

# Futures and Derivatives Clearing Client Disclosures

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## RISK DISCLOSURE STATEMENT FOR FUTURES AND OPTIONS

This brief statement does not disclose all of the risks and other significant aspects of trading in futures and options. In light of the risks, you should undertake such transactions only if you understand the nature of the contracts (and contractual relationships) into which you are entering and the extent of your exposure to risk. Trading in futures and options is not suitable for many members of the public. You should carefully consider whether trading is appropriate for you in light of your experience, objectives, financial resources and other relevant circumstances.

### FUTURES

#### 1. Effect of 'Leverage' or 'Gearing'

Transactions in futures carry a high degree of risk. The amount of initial margin is small relative to the value of the futures contract so that transactions are 'leveraged' or 'geared.' A relatively small market movement will have a proportionately larger impact on the funds you have deposited or will have to deposit: this may work against you as well as for you. You may sustain a total loss of initial margin funds and any additional funds deposited with the firm to maintain your position. If the market moves against your position or margin levels are increased, you may be called upon to pay substantial additional funds on short notice to maintain your position. If you fail to comply with a request for additional funds within the time prescribed, your position may be liquidated at a loss and you will be liable for any resulting deficit.

#### 2. Risk-reducing orders or strategies

The placing of certain orders (e.g., 'stop-loss' orders, where permitted under local law, or 'stop-limit' orders) which are intended to limit losses to certain amounts may not be effective because market conditions may make it impossible to execute such orders. Strategies using combinations of positions, such as 'spread' and 'straddle' positions, may be as risky as taking simple 'long' or 'short' positions.

### OPTIONS

#### 3. Variable degree of risk

Transactions in options carry a high degree of risk. Purchasers and sellers of options should familiarize themselves with the type of option (i.e., put or call) which they contemplate trading and the associated risks. You should calculate the extent to which the value of the options must increase for your position to become profitable, taking into account the premium and all transaction costs.

The purchaser of options may offset or exercise the options or allow the options to expire. The exercise of an option results either in a cash settlement or in the purchaser acquiring or delivering the underlying interest. If the option is on a future, the purchaser will acquire a futures position with associated liabilities for margin (see the section on Futures above). If the purchased options expire worthless, you will suffer a total loss of your investment, which will consist of the option premium plus transaction costs. If you are contemplating purchasing deep-out-of-the-money options, you should be aware that the chance of such options becoming profitable ordinarily is remote.

Selling ('writing' or 'granting') an option generally entails considerably greater risk than purchasing options. Although the premium received by the seller is fixed, the seller may sustain a loss well in excess of that amount. The seller will be liable for additional margin to maintain the position if the market moves unfavorably. The seller will also be exposed to the risk of the purchaser exercising the option and the seller will be obligated to either settle the option in cash or to acquire or deliver the underlying interest. If the option is on a future, the seller will acquire a position in a future with associated liabilities for margin (see the section on Futures above). If the position is 'covered' by the seller holding a corresponding

position in the underlying interest or a future or another option, the risk may be reduced. If the option is not covered, the risk of loss can be unlimited.

Certain exchanges in some jurisdictions permit deferred payment of the option premium, exposing the purchaser to liability for margin payments not exceeding the amount of the premium. The purchaser is still subject to the risk of losing the premium and transaction costs. When the option is exercised or expires, the purchaser is responsible for any unpaid premium outstanding at that time.

## **Additional risks common to futures and options**

### **4. Terms and conditions of contracts**

You should ask the firm with which you deal about the terms and conditions of the specific futures or options which you are trading and associated obligations (e.g., the circumstances under which you may become obligated to make or take delivery of the underlying interest of a futures contract and, in respect of options, expiration dates and restrictions on the time for exercise). Under certain circumstances the specifications of outstanding contracts (including the exercise price of an option) may be modified by the exchange or clearing house to reflect changes in the underlying interest.

### **5. Suspension or restriction of trading and pricing relationships**

Market conditions (e.g., illiquidity) and/or the operation of the rules of certain markets (e.g., the suspension of trading in any contract or contract month because of price limits or 'circuit breakers') may increase the risk of loss by making it difficult or impossible to effect transactions or liquidate/offset positions. If you have sold options, this may increase the risk of loss.

Further, normal pricing relationships between the underlying interest and the future, and the underlying interest and the option may not exist. This can occur when, for example, the futures contract underlying the option is subject to price limits while the option is not. The absence of an underlying reference price may make it difficult to judge 'fair' value.

### **6. Deposited cash and property**

You should familiarize yourself with the protections accorded money or other property you deposit for domestic and foreign transactions, particularly in the event of a firm insolvency or bankruptcy. The extent to which you may recover your money or property may be governed by specified legislation or local rules. In some jurisdictions, property which had been specifically identifiable as your own will be pro-rated in the same manner as cash for purposes of distribution in the event of a shortfall.

### **7. Commission and other charges**

Before you begin to trade, you should obtain a clear explanation of all commissions, fees and other charges for which you will be liable. These charges will affect your net profit (if any) or increase your loss.

### **8. Transactions in other jurisdictions**

Transactions on markets in other jurisdictions, including markets formally linked to a domestic market, may expose you to additional risk. Such markets may be subject to regulation which may offer different or diminished investor protection. Before you trade, you should inquire about any rules relevant to your particular transactions. Your local regulatory authority will be unable to compel the enforcement of the rules of regulatory authorities or markets in other jurisdictions where your transactions have been effected. You should ask the firm with which you deal for details about the types of redress available in both your home jurisdiction and other relevant jurisdictions before you start to trade.

## **9. Currency risks**

The profit or loss in transactions in foreign currency-denominated contracts (whether they are traded in your own or another jurisdiction) will be affected by fluctuations in currency rates where there is a need to convert from the currency denomination of the contract to another currency.

## **10. Trading facilities**

Most open-outcry and electronic trading facilities are supported by computer-based component systems for the order-routing, execution, matching, registration or clearing of trades. As with all facilities and systems, they are vulnerable to temporary disruption or failure. Your ability to recover certain losses may be subject to limits on liability imposed by the system provider, the market, the clearing house and/or member firms. Such limits may vary; you should ask the firm with which you deal for details in this respect.

## **11. Electronic trading**

Trading on an electronic trading system may differ not only from trading in an open-outcry market but also from trading on other electronic trading systems. If you undertake transactions on an electronic trading system, you will be exposed to risk associated with the system, including the failure of hardware and software. The result of any system failure may be that your order is either not executed according to your instructions or is not executed at all.

## **12. Off-exchange transactions**

In some jurisdictions, and only then in restricted circumstances, firms are permitted to effect off-exchange transactions. The firm with which you deal may be acting as your counterparty to the transaction. It may be difficult or impossible to liquidate an existing position, to assess the value, to determine a fair price or to assess the exposure to risk. For these reasons, these transactions may involve increased risks. Off-exchange transactions may be less regulated or subject to a separate regulatory regime. Before you undertake such transactions, you should familiarize yourself with applicable rules and attendant risks.

## CFTC RISK DISCLOSURE STATEMENT

The risk of loss in trading commodity futures contracts can be substantial. You should, therefore, carefully consider whether such trading is suitable for you in light of your circumstances and financial resources. You should be aware of the following points:

(1) You may sustain a total loss of the funds that you deposit with your broker to establish or maintain a position in the commodity futures market, and you may incur losses beyond these amounts. If the market moves against your position, you may be called upon by your broker to deposit a substantial amount of additional margin funds, on short notice, in order to maintain your position. If you do not provide the required funds within the time required by your broker, your position may be liquidated at a loss, and you will be liable for any resulting deficit in your account.

(2) The funds you deposit with a futures commission merchant for trading futures positions are not protected by insurance in the event of the bankruptcy or insolvency of the futures commission merchant, or in the event your funds are misappropriated.

(3) The funds you deposit with a futures commission merchant for trading futures positions are not protected by the Securities Investor Protection Corporation even if the futures commission merchant is registered with the Securities and Exchange Commission as a broker or dealer.

(4) The funds you deposit with a futures commission merchant are generally not guaranteed or insured by a derivatives clearing organization in the event of the bankruptcy or insolvency of the futures commission merchant, or if the futures commission merchant is otherwise unable to refund your funds. Certain derivatives clearing organizations, however, may have programs that provide limited insurance to customers. You should inquire of your futures commission merchant whether your funds will be insured by a derivatives clearing organization and you should understand the benefits and limitations of such insurance programs.

(5) The funds you deposit with a futures commission merchant are not held by the futures commission merchant in a separate account for your individual benefit. Futures commission merchants commingle the funds received from customers in one or more accounts and you may be exposed to losses incurred by other customers if the futures commission merchant does not have sufficient capital to cover such other customers' trading losses.

(6) The funds you deposit with a futures commission merchant may be invested by the futures commission merchant in certain types of financial instruments that have been approved by the Commission for the purpose of such investments. Permitted investments are listed in Commission Regulation 1.25 and include: U.S. government securities; municipal securities; money market mutual funds; and certain corporate notes and bonds. The futures commission merchant may retain the interest and other earnings realized from its investment of customer funds. You should be familiar with the types of financial instruments that a futures commission merchant may invest customer funds in.

(7) Futures commission merchants are permitted to deposit customer funds with affiliated entities, such as affiliated banks, securities brokers or dealers, or foreign brokers. You should inquire as to whether your futures commission merchant deposits funds with affiliates and assess whether such deposits by the futures commission merchant with its affiliates increases the risks to your funds.

(8) You should consult your futures commission merchant concerning the nature of the protections available to safeguard funds or property deposited for your account.

(9) Under certain market conditions, you may find it difficult or impossible to liquidate a position. This can occur, for example, when the market reaches a daily price fluctuation limit ("limit move").

(10) All futures positions involve risk, and a “spread” position may not be less risky than an outright “long” or “short” position.

