Review of the 12th Annual Conference of the Association of Futures Markets (AFM) in Budapest

After the AFM conference visited its roots in Buenos Aires in 2007 and Asia the first time in 2008 when Bangkok was the host it returned this year to its homebase, Budapest. The event was hosted by the the **Budapest Stock Exchange** and **KELER** (Central Depository and Clearing House), both members of AFM. Budapest is very rich in culture and the participants had time to debate both the business issues at hand as well to enrich their cultural knowledge.

Summary of Discussions at Pre-Conference Workshop

The conference was preceded by a workshop entitled "Getting IT Ready" sponsored by Contango Markets and moderated by Clive Furness. The day was aimed at providing case studies on system implementations at (primarily) emerging market exchanges around the world so that attendees could learn from both the successes and mistakes of their peer group. The sessions were lively and with significant audience interaction.

From an attendee's perspective the overwhelming value was the honesty of the presentations. Paul Constantinou fromTrayport and Darius Cipariu from Sibex tackled the issue of building competitive advantage through choosing the right technology solution. The primary factor in the Sibiu choice of trading technology was the flexibility that they could develop that would enable expansion of products, asset classes and services. Kjell Paulson from NASDAQ OMX and Pavel Opara from Polpx gave followed with a detailed account of the implementation of NOMX technology in the Polish electricity market. The key lessons they shared were of the importance of communication and for the product and technology areas to work in harmony throughout any implementation process.

The final session before lunch featured Graeme Neilly and Myriam Condon from Patsystems and Dr Nitus Patrayotin, President of AFET. After an interesting discussion on decision making on chosing the vendor it covered the Pats implementation in AFET which was more of a 'regular' futures market implementation than the previous two and providing important insights into key differences and similarities.

After lunch the JSE/STT team led by Rod Gravelet-Blondin/JSE and Michelle Janke/STT discussed their cooperation on development of a wide variety of systems from trading through to physical delivery and clearing. The honesty with which Rod spoke of the frustrations that the exchange had experienced with previous technology and implementation partners was refreshing and enlightening, highlighting that cooperation and communication aligned with a clear knowledge of what the exchange wishes to achieve are the solid foundations for successful technology choice and implementation.

The day was rounded off by John Mathias, Singapore Mercantile Exchange, giving a geographic overview of the public/private partnership model operated by the FTIL group of exchanges.

Day One closed with the AFM General Assembly and the Opening Dinner.

Opening Remarks to the Conference were delivered by Dr. Nitus Patrayotin of the Agricultural Futures Exchange of Thailand (AFET) representing outgoing AFM Chairman Mr. Sanit Vorapanya. The new AFM Chairman, Mihály Patai of the Budapest Stock Exchange thanked Mr. Vorapanya for his work on behalf of the Association and welcomed every one to Budapest.

The keynote address was given by Julia Király, Deputy Governor of the Hungarian National Bank. Using dramatic slides of natural phenomena such as tornados, tsunamis and avalanches she emphasized the huge effect the financial crisis was having on countries such as Hungary. The Hungarian authorities are very actively at work trying to dig out of the problem, but it will take time and perseverance from all concerned. The main focus is on restoring confidence, broaden market liquidity and to clearly demonstrate a commitment to the restoration of financial stability.

Her slide show is available on the AFM website: http://www.afmorg.net/conferences/2008-annual-conference/Conference-Proceedings.

Roundtable 1: The response of small, open markets to global crisis - the Hungarian case

David Setters of Contango Markets moderated this panel where distinguished local panelists István Hamecz, OTP Fund Manager, Tamás Móró, Concorde Securities, György Dudas, CEO of KELER, Péter Duronelly, Budapest Investment Management Company debated the current state of affairs of the Hungarian markets. All underlined the difficulties Hungarian markets faced in the face while supporting Kiraly's plea for a concerted international response to the problems. This request is not unusual since many of the problems are imported.

One interesting aspect was brought out by Duronelly. He and his colleagues are facing difficult political and ethical issues. As a Hungarian citizen and patriot, should he be helping the downward spiral of the local currency by moving assets away from the forint into foreign currency, thus trying to preserve value for clients?

György Dudás, CEO, KELER described the handling of the situation by the Clearing House. Although on a smaller scale than the issues which the major international clearing houses had to face they were very serious. But the situation was always under control and the CCP model had stood up well in the face of the crisis.

Roundtable 2: Restoring Investors' Confidence

The current situation rattled the investors' confidence strongly. Therefore a special panel was devoted discuss this issue. The panel moderated by Allan Thomson of JSE included Otto Naegeli of OEN Consulting, Simon Rostron of Rostron Parry, David Hiscock of ISMA and Robert Ray of CME Group.

The panel concentrated particularly on the perceived role that derivatives have played in causing the financial crisis in their respective countries and jurisdictions. Derivatives cannot be thrown into one basket, however. The exchange traded products have held up very well, thanks to their transparency and central clearing. OTC products, however, still overwhelm the markets and no question some were central to the failures in the markets. OTC products will stay, but there are a lot of them that could/should at least be cleared on a regulated clearing house. It became clear that better education is necessary in many areas – investors, regulators, politicians, media and many others have to better understand derivatives. The panel agreed that populist hype and more regulation are not the answer – there is plenty (if not too much) regulation already! Any new regulation should be co-ordinated among jurisdiction to avoid points of friction and regulatory arbitrage down the road.

Roundtable 3: Will the Central European Region Reach Its Potential?

