



Exchange Futures for Physical (EFPs)

October 13, 2005

IPE Brent Crude

The ICE Futures offers the facility for participants in oil markets to use the IPE Brent Crude futures contract to separate the pricing of crude oil from supply and at the same time enable counterparties in the delivery process to be known.

There are several ways in which EFPs can be useful for market participants, where they can be used to initiate futures positions, close futures positions and to directly swap a futures position for a similar physical position.

Exchanging Futures for Physical trades work on the basis that counterparties agree that they wish to complement their physical transaction with an accompanying futures transaction. They then advise their brokers operating to register their transactions with the ICE Futures.

When the EFPs are registered with ICE Futures the volume is attributed to that trading day but the price is not declared to the market.

The advantages are best illustrated by example. The following three scenarios enable oil market participants to trade with preferred physical counter parties, even if they have differing views of the future direction of market price.

Importantly, EFPs enable delivery of crude against the IPE Brent Crude contract, as in the first example.

Using an EFP to directly swap a futures and physical position

Scenario

A crude oil producer has 2 million bbls of crude unsold. He believes the market to be undersupplied and that the price is going to increase.

A refiner needs to have 2 million bbls of crude available on the 10th of December. He has bought 2000 December IPE Brent Crude futures contracts at \$17 in the anticipation that the price of crude is going to rise between November and December.

Both participants are therefore long in a market where they expect the price to rise. However, the producer has not secured a buyer for his crude oil and the refinery buyer wants to be able to secure supply of the quality and delivery timing he needs.

The producer and refiner have done business together before. They agree to exchange their respective positions in order to meet their needs i.e. the seller

wants to remain long the market as he thinks the price is going up. The buyer wants to secure a price and the quality and delivery timing he needs.

How does the Exchange of Futures for Physical work?

On November 10th, the producer agrees to sell 2 million bbls of crude at the IPE December Brent Crude Futures Contract settlement price for that day's trading. The crude oil will be delivered on 10th December. The refiner's long futures position will be exchanged for this physical supply.

The two parties advise their brokers that they have agreed this EFP.

The two brokers then contact each other and register with the Exchange that this EFP has been agreed and the price. The refiner's long December futures position is passed over to the producer's account at

the IPE December Brent Contract settlement price for November 10th.

Positions after the EFP

The November 10th settlement price for the IPE December Brent contract is \$17.50 barrel.

Producer	Short 2 million barrels of crude	\$17.50
	Long 2000 December Brent futures	\$17.50
	Sale of crude not priced until producer sells futures	
Refiner	Long 2000 December Brent futures	\$17.00
	Sold 2000 December Brent futures	<u>\$17.50</u>
		\$00.50 profit
	Long 2 million bbls crude at	\$17.50
	December delivery has been fixed at \$17.00	

Because both participants believe the price is going to increase the EFP has suited both their needs, enabling security of supply without commitment to a price on behalf of the Producer.

Using an EFP to open a futures position

Scenario

Assume that neither party has an existing open position in IPE Brent Crude futures.

A crude oil producer has been approached by one of his long standing customers, who wishes to purchase 500,000 bbls for loading in 15 days time. He would like to supply the customer but does not want to commit to a price because he believes the price is going to rise.

The buying customer wants to secure supply from the producer to minimise freight on a VLCC, but does not want to commit to the price as he believes the price is going to fall.

The producer and customer agree to do business via an EFP so that they can retain exposure to the price of crude oil but secure each other's delivery requirements.

They agree to take equal and opposite futures positions to that which they are transacting in the physical deal.

How does the Exchange of Futures for Physical Work?

On October 1st, the producer agrees to sell 500,000 bbls of crude oil to the customer at the IPE November Brent Crude Futures Contract settlement price for that day's trading. The crude oil will be delivered on October 16th. They will also take out equal and opposite positions in the November Brent Crude Futures Contract at the same price.

The two parties advise their brokers that they have agreed this EFP.

The two brokers then contact each other and register with the Exchange that this EFP has been agreed and the price. A long position of 500 lots is opened for the

producer and a short position of 500 lots is opened for the customer.

Positions after the EFP

The October 1st settlement price for the IPE November contract is \$16.00

Producer	Short 500,000 bbls crude oil	\$16.00
	Long 500 lots November Brent futures	\$16.00

Crude Oil not priced until futures sold

Customer	Long 500,000 bbls crude oil	\$16.00
	Short 500 lots November Brent futures	\$16.00

Crude Oil is not priced until futures bought

Because equal and opposite positions in the November futures contract have been exchanged for the physical positions, both parties remain exposed to the price of crude oil as they were before the physical trade was completed. Thus the pricing of the transaction has been separated from the physical trade itself.

It is now up to the refiner and customer to separately decide when is the best time for them to price the transaction, which will occur when they close the futures positions they hold.

Using an EFP to close futures positions

Scenario

A producer has 2 million bbls of crude oil in tank. In anticipation of the price going down before he has sold the crude, he has previously sold 2000 May IPE Brent Crude futures at \$17.00. The price has fallen \$0.50/bbl since then.

settlement price for that trading day, plus 20c barrel to reflect the quality of the crude oil. They agree to EFP the trade and take equal and opposite futures positions to that which they have physically traded.

A refiner wants to buy the crude from the producer but is concerned that the price of oil is going to fall further.

The two parties advise their brokers that they have agreed this EFP. The two brokers then contact each other and register with the Exchange that this EFP has been agreed and the price. The producers' existing short 2000 May futures position is closed. The customer has a position opened of 2000 short May futures.

How does the Exchange of Futures for Physical Work?

On April 5th, the producer agrees to sell 2 million bbls to the customer at the IPE May Brent Crude futures contract

Positions after the EFP

The April 5th settlement price for the IPE May Brent futures contract is \$16.50

Producer	Short 2000 May Futures at	\$17.00
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	Long 2000 May Futures at	<u>\$16.50</u> \$00.50 profit
	Short 2 million bbls crude at	\$16.70 (settlement + 20c)
	Producer's selling price to customer fixed at \$17.20	
Customer	Long 2 million bbls crude	\$16.70
	Short 2000 May Futures	\$16.50
	Crude is not priced until futures are bought back	

Because both parties believe the price is going further down, the EFP has enabled them to detach pricing from supply, meeting both their pricing and physical supply requirements.

The customer can price the product at any time by buying back the 2000 May futures contracts.

For further information contact:

ICE Futures
Market Development
International House
1 St Katharine's Way
London E1W 1UY

Tel: +44 (0) 20 7481 0643
Fax: +44 (0) 20 7481 8485

Website: www.theice.com
Email: info@theice.com