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Additional Reading Material
on
USD RBD Palm Olein Futures Contract

(Issued in November 2015)

Relevant for

1. **Module 14 (Derivatives *[Formerly known as Futures and Options]*)**

2. **Module 18 (Securities and Derivatives Trading [Products and Analysis])**

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(This document consists of 9 pages including the cover page)

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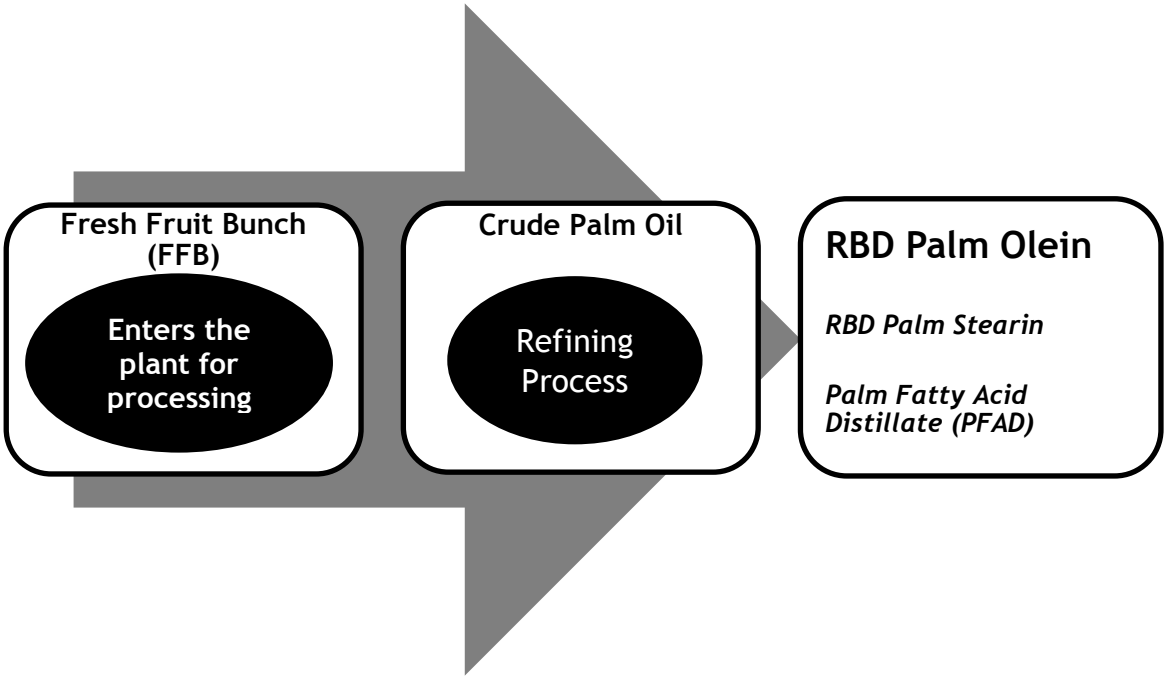
1. Introduction to USD RBD Palm Olein Futures Contract (FPOL)

Palm olein futures (FPOL) contract is an agreement to buy or sell Refined, Bleached and Deodorised (RBD) palm olein on a future date at an agreed-upon price. FPOL is a US Dollar (USD) denominated RBD palm olein futures contract traded on Bursa Malaysia Derivatives. Being a refined palm product, FPOL specifically provides palm refiners, end users of palm olein and foreign palm olein importers a mechanism that allows for transparent price discovery, regulated trading and an instrument for hedging.

Table 1: Process of Refined, Bleached and Deodorised (RBD) Palm Olein



Similar to other commodity contracts, FPOL can be used for hedging, speculating and arbitraging. Each FPOL contract is equivalent to 25 metric tons and the contract is a physically deliverable contract. Besides FPOL, other commodity futures available on Bursa Malaysia Derivatives include crude palm oil futures, crude palm kernel futures, USD crude palm oil futures and gold futures[1].

[1] *Refer to Topic 4.04 of the Examination Study Guide for Module 14: Futures and Options for more information on commodity futures*

2. Contract Specifications for FPOL

Contract specifications for FPOL may vary from time to time. The table below is an example and will be used as the basis in the following exercises. You can refer to the Bursa Malaysia website at www.bursamalaysia.com for the latest contract specifications.

