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This latest issue of the *Oxford Energy Forum* provides an update on the state of play of the world's oil benchmarks. The theme of oil benchmarks was examined in the February 2012 edition of *OEF*. The new edition is timely. In May 2013, the world of oil trading was thrown into turmoil by raids on the offices of Shell, BP, Statoil, and Platts (the price reporting agency), conducted by the European Union alleging collusion to manipulate prices. September 2013 saw the publication of a draft proposal by the European Commission for the regulation of financial benchmarks in the wake of the LIBOR scandal. The proposal, which also applies to commodities such as oil, has been described as 'draconian' and 'unworkable' by industry analysts.

The first section of this *OEF* provides analysis of the need, or otherwise, for such a tightening of the regulations on benchmarks, and evaluates the consequences for both the market and price discovery.

Opening the *Forum*, *Peter Stewart* writes that the decades of improvement in oil market transparency, achieved over the years by price reporting firms and exchanges, may be about to be reversed by the recent benchmark regulations proposed by the European Commission. Stewart notes that these rules are being rushed through before the results of an EU probe into oil pricing, that began with highly publicized raids on the offices of Shell, BP, Statoil, and Platts, have been made public. Stewart reviews the evolution of oil market transparency from the 1970s to the present, and concludes that oil markets in Europe have become less transparent in recent years, partly as a result of misplaced regulatory zeal. In contrast, oil markets in Asia have prospered, and have grown in transparency and liquidity in this period.

Liz Bossley says that the lack of any dénouement from the EU probe of oil prices does not mean that all is well in the world of oil price reporting. Bossley says that while oil companies have the motive, means, and opportunity to influence prices, she suggests that any distortion in prices is likely to be to be driven by a desire to push prices lower – in contrast to EU allegations that companies colluded to generate high prices. Bossley says that the Platts window – the period at the end of the day when companies' bids, offers, and trades are recorded for use in the daily assessments – may be

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vulnerable to non-arm's length transactions being done at 'off-market' prices, as Platts has no power to force any company to reveal all the deals it does.

Peter Caddy sees the European Commission's proposal for the regulation of benchmarks as flawed. Caddy says that the proposal has been drawn up on the assumption that the oil market, and all other commodity markets, are inherently like financial markets. The reality is that oil is a physical commodity with complex quality specifications, logistical constraints, and uneven liquidity. Unlike activities in the financial markets, oil contracts are highly non-standardized. Caddy says that these factors would make a European regulation that is designed for financial market benchmarks, such as the discredited LIBOR interest rate, inappropriate in physical energy markets. He notes that the Commission's proposed regulation goes far beyond the recommendations of the International Organization of Securities Commissions (IOSCO), which were endorsed by the G20 in November 2012.

Patrick Heren believes that the bias of regulators is towards tidy methodologies based on 'verifiable' data. He argues that this bias is leading potentially to the introduction of tightly prescriptive rules that would seriously distort physical commodity trading in Europe. Heren notes the EC's benchmarks proposal would set rules on who could contribute information to Price Reporting Agencies (PRAs) and on the extent of their participation in trades making up an index, as well as putting potentially unlimited financial liability on those contributing information. He argues that the proposed benchmarks regulation is likely to make energy markets more opaque rather than more transparent, and therefore more liable to manipulation.

David Fyfe and *Brian Lewis* describe the business model for commodity traders and how the trading business has been evolving over the years. Contrary to the general belief, commodity traders have been subject to an increasing array of regulations – which is not unexpected given their wide geographical reach and their involvement throughout the global energy value chain. However, the authors argue that authorities should be careful when introducing new regulations; otherwise these could result in some unintended consequences, with the ultimate effect of increasing the cost of energy to the final consumer. The authors also warn against the risk associated with treating commodity traders like financial institutions, as the two business models are fundamentally different; and hence they call for physical participants to cooperate closely with regulators to avoid the risk of inappropriate or excessive regulation.

The *Forum's* second section focuses on the evolution of oil benchmarks around the world, given the changing landscape of supply and demand for the different grades of oil.

Robert Levin opens the section on benchmarks by looking at the role of US pricing benchmarks, comparing these with Brent. He argues that US benchmarks are underpinned by market mechanisms based on straightforward designs; information about market fundamentals; and lack of artificial of barriers to entry, which leads to an active arbitrage process. This in turn ensures that US benchmarks, including WTI, reflect accurately supply and demand fundamentals. The author argues that this is in contrast to the Brent structure, where regular information about oil market fundamentals is missing. At a deeper level, Levin questions whether existing mechanisms in the Brent system allow a role for arbitrage, arguing that there is 'nothing that compels physical market supply and demand discipline to be administered through these mechanisms'. Levin concludes by arguing that unlike the US market benchmarks which reflect fundamental supply and demand (and are subject to confirmation by authoritative data), there is still a 'need to determine what are the prime driving forces in the North Sea market and whether fundamentals are at the core or something else altogether'.

Amrita Sen examines recent developments in the Brent system and argues that while the Brent benchmark is still responsive to global supply and demand fundamentals, it also responds to Brent-specific issues. Sen argues that there are three main factors setting the stage for a considerable increase in the volatility in Brent time spreads: the South Korean arbitrage; the introduction of the Platts escalator for assessing Dated Brent prices; and the greater sensitivity of Brent to European refining margins. The author discusses each of these factors in detail and argues that among these, refining margins will have the biggest impact and are likely to be a constant factor impacting sentiment about the structure of the Brent curve, especially given the current glut in global refining capacity.

Owain Johnson examines the prospects of new benchmarks emerging in the Mideast region. Johnson describes the recent dynamics in the region, such as the increase in refining capacity and the increase in domestic demand, which are leading to the development of new trading practices. According to the author, these changing regional dynamics and shifts towards increased regulation will have their biggest impact on the Dubai crude oil assessment, which suffers from low levels of trading activity and only a small number of participants. This will create opportunities for new benchmarks to emerge in the 'post-Dubai world', including consolidation of the position of DME futures contracts. Johnson argues that while many benchmarks could emerge, the success of any benchmark will be determined by tight regulation and a tight convergence with the underlying physical market.

Jim Henderson explores whether East Siberia/Pacific Ocean (ESPO) crude could become a new benchmark in the Asian region. Henderson argues that while it is clear that ESPO crude has changed the dynamics of the Asian crude market, it remains less clear whether ESPO can meet the conditions for becoming a benchmark crude. The article analyses some of these conditions and concludes that it is still some way from the emergence of ESPO as benchmark. The author identifies some of the key challenges, which include the establishment of 'a solid production base in East Siberia, a continued diversity of buyers and sellers, a secure quality assessment and, most critically, an improved perception of Russian political risk'.

Finally, *Jorge Montepeque* looks at the gyrations of oil and commodity prices in 2008 and after, and concludes that the core role of the market – that of balancing supply and demand through price – has worked well in this period. Montepeque traces the rise in the price of Dated Brent crude oil to above $145/barrel in June 2008, and its subsequent fall to $35/barrel later in the year. He argues that other commodities – such as coal, iron ore, and food, among others – experienced similarly sharp rises and subsequent reversals. Even if price volatility is painful, Montepeque argues that the market should be allowed to function without intervention.

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