Option on Ringgit Malaysia Denominated Crude Palm Oil Futures (OCPO) – Frequently Asked Questions (FAQ)

1. What is an option?

An option is a contract which gives the buyer (holder) the right, without the obligation, to buy or sell a specified quantity of an underlying asset, at a stipulated price (exercise/strike price) on or before a specified time (expiration date)**.**

2. What are call options?

A call option gives the buyer of the call option the right to buy a specified quantity of an underlying asset at the strike price on or before expiration date. The seller of the call option, on the other hand, has the obligation to sell the underlying asset if the buyer decides to exercise his option to buy. The buyer pays a premium to the seller to have this right.

Example: The "OCPO September 3000 Call" gives the buyer of the option to buy the September FCPO at RM3000 upon the OCPO expiration.

3. What are put options?

A Put option gives the buyer of the put option the right to sell a specified quantity of an underlying asset at the strike price on or before expiration date. The seller of the put option, on the other hand, has the obligation to buy the underlying asset if the buyer decides to exercise his option to sell.

Example: The “OCPO September 3000 Put” gives the buyer of the option to sell the September FCPO at RM 3000 upon the OCPO expiration.

4. What is an option premium?

An option premium is the price paid by buyers to sellers to acquire the right to buy or sell. It's basically the sum of the option's intrinsic and time value. Basically, this theoretical premium value depends on the exercise price, the underlying price, volatility of the underlying, the length of time before the expiration date and the risk free interest rate.

5. What is an Option on Ringgit Malaysia Denominated Crude Palm Oil Futures?

An Option on Ringgit Malaysia Denominated Crude Palm Oil Futures is an option contract which gives the buyer (holder) the right, without the obligation, to buy or sell its underlying instrument, i.e. a Ringgit Malaysia Denominated Crude Palm Oil Futures (“FCPO”) Contract at a stipulated price (exercise/strike price) on a specified time (expiration date)**.**

There are two types of OCPO options that an investor can choose to buy or sell a **Call** OCPO Option or a **Put** OCPO Option.

6. **There are two major classes of options, European & American Options, what are their differences?**

   An American style option can be exercised by the buyer on or before the expiration date, i.e. anytime between the day of purchase of the option and the expiration date. A European style option can be exercised by the buyer on the expiration day only. OCPO is a European style option contract.

7. **How are OCPO contracts quoted on the market?**

   The price/premium of an OCPO contract shall be quoted in Ringgit Malaysia per Metric Ton (RM/MT). The minimum fluctuation shall be RM0.50 valued at RM12.50. For example, a 3500 call could be priced at RM24.50/Ton for 3-month duration OCPO when the underlying FCPO is at RM3000.

8. **What is the options pricing model used by the Exchange for OCPO?**

   The Exchange uses the Black 76 model.

9. **What is delta and how do I determine the delta factor of my option position?**

   Delta measures the amount of change in the option premium when the underlying futures price changes by one unit, with other pricing factors remaining constant. The delta of a call ranges from 0 to 1.

Call Options		
Deep In-the-Money	→	Delta ≈ 1.00
At-the-Money	→	Delta ≈ 0.50
Deep Out-of-the-Money	→	Delta ≈ 0.00

   On the other hand, the delta of a put option is negative since the option value falls when the underlying futures price increases. The delta of a put ranges from 0 to -1.

10. **How are the futures equivalent positions (combination of FCPO and OCPO) determined in monitoring the speculative position limit?**

    Futures equivalent is the number of futures contracts needed to be associated with an option position. The futures equivalent can be calculated by taking the number of options and multiplying it by the corresponding delta factors.

    Long-call and short-put positions are converted to long futures-equivalent positions. Likewise, short-call and long-put positions are converted to short futures-equivalent positions. For example, a trader holding a long put position of 500 contracts with a delta factor of 0.50 is considered to be holding a short futures-equivalent position of 250 contracts. For example, a trader's long and short futures-equivalent positions derived from OCPO are added to the trader's long and short (FCPO) futures positions to give "combined-long" and "combined-short" positions.

11. Once I entered into an option position, must I hold until expiration to realize my profit or loss?

Not necessary.

If you have bought a call or put option, you can either:

a) Offset your option position by selling the same option contract in the market. The gain or loss will be the difference in the premium paid and received; or

b) Do nothing till expiration. If the option is in-the-money at expiration, it will be automatically exercised by the Clearing House (unless otherwise instructed by the buyer). Option exercised will result in a long FCPO position for a call buyer and a short FCPO position for a put buyer. The resultant expiring positions in FCPO shall then be subject to the same margining and daily marked-to-market procedures. Expiration of spot month FCPO results in physical delivery obligations. If the option is out-of-the-money at expiration, it will expire worthless.

