Manager at Deutsche Boerse Systems, emphasised the important role that technology was taking in modern day. In Jonathan's opinion technology, systems and software had to respond to the requirements of the business, and not the other way round. It was a case of the dog wagging the tail, and not the tail wagging the dog. The World's best technology solution could be put in place, but if there was no business requirement for it, or if it did not fit sufficiently well to what was needed by the market, then it would not be used. Sourcing the right technology was all about sourcing technology that fit to the business in question.

Scalability was one of the key issues that needed to be kept in mind with technology. It was very important to have a flexible system that could incorporate requirements from the business side quickly and easily. New technology was the key to stability and reliability. A good IT system had to handle what it was planned to be able to handle as well as what would come in the future, these two things being different more often than not.

Speaking about technology and reliability of IT systems, Michel A Legler, Institutional Investor Relations, DFL Financial Services, Switzerland, asked how the crash at the NYSE at the end of February 2007 could have occurred (there had been a correction in global equity markets that had resulted in high traded volumes and volatility) and why it was possible that this could happened?

Jonathan answered that everyone gave their best and tried to manage risk and be prepared for peak load situations as well as they could. That being said, there was always the unpredictable, and when difficulties occurred it was necessary to learn from the experience, invest and take the right measures to improve and ensure that you are in a better position the next time round.

Kaz added that it is always very problematic when IT systems fail. It was an outcome that no IT professional wished to happen.

Roundtable 3: Currencies - the Largest and One of the Oldest Markets - Largely Untouched by Emerging Derivatives Markets. Would they Offer Potential? If Yes - How Could This be Tapped? If Not - Why Not?

The third and final roundtable discussion of the first day was moderated by Paul Meier, Chairman of The Swiss Futures and Options Association.

Setting the scene for the discussion to come, Paul began by introducing roundtable members and by drawing Conference's attention to the fact that the currency markets were enormous. Referring to a recent article of his own, Paul pointed out that although currency futures were one of the first financial futures created they had never really taken off. Currency markets could greatly benefit from the advantages of having established on-exchange futures markets - efficient margining, daily marking to market, etc. This being said, why had currency futures markets not yet been of any great success?

Patrick L Young related to Conference that, in his opinion, on-exchange currency futures markets just were not "tango'ing". ODL Monaco, a specialist boutique providing brokerage and advisory services that Patrick was a director of, was active in all markets except currencies. The large exchanges often tried to compete with the inter-bank currency markets, but those were established, on platforms such as the Electronic Clearing System (ECS), and difficult to break into. Exchanges might be more successful if they provided products in different currencies and focused on concepts such as the "micro-trade" and "market DNA" that Patrick had recently been involved in researching.

Patrick suggested that one way of entering the currency markets would be for exchanges to launch products denominated in different currencies. Why, for example, were grain contracts always listed in US Dollars (USD)?

Simona Simon, Sales Manager with Eurex, related that Eurex' experience with currency markets had not admittedly been particularly successful until now. EurexUS, the US futures market that Eurex had set up, had listed pair contracts on G7 currencies as a way of diversifying into different asset classes. It became clear relatively quickly however that the contracts would not work. The markets at the CME, in OTC and on dedicated platforms had been too established.

In the context of emerging markets (EM), Simona suggested that exchanges in Eastern Europe could try to establish currency markets. In Romania, for example, there was a large amount of inter-bank and broker trading in RON (the Romanian new currency) / USD contracts. Now the role that USD had taken was being gradually taken over by the Euro (EUR), not just in Romania but across wider Eastern Europe.

Alan van Griethuysen, Executive Director, Euronext.LIFFE, pointed out that the US Dollar was the largest global commodity. Currency markets were professional / wholesale, established and difficult to break into. Alan recounted experience with a Dutch Guilder / USD contract where his exchange had captured some 5000 daily traded contracts. This had been great for the exchange, but had represented a small share of the total market.

Alan's suggestion was for exchanges to turn to the retail currency markets as the wholesale ones were difficult to get into. Volumes in EUR / USD contracts were growing and Euronext.LIFFE were concentrating on smaller companies for example which were interested in obtaining better price transparency. Euronext.LIFFE had continuous, good quality prices in currency options and this looked good in the [exchange's] "shop window".

Euronext.LIFFE had been asked to introduce "jumbo" size currency contracts, Alan continued. LIFFE Connect was used for hosting the main central market, and the Euronext Bclear platform for wholesale. Alan questioned if it made sense at all to bring wholesale currency business onto a central market, or whether the central market should be reserved for dealings from small companies and retailers only.

Sergey Mayorov, Director at MICEX, Russia, explained that MICEX was a global market place that traded almost everything in Russia that could be traded. MICEX currently had 30% of the open interest in currency contracts and Sergey asked if it might be possible to obtain more, for example 50%.

In Sergey's opinion there was room in EM currency markets for exchanges. Execution and tax regimes were not perfect, but if exemptions were made then conditions would be good for exchange entry.

Moderator Paul Meier tendered that key to successfully building up on-exchange currency markets was to first begin with spot markets, progressing to futures markets thereafter. It was of utmost importance to keep on good terms with regulators.

