

Hedging price risk

*Dr Alexander Ressos, TEP
Attorney-at-Law (Switzerland), Solicitor (Hong Kong),
Solicitor (England & Wales)*

The trader's margin comes from differentials between places, times, qualities and forms, but a movement in market prices between purchase and sale could wipe it out. He therefore hedges his price risk by means of derivative instruments — futures, options, swaps — traded on the commodity exchanges or over the counter.

The mechanism is simple in principle. When he buys a physical cargo, the trader simultaneously sells futures contracts on the same commodity for an equivalent quantity, and then buys the contracts back when he resells the cargo. If the price has fallen in the meantime, the loss on the cargo is offset by the gain on the contracts, and vice versa. The trader retains only the risk on the differential between the physical price and the futures price, known as the basis, which is generally smaller and more predictable.

The principal commodity exchanges are found in Chicago for cereals, in London for metals and North Sea oil, in New York for American oil and sugar, and in Asia for certain products.¹ Geneva traders gain access to them through brokers and clearing members, often banks, with whom they must deposit margin to guarantee their positions. Margin calls, in periods of high volatility, can require considerable liquidity, as the crisis of 2022 showed for energy traders.²

Hedging leaves in place the basis risk, the liquidity risk associated with margin calls, the counterparty risk on over-the-counter contracts and the risk that the physical position does not materialise as planned. It demands a rigorous organisation, position-monitoring systems and risk limits set by management. The great losses in the history of the trading sector have often resulted from unhedged positions or failed controls.

Caution. Hedging price risk with derivative instruments protects the trader's margin, but it creates liquidity, basis and counterparty risks.

Hedging price risk

Margin calls in periods of high volatility can endanger traders who are solvent but insufficiently liquid.

1 Notes

1. Wikipedia (en), art. “CME Group”: merger of July 2007 between the Chicago Mercantile Exchange (founded in 1898) and the Chicago Board of Trade (1848), acquisition of NYMEX and COMEX in August 2008 for 8.9 billion dollars, more than 7 billion contracts traded in 2025; art. “London Metal Exchange”: founded in 1877, acquired by Hong Kong Exchanges and Clearing in 2012 for 1.4 billion pounds; art. “Intercontinental Exchange”: founded in Atlanta in May 2000, acquisition of the International Petroleum Exchange in London in June 2001 (ICE Futures Europe) and of the New York Board of Trade in January 2007; art. “Singapore Exchange”: created on 1 December 1999, the world’s leading clearer of iron ore swaps; art. “China futures market”: Zhengzhou (1993), Dalian (February 1993), Shanghai Futures Exchange (1999). ↩
2. ECB, Financial Stability Review, November 2022, “Financial stability risks from energy derivatives markets”: initial margins roughly twice as high in mid-2022 as at the end of 2021; credit lines of electricity producers raised from about 3 to more than 6 billion euros between March and April 2022; TTF contract at EUR 227/MWh on 7 March 2022 and EUR 339/MWh at the end of August; Green Central Banking, 24 March 2022: request by the European Federation of Energy Traders for emergency liquidity support, “Margin requirements have reached a level where multiple market participants face a risk of not having sufficient cash reserves to meet margin calls”; Trafigura, press release of 8 December 2022: credit lines raised to 73 billion dollars with some 140 banks. ↩

For general information only. This article does not constitute legal or tax advice, does not replace advice on an individual case and creates no lawyer-client relationship. It reflects the legal position as of September 2026.

Online version: helveticaregister.com/geneva-hedging-price-risk