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Days of Futures Past | Episode 7

Adi Imsirovic, Director at Surrey Clean Energy and Former Global Head of Oil Trading at Gazprom Marketing & Trading

This week on our *Days of Futures Past* series, we welcome Adi Imsirovic into the studio. SmarterMarkets™ host David Greely sits down with Adi to discuss the history of the Brent crude oil market and speculate on its future.

Adi Imsirovic is Director at Surrey Clean Energy, Former Global Head of Oil Trading at Gazprom Marketing & Trading, and Senior Research Fellow at the Oxford Institute for Energy Studies. He is the author of *Trading and Price Discovery for Crude Oils: Growth and Development of International Oil Markets* and the editor of *Brent Crude Oil: Genesis and Development of the World's Most Important Oil Benchmark*.

Adi Imsirovic (00s):
You know, we have the introduction of oil coming from the world's biggest producer in the world. So, you know, it's not a small thing. It's not just the introduction of another new field and North Sea or another grade from West Africa. This is a big deal. This is the introduction of a major crude oil from the biggest producer in the world. So everything sort of tallies up to make it quite a big event and something we haven't had in the past. All of this is now adding a lot more complexity to this benchmark that was already probably the most complex benchmark of any commodity in the world.

Announcer (34s):
Welcome to SmarterMarkets. A weekly podcast featuring the icons and entrepreneurs of technology, commodities and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together, we examine the questions: are we facing a crisis of information or a crisis of trust, and will building Smarter Markets be the antidote?
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David Greely (01m 15s):
Welcome back to Days of Futures, past on SmarterMarkets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Adi Imsirovic, Director at Surrey Clean Energy, Former Global Head of Oil Trading at Gazprom Marketing and Trading, and Author of *Trading and Price Discovery for Crude Oils*, as well as editor of the book, *Brent Crude Oil: Genesis and Development of the World's Most Important Oil Benchmark*. We'll be discussing the history and speculating on the future of the Brent Crude oil market. Hello, Adi, welcome to SmarterMarkets.

Adi Imsirovic (01m 50s):
Hi David.

David Greely (01m 51s):
Thank you for joining us today. On this podcast series, we've been discussing the past to draw lessons for building smarter commodity markets for the future and I've been looking forward to this because you've recently published a book in sort of the same spirit, looking back to the history of the Brent Crude Oil market to better understand its future and I believe the recent inclusion of WTI Midland Crude Oil in the Brent Benchmark Complex is what motivated you to write this book, or at least to put it together at this point in time. So I was thinking to start us off, maybe you could tell us what makes this such an important event in the history of the Brent Crude Oil benchmark.

Adi Imsirovic (02m 31s):
Thanks David it's a pretty good match you're right and I think the way we came up with the book sort of came, happened roughly this time last year. I was kicking around, you know, with some material from my previous book on, on trading and price discovery for crude oils and I spoke to a couple of my colleagues Liz Bosley and Colin Bryce, both of whom are sort of veterans from oil trading in the Brent Market and they thought it was a good idea probably to put something together, but I really wanted to kind of, you know, speed it up a

little bit for the introduction of WTI into Brent because it's such an important event as you just mentioned, and the reason why it's such an important event. Well, Brent has been global benchmark for crude oils and, and sort of one of these, the prices that you actually look at first thing when you wake up in the morning in financial markets, right.

Adi Imsirovic (03m 23s):
And it's been, it's been that key number for, for decades now, a true international benchmark and suddenly it's always been linked to the North Sea, to Europe and the North Sea. So that's reason number one. Reason number two is it's always been a DNFB loading contract and suddenly now we have a new contract that is going to be based on, on delivery of WTI into Europe. So that's the, the second reason, and probably the biggest reason is the fact that, you know, we have the introduction of oil coming from the world's biggest producer in the world. So, you know, it's, it's not a small thing. It's not just introduction of another new field and North Sea or another grade from West Africa. This is, this is a big deal. This is introduction of a major crude oil from, from the biggest producer in the world. So everything sort of tallies up to make it quite a big event and something we haven't had in the past. All of this is now adding a lot more complexity to this benchmark that was already probably the most complex benchmark of any commodity in the world.

