



# Metal-morphosis

The burgeoning global metals market is leading to new demand for processing and risk management applications, as **FOW** reports

Although some may suggest that the bull has had its run, pointing to a potential slow down in the global economy having a knock on effect on demand, the metals sector has nevertheless enjoyed a pretty exciting spell in recent times – both nickel and copper have hit all time high prices last year, driven by a combination of growing consumption, tumbling stocks and speculative interest. And many analysts predict that the long-term bull case for natural resources and industrial materials remains intact.

China, whose growing economy has been a major contributor to increasing consumption of base metals, has continued to have an impact on markets throughout this decade. For example, the country accounts for a quarter of the world's copper consumption.

Meanwhile, high levels of volatility seen in base metals have acted as a magnet to the ongoing surge of interest from hedge funds and pension funds, in search of new and alternative sources of alpha and performance, entering the market.

The consequence of this underlying activity is increased trading volumes in metals derivatives, both on and off exchange.

Activity from areas such as hedge funds, which some time ago was shunned by some in the market, is increasingly being encouraged by exchanges as it enhances liquidity. As a sign of this acceptance, London Metal Exchange launched mini-sized base metals contracts at the end of 2006. US dollar mini copper, aluminium and zinc contracts began trading on LME's online platform, Select, on 4 December. The

contracts are sized at five metric tonnes per lot, compared to the 25 tonnes size of the exchange's standard contracts, and are cash settled against the official settlement price of the full sized LME contracts. The products are mainly aimed at funds and anybody looking to gain access and exposure to the base metals market. "LMEminis are accessible, transparent and electronically-traded monthly contracts, and will appeal to all those looking for a simple way to trade base metals on the LME," says Martin Abbott, LME CEO.

LME's move mirrors a similar launch at New York Mercantile Exchange's Comex division with its introduction of e-mini base metals contracts (smaller sized, electronically traded contracts) on copper, aluminium and zinc aimed at the retail and fund markets. The products trade on the Globex trading system, which has a wider distribution network than LME's Select and already carries a range of mini-sized contracts that appear to a wider trading community.

Of course, other new products are also entering the metals sphere. While steel futures remain a little way off, plastic futures were launched by LME in 2005 and, although the contracts are only seeing moderate volume, the market expects them to gain traction as

they become more widely recognised as a risk management tool. Many observers point to the slow pace of acceptance of aluminium futures when they were launched some 30 years ago, adding that the same process will be seen in plastics.

These developments, along with the general move towards electronic trading, globalisation and new, emerging markets such as Shanghai Futures

**"It's about having all the information at your fingertips."**

Exchange and Multi Commodity Exchange of India (which uses LME prices to settle its own contracts in aluminium, tin and nickel), are putting new demands on the back office of the firms active in metals markets.

"As a trade market, LME presents more of a technology challenge than most people assume," explains Lester Doman, the product manager for Exchange Systems Technology's Eclipse Metals product. "In addition to the demands of the exchange clearing and settlement for listed derivatives, there is

