

Elevator's Best Practices

Structured Commodity Solutions, LLC

Table of Contents

1. The Basics

- Welcome
- Where to Start
- The Tools
- The Structures
- The SCS Process
- Educating Management
- Educating Staff
- Supervision
- Regulation
- Creating Structured Grain Contracts

2. The Sales Process

- Origination Pools
- Meeting Customer Requests
- Offering Customer Choices
- Satisfying Own Hedging Needs

Table of Contents (cont.)

3. Protecting Your Customer

- Know Your Customer
- Educate Your Customer
- How much To Do?
- Remind Your Customer

4. Reducing Risk

- Education
- Control
- Margin
- Documentation

1. The Basics – Welcome!

SCS would like to welcome you to the SCS Program, whose aim is to empower our grain aggregator and hedging partners with tools, choices, transparency and potential upside.

In order to facilitate your entry into the program, SCS has put together the following series of recommendations for Elevator Best Practices. These recommendations are based on our experience with the customers already in the SCS Program.

The Basics – Where to Start



To start, our partners tend to designate a point person (or more than one) to drive the integration of the SCS Program into their already existing business model and processes.

This point person becomes the initial focus of SCS's education efforts, ensuring that at least one person within our partner's organization understands the SCS framework.

The point person can in turn pinpoint additional personnel within his organization whose participation will be required for the SCS Program to be appropriately and successfully implemented.

The Basics – The Structures



- SCS has prepackaged a number of popular structures for our partners' use. These structures can be priced and graphed using the SCS Pricing and Analysis Tools. Our partners are not limited to these pre-canned structures however - SCS can price and transact a number of other structures.

The Basics – The SCS Process



- SCS provides the aggregator/consumer with a wide variety of structured grain solutions for marketing and hedging. They then originate/hedge grain using these solutions, according to their or their customer's needs.
- SCS hedges the resultant exposure using futures and options inside of a segregated brokerage account, with a view to extracting the edge in the trade.
- When structures expire, the accumulated futures are transferred from the segregated brokerage account to the main brokerage account of the entity.
- Every six months, the profits in the SCS account** are divided between SCS and the aggregator/consumer, with SCS absorbing all losses, if any.

**See next slide

The Basics – How SCS Works



The SCS Process

Note that the value of the SCS sub-account is defined as:

1. The marked-to-market value of all structures, plus...
2. The marked-to-market of the options and future hedges (valued using the same market data as the structures), which...
3. Include all cash transfers of any premiums and structure settlements between the sub-account and main account, minus...
4. Any trading commissions

SCS Account Value = (structure Mk2Mkt) + (future and options Mk2Mkt) +/- (cash transfers) – (trading commissions)

The Basics – Educating Management



It is important that our partners' management be aware of their participation in the SCS program, understanding the benefits, risks, and obligations of being in the program for both themselves and their customers.

To that end, SCS is available to provide educational presentations to our partners' management as often as needed until they feels comfortable with the details of the SCS Program. SCS encourages all of our partners to take full advantage of this resource.

The Basics – Educating Staff



- SCS also encourages our partners to make their staff (whether originators, marketers, or controllers) available for training sessions with SCS personnel.
- These training sessions are complimentary and will be held in group settings from time to time. Alternatively, your SCS representative will be happy to set up more targeted educational sessions.

The Basics – Supervision



- Whether SCS products are embedded into structured grain contracts and offered to our partner's customers, or used to hedge our partner's own hedging needs, it is important that adequate protocols be in place to ensure that the structures and quantities being traded are at a level which management is comfortable with.
- Our partners often designate marketing managers (who undergo the requisite SCS training if not already educated in structured products) to sign off on all SCS structures offered to customers. Similarly, only our partner's designated risk managers are allowed to enter into hedges for their own needs with SCS products.

The Basics – Regulation



- While each customer is responsible for knowing and complying with their own state's regulations, SCS has vetted its Program with legal experts in the agriculture markets. SCS customers are both aggregators (such as elevators) and consumers, and are situated across numerous states.
- Additionally, SCS has worked to educate regulators regarding the SCS Program when requested to by its customers.

The Basics – Creating Structured Grain Contracts



- Customers who use SCS products to create structured grain contracts do so by embedding details of the structure directly into their standard HTA contract. The language used is lifted directly from the pricing tool. An example of such language (in this case for a Master Producer Enhancer Plus Plan) is found below:

.....CZ16 Futures Price: 4.10000

Master Producer Enhancer Plus Plan

Pricing initial quantity of 1,639 per week for 61 weeks (= 100,000 bushels total, not including add'l qty). Bushels are priced weekly at a fixed price of the CZ16 futures contract, ending 11/23/2016, with the fixed price set at \$ 4.48500. If at the very end the futures price is above \$ 4.48500, an additional 100,000 bushels will be priced at \$4.48500. If the CZ16 futures price ever trades at or below \$ 3.48000, no more pricing occurs with the above rules. All the remaining weeks bushels can either be cancelled or priced at a fixed \$ 3.48000. This structure can be executed at NO COST to the Producer (**indicative only)

2. The Sales Process

There are a number of different needs which SCS products could satisfy, and our partners have generally had different safeguards and protocols for dealing with each of them. Four are listed below:

- Origination Pools
- Meeting Customer Requests
- Offering Customers Choice
- Satisfying Own Hedging Needs

The Sales Process – Origination Pools



- Origination Pools - The designated manager decides on the parameters of a structure and then he (or his origination team) pitches it to his customer base.
- Because the manager is pre-fabricating the structure, there can be good oversight of the structuring and sales process. The manager is able to select strategies he is comfortable with, and has time to develop accompanying materials for each transaction.