(11) The high degree of leverage (gearing) that is often obtainable in futures trading because of the small margin requirements can work against you as well as for you. Leverage (gearing) can lead to large losses as well as gains.

(12) In addition to the risks noted in the paragraphs enumerated above, you should be familiar with the futures commission merchant you select to entrust your funds for trading futures positions. The Commodity Futures Trading Commission requires each futures commission merchant to make publicly available on its Web site firm specific disclosures and financial information to assist you with your assessment and selection of a futures commission merchant. Information regarding this futures commission merchant may be obtained by visiting our Web site, <http://www.bofamf.com/en-us/content/futures-options-otc-clearing.html>.

ALL OF THE POINTS NOTED ABOVE APPLY TO ALL FUTURES TRADING WHETHER FOREIGN OR DOMESTIC. IN ADDITION, IF YOU ARE CONTEMPLATING TRADING FOREIGN FUTURES OR OPTIONS CONTRACTS, YOU SHOULD BE AWARE OF THE FOLLOWING ADDITIONAL RISKS:

(13) Foreign futures transactions involve executing and clearing trades on a foreign exchange. This is the case even if the foreign exchange is formally “linked” to a domestic exchange, whereby a trade executed on one exchange liquidates or establishes a position on the other exchange. No domestic organization regulates the activities of a foreign exchange, including the execution, delivery, and clearing of transactions on such an exchange, and no domestic regulator has the power to compel enforcement of the rules of the foreign exchange or the laws of the foreign country. Moreover, such laws or regulations will vary depending on the foreign country in which the transaction occurs. For these reasons, customers who trade on foreign exchanges may not be afforded certain of the protections which apply to domestic transactions, including the right to use domestic alternative dispute resolution procedures. In particular, funds received from customers to margin foreign futures transactions may not be provided the same protections as funds received to margin futures transactions on domestic exchanges. Before you trade, you should familiarize yourself with the foreign rules which will apply to your particular transaction.

(14) Finally, you should be aware that the price of any foreign futures or option contract and, therefore, the potential profit and loss resulting therefrom, may be affected by any fluctuation in the foreign exchange rate between the time the order is placed and the foreign futures contract is liquidated or the foreign option contract is liquidated or exercised.

THIS BRIEF STATEMENT CANNOT, OF COURSE, DISCLOSE ALL THE RISKS AND OTHER ASPECTS OF THE COMMODITY MARKETS.

## OPTIONS DISCLOSURE STATEMENT

BECAUSE OF THE VOLATILE NATURE OF THE COMMODITIES MARKETS, THE PURCHASE AND GRANTING OF COMMODITY OPTIONS INVOLVE A HIGH DEGREE OF RISK. COMMODITY OPTION TRANSACTIONS ARE NOT SUITABLE FOR MANY MEMBERS OF THE PUBLIC. SUCH TRANSACTIONS SHOULD BE ENTERED INTO ONLY BY PERSONS WHO HAVE READ AND UNDERSTOOD THIS DISCLOSURE STATEMENT AND WHO UNDERSTAND THE NATURE AND EXTENT OF THEIR RIGHTS AND OBLIGATIONS AND OF THE RISKS INVOLVED IN THE OPTION TRANSACTIONS COVERED BY THIS DISCLOSURE STATEMENT.

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW THAT THE OPTION IF EXERCISED, RESULTS IN THE ESTABLISHMENT OF A FUTURES CONTRACT (AN "OPTION ON A FUTURES CONTRACT").

BOTH THE PURCHASER AND THE GRANTOR SHOULD KNOW WHETHER THE PARTICULAR OPTION IN WHICH THEY CONTEMPLATE TRADING IS SUBJECT TO A "STOCK-STYLE" OR "FUTURES-STYLE" SYSTEM OF MARGINING. UNDER A STOCK-STYLE MARGINING SYSTEM, A PURCHASER IS REQUIRED TO PAY THE FULL PURCHASE PRICE OF THE OPTION AT THE INITIATION OF THE TRANSACTION. THE PURCHASER HAS NO FURTHER OBLIGATION ON THE OPTION POSITION. UNDER A FUTURES-STYLE MARGINING SYSTEM, THE PURCHASER DEPOSITS INITIAL MARGIN AND MAY BE REQUIRED TO DEPOSIT ADDITIONAL MARGIN IF THE MARKET MOVES AGAINST THE OPTION POSITION. THE PURCHASER'S TOTAL SETTLEMENT VARIATION MARGIN OBLIGATION OVER THE LIFE OF THE OPTION, HOWEVER, WILL NOT EXCEED THE ORIGINAL OPTION PREMIUM, ALTHOUGH SOME INDIVIDUAL PAYMENT OBLIGATIONS AND/OR RISK MARGIN REQUIREMENTS MAY AT TIMES EXCEED THE ORIGINAL OPTION PREMIUM. IF THE PURCHASER OR GRANTOR DOES NOT UNDERSTAND HOW OPTIONS ARE MARGINED UNDER A STOCK-STYLE OR FUTURES-STYLE MARGINING SYSTEM, HE OR SHE SHOULD REQUEST AN EXPLANATION FROM THE FUTURES COMMISSION MERCHANT ("FCM") OR INTRODUCING BROKER ("IB").

A PERSON SHOULD NOT PURCHASE ANY COMMODITY OPTION UNLESS HE OR SHE IS ABLE TO SUSTAIN A TOTAL LOSS OF THE PREMIUM AND TRANSACTION COSTS OF PURCHASING THE OPTION. A PERSON SHOULD NOT GRANT ANY COMMODITY OPTION UNLESS HE OR SHE IS ABLE TO MEET ADDITIONAL CALLS FOR MARGIN WHEN THE MARKET MOVES AGAINST HIS OR HER POSITION AND, IN SUCH CIRCUMSTANCES, TO SUSTAIN A VERY LARGE FINANCIAL LOSS.

A PERSON WHO PURCHASES AN OPTION SUBJECT TO STOCK-STYLE MARGINING SHOULD BE AWARE THAT, IN ORDER TO REALIZE ANY VALUE FROM THE OPTION, IT WILL BE NECESSARY EITHER TO OFFSET THE OPTION POSITION OR TO EXERCISE THE OPTION. OPTIONS SUBJECT TO FUTURES-STYLE MARGINING ARE MARKED TO MARKET, AND GAINS AND LOSSES ARE PAID AND COLLECTED DAILY. IF AN OPTION PURCHASER DOES NOT UNDERSTAND HOW TO OFFSET OR EXERCISE AN OPTION, THE PURCHASER SHOULD REQUEST AN EXPLANATION FROM THE FCM OR IB. CUSTOMERS SHOULD BE AWARE THAT IN A NUMBER OF CIRCUMSTANCES, SOME OF WHICH WILL BE DESCRIBED IN THIS DISCLOSURE STATEMENT, IT MAY BE DIFFICULT OR IMPOSSIBLE TO OFFSET AN EXISTING OPTION POSITION ON AN EXCHANGE.

THE GRANTOR OF AN OPTION SHOULD BE AWARE THAT, IN MOST CASES, A COMMODITY OPTION MAY BE EXERCISED AT ANY TIME FROM THE TIME IT IS GRANTED UNTIL IT EXPIRES. THE PURCHASER OF AN OPTION SHOULD BE AWARE THAT SOME OPTION CONTRACTS MAY PROVIDE ONLY A LIMITED PERIOD OF TIME FOR EXERCISE OF THE OPTION.

THE PURCHASER OF A PUT OR CALL SUBJECT TO STOCK-STYLE OR FUTURES-STYLE MARGINING IS SUBJECT TO THE RISK OF LOSING THE ENTIRE PURCHASE PRICE OF THE OPTION—THAT IS, THE PREMIUM CHARGED FOR THE OPTION PLUS ALL TRANSACTION COSTS.

THE COMMODITY FUTURES TRADING COMMISSION REQUIRES THAT ALL CUSTOMERS RECEIVE AND ACKNOWLEDGE RECEIPT OF A COPY OF THIS DISCLOSURE STATEMENT BUT DOES NOT INTEND THIS STATEMENT AS A RECOMMENDATION OR ENDORSEMENT OF EXCHANGE-TRADED COMMODITY OPTIONS.

### **(1) Some of the risks of option trading.**

Specific market movements of the underlying future cannot be predicted accurately.

The grantor of a call option who does not have a long position in the underlying futures contract is subject to risk of loss should the price of the underlying futures contract be higher than the strike price upon exercise or expiration of the option by an amount greater than the premium received for granting the call option.

The grantor of a call option who has a long position in the underlying futures contract is subject to the full risk of a decline in price of the underlying position reduced by the premium received for granting the call. In exchange for the premium received for granting a call option, the option grantor gives up all of the potential gain resulting from an increase in the price of the underlying futures contract above the option strike price upon exercise or expiration of the option.

The grantor of a put option who does not have a short position in the underlying futures contract is subject to risk of loss should the price of the underlying futures contract decrease below the strike price upon exercise or expiration of the option by an amount in excess of the premium received for granting the put option.

The grantor of a put option on a futures contract who has a short position in the underlying futures contract is subject to the full risk of a rise in the price in the underlying position reduced by the premium received for granting the put. In exchange for the premium received for granting a put option on a futures contract, the option grantor gives up all of the potential gain resulting from a decrease in the price of the underlying futures contract below the option strike price upon exercise or expiration of the option.

