NOTICE TO ALL NCEL REGISTERED BROKERS

Circular No. NCEL/Mem-574-2007

Date: November 26thth, 2007

Circular Name: Calendar Spreads and Spread Discounts in NCEL Gold Futures Contracts

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In pursuance of NCEL General Regulations, the following is hereby notified:

In order to facilitate creation of Calendar Spread positions in a given commodity, the Exchange will apply Calendar Spread discounts on such positions at the End-of-Day starting from Monday, December 3rd, 2007.

Please read this Circular in conjunction with NCEL Circular No: NCEL/002/052007 dated May 10, 2007.

Definition

A Calendar Spread position in terms of futures trading is defined as the purchase in one delivery month of a given commodity futures contract and sale of the same commodity futures contract in another delivery month on the same Exchange. A calendar spread position represents low risk to the underlying commodity price. In fact, a spread position eliminates exposure to underlying commodity price and exposes one to basis risk only, which is a much smaller risk in terms of magnitude when dealing with short-dated maturities.

Initial Margin for Calendar Spread Positions

Given the low inherent risk in calendar spread positions, NCEL is lowering margin requirements for such positions. The methodology for margin reduction is based on applying a spread discount to existing outright position in different contract months. By doing this, NCEL will be following standard international practices for spread margin discounts.

A Calendar Spread discount would be applied only at the End-of-Day on the basis of outstanding positions. Due to the dynamic nature of trading, it is only practical to apply these discounts at the end of trading once outright positions in all months have been determined. Spread margin discounts are of use to those traders who intend to keep spread positions for a longer period of time, including funds specialising in cost-of-carry arbitrage.

On Calendar Spread positions, Initial Margin shall be charged at the higher value of the near month or the far month position or at such rate as may be specified by the Exchange, from time to time. The near month position is the long/short position on the Spread Position that expires first. The far month Spread Position is the long/short position that expires next. This method is still conservative; however, as spread margin discounting is being introduced to Pakistan for the first time, it is appropriate to start with these levels which will still be extremely attractive for market participants.

A Calendar Spread position will be treated as non-spread (naked) positions during the last 5 trading days prior to expiration of the near month contract. Elimination of Spread Discount towards the expiry of near month contract is essential because at that point the risks inherent in near and far months become different as delivery risk gains a greater significance than market risk. Spread Discount on Initial Margins also needs to be removed during the last 5 trading days of the near month contract as during this period, Initial Margin is also replaced by Delivery Margin for the near contract.

Clearing Limit & Computation of Outstanding Exposure for Calendar Spread Positions

For Broker Clearing Limit/Exposure calculations, calendar spread positions in commodity futures contracts shall be treated as open position of one third of the value of the spread position. However, calendar spread positions shall be treated as naked positions five trading days prior to expiry of the near month contract.

Position Limits for Calendar Spread Positions

Both legs of the Calendar Spread will grossed up for the purpose of position limited at both levels Client and Broker.

Examples of Spread Margin Discounts

Example 1:

Month	*Position*	*Spread Position*	*Naked Position*	*Margin per Contract*	*Margin*
Aug	+100	75	25	4,300	25*4,300
Sep	-75	0	75	4,400	75*4,400
Oct	0	0	0	4,500	0

Example 2:

Month	*Position*	*Spread Position*	*Naked Position*	*Margin per Contract*	*Margin*
Aug	+100	+100	0	4,300	0
Sep	-75	0	75	4,400	75*4,400
Oct	-50	0	50	4,500	50*4,500

Spread Positions: 75 Contracts Aug/Sep, 25 Contracts Aug/Oct
Spread Margin Discount: 4,300 x 75 + 4,300 x 25
Total Margin Requirement: 75 x 4,400 + 50 x 4,500

Example 3:

Month	*Position*	*Margin per Contract*
Aug	+100	4,300
Sep	+60	4,400
Oct	-200	4,500

Spread Positions: 100 Contracts Aug/Oct, 60 Contracts Sep/Oct
Spread Margin Discount: 4,300 x 100 + 4,400 x 60
Total Margin Requirement: 200 x 4,500

Example of Clearing Limit & Computation of Outstanding Exposure for Calendar Spread Positions

Example 4:

Month	*Gross Positions (Broker + Clients)*
Aug	+200
Sep	-100
Oct	+50

Total Positions before Discount: 350
Spread Positions: 100
Positions used for Exposure Monitoring: (350 – 100) x 2/3 = 283

If you have any queries regarding this Circular, please contact the undersigned the Head of Compliance, NCEL.

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