The Sales Process – Meeting Customer Requests



- Customer Requests - Here a customer specifically requests a specific solution. In this case, though there may be multiple people authorized to discuss different structuring solutions with the customer, only a few employees (those who have the most expertise with the products) should be able to sign off on the transaction.

The Sales Process – Offering Customers Choice



- Customers Choice - Where a marketing manager designates several structuring choices as acceptable
- Because the manager has designated what structures can be made available, there can be good oversight of the structuring and sales process. The manager is able to select strategies he is comfortable with, and has time to develop accompanying materials and pricing parameters for each type of structure.

The Sales Process – Satisfying Own Hedging Needs



- Own Hedging Needs - where SCS's partner uses structures to meet its own hedging needs.
- When partners wish to use SCS structures for their own hedging needs, it is particularly important that only a select number of well-informed staff members be authorized to implement hedging strategies. In these cases, the partner's representative should certify that he understands the risks and obligations of the hedge being implemented, to ensure appropriate use of the structure.

3. Protecting Your Customer

Structured products are not inherently more, or less, risky than any other hedges (including no hedge!). It's all about education, and making sure each producer and end-user understands what its obligations are for every contract. SCS provides its customers with easy-to-use tools that explain both graphically and in simple language what obligations and payouts each structure implies.

Protecting Your Customer



The following 4 points are key to ensuring your customer is entering into a structure appropriate for his needs and risk appetite:

- **Know Your Customer**
- **Educate your Customer**
 - **How Much To Do?**
- **Remind Your Customer**

Protecting Your Customer – Know Your Customer



- Know Your Customer - The first rule of dealing with any customer applies as much to structured products as it does to other types of hedges like puts, calls, HTAs, etc.
- Understanding a customer's hedging needs, risk appetite and education level is fundamental to ensuring the structure he chooses to employ for hedging is appropriate.

Protecting Your Customer – Educate Your Customer



- It is vital that your customer understand the tradeoffs implicit in a structured grain contract. This means each client should have both an intuitive understanding of how a structure will benefit/cost him under different market conditions, but also an explicit understanding of his contractual obligations.
- SCS provides tools to facilitate both facets of understanding. The SCS Analysis Tool graphically displays how each structure performs in different markets, while the SCS Pricing Tool displays his obligations in simple yet explicit language.

Protecting Your Customer – How Much to Do



- While structured grain contracts can be a targeted and cost efficient way to tailor a hedge to a customer's position and market view, it is still necessary to consider worst case scenarios when deciding how much of a customer's total grain to hedge through one structure. This is particularly true for structures with variable quantities - a customer should avoid committing to the possible delivery of more bushels than he can reasonably grow.
- As with any other hedge (including no hedge at all!), extreme case scenarios for production and price movement are important factors when deciding how much of the customer's production to hedge at one time.

Protecting Your Customer – Remind Your Customer



- It may seem intuitive, but it is important that your customers not forget about their contractual obligations, whether through structured grain contracts or other hedges like puts, calls or HTAs. SCS provides weekly accumulation reports for all structures, which provides a convenient means to remind your customer of the hedges they have entered into on a regular basis.

4. Reducing Risk

Even with the best intentions, it is still recommended that our partners institute common sense guidelines to help protect their business against reputational or financial loss. The following are some areas where such guidelines might be beneficial:

Education • Control • Documentation • Review

Reducing Risk – Education



- Educating your customer is important. So is educating your sales force and staff. The greater the level of understanding among both parties involved in structured grain contracts, the lower the chance of the structure leading to unforeseen complications.
- Our partners may wish to institute controls on which customers can transact structured grain contracts until after they have demonstrated an understanding of how these contracts perform. Similarly, staff should have undergone an educational process and demonstrated mastery of SCS products and process before they advise customers on those products.

Reducing Risk – Control



- In the same way that every structure is not appropriate for every customer, our partners should determine on an on-going basis the types and quantities of structures they are comfortable offering to their customers, or using for their own hedging needs.
- Internal controls should be set up to limit use of these structures to the guidelines that management authorizes, with only authorized staff permitted to sign off on any deviation from these established limits.

Reducing Risk – Margin



- In the same way that customers should take into account extreme scenarios when deciding on appropriate quantities to be hedged (taking into account structures with variable quantities for example), our partners need to consider possible extreme scenarios in the context of the margin they may have to post should these scenarios come to pass.
- While SCS is committed to working with its partners to alleviate margin concerns that may arise from time to time, the ultimate responsibility to post margin for SCS product hedges rests on our partners.

Reducing Risk – Documentation



- Documentation is key to mitigating any adverse consequences from the use of SCS products. SCS recommends that our partner's customers not only sign confirmation of each structured grain contract they enter into, but that they also be provided (and sign) a copy of the graphical depiction of the structures behavior in various markets (from the SCS Analysis Tool). Partners should also document educational sessions in which customers participated.
- SCS also recommends that our partners maintain records of their staff's competence with structured products, should that expertise ever be called into question.

Questions? Comments?

Contact the SCS Desk at:

structureddesk@structuredcommoditysolutions.com