

USD CRUDE PALM OIL FUTURES (FUPO)

THINGS YOU NEED TO KNOW



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Futures and options trading involve risk. Please seek the advice of independent professionals, as appropriate, in respect of the evaluation and trading of the USD Crude Palm oil Futures (FUPO).

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USD CRUDE PALM OIL FUTURES (FUPO)

CONTRACT SPECIFICATIONS

Contract Size	25 metric tons of Crude Palm Oil (CPO)
Contract Months	Spot month and the next 5 succeeding months, and thereafter, alternate months up to 24 months ahead
Settlement Methodology	Cash settled
Trading Hours	<ul style="list-style-type: none">• First trading session : Malaysian Time: 10:30 am to 12:30 pm• Second trading session : Malaysian Time: 3:00 pm to 6:00 pm
Min. Price Fluctuation	USD0.25 per metric ton
Daily Price Limit	<p>A +/- 10% limit from the Settlement Prices of the preceding trading day will apply for all contract months, except for the spot month. When at least 3 non-spot month contracts are trading at the 10% limit, a 10 minute Cooling Off period will apply for all quoted months (except spot month as there are no price limits for spot month contract) during which trading shall only take place within the 10% Limit. Following the Cooling Off period, all quoted months shall be interrupted for 5 minutes, after which the price limit will be expanded to +/-15%.</p> <p>The 10% price limit will apply for the rest of the 1st trading session if the price limit is triggered less than 30 minutes before the end of session, and the price limit will be expanded to 15% for the 2nd trading session.</p> <p>If the 10% limit is triggered less than 30 minutes before the end of the 2nd trading session, the 10% limit will apply for the rest of the trading day.</p>
Speculative Position Limit	<ul style="list-style-type: none">• 500 contracts net long or net short for the spot month• 5,000 contracts for any single contract month except for the spot month• 8,000 contracts for all contract months combined
Final Trading Day	Contract expires at noon on the 15th day of the spot month, or if the 15th is a non-Business day, the preceding Business Day.
Final Settlement Price	<p>The average price of the Daily Spot Month Settlement Price of the FCPO on the last 5 Business Days prior to the expiration including the Final Trading Day. The mid exchange rate of USD/MYR as at 6.00pm on each of the 4 Business Days prior to the Final Trading Day taken from Bank Negara Malaysia shall be used as the conversion price for the calculation of FCPO Daily Spot Month Settlement Value (Mid price USD/MYR multiplied by the Daily Spot Month Settlement Price of FCPO).</p> <p>The mid Exchange rate of USD/MYR as at noon will be used for calculation of Daily Spot Month Settlement Price for the Final Trading Day.</p> <p>The FUPO Final Settlement Value shall be the average of the converted FCPO Daily Spot Month Settlement Prices rounded to the nearest 25 cents.</p>

Note:

This is the abridged version. For full contract specifications, please visit <http://www.bursamalaysia.com>

USD CRUDE PALM OIL FUTURES (FUPO)

FREQUENTLY ASKED QUESTIONS

1. What is FUPO?

FUPO is a USD-denominated Crude Palm Oil futures contract. Each FUPO contract is equivalent to 25 metric tons of crude palm oil. FUPO will be listed on Bursa Malaysia Derivatives Berhad (“Bursa Derivatives”) and will be traded alongside the MYR denominated Crude Palm Oil futures (FCPO).

When you buy or sell a FUPO contract, it is equivalent to buying or selling 25 metric tons of crude palm oil at an agreed price now. Upon expiry, the FUPO is cash settled, i.e. it is settled against a Final Settlement Price (refer Q. 14) that is based on the FCPO prices. However you may close out your bought (long) or sold (short) contract at any time before expiry with an offsetting trade.

2. How is it different from FCPO?

FUPO is a USD-denominated contract and will be cash settled upon expiry, i.e. the 15th business day of the contract month whereas FCPO is a MYR contract that is physically settled upon maturity. Although you may choose to deposit MYR to trade FUPO (refer Q.12), you would be exposed to the US currency risk rather than the MYR currency risk when trading in FUPO, as the prices are quoted in USD.