Picking up on Paul's point concerning regulators, Sergey Mayorov added that the Russian National Bank was the regulator of all currency markets in Russia and that it had always been constructive and supportive when it came to MICEX' efforts to establish currency markets.

Paul turned next to the central question of contract size, asking the panel if currency contracts with smaller contract sizes appealed to a larger number of users.

Sergey Mayorov related that contract size at MICEX was currently 1000 USD, but that wholesale market participants had requested a contract size of 10 million USD.

Paul asked: why not list both and let the market choose?

Sergey responded that he thought this might distribute or split liquidity.

Lending the benefit of invaluable local experience to Conference, the representative of the Mercado a Termino de Rosario (ROFEX) informed delegates that his exchange had launched a USD / Argentinean Peso contract in 2002. There had been high volume in the currency markets in Argentina then, due to the country's financial crisis. ROFEX had used an electronic platform to allow easy access for market participants. Deutsche Bank and some Brazilian banks had entered the market, this had resulted in additional participants being pulled in and volumes had grown very fast. Contracts were cash settled, and the ROFEX representative emphasised a very important point: a good central counter party (CCP) had been essential for the market as credit had been a very serious problem in Argentina at the time of the crisis in 2002.

Continuing on the theme of size, Paul Meier turned to Patrick L Young and asked if his organization, ODL Monaco, was aimed at smaller or larger clients.

Patrick responded that ODL Monaco had approximately 15,000 clients, many of whom were high net worth, big ticket individuals. Many clients were Eastern Europe based banks that used ODL Monaco for treasury transactions and wished to avoid large financial centres with their business, such as London or New York. Key in Patrick's eyes was the provision of high quality settlement and risk management services.

Paul Meier turned discussion to the relationship between the exchanges and their users, the banks and brokers for example. Paul asked Sergey about the relationship between MICEX and the banks that used MICEX.

Sergey Mayorov explained that the banks that used MICEX were in general constructive and helpful. MICEX had a friendly community of market participants. Tying in with the remarks of the ROFEX representative, Sergey added that MICEX had launched currency contracts also after the Russian financial crisis in 1998. The contracts had, however, not been successful at that stage. In 2003 the banks approached MICEX realising that they required the clearing arrangements of MICEX. They were then supportive of the contract and it had been very successful thereafter.

Reporting from the Euronext.LIFFE perspective, Alan van Griethuysen noted that his exchange had large international brokers as participants. They, in turn, had clients based in different countries that used contracts denominated in different currencies. They might therefore be inclined, out of convenience, to use on exchange currency contracts too. If the exchanges could maintain currency markets with good prices then customers would surely come.

Patrick L Young mentioned that much business was generated in currency markets from participants rolling their positions. On-exchange futures markets had a strong advantage here as the cost of rolling positions was relatively low in comparison to off-exchange transactions were market participants usually had to pay larger spread and brokerage fee costs.

Simona Simon brought to discussion the topic of whether smaller currency contract sizes were more attractive to retail investors. Simona also asked about currency options. There was discussion about cash and futures currency markets, but what about currency options markets, Simona continued?

The interesting point was noted that both ROFEX and MICEX in common had used the financial crises in Argentina and Russia to start currency markets. Whilst the crises had been terrible for the countries' economies, they had opened up opportunities which, in the case of currency markets, ROFEX and MICEX had tapped into. On the other hand, it was much more difficult for exchanges to break into established foreign exchange (FX) elsewhere were it seemed near impossible to penetrate the jungle of platforms, bi-lateral trades, etc.

Coming back to Paul Meier's earlier question concerning size, Jahja Sudomo, Director of the Jakarta Futures Exchange (JFE), said that it was important to consult clients and potential clients concerning contract size. Jahja was satisfied with his exchange's contract size which had been reduced from 100,000 USD to 10,000 USD (the inter-bank market in Indonesia started with contract sizes of 1 million USD). The Indonesian Government had wanted to avoid instability in the currency markets and did not want to allow a contract size smaller than 10,000 USD.

Speaking from the floor, Jonathan Butler of Deutsche Börse Systems asked Sergey Mayorov why it had taken the 3 years or so before FX at MICEX had taken off.

Sergey responded that the approach of MICEX had been to first set the market up to then be able to say to the banks, "here, we have established a market that you can now use". The alternative, of asking "if we set up such and such a market will you use it?" did not work particularly well in Sergey's experience.

Drawing on his experience working in the Hungarian financial sector at the time of the 1998 crisis, Gergely Horvath pointed out that the risks had been very high at the time. This had made it necessary to develop a very solid and reliable system that had been based on bank credit lines.

Sergey took up this point by informing Conference that there were different circles of banks active in the markets in Russia. A bank with first tier credit rating would never generally enter into a [bi-lateral] FX transaction with a third tier bank for example. Such transactions were possible on-exchange with the improved liquidity, risk management and clearing services offered in exchange based trading systems.

Richard Hoo asked why banks would support exchanges in launching on-exchange FX markets when the banks currently conduct their transactions OTC.

Sergey Mayorov responded by pointing out that execution requirements led to the need for central trading venues. Exchange transactions were protected, which was important from a regulation point of view. Taxation aspects also led to exchange based trading being important.

