AGRICULTURAL DERIVATIVES

Key Information Document (KID)

2018

PURPOSE

This document provides you with key information about investment in agricultural commodities. It is not marketing material. The information is required by law to help you understand the nature, risks, costs, potential gains and losses the products and to help you compare it with other products.

PRODUCT

Product name: Agricultural Futures and Options
Manufacturer: JSE Limited
Website: https://www.jse.co.za/trade/derivative-market/commodity-derivatives/agricultural-derivatives
Email: commodities@jse.co.za
Tel: 011 520 7039

WHAT IS THIS PRODUCT?

Type: Derivative based contracts
Product overview:
Agricultural derivatives market plays an active role in price determination and transparency in the South and Southern African market whilst providing an efficient price risk management facility. The JSE offers Derivatives on a wide range of local and international agricultural commodities.

All the local agricultural products predominately grains are physically settled at expiry in fulfillment of a futures contract. The exchange makes use of a silo receipt, a transferable but not negotiable document, representing a specific quantity and quality of stock in a registered silo to effect delivery. The silo receipts can be retendered a number of times through the market. When a silo receipt is returned to a storage operator for out loading of the physical product the receipt is only then finally cancelled. The exchange accepts only electronic receipts issued by registered storage operators. There are currently 17 registered storage operators with over 200 registered delivery points across South Africa where sellers can decide to tender their delivery.

The market also offers foreign-referenced agricultural commodities through a licensing agreement with CME Group. These products are cash settled in which participants may either hold the position until expiry and receive a cash settlement or buy back the JSE contract and then cash settle the contract in this way. Either way, the cash adjustment is used to offset its price risk component versus the physical market. All products are traded and settled in South African Rands.

WHAT IS A FUTURES CONTRACT?

A futures contract is a standardised contract between two parties to exchange a specified asset for a price agreed today, with the commitment to either make or take physical delivery occurring at a specified future date, making it a type of derivative instrument. If the futures contract is cash settled, and then a reliable information source is required that reflects the underlying physical market.

WHAT IS AN OPTION CONTRACT?

Option contracts give buyers the opportunity to secure a floor price (Put Option) or a ceiling price (Call Option) at the cost of an agreed premium. The sellers have to take on the opposite position if the buyer wishes to exercise their Option. Buyers don’t have to exercise their Option.

Basic Option Strategies

<u>Buying a Call Option</u>:
One way that a user of a traded product can obtain protection against adverse commodity price exposure via the options market is to buy a call option. In effect, a call option gives the buyer of the option the right, but not the obligation, to buy the underlying commodity at a pre-determined price, called the strike price, for a fixed period of time. The cost of this right or benefit is the premium, which is paid by the option buyer to the option seller (writer). The premium is paid and received over the life of the option through the daily process of Mark to Market. This premium, which is determined by the market on the ATS, depends on market conditions such as volatility of the market, time to expiration, market direction, and the supply and demand for options in general.

The cost of an option to the option buyer is limited to the premium paid for the option. The option seller is margined by the exchange to ensure that in the event of the option being exercised, the option seller will indeed be in a position to meet the obligations of the option and sell the product to the option buyer at the strike price. The Agricultural market trades American style options that can be exercised at any time, before and including option expiry date. Options that expire “in-the money” are automatically exercised by the exchange. Options that expire “at-the-money” (where the closing futures price is exactly at the level of the strike price) will not be exercised by the exchange. Options that expire “out-the-money”, in other words, which have no value, will expire worthless.

<u>Buying a Put Option:</u>
One way that a producer can protect against an adverse price movement is to purchase a put option. A put option gives the option buyer the right, but not the obligation to sell the underlying commodity at a fixed price for a fixed period of time.

The price for this flexibility is the premium paid by the put option buyer and received by the seller over the course of the Mark-to-Market process. This premium depends on market conditions such as market volatility, time to option expiration, market direction and the supply and demand for options in general.

Regardless of market fluctuations, the maximum loss an option buyer can sustain is the premium paid for the put option. Because of this limited and known risk, buyers of options are never faced with additional margin calls.

<u>There are three ways to exit an option position</u>:
Offset: This is done by selling back the option that you previously bought on the exchange. This may or may not result in a profit, depending on the level of premium paid for the option against the level of premium for which the option is sold.

Exercise: An option buyer decides whether to exercise an option or hold it to maturity. The investor might find it optimal to exercise the option before expiry if the futures market is trading higher than the strike price of the call option that the investor purchased and there is a possibility that the price may decrease in the future. When an option is exercised, both the buyer and seller are assigned opposite futures positions on a random basis.
Expiration: If the option is out-the-money the option holder could let it expire worthless by simply doing nothing.

Intended User:
Hedgers can be described as those market participants who use derivative contracts to manage price risk of a underlying commodity that is present in the physical market and who aim to pass on price risk.