3. How does FUPO work?

This is an explanation of the mechanics of a June 2008 FUPO contract, which has the reference FUPO JUN 08:

Assume that the FUPO JUN08 price is currently trading at USD1,050. You believe that it will rise over the short term and decide to buy 1 FUPO JUN08 contract, which is equivalent to 25 metric tonnes of Crude Palm Oil. Assuming that your futures broker sets an Initial Margin (a form of collateral) of USD4,000 per contract, this amount will be debited from your trading account and deposited in trust with the broker.

Let us assume that the FUPO JUN08 contract rises steadily upwards and reaches USD1,200. You now believe that it has peaked and decide to close out the position. You will then sell 1 FUPO JUN08 contract to close your outstanding long position. The Initial Margin is then refunded along with the difference in the value of the underlying shares, which is $25 \text{ metric tons} \times (\text{USD}1,200 - \text{USD}1,050) = \text{USD}3,750$.

Your capital has now increased to USD7,750 from USD4,000, a return of about 94% during a period in which the underlying price of Crude Palm Oil only increased by 14% (from USD1,050 to USD1,200).

Note: This example does not take transaction costs into account

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FREQUENTLY ASKED QUESTIONS

4. How will I benefit from trading FUPO?

Profit from both bull or bear commodities market

Both FUPO and FCPO provide retail investors with a structured product to access the crude palm oil market. You can take either a bullish or bearish position on movement of crude palm oil prices by buying low and selling high for a bullish outlook, and vice versa for a bearish outlook.

Leverage/Gearing

The Initial Margin is about 10% to 13% of the notional value (FUPO traded price x 25 [size of contract]), which frees up cash, and enables you to invest the difference or make use of the funds for other purposes. Initial Margin may be posted in the form of USD or MYR cash, selected foreign currencies, approved stocks and/or letters of credit.

FUPO supports the following trading strategies:

Hedging – hedging of crude palm oil price risk in physical market

Spread Trading between FUPO/FCPO – facilitated by FUPO/FCPO spread margins (refer Q.9)

Leveraged Trading – the use of leverage will magnify the effect of a given change in price

5. What should I be aware of when trading FUPO?

Monitor your positions

Trading futures can be risky, so you need to check your positions regularly as part of your risk management strategy.

Margin calls

Apart from collecting Initial Margin as a form of collateral, your broker will also 'mark-to-market' or revalue your FUPO portfolio at the end of each business day based on settlement prices determined by Bursa Derivatives. If your position generates a loss, you will be asked to replenish your account within a stipulated time. Failure to do so may result in forced liquidation of your positions.

Conversely, if your position results in a profit, you may be allowed to withdraw excess funds from your trading account. The concept of margin calls is further explained in Q.9 "What is margining and how does it work?"

Stop-loss triggers

You may place stop-loss instructions with your broker, if you are unable to actively monitor your positions.

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FREQUENTLY ASKED QUESTIONS

6. What are the risks of trading FUPO?

Leverage magnifies the effect of a price change and may also result in significant losses if the market moves against your FUPO positions. An adverse price move may lead to a margin call, requiring an investor to send more money. If you do not maintain your margin balances, your FUPO positions may be closed out at a loss.

When opening a futures trading account, you must read and understand the Risk Disclosure Document provided by your futures broker.

7. How can I start trading FUPO?

You will be required to open a futures trading account with a futures broker, and will also need to deposit cash or collateral with your broker before you start trading.

8. What FUPO contract months are available for trading?

Spot month, also known as the current month; the next 5 succeeding months; and thereafter alternate months up to 24 months forward. We expect the activity in FUPO to be correlated to the FCPO, and thus the most active contract month is expected to be the 3rd contract month (i.e. assuming the date is 5 September 2008, the most active contract month would be November 2008).

