The Application of the Tokyo Communiqué to Exchange-Traded Financial Derivatives Contracts

Technical Committee

of the

International Organization of Securities Commissions

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INTRODUCTION

During the meeting of the International Organization of Securities Commissions’ (IOSCO) Technical Committee in Taipei in November 1997, the Co-chairs of the Tokyo Commodity Futures Markets Regulators’ Conference (“Tokyo Conference”)\(^1\) reported on their work program, the October 1997 *Tokyo Communiqué on Supervision of Commodity Futures Markets* (“Tokyo Communiqué”) and related guidances,\(^2\) and the resulting specific recommendations for further work by the Technical Committee. The Tokyo Guidances were described as setting forth matters that market authorities should consider when they design frameworks for the supervision of physical delivery contracts on commodity futures markets, particularly contracts for which the underlying commodity is a product of limited supply, including the components of an effective market oversight and surveillance regime and the information needs of such a regime.

The Co-chairs indicated to the Technical Committee that commodity regulators believed that IOSCO should further the appropriate oversight of markets through exploring the applicability of the Guidances to financial markets other than derivatives markets based on deliverable commodities of finite supply. It was their view that IOSCO was uniquely situated as the premier international organization of regulators for securities and financial derivatives markets to determine the relevance of the Tokyo work to financial markets generally.

The Chairman of the Technical Committee noted that derivatives and cash markets, as well as financial and other derivatives markets, were related. In the Final Communiqué of its XXIInd Annual Conference, IOSCO announced that it agreed, among other things, “to further consider the extent to which the guidances developed for physical delivery commodity markets or markets with deliverables of finite supply could be extended to financial or other derivatives markets including over-the-counter markets” and “to further develop the surveillance components addressed by the guidances by expanding upon the techniques of market surveillance.” The Technical Committee committed these projects to its Working Group on the Regulation of Secondary Markets (Working Party). This report was approved by the Technical Committee at its meeting in Nairobi, Kenya on September 13, 1998.

In determining the desirability and feasibility of extending the Tokyo Guidances to financial derivatives and to derivatives not based on a deliverable of finite supply, the Working Party determined to focus initially on the extent to which the surveillance

\(^1\) The Tokyo Conference was jointly chaired by the Japanese Ministries of International Trade and Industry (“MITI”) and Agriculture, Forestry and Fisheries (“MAFF”), the US Commodity Futures Trading Commission (“CFTC”) and the UK Financial Services Authority (“FSA”).

\(^2\) Attached to the Tokyo Communiqué were two guidances: *Guidance on Standards of Best Practice for the Design and/or Review of Commodity Contracts* and *Guidance on Components of Market Surveillance and Information Sharing* (collectively the “Tokyo Guidances”).
practices set forth in the Surveillance Guidance could be applied to exchange-traded
derivatives other than those for which it was originally developed and, then, to consider
the related guidance on contract design and information sharing. Equity derivatives raise
additional issues which were not addressed in the Tokyo Guidances and which are not
intended to be addressed by this Report. The Working Party decided not to consider, at
this time, the extent to which the Guidances could apply to over-the-counter derivatives
markets. The evolution of the Tokyo Communiqué Guidelines should be considered in
the context of the overall work of IOSCO directed to the practical implementation of
regulatory measures to promote investor protection, fair, efficient and transparent markets
and to reduce systemic risk.

BACKGROUND

In October 1997, regulatory authorities from 16 jurisdictions responsible for supervising
commodity futures markets participated in the Tokyo Commodity Futures Markets
Regulators’ Conference in Tokyo, Japan. This conference announced the completion of
the work program contained in the London Communiqué issued in November 1996. At
the end of the meeting the regulators issued the Tokyo Communiqué on Supervision of
Commodity Futures Markets which, among other things, endorsed two guidance papers
relating to exchange-traded derivatives:

(l) Guidance on Standards of Best Practice for the Design and/or Review
of Commodity Contracts (“Design Guidance”); and

(2) Guidance on Components of Market Surveillance and Information
Sharing (“Surveillance Guidance”) (collectively “the Tokyo Guidances”).

