

ETRMA: EU AND INTERNATIONAL ACTION NEEDED TO ENHANCE TRANSPARENCY AND REDUCE PRICE VOLATILITY IN THE NATURAL RUBBER MARKET

Introduction

Natural rubber (NR) is a principal raw material for the production of tyres globally and ETRMA members have a large and direct commercial interest in securing effective price discovery and reduced price volatility for their NR purchases. The ETRMA is therefore focusing on the on-going conceptual and regulatory work on commodities that is under way at both global and European levels. Much of this work is aimed specifically at improving transparency and price discovery and thereby reducing commodity price volatility. Importantly, these efforts have regard to both the physical and futures markets for the commodities covered.

The 2007-2008 financial market crisis and ensuing global economic downturn have conferred on commodity markets a priority and visibility that haven't been witnessed for many years. Since 2008, major price rises and high volatility have impacted a number of commodities, with NR among those worst affected. The price and volatility developments of NR have shown some patterns similar to those of other commodities, in particular in the light of similar demand growth patterns and financialisation of commodities generally. However, the NR market also has certain important specificities. These considerations provided the backdrop for the Natural Rubber Pricing Study commissioned by ETRMA in July 2011. That Study has now made clear both the direct and the indirect relevance of the work being undertaken on commodities by the respective international and EU institutions.

The most manifest expression of the new strategic interest in commodities has been the creation of the G-20 Summit as such, as well as a series of changes in the roles of existing institutions (e.g., FSB, IOSCO, WB, and OECD) and the way in which these bodies interact with one another. While the G-20 Summit undoubtedly continues to head the "hierarchy" addressing the key commodities issues, the other institutions have been assimilating the G-20 priorities into their own work programs. The consequences are twofold. First, every institution naturally has its own mandate and culture so that its work remains largely sectorial. Second, while the G-20 Summit, having a heterogeneous membership, is able to define strategic objectives and priorities, it cannot force its members to accept specific disciplines. This in turn explains why, despite the huge efforts invested, for example by the IOSCO TC, the outcome is presented in the form of "principles".

Hence it is essential for interested economic actors like the ETRMA members to, on the one hand, clearly understand the way in which the relevant institutions operate and interact on commodities, in terms of both substance and timing of these actions. On the other hand, industry needs to work closely with the relevant authorities and regulators in the respective regions to ensure that the "principles" agreed at the top are properly incorporated, in a consistent manner and as broadly as possible, into the respective national legal frameworks.

Moreover, these efforts, on the part of both regulators and ETRMA, need to have regard to all three market elements that are crucial to a proper evolution of pricing in the NR market, i.e. the physical supply, the trading and financial platforms as well as the overarching global trade policy arrangements. The specifics of ETRMA's NR interests are set out below in connection with each of these areas where changes are required for better functioning of the NR market.

1. THE NEED FOR MORE TRANSPARENCY IN THE PHYSICAL TRADE

The overall aim is to achieve improved transparency in the price discovery of the physical commodity.

- For the tyre industry, improved transparency of data relating to NR production (supply) remains the principal objective and key to securing the necessary level of transparency in the physical market overall. However, for many reasons including trust-building, it is essential to achieve increased reliability and timeliness of statistical data regarding both NR supply and demand, including the development of data on inventories as possible (at all levels of the supply chain).
- ETRMA is interested in the work undertaken by various organisations relating to the development and systematic use of data repositories (comprehensive commodity databases).
- The tyre industry is strongly supporting a relaunch of the International Rubber Study Group (IRSG), an intergovernmental body based in Singapore that historically encompasses both NR producers and industry consumers. Despite the fact that some key players, from both sides, have recently left or intend to leave the IRSG, its mandate corresponds by and large to what other commodity sectors now wish to set up. In other words, IRSG - with the help of the official representatives - could ideally regain relevance as a primary platform for NR market data exchange.
- Within the framework of actions recommended by IOSCO in the derivatives field, there are related concerns expressed with regard to transparency and operation of the underlying physical markets. In this regard, ETRMA supports all measures that would serve to enhance national authorities' access to quality information concerning the underlying physical markets and their legal powers to investigate, intervene and impose penalties in instances of manipulative/abusive conduct.
- In the EU, the industry wishes to work closely with the Commission to assess the possible means and instruments that could serve to enhance the availability and quality of information for all stakeholders relating to both physical trading positions and concerning the upstream fundamentals and market dynamics of the physical market.
- At a more global level, ETRMA wishes to see more systematic work undertaken by all relevant institutions in order to secure the physical sustainability of NR.