9. What is margining and how does it work?

The term “margin” refers to two levels of minimum margin - Initial and Maintenance Margins. Initial Margin is a deposit required when you initiate a position, whilst Maintenance Margin is the minimum level you need in your trading account to continue holding your futures positions.

Before you can start trading, your broker will collect Initial Margin, which is a form of collateral or performance bond that is returned to you once you have closed out all your open positions (net of transaction fees, losses and/or any amounts owing to your broker). Generally, the Initial Margin determined by Bursa Derivatives is between 10% and 25% of the underlying contract value, but your broker may require more than the minimum margins set by the Exchange to reduce the frequency of margin calls. Initial Margin may be posted in the form of USD or MYR cash, selected foreign currencies, approved stocks and letters of credit/bank guarantee. The Initial Margin determined by Bursa Derivatives will be changed periodically depending on market conditions.

Your broker will also ‘mark-to-market’ or revalue your FUPO portfolio at the end of each business day based on settlement prices determined by Bursa Derivatives, and your account will be credited (profit) or debited (loss) accordingly. If your position generates a loss that is greater than the Maintenance Margin level, you will be asked to top up your trading account within a stipulated time, failure of which may result in forced liquidation of your positions. On the other hand, if your position results in a profit, you may be allowed to withdraw excess funds up to the Maintenance Margin level from your trading account.

Note: See page 5 for example:

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FREQUENTLY ASKED QUESTIONS

Example

Day/Activities		Settlement Price FUPO JUN 06 (USD)	Account Balance (USD)	Explanation
Day 1	You deposit \$5,000 in your trading account		5,000	Margin required for each lot of FUPO JUN 06 contract: Initial Margin: \$5,000 Maintenance Margin: \$4,000
Day 2	You buy 1 FUPO JUN 06 contract @ \$1,000	1,020	5,000 + 500 = 5,500	A profit of \$500 is credited to the account. $(\$1020 - \$1000) \times 25 = \$500$
Day 3	Price of FUPO JUN 06 drops	1,010	5,500 - 250 = 5,250	A loss of \$250 is debited to the account. $(\$1010 - \$1020) \times 25 = -\$250$
Day 4	Price of FUPO JUN 06 drops drastically	900	5,250 - 2,750 = 2,500	A further loss of \$2,750 is debited to the account. $(\$900 - \$1010) \times 25 = -\$2,750$ A margin call is issued as the account balance is now less than the maintenance margin requirement of \$4,000 You have the following choices: (1) Top up the margin account to the Initial Margin level of \$5,000; or (2) Close out your open position.
Day 5	You chose to top up your account and maintain your positions. Price of FUPO JUN 06 recovers.	1,000	2,500 + 2,500 + 2,500 = 7,500	You deposit \$2,500 to restore your minimum Initial Margin level. At the end of the trading day, a profit of \$2,500 is credited to the account. $(\$1,000 - \$900) \times 25 = \$2500$
Day 6	Price of FUPO JUN 06 rises again. You decide to close out your position by selling all 1 FUPO JUN 06 contract at \$1,050.	1,050 (close-out)	7,500 + 1,250 = 8,750	A profit of \$2,200 was credited to the account. $(\$1,050 - \$1000) \times 25 = \$1,250$ Net Profit = \$8,750 – (Total capital of \$5,000 + \$2,500) = \$1,250

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FREQUENTLY ASKED QUESTIONS

10. What are the margin requirements for FUPO?

The minimum Initial Margins for FUPO levied by the clearing house are revised from time to time depending on the volatility of the market. Initial Margins are increased in response to higher price volatility, and vice versa. Refer to Clearing Circulars for the latest Initial Margin rates.

Futures Brokers may require a higher Initial Margin deposit from their clients, depending on their risk management policies.

Outright Margin

Outright Margin is levied on futures positions which have no accompanying risk-reducing positions.

Spread Margin

Lower margin rates are levied on futures positions that have accompanying risk-reducing positions. For FUPO, Spot Month Spread Margins are applicable for spread positions that include the spot month contract, whilst Back Month Spread Margins are applicable for spread positions that do not include the spot month contract. However, Spot Month Spread Margin is not applicable for FCPO, as spot month may involve physical delivery and is margined on an outright basis.