David Greely (04m 25s):
Well, this is certainly a big deal, and it's certainly a complex benchmark, and I wanted to like go back in time a little bit with you though, because the, the history of Brent has demonstrated, I think what it takes for a benchmark to form, to grow, to evolve and adapt or not adapt and die and it remains to be seen if this will be the last chapter in the history of the Brent Benchmarker, just a new one for a benchmark that's evolved and adapted many times before. Now, I'd like to go back to the beginning because to borrow and twist a phrase from our guest, Michael Marks a few weeks back, the transformative events of the 1970s and 1980s made it inevitable that crude oil benchmark would form, but it wasn't inevitable that it would be Brent and so I was wondering your thoughts on what conditions laid the foundation for Brent to emerge as the international benchmark for global oil trading?

Adi Imsirovic (05m 20s):
Thanks, Dave, I listen to Michael's podcast and I thought it was excellent. I always enjoy going back to history because there's so much to learn from it and the events that we see these days as, as we speak in the oil market, remind us so much of the events in the past and that's how we learn and that's how we, I guess, adapt and trade in today's market. Just, just to probably. I'll just sort of revisit some points that Michael mentioned, but in a slightly different angle, I think, obviously yeah, there was a seventies were big. Initially there was a collapse of the horizontal control by the oil majors of the market with the Iranian revolution. That was the vertical so-called integration of the oil market collapsed and in many ways, actually, OPEC countries helped creation of the spot market because while, you know, kingdom of Saudi Arabia, Algeria, Venezuela refused to participate in the spot market, somewhat OPEC countries actually loved it.

Adi Imsirovic (06m 17s):
Iran, for example, used it almost entirely for a period of time just selling to spot markets and the reason was the fact that spot prices were actually higher than the, the so-called official prices but, you know, and so we had this period when, when OPEC is kind of losing control of the oil market, not to say in the book, in my first book, I said, I don't think they ever really were in control, because throughout 1970s, the markets were the due to growing demand. I think OPEC was simply riding the market. The market was going up, and they were just adjusting their prices up and up and up. But of course, as soon as that, there was this major collapse in, in in demand, and there was a massive, by the way, you know, we've seen this recently, Dave, with COVID, we've seen a big drop over 7 million barrels in demand.

Adi Imsirovic (07m 04s):
Well, here in the period between 79 Iranian Revolution 85 we actually saw a fall in demand of 8.7 million barrels, which is absolutely given that demand at the time was just over 60 million barrels. That was absolutely massive and at the same time, you have appearance of these new crudes coming from Alaska, for example, in the US coming from the North Sea, significant production. So OPEC actually, what we call now coal on OPEC, fell by almost 14 million barrels. It's just unheard of. It's ridiculous how, how big it was. OPEC really wasn't in control and if you can imagine now, OPEC trying to set their so-called official prices and markets falling, so every time they set it, the market falls and they're too high, and they just, they just had no control essentially of, of, of the market. That happens roughly at the same time when you have Ronald Reagan and Maggie Thatcher who came out, this is hugely important.

Adi Imsirovic (07m 58s):
Without this things probably wouldn't have happened. They liberalized the markets. In the UK we had the British National Oil Company, BNOC, there was a monopoly that was actually discussing quite openly with OPEC and negotiating prices. So Maggie Thatcher comes in and basically says, this is all nonsense and, and sort of gets rid of VOC eventually and gets all of that gets privatized. Also, this coincides with that, this process authorization where so-called Big Bang in the city of London happened where the whole financial industry gets liberalized. So you've got this wonderful merger of commodities and finance, the banks, US banks come to London to trade. Japanese banks come to London to trade Japanese players and traders, like what we call sogo, came to trade at the same time. So we have this wonderful ecosystem, which is so sort of fertile ground for sort of creation of, of trading environment. The last point I think, which I think everyone agrees on was the, the, the fiscal or tax system in the UK that sort of just facilitated movement of oil outside the integrated systems of major oil companies. Normally they could have kept it in inside, but the tax system was such that actually as we'll probably discuss in a minute, you know, we'll facilitate that oil to come out into the market space.

David Greely (09m 21s):
Oh, there are so many great points you made in there. I love the, the piece of calling out the decline in demand. So what you often see in commodity markets is that in excess of supply tends to create spot markets and a shortage of supply tends to create forward markets and it looks like in this case, correct, it helped really support the spot market. and I wanted to get back to the point about the, the tax policies, because with any new market, there's always trying to get those initial volumes that can create a pool of liquidity. And a lot of that in the, in the UK market from my understanding, was attributed to tax spinning brought around by, by the fiscal policy. So I was hoping you might be able to describe for our listeners what was meant by tax spinning and how important was it for creating those trading volumes and the liquidity in the early Brent market.