## **(2) Description of commodity options.**

Prior to entering into any transaction involving a commodity option, an individual should thoroughly understand the nature and type of option involved and the underlying futures contract. The futures commission merchant or introducing broker is required to provide, and the individual contemplating an option transaction should obtain:

- (i) An identification of the futures contract underlying the option and which may be purchased or sold upon exercise of the option or, if applicable, whether exercise of the option will be settled in cash;
- (ii) The procedure for exercise of the option contract, including the expiration date and latest time on that date for exercise. (The latest time on an expiration date when an option may be exercised may vary; therefore, option market participants should ascertain from their futures commission merchant or their introducing broker the latest time the firm accepts exercise instructions with respect to a particular option.);
- (iii) A description of the purchase price of the option including the premium, commissions, costs, fees and other charges. (Since commissions and other charges may vary widely among futures commission merchants and among introducing brokers, option customers may find it advisable to consult more than one firm when opening an option account.);
- (iv) A description of all costs in addition to the purchase price which may be incurred if the commodity option is exercised, including the amount of commissions (whether termed sales commissions or otherwise), storage, interest, and all similar fees and charges which may be incurred;
- (v) An explanation and understanding of the option margining system;
- (vi) A clear explanation and understanding of any clauses in the option contract and of any items included in the option contract explicitly or by reference which might affect the customer's obligations under the contract. This would include any policy of the futures commission merchant or the introducing broker or rule of the exchange on which the option is traded that might affect the customer's ability to fulfill the option contract or to offset the option position in a closing purchase or closing sale transaction (for example, due to unforeseen circumstances that require suspension or termination of trading); and
- (vii) If applicable, a description of the effect upon the value of the option position that could result from limit moves in the underlying futures contract.

## **(3) The mechanics of option trading.**

Before entering into any exchange-traded option transaction, an individual should obtain a description of how commodity options are traded.

Option customers should clearly understand that there is no guarantee that option positions may be offset by either a closing purchase or closing sale transaction on an exchange. In this circumstance, option grantors could be subject to the full risk of their positions until the option position expires, and the purchaser of a profitable option might have to exercise the option to realize a profit.



For an option on a futures contract, an individual should clearly understand the relationship between exchange rules governing option transactions and exchange rules governing the underlying futures contract. For example, an individual should understand what action, if any, the exchange will take in the option market if trading in the underlying futures market is restricted or the futures prices have made a "limit move."

The individual should understand that the option may not be subject to daily price fluctuation limits while the underlying futures may have such limits, and, as a result, normal pricing relationships between options and the underlying future may not exist when the future is trading at its price limit. Also, underlying futures positions resulting from exercise of options may not be capable of being offset if the underlying future is at a price limit.

#### **(4) Margin requirements.**

An individual should know and understand whether the option he or she is contemplating trading is subject to a stock-style or futures-style system of margining. Stock-style margining requires the purchaser to pay the full option premium at the time of purchase. The purchaser has no further financial obligations, and the risk of loss is limited to the purchase price and transaction costs. Futures-style margining requires the purchaser to pay initial margin only at the time of purchase. The option position is marked to market, and gains and losses are collected and paid daily. The purchaser's risk of loss is limited to the initial option premium and transaction costs.

An individual granting options under either a stock-style or futures-style system of margining should understand that he or she may be required to pay additional margin in the case of adverse market movements.

#### **(5) Profit potential of an option position.**

An option customer should carefully calculate the price which the underlying futures contract would have to reach for the option position to become profitable. Under a stock-style margining system, this price would include the amount by which the underlying futures contract would have to rise above or fall below the strike price to cover the sum of the premium and all other costs incurred in entering into and exercising or closing (offsetting) the commodity option position. Under a future-style margining system, option positions would be marked to market, and gains and losses would be paid and collected daily, and an option position would become profitable once the variation margin collected exceeded the cost of entering the contract position.

Also, an option customer should be aware of the risk that the futures price prevailing at the opening of the next trading day may be substantially different from the futures price which prevailed when the option was exercised.

#### **(6) Deep-out-of-the-money options.**

A person contemplating purchasing a deep-out-of-the-money option (that is, an option with a strike price significantly above, in the case of a call, or significantly below, in the case of a put, the current price of the underlying futures contract) should be aware that the chance of such an option becoming profitable is ordinarily remote.

On the other hand, a potential grantor of a deep-out-of-the-money option should be aware that such options normally provide small premiums while exposing the grantor to all of the potential losses described in section (1) of this disclosure statement.

#### **(7) Glossary of terms—**

- (i) *Contract market.* Any board of trade (exchange) located in the United States which has been designated by the Commodity Futures Trading Commission to list a futures contract or commodity option for trading.
- (ii) *Exchange-traded option; put option; call option.* The options discussed in this disclosure statement are limited to those which may be traded on a contract market. These options (subject to certain exceptions) give an option purchaser the right to buy in the case of a call option, or to sell in the case of a put option, a futures contract underlying the option at the stated strike price prior to the expiration date of the option. Each exchange-traded option is distinguished by the underlying futures contract, strike price, expiration date, and whether the option is a put or a call.
- (iii) *Underlying futures contract.* The futures contract which may be purchased or sold upon the exercise of an option on a futures contract.
- (iv) [Reserved]

- (v) *Class of options.* A put or a call covering the same underlying futures contract.
- (vi) *Series of options.* Options of the same class having the same strike price and expiration date.
- (vii) *Exercise price.* See strike price.
- (viii) *Expiration date.* The last day when an option may be exercised.
- (ix) *Premium.* The amount agreed upon between the purchaser and seller for the purchase or sale of a commodity option.
- (x) *Strike price.* The price at which a person may purchase or sell the underlying futures contract upon exercise of a commodity option. This term has the same meaning as the term “exercise price.”
- (xi) *Short option position.* See opening sale transaction.
- (xii) *Long option position.* See opening purchase transaction.
- (xiii) *Types of options transactions—*
  - (A) *Opening purchase transaction.* A transaction in which an individual purchases an option and thereby obtains a long option position.
  - (B) *Opening sale transaction.* A transaction in which an individual grants an option and thereby obtains a short option position.
  - (C) *Closing purchase transaction.* A transaction in which an individual with a short option position liquidates the position. This is accomplished by a closing purchase transaction for an option of the same series as the option previously granted. Such a transaction may be referred to as an offset transaction.
  - (D) *Closing sale transaction.* A transaction in which an individual with a long option position liquidates the position. This is accomplished by a closing sale transaction for an option of the same series as the option previously purchased. Such a transaction may be referred to as an offset transaction.
- (xiv) *Purchase price.* The total actual cost paid or to be paid, directly or indirectly, by a person to acquire a commodity option. This price includes all commissions and other fees, in addition to the option premium.
- (xv) *Grantor, writer, seller.* An individual who sells an option. Such a person is said to have a short position.
- (xvi) *Purchaser.* An individual who buys an option. Such a person is said to have a long position.

## NOTICE REGARDING AVERAGE PRICE SYSTEM ("APS")

You should be aware that certain US and non-US exchanges, including the CME and CBOT, may now or in the future allow a futures commission merchant ("FCM") such as Merrill Lynch to confirm trades executed on such exchanges to some or all of their customers on an average price basis regardless of whether the exchanges have average price systems of their own. Average prices that are not calculated by an exchange system will be calculated by your FCM. In either case, trades that are confirmed to you at average prices will be designated as such on your daily and monthly statements.

APS enables a clearing firm to confirm to customers an average price when multiple execution prices are received on an order or series of orders for the same accounts. For example, if an order transmitted by an account manager on behalf of several customers is executed at more than one price, those prices may be averaged and the average may be confirmed to each customer. Customers may choose whether to use APS, and may request that APS be used for discretionary or non-discretionary accounts.

An order subject to APS must be for the same commodity. An APS order may be used for futures, options or combination transactions. An APS order for futures must be for the same commodity and month, and for options, it must be for the same commodity, month, put/call and strike.

An APS indicator will appear on the confirmation and monthly statement for a customer whose positions have been confirmed at an average price. This indicator will notify the customer that the confirmed price represents an average price or rounded average price.

The average price is not the actual execution price. APS will calculate the same price for all customers that participate in the order.

APS may be used when a series of orders are entered for a group of accounts. For example, a bunched APS order (an order that represents more than one customer account) executed at 10:00 a.m. could be averaged with a bunched APS order executed at 12:00 p.m. provided that each of the bunched orders is for the same accounts. In addition, market orders and limit orders may be averaged, as may limit orders at different prices, provided that each order is for the same accounts.

The following scenario exemplifies what occurs if an APS order is only partially executed. At 10:00 a.m. an APS order to buy 100 Dec S & P 500 futures contracts is transmitted at a limit price of 376.00; 50 are executed at 376.00, and the balance is not filled. At 12:00 p.m. an APS order to buy 100 Dec S & P 500 futures contracts is transmitted at a limit price of 375.00; 50 are executed at 375.00, and the balance is not filled. Both orders are part of a series for the same group of accounts. In this example, the two prices will be averaged. If the order was placed for more than one account, the account controller must rely on pre-existing allocation procedures to determine the proportions in which each account will share in the partial fill.

Upon receipt of an execution at multiple prices for an order with an APS indicator, an average will be computed by multiplying the execution prices by the quantities at those prices divided by the total quantities. An average price for a series of orders will be computed based on the average prices of each order in that series. The actual average price or the average price rounded to the next price increment may be confirmed to customers. If a clearing member confirms the rounded average price, the clearing member must round the average price up to the next price increment for a sell order. The rounding process will create a cash residual of the difference between the actual average price and the rounded average price that must be paid to the customer.

APS may produce prices that do not conform to whole cent increments. In such cases, any amounts less than one cent may be retained by the clearing member. For example, if the total residual to be paid to a customer on a rounded average price for 10 contracts is \$83.333333, the clearing member may pay \$83.33 to the customer. If you would like more information on APS orders, please contact your account representative.

## ELECTRONIC TRADING AND ORDER ROUTING SYSTEMS DISCLOSURE STATEMENT

Electronic trading and order routing systems differ from traditional open outcry pit trading and manual order routing methods. Transactions using an electronic system are subject to the rules and regulations of the exchange(s) offering the system and/or listing the contract. Before you engage in transactions using an electronic system, you should carefully review the rules and regulations of the exchange(s) offering the system and/or listing contracts you intend to trade.