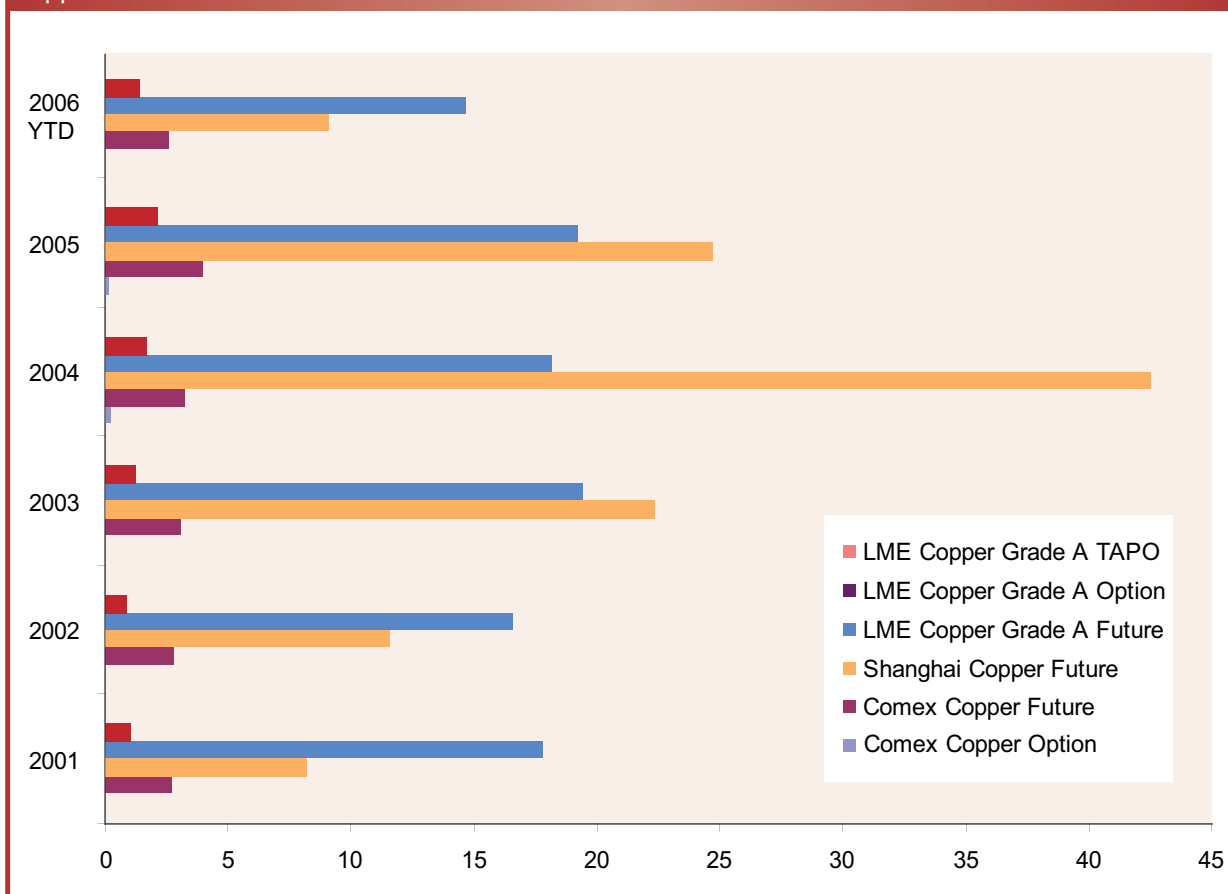
far more depth required of systems. Just being able to process the basic derivatives elements is not sufficient for LME members."

Eclipse Metals, which has emerged from EST's flagship back office technology, links directly to LME's matching system and allows customers the ability to process warrants, process and price Average Priced contracts and provide real time updates of clients positions and margins. It also manages resultant FX hedges and FX averaging and regulatory reports to LME and the UK's Financial Services Authority (FSA).

"Volatility in the metals markets has brought about short term juggling," says Doman, whose experience of the metals markets includes a stint at LME where he worked as a consultant on the project team managing a series of projects to bring new products, such as plastics, to the marketplace. Prior to that, he was chief information officer at Natexis. He is fully aware, therefore, of the alternative systems available to back offices in metals trading firms, and also aware of their deficiencies. "A lot of these systems are held together by people with very good heads and lots of sticky tape. When you get massive shifts in the market, up and down –



**Figure 1.**  
Copper Volumes (in millions)



and that trend is likely to continue for some time yet – how many people can tackle that without having robust systems in place?”

Eclipse Metals is also designed to provide flexibility to its users. It is web-enabled, with a client area for report downloads and enquiries, and is available as an ASP service, bureau or in-house. Users choose the approach best suited to their requirements.

“At the end of it all, you have a client trading,” says Doman. “And you want to know what that client is worth. You need to bring back all that trading activity to one number and one common base.”

“It’s about profiling risk easily,” adds Patrick Thornton-Smith, director of sales at EST.

Globalisation of the market not only means there are exchanges located in various time zones, but the users and clients too can be all over the globe. “People need to be able to keep an eye on their overall

**Figure 2.**  
LME Annual Volumes

2001	59,413,250
2002	58,634,004
2003	72,308,327
2004	71,906,901
2005	78,628,852
2006 YTD (to end Sept)	65,815,425

**“As a trade market, LME presents more of a technology challenge than most people assume.”**

positions, globally and in real time,” says Doman.