Contract Code	FPOL
Underlying Instrument	RBD Palm Olein
Settlement Method	Physical Delivery via e-Negotiated Storage Receipts (e-NSRs). Ex-tank as per FCPO
Contract Size	25 metric tons (25,000 kilogrammes)
Price Quotation	US$ per metric ton
Minimum Price Fluctuation	US$0.50 per metric ton
Contract Months	Spot month and the next 5 succeeding months, and thereafter, alternate months up to 24 months ahead.
Trading Hours	Monday to Friday **Trading Sessions:** (Malaysian Time) 0900 - 1200 hours 1330 - 1800 hours **Business Day**: Follows KL Business Days
Daily Price Limit	1. With the exception of trades in the current delivery month, trades for future delivery of RBD Palm Olein in any month shall not be made, during any one Business Day, at prices varying more than 10% above or below the settlement prices of the preceding Business Day ("the 10% Limit") except as provided below: a) When the 10% Limit is triggered (except for the current month), the Exchange will announce a 10-minute cooling off period ("the Cooling Off Period") for Contracts of all contract months (except the current delivery month) during which trading may only take place within the 10% Limit. b) Following the Cooling Off Period, Contracts of all contract months will be specified as reserved for a period of 5 minutes, after which the price limit will be expanded to 15%. The prices traded for Contracts of all contract months (except the current month) must then not vary more than 15% above or below the settlement prices of the preceding Business Day ("the 15% Limit"). c) If the 10% Limit is triggered less than 30 minutes before the end of the first trading session, the 10% Limit will apply to Contracts of all contract months (except the current month) for the rest of the first trading session and the 15% Limit will

<table>
<tr><td></td><td>apply to Contracts of all contract months (except the current month) during the second trading session.
d) If the 10% Limit is triggered less than 30 minutes before the end of the second trading session, the 10% Limit will apply to Contracts of all contract months (except the current month) for the rest of the Business Day.

2. For the purposes of paragraph 1(a), the 10% Limit will be considered triggered in the manner as may be prescribed by the Exchange.</td></tr>
<tr><td>Final Trading Day</td><td>1. 15th day of the delivery month or, if the 15th day is a non-Business Day, the Final Trading Day will be the last Business Day preceding the 15th day.

2. Trading in the delivery month ceases at 1200 hours (Malaysia time) on the Final Trading Day.</td></tr>
<tr><td>Final Settlement Day</td><td>1. Any Contracts remaining open after the cessation of trading for a delivery month will be settled by delivery which must be made by the 20th day of that month or, if the 20th day is a non-Business Day, by the last Business Day preceding the 20th day.
2. The Tendering and delivery process must be done in accordance with the Clearing House Rules.</td></tr>
<tr><td>Contract Grade and Delivery Points</td><td>Contract Grade

1. The contract grade is for RBD Palm Olein of good merchantable quality, in bulk, in Port Tank Installations, and conforming to the specifications prescribed by Palm Oil Refiners Association of Malaysia (“PORAM”), as may be amended by PORAM and supplemented by the Exchange from time to time.

2. The specifications* for the time being are as follows:

<table>
<tr><td>Specification</td><td>In</td><td>Out</td></tr>
<tr><td>FFA</td><td>0.07%</td><td>0.10%</td></tr>
<tr><td>M&I</td><td>0.10%</td><td>0.10%</td></tr>
<tr><td>Iodine Value (Wijs) , min</td><td>56 min</td><td>56 min</td></tr>
<tr><td>Melting Point, °C (AOCS Cc 3-25)+, max</td><td>24 max</td><td>24 max</td></tr>
<tr><td>Colour (5 ¼” Lovibond Cell) #, max</td><td>2.6 Red max</td><td>3 Red max</td></tr>
</table>

3. The specifications above must be satisfied by sample(s) drawn and analysed on delivery into Port Tank Installations and from Port Tank Installations in accordance with procedures governing sampling and analysis that the Exchange may prescribe.</td></tr>
</table>

	Delivery Points 4. Port Tank Installation located, at the option of the seller, in Port Klang, Pasir Gudang and such other ports as the Exchange may specify. * Notes: (a) The specifications in paragraph 2 above are the specifications of PORAM as at 16 June 2014, supplemented by the Exchange. For the avoidance of doubt, all parties must refer to PORAM for the up-to-date specification. (b) + Slip Point, Softening Point or Rising Point (c) # Colour measurement based on Tintometer Model 'E' AF 900 and Model 'D' AF 702
Speculative Position Limit	The maximum number of net long or net short positions which a client or a participant may hold or control is: 800 contracts for the spot month 10,000 contracts for any one contract month except for spot month 15,000 contracts for all months combined.

3. Trading FPOL

RBD palm olein futures are traded by those who wish to manage or take advantage of the underlying price movement by assuming the price risk. Below are the main reasons why FPOL is traded:

- **Manage RBD Palm Olein Price Risk**
  End users and importers can use FPOL to manage risk and hedge against the risk of unfavorable price movement in the physical market.