The London Conference focused on the special contract design and market surveillance
implications of physical delivery markets because no forum previously had addressed the
particular supervisory concerns raised by those markets and such concerns were particularly
timely in light of then recent events in the copper markets (i.e., the losses sustained by the
Sumitomo Corporation).

The Tokyo Conference determined that setting benchmarks could promote further
accountability of market authorities at the regulatory and self-regulatory, including

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3 If the Working Party believes that it would be useful to consider the over-the-counter
derivatives markets at a later date, the Working Party would present a mandate to the
Technical Committee for its approval.

4 The work program involved, among other things, a survey of existing oversight
practices by the participating market authorities and consideration of comments
submitted by a Subcommittee on the London Communiqué of the Consultative
Committee of the International Organization of Securities Commissions (“IOSCO”).
The Subcommittee is comprised of representatives from a number of futures markets.
exchange, level. The delegates concluded that the Guidances could assist competent market authorities:

- to provide a clear framework for the design and review of products and for conducting market surveillance, compliance and enforcement activities; and

- to develop information sharing arrangements essential to making such activities effective in an increasingly linked global marketplace.

The Tokyo Guidances set international benchmarks, against which regulators and other market authorities can assess their own standards and practices and consider possible regulatory improvements. The Guidances issued at Tokyo were developed for exchange-traded derivative contracts based on a physical commodity or a non-financial deliverable with a finite supply.

The London and the Tokyo Conferences focused on the particular contract design and market surveillance implications of physical delivery markets. However, the delegates to the Tokyo Conference recognized that the standards of best practice set forth in the Guidances could assist authorities responsible for the supervision of derivatives markets generally. Accordingly, the Tokyo Conference also referred the following to IOSCO:

- the need to provide further content to the components of surveillance by publishing additional guidance on existing structures and techniques used for the oversight of markets and clearing organizations; and

- the extent to which the best practices set forth in the Guidances can be applied to exchange-traded financial and over-the-counter derivatives markets.

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DISCUSSION:

I. APPLICABILITY OF THE SURVEILLANCE GUIDANCE TO OTHER EXCHANGE-TRADED DERIVATIVES

- The basic purpose of market surveillance and, accordingly, the basic precepts of the Surveillance Guidance apply equally to exchange-traded futures, options on futures, and options (“derivatives”) contracts on all types of commodities.

- Nonetheless, in developing surveillance regimes, market authorities may need to place different emphasis on specific issues (such as delivery characteristics) depending on the nature of the underlying reference commodity and differences in the size (e.g., large open interest, small open interest) and composition (e.g., ability of traders to make or to take delivery) of the market. The form of trading, such as open-outcry pit-based or electronic or both, also may affect how surveillance should be tailored and the actual methodologies used.

- Therefore, while the Surveillance Guidance provides a useful menu of components for a surveillance program for exchange derivatives markets generally, market authorities may need to adapt the recommendations in the Surveillance Guidance to their surveillance programs in certain respects most effectively to monitor their particular derivatives markets.

The Variety of Contracts

The international derivatives industry has grown tremendously during the past several decades as exchanges globally have launched derivatives contracts on an increasingly diverse array of underlying products. In doing so, exchanges have stretched the concept of “commodity” far from its origins of tangible physical products. Such contracts are based on the full (and ever-expanding) range of physical commodities, market instruments and indices (whether settled by physical delivery or in cash) (hereinafter referred to as “commodities”) that are available on exchanges around the world. This continuing growth and innovation in financial design has challenged regulators to keep pace by maintaining regulatory structures and practices that are appropriate to the new markets, without unnecessarily affecting future market innovation.

Today, derivatives are traded on exchange markets around the globe based on the following commodities, among others:

-- agricultural crops and their products;
-- livestock and their products;
-- metals;
-- energy (including electricity);
-- interest rates;
-- freight rates;
-- equities, including broad- and narrow-based indexes and derivatives on
  individual securities;
-- foreign exchange;
-- insurance; and
-- other rights or interests, such as output or production yields or credit.

