

# Managing your commodity risk through market uncertainty

KPMG's Global Energy Institute (GEI) participated in the 2014 Commodity Market Risk Forum in Singapore. Hosted by Platts and ZE Power Group, the forum provided a series of insightful presentations made by speakers from KPMG and S&P Capital IQ on commodity risk management. There was an overwhelming response and interest from the trading community, who participated in the sessions.

## An overview of past and recent developments in the monitoring and control of risk within corporations

KPMG in Singapore, Head of Risk Consulting, Irving Low, provided an overview of past and recent developments on monitoring and controlling risks within corporations. He outlined current leading practices in governance, risk and compliance with a

focus on enterprise risk management. Key dimensions of the global business landscape have changed (see below). Risk management has become a key tool to enable boards and management to meet their overall governance and performance agenda.

## Latest Governance and Risk Management developments in Singapore

Over the past four years, Singapore has experienced significant changes in the regulatory environment to improve governance and risk management practices.

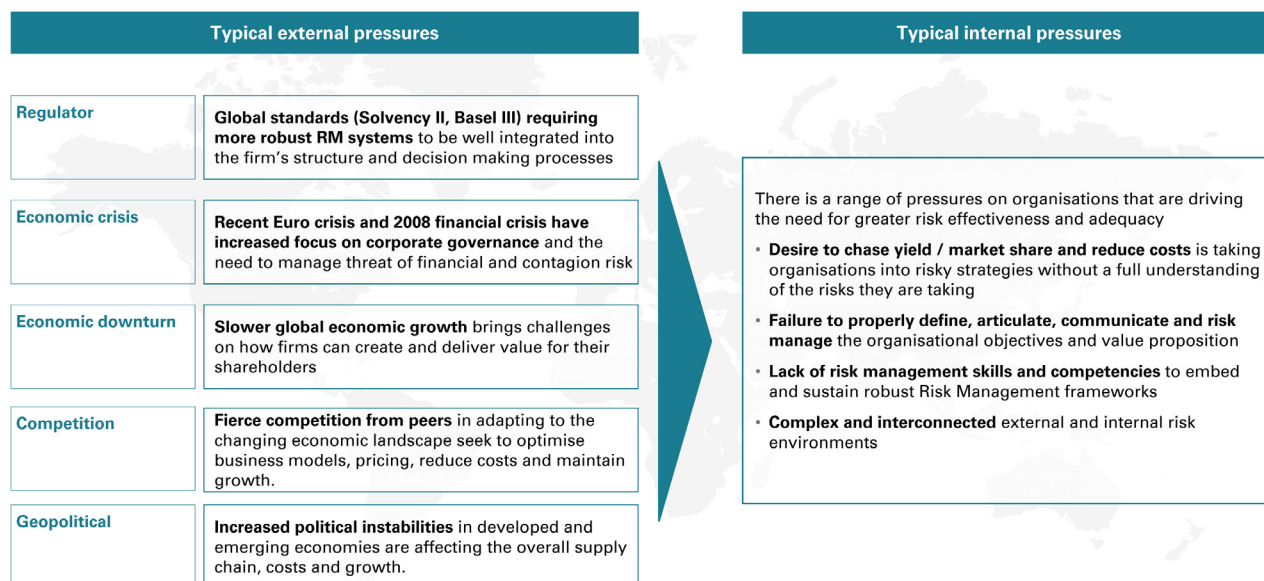
The current corporate governance landscape in Singapore has witnessed several key changes including the Listing Rule 1207 sub section (10) and the revised 2012 Singapore Code of Corporate Governance.

## Significant changes in regulatory environment

- 2010** MAS Guidelines for Corporate Governance
- 2011** SGX Listing Rule 1207(10)
- 2012** MAS Securities and Futures Act  
Revised Singapore Code of Corporate Governance (SCCG)
- 2013** The Companies Act  
Risk Governance Guidelines for Listed Boards
- 2014** MAS ERM Notice 126 for Insurers  
Revised Audit Committee Guidance Committee Guidebook

Source: 'Overview – past and recent developments in the monitoring and control of risk within corporations' by Irving Low, KPMG in Singapore, 2014

## Key dimensions of the global business landscape have changed



Source: 'Overview – past and recent developments in the monitoring and control of risk within corporations' by Irving Low, KPMG in Singapore, 2014

Under Code 2012's Principle 11, the Board is responsible for the governance of risk.

### SGX 1207 (10)

LR1207 (10): "Opinion of the board with the concurrence of the audit committee on the adequacy of the internal controls, addressing financial, operational and compliance risks."

### Code 2012

P11.3: "The Board should comment on the adequacy and effectiveness of the internal controls, including financial, operational, compliance and information technology controls, and risk management systems, in the company's Annual Report."

