



Areas for
commodity traders'
focus as COVID-19
changes the market
landscape



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Global financial and commodity markets have seen unprecedented levels of disruption as coronavirus sweeps around the world. There has been a sharp fall in economic activity due to large-scale lockdowns, a reduction in industrial activities and travel restrictions across the globe. A severe demand and supply shock sent oil prices crashing to their lowest levels ever, dropping below zero in the US. A slowing demand for transport fuels was combined with a temporary breakdown in the OPEC+ production arrangements and a shortage in global storage capacity. In metals, the economic outlook has impacted the short-term demand, although supply disruptions and government stimulus measures could provide support in the medium term. Regional power markets are increasingly at risk of prolonged demand destruction, and there are heightened liquidity fears especially for energy retailers. With restrictions now in place for over half the world's population, the disruption in the daily lives of consumers and producers has resulted in a high level of volatility in global commodity markets.

In this unprecedented time, EY Commodities Markets professionals have set out four key areas for commodity traders to focus on:

1

Prioritize people safety and continuous engagement

- ▶ Follow government and medical experts' advice regarding best practices to limit the spread of COVID-19 and ensure individual safety and wellbeing. This is the most critical management responsibility
- ▶ Provide clear, transparent and timely communications to secure ongoing support and engagement from employees, counterparts, regulators and other stakeholders
- ▶ Designate single points of contact to facilitate seamless engagement on matters related to commercial strategy and execution, risk management, compliance, finance and human resources

2

Review trading strategies

- ▶ Review trading strategies and algorithms that might require adjustment due to the change in demand and supply patterns, or as a result of the revised view of the market price outlook in the short to medium term
- ▶ Review models that rely on historical data to determine the load and consumption forecast used for hedging decisions and adjust existing long-term positions to reflect changing demand
- ▶ Review modes of trade execution, including a move to exchanges and platforms to better manage credit risk and liquidity

3

Adjust risk management policies and procedures

- ▶ Increase focus on the tracking of scheduling operations for physical commodity delivery. This will help ensure that contractual obligations are met without incurring unexpected delays and charges
- ▶ Plan for unexpected delays in shipping delivery due to ports' handling capacity or availability of staff for warehousing and trucking. This could help with better estimation of movement dates and other events
- ▶ Thoroughly review market liquidity and independent price verifications to determine forward curve values for realistic valuation and informed market risk management
- ▶ Increase the frequency of review for credit risk ratings, limits and real-time monitoring to effectively manage counterparty default risk
- ▶ Consider reviewing your allocation of position, tenor and Value at Risk (VaR) limits to the trading books to help identify required adjustments
- ▶ Determine stress testing scenarios with changes to multiple variables to identify impact on your portfolio – and plan for ways to manage the change in positions
- ▶ Manage infrastructure resilience – in an environment where the majority of people are working remotely, the network is potentially more vulnerable to cybercrime

4

Strengthen finance procedures

- ▶ Evaluate the teaming and task management tools available to manage the ledger and enable you to perform key procedures such as month-end close, reconciliations and journal entries
- ▶ Monitor the performance of existing controls and consider enhancements to address the change in situation, including remote working
- ▶ Revisit your procedures to determine the fair value of long-term contracts in the current environment

During these uncertain times, it is important to support your people and focus on operational resilience that allows the front, middle and back office teams to work effectively and collaboratively. Organizations that adapt and embrace the remote or home working environment, through what may be a prolonged lockdown scenario, can expect to come out strongly. The use of collaboration tools that support remote working should be given serious consideration, not only with a focus on cost management, but also to support business continuity.

EY commodities markets services:

Evolving global supply and demand patterns for commodities present new opportunities for companies to maximize returns through commodity markets. Companies with commodity trading operations are exploring new business models, rationalizing portfolios, accelerating investments in digital technologies and increasing efficiencies, while managing market, credit and operational risks. The EY Commodities Markets team provides advisory and assurance services for business transformation, technology enablement, risk management, regulatory compliance, financial reporting, and external and internal audit services to companies with commodity trading, marketing and hedging operations. The key contacts at Ernst & Young LLP are:



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