Most derivatives contracts require delivery of the underlying commodity or market
instrument, although an increasing number are cash-settled on the basis of a specified
cash-price series or index. Some of the underlying commodities are produced seasonally
or periodically, while others are continuously produced. Some are perishable, while
others are storable. Some commodities are widely available or easily transported, while
others have more rigid supply channels and are more costly and time-consuming to move.
Some are based on products traded in niche domestic cash markets and others on global
or world commodities. Some have very competitive and transparent underlying cash
markets, while for others reliable cash prices or data on trading volumes may not be
available.

The Objectives of Market Surveillance\(^6\) (Prevention and Deterrence)

Before examining how the design of surveillance regimes relates to different types of
contracts and markets, it is useful to consider the objectives of a market surveillance
program. Market surveillance is intended, in combination with appropriate contract
design and enforcement activities, to ensure that trading activity does not disrupt the
appropriate functioning of the market or the contract and that customers are adequately
protected. The Surveillance Guidance provided the following list of manipulative or
abusive practices that market authorities should seek to prevent:\(^7\)

-- intentionally causing, or attempting to cause, artificial pricing in the
  market;

-- creating a false or misleading appearance of active trading;

---This Report and the Tokyo Communiqué do not address financial surveillance.
Nonetheless, (1) awareness of market concentrations and exposures, (2) information
about on which side of the market they are concentrated, and (3) information as to
through which firms they are held and as to the financial capacity of such firms, also are
some of the elements that are critical to financial surveillance.

---The list included in the Surveillance Guidance was not intended to identify all of
the manipulative and abusive activity that surveillance programs should address, or to serve
as a complete description of the factual and legal elements of such conduct.
-- intentionally disseminating false or misleading market information;

-- creating a corner or squeeze, in which an abusive controlling position is accumulated in the physical and/or futures markets, forcing those holding short positions to settle their obligations, by purchase or offset or otherwise, to their detriment;

-- abuse of customer orders;

-- “wash trades” involving no change of beneficial ownership;

-- collusive trades which seek improperly to avoid exposure to the pricing mechanism of the market;

-- violation of applicable position limits; and

-- concealment of a position holder’s identity.

Some of these abusive practices can be identified in their formative stages by an effective market surveillance program. In these instances, the relevant authorities can initiate appropriate actions to prevent the abuse from occurring. Attempts to manipulate prices through the use of market power associated with a dominant market position may be identifiable and preventable, as may attempts to disrupt the delivery process. Government regulators and other market authorities that have a role in market surveillance should coordinate their respective activities to ensure that effective surveillance occurs without unnecessary duplication of efforts.

Many other market abuses are best prevented by effective deterrence or by structural limits on trading, such as spot month or other position limits and margin differentials or other measures. If market participants believe abusive practices will promptly be detected, investigated and, as appropriate, penalized by market authorities, they are less likely to risk engaging in the abusive activity.

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8 In many jurisdictions, self-regulatory authorities, including exchanges, have specified responsibilities to perform surveillance, to prevent disorderly conditions and to deter manipulative or other abusive practices.

9 These concerns currently are the principal focus of the market surveillance programs of many exchanges and regulators.

10 The Subcommittee on the London Communiqué of the Consultative Committee of IOSCO agreed that certain abusive practices transcend commodity and market distinctions and should be addressed on all markets to promote fairness, efficiency and market integrity, although the techniques and/or structural measures to address such abuses may differ.
Differences Among Markets from a Surveillance Perspective

Despite the great diversity among the underlying commodities on which futures contracts are based, as a practical matter, from a surveillance perspective, markets can be grouped according to their settlement provisions. A useful grouping is settlement by:

-- delivery of a physical commodity;
-- delivery of a financial instrument; or
-- cash settlement (including cash settlement by a foreign currency, as in foreign exchange contracts).

Contracts Settling with Delivery of a Physical Commodity

Derivatives contracts which require delivery of the underlying commodity may be subject to squeezes or corners where supplies of the deliverable commodity are finite and there may be significant costs associated with making delivery. This form of manipulation may occur solely in the derivatives market or in conjunction with a cash market manipulation.