The representative of ROFEX explained that in his experience the banks did not want on-exchange currency contracts. They did require liquidity, however. In developed established markets there were generally little or small arbitrage opportunities between spot and futures markets for example. On the other hand, in developing markets arbitrage often existed between local, central or international currency markets. The Argentinean Peso was relatively volatile, this often being down to the effects of government intervention and policy change.

Simona Simon picked up on an earlier point from Sergey Mayorov by relating that having market infrastructure with a good clearing house and CCP was essential. She saw this as being a fundamental prerequisite for the establishment of successful on-exchange based markets, particularly in Eastern Europe for example, where she had collected much experience recently.

Currency was a "street commodity" to Alan van Griethuysen and he thought it was not always ideal that governments became involved in derivatives markets when they did not always understand what derivatives were. Alan emphasised that education of governments was something which was key to all markets, market operators, market users and market stake holders.

Moderator Paul Meier tendered the point that the view of educational efforts was often woefully short-term. Education was not something that was attractive in bringing new clients and business in the short-term. It was, however, key to sustained growth and attraction of new business in the long-term, and was therefore essential.

Responding to Alan van Griethuysen's and the ROFEX representative's points earlier, Patrick L Young noted that currency was a key instrument of government and currencies and FX markets were there politicised.

Turning to Sergey Mayorov, and in reference to the early point from Simona Simon concerning currency options markets, Paul Meier asked if MICEX planned to introduce FX options.

Sergey responded that there were still some technical problems. As pointed out by Gergely Horvath a tighter risk system was required for options. MICEX would switch to risk based margining towards the end of 2007, and as a result FX options were to be launched at MICEX mid of 2008.

A member of the audience mentioned that FX contracts were suited to USD as many other products and instruments were listed in USD. If one had earned a profit with a USD denominated product or instrument it was then necessary to convert the profit back to your own domestic currency.

Paul Meier stated that he had heard this elsewhere in the markets. Patrick L Young pointed out that there was also large growth in cash equities in other currencies.

Talking from his work and experience in the markets, Paul Meier related that UBS had experienced enormous growth in demand for structured products. This had brought them to realise that there was also huge potential with currencies too.

Rounding up roundtable 3, Paul Meier summarised the discussion by noting that, in terms of successful establishment of on-exchange currency futures markets, it was essential to:

i) make sure that the cash (spot) market was well established;
ii) obtain the right contract size: a regular size and not a "jumbo" size generally;
iii) make sure you had the backing of the regulators: educate not just clients and market participants, but regulators and governments too.

Roundtable 4: Physical Delivery in Emerging Markets: Challenges and Risks

Moderator Lamon Rutten got the ball rolling on the second day of the AFM Annual Conference by relating to Conference some of his, and his organisation's experience, in India.

Physical delivery was difficult, but MCX had a way round it: "copy cat contracts". Copper, crude oil and palm oil contracts could be traded at MCX by local participants who were not able to use exchanges in London or New York. For these contracts MCX had cash settlement. Prices for the contracts followed the international contracts any way.

But the question was what to do for products for which no international markets existed? Go for physical delivery?

MCX had cash settlement for some domestic contracts. Lamon had a department of six employees who telephoned round traders, usually four times per day, to determine prices for cash settlement. MCX hoped that they were able to pick up any price manipulations.

In developing countries it was really necessary to move towards physical delivery. MCX did not allow market participants from outside the country. An inspection agency was difficult. One week grain, for example, could be one grade, the next week it might be a different grade. It was often difficult to obtain financial reimbursement from the inspectorate, so MCX had set up their own inspector. MCX did not own their own warehouses, but controlled the warehouses used for delivery of their contracts. The most important fundamental point in Lamon's view was that if you do not have delivery systems right then it can cost you a lot of money.

Chris Sturgess, Senior Manager with the Johannesburg Securities Exchange (JSE), reported to Conference from his and the JSE's experience in South Africa. SAFEX, the Agricultural Products Division at JSE, listed contracts in particular on white maize, yellow maize, wheat and small soya beans.

South Africa was lucky to have a network of concrete warehouses, comprising 180 delivery points in total. Fascinating many delegates, Chris explained the pricing mechanism applied by SAFEX in South Africa. This worked by using a set of price "differentials". A single, central price was discovered by the SAFEX market. The delivery price at a particular delivery point was then determined by deducting the price differential for the delivery point in question from the central price.

Weekly traded volumes on SAFEX were currently around 900,000 to 1 million tonnes.

SAFEX operated a system of "silo receipts" which proved ownership. 15 to 16 silo operators had themselves become participants in the SAFEX markets. It was essential to ensure that silo operators offered fair services and that no preferential treatment was given to local participants. Chris hoped that the recent introduction of "sausage" silo bags to South Africa would improve competition (Chris had noted that he had already seen these in use in Argentina during his trip to the country) and keep warehouse operators on their toes.

Settlement on SAFEX was processed on a T+2 days basis, the delivery notice period having been built into the trading system used by the exchange.