Source: Singapore Attorney-General's Chambers website

The Board ensures that the Management maintains a sound system of risk management and internal controls to safeguard shareholder interests and the company's assets. Management should determine for the Board the nature and extent of risks that it is willing to take to achieve its strategic objectives.

Under the guidelines for the new rule, Boards should:

- Determine the company's level of risk tolerance and risk policies
- Review, at least annually, the adequacy and effectiveness of the company's risk management and internal control systems
- Provide commentary on the adequacy and effectiveness of the internal controls in the company's Annual Report
- Give details in the Annual Report on

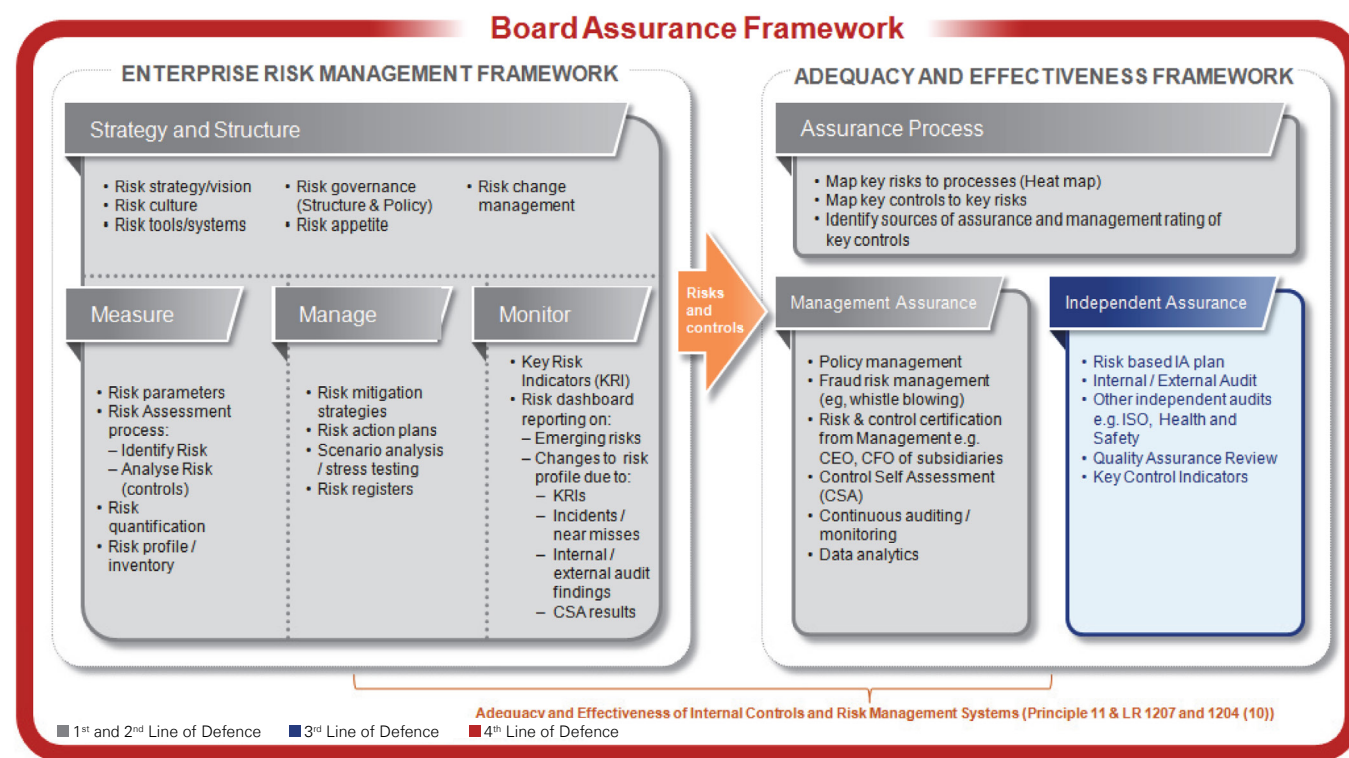
whether it has received assurances from the CEO and the CFO regarding the effectiveness of the company's risk management and internal control systems

### Risk Management Frameworks

Widely used in the industry, ISO 31000 and COSO are two internationally recognised standards providing guidance in the overall risk management program objectives and processes.

Aligned with global practices, the KPMG integrated "Board Assurance Framework" (see below) is specifically tailored to help companies meet local requirements and build four lines of defence. It aims to better link and integrate both the Enterprise Risk Management and the adequacy and effectiveness of internal controls and risk management systems.

## Board Assurance Framework



Source: KPMG Risk Consulting Singapore Board Assurance Framework (incorporating KPMG's 4 Lines of Defence model), KPMG in Singapore, 2014

### Building the four lines of defence

In order to discharge its new responsibilities, the Board must develop an **informed opinion** based on an appropriate and documented structure.