Adi Imsirovic (10m 08s):
Dave was hugely important. I think it was one of the key elements. Obviously there were several as I said, but that was a key one and I'll just probably simplify it a little bit for, for the listeners because obviously nobody likes to listen about tax too much. And every time I mentioned tag to my wife, she just goes, I'll forget it. She just switches off. Anyway, so tax, basically the idea is if, because you have integrated oil companies in the North Sea, they have their exploration production and, and then refineries or is as in industry speak, we say there's upstream and downstream. They can literally produce their oil and then put it into their own refineries, in which case we don't have a price, right. I mean, they can put whatever price they want on that, but if there's no price, how do you tax them.

Adi Imsirovic (10m 52s):
So of course, you know, the governments need some sort of price assessment and they look at other markets, whatever is any available information out there to sort of set the price. So now you have some sort of, let's imagine long-term, let's say average month, it was average month sort of rolling average prices assessment of, of the value of brand. Now, if you are a major old company, let's say I'm a trader and I was, and I did this sitting in as I was in Texaco office in London, sitting and looking at the average prices of, of brand, let's say average price today are $80 a barrel, which is, and tax reference price is $80 a barrel, exactly the same as the market price. I don't really need to do anything because everything's fine on equilibrium, but let's say there's a sudden fall in, in the spot price to $70 a barrel, suddenly spot price is $70 a barrel.

Adi Imsirovic (11m 45s):
If I sell my cargo rent, I will get taxed at $70 a barrel, not $80, which is a tax reference price. Then what I can then do, sell their cargo at $70 a barrel and buy from another major, a brand cargo, okay, at $80 a barrel and put in bio system. So the net result is I get taxed on 70 rather than 80. Now, the key to this whole equation was the fact that trading was taxed only a corporate tax rate and upstream was taxed at additional tax rates. So they were different. So it was a perfectly legal tax loophole, which was closed over a period of time, which was being closed. But that facilitated big companies with big integrated systems not to keep it in the system and keep that sort of price secret, but actually to release the barrels into the marketplace and either directly to another major or by intermediate which also happened to grow in the 1980s and, and trading companies that came in to facilitate those trades.

David Greely (12m 47s):
Such a fascinating piece of the early Brent market that, you know, a way to unlock those transactions that were occurring within companies and have them move to the market where they could be visible. And there's always different things in every market like that but, you know, we often see a pretty broad pattern over the life cycle in commodities markets that kind of repeats from market to market. And that's, a lot of these markets begin with integrated firms and long-term contracting, and then that evolves into bilateral trading in the physical markets. Eventually an O T C over the counter market may develop, and then eventually as that becomes more

robust in exchange traded futures market. And I'm curious, how did the OTC forward markets develop in Brent and how important were the price reporting agencies in creating Brent's rise to being a global benchmark?

Adi Imsirovic (13m 39s):
Right, well, we are going now into one of the chapters written by a colleague of mine, Colin Bryce, who was head of commodities at Morgan Stanley global head of commodities, Morgan Stanley. And, and also at the time he was trading Brent. Basically what happens now is you've got, I think when we stopped at sort of development big bang in London financial markets banks coming in, Soho's coming in, you've got also one, one interesting thing which your listeners may not know is traders come in and the reason traders come in is not just to speculate on the price. There is obviously a big element of that, but there was, with Brent, something peculiar was called tolerance. So if you, if you buy a brand, the end user can lift either plus my or minus 5%, which is on a 500,000 cargo, 25,000 barrels.

Adi Imsirovic (14m 29s):
So it's a swing of 50,000 barrels. So obviously if you buy it at high price, you want to minimize the cargo, you want to lo what you want to load as little as possible or 475,000 barrels, or if you bought a low price relative to the market, you maximize it. So now these companies discovered a whole new game where you can actually have a lot of buys and sell and actually construct these chains where you could actually do buy, sell by sell by sell at the end, keep the cargo maximizing or minimizing that volume. And in fact, on, on one cargo, you can make in theory, over a million dollars. Okay, just by having lots of buys and sell. So that's another thing that's not very often mentioned that this tolerance game actually, it made people go in and actually quite happily trade as much as possible because that would give them a whole range of prices.

Adi Imsirovic (15m 20s):
We called it on our boards because we literally have boards on the wards and have buys and cells, and we would have all the brand physical trades on i e cash trades on, on the board. So that was quite interesting as a development. The, the other one was Sogo, they were quite happy to go in between for a smaller, you know, margins. They also in increased liquidity in the brand market and then of course PS came, you know, came back from, you know, us from Warren Platz, I think it was in 1900s. But when Rockefeller and his standard oil were disband, you know, through anti-monopoly regulation. But of course, suddenly companies, you know, like Platz suddenly have a fertile ground because the governments want them, because the governments want to know what the price is for tax reasons.