SAFEX was in the process of implementing a change to electronic certificates. Paper ones had been experienced to get lost or stolen in the post. Electronic ones would also provide an excellent audit trail. As the long holder of a warehouse certificate or silo receipt was entitled to receive good quality delivery, it was up to the exchange to check that quality at the warehouse and silo operators was good enough.

Razvan Tudor, Director of Marketing and Communication, Romanian Commodities Exchange (RCE), informed Conference that operations at his exchange, the RCE, had recently been had to be changed due to a change in Romanian law.

The RCE had compiled a list of some 300 to 400 agricultural products and had embarked upon visiting large producers, across Romania, to persuade them of the advantages of trading their products on exchange.

Due to delivery problems the first transaction in an agricultural product on the RCE had concluded at twice the price that the Romanian Ministry of Agriculture had advised. All producers had then wanted to sell, but there had been delivery difficulties.

Razvan reported that there were also difficulties with quality in Romania. A market participant might negotiate a short position in a contract based upon the prediction of having a particular quality at delivery time. A long participant may return to take delivery and find that the quality was in fact lower than previously thought.

Warehouses in Romania were run by large companies and local tycoons. Buyers were often expected to take delivery of a product of lower quality than previously thought with a "cash compensation" to make good the transaction. This had served to bring producers round one table and had concentrated minds on designing good contracts.

The RCE was also working on developing agricultural commodity indices using prices which were averaged across geographical regions in Romania. This was hoped to going to aid the RCE in avoiding the difficulties with physical delivery described.

Changes with respect to physical delivery of agricultural commodities in Romania arising from EU ascension were also difficult to foresee – no other EU countries operated a system of warehouse receipts as in Romania.

The RCE was concentrating on oil and electric power markets in Romania. The market had opened in 2006. Bi-lateral contracts had been used to secure long-term power delivery over 10 year periods. These had mostly been closed at good prices, but providers were obliged [by regulators] to deliver power to residential homes, for example, at controlled prices. The result was that providers could no longer find "cheap" power. Price differentials were now too large.

As a result of these difficulties, the RCE had provided the Romanian Ministry of Energy with a proposal for an alternative market structure. It was hoped that this would be accepted and that the first energy transaction would take place at the RCE in the near future.

Moderator Lamon Rutten was impressed by the diversity of different products and markets that RCE was active in. Razvan Tudor explained that there was great change in Romania with many older people, for example, working far harder now than when they had been younger. In the old days, under the communist regime, no one had worked for themselves.

Jahja Sudomo, Director of the Jakarta Futures Exchange (JFE), provided Conference with information concerning his exchange's markets. The commodities exchange in Jakarta had started in 1980 under the initiative of the Indonesian Government, using Malaysia as a role model.

It had been decided to focus on the auction market in Indonesia, but with hindsight this had never really taken off. Many market participants knew who their counter parties were and preferred, therefore, to negotiate bi-laterally. Some auction transactions had been carried out on-exchange in Jakarta, but these had been mostly as public relations exercises.

Jahja was himself originally from the refined oil market side of the business. He had been active in private industry, and the Indonesian Government had changed its mind: it should no longer have been the Government that was responsible for setting up market infrastructure but private industry working on a not-for-profit basis. A government bill to this effect had been passed at the end of 1997, but the reality was that it had proved difficult to set up market infrastructure under the guidelines. The economic crisis in 1997 to 1998 had made it even more difficult.

A more favourable government minister had been responsible for supporting the exchange's efforts to set up markets in Jakarta. But the Government still required that the exchange be licensed. Jahja and his colleagues finally obtained government licenses on the 22.11.1997, but it was suddenly realised that brokers also required licenses and that none of the brokers had licenses! This was finally resolved some three weeks later when the Indonesian Government called Jahja on 14.12.1997 to inform him that all brokers had been given licenses and that trading should start the next day!

The JFE had had electronic terminals on their trading floor. But there had been no one to operate the terminals at the end of 1997.

Jakarta had also not dared to go into head to head competition with the Kuala Lumpur exchange. Kuala Lumpur had had a crude oil contract, so Jakarta had launched a refined oil contract.

Concerning delivery, no oil refinery wanted to accept oil from another refinery. But Jahja came from the cooking oil sector and knew all the producers and refineries. Jahja put it to them that if they could not deliver then they should not sell. He pointed out that it was their own reputations that were at stake.

The Jakarta refined oil contract followed the Kuala Lumpur crude oil contract. The Jakarta contract had a contract size of 20 tonnes which was equivalent to one road tanker (the Kuala Lumpur crude oil contract had a contract size of 25 tonnes).

The Indonesian Government had wanted a contract size of 5 tonnes, but Jahja had asked how could delivery be taken: with buckets? In fact it had been a typo. The Government had been out by a factor four, but Jahja asked how can you tell your Government that it has made a typo?

Jahja went on to describe the clearing house at the JFE. The clearing house was not for profit, but this had led to them not wanting to do anything. They had not even checked papers for road tankers. It was necessary to take the empty tanker onto the weighbridge, fill it with oil and then take it back onto the weighbridge [to determine what tonnage of oil had been decanted].

Speculators had become involved in the markets at the JFE. But prices had been inflated to sometimes 100% of fair value as a result. Speculators did perhaps not have so much commercial interest in the products they traded.