FUPO/FCPO Inter-commodity Margin Offset

As both FCPO and FUPO have the same underlying product – i.e. crude palm oil, clients that hold opposite positions of both contracts under the same account will receive rebates/offset on total initial margin requirement.

11. Will there be a difference between the prices for FUPO & FCPO?

The price of the FUPO and FCPO will be closely correlated and this convergence increases towards the expiry of the contracts. This is because upon expiry, the FUPO will be cash settled based on the final settlement price based on FCPO prices (refer Q.14 “How is the final settlement price for FUPO determined?”).

Although FUPO and FCPO prices generally move in the same direction, there will be instances where there may be temporary distortions in the prices. This presents an opportunity for arbitrageurs to make a simultaneous purchase from the lower priced market, and sell in the higher priced market, to profit from the inconsistencies in prices. The presence of such inter-market trading activities ensures convergence of the 2 markets.

12. Must I open a USD account to trade FUPO?

It is not necessary to open a USD account to trade FUPO. Your Futures Broker will be able to convert your MYR deposits to meet FUPO margin calls. Bank Negara Malaysia has allowed Futures Brokers to act as agents to licensed onshore banks to quote exchange rates (provided by the licensed onshore banks) to facilitate settlement in USD.

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FREQUENTLY ASKED QUESTIONS

13. Are there foreign exchange controls for FUPO?

There are no foreign exchange restrictions on investment for Non-Residents.

There are also no restrictions for Residents without Domestic MYR Credit Facilities (borrowings) but Residents with borrowings are capped at MYR1 million per calendar year for individuals and MYR50 million per calendar year for corporations. However, if Residents with borrowings choose to pay and receive in MYR for the trading of FUPO, then they will be excluded from the aforementioned restriction.

Domestic MYR credit facilities (borrowings) are defined as:

Any MYR advance, loan, trade financing, hire purchase, factoring, leasing facilities, redeemable preference shares or similar facility in whatever name or form, other than:

- a) Trade credit terms extended by a supplier for all types of goods and services.
- b) Forward exchange contracts entered into with licensed onshore banks.
- c) One personal housing loan and one vehicle loan obtained from residents.
- d) Credit card and charge card facilities.
- e) Inter company borrowing within a corporate group.

Note: Refer Appendix 1 on page 8 for schematics on foreign exchange controls in relation to Residents.

14. How is the final settlement price for FUPO determined?

The FUPO final settlement price is determined from the average price of the Daily Spot Month Settlement Price of the FCPO on the last 5 Business Days prior to the expiration, including the Final Trading Day. The mid exchange rate of USD/MYR as at 6.00pm on each of the 4 Business Days prior to the Final Trading Day taken from Bank Negara Malaysia shall be used as the conversion price for the calculation of FCPO Daily Spot Month Settlement Value (Mid price USD/MYR multiplied by the Daily Spot Month Settlement Price of FCPO). The mid Exchange rate of USD/MYR as at noon will be used for calculation of Daily Spot Month Settlement Price for the Final Trading Day.

The FUPO Final Settlement Value shall be the average of the converted FCPO Daily Spot Month Settlement Prices rounded to the nearest 25 cents.

15. What are the definitions of a Resident?

- Citizens of Malaysia (excluding persons who have obtained permanent resident status of a territory outside Malaysia and are residing abroad);
- Non-citizens who have obtained permanent resident status in Malaysia and are residing permanently in Malaysia; or
- Persons, whether body corporate or unincorporated, registered or approved by any authority in Malaysia.

16. What are the definitions of a Non-Resident?

- Overseas branches, subsidiaries, regional offices, sales offices and representative offices of resident corporations;
- Embassies, Consulates, High Commissions, supranational or international organisations recognised by the Government of Malaysia; or
- Malaysian citizens who have obtained permanent resident status of a territory outside Malaysia and are residing outside Malaysia

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APPENDIX 1