Adi Imsirovic (16m 11s):
Companies want them because they want prices. Cover brokers want them because then, then they can refer to some sort of set price at the end of the day. So they suddenly start playing a very, very important role. So you have a number of PR what we call them, like Platz Argus, which is Argus Media. Today you have London oil report in Japan, you've got Rim and so on. Everyone gets involved. So with a number of brokers, you've got this whole ecosystem and it becomes particularly important in rent market where suddenly because of the volatility in the 1980s, so-called physical or dated brand becomes really important. And a lot of people don't get the difference between forward and data brand. It's very simple. Data brand is a forward brand with dates it has a dates attached to it, which means it's kind of turning physical, it's going to load. Okay. So PRAs now go and actually look at this data brand. They, they see the trades, they set the prices, and very soon because of volatility, companies go out there and say like, well, we, we don't want to trade fixed prices way too volatile. We we're just gonna trade our accrued relative to this great new benchmark, which is very liquid, and it's called dated brand. So and we still have it today.

David Greely (17m 27s):
And it's pretty fascinating in that, you know, when you talk about this ecosystem that was kind of primed to be trading oil at that point in time with the banks, the quote unquote Wall Street refiners, the physical traders, I think often people think, well, there's a physical spot market and then there's a forward or futures market, but Brent shows there can be many things in between and many innovative types of financial contracts that sprout up to kind of tie the members of this ecosystem together. I was curious, were there any like, innovative developments in the OTC market in those early years before the futures contract that helped to lead to the creation of a futures contract?

Adi Imsirovic (18m 05s):
Oh, absolutely. If, if you just allow me to take a little step back, just as an introduction, we, I always say in Brent, the, the complexity comes, Brent, over time evolved a little bit. Like sort of, you know, if one believes in evolution, a human of human body, I mean, we've

got an appendix, do we need it. Well, not really, but it's there. Is it pretty? No but it's there, it probably doesn't function, you know tonsils wisdom teeth and, and so on and so forth. They, you know. But one important thing, which I say time after time was when we had the crisis of 2020 in April, 2020, as we know, WTI were negative, well, negative. And you spoke about it early on, a lot of benchmarks such as WTI, Dubai, INE in China had lots of problems, but Brent didn't.

Adi Imsirovic (18m 55s):
And one of the reasons why didn't have problems was this complexity actually proved to be a strength rather than a weakness, even though people don't particularly like it. Anyway now, going back to directly to your question, following the development of Ford Market, at the time, in the early days, brand was trading at 600,000 barrels, which is quite a big volume on the F4B basis. So, you know, smaller players are on the upstream and downstream if they want to do some hedging, they had a problem. You either trade a whole cargo, you get nothing. There was no futures contract. There was, you know in, in 83 WTI futures contract. But until then, and even after then WTI or TI as we often say, you know, had a bit of a basis risk, they come to Wall Street players such as, such as the likes of Morgan Stanley, Goldman Sachs, and everyone else.

Adi Imsirovic (19m 44s):
They come in and, and, and I think, I think it was Morgan Stanley that came, came up with the idea of cash parcels, so called cash parcels. So you'd only have forward contracts at the moment, no futures and they would go to smaller players and say, look, cargo is 600,000 barrels, but you have to, you have to do some hedging, maybe you don't know at this stage, could be 300, 400, we'll just trade a hundred at a time or 50 at a time, whatever the volumes and then as we come to the end of the month where the contract expires, we either build it up to full cargo, if you wish, or we just book what so-called book out or it's kind of financial settlement, right. So that was a contract that actually was developed and worked like a dream. It was a great contract. Smaller players loved it. It was totally based on the forward contract, which is the existing Brent Ford contract and that was a pretty much, I mean, my opinion, a precursor to the first successful IPE brand contract because there were two earlier ones that were not successful. They're based on delivery in Rotterdam in 83 and 85, and they were not successful and finally when they copied this cash partials contract, actually it was a success.

David Greely (20m 57s):
And that's interesting. So now, let me see if I can wade into the complexity. So you have the forward Brent market, which is based on delivery, physical delivery of a full cargo. So that's something like 600,000 barrels. Then you have, you know, and those forwards have months, but not days attached to them. So then you have the dated Brent market, which has a date when you have to deliver. Yep. And then I'm curious because, you know, if you look at the, on this side of the Atlantic, the NYMEX WTI crude oil contract, like the Brent Forward market specified physical delivery, the International Petroleum Exchange, which introduced the Brent Futures contract. Now of course it's owned by ice, you know, went with this financially settled mechanism, and you said a previously physically settled one didn't work. So I'm curious, maybe you could take a little bit more into why did the IPE choose the financially settled route?