### Differences Among Electronic Trading Systems

Trading or routing orders through electronic systems varies widely among the different electronic systems. You should consult the rules and regulations of the exchange offering the electronic system and/or listing the contract traded or order routed to understand, among other things, in the case of trading systems, the system's order matching procedure, opening and closing procedures and prices, error trade policies, and trading limitations or requirements; and in the case of all systems, qualifications for access and grounds for termination and limitations on the types of orders that may be entered into the system. Each of these matters may present different risk factors with respect to trading on or using a particular system. Each system may also present risks related to system access, varying response times, and security. In the case of Internet-based systems, there may be additional types of risks related to system access, varying response times and security, as well as risks related to service providers and the receipt and monitoring of electronic mail.

### Risks Associated with System Failure

Trading through an electronic trading or order routing system exposes you to risks associated with system or component failure. In the event of system or component failure, it is possible that, for a certain time period, you may not be able to enter new orders, execute existing orders, or modify or cancel orders that were previously entered. System or component failure may also result in loss of orders or order priority.

### Simultaneous Open Outcry and Electronic Pit Trading

Some contracts offered on an electronic trading system may be traded electronically and through open outcry during the same trading hours. You should review the rules and regulations of the exchange offering the system and/or listing the contract to determine how orders that do not designate a particular process will be executed.

### Limitation of Liability

Exchanges offering an electronic trading or order routing system and/or listing the contract may have adopted rules to limit their liability, the liability of FCMs, and software and communication system vendors and the amount of damages you may collect for system failure and delays. These limitations of liability provisions vary among the exchanges. You should consult the rules and regulations of the relevant exchange(s) in order to understand these liability limitations.

\*Each exchange's relevant rules are available upon request from the industry professional with whom you have an account. Some exchange's relevant rules also are available on the exchange's Internet home page.

## UNIFORM NOTIFICATION REGARDING ACCESS TO EXCHANGE MARKET DATA

As a market user you may obtain access to exchange Market Data available through an electronic trading system, software or device that is provided or made available to you by a broker or an affiliate of such. Market Data may include, but is not limited to, "real time" or delayed market prices, opening and closing prices and ranges, high-low prices, settlement prices, estimated and actual volume information, bids or offers and the applicable sizes and numbers of such bids or offers.

You are hereby notified that Market Data constitutes valuable confidential information that is the exclusive proprietary property of the applicable exchange, and is not within the public domain. Such Market Data may only be used for your firm's internal use. You may not, without the authorization of the applicable exchange, redistribute, sell, license, retransmit or otherwise provide Market Data, internally or externally and in any format by electronic or other means, including, but not limited to the Internet.

You must provide upon request of the broker through which your firm has obtained access to Market Data, or the applicable exchange, information demonstrating your firm's use of the Market Data in accordance with this Notification. Each applicable exchange reserves the right to terminate a market user's access to Market Data for any reason. You also agree that you will cooperate with an exchange and permit an exchange reasonable access to your premises should an exchange wish to conduct an audit or review connected to the distribution of Market Data.

NEITHER THE EXCHANGE NOR THE BROKER, NOR THEIR RESPECTIVE MEMBERS, SHAREHOLDERS, DIRECTORS, OFFICERS, EMPLOYEES OR AGENTS, GUARANTEE THE TIMELINESS, SEQUENCE, ACCURACY OR COMPLETENESS OF THE DESIGNATED MARKET DATA, MARKET INFORMATION OR OTHER INFORMATION FURNISHED NOR THAT THE MARKET DATA HAVE BEEN VERIFIED. YOU AGREE THAT THE MARKET DATA AND OTHER INFORMATION PROVIDED IS FOR INFORMATION PURPOSES ONLY AND IS NOT INTENDED AS AN OFFER OR SOLICITATION WITH RESPECT TO THE PURCHASE OR SALE OF ANY SECURITY OR COMMODITY.

NEITHER THE EXCHANGE NOR THE BROKER NOR THEIR RESPECTIVE MEMBERS, SHAREHOLDERS, DIRECTORS, OFFICERS, EMPLOYEES OR AGENTS, SHALL BE LIABLE TO YOU OR TO ANY OTHER PERSON, FIRM OR CORPORATION WHATSOEVER FOR ANY LOSSES, DAMAGES, CLAIMS, PENALTIES, COSTS OR EXPENSES (INCLUDING LOST PROFITS) ARISING OUT OF OR RELATING TO THE MARKET DATA IN ANY WAY, INCLUDING BUT NOT LIMITED TO ANY DELAY, INACCURACIES, ERRORS OR OMISSIONS IN THE MARKET DATA OR IN THE TRANSMISSION THEREOF OR FOR NONPERFORMANCE, DISCONTINUANCE, TERMINATION OR INTERRUPTION OF SERVICE OR FOR ANY DAMAGES ARISING THEREFROM OR OCCASIONED THEREBY, DUE TO ANY CAUSE WHATSOEVER, WHETHER OR NOT RESULTING FROM NEGLIGENCE ON THEIR PART. IF THE FOREGOING DISCLAIMER AND WAIVER OF LIABILITY SHOULD BE DEEMED INVALID OR INEFFECTIVE, NEITHER THE EXCHANGE NOR THE BROKER, NOR THEIR RESPECTIVE SHAREHOLDERS, MEMBERS, DIRECTORS, OFFICERS, EMPLOYEES OR AGENTS SHALL BE LIABLE IN ANY EVENT, INCLUDING THEIR OWN NEGLIGENCE, BEYOND THE ACTUAL AMOUNT OF LOSS OR DAMAGE, OR THE AMOUNT OF THE MONTHLY FEE PAID BY YOU TO BROKER, WHICHEVER IS LESS. YOU AGREE THAT NEITHER THE EXCHANGE NOR THE BROKER NOR THEIR RESPECTIVE SHAREHOLDERS, MEMBERS, DIRECTORS, OFFICERS, EMPLOYEES OR AGENTS, SHALL BE LIABLE TO YOU OR TO ANY OTHER PERSON, FIRM OR CORPORATION WHATSOEVER FOR ANY INDIRECT, SPECIAL OR CONSEQUENTIAL DAMAGES, INCLUDING WITHOUT LIMITATION, LOST PROFITS, COSTS OF DELAY, OR COSTS OF LOST OR DAMAGED DATA.

## **DISCLOSURE STATEMENT ON FUTURES EXCHANGE OWNERSHIP INTERESTS AND INCENTIVE PROGRAMS**

You should be aware that your Futures Commission Merchant ("FCM") or one or more of its affiliates may own stock of, or has some other form of ownership interest in, one or more U.S. or foreign exchanges and clearing houses that you may trade on or that may clear your trades. As a result, you should be aware that your FCM or its affiliate might receive financial benefits related to its ownership interest when trades are executed on such an exchange or cleared at such a clearing house.

In addition, futures exchanges from time to time have in place other arrangements that may provide members with volume or market making discounts or credits, may call for participating members to pre-pay fees based on volume thresholds or may provide other incentive or arrangements that are intended to encourage market participants to trade on or direct trades to that exchange. Your FCM, or one or more of its affiliates, may participate in and obtain financial benefits from such an incentive program.

You should contact your FCM directly if you would like to know whether it has an ownership interest in a particular exchange or clearing house, or whether it participates in any incentive program on a particular exchange or clearing house. You may also contact any particular futures exchange directly to ask if it has any such incentive program for member firms.

## **DISCLOSURE ON PAYMENT FOR ORDER FLOW**

When firms provide execution services to customers, either in conjunction with clearing services or in an execution only capacity, they may, in some circumstances, direct orders to unaffiliated market makers, other executing firms, individual floor brokers or floor brokerage groups for execution. When such unaffiliated parties are used, they may, where permitted, agree to price concessions, volume discounts or refunds, rebates or similar payments in return for receiving such business. Likewise, on occasion, in connection with exchanges that permit pre-execution discussions and “off-floor” transactions such as block trading, exchanges of physicals, swaps or options for futures or equivalent transactions, a counterparty solicited to trade opposite customers of an executing firm may make payments described above and/or pay a commission to the executing firm in connection with that transaction. This could be viewed as an apparent conflict of interest. In order to determine whether transactions executed for your account are subject to the above circumstances, please contact your executing firm account representative.

## DISCLOSURE ON LIMITATION OF LIABILITY RULES

When you execute a trade on or pursuant to the rules of an exchange or other trading facility or clear a trade through a clearing organization, your trade is subject to rules of the applicable exchange, trading facility and/or clearing organization. Such exchanges, trading facilities and clearing organizations have adopted rules that generally limit their liability for any failure, malfunction, fault in delivery, delay, omission, suspension, inaccuracy, interruption, termination, or any other cause, in connection with the furnishing, performance, operation, maintenance, use of or inability to use all or any part of any of the systems and services of the exchange, trading facility or clearing house or one of their independent software vendors or network providers. For example, if you trade on Nasdaq Futures, Inc. ("NFX"), any limitation of liability in an agreement between you and Merrill Lynch will, pursuant to NFX rules, also apply to NFX as a third party beneficiary. In addition, exchanges, trading facilities and clearing organizations typically disclaim liability for error, inaccuracies in information and unauthorized access or use of a system or service. These limitations of liability may increase your risk of loss in certain circumstances.



## DIRECT ORDER TRANSMITTAL CLIENT DISCLOSURE STATEMENT

This statement applies to the ability of authorized clients of Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") to place orders for foreign futures and options transactions directly with non-US entities (each, an "Executing Firm") that execute transactions on behalf of Merrill Lynch's foreign futures and options customer omnibus accounts.

Please be aware of the following should you be permitted to place the type of orders specified above.