On the other hand, if you have sold a call or put option, you can either:

a) Offset the position by buying back the same option. The gain or loss will be the difference in the premium received and paid; or

b) Do nothing. If the option is exercised upon expiration, you will have to fulfill your obligations as the seller. Option exercised will result in a long FCPO position for a put seller and a short FCPO position for a call seller. The resultant expiring FCPO positions shall then be subject to the same margining and daily marked-to-market procedures. Expiration of spot month FCPO results in physical delivery obligations. If the option is not exercised upon expiration, your profit will be the premium received net of the transaction costs.

For example, assuming you sold 1 contract of OCPO Call (strike price of 2800) at a premium of RM150 when the underlying FCPO was trading at 2900. One week down the road, if the underlying FCPO drops to 2750, you may realize your gain immediately by buying back the option at a lower market price, say RM20. Your profit will be RM130 per MT or RM130 x 25 MT per contract = RM3250 (difference of the 2 premiums i.e. 150 - 20 = 130 x 25MT per contract). Conversely, if the underlying FCPO climbs up to 2950 and you worry that the FCPO will go up further. Instead of doing nothing and continue exposing yourself to unlimited risk of loss, you may cut loss / offset your short position immediately by buying back the option at market price, say RM185. Your loss will be RM35 per MT or RM35 x 25 MT per contract= RM875 (difference of the 2 premiums i.e. RM150-RM185 = -35 x 25MT per contract) but you no longer have to worry about greater potential loss incurred should you keep your position until expiration.

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12. What exercise/strike prices will be available for trading?

Trading shall be conducted for put and call options with strike prices set at intervals of RM 50 per MT. There will be at least 11 exercise prices (5 are in-the-money, 1 is at-the-money and 5 are out-of-the-money) listed on the first day of trading.

For illustration, on the first day of launch, assuming the FCPO settled at 2800 (for all contract months) on previous business day, the strike/exercise prices available for trading shall be as follows:

	Spot/Next Month
In-the-money for puts; Out-of-the-money for calls	3050
	3000
	2950
	2900
	2850
At-the-money	**2800**
In-the-money for calls; Out-of-the-money for puts	2750
	2700
	2650
	2600
	2550

Subsequently, new options series / exercise prices will be introduced in accordance with the movement of the daily settlement prices of the underlying FCPO contracts. For example, if the underlying futures (spot month) close 50 higher to 2850 on the first trading day of OCPO, a new option series with strike price of 3100 will be available for trading on the next business day.

13. What happens when OCPO contract expires?

The current month options will cease trading at 6pm on the 10th day of the current month, or the preceding business day if the 10th day is a non-business day. The futures position will be delivered at end-of-day process and will be available for trading on the next business day. In the absence of contrary instructions delivered to the Clearing House, an option that is in-the money at expiration shall be automatically exercised. Exercise results in a long 3rd month FCPO position, which corresponds with the option's contract month for a call buyer or a put seller, and a short 3rd month FCPO position for a put buyer or a call seller.

14. Can I exercise an out-of-the-money OCPO options or instruct the Clearing House not to exercise an in-the-money option and is there a cut-off time for doing so?

Yes, an out-of-the-money option can be exercised on the final trading day and the cut-off time for such exercise is 7.30pm on the final trading day. Similarly, if a buyer does not wish to exercise an in-the-money option, he may instruct the clearing house through his broker of his intention before 7.30pm on the last trading day.

15. Is there a fee charge for exercising the OCPO contract?

Yes, the Clearing House will charge RM1 per contract for the exercise and assignment.

16. What are the OCPO contract months that are available for trading on the first day?

Available months to trade as at 16 July 2012

FCPO	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Mar-13	May-13	Jul-13
OCPO	-	-	Oct-12	Nov-12	Dec-12	Jan-13	Mar-13	May-13	Jul-13

FCPO	Sep-13	Nov-13	Jan-14	Mar-14	May-14	Jul-14
OCPO	Sep-13	Nov-13	Jan-14	Mar-14	May-14	Jul-14

*Oct-12 OCPO contract will expire on 10 August 2012. An Oct-12 OCPO contract that is exercised will result in an Oct-12 FCPO contract. The newly created FCPO is ready to be traded on the next business day.

*New OCPO contract will be listed on 16 August 2012 together with the FCPO new contract month.

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17. What are the contract months that are available to trade?