Adi Imsirovic (21m 52s):
This is, this is Dave. This is really interesting point because not just because of history, but because of, you know, what can be learned from it today for some contracts, like I've been involved, I've written the papers on, on the Melbourne contract, there'll be new contract, these old futures in the Middle East and Allman contract and so on. Basically what happened, it was very, very simple. I think it was 600,000 barrels, as I mentioned, for smaller players, was just too much. It was just too big. Now, of course, for listeners in the United States, you know, you, you can deliver 1000 barrels into Cushing and no problem. But that's obviously because it's pipe, these are pipeline barrels, and you've got a lot of storage. So storage is a key here. You've got 60 million barrels of storage. You Cushing you can deliver it whatever you want, you can chop it up way you like it or not.

Adi Imsirovic (22m 39s):
Whereas with brand, you basically have it delivered in tank waiting for a ship to load full 600,000 barrels. So there wasn't much of an option there to have a physical delivery, I don't think it would've been particularly successful. And the reason now, you can kind of take that lesson on and, and I traded DME, which is, the DME contract in the Middle East DME Oman from day one until about 2020. And one of the problems was always towards the expiry. It, it becomes extremely volatile. It's a physical delivery contract. So you go along Oman, 500,000 barrels, and if you've got last 2020 lots or 20,000 barrels to buy on the last day and liquidity di dries up, you get ridiculous volatility because everyone panics, I only have to buy 20 lots And let's say offer is about $5 above and or there's no offer whatsoever.

Adi Imsirovic (23m 33s):
And you go like, well, I can't deliver now. So the problem is with contracts with no alternative delivery, they are physical and you can only deliver a whole full cargo. They really exclude a number of players. So they asked, when the BME was trying to develop it, they asked, you know, people whether they wanted a financial contract and they said yes, but they didn't trade it, but they So it's a catch 22, you know, you've got to have a contract that should be trading. It is trading fine, it's actually doing reasonably well, but this size excludes a lot of players. So you get volatility in the last days of trading. And I'm sure that's the case with some other commodity markets out there.

David Greely (24m 14s):
And so then I would imagine the forward market with the physical delivery continued to be utilized the dated Brent market, which is closely connected to that forward market, provided the, the prices that then the futures contract could be cash settled against. So you kind of, I guess why people refer to it as the Brent Complex you have All these different markets under, under that overall heading of Brent and so did the, I guess the, the producers and the big players would continue to use the forward market and then those who aren't active in the physical market would use the, would use the financially settled futures, is that right?

Adi Imsirovic (24m 48s):
Yeah, and also the nice thing with brand over time, you've got another thing which is called EFP, which you have in other markets as well, which is a change of physicals for futures for physicals. Okay. So you can actually change your, if you want, change your position from physical to futures. And then a couple of other really important things that happened in the meantime was CFD is one of the most important developments we know, see what CFD means, contracts for differences. But there were in, there were used in the brand market really, really early at the end of, in the late 80s, early 90s and essentially the need they developed because of a real need I mentioned earlier, volatility. So you're trading a lot of forward cargoes on fixed price basis and then you, you have this dated brand as well.

Adi Imsirovic (25m 31s):
When they turn dated, they become sort of dated and a lot of oil trades on dated floating basis. So if you wanted to change the pricing from fixed to dated or from data to fixed, you, you could utilize this CFD market and then it really exploded. I remember I was young trader in 91 in London, it was at CFD, it was just exploding and it was, it was, it was crazy how much it was trading, but it was brilliant because you could easily change your fixed price into floating and float the fixed price or, or have both legs floating. So it was a great market and eventually had a, something called a DFFL market, which is dated to frontline average month and if you were a refiner trying to hedge your margin, usually you do it over a whole month, you could utilize those types of swaps as well. So you've got all these terrible acronyms in the brand market, EFPS, DFL, CFTs whatnot. But, you know, it's, it's pretty crazy out there, but it works.

David Greely (26m 26s):
Yeah, you can tell how early in the history they were developed, right. Or else we would just be calling them various flavors of swaps.

Adi Imsirovic (26m 32s):
Yeah, absolutely. In colors or something easy to remember. Yeah.