- The orders you place with an Executing Firm are for Merrill Lynch's foreign futures and options customer omnibus account maintained with a foreign clearing firm. Consequently, Merrill Lynch may limit or otherwise condition the orders you place with the Executing Firm.
- You should be aware of the relationship of the Executing Firm and Merrill Lynch. Merrill Lynch may not be responsible for the acts, omissions, or errors of the Executing Firm, or its representatives, with which you place your orders. In addition, the Executing Firm may not be affiliated with Merrill Lynch. If you choose to place orders directly with an Executing Firm, you may be doing so at your own risk.
- It is your responsibility to inquire about the applicable laws and regulations that govern the foreign exchanges on which transactions will be executed on your behalf. Any orders placed by you for execution on that exchange will be subject to such rules and regulations, its customs and usages, as well as any local laws that may govern transactions on that exchange. These laws, rules, regulations, customs and usages may offer different or diminished protection from those that govern transactions on US exchanges. In particular, funds received from clients to margin foreign futures transactions may not be provided the same protections as funds received to margin futures transactions on domestic exchanges. Before you trade, you should familiarize yourself with the foreign rules which will apply to your particular transaction. United States regulatory authorities may be unable to compel the enforcement of the rules of regulatory authorities or markets in non-US jurisdictions where transactions may be effected.
- It is your responsibility to determine whether the Executing Firm has consented to the jurisdiction of the courts in the United States. In general, neither the Executing Firm nor any individuals associated with the Executing Firm will be registered in any capacity with the Commodity Futures Trading Commission. Similarly, your contacts with the Executing Firm may not be sufficient to subject the Executing Firm to the jurisdiction of courts in the United States in the absence of the Executing Firm's consent. Accordingly, neither the courts of the United States nor the Commission's reparations program may be available as a forum for resolution of any disagreements you may have with the Executing Firm, and your recourse may be limited to actions outside the United States.
- Unless you object within five (5) days, by giving us written notice, Merrill Lynch will assume your consent to the aforementioned conditions. Any such notice should be directed to Merrill Lynch, Pierce, Fenner & Smith Incorporated, 540 W Madison St., Chicago, IL 60661, Attention: Futures New Accounts.

## **FOREIGN BROKER OR TRADER DISCLOSURE STATEMENT AND SPECIAL CALLS FOR INFORMATION**

In accordance with Rules 15.05 and 21.03 of the Commodity Futures Trading Commission ("CFTC"), 17 C.F.R. §§15.05 and 21.03, we are considered to be your agent for purposes of accepting delivery and service of communications from or on behalf of the CFTC regarding any commodity futures contracts or commodity option contracts which are or have been maintained in your account(s) with us. In the event that you are acting as agent or broker for any other person(s), we are also considered to be their agent, and the agent of any person(s) for whom they may be acting as agent or broker, for purposes of accepting delivery and service of such communications. Service or delivery to us of any communication issued by or on behalf of the CFTC (including any summons, complaint, order, subpoena, special call, request for information, notice, correspondence or other written document) will be considered valid and effective service or delivery upon you or any person for whom you may be acting, directly or indirectly, as agent or broker.

You should be aware that Rule 15.05 also provides that you may designate an agent other than Merrill Lynch. Any such alternative designation of agency must be evidenced by a written agency agreement which you must furnish to us and which we, in turn, must forward to the CFTC. If you wish to designate an agent other than us, please contact us in writing. You should consult 17 C.F.R. § 15.05 for a more complete explanation of the foregoing.

Upon a determination by the CFTC that information concerning your account(s) with us may be relevant in enabling the CFTC to determine whether the threat of a market manipulation, corner, squeeze, or other market disorder exists, the CFTC may issue a call for specific information from us or from you. In the event that the CFTC directs a call for information to us, we must provide the information requested within the time specified by the CFTC. If the CFTC directs a call for information to you through us as your agent, we must promptly transmit the call to you, and you must provide the information requested within the time specified by the CFTC. If any call by the CFTC for information regarding your account(s) with us is not met, the CFTC has authority to restrict such account(s) to trading for liquidation only. You have the right to a hearing before the CFTC to contest any call for information concerning your account(s) with us, but your request for a hearing will not suspend the CFTC's call for information unless the CFTC modifies or withdraws the call. Please consult 17 C.F.R. §21.03 for a more complete description of the foregoing (including the type of information you may be required to provide).

**Certain additional regulations may affect you. Part 17 of the CFTC Regulations, 17 C.F.R. Part 17, requires each futures commission merchant and foreign broker to submit a report to the CFTC with respect to each account carried by such futures commission merchant or foreign broker which contains a reportable futures position. (Specific reportable position levels for all futures contracts traded on U.S. exchanges are established in Rule 15.03.) In addition, Part 18 of the CFTC Regulations, 17 C.F.R. Part 18, requires all traders (including foreign traders) who own or control a reportable futures or options position and who have received a special call from the CFTC to file a Large Trader Reporting Form (Form 103) with the CFTC within one day after the special call upon such trader by the CFTC. Please consult 17 C.F.R. Parts 17 and 18 for more complete information with respect to the foregoing.**

## **NON-CASH MARGIN DISCLOSURE**

THIS STATEMENT IS FURNISHED TO YOU BECAUSE RULE 190.10(c) OF THE COMMODITY FUTURES TRADING COMMISSION REQUIRES IT FOR REASONS OF FAIR NOTICE UNRELATED TO THIS COMPANY'S CURRENT FINANCIAL CONDITION.

YOU SHOULD KNOW THAT IN THE UNLIKELY EVENT OF THIS COMPANY'S BANKRUPTCY, PROPERTY, INCLUDING PROPERTY SPECIFICALLY TRACEABLE TO YOU, WILL BE RETURNED, TRANSFERRED OR DISTRIBUTED TO YOU, OR ON YOUR BEHALF, ONLY TO THE EXTENT OF YOUR PRO RATA SHARE OF ALL PROPERTY AVAILABLE FOR DISTRIBUTION TO CUSTOMERS.

NOTICE CONCERNING THE TERMS FOR THE RETURN OF SPECIFICALLY IDENTIFIABLE PROPERTY WILL BE BY PUBLICATION IN A NEWSPAPER OF GENERAL CIRCULATION.

THE COMMISSION'S REGULATIONS CONCERNING BANKRUPTCIES OF COMMODITY BROKERS CAN BE FOUND AT 17 CODE OF FEDERAL REGULATIONS PART 190.

## **NOTICE TO CLIENTS**

### **POSITION LIMIT AND LARGE OPEN POSITION REPORTING REQUIREMENTS FOR OPTIONS AND FUTURES TRADED ON THE HONG KONG EXCHANGES**

The Hong Kong regulatory regime imposes position limit and reportable position requirements for stock options and futures contracts traded on the Stock Exchange of Hong Kong and on the Hong Kong Futures Exchange.

These requirements are set out in the Hong Kong Securities and Futures (Contracts Limits and Reportable Positions) Rules (as amended, the “**Rules**”) made by the Securities and Futures Commission (“**SFC**”) under the Securities and Futures Ordinance. The Rules impose monitoring and reporting obligations with regard to large open positions. Where you are holding a reportable position for your client, you must disclose the identity of the client. For the purposes of the Rules, a client is the person who is ultimately responsible for originating instructions you receive for transactions - i.e., the transaction originator.

Further guidance on the Rules and what they require is set out in the SFC’s Guidance Note on Position Limits and Large Open Position Reporting Requirements. Copies of the Rules and Guidance Note can be downloaded from the SFC’s website ([www.sfc.hk](http://www.sfc.hk)).

#### **Purpose of the Rules**

The purpose of the Rules is to avoid potentially destabilizing market conditions arising from an over-concentration of futures/options positions accumulated by a single person or group of persons acting in concert, and to increase market transparency.

Some of the major requirements of the Rules and Guidance Note are summarised below. However, you should review the Rules and Guidance Note in their entirety, and consult with your legal counsel in order to ensure that you have a full understanding of your obligations in connection with trading in Hong Kong.

Please note that the Rules make you responsible for ensuring that you comply with the Rules. Section 8 of the Rules makes it a criminal offence not to comply (subject to a maximum fine of HK\$100,000 and imprisonment for up to 2 years).

In 2004, the SFC investigated 6 breaches of the Rules, including a breach by a non-Hong Kong fund manager which was referred to the fund manager’s overseas regulator. It should be noted that the SFC has expressly stated that it is not sympathetic to claims by overseas persons that they are not aware of the Hong Kong restrictions, and that a failure to trade within the limits or make reports reflects badly on a firm’s internal control measures (which might itself lead to disciplinary action).

#### **Position Limits**

The Rules say that you may not hold or control futures contracts or stock options contracts in excess of the prescribed limit, unless you have obtained the prior authorisation of the Hong Kong regulators. For example, the prescribed limit for Hang Seng Index futures and options contracts and Mini-Hang Seng Index futures and options contracts is 10,000 long or short position delta limit for all contract months combined, provided the position delta for the Mini-Hang Seng Index futures contracts or Mini-Hang Seng Index options contracts shall not at any time exceed 2,000 long or short for all contract months combined. For many futures contracts and stock options contracts, the position limit is set at 5,000 contracts for any one contract/expiry month.

The prescribed limit for each contract traded on the Hong Kong exchanges is set out in the Rules.

#### **Reportable Positions**

If you hold or control an open position in futures contracts or stock options contracts in excess of the specified level, the Rules require you to report that position in writing to the relevant Hong Kong exchange (i) within one day (ignoring Hong Kong public holidays and Saturdays) of first holding or controlling that position, and (ii) on each succeeding day on which you continue to hold or control that position.

The specified reporting level for each contract traded on the Hong Kong exchanges is set out in the Rules. The report must state:

- (a) the number of contracts held or controlled in respect of the position in each relevant contract month; and
- (b) if the position is held or controlled for a client, the identity of the client, and the number of contracts held or controlled for such person in respect of the reportable position in each relevant contract month.