Cash markets for physical commodities and financial instruments generally differ in liquidity and transparency. A given physical commodity may be characterized by wide variances in quality; relatively rigid, costly and slow modes of transportation between where the commodity originates and where it is needed for processing or consumption; and a paucity of cash price information. These factors, separately or in combination, may impair the effectiveness of the derivatives delivery process to arbitrage differences between the cash market and the price of an expiring futures contract. Appropriate derivatives contract design can help to reduce the potential for market abuse. (See “Design Guidance” and related discussion below.)

However, it also is the nature of physical commodities, and the manner in which they are produced, marketed and consumed, that may make the transportation of such commodities slow and costly to accomplish and that renders contracts on such commodities different from derivatives based on financial products. These factors can create opportunities for market users to interfere with the price formation process or to affect adversely the proper convergence of the cash and futures prices more readily than for other types of commodities.

Contracts Settling with Delivery of a Financial Instrument

Financial instruments, particularly for niche domestic instruments, also may have finite supplies, potentially making their derivatives or cash markets susceptible to squeezes or corners. However, the cash markets for the internationally traded financial instruments tend to be of a much more uniform (or even identical) quality, to have insignificant transportation costs, and to have a more transparent pricing system than do physical commodities. These factors tend to reduce the susceptibility of derivatives contracts on financial instruments to manipulation. However, the potential for intermarket
For example, if a derivatives on a debt instrument is based on a single security, actions undertaken to restrict the availability of that security in the cash market may affect both cash and derivatives prices.

Contracts Settling in Cash

Cash settled derivatives contracts, whether based on a physical commodity or a financial instrument, are not susceptible to squeezes or corners through positions undertaken in the futures markets. Consequently, trader position concentrations in cash settled derivatives contracts are less important than those in physical delivery contracts, except to the extent that those positions provide a motive for affecting the price of the underlying cash market. For these markets, the primary concern is whether the underlying cash price series or the components of the index itself can be manipulated to benefit a futures position based on that cash price. Indexes based on a thinly-traded cash market with few participants and infrequently reported transactions, for example, may be prone to manipulation.

Surveillance of Derivatives on Physical Commodities

Derivatives contracts that require the delivery of a physical commodity are most susceptible to manipulation when the deliverable supply on such contracts is small relative to the size of positions held by traders, individually or in related groups, as the contract approaches expiration. The more difficult and costly it is to augment deliverable supplies within the time constraints of an expiring derivatives contract’s delivery terms, the more susceptible to manipulation the contract becomes.

Pertinent surveillance questions for such markets are:

--Are the positions held by the largest long trader(s) greater in size than deliverable supplies not already owned by such trader(s)?

--Are the long traders likely to demand delivery?

--Is taking delivery the least costly means of acquiring the commodity--an economical means of acquiring the commodity for the market participant’s specific needs?

--To what extent are the largest shorts capable of making delivery?

--Is making delivery on the derivatives contract a more economical alternative than selling the commodity in the cash market?

Large open interest in an expiring contract could be driven by supply shortages and price distortions and, thus, is not necessarily an indication of manipulative intent.
--Does the derivatives price, as the contract approaches expiration, reflect the cash market value of the deliverable commodity?

--Is the price spread between the expiring derivative and the next delivery month reflective of underlying supply and demand conditions in the cash market?

An excellent barometer for potential liquidation problems is the basis relationship (i.e., the cash and future price difference) as the contract approaches expiration. When the price of the liquidating future is abnormally higher than underlying cash prices or both the derivatives and underlying cash price are abnormally higher than comparable cash prices, there is ample reason to investigate the causes and the motives of traders holding long futures positions.