Jahja's exchange had launched a coffee contract which followed the Robusta contract in London. It had not been clear if the contract should have been made fungible, but it had not yet really worked in any case.

A gold contract had also been tried. Indonesia mined enough gold for domestic requirements, but the gold was mined by foreign companies with 95% of the product being exported, Indonesia being required to import 95% of its domestic gold requirement from world markets. The problem was that there was an import tax of 2 or 2½%, so most of the gold imported to Indonesia was smuggled in, to avoid import tax, and this was certainly not good for the market or price transparency. Rounding off on a light note, Jahja related that if you were observed to being selling at a good price the Indonesian Tax Office would almost certainly come looking for you.

Turning to the next roundtable member, Richard Jelinek, Director with the CBOT, Lamon Rutten reminded Conference that delivery was taken very seriously by the CBOT: the exchange organized two day seminars on the subject and published a 200 to 300 page book on delivery.

Richard Jelinek informed Conference that he was responsible for the agricultural commodity markets at CBOT. Much of his organisation's strength was derived from its diversity however; Richard pointing out that the CBOT operated many other markets apart from the agricultural commodities ones, financials and precious metals being two examples.

Following Lamon's lead in, Richard confirmed that the CBOT indeed took delivery very seriously. Delivery depended upon the product or product class. CBOT operated a system of warehouse receipts for agricultural products as opposed to [electronic] "wire transfers" for financial products.

The CBOT had experimented with new contracts, for example of local significance in Argentina: the South American soya bean contract. Experience had been mixed, good and bad, but a common challenge was that of finding highly capitalized companies that were prepared to handle futures market deliveries. It was often necessary to educate firms that were willing to enter this business, or it was sometimes even necessary to establish such firms yourself.

Making a subtle but important point, Richard's tip in setting up exchange infrastructure was that government intervention was often not good, but that government support was required. Building infrastructure, for example, needed government help. Once you have roads, rivers developed for navigation, airports, etc, capitalised companies will see opportunities and come to centralised market places.

In Richard's eyes cooperation with partners was also paramount in the exchange business. Important was also not trying to run before you could walk. Know your limitations, but do not limit your opportunities.

On a personal note Richard related allegorical family anecdotes about his children learning basket ball. First it was essential to buy all the right equipment. Then it was needed to keep trying and keep practising. "If you can't dunk like Michael Jordan, keep practising. Maybe you'll develop some other moves or do some things differently and build up an advantage in this way," Richard told his children.

Returning to direct business terminology, Richard queried: why focus so much on delivery? Only approximately 2% of traded contracts at CBOT ended in being delivered. But delivery was so crucial: if it failed then the Government would have to step in and no one wanted that.

Lamon Rutten echoed the last points from Richard by sharing with Conference the fact that Chinese exchange operators had apparently expressly ignored delivery issues in order to encourage speculators to enter the markets. This had resulted in the Chinese Government closing down the markets in China.

Drawing on valuable local experience, Mario Marincovich, Secretary of Board with MATba, informed Conference that the first 10 years of MATba's history were the most fruitful in terms of traded contracts as a proportion of Argentinean domestic product. At that time it had been mostly foreign exporters that had wanted to secure prices for delivery. Farmers had also wanted to insure delivery conditions. MATba and its market participants had been helped by having a standardised framework.

Trade was liberalised in Argentina towards the end of the 1920s, and physical delivery had been focused on. New ports and docks had been built for exportation of produce and delivery became better standardised for some products.

There had been no state owned ports in Argentina and all market participants had been familiar with ports, port locations, delivery regulations and requirements, etc. Market interest from outside the agricultural sector began to increase as transparency in the markets improved. Increased liquidity and speculation brought, in turn, additional liquidity. Then came the Argentinean financial crisis in 2001/2002.

Renewed growth in the recent years showed that there had been new market entrants. Concerning delivery specifically, growth through the 1990s at MATba proved that physically delivered contracts had been the right choice to attract participants from outside the agricultural sector.

In all the years of operations at MATba there had never been any problems of non-conformance with respect to delivery. At MATba around 10 to 12% of traded contracts resulted in delivery. Financial markets took positions based upon MATba markets, products and prices, and this was firm evidence of the confidence levels attained by MATba markets.

Speaking from the floor, Paul Meier raised an emphatic, fundamental and highly astute point. Paul suggested that delivered contracts might account for perhaps some 1% of traded contracts in many markets. But the fact that physical delivery for that 1% worked correctly and efficiently was an absolutely essential prerequisite to permit the other 99% of contracts to trade. Delivery was therefore absolutely crucial.

Following up on roundtable comments concerning government support, Paul suggested that if government was not supportive of a proposed contract then it was essential to approach the trade and to seek to obtain their support. If that also failed [and there was no industry support for the contract] then there was no basis for the contract and it should not be further pursued.

Roundtable 5: The Role of Brokers and Investment Banks in Developing Emerging Markets

Moderator Simona Simon initiated the discussion by alerting Conference to the fact that the situation in emerging markets (EM) had changed dramatically in the last years. 17 years ago all the banks in Central and Eastern Europe (CEE) had been state owned. Now we were having a roundtable discussion concerning banks and brokers in EM.