### Scope of the Rules

You should note:

- The prescribed limits and reportable position requirements apply to all positions held or controlled by any person, including positions in any account(s) that such person controls, whether directly or indirectly. The SFC takes the view that a person is regarded as having control of positions if, for example, the person is allowed to exercise discretion to trade or dispose of the positions independently without the day-to-day direction of the owner of the positions. (Section 4 of the Rules and Para. 2.6 of the Guidance Note)
- If a person holds or controls positions in accounts at more than one intermediary, the Rules require him to aggregate the positions for the purposes of applying the prescribed limits and reportable position requirements. (Para. 6.1 of the Guidance Note)
- The person holding or controlling a reportable position in accounts at more than one intermediary has the sole responsibility to notify the relevant exchange of the reportable position. The person may request its intermediary to submit the notice of the reportable position. If a firm agrees to submit the notice on his behalf, the person should provide to the firm its total positions held at other intermediaries so that the firm can submit the notice of the reportable position. Alternatively, the person should ask all of his intermediaries to report the positions in each of the accounts separately to the exchange, even if the positions in the individual accounts do not reach the reportable level. (Paras. 4.6 and 6.2 of the Guidance Note)
- Where you are holding a reportable position for your client, the Rules say that you must disclose the identity of the client. The SFC's view is that, for the purposes of the Rules, a client is the person who is ultimately responsible for originating the transaction instructions - i.e., the transaction originator. (Para. 6.4 of the Guidance Note)
- The Rules apply separately to the positions held by each of the underlying clients of an omnibus account, except where the omnibus account operator has discretion over the positions in which case the account operator must also aggregate these positions with his own positions. Positions held by different underlying clients should not be netted off for purposes of calculating and reporting reportable positions or determining compliance with the prescribed limits. (Para. 6.8 of the Guidance Note)

## A GUIDE TO THE STRUCTURE, MARKET TERMINOLOGY AND ORDER EXECUTION OF THE LONDON METAL EXCHANGE INTRODUCTION AND PURPOSE

1. This document is designed to provide customers of the London Metal Exchange (LME) with an overview of the structure of the LME, market terminology, and order execution. It is not a comprehensive trading guide, nor a complete guide to market terminology. Customers should always ensure that their requirements are explained in detail to the member responsible for order execution.

### THE LME

#### Principal Nature

2. There are two types of contracts traded on the LME - Exchange Contracts and Client Contracts. Exchange Contracts are contracts between clearing members of the LME. Client Contracts are contracts between customers and ring dealing members (RDMs), or associate broker clearing members (ABCMs), or associate broker members (ABMs)<sup>1</sup>. Only RDMs, ABCMs and ABMs may issue Client Contracts. Open Position Statements issued to clients must state clearly **'THIS IS AN LME REGISTERED CLIENT CONTRACT'**. Contract criteria relating to LME contracts, including metal specifications, acceptable currencies, prompt dates, option strike prices for metals etc. are detailed in the LME rulebook and appropriate notices.
3. Exchange Contracts are traded between members, **matched** in LMEsmart (the LME matching system) and cleared by the Exchange's clearing house. Client Contracts are **registered** in LMEsmart and transmitted to the Exchange's clearing house but clearing arrangements are left to members to agree with their customers (subject to LME rules). Further details as to clearing arrangements are set out below.
4. All LME contracts are between parties acting as principals. This prevents any party entering into an LME Contract as agent for someone else but does not prevent an agent effecting a contract between two parties if the resulting LME contract is between disclosed parties, each acting as a principal. It is an essential requirement of an LME Client Contract that one party must be an RDM, ABCM or ABM. A list of members is available from the LME, and on the LME website: [www.lme.com](http://www.lme.com). A principal relationship does not mean that members do not take on quasi-fiduciary responsibilities when they effect trades for customers. In particular, if a member undertakes to deliver a particular service, for example deal a specific number of lots 'in the Ring' (see below), then it should take care to ensure that it complies with all the terms of such a transaction.
5. In respect of Exchange Contracts, an LME broker buying metal under an Exchange Contract from another LME broker cannot do so as agent for his customer. Where an LME broker buys metal under an Exchange Contract with a view to selling that metal to his customer, this is achieved by entering into a back-to-back Client Contract with the customer. Brokers and customers can agree the conditions that apply to their Client Contracts. For example, a customer may make it a condition of his Client Contract that the broker must enter into a back-to-back Exchange Contract for the metal being bought or sold. This does not make the customer a party to the Exchange Contract but does create additional duties and obligations owed by the broker under the Client Contract.
6. Customers should be clear about conditions that apply to their Client Contracts and about the obligations and duties that the broker owes as a result of those conditions.
7. Brokers should be clear about the duties and obligations they owe as a result of conditions attaching to their Client Contracts. They should also be clear about the duties they owe to their customers under the FCA's Conduct of Business Rules (COB).

<sup>1</sup>For the purposes of this document these categories of members will be referred to as LME members, members or by the appropriate abbreviation.

## Dual Capacity

8. LME members may act both in the capacity of market maker and broker. They may act in a particular manner depending on a number of circumstances, including the size of the order, the liquidity of the market at the time the order was placed, and, not least, the customer's instructions. Customer orders may be filled directly from a member's 'book' or following the purchase/sale of metal in the LME market. Furthermore, customer orders may be offset, amalgamated, broken-up or netted for execution. These methodologies apply equally to orders whether any resulting Exchange Contract is effected in the ring, in the interoffice market, or on LMEselect.
9. Customers with specific order requirements must make these known to the member at the time the order is placed. Customers wishing to know how their order was executed should request such information from the member.

## Trading on the LME

10. Trading takes place on the LME by open outcry in the rings and kerbs, between members in the inter-office, and over the Exchange's electronic trading system LMEselect.

## Open Outcry

11. Historically, during ring and kerb sessions, the majority of customer business reflects prices traded in the open outcry sessions. Customers can follow the market activity by monitoring quoted and traded prices disseminated via the LME market data dissemination system, or by listening to the simultaneous floor commentary provided by member(s). The LME market data dissemination system publishes prices traded during ring and kerb times on price vendor information services such as Reuters.
12. Members can continue to 'make a market' when requested by a customer during the ring and kerb sessions, although this is entirely at the member's discretion. Alternatively, the customer can decide whether to place an order using the 'order styles' mentioned below.

## Inter-office

13. Inter-office trading is conducted between members by telephone or by electronic means. On contacting an LME member for a quote, customers will usually be provided with the member's current bid and offer. The customer may trade on this quote, call another member in an attempt to improve the quote, leave a resting order with a member, or wait and monitor prices on the LME market data dissemination system. If an order cannot be filled from the member's book, it may be executed via a back-to-back Exchange Contract agreed via a telephone deal with another member or executed via LMEselect.

## LMEselect

14. LMEselect allows members to trade LME futures contracts, traded options and traded average price options, LMEswaps, LMEminis and index futures. Some brokers offer their customers an order-routing facility via an API<sup>2</sup> where they can view LMEselect prices, execute trades, and place resting orders. All trading on LMEselect is in US dollars.
15. LMEselect replaces neither inter-office trading nor trading in the ring. Depending on the time of day, it is possible for members to deal by telephone or electronically in the inter-office, by LMEselect, or in the rings. Customers should specify which mechanism their broker should use to effect an order, where they have a preference.
16. Information vendors will display, amongst other things, firm prices of the best bid and offer available on LMEselect, the total volumes available at these prices, and the price and volume of each trade. Only LMEselect prices are displayed, not those of other third party electronic trading systems providing LME prices. Only RDMs and ABCMs are eligible to become LMEselect participants and to have direct access to the system. Customers may effect back-to-back Client Contracts with RDMs and ABCMs based upon prices available on LMEselect, whether on the telephone or via electronic order-routing systems.

<sup>2</sup>API Application Protocol Interface

## ORDER STYLES

### Ring

17. **Customer orders are not traded in the rings or kerbs**, so an order using the term 'in/on/during the ring/kerb' will be executed on the basis of the prices traded/quoted during the particular session. If a customer requires their order to be 'shown' or traded across the ring/kerb then they should make this requirement known to their executor, who may or may not accept this as a term of the order. The equivalent Exchange Contract for a customer order may not replicate its terms. As the customer is **not** a party to any Exchange Contracts i.e. those traded in open outcry between members in the ring/kerb sessions, in specifying ring/kerb, the customer is merely identifying a pricing mechanism. A member which undertakes to match a price traded in the ring/kerb is not necessarily undertaking that it will trade during that ring/kerb, only that it may do so. However, a customer may place an order with the specific request that the member trades an Exchange Contract replicating its order in the ring. In such circumstance the RDM can only trade this order by open outcry in the ring.
18. If a customer trades at the prevailing market quote proffered in the ring/kerb, their executor is not necessarily obliged to effect an Exchange Contract at the same price. This can lead to situations where the customer has traded at the prevailing market quote, without that same price trading in open outcry across the floor of the Exchange. However, if the instructions from the customer are to achieve a specific price i.e. close of ring 2, then this is the price that should be given, if that specific order is accepted.

### Market

19. In normal circumstances a market order is one executed on a timely basis at the prevailing market price. As mentioned above, at certain times of the business day, trading is taking place simultaneously in the ring or kerb, on LMEselect, and in the inter-office market. Traditionally, when open outcry trading is in session, the market is defined by activity within the ring/kerb. At other times, the market is split between inter-office trading and trading on LMEselect. During inter-office sessions, indicative quotes are available on the LME market data dissemination system; firm prices are available on LMEselect and the LMEselect page on information vendors' systems. The indicative prices might not be available to all parties.

