Give the Oil Market the Regulation it Needs: Liz Bossley

Well-meaning regulation of markets is making life harder for oil companies looking to manage their oil price risk.

The US Dodd Frank and the European EMIR initiatives want to shift the opaque over-the-counter (OTC) market onto regulated exchanges that can be more easily measured and monitored. This ignores the fact that many hedgers do not have the credit capacity to meet the daily cash calls that protect the regulated clearing houses from defaulters. Regulated exchanges see only the hedge side of a hedger's position and make no allowance for offsetting price moves in the tangible asset the financial instrument is hedging. OTC market makers can see both sides of the position and can make a more informed assessment of the hedger's true risk.

The Volcker rule, one aspect of Dodd Frank, aims to stop US banks from "proprietary" trading, using their strong balance sheets to make markets for the oil company hedger. The banks are being further hamstrung by proposals to keep them out of trading physical oil altogether. Where are the banks to put the complex risks they take away from "real" oil industry players if not into the physical arbitrages that are beyond the scope of the small industrial firms? Take banks out of the equation and you remove the only real competition to the oil majors and the large trading houses. These will have a clear field to offer risk management and financing solutions to small players at the price of a chunk of equity in their projects.

Where regulation is really needed, regulating the "Brent" oil price benchmark that sets the price of at least 200 billion barrels of oil p.a., the regulators are nowhere to be seen. Although the EC and the US Department of Justice are taking a hard look at whether this benchmark is , like Libor, manipulated no-one is ensuring that the benchmark itself remains robust as underlying physical production declines. Companies looking to hedge, finance developments or simply sell their physical oil at a fair price, face this unquantifiable risk because no-one is in charge of when the next change to the benchmark is coming or what form it will take.

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