- Typically a farmer producing the grains we trade, a miller who processes the grain, a trader involved in grains market who could export or import the product, banks involved in providing financing to the grain market

Speculators are those market participants who use derivative contracts, not to manage price risk, but with the purpose of benefiting from a directional move in the derivatives market, in other words who aim to take on risk.

- Could be farmers who will not harvest the underlying crop as per their derivative position, traders, retail and institutional clients

WHAT ARE THE RISKS AND WHAT COULD I GET IN RETURN?

Using agricultural derivatives encourages increased productivity in the agricultural sector as producers and users are able to concentrate their efforts on managing production risks. Financial institutions lending to these sectors are also ensured of reduced risk profiles when dealing with clients who have hedged a portion of their price risk. Such clients could typically access funds at cheaper rates than would otherwise have been offered
There are the risks associated with variables such as weather, farm/production management, socio-economic issues, seasonal conditions, local and global environmental factors can significantly impact the price of commodities

Foreign-referenced commodity products offer price mitigation or directional price exposure opportunities to a range of market participants. No exchange control approval is required as they are classified as inward listed.

Additional benefits

- Enables identification of short and long term price and volatility patterns
- Enables realization of arbitrage and spread opportunities between local and foreign referenced products
- Procurement of physical products are guaranteed by approved storage operators and payment is received within one business day of delivery
- Enables easy access to the international market with contracts traded in Rands

WHAT HAPPENS IF THE PRIIP MANUFACTURER IS UNABLE TO PAY?

JSE Clear, a wholly owned subsidiary of the JSE, is the clearing house for all Exchange-Traded Derivatives in South Africa. In this capacity, JSE Clear novates all matched trades transacted through the JSE. JSE Clear has a number of clearing members, who clear for its members, through which clients' trade. Each member is responsible for its client's losses (if a client defaults); just as each clearing member is responsible for the losses of the members for which it clears, should those members default. If a client (or trading member) cannot make good on its obligations, the trading member (or clearing member) will stand good for those obligations. JSE Clear, therefore, ultimately protects against the risk that one of the clearing members possibly defaults on their obligations.

For further information on the mechanisms that JSE Clear employs, please refer to the following website: https://www.jse.co.za/services/post-trade-services/clearing-and-settlement/derivatives

WHAT ARE THE COSTS?

The following transaction fees would be applicable:

Commodity Product		On Screen (per contract)		Reported trades		
Physically Settled Grain Contracts	Contract Code	Futures	Options	Futures	Options	Delivery fee
White Maize	WMAZ	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery
White Maize Grade two	WOPT	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery
Yellow Maize	YMAZ	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery
Yellow Maize Grade two	YOPT	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery
Bread Milling Wheat	WEAT	R 7.50	R 3.75	R 8.00	R 4.00	R200/contract/delivery
Sunflower Seed	SUNS	R 7.50	R 3.75	R 8.00	R 4.00	R200/contract/delivery
Soya Beans	SOYA	R 7.50	R 3.75	R 8.00	R 4.00	R200/contract/delivery
Sorghum	SORG	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery
Bitter Sorghum	SGBT	R 15.00	R 7.50	R 16.00	R 8.00	R200/contract/delivery

Commodity Product		On Screen (per contract)	
Physically Settled Grain Contracts	Contract Code	Futures	Options
Beef Carcass	BEEF	R 15.00	N/A
Lamb Carcass	LAMB	R 15.00	N/A
Merino Wool	WOOL	R 5.00	N/A
Soya Bean Crush	CRSH, CRSK,CRSN,CRSU and CRSZ	R 30.00	N/A
Chicago Corn	CORN	R 16.00	R 11.00
Chicago Soybean	BEAN	R 16.00	R 11.00
Chicago Soybean Meal	MEAL	R 16.00	R 11.00
Chicago Soybean Oil	OILS	R 16.00	R 11.00
KC Hard Red Winter Wheat	KANS	R 10.00	R 6.00
Chicago Soft Red Winter	REDW	R 10.00	R 6.00
Euronext Milling Wheat	MATF	R 10.00	R 6.00

HOW LONG SHOULD I HOLD IT AND CAN I TAKE MONEY OUT EARLY?

There is no recommended holding period for these products. The optimal holding period depends upon the retail investor's individual strategy and risk profile. A derivative position can be traded and closed out on any trading day until expiration date. In particular, a long position can be closed by entering a sell order in the market on any day up to and including the expiration date of the contract, and a short position can be closed by entering a buy order in the market on any day up to and including the expiration date of the contract. An investor should contact a broker who will be able to provide a recommendation.

HOW CAN I COMPLAIN?

Retail investors should address complaints to the broker or intermediary with whom the investor has a contractual relationship or directly to the Financial Services Board (FSB) at 012 428 8000. Furthermore, the retail investor can address complaints to the JSE at info@jse.co.za