### Best

20. Order styles on the LME using the word 'best' confer some discretion upon the members when executing the order, requiring them to use their 'best endeavours' on the customer's behalf. The extent of the discretion is fixed by the terms of the order. This type of order is distinct from 'best execution' as defined by the FCA.
21. Best orders may be executed both in rings/kerbs, inter-office and on LMEselect. Inter-office trades rely upon the members' skill in determining the level of the market at any particular time. Best orders received during ring/kerb times may not result in the customer receiving the 'best' price achieved during the session if the price improves after the member has booked the metal intended to fill the order. At any given time, the best price on LMEselect will be displayed on the system and by the information vendors. Customers should be aware that depending on market conditions, the best price may move during the period from when the order was placed and when it was executed.

### Close

22. Most orders placed 'on the close' are for either the close of the second ring (official LME prices) or the final kerb (closing prices). Both these prices are demonstrable because of the publication of official and closing prices. Closing prices for other sessions are harder to determine, although the LME does publish unofficial prices which are established at the close of the fourth ring. In all circumstances, customers and members need to agree the style of execution i.e. bid/offer, mean or traded price. Members may not always be able to guarantee execution (price or volume) due to prevailing market conditions. A closing price on LMEselect is the last price traded before the system closes.



## Open

23. Customers placing orders to trade on the opening of a market session must provide clear instructions to the LME member which indicate how this order should be activated i.e. basis the opening bid/offer or basis the first trade in the session. Customers will also need to inform their executor of their requirements if the executor is unable to fill the order basis the 'opening' price in its entirety, due to market constraints such as insufficient liquidity. Customers may place orders with members for LMEselect that can be placed into the system for activation when the market opens.

## Resting Orders

24. When placing resting orders such as 'good 'til cancelled' ('GTC', or any derivations thereof) or stop loss orders, customers should ensure that they are in agreement with their executor's definition of the 'trigger' point of the order. Usually, this is interpreted as being the point when the order price is seen to be trading in the market, but it is possible to request the order be activated when the order level is either bid or offered as appropriate, via the prevailing market quote. Stop loss orders become market orders when a trade, or a bid or an offer triggers the stop, with members then executing the order at the current market price.
25. It is possible for a customer not to receive a 'fill' on a resting order despite the 'trigger' point being 'touched'. This could be due to a number of circumstances such as order priority, illiquidity, prevailing market conditions etc. Whatever the reason, the executor should be able to provide the customer with a full explanation of why it was unable to fill the order.
26. Customers should be aware that resting orders might be activated during periods of illiquidity in the market. As previously mentioned, this could result in the trade not being filled, or for 'stop' orders, a worse fill than anticipated ('slippage'). Customers should ensure the executor is fully aware of their requirements regarding the execution of an order, and adheres to any limitations, especially if the customer is not in contact with the market/member when the trigger point is reached.

## LMEselect

27. It is possible for customers to ask members to place resting orders in LMEselect. Where the broker has an order-routing system into LMEselect, customers will be able to place orders directly. The system accepts GTC orders (for Cash and 3 Month prompt dates only) and will also permit other variations such as Good for Day. There are also certain other LMEselect-specific order types such as Iceberg<sup>3</sup>, Discretionary<sup>4</sup>, Scaling<sup>5</sup> and Fill or Kill orders<sup>6</sup>.

## Conclusion

28. The above order styles do not represent all possible methods of order execution on the LME. Members and customers should ensure that orders are communicated in meaningful terms that deliver the required execution in accordance with LME rules.

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<sup>3</sup> Iceberg orders allow a trader to place an order without disclosing the full order quantity to the market. The trader specifies the open quantity amount seen by the market and the subsequent open order amounts at the time of the order placement. Any subsequent amendments to open quantity amount only take affect with the next order quantity to be placed, the current open quantity seen by the market does not change.

<sup>4</sup> A discretionary order allows a trader to place an order with a discretionary price. This discretionary price remains hidden from view by the market. A discretionary Bid order will only trade when an opposing order is placed with an order price equal to or less than the discretionary price. For an Ask order the opposing order price must equal to or exceed the discretionary order price.

<sup>5</sup> A scaling order allows the user to automatically place repeat orders for an outright valid prompt date with a scaled order price. I.e. scaled down buying or scaled up selling; although the user is not forced to change the order price and therefore can enter repeat order at the same price level. This function will place an order with the same quantity and prompt date with an adjusted order price if desired, once the previous order has traded in the LMEselect system.

<sup>6</sup> A Fill and Kill Order is entered at a specific price with the intention to execute immediately and therefore fill all or part of, the order and immediately cancel any unfulfilled balance.

## **CLEARING ARRANGEMENTS**

### **Segregation**

29. The LME rules specify that Client Contracts must be registered in the Exchange's matching system (LMEsmart) and such registration must align the contract to a specific "omnibus" or "individually segregated" account at the Exchange's clearing house. LME Members are required to offer clients a choice of either type of account. The distinguishing factor between the two is: either (i) an "omnibus" account which has assets and positions allocated to it for multiple customers; or (ii) an "individually segregated" account which has assets and positions allocated to it for a single customer.

### **Portability**

30. Where there is an Event of Default (as defined in the LME rules) in relation to an LME Member and a customer wishes to transfer its positions from an account maintained with the defaulting LME Member to a solvent LME Member, it must notify the Exchange's clearing house in accordance with the procedures set out by the Exchange's clearing house from time to time. Failure to adhere to the procedures of the Exchange's clearing house within the prescribed timescales will result in the positions of a customer being closed out by the Exchange's clearing house.

## MERRILL LYNCH BUSINESS CONTINUITY STATEMENT

Merrill Lynch is responsible for creating and maintaining business continuity plans for all of its businesses. In the event of a business disruption, we have plans designed to allow us to continue operations of critical business functions, such as entering of client orders, completing securities transactions and providing clients access to their cash and securities. We accomplish this in part by:

- Relocating impacted businesses to designated recovery locations.
- Using redundant processing capacity at other locations.
- Designing our technology and systems to support the recovery processes for critical business functions.
- Using business and technology teams that are responsible for activating and managing the recovery process.
- Adopting a communication plan to ensure that Merrill Lynch employees receive emergency notifications and instructions via a variety of sources, including in-building announcements, telephone contact, toll-free phone numbers and websites.
- Rehearsing our recovery procedures and testing those procedures on a regular basis.

As part of our plans, Merrill Lynch has identified the applications that are critical to each of our business divisions. These applications are implemented in separate production and recovery data centers using industry-standard practices to copy data from the production site to the recovery site in real time. In most cases, recovery times will range from nearly instantaneous to approximately four hours. For some business functions, next-day recovery is projected.

With regard to client assets, nearly all market-traded securities are held in central depositories (such as the Depository Trust Co. in the U.S.) or with custodian banks, rather than in physical certificates. Ownership of the securities is reflected on a book-entry record-keeping basis with our custodian banks or depositories' participants (such as Merrill Lynch) maintaining on their records the beneficial ownership positions of their clients. This structure is recognized worldwide as providing investors with an unsurpassed level of liquidity and security for the assets they choose to custody with major financial institutions.

As a premier financial service firm, we take our commitment to our clients very seriously and participate globally in various industry-level discussions regarding business continuity planning under the auspices of industry organizations. Participation in these types of forums increases our ability to proactively recognize and manage business disruption risks and coordinate recovery efforts across the financial service industry.

Although we have taken significant steps to develop and implement sound business recovery plans, we cannot guarantee that systems will always be available or recoverable after a disaster or significant business disruption. However, we believe that our planning for such events is robust and consistent with many of the best practices established within the industry. Any material changes to the above information will be available on our website or upon request.

If you have further questions regarding our business continuity plans, please contact your Merrill Lynch representative.

## PRIVACY AND DATA SECURITY INFORMATION STATEMENT

With respect to any personal information delivered or made available to Merrill Lynch pursuant to the Institutional Futures Client Account Agreement (the "Agreement"), Merrill Lynch agrees that:

- (a) it shall use and process such personal information solely for the purposes of carrying out its obligations under, and as expressly set forth in, the Agreement and not for any other purposes;
- (b) it shall maintain an effective information security program, keep such personal information confidential and take appropriate administrative, technical and physical measures to secure and protect such personal information against unauthorized, unlawful or accidental access, disclosure, transfer, destruction, loss or alteration;
- (c) it shall limit access to such information to employees and agents who require such access in order to perform the services described in the Agreement and shall inform its employees and agents who have access to such personal information of its highly confidential nature and the limitations and procedures that apply to access and use of such personal information;
- (d) it may make such information available to vendors which provide services to Merrill Lynch for its futures trading and processing, however, it shall not disclose or make such personal information available to a vendor without entering into an agreement in writing with the vendor whereby the vendor agrees to comply with, and treat such personal information in accordance with, these policies
- (e) it shall promptly notify Client if it becomes aware of any unauthorized access of such personal information or if it becomes the subject of any government, other enforcement or private proceeding relating to its data handling practices with respect to such personal information and
- (f) it shall, upon the reasonable request of Client, provide Client with information regarding its privacy/data protection practices.

Nothing herein shall affect any data or information that Merrill Lynch validly receives from a source apart from the Agreement or the relationship established pursuant to the Agreement, nor affect Merrill Lynch's rights to use certain data or information in a non-identifiable, statistical manner.

**DISCLOSURE UNDER ERISA SECTION 408(B)(2)**

Pursuant to regulations under ERISA section 408(b)(2), under certain circumstances, the U.S. Department of Labor requires service providers to furnish disclosures concerning their services and compensation arrangements to the responsible plan fiduciary of a pension plan governed by ERISA. There may be similar requirements under laws applicable to governmental and other plans which are not governed by ERISA.

This disclosure for all relevant lines of business and products in Bank of America Merrill Lynch's Global Banking & Markets (GBAM) business segment is available at the following web address:

<http://baml.com/ERISA408b2>

Please note that the disclosure in this website will be updated periodically as required under these rules. Please check this website from time to time for any updates.