Sergey Mayorov explained to Conference that MICEX was no longer an inter-bank only market. MICEX was now an open exchange that had a 90% market share in bond futures and currency trading in Russia.

Reporting from Poland, Lidia Adamska, Member of the Management Board, Warsaw Stock Exchange (WSE), explained that the WSE had been established in 1991. Stocks and derivatives were traded at WSE and one of the most important products was the futures contract on the main Polish blue chip index (the WIG 20 index). 2006 had been the most successful business year until then for the WSE. Poland's ascension to the EU was changing the WSE's business.

Michel A Legler explained that his organization was a user of exchange services and products. DFL Financial Services had a total of 400 million Euro under management in two hedge funds.

Rod Gravelet-Blondin, General Manager with the JSE Limited, South Africa, described his organization as a multi-asset electronic exchange. The JSE operated markets for cash instruments, financial derivatives and agricultural derivatives.

Moderator Simona Simon asked roundtable members to comment on, and explain, their views on the relationships between banks, brokers and exchanges.

Sergey Mayorov explained that banks and brokers were very important to MICEX. Sergey and his organization consulted with banks and brokers and strove to implement what they wanted and required. It was important for MICEX to work with the banks and brokers.

Sergey continued that the interest rate and currency markets of MICEX were mostly markets of the large banks. The equity index derivative markets, on the other hand, were mostly dominated by brokers. To Sergey's mind it could have been problematic when attempting to merge both markets for example. Banks and brokers were very important, but they may have contradictory requirements in some aspects.

According to Lidia Adamska, the WSE had 24 members, 11 of which were foreign (within the EU) based. The foreign based members had direct access to WSE, but no premises in Poland. The exchange had a "single EU passport" to entry.

80% of WSE income was generated by business from brokers, approximately 10% from issuers and the remaining 10% from the data vending business. The structure of the WSE had been static since 10 years. Lidia observed that the retail investment market was not so well developed in EM. Transparency and trust were prerequisite for attracting retail investors to the cash market. On the other hand, 70% of investors in WSE futures markets were domestic retailers.

The WSE were preparing to launch an alternative trading system (ATS) for smaller companies and retailers in July 2007. The new market would be similar to the Alternative Investment Market (AIM) operated by the London Stock Exchange (LSE).

With a typically entertaining and light humoured touch, Rod Gravelet-Blondin informed Conference that he was an economist by training, and that economists needed to make assumptions. Developing was a verb in Rod's dictionary, and not an adjective. Introducing a local slant to the discussion, Rod continued that the relationship between banks and brokers might be likened to Tango: a male and female were needed. Perhaps investment banks took the male role in the Tango, Rod suggested.

Brokers played an important role as they were the link to clients of exchange services. They had therefore an important role to play in marketing for example. Rod warned however that brokers could often be acting in the short term and in their own self interest. It might be necessary for exchanges to rein in the activities of brokers and to ensure the ethics of the market and market participants.

Electronic exchanges could now be connected to from essentially anywhere, so what was then the role of the modern day broker Rod asked. To link in clients from all over the world he asked.

Rod continued that the JSE was currently considering whether the exchange's brokers should be required to have qualifications. The conclusion had been that yes, companies should be required to fulfil the requirements of a broker qualification if they wished to provide services to the public.

Banks could be thought of as the other Tango partner, but had, according to Rod, an important role in also providing initial start up capital for exchanges. SAFEX had chosen a system of issuing "seats" – if organisations or individuals had provided capital then they had provided a commitment.

Additionally, banks had the role of bringing smaller participants to the markets. Finally, banks were also often responsible for providing clearing services for the markets operated by exchanges.

Michel A Legler pointed out that it was important for the markets to have brokers and market makers present who were there for the long term. It was certainly not wanted to have con men engaging in these activities and education was needed.

Michel saw security as an issue: as a user of exchange services it may have been securer to trade through a bank, but more expensive. Brokers, on the other hand, go of course directly to the exchange so there was no counter party risk per se [as the exchange, or the exchange's clearing house, covered that]. The client of the broker had however to bear the risk associated with the broker.

Referring to recent events at the end of February 2007, when a relatively sharp equity market correction had led to massive global trading volumes and knock-on technical and system problems at many trading and clearing venues, Michel concluded that it was not acceptable for market makers, who make a lot of money under normal circumstances, to simply close their business if there was a crisis or if the going became too tough.

Simona Simon added some remarks of her own. It was interesting to note, Simona suggested, that the banking structure in Russia still remained different to other CEE countries. The main banks in Russia remained state owned, whereas the banking sectors in other CEE countries such as Hungary and Romania were dominated by commercial banks such as Societe General and Erste Bank.

The derivatives markets at MICEX and WSE were also very interesting in Simona's opinion as those markets were established, well functioning and successful. Derivatives markets in other CEE countries had not been anywhere near as successful.

Ricardo Marra responded from the floor to roundtable members' requests for input on the local structures and relationships between banks and brokers in Argentina. In Argentina the brokers had contracts with the stock market. In derivatives markets the brokers were active in OTC markets as well as on MATba. Banks were providing capital and risk management services according to Ricardo, and there were also electronic brokerage platforms in Argentina.