It was apparent from early on in this panel that one size does not fit all. The exchanges represented on the panel moderated by Bill Templer, of UBS: Lidia Adamska of Warsaw Stock Exchange Attila Tóth of Budapest Stock Exchange, Septimius Stoica representing the Bucharest Commodity Exchange and Darius Cipariu of Sibiu Exchange are at different stages of development in the growth and independence lifecycle.

Obviously the region has great potential. But the current situation is very difficult. Foreign investments are needed but unfortunately the opposite of often happening these days – many are being withdrawn. This accentuates an already difficult situation. Politically a lot of work needs to be done to set a proper framework for the growth of these markets. Closer co-operation or consolidation was a central discussion point. It was clear that while each exchange could see the benefits but the reality remains that as important national institutions, the desire to remain independent will overcome the benefits that consolidation would bring.

<u>Roundtable 4</u>: Wrap-up of preconference workshop

Throughout the day Clive had been writing a list of key words emanating from the proposals and it was these that were used as the starting point for the round up panel session on Day 1 of the conference. Panelsists Rod Gravelet-Blondin, Paul Constantinou, Graeme Neilly and Chip Dempsey chose one of the words and gave their thoughts on the importance of 'people', 'language', 'the curse of knowledge', 'education' and the importance of products as the drivers for any process. Prior to the conference, the panellists had met and cunningly devised a question for the audience – 'If there is a system failure who is responsible? The exchange or the supplier?'. The discussion that followed this question was heated and showed just how sore market users feel about this subject. Bill Templer of UBS summed up the user perspective by saying it really doesn't matter who is responsible as it's the customer who bears the brunt as the exchanges cover their liability for such events in their terms and conditions. Clearly a raw nerve had been touched…….

The day provided some very interesting panels which made for some good discussions in the ensuing hours! A special treat awaited the delegates before dinner, a traditional Hungarian delight in a beautiful wine-cellar: a reception by the Ministry of Finance and a sightseeing tour of the Hungarian Parliament – the biggest House of Parliament in Europe.

<u>Keynote on Education</u>

Education is the key to success and Holland has done and continues to do an excellent job of educating anyone on the merits of derivatives products. opened by an interesting case study presentation by Alan van Griethuysen of NYSE Euronext opened on how this has been achieved. The presentation is available under www.afmorg.net/

<u>Roundtable 5:</u> Indexes - Great for markets and investors but how to set them up properly?

This panel was moderated by Stuart Beavis, Director at HSBC Futures and Options, and included John Mathias, Chief Business Officer of Singapore Mercantile Exchange, Paul Meier, Chairman of SFOA, Dr. Markus Thomas, Director of STOXX Ltd and Yaman Basaran, CEO of Turkdex.

The round table opened with a brief history of Index products and then onto a more macro discussion. Themes covered were issues in developing index products in general and commodity index in particular. The panel was clear that the index needs to reflect a working, liquid underlying market – be it local or regional. Indices are an easy way for investors to invest in a foreign country – attention has to be paid that these investments do not overwhelm a market. An index should have the potential to be a benchmark. An important question is who should set-up the indices – the exchanges themselves or an independent provider? The latter guarantees independence and fairness, but an exchange can achieve the same by having an independent body controlling the indices. Central to success is a clear settlement process.

<u>Roundtable 6: Energy – Fit For Local Markets?</u>

The session was moderated by Michael Jesch, bankon Management Consulting in Munich and included panellists John Mathias, CBO of Singapore Mercantile Exchange, Mrs. Rodica Popa, Romanian Power Market Operator (OPCOM) and Sverre Hakestad, Senior Vice President, Nordpool Consulting.

In many areas the energy markets are not fit yet for derivatives. Markets are still too fragmented, reference points are missing and transparency must be created. Authorities must understand the functioning of the markets and make proper rules. There are tendencies for politicians to go to price regulation. This is inefficient for the cash market and bad for a derivatives market. Setting up a derivatives markets is facilitated if an efficient OTC market is existing, including trading of receipts. Sufficient spot volumes and physical market share are a pre-requisite to establish derivatives on top. Cash settlement would certainly attract investors and boost open interest – but probably at the detriment of the involvement of the cash trader for whom the derivatives trade becomes part of his value chain. An issue to be carefully weighted!

Roundtable 7: Food Crisis: Myth or Reality?

The closing panel had a very challenging if not contentious question. Under the moderation of Adam Gross, Bourse Africa, Roderick Gravelet-Blondin, JSE; Lamon Rutten, MCX; Robert Ray, CME Group; Attila Kovács, Nidera and Elena Gabre-Madhin, Ethiopian Commodity Exchange took on the challenge to discuss this.

Adam Gross, summarised in his introduction how the Food Crisis had impacted governmental thinking as observed at the United Nations. Lamon Rutten discussed the impact of government interventions in the Indian market last year, outlining how the suspension of four agricultural contracts actually exacerbated some characteristics of the crisis. Non-exchange traded food staples showed price increases equal to or in excess of those traded on exchange!

Everyone agreed that the crisis was real, but was one more of affordability than availability as the spikes in prices were driven by a combination of fundamentals, expectations and market conduct. The importance of education for all stakeholders was emphasized as in previous panels – too many people blame the derivatives without knowing their functioning. Important is the design of the products to facilitate a strong commercial participation, otherwise the markets can become excessively speculative. This precondition is given by most products today. There is no question that speculation may have had some part in the price rises (as it did in the recent declines!) but the fundamental issues were lack of margin financing by bank, political interventions (more than 30 countries to restrictive tariff measures among others), rising demand (China, India), lack of proper infrastructures in many places and crop problems.

After two (for those participating in the pre-conference three) interesting days the participants enjoyed the sights of Budapest by night on a relaxing Danube River Cruise, accompanied by great food and good music.