	Contract month series for OCPO from the 1st to the 10th day of the month																																					
	Current Year													1st Following Year													2nd Following Year											
As at 1st to 10th	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
JANUARY			X	X	X	X	X		X		X			X		X		X		X		X		X														
FEBRUARY				X	X	X	X		X		X			X		X		X		X		X		X			X											
MARCH					X	X	X	X	X		X			X		X		X		X		X		X			X											
APRIL						X	X	X	X		X			X		X		X		X		X		X			X		X									
MAY							X	X	X	X	X			X		X		X		X		X		X			X		X									
JUNE								X	X	X	X			X		X		X		X		X		X			X		X		X							
JULY									X	X	X	X		X		X		X		X		X		X			X		X		X							
AUGUST										X	X	X		X		X		X		X		X		X			X		X		X		X					
SEPTEMBER											X	X		X	X	X		X		X		X		X			X		X		X		X					
OCTOBER												X		X	X	X		X		X		X		X			X		X		X		X		X			
NOVEMBER														X	X	X	X	X		X		X		X			X		X		X		X		X			
DECEMBER															X	X	X	X		X		X		X			X		X		X		X		X		X	

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Contract month series for OCPO from the 11th - 15th day of the month - to reflect the expiration of the spot month options on the 10th day of the month

	Current Year													1st Following Year													2nd Following Year											
As at 11th to 15th	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEPT	OCT	NOV	DEC
JANUARY				X	X	X	X		X		X			X		X		X		X		X		X														
FEBRUARY					X	X	X		X		X			X		X		X		X		X		X			X											
MARCH						X	X	X	X		X			X		X		X		X		X		X			X											
APRIL							X	X	X		X			X		X		X		X		X		X			X		X									
MAY								X	X	X	X			X		X		X		X		X		X			X		X									
JUNE									X	X	X			X		X		X		X		X		X			X		X		X							
JULY										X	X	X		X		X		X		X		X		X			X		X		X							
AUGUST											X	X		X		X		X		X		X		X			X		X		X		X					
SEPTEMBER												X		X	X	X		X		X		X		X			X		X		X		X					
OCTOBER														X	X	X		X		X		X		X			X		X		X		X		X			
NOVEMBER															X	X	X	X		X		X		X			X		X		X		X		X			
DECEMBER																X	X	X		X		X		X			X		X		X		X		X		X	

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	Contract month series for OCPO from 16th to the end of the month - reflecting a new contract month series generated (same of FCPO new contract month)																																					
	Current Year													**1st Following Year**													**2nd Following Year**											
As at 16th to end of month	**JAN**	**FEB**	**MAR**	**APR**	**MAY**	**JUN**	**JUL**	**AUG**	**SEPT**	**OCT**	**NOV**	**DEC**		**JAN**	**FEB**	**MAR**	**APR**	**MAY**	**JUN**	**JUL**	**AUG**	**SEPT**	**OCT**	**NOV**	**DEC**		**JAN**	**FEB**	**MAR**	**APR**	**MAY**	**JUN**	**JUL**	**AUG**	**SEPT**	**OCT**	**NOV**	**DEC**
JANUARY				X	X	X	X		X		X			X		X		X		X		X		X			X											
FEBRUARY					X	X	X	X	X		X			X		X		X		X		X		X			X											
MARCH						X	X	X	X		X			X		X		X		X		X		X			X		X									
APRIL							X	X	X	X	X			X		X		X		X		X		X			X		X									
MAY								X	X	X	X			X		X		X		X		X		X			X		X		X							
JUNE									X	X	X	X		X		X		X		X		X		X			X		X		X							
JULY										X	X	X		X		X		X		X		X		X			X		X		X		X					
AUGUST											X	X		X	X	X		X		X		X		X			X		X		X		X					
SEPTEMBER												X		X	X	X		X		X		X		X			X		X		X		X		X			
OCTOBER														X	X	X	X	X		X		X		X			X		X		X		X		X			
NOVEMBER															X	X	X	X		X		X		X			X		X		X		X		X		X	
DECEMBER																X	X	X	X	X		X		X			X		X		X		X		X		X	

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18. How is the performance bond (margin) requirement for options position calculated?

Clearing House is using CME SPAN® (Standard Portfolio Analysis of Risk) methodology to calculate performance bond requirement, i.e. Option buyer will be required to pay for premium only, while option seller will be required to pay performance bond to Clearing House to ensure the timely and orderly performance of financial obligations under the contracts. For more detailed explanation, please refer to following link –

http://www.bursamalaysia.com/website/bm/trading/derivatives/downloads/BMD_Margining_Guide.pdf

[End of FAQ]

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