Simona Simon asked roundtable members to paint a picture of the future situation and how things were likely to change in the coming years.

Sergey Mayorov predicted that remote access to Russian markets could be significant. Banks in Russia were also only allowed to trade agricultural products if they were cash settled, even if the banks were trading on behalf of customers. This might change in the future.

Lidia Adamska noted that brokers and investment banks "sailed in the same boat". MiFID would bring significant future change in Europe. The "concentration rule" would lead to enhanced competition between brokers and investment banks. The changes to internalisation (the practice of brokers and banks netting order flow internally to keep trades within their own organisations and to avoid sending order flow to the exchanges) rules, where if systematic internalisation was taking place then pricing and quoting information would have to be made available to other market participants, would be significant.

Another interesting development for the future would be the emergence of independent [to the exchanges] ATS which would compete with exchanges on fees.

Project Turquoise (an ATS being established in Europe with the backing of 7 of the largest investment banks) was one such example. Lidia concluded that there may be far less space for the traditional exchanges in ten years time.

For Rod Gravelet-Blondin, the Tango would become more male dominated going forward: the role of investment banks would become more significant whilst that of the brokers would become less.

Conference Presentation by Gustavo Picolla, CEO of MATba

Gustavo Picolla presented a film that had been produced by MATba especially for the occasion of the AFM's 10th Anniversary. Conference enjoyed the moving and beautiful words of Gustavo and the film, the focal points of which were opportunities, the advantages of working together, managing business strength and win-win situations which would lead to profitability and success.

Visit to Mercado a Termino de Buenos Aires

Conference delegates made the short walk through the bustling streets of Buenos Aires to the building of MATba and Bolsa de Cereales, Buenos Aires (Buenos Aires Grain Exchange). Delegates were treated to a tour of the trading floor of MATba where younger delegates, that had been brought up on electronic trading only, where given their first taste of the lively, intense and boisterous world of pit trading.

Close of trade at MATba was followed by a charming reception at the Bolsa de Cereales, where Chairman, Jose M Gogna, cordially welcomed the AFM and Conference delegates to Argentina, Buenos Aires and to the Bolsa de Cereales.

Rod Gravelet-Blondin responded with some short, touching and fitting words, and thanked Jose and the Bolsa de Cereales on behalf of the AFM for the warm and hospitable reception.

Roundtable 6: Products: Are New Emerging Products Feasible for Emerging Exchanges (Weather Derivatives, Climate Exchanges)?

Moderator Patrick L Young introduced the products roundtable by suggesting that we were in a golden age of product development. Patrick then asked roundtable members how they saw equity product development.

Richard Hoo reported that his exchange, TAIFEX, had been very successful with their index futures contract. TAIFEX was one of few exchanges that also had reasonably successful sector indices futures contracts. These could well be the next big growers at TAIFEX predicted Richard.

Patrick asked if there was a limit to what could be commoditised as products.

With a clever twist, Rod Gravelet-Blondin asked whether the "weather derivatives" in the roundtable title should have read "whether derivatives". Whether derivatives was an entirely different question as to weather derivatives. Whether derivatives depended upon whether there was a need for derivatives.

With reference to the topic of sports derivatives, Rod suggested that if there was a need for products then it was important to develop products to respond to those needs. But, in Rod's opinion, products should be designed for risk management purposes not just for speculation.

Richard Jelinek saw that there should be no limits to product development. There had however to be the need for a product from the commercial side, for example the need for hedgers to hedge positions in a product.

Bill Olsen, Sales Executive with Trayport Inc, USA, believed that product development was ready to explode.

Patrick L Young steered the discussion onto the moral issues of product development. Was a futures contract on cocaine acceptable for example? Was there a quality issue, Patrick joked?

From Rod's perspective it was important to maintain the moral high ground generally. But Rod acknowledged that it was a question of perception. What was the difference between sport betting and betting that the Dow Jones Industrial Average will close above a certain level?

Patrick drew Conference's attention to a website he had recently stumbled across, www.adultwork.com. The site permitted adults to meet on-line and arrange meetings.

Rod Gravelet-Blondin lauded Patrick's careful scanning of the World Wide Web, but asked as to whether the adultwork.com contract was physically or cash settled? Roundtable members agreed, in a jovial manner, that it was almost certainly a cash settled contract with physical delivery at adultwork.com.

Richard Jelinek took up the discussion by pointing out that the best markets were for standardised products, were homogeneous and had no government intervention. Drugs and sport betting were not part of our markets.

Richard did continue that, referring to his organization, the CBOT, as only one example of a wider phenomenon, people and organisations did often find it difficult to embrace change and new things. The CBOT had started with agricultural products. When futures on money came along [financial futures] the fear was that these products would push the agricultural products aside. When options came along, the suspicion was that they might take business away from the futures markets. It was the migration to electronic trading that had caused most worries in more recent years.

What had actually happened with all these developments was that each one had led to growth and to new additional business being created and captured. New development and change had in fact resulted in tremendous overall growth at CBOT, even if individual changes along the way had not always been immediately welcomed with open arms.