A global view is certainly necessary, but so too is an overall view of market positions across listed and

over-the-counter markets. Although accurate data is hard to come by, it is widely acknowledged that the OTC side of the metals business has grown substantially in the past five years. And that growth has also had an impact on what clients need to be able to monitor. LCH Cleargnet margins OTC contracts and systems such as Eclipse need to be able to manage those positions too.

Eclipse Metals doesn’t differentiate between exchange-traded and OTC activity. “The system treats listed and OTC as one product for position management and certain risk measurements,” explains Thornton-Smith.

Alongside the growth in OTC trading which LME itself intends to cater for with the launch of a new platform in the first half of 2007 – has been the rise in electronic trading. While LME maintains its floor operation, Select, its online trading platform, faces competition from other screen based platforms and expectations are, with the launch of

the mini contracts, of a potential migration off the floor entirely. The result of that growth in electronic trading is that market participants have to gather information on market positions from different sources, and have to do so in real time. "The impact on Eclipse is that the system has to take all the feeds from all the different sources and reflect what is happening in these markets straight away to the middle and back office," says Thornton-Smith. "Clients can then extract the data and information they need, either on screen, in a report or as a download."

Flexibility is the key to providing clients with what they want. In today's market, more people in an organisation need to have a view of the market at the same time, often on a global basis. And for a lot of the smaller players in the market, getting that information is proving more costly as the cost of technology escalates.

"It is important for clients to be able to view information and interpret it easily. As markets become more transparent, clients want transparency too. They want to know how you calculate their margins, for example," says Doman. Today, clients are used to

## Eclipse Metals features

- ❑ Updates client positions and margins in real time
- ❑ Detailed account enquiry screens with drill downs
- ❑ Shows alleged, unmatched, suspended and matched trade views of the LMCS
- ❑ Average trade pricing model
- ❑ Warrants (cleared – metals & plastics; OTC, financing)
- ❑ Manages resultant FX hedges and FX averaging
- ❑ Interfaces to external systems (LCH Clearnet, SWORD, Select and ISVs)
- ❑ Credit management (margin calls, margin diary, equity utilisation)
- ❑ Regulatory reporting (LME, FSA)
- ❑ Multi-currency accounting system
- ❑ Web-enabled
- ❑ Client area with report downloads and enquiries
- ❑ DR included in package
- ❑ ASP, bureau or in-house

having the same information as the brokers, so the brokers have to have the right systems in place to enable that sharing of information. "It's about having all the information at your fingertips," adds Thornton-Smith. "You need to know your risk profile, both your client risk and your traders' risk," says Doman.

There is a growing need for more people across an organisation to be able to monitor the various components of risk easily. Eclipse Metals has been designed to allow just that. "We have successfully managed to demonstrate the possibility of engineering systems for managers who do not need to remember more than their password access," says Doman. "There is a large part of the system that is not menu driven and is highly intuitive."

While analysts may argue about the long-term trends for commodities in general, and metals more specifically, it seems certain that volatility will continue as the balances of consumption and supply shift. "I don't see it flattening out," says Doman. And that means that the demand for technology that provides accurate, flexible and cost-effective risk management of metals trading will continue to grow. ❑

## eclipse: precision engineered metals

Eclipse Metals is a unique next generation Back-office and Risk management system specifically designed for the metals industry.

The system is a complete front to back application fully integrating with the LME Matching and Clearing System.

In addition to cleared LME and Comex products; Eclipse Metals handles all aspects of APCs (average price contracts) and warrant processing on a cleared and OTC basis.

Key benefits to users include dynamic autohedging of non-dollar products, real time measurement of P&L and net equity calculations, output and access available via a client internet portal.

LME, COMEX, Warrants, APC, Plastics, Bullion, OTC, FX, LMCS, LCH, Sword, Select...

For further information please contact:  
info@exchangesys.com

Tel: +44 (0)207 065 7550  
www.exchangesys.com

EXCHANGESYS 