- **Manage Palm Refining Margin**
  Refiners can use FPOL to manage their refining margins. Together with crude palm oil futures (FCPO), refiners can lock in their refining margins on paper. This can be achieved by going long on FCPO and short on FPOL.

- **Exposure to RBD Palm Olein Price Movements**
  Traders can use FPOL to gain leveraged exposure to movements in RBD Palm Olein prices.

- **Gain Immediate Exposure to the Commodity Market**
  FPOL allows global fund managers, commodity trading advisers and proprietary traders to gain exposure to one of the largest edible oil markets in the world.

The following are some examples for trading FPOL:

i. Buying hedge (bullish market)

Sawit Berhad, a cooking oil packer is required to deliver 100,000 metric ton (MT) of cooking oil in 3 months' time. During the period of time, the company anticipated that the cost of purchasing RBD palm olein will be higher. The company decided to use the FPOL to protect themselves against the anticipated upward price movement.

Assume that it is January 201X and the company needs to deliver the RBD palm olein in March 201X. The current selling price of FPOL is USD700 per MT and the RBD palm olein price is expected to increase to USD750 by March 201X.

For a full hedge, Sawit Berhad would need to buy 4,000 lots (100,000 MT/25MT) of FPOL March 201X contract at USD700 per MT and hold this position till expiry to collect the physical RBD palm olein. Assuming that the price of RBD palm olein in March 201X is USD750 per MT, the company will save USD5,000,000 [(USD750*25) – (USD700*25) x 4,000] from trading FPOL.

ii. Selling hedge (bearish market)

ABC Berhad, a refiner of RBD palm olein is required to deliver 100,000 MT of the product in 6 months' time. The company anticipated that the selling price of RBD palm olein will decline during that period. To secure their profit from the downward price movement, the company has entered into futures contract by trading FPOL.

Assume that it is February 201X and the company needs to deliver the RBD palm olein in July 201X. The current price of FPOL is USD650 per MT and the company anticipates that the price in July 201X will drop to USD600 per MT.

For a full hedge, ABC Berhad would need to sell 4,000 lots (100,000 MT/25MT) of FPOL July 201X contracts at USD650 per MT and liquidate their position when the price goes down. The total profit from trading the FPOL July 201X contract is USD5,000,000 [(USD650*25) – (USD600*25) x 4,000].

iii. Arbitraging

An arbitrageur observed that FPOL is trading at a premium to another exchange's RBD palm olein futures. The arbitrageur decides to take a short position on the FPOL contract and a long position on RBD palm olein traded on the other exchange. The position will be liquidated later once the spread of the price between both exchanges returns to normal. The arbitrageur will benefit from the temporary price discrepancy between the two exchanges.

**All examples are based on the following assumptions:*

1. *Initial margin is to be deposited prior to trading; and*
2. *Transaction costs have been excluded*

4. Summary

FPOL contract provides market participants with more trading and investment opportunities in commodity derivatives. In addition, it is one of the risk management mechanisms for primary users of RBD palm olein such as crude palm oil refiners and cooking oil packers.

Refiners of RBD palm olein can sell the FPOL contract if they anticipate that the RBD palm olein price will decline and buy the FPOL contract if the price is expected to increase. For cooking oil packers, they could buy the FPOL contract and hold till expiry to collect the physical RBD palm olein. This could be done if the packer anticipates that the cost of purchasing RBD palm olein will increase.

Arbitragers who are not the primary users of palm olein could take advantage of the mispricing of FPOL and RBD palm olein contracts offered elsewhere. Hence, they can sell the palm olein contract that is trading at a premium and buy the other. The position is liquidated when the spread between the two prices has normalised.

Reference:

Bursa Malaysia: www.bursamalaysia.com

Practice Questions

Question 1

Which of the following statements with regard to RBD palm olein futures is TRUE?

(A) The minimum price fluctuation is USD0.50 per metric ton

(B) The final trading is the last business day of the contract month

(C) The tender period is 1st calendar day to the 15th calendar day of the spot month

(D) The speculative position limit is a maximum of 1,000 contracts of net long or net short positions for the spot month

Question 2

How many palm olein futures (FPOL) contracts are required to fully hedge 100,000 metric tons (MT) of RBD palm olein against downward price movements?

(A) 1,000 lots

(B) 2,000 lots

(C) 4,000 lots

(D) 10,000 lots

Question 3

On January 201X, OLL Berhad was required to deliver 100,000 MT of RBD palm olein in 6 months' time. The company anticipated that the selling price of RBD palm olein would decline during that period. Which of the following action should the company take to manage the price risk?

(A) Buy a FPOL January 201X contract

(B) Buy a FPOL June 201X contract

(C) Sell a FPOL January 201X contract

(D) Sell a FPOL June 201X contract

Answer

1. A 2. C 3. D