**Surveillance of Derivatives on Financial Instruments**

Derivatives contracts that require the delivery of a financial instrument are less likely than derivatives on physical commodities to be subject to manipulation in the form of squeezes. The underlying cash markets for financial instruments tend to be deeper, more liquid, more transparent and more readily arbitraged than physical commodity markets. Nonetheless, certain of the questions specified above still pertain. In fact, surveillance personnel of the competent market authority need to be vigilant for circumstances in which the above-stated assumptions do not hold for derivatives on a financial instrument. For example, when the particular financial derivatives contract either provides for a deliverable supply that is of finite size or is a narrow segment of the broader cash market for the underlying financial instrument, the questions raised in the prior section on physical commodities become relevant.

In addition, price aberrations in the cash market for the underlying financial instrument may provide an indication of (or an opportunity for) an attempted manipulation. Surveillance staff should monitor cash prices for the financial instrument specified for delivery on the derivatives contract in relation to cash prices for non-deliverable instruments that would be close, or identical, substitutes in the cash market. Relatively high prices for deliverable—as compared to nondeliverable—financial instruments may be an indication of an attempt to remove deliverable supplies from the derivatives market as part of an attempted manipulation.12

Also, to the extent participants in the markets take positions beyond their normal trading patterns or clear financial means or capacity to take delivery or make settlement, this may be a sign of manipulative activity. Even if the activity is not manipulative, it may provide an indication of a potentially disorderly market, to the extent that default is a likely outcome.

12 Price aberrations also may reflect other market dynamics and need to be assessed in the context of the overall cash market.
Surveillance of Cash-Settled Futures Markets

The size of trader’s futures position at the expiration of a cash settled futures contract cannot affect the price of that contract because the trader cannot demand or make delivery of the underlying commodity. The surveillance emphasis in cash settled contracts therefore focuses on the integrity of the cash price series used to settle the derivatives contract. Since manipulation of the cash market can yield a profit in the related derivatives contract, staff should monitor futures positions of significant size and be alert for unusual cash market activities on the part of large derivatives traders (or their associates), especially in the period of time that the final cash price for futures settlement is determined.

Pertinent surveillance questions for these markets are:

-- As the derivatives contract expiration approaches, does the cash price move in a manner inconsistent with supply and demand factors and/or with other comparable cash prices that are not used in the cash settlement process?

-- Do traders with large positions in the expiring derivative have the capacity to affect the cash price series used to settle the derivatives contract?\(^{13}\)

-- What information can be obtained from the organization that compiles the cash price series regarding how the price was determined for the period in question? Did anyone report prices that appeared to be out of line with prices reported by others, and can it be determined if the party reporting those prices held a derivatives position that would be affected favorably by those prices?

Special Concerns Related to Equity Derivatives

As noted previously, equity derivatives raise additional issues which were not addressed by the Tokyo Guidances and which are not intended to be addressed by this Report. For example, the design of index products may raise surveillance considerations that were not addressed by the Tokyo Guidances.\(^{14}\) Some general observations may be made, however. Effective surveillance of financial derivatives and, in particular, equity-based derivatives, may require the type of enhanced coordination between markets essential to surveillance of linked markets. In some jurisdictions, derivatives contracts may be traded on different exchange(s) from the underlying equities. Separate government regulatory agencies for

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\(^{13}\) The answer may depend on how the series is determined -- by price survey or price discovery.

the derivatives and other markets also may exist. As there is potential for intermarket trading abuses, such as frontrunning, inter-exchange and inter-regulator information sharing arrangements are critical. 15

Other Factors Affecting Surveillance

The susceptibility of a derivatives market to manipulation, and hence the intensity of surveillance required, can be affected by factors other than the nature of the market for the underlying commodity. For example, the size and composition of the derivatives markets also have a bearing. If the derivatives market is small (i.e., total open interest), particularly in relation to the underlying cash market that would provide any needed deliverable supplies, the likelihood of a manipulation of the price of the derivative contract is reduced. Even a trader who holds all or most of the open contracts in a small derivatives market does not pose a manipulation threat if there is sufficient available deliverable supply to satisfy any delivery demand of that trader. Similarly for a cash settled contract if the derivatives position is small in relation to the underlying market, there is less likelihood that the derivatives trader would have the incentive or capacity to manipulate the cash price on which the derivative is settled.