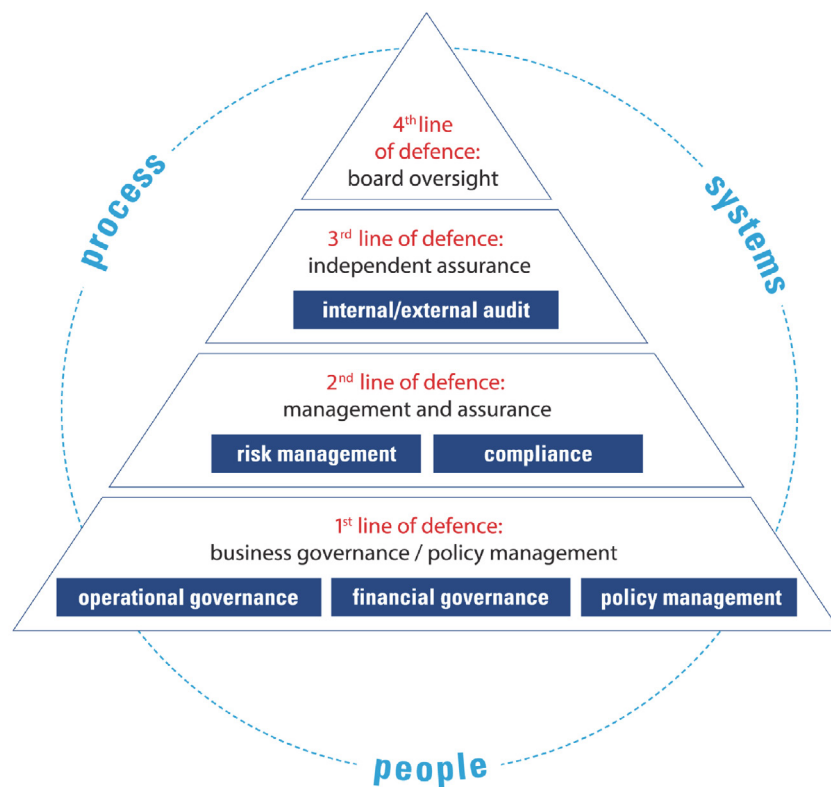
These four lines of defence can be summarized in the opposite diagram.

### Concluding on the current state of Risk Management in Singapore

A recent KPMG survey<sup>1</sup> found that there are still significant efforts needed to build adequate and effective internal controls and Risk Management frameworks.



### Building the four lines of defence



Source: Overview – past and recent developments in the monitoring and control of risk within corporations' by Irving Low, KPMG in Singapore, 2014

### Three key enablers - People, Processes and Systems



**People**  
The hardest to control is People.



**Processes**  
Processes are relatively easy to design. Like strategy, the secret to success is in the implementation.



**Systems**  
Systems require consistency and visibility.

<sup>1</sup> ISCA-KPMG risk management study: Towards better risk governance, a study of Singapore listed companies 2013; and a global KPMG ACI survey



### Current trends in Commodity Risk Management

Matthew Sullivan, Director of Commodity and Energy Risk Management at KPMG in Singapore, shared with participants information about some of the current trends in commodity risk management in Singapore.

The pendulum has swung from liberalisation to control over the past four decades. Compliance risk management strategies in middle and back office operations, specifically to commodity trading houses, have to adapt.

Organisations need to prioritise resources to deal with the multitude of regulatory,

accounting and tax changes expected to be implemented by authorities in the short-term.

### Transfer of regulatory oversight for commodity derivatives

A consultation paper was issued in February 2012 by the Monetary Authority of Singapore (MAS) and International Enterprise (IE), proposing the transfer of regulatory oversight of over-the-counter (OTC) commodity derivatives under the Commodity Trading Act (CTA) to the Securities and Future Act (see below).

This change in oversight represents a potentially significant licensing obligation to commodity market participants.

## Summary of the transfer of regulatory oversight for OTC commodity derivatives under the Commodity Trading Act (CTA) to the Securities and Future Act (SFA).



### Commodity Trading Act (CTA)

Initially enacted in 1992 as "Commodity Futures Act"

- Administrated by IE Singapore
- Approves and regulates commodity futures exchanges and clearing houses
- Licensing of commodity futures brokers and commodity future trading advisers
- Imposes statutory requirements vis-a-vis audit and disclosures
- Provides a system for the conduct of participants to ensure adequate protection to investors
- Only applies to contracts on the Singapore Commodity Exchange

Amended in 2001 to become "Commodity Trading Act" and expanded to cover all commodities and all forms of commodity trading, broking and advisory functions

- Commodity futures; Leveraged commodity trading; Contracts for difference
- Commodity forwards; Spot commodities
- An index, a right or an interest in such commodities

Further amended in 2008, the oversight of commodity futures was transferred from IE to MAS under the "Securities and Futures Act"



