

IRON ORE SWAPS – THE NEW MARKET PARADIGM

THE IRON ORE MARKET

Iron ore is one of the biggest dry bulk commodities traded and shipped. Total iron ore production in 2013 was over 2bn tonnes; seaborne trade was estimated at 1.2bn tonnes and worth approximately \$170bn.

The growth of spot trading in this huge market presents an opportunity for banks, traders, producers and consumers to manage price risk and exposure.

Trading since 2008, the iron ore swap has emerged as the leading instrument for iron ore hedging and risk management. FIS has been instrumental in developing the market; expanding the use of clearing and bringing unrivalled knowledge and unparalleled access for traders.

The first independent brokerage to offer iron ore swaps, FIS provides a daily forward curve to clearing houses globally to ensure an accurate mark-to-market assessment that supports trading decisions.

THE FIS IRON ORE SWAP

Until 2010, the majority of traded iron ore – up to 80% – was sold using an annual benchmark price negotiation. Spot trading was predominantly in iron ore fines driven by producers dealing with trading houses and mills.

But huge swings in the delivered price of ore and the emergence of a larger spot market saw the benchmark system finally abandoned in 2010 after failure to agree a level for the second consecutive year.

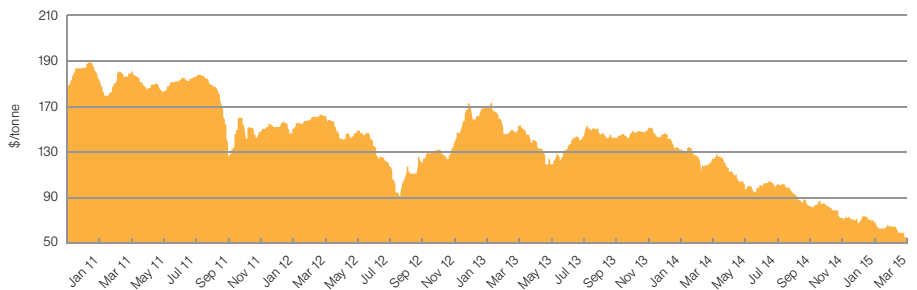
Since quarterly – and monthly – pricing have become established, iron ore prices have remained volatile, underlining the need for a dedicated, cleared swap contract to manage price risk.

To answer this demand, FIS has helped to pioneer the market for iron ore swaps, enabling better price risk management for users and traders and eliminating counterparty risk, thus managing financial exposure.

Already the leading freight derivatives and fertilizer swap broker, FIS was the first independent brokerage for iron ore swaps, producing the only independent forward curve as well as daily market information, comment and price history. In the first half of 2014, over 250 million tonnes of iron ore swaps and futures with a notional value of over \$26 billion were traded.

The cleared iron ore derivative contract operates as a cash-settled swap and a futures contract, with

62% Fe Delivered China (TSI)



Source: TSI

settlement against The Steel Index TSI, 62% FE grade product delivery North China. Trades can be made on a per month, per quarter or per calendar year basis and prices quoted up to 48 months forward.

The direct link to the clearing houses ensures the product is designed to meet the needs of the market, through elimination of counterparty risk and better cash management. Banks and funds as well as producers, shippers and end-users of iron ore can each use the swap contract to benefit their business.

The contract can be traded stand-alone or combined with a freight derivative contract to provide strong risk management.

IRON ORE OPTIONS – BUILDING INTEREST

As iron ore swaps become established as a fully liquid market, the next wave of risk management products is emerging in this exciting new commodity class.

The jump in iron ore swaps trading volume in the past few years has led to a rapid expansion of iron ore options volumes – indicative of the need to hedge against increasing volatility in iron ore prices. Underlying iron ore market volatility came close to 30% compared to the lowest of 7% in 2013.

Options are also of increasing interest to traders with exposure to the iron ore market as they can be efficiently tailored to physical positions and can provide a cost-efficient means of hedging.

FIS has expanded its cross-commodity options broking team to serve this market and has already attracted significant liquidity. The increased liquidity on the underlying iron ore swaps means the opportunity to trade options is growing very fast and is increasingly appealing for traders looking to hedge direct physical tonnage.

The closer integration of commodity derivatives in the swaps and options markets is a concept FIS has been advocating as the markets have become more volatile and unpredictable.

With physical iron ore contracts almost all now priced on a spot or index linked basis, more and more end-users are examining how to protect their margins on the underlying commodity.

Iron ore options provide the perfect vehicle for hedging and trading, cleared and in confidence.

For further details about Iron Ore Swaps or to discuss trading opportunities, call:

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