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NZX to launch NZ milk price futures and options contracts

NZX has received formal approval from the Financial Markets Authority and the Reserve Bank of New Zealand for its proposed milk price futures and options contracts, expected to launch in May 2016.

The futures and options contracts are designed to address growing demand from producers and purchasers of milk products wishing to manage risk relating to price fluctuations. For example, both contracts can help New Zealand dairy farmers to mitigate the financial risks associated with a variable milk price.

NZX Head of Markets Mark Peterson commented: "This is an important milestone in the development of commodity risk management tools needed to support New Zealand's agricultural sector. It was also identified as a project in the Government's Business Growth Agenda which seeks to explore how risk management tools such as derivatives could address volatility in agricultural commodity prices."

"With 95% of their product sold overseas, New Zealand dairy farmers are highly exposed to the global dairy market. They have few tools available to help them manage milk price risk which leaves farmers at a disadvantage to their overseas counterparts in the US or Europe, who have access to a wide range of risk management tools."

"Although futures and options contracts will not be suited to everyone, they are a key step towards building a meaningful risk management culture in New Zealand's agricultural sector."

Once the futures and options contracts are available for trading on NZX's Derivatives Market, all parties will be required to trade through an NZX Derivatives Participant (a broker).

Derivatives contracts carry risk and operate differently to fixed price schemes offered by milk processors. NZX encourages all parties to seek advice prior to trading.

To view the final contract specifications, learn more about NZX's Derivatives Market and download an introductory guide to milk price futures and options contracts, please visit: www.nzx.com/derivatives

Frequently asked questions:

What are futures and options contracts?

A futures contract is an agreement, generally made through an exchange, to buy or sell a commodity or asset at a date in the future, and at a price agreed today.

When futures contracts mature, they can be settled by buyers and sellers either exchanging the commodity or asset, or by settling in cash whereby the contracting parties pay or receive a loss or gain (calculated by reference to the settlement price).



In the case of NZ milk price futures, the buyers and sellers will settle by exchanging cash, calculated by reference to Fonterra's announced Farmgate Milk Price.

Options contracts provide the purchaser with the right, but not the obligation, to buy or sell a particular asset or commodity at a pre-determined price, on an agreed date in the future. For example, a dairy farmer may use an options contract to protect against the milk price falling but retain the benefit of potentially higher milk prices.

How do futures or options contracts differ from fixed price schemes offered by milk processors?

Fixed milk price schemes generally allow parties to lock in a price for a percentage of their milk production. NZX's futures and options contracts operate very differently. Trading parties buy and sell futures contracts to hedge their exposure to movements in the milk price. For example, if the Farmgate Milk Price declines, the drop in the price a farmer receives from a processor for milk supplied will be offset by a gain in the futures market.

Parties that trade futures contracts are also subject to obligations relating to holding a margin account, as well as 'basis risk' (where the futures contract price differs from the underlying physical market price).

How can I learn more about the futures or options contract specifications?

Contract specifications and an introductory guide to the products are available to view and download from: www.nzx.com/derivatives

NZX and participating brokers will be holding educational seminars throughout the NZ National Agricultural Fieldays to be held 15-18 June 2016. You can also register your interest with NZX to receive updates on the seminars by clicking the link above.

Why does the NZ milk price futures contract settle to Fonterra's announced Farmgate Milk Price?

When cash settling futures contracts, the reference price for settlement should be a recognised benchmark on which the majority of the industry either directly depends on or has a link to.

NZX reviewed alternative reference prices and consulted with expected trading parties and industry participants. Fonterra's Farmgate Milk Price best fulfilled the requirements for a reference price used to settle futures from a benchmark and governance perspective.

NZX considers that the governance arrangements that apply to the calculation of Fonterra's Farmgate Milk Price (including oversight by the Commerce Commission) are adequate to ensure the integrity of the new contracts.

To learn more about how Fonterra calculates the Farmgate Milk Price, visit: <http://www2.fonterra.com/our-financials/milk-price-methodology>

When is the last trading day and the final settlement date?

The last trading day each year will be the second Thursday of September and the NZ milk price futures contracts will settle on or about 1 October (being the business day after the date by



which Fonterra is required to announce its final Farmgate Milk Price). The same timetable will apply to NZ milk price options.

Trading of NZ milk price futures and options is expected to decrease towards the end of the season as the milk price becomes more certain. Setting the final trading day in early September provides an opportunity for market participants to exit positions up until several weeks prior to Fonterra announcing its final Farmgate Milk Price.

When can I start trading?

The contracts are expected to be available to trade in May 2016. You can register your interest with NZX to receive updates on the development of the market by visiting:

www.nzx.com/derivatives

How can I trade?

All parties must trade through an NZX Derivatives Participant (a broker). To view a list of accredited NZX Derivatives Participants, please visit: <http://www.nzxfutures.com/access>

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About NZX Limited

NZX builds and operates capital, risk and commodity markets and the infrastructure required to support them. We provide high quality information, data and tools to support business decision making. We aim to make a meaningful difference to wealth creation for our shareholders and the individuals, businesses and economies in which we operate. To learn more about NZX, please visit: www.nzxgroup.com