With respect to market composition, the key factor is the balance between the capacity of traders to make or take delivery. Not all traders who merchandise, process or use the underlying commodity are physically or economically positioned to participate in the delivery process. Consequently, surveillance procedures must look beyond the distribution of speculative and commercial positions and the size of individual traders’ positions when assessing whether a threat of manipulation or market disruption exists.

The form of trading, such as open-outcry pit-based or electronic or both, also may affect how surveillance should be tailored and the actual methodologies used.

15 For example, in the case of equity-based index products, different contract designs may require more aggressive surveillance and added protections with respect to abusive trading or misuse of information, especially to the extent that the market acts like a market in a single security. Special intermarket surveillance and cooperation arrangements also will be required if the index’s reference is a thinly-traded cash market as there may be potential for price distortions or manipulation of the price of the instrument underlying the derivative. Where surveillance regimes must operate across or between one or more markets under separate governance and possibly supervision, market authorities may find that potential inter-exchange competitive issues should be considered in designing surveillance programs. Intermarket cooperation on surveillance issues will be enhanced where programs are developed between authorities responsible for the markets in advance of problem events.
II. APPLICABILITY OF THE DESIGN GUIDANCE TO OTHER EXCHANGE-TRADED DERIVATIVES PRODUCTS

- Many of the issues in the design of commodity contracts are generic to all derivative contracts. Accordingly, the basic tenets of the Design Guidance are equally useful to all types of exchange-traded derivatives contracts.

- Nonetheless, market authorities may need to place different emphasis on specific issues (such as delivery characteristics or cash settlement terms) depending on the nature of the underlying reference commodity and differences in the cash market.

As stated in the Tokyo Communiqué, contract design standards should be viewed as a complement to an appropriate surveillance system. In general, contract design standards are intended to assure that contracts are not readily susceptible to manipulation, that the delivery and/or settlement mechanism is reliable, and that the prices of the underlying and the derivative converge at expiration and, as a consequence, can serve a valid risk management function. Such standards also should maximize the economic utility and commercial appeal of such contracts by assuring that they can serve potential user needs to manage price or other risks. The initial responsibility for contract design generally rests with the exchange proposing to offer the contract. Contract design procedures should take account of whether either the cash or the derivatives side of the market can be distorted or can impair the pricing relationship.

16 IOSCO’s Technical Committee previously has determined that the following points should be taken into consideration in the design of all indexes, although the application of any particular point may vary depending on whether the index is broad or narrowly based:

- method of calculation;
- number of component stocks (degree of correlation or affiliation among component stocks and capitalization of individual component stocks);
- liquidity of component stocks;
- dispersion of component stocks within a business sector or across sectors;
- replacement of component stocks;
- selection of component stocks; and
- interaction of clearance and settlement with the cash market.


17 In this connection, the Subcommittee on the London Communiqué of the IOSCO Consultative Committee noted that they agree with the regulatory authorities that the general principles underlying the Guidance are relevant considerations for designing contracts, which facilitate their usefulness as tools for hedging and price discovery and assist in assuring the reliability of pricing relationships between the cash and the
The Design Guidance is relevant to financial derivatives, among other things, because:

- the promotion of harmonization and consistency of regulation among futures markets should be encouraged; and

- market innovation may result in contracts that combine elements of financial and commodity futures and, thus, permit price discovery and risk management on what are essentially financial instruments.

In general, the same characteristics of products that are relevant to market surveillance programs for specific contracts are also relevant to designing products which will have economic utility. As was stated with respect to surveillance, in the case of physical deliverables the emphasis will be on the nature of the delivery mechanism and the availability of the underlying commodity. In the case of cash settled products, the emphasis is generally on the method of calculating the settlement price and, in the case of index-linked derivatives, the design of the index used for making settlement. In each case the transparency and liquidity of the cash market is relevant to determining the elements that need to be emphasized in any review of contract design.

Appropriate contract design will enhance the ability to surveill a market in any type of derivative product, and market surveillance measures can be targeted to address those aspects of a contract that may potentially render it vulnerable to abusive practices.