2. EVOLUTION OF TRADE POLICY AND INSTRUMENTS TO ADDRESS INTERNATIONAL COMMODITY PRIORITIES

ETRMA wishes to contribute to the orderly and sustainable adjustment of the general pattern of supply and demand streams in the light of the major macro-economic transformations under way. The necessary adjustments are requiring, *inter alia*, an overhaul of the traditional trade policy instruments. A specific stress needs to be placed on access to supply.

- ETRMA is fully backing the intention of the EU to use its negotiation of bilateral trade instruments such as FTAs and Partnership and Cooperation agreements in order to help secure access to

resources in general and to essential commodities and raw materials in particular. FTAs have the particular advantage of allowing for combating cases of anti-competitive and other market-distorting behaviours, but FTAs are not currently envisaged for all NR producer countries so a broader strategy is needed.

- When defining the priorities for such trade negotiations it is important to take into account which other countries may have convergent pro-active interests. In the specific case, special care should be applied in relation to the role of partners that are particularly significant producers of NR.
- Beyond the panoply of purely bilateral instruments, the OECD and the G-20 contribution to the larger trade debate should not be underestimated, even if no operational decisions can be expected from these bodies.
- Having regard to the medium and longer-term, it is important to prepare the ground for consideration of potential additional multilateral trade disciplines, namely to enact a “fair access to supply” principle for essential commodities and certain other raw materials. The WTO is and will certainly remain the appropriate platform for the negotiation and the broad implementation of such new and non-discriminatory trade disciplines. The WTO is equally essential for verifying whether bilateral or regional agreements are consistent with the relevant WTO provisions.

3. THE NEED FOR REFORM OF COMMODITIES FUTURES MARKETS

In the case of NR, transparency and efficient price discovery in the relevant futures markets is essential. Because of the geographic origin of the raw material and the particular history of NR futures trading, the tyre industry also has a distinct and focussed interest in enhancing regulation and price discovery in futures markets outside of the EU. Conversely, the industry needs to follow closely regulatory developments at the EU level given their potential bench-marking influence.

- From a NR point of view, the work of the EU in the area of financial markets is significant. The three key legal instruments that are being reformed (EMIR, MIFID, MAD) aim at becoming new benchmarks in the field. These instruments can have a significant impact on ETRMA’s NR market objectives.
- The EU reforms are relevant because the new provisions cover the full chain of trading activities and a wide spectrum of commodities. A systematic regulation of OTC commodity contracts is the very centrepiece of the regulatory work, but detailed criteria for implementation remain to be worked out by the Commission and ESMA. Hence it is important to understand which new disciplines will apply to which commodities and to which facet(s) of the trading process. Even if, a priori, the immediate NR purchasing arrangements would not fall under the new EU regimes, the new provisions are relevant in that they establish a model for transparency and take aim against market abuses. Crucially for ETRMA, these are also the legal frameworks that the EU should encourage relevant third countries to enact. The Commission and ESMA are both equipped with third country competences that will have to be fine-tuned and targeted correctly.
- Furthermore, the EU regulatory trends can impact the debate at global/G-20 levels. IOSCO recently agreed important principles that can serve as a strong and specific foundation for reform and enacting compatible commodity futures market regulations globally. The influence of these principles in third countries will come about not just by EU bilateral action but also via the

continuing work of these international bodies. IOSCO and the FSB will be particularly important in this regard.

- For many years US regulation, embodied by the CFTC, has been the most far reaching. With the EU now catching up and considering the rising economic and political challenges from other parts of the world, it is in the interest of the tyre industry to promote a closer cooperation between the EU, the US and other like-minded partners. There are two good reasons for this. First, from a purely industry point of view, major regulatory divergences between the US, EU and other major financial centres are problematic in terms the costs they generate. Second, cooperation may further help defining convergent positions in other parts of the world.
- In the light of the growing interdependence among different categories of assets, the “financialisation” of commodity derivatives markets plays an important role in the functioning of market mechanisms. There is, however, no proven indication yet that purely financial investors have unduly impacted price trends or volatility of NR prices. The sector has nevertheless an evident interest to continue following the deliberations on this “financialisation” issue by regulators and with regard to the specificities of the NR futures trading.
- These regulatory trends and whether they are taken up or not more widely can also affect the relative position of the key exchanges for different commodities. In the case of NR, the current reference role of SGX/Singapore could potentially change but this could depend also on whether the other current major NR futures exchanges (TOCOM in Tokyo and SHFE in Shanghai) would take up important reforms or not.

* * *

Brussels, 10 October 2011

For further contact:

Mrs Fazilet Cinaralp, Secretary General

f.cinaralp@etrma.org

+32 2 218 49 40