David Greely (26m 36s):
Right, right, well, I feel like we, we've kind of gotten to almost the high point with Brent maybe in that, you know, Brent became a leading international crude oil benchmarks used to set the price of the majority of the world's internationally traded crude oil and other products as well out there like LNG and Asia and other places and contracts. But of course, things change and the physical oil market on which the Brent financial markets are built, changed as production of Brent and North Sea crude oil fell and so the process began of adding more oils to the Brent Pool, first other North Sea crude. and now as we've discussed for the first time, a North American crude oil, WTI Midland as an oil trader yourself, how does this pooling affect how the benchmark trades you know, there's always this tension between you want to add more to the pool so that you create liquidity. But you also want the stuff to be similar enough that you can trade it as the same thing more or less. So you want those components to be similar to one another. So how do you see those tensions balancing out?

Adi Imsirovic (27m 44s):
It is a, a bit of a tension. You're absolutely right. And the tension I think comes from the diversity of players. From trader's point of view, it tends to be easier because if you're pure, what we call proprietary trader, all you really care is getting liquidity and getting the values.

But you've got in the brand, so-called complex, you've got a number of people who are upstream producers who are refiners and so on and so forth and they, they do have a problem with that a lot more and obviously there's always some friction coming in from new grades being evolved. For example, refiners don't want to be delivered if, if some, if a refiner is in a forward market, they don't want to be delivered the grade they don't expect. So the idea developed by PRAs which I think is an excellent idea, was that the lowest grade sets the price, which basically means that well, if somebody delivers you better crude, you get it, you get a really good price.

Adi Imsirovic (28m 41s):
So if you're refiner, for example, and you get eco fist that's worth $2 more, you get it delivered and there's something I don't want to bore your listeners where there's something called QP or Quality Premium. Yes, there is an adjustment. So if you get an EQU Fisk, you, you have to pay a little bit more, but you pay only about 60% more. So you actually get a, a great benefit out of this new crude. So that's the way sort of this alternative delivery has been eased into the refiners as far as far as the sort of sort of suppliers or sellers into the contract. It's always easier when you have, when you have alternatives and I mentioned with Oman, as a trader, I always prefer liquidity than basis risk. So if it's gonna cost me a little bit more, I don't mind, as long as I know I can easily perform.

Adi Imsirovic (29m 31s):
So the fact that introducing more crude oils makes it a lot easier for a trader to be comfortable with the performance. If I cannot get brand, I can look at forties. If I can't get forties, I'll look for Roseberg and so on and so forth. So on one hand I think that works out well. And on the other hand, for refiners, they just get better crude at low prices. So that's not too bad either. So that's kind of the, the way the whole ecosystem's developed and has been working reasonably well similarity. I think just if you don't allow me to address that, because I think it's an important point, point because this whole process of changing brands been lasted well over two years and the series contender was Johan Swerdu, which is which is another North Sea grade produced in Norway. One of the key reasons, not, not the only one, but one of the reasons why it, it has not been accepted by the industries is just the quality. It's much heavier, it's much higher sulfur, and it really kind of sticks out as this is like sore thumb in on, you know, between, in that sort of brand basket whereas WTI Midland actually is very similar to Equa Fisk. So it fits very well from the quality point of view into the, into the brand basket.

David Greely (30m 47s):
Yeah and as you said as you broaden the basket, it kind of moves to this cheapest to deliver type world or type market and that can be good for refiners, can be good for traders, because you're keeping the liquidity going. I imagine producers are the ones who aren't thrilled with it because they're only gonna want to deliver the crude they're getting paid for, which will, which will be the cheapest grade. Is that right? What do they do? Do they tend to like not go to the market or do things in a different way?

Adi Imsirovic (31m 12s):
Well, that's something that we can come back to. It's something a little bit technical. When accrued becomes a, a benchmark, very important benchmark, they are quite actually happy about it and we can talk about it in, in terms of WTI in Midland, what tends to happen is when, for example, when forties was introduced into the rent basket, the value of forties increased and that's, I will argue will happen. We've only had a few weeks, so we can't tell now will happen with WTI Midland as well, which will be a good thing for the producers and the reason is that if you have this grade that's being, that you can now deliver into major global benchmark, you have additional optionality and optionality, as we know in markets, always been worth something, right. So as a rule of thumb, I would say the forties improved over time, but at least $00.50 a barrel at least maybe 70 and I would expect WTR to do the same.

Adi Imsirovic (32m 04s):
So that sort of that's another thing that helps the producers, right. So rather than, rather than sell it, and as many producers in the US will find out soon, you know, you can sell your crew the old fashioned way, turn barrels or sport barrels, but now suddenly you can just go and say, okay, I know I've got Midland Cargo, 700,000 barrels in December, I can just sell it into Brent and it's a great option to have because it's a very liquid market. It's easy to sell the whole cargo very far forward and gives you an additional optionality.