### III. THE INFORMATION SHARING PORTION OF THE SURVEILLANCE GUIDANCE

Cooperative information sharing is an important element of market surveillance, supervision and enforcement particularly with respect to increasingly linked global markets and products. Appropriate and effective information sharing mechanisms are essential to maintaining market integrity, detecting, deterring and sanctioning potentially abusive or manipulative conduct, and reducing systemic risk for exchange markets involving all types of financial products. The Technical Committee of IOSCO has often stressed the importance of information sharing and has issued several reports on this topic.\(^\text{18}\)

\(\text{derivatives market, although there are certain areas where the Subcommittee’s views differ, reflecting the Subcommittee’s emphasis on the role of self-regulation.}\)

\(^{18}\text{See Principles for Memoranda of Understanding (September 1991), Mechanisms to Enhance Open and Timely Communication Between Market Authorities of Related Cash and Derivative Markets During Periods of Market Disruption (October 1993), Resolution on Commitment to Basic IOSCO Principles of High Regulatory Standards and Mutual Cooperation and Assistance (1994), Report on Cooperation Between Market Authorities and Default Procedures (March 1996).}\)
Most recently, and in response to some of the same issues addressed by the Tokyo Communiqué, IOSCO published *Guidance on Information Sharing* which identifies information relevant to regulators and market authorities in addressing specific types of market events. In many cases, market manipulation or abuse may lead to a market or firm crisis. Many of the information sharing elements contained in that document are also applicable to surveillance of suspected market abuse and manipulation.

The information sharing portion of the Surveillance Guidance recommends that market authorities should be able to access sufficient information about on-exchange and related cash and over-the-counter positions to identify dangerous concentrations of positions, to evaluate the overall composition of the market and to assess its functioning. This information is important irrespective of the nature of the underlying reference price. Knowing the whole position of a market participant in related exchange, cash and over-the-counter markets generally is necessary appropriately to assess the risk of the participant’s position and the nature of that participant’s trading strategies.

The Tokyo Communiqué Guidance states that commodity market authorities should take account of the guidances issued by IOSCO on information sharing, existing Memoranda of Understanding and the *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations* (Declaration”). The Guidance also identifies types of information about commodities activity that market authorities should be able to share with each other. This approach is similar to that taken in the IOSCO *Guidance on Information Sharing*.

Therefore, all of the matters discussed in the Tokyo Guidances related to information sharing apply to financial derivatives contracts and contracts for which there is not a finite deliverable supply.

*Over-the-counter contracts:*

The appropriateness of contract design or market surveillance standards for the over-the-counter derivatives markets requires careful consideration. There are significant differences in how exchange and over-the-counter derivatives products are traded. Also, over-the-counter derivatives markets are primarily dealer markets in which dealers enter into contracts as principals with other dealers or end-users as direct counterparties. Contracts may be tailored to unique risk-management needs, and standardization, as a consequence, may not be and, in some jurisdictions, cannot be an aspect of such contracts’ basic economic terms.

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The markets are not static, however. The over-the-counter and exchange markets are constantly evolving and may tend to converge in response to end-user demands and other factors, such as exhaustion of intermediary credit and expansion of electronic facilities for concluding trades and disseminating prices. It may be that, as the result of this evolution, much of the information considered in the Guidances discussed herein is likewise relevant to portions of such markets, although it is noted that the over-the-counter markets rarely are subject to specific, market-focused surveillance and contract review programs.

In view of the foregoing, the extent to which the Guidances are relevant to the various segments of the over-the-counter markets, and how such Guidances may be implemented, may require additional and complex analysis.

**CONCLUSION**

Based on the above, the Technical Committee concludes that:

- Many aspects of the Tokyo Communiqué Guidances are applicable to the oversight of financial derivatives markets and contracts not settled by a deliverable of finite supply.

- Regulators and market authorities may need to emphasize different issues depending on the nature of the underlying reference commodity and manner of settlement.

- The Guidances are a useful source of best practices for authorities to consider when conducting financial derivative contract oversight.