### Securities and Futures Act (SFA)

Enacted in 2001

- Provides for the supervision of the securities industry and the licencing authority for regulated activities by MAS
- Applies rules and regulations concerning markets, market operators, clearing facilities, intermediaries and representatives
- Regulated activities include (among others) trading as principal or agent in futures contracts
- To conduct a regulatory activity, participants are required to hold a Capital Markets Services (CMS) Licence as a corporation. Individuals who wish to conduct any regulated activities for a CMS Licence holder must obtain a CMS Representative's Licence
- Individuals are required to meet minimum academic qualifications, sit an examination, and satisfy MAS 'fit and proper' guidelines
- Exemptions exist for certain participants





### Background to the changes in legislation

The G20 has been a driver of change in oversight of the OTC markets. Commodity derivatives markets have grown and evolved since the early-to-mid 1990s. The scope of regulation of commodity derivatives under the CTA presently does not adequately capture even basic derivatives.

Shifting all commodity derivatives regulation to MAS therefore provides greater clarity and efficiency for the market's participants. Singapore is actively meeting international standards by expanding the regulatory scope of the SFA to provide increased responsiveness for regulatory development.

The MAS intends to expand the scope of the SFA to include regulation of OTC commodity derivative markets, clearing facilities and intermediaries. "Commodity" will be designated as one of the derivative asset classes that MAS is responsible for regulating.

Physically-settled commodity spot contracts will be excluded from the scope. Under the CTA, the exclusion of such contracts from regulation is consistent with the current approach of exempting players who trade in commodity markets involving physical delivery of the commodity for business purposes.

Therefore, with the transfer of regulatory oversight of commodity derivatives from the CTA to the SFA, the remaining regulatory scope of the CTA will be on spot commodity trading.

"All standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse."

**G-20 statement from the Pittsburgh Summit, September 2009**

### Central Clearing of Commodity Derivatives

Matthew Sullivan outlined the current definitions of the Securities and Futures Act's (SFA) clearing mandate and a comparison of bilateral to cleared trades.

### Legislation mandating central clearing

Provisions in the SFA and its regulations relating to establishment of the regulatory regimes for clearing facilities for OTC derivatives and licensed trade repositories came into operation in October 2013. Legislation also contained an amendments to the SFA to mandate central clearing and reporting of OTC derivatives.

SFA, Part VIB – Clearing of Derivatives Contracts - S.129C(1) – the clearing mandate

"Every **specified person**\* who is a party to a **specified derivatives contract**\* shall, within such time as the Authority may

prescribe by regulations made under section 129G, cause the specified derivatives contract to undergo clearing, by a clearing facility operated by an approved clearing house or a recognised clearing house, in accordance with the business rules of the approved clearing house or recognised clearing house, as the case may be."

### Conclusion

Organisations should be seeking answers to the following questions:

- What are your regulated activities according to SFA?
- Will your organisation require a CMS Licence?
- Will your staff require CMS Representative's Licences?
- Which underlying commodities will be covered by the clearing mandate?
- Will all CMS Licence holders be covered by the clearing mandate?

On the whole, the energy sector lags behind other sectors such as Financial Services which have standalone Risk Management functions:

- **More complex environments** and greater regulatory scrutiny have significantly increased the challenges for organisations, which should re-assess the adequacy and effectiveness of their risk management systems.
- **Despite greater implementation of risk management** practices in Singaporean organizations, significant effort still remains to build adequate and effective risk systems.
- **Investing in risk management enablers:** People, Process and Systems - distinguishes the mature energy organisations.

\*To be determined at a later date.

### About the KPMG Global Energy Institute (GEI)

The GEI is a worldwide knowledge sharing platform detailing insights into current issues and emerging trends within the Oil & Gas and Power & Utilities sectors. Launched in 2007 in Houston, United States, the Institute opened its first regional centre in Singapore at the KPMG Global Energy Conference – Asia Pacific 2013.

Energy professionals can gain access to valuable thought leadership, studies, events and webcasts on key industry topics. A regional focus to the GEI provides decision makers tailored insight within the Americas, Asia Pacific and the Europe, Middle East and Africa regions.

The GEI strives to equip professionals with new tools to better navigate the changes in the dynamic energy arena.

### About the Business Club

Launched in 2013, the KPMG Global Energy Institute in Asia Pacific aims to bring together senior decision makers in the Energy & Natural Resources sector every two months. While the main objective of the event is to allow participants to network, the GEI also aims to be a platform for global energy specialists to share their insights into the sector. Participants can gain a broad perspective on what's happening in the energy sector.

### Register

Individuals can register for the GEI at the following link: [www.kpmg.com/energyaspac](http://www.kpmg.com/energyaspac) and receive regular updates, thought leadership and invites to events and web conferences.

[kpmg.com/energyaspac](http://kpmg.com/energyaspac)

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