David Greely (32m 38s):
Yeah. I'm glad you pivoted to thinking about what's currently happening in the market and what it might hold for the future. So I want to talk some more about this inclusion of WTI Midland. First off, just for some context for our listeners, , I think many people are surprised that following the 25th 15 lifting of the US ban on crude oil exports, US Gulf Coast's exports of WTI Midland, quality crudes to Europe have become quite substantial in the intervening years. I think your book quotes a number of over 1.1 million barrels a day in 2022 and in context that compares to the other five crudes in Brent that are less than 700,000 barrels a day. So, you know, much bigger than the other crudes already and further that WTI has been the cheapest to deliver price setting crude for much of that time. Now that

my price might go up, as you said, but I want to ask you about the implications of that does that mean that Brent may lose its role as a benchmark and could simply become a spread or basis differential to WTI in the future? You know, will it just trade? Will Brent become w t i at the Gulf Coast plus freight

Adi Imsirovic (33m 49s):
Yeah, I mean that's a really fair question, and that has been a topic of discussion for quite some time. Of course, everyone has, has their own, have their own angle to the fact. Let, let me start from the back, from the last point that you made WTI US Gulf Plus trade equals Brent not really simply because US Golf WTI is not a benchmark at the moment. It's Cushing. So, and US Gulf is just a spread to Cushing. So yes, you can do Cushing plus, you know, pipeline plus freight and then get to Brent, which, which is great and I think if anything, they're just a good thing because it just brings together two most important benchmarks in the world. Okay. You know, WTI could have been probably the key benchmark before I would argue if, if it wasn't for the ban export ban.

Adi Imsirovic (34m 40s):
Okay, but now with the export ban, the next question becomes, is it going to flood the brand market, because currently, yes, I mentioned in the book when we were writing is just over 1.1 million barrels, but we've seen months where we went over one and a half million barrels, especially now with the, with the War Ukraine and the Russian barrels being moved into Asia. So these are huge volumes. So it's roughly double, almost double the volume of, of the brand benchmark. But as I said, I don't think it is going to be at least not at this stage going to happen. Now, a big question, you know, talking about future is Cushing going to remain as a benchmark rather than us Gulf because with being, being one of the biggest exporters in the world, it would or second biggest exporter in the world, effectively, it would make sense to have a benchmark in the US Gulf, but it's really for the buyers and sellers in the us market to decide not for me.

Adi Imsirovic (35m 36s):
So whenever you have these changes in flows of oil you, you do have tendency for benchmarks to swap and change. But in the meantime, , I really, I actually don't see it because original, my original idea about inclusion of WTI and brand came quite a long time ago. I wrote my first paper on the subject in March, 2019 okay and the reason was I was talking to a US trader who basically said, well, you know, as soon as we as, as WTI hits the water, it becomes a brand effectively and it just, all sorts of blight bulbs started flashing and I was thinking like, well, obviously it is because it's not, people get a little bit carried away almost like supporting their teams TI or Brent or Dubai, whatever, as if there were teams. It's from the trader's point of view, it, it's really about that number being convenient.

Adi Imsirovic (36m 26s):
Brent, we all know is not Brent. I mean, they're only two or three cargos of Brent a month, and it's, it's a trickle. In fact, some people, some big players are arguing for exclusion of brand from the bare brand basket because bit of a nuisance, you know, but it's just a brand name and just WTI has become a part of their brand name and I don't know if your listeners are aware, I mean, a lot of, most people in the old market are aware that it actually, the whole idea of this alternative delivery came from NYMEX because in, in the mid-80s when there was a big crash in the price of oil, a number of wells in the US over, I hear over 20,000 wells were shut and there was simply not enough oil in the contract.

Adi Imsirovic (37m 08s):
And which felt about hundred thousand are open contracts, and they invented this alternative delivery, and Brent became part Brent Bonney light and some other sweet fruits were deliverable into Cushing up the pipeline, which was going the wrong way. Well, currently opposite of what it is doing now and I remember as the young trader, and, and I think it was 91, 92, we delivered one light into, into Cushing, and it worked, it worked just fine. So I, that's one of the reasons why I think, you know, why shouldn't WTI be part of Brent?

David Greely (37m 41s):
Right ,otherwise, it's, you know, right now it seems like it'll just become a, a spread to a spread with TI Cushing TI on the coast to the, from the water on the coast to the water in the North Sea.