## **DISCLOSURE OF FUTURES COMMISSION MERCHANT MATERIAL CONFLICTS OF INTEREST**

The purpose of this document is to provide you with information about some of the material conflicts of interest that may arise between you and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") in connection with Merrill Lynch performing services for you with respect to futures, options on futures, swaps (as defined in the Commodity Exchange Act), forwards or other commodity derivatives ("Contracts"). Conflicts of interests can arise in particular when Merrill Lynch has an economic or other incentive to act, or persuade you to act, in a way that favors Merrill Lynch or its affiliates.

Under applicable law, including regulations of the Commodity Futures Trading Commission ("CFTC"), not all swaps are required to be executed on an exchange or swap execution facility (each, a "Trading Facility"), even if a Trading Facility lists the swap for trading. In such circumstances, it may be financially advantageous for Merrill Lynch or its affiliate to execute a swap with you bilaterally in the over-the-counter market rather than on a Trading Facility and, to the extent permitted by applicable law, we may have an incentive to persuade you to execute your swap bilaterally.

Applicable law may permit you to choose the CFTC-registered derivatives clearing organization ("Clearing House") to which you submit a swap for clearing. You should be aware that Merrill Lynch may not be a member of, or may not otherwise be able to submit your swap to, the Clearing House of your choice. Merrill Lynch consequently has an incentive to persuade you to use a Clearing House of which Merrill Lynch or its affiliate is a member.

You also should be aware that Merrill Lynch or its affiliate may own stock in, or have some other form of ownership interest in, one or more U.S. or foreign Trading Facilities or Clearing Houses where your transactions in Contracts may be executed and/or cleared. As a result, Merrill Lynch or its affiliate may receive financial or other benefits related to its ownership interest when Contracts are executed on a given Trading Facility or cleared through a given Clearing House, and Merrill Lynch would, in such circumstances, have an incentive to cause Contracts to be executed on that Trading Facility or cleared by that Clearing House. In addition, employees and officers of Merrill Lynch or its affiliate may also serve on the board of directors or on one or more committees of a Trading Facility or Clearing House.

In addition, Trading Facilities and Clearing Houses may from time to time have in place other arrangements that provide their members or participants with volume, market-making or other discounts or credits, may call for members or participants to pre-pay fees based on volume thresholds, or may provide other incentive or arrangements that are intended to encourage market participants to trade on or direct trades to that Trading Facility or Clearing House. Merrill Lynch or its affiliate may participate in and obtain financial benefits from such incentive programs.

When we provide execution services to you (either in conjunction with clearing services or in an execution-only capacity), we may direct orders to affiliated or unaffiliated market-makers, other executing firms, individual brokers or brokerage groups for execution. When such affiliated or unaffiliated parties are used, they may, where permitted, agree to price concessions, volume discounts or refunds, rebates or similar payments in return for receiving such business. Likewise, where permitted by law and the rules of the applicable Trading Facility, we may solicit a counterparty to trade opposite your order or enter into transactions for its own account or the account of other counterparties that may, at times, be adverse to your interests in a Contract. In such circumstances, that counterparty may make payments and/or pay a commission to Merrill Lynch in connection with that transaction. The results of your transactions may differ significantly from the results achieved by us for our own account, our affiliates, or for other customers.

In addition, where permitted by applicable law (including, where applicable, the rules of the applicable Trading Facility), Merrill Lynch, its directors, officers, employees and affiliates may act on the other side of your order or transaction by the purchase or sale for an account, or the execution of a transaction with a counterparty, in which Merrill Lynch or a person affiliated with Merrill Lynch has a direct or indirect interest, or may effect any such order with a counterparty that provides Merrill Lynch or its affiliates with discounts related to fees for Contracts or other products. In cases where we have offered you a discounted commission or clearing fee for Contracts executed through Merrill Lynch as agent or with Merrill Lynch or its affiliate acting as counterparty, Merrill Lynch or its affiliate may be doing so because of the enhanced profit potential resulting from acting as executing broker or counterparty.

Merrill Lynch or its affiliate may act as, among other things, an investor, research provider, placement agent, underwriter, distributor, remarketing agent, structurer, securitizer, lender, investment manager, investment adviser, commodity trading advisor, municipal advisor, market maker, trader, prime broker or clearing broker. In those and other capacities, Merrill Lynch, its directors, officers, employees and affiliates may take or hold positions in, or advise other customers and counterparties concerning, or publish research or express a view with respect to, a Contract or a related financial instrument that may be the subject of advice from us to you. Any such positions and other advice may not be consistent with, or may be contrary to, your interests or to positions which are the subject of advice previously provided by Merrill Lynch or its affiliate to you, and unless otherwise disclosed in writing, we are not necessarily acting in your best interest and are not assessing the suitability for you of any Contract or related financial instrument. Acting in one or more of the capacities noted above may give Merrill Lynch or its affiliate access to information relating to markets, investments and products. As a result, Merrill Lynch or its affiliate may be in possession of information which, if known to you, might cause you to seek to dispose of, retain or increase your position in one or more Contracts or other financial instruments. Merrill Lynch and its affiliate will be under no duty to make any such information available to you, except to the extent we have agreed in writing or as may be required under applicable law.

**NOTIFICATION FOR CANADIAN-DOMICILED CLIENTS**

This notice is provided to you pursuant to National Instrument 31-103. Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") is a U.S.-based broker-dealer subsidiary of Bank of America Corporation and a member of the Financial Industry Regulatory Authority.

Please note that:

- (i) Merrill Lynch is not registered in your jurisdiction. Merrill Lynch's jurisdiction of residence is the United States and there may be difficulty enforcing legal rights against Merrill Lynch or any of its directors, officers, employees or agents because they are resident outside Canada and all or substantially all of their assets may be situated outside of Canada;
- (ii) In Alberta, Merrill Lynch also operates under an exemption granted under the Alberta Securities Act, and because of that exemption, the protections available to clients of a dealer registered under that Act will not be available to client of Merrill Lynch resident in Alberta; and
- (iii) the name and address of the agent for service of process of Merrill Lynch is set forth below:

**MERRILL LYNCH'S AGENTS FOR SERVICE OF PROCESS IN CANADA**Ontario

Merrill Lynch Canada Inc.  
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Toronto ON M5J 2V8  
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Québec

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Attn: Legal Department

Manitoba

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Attn: Bruce S. Thompson, Partner

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**FIRM SPECIFIC DISLCOSURE STATEMENT  
REQUIRED BY  
CFTC RULE 1.55(i), (k) and (o)**

Information that may be material to entering into a futures and/or derivatives clearing account agreement with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch") or entrusting your funds to Merrill Lynch is set forth in a disclosure statement that can be viewed on this website: <http://www.bofaml.com/en-us/content/futures-options-otc-clearing.html>.

You may download a paper copy of that statement from the website or request one from your client services representative.

## NOTICE TO CUSTOMERS EXCHANGE FOR RELATED POSITIONS

Certain futures exchanges permit eligible customers to enter into privately-negotiated off-exchange futures or option on futures transactions (collectively, “**futures**”) known as exchange for related positions (“**EFRP**”). An EFRP involves the simultaneous execution of a futures transaction and an equivalent related position. Types of EFRPs include:

- Exchange of Futures for Physical (“**EFFP**”) or Against Actual (“**AA**”) – the simultaneous execution of a futures contract and a corresponding physical transaction or a forward contract on a physical transaction.
- Exchange of Futures for Risk (“**EFR**”) – the simultaneous execution of a futures contract and a corresponding OTC swap or other OTC derivative transaction.
- Exchange of Option for Option (“**EOO**”) – the simultaneous execution of an option contract and a corresponding transaction in an OTC option or other OTC instrument with similar characteristics.

EFRP transactions are subject to Applicable Law, as defined in the agreement between a futures commission merchant (“**FCM**”) and its customers. Customers that engage in EFRP transactions are responsible for reviewing, understanding and complying with the provisions of Applicable Law governing EFRP transactions including, but not limited to, Rule 538 of the CME Group (CME, CBOT and NYMEX) and Rule 4.06 of ICE Futures US, and the frequently asked questions and other guidance that each exchange has issued with respect thereto.

Customers are subject to the jurisdiction of the exchange through which the EFRP transaction is entered into and, therefore, may be required to produce records and otherwise cooperate in any inquiry that the exchange may undertake with respect to the EFRP transaction. Moreover, customers may be sanctioned by the exchange if an EFRP transaction does not comply with the requirements of applicable exchange rules and guidance. For this reason, customers are encouraged to review these requirements with any employees that may engage in EFRP transactions on their behalf.

Certain common requirements of the rules and guidance issued by CME Group and ICE Futures US are summarized below. However, this summary is not a substitute for the customer's obligation to review and understand such rules and related guidance in their entirety.

- The futures contract and the related position must be effected for the account of the same beneficial owner. If the customer is the seller of (or the holder of the short market exposure associated with) the related position, the customer must be the buyer of the futures contract(s) being exchanged in the EFRP; conversely, if the customer is the buyer of (or the holder of the long market exposure associated with) the related position, the customer must be the seller of the futures contract(s) being exchanged in the EFRP.
- Contingent EFRP transactions are prohibited. EFRP transactions may not be contingent upon the execution of another EFRP or related transaction that results in the offset of the related position without the incurrance of market risk that is material in the context of the related position transactions.
- EFRP transactions may be executed at any commercially reasonable price agreed by the parties. However, parties may be asked to demonstrate that EFRPs executed at prices away from the prevailing market price were executed at such prices for legitimate commercial purposes.
- The customer must maintain all records relevant to the futures transaction and the related cash, swap or derivative transaction in accordance with applicable exchange rules. Upon request, the customer must provide its FCM with documentation sufficient to verify its purchase or sale of the related position.