Patrick L Young echoed these points by noting that investment banks were also not famed for their ability to deal with change.

Bill Olsen's sentiments concerning the moral issues of product development were that the organisations involved had to think of their reputations. Trayport, Bill's organization, would not get themselves into betting or gambling as it was important to them to maintain the moral high ground.

Patrick challenged this. It was not just sports betting but politics and event driven markets: "prediction markets" was the generic term that Patrick used to refer to these markets. Could exchanges ignore the money in these markets? The LSE for example settled on a T+3 days basis. Bet Fair, on the other hand, settled on a T + 15 minutes basis. Patrick doubted how long exchanges could hold on to this "moral high ground".

Patrick asked Bill Olsen about the fish market, "Fish Pool" that Bill's organization, Trayport, provided technology for.

Bill responded that Fish Pool had been very successful. Salmon had a shelf life of approximately one week, and Fish Pool had proved popular with fishermen and fish companies wishing to hedge and mitigate risk.

Rod Gravelet-Blondin pointed out that where products were traded depended upon economics. If exchanges became too expensive, then markets may shift to OTC. Concerning product development, Rod informed Conference that "can do" options were the latest option product offering from JSE, can dos being similar to contracts known as flexible options in some other markets.

Patrick L Young asked further about the process which brought new products into being. Was it a case of just wait and see or kiss as many frogs as possible in the hope that one will become a prince?

For Richard Jelinek the success of new products was often down to changes in fundamentals. Political, society and economic changes may all bring about the need for new products. The example Richard cited was the ethanol contract in the energy sector, this having become of great importance against the backdrop of current environmental developments and global warming.

Chip Dempsey asked roundtable members how they would view an event futures contract on the next terrorist attack in the US.

Richard Jelinek, Richard Hoo and Rod Gravelet-Blondin all agreed that such a contract would be inherently open to manipulation from those with insider information.

Bill Olsen viewed such an idea as political incorrect.

Chip Dempsey emphasised that it would be possible to set up a market for such a contract.

In questions from the floor, Paul Meier asked what roundtable members' opinions were concerning insurance contracts. It was a huge market with huge demand if good contracts could be designed, but that was exactly the problem: how could a good insurance contract be designed?

Paul's question led into the topic of structured products, Rod reporting that business in structured products had undergone enormous growth in South Africa in recent years. It was an excellent market to be in for exchanges if they could find a way in which to bring additional value to the products.

Bill Olsen identified OTC markets as being trail blazers when it came to product development. They were subject to less stringent intervention and exhibited stronger social aspects where counter parties often spoke to one another on the phone whilst concluding a deal for example.

Richard Jelinek pointed out that OTC markets were innovative, but had major disadvantages [in comparison to futures markets] when it came to aspects such as clearing.

In an entertaining and concise round up, Patrick L Young summarised the sixth and final roundtable discussion and the 10th AFM Annual Conference by noting that Richard Hoo had reported fantastic growth in equity index futures at TAIFEX. There were no limits to product development for Rod Gravelet-Blondin, but not much more to life than sex, Patrick cited adultwork.com! There were moral hazards in product development, but these were no restriction to thinking. There was the moral high ground, and there was reference to David Bowie who had once issued bonds dependent on the sales of his records.

Futures did not battle options – everything in this business was complimentary. There were "hybrid markets" for Bill Olsen, and in reference to Gustavo Picolla's speech, Patrick emphasised that cultural differences were no bar to progress and breaking new ground. In the words of the AFM 10th Anniversary film from MATba, life would be better and time would fly past.

Abbreviations

AIM – Alternative Investment Market (operated by the LSE)
API – application programming interface
AFM – Association of Futures Markets
ATS – alternative trading system
CBOT – Chicago Board of Trade
CCP – central counter party
CEE – Central and Eastern Europe
CME – Chicago Mercantile Exchange
DTB – Deutsche Terminbörse
ECS – Electronic Clearing System
EM – emerging markets
EU – European Union
EUR – Euro
FIX – Financial Information Exchange protocol
FOW – Futures and Options Week
FX – foreign exchange
ISV – Independent Software Vendor
JFE – Jakarta Futures Exchange
JFX – Jakarta Futures Exchange, Indonesia
JSE – Johannesburg Securities Exchange Ltd
LIFFE – London International Financial Futures Exchange
LSE – London Stock Exchange
MAE – Mercado Abierto Electronico
MATba – Mercado a Termino de Buenos Aires
MCX – Multi Commodity Exchange India
MexDer – Mexican Derivatives Exchange
MICEX – Moscow Inter-bank Currency Exchange
OTC – over the counter
RCE – Romanian Commodities Exchange
ROFEX – Mercado a Termino de Rosario
RON – New Romanian Leu
RTS – Russian Trading System Stock Exchange
SAFEX – Agricultural Products Division (of JSE)
SFOA – Swiss Futures and Options Association
TAIFEX – Taiwan Futures Exchange
TurkDEX – Turkish Derivatives Exchange
UNCTAD – United Nations Conference on Trade and Development
USD – US Dollars
WBAG – Vienna Stock Exchange (Wiener Börse AG)
WIG 20 – main Polish blue chip index
WSE – Warsaw Stock Exchange

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