Adi Imsirovic (37m 52s):
Well it is a little more complicated than that. Sorry to interrupt, but, but because this is what was going goes into Brent is Midland and it's not necessarily stuff that comes from Cushing is a stuff that comes from, from the, from Midland with very specific quality. So yeah,

David Greely (38m 08s):
No, it's a good point and you, you've warned me that you crude oil traders are not a sentimental lot in, in how you think about these things and there are differences of opinions, but I think you're a little bit more optimistic about the future of Brent as a benchmark than some others may be and I was curious, what in Brent's history gives you that optimism for its future, if it is optimism, and what do you see as the risks to Brent as a benchmark in the future?

Adi Imsirovic (38m 34s):
Right. Well, that's a great question. What I find interesting in this whole set of exercise was that people, generally, people who do not like this idea of inclusion of WTI and additional complexity tend to be older traders and they just don't want to know. It's, when I speak to some younger guys some really bright young guns, they're like, no, that's alright. It's, no, it's not complex. You know, you just put in the spreadsheet and it's fine, you know, it works. So it depends which kind of point of view you take. I'm not a young gun anymore, but I think, I think it's manageable. I think it's doable. You know, I start Dave, I start, first of all with a very pragmatic view. I, you know, what were the options for the brand market.

Adi Imsirovic (39m 20s):
You know, in my last job, I was hedging LNG about 15 years out using Brent, dated Brent. Of course, we can't, couldn't hedge 15 years out. We we're hedging about five, six years out and then rolling those hedges further out. The reason I'm mentioning this is that there's a huge open interest of these contracts out there that people have. So if we were to materially change Brent, or get rid of it, as some people were suggesting and come up with something new, new, you would have to get rid of all these contracts and the, I dunno, tens and god, nobody knows, tens and millions of barrels of, of, of these, not just paper contracts, but physical contracts as well. All of that would have to be totally renegotiated. So the industry has, has had a vested interest to make it work. Okay.

Adi Imsirovic (40m 07s):
And trust me, I've been involved in it quite a bit. It's not, nobody wanted com complexity, complexity came out as a result of historical events as a result of taxation, as a result of legal issues. So we have originally the know, the intent of the industry was to have WTI FOB loading, but number of players could not accept a sort of potential involvement of US jurisdiction and tax. Okay, so now we basically pass the title in the sort of outside territorial waters on delivered basis. So that should eliminate that. So that complexity came out as a result of trying and circumvent all these, all these problems. For being very pragmatic, I think this is probably the only way Brent could have been reorganized, but as I mentioned earlier, I think Brent worked well in WTI.

Adi Imsirovic (41m 03s):
So I see no reason why WTI shouldn't work well in Brent. It's a great crude, it's very similar to the North Sea. It comes from a country, you know, free country that will not put any, is very unlikely to put any further restrictions on destination and so on and so forth. Like we have with many other types of crude oil, it's freely traded, you have very transparent prices. We use, you know, for brand, we use English law, which is just an excellent law for transactions. So, you know, the, the problems will happen for sure. We always said Kurt Chapman and I who wrote several papers together on the subject, there will be some bumpy rides. I don't want to get too technical, but you know, on, on at the moment, I think the key is, is convergence. I think you've had it in your podcast early on in every futures contract.

Adi Imsirovic (41m 48s):
Convergence is absolutely essential. So you have to make sure that that dated brand, which is the physical side of Brent and that futures brand actually converge. I think that there'll be some little bumps there, but there, there's nothing that cannot be fixed. And one of the reasons they can be fixed is that you've got so many of these crazy brand instruments that you can fiddle with, you know, sulfur adjustments, QP, which is quality, premium adjustments, you know EFPs, DFLs CFDs and whatnot. So yes I think this is probably the right way to go and I think judging by the first month of trading and the brand market has been absolutely remarkable. It's exceeded my expectations. The number of cargoes traded, the number of cargoes chained from, from Midland has been exceptional. So gives me a lot of material for me and mate Kurt, to write another paper.

David Greely (42m 44s):
Thanks again to Adi Imsirovic Director at Surrey Clean Energy, Former Global Head of Oil Trading at Gazprom Marketing and Trading, and Author of Trading and Price Discovery for Crude Oil, as well as editor of the book, Brent Crude Oil Genesis and Development of the World's Most Important Oil Benchmark. Join us next week when we continue our time in Europe learning lessons from the past to build a better smarter markets future. We hope you'll join us.

Announcer (43m 11s):
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Announcer (44m 18s):
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