Part 3 – Frequently asked questions

1. How can a producer know they will be better off using the PPOs than staying in the pool accounts?

It depends on how you define "better off". Each type of PPO program offers something different that may help producers meet their marketing needs. The FPC, for example, enables producers to lock in a price for wheat, durum, selected barley and feed barley. This gives producers greater certainty about the price they will receive when they deliver grain. The FPC also provides producers with full up-front payment of the price they locked in; they will not be waiting for adjustment, interim and final payments. So, if greater price certainty and earlier cash flow are very important, the FPC can be beneficial to producers' operations. However, none of these options guarantee a higher price than what producers would receive through the pool accounts. Producers may lock in a higher price through the FPC or the BPC that is higher than the CWB's PRO at the time, but if prices rally through the year, the final pool returns may end up being higher than either the producer or the CWB foresaw when the pricing occurred.

Producers can diversify their marketing strategy by contracting under the BPC, FPC, DPC and EPO and using the CWB pool accounts.

2. When producers receive payments from the CWB, there are different deductions referencing PPOs on their cheque. What are these deductions and what do they mean?

FPC/BPC overpayment
When the CWB has issued a BPC or FPC additional payment cheque based on a cash ticket that is later cancelled by the grain company without a corresponding replacement, a deduction is required to collect the overpayment.

FPC/BPC initial overpayment
When a producer delivers on a BPC or FPC and receives a higher payment at the elevator than the price locked in on the PPO contract, a deduction is required to collect the overpayment. The deduction is the difference between what the producer received and the PPO contract price.

FPC/BPC pricing damages
The PPO contracts require 100 per cent application of deliveries and any shortfall is subject to pricing damages. The producer is invoiced for pricing damages for the shortfall based on market conditions at the end of the crop year. A 30-day payment period is provided after which any subsequent CWB payment is subject to deduction for the pricing damages.

FPC/BPC buyout fee
A buyout fee is assessed when producers initiate a buyout of their BPC or FPC. The buyout fee is equal to the pricing damages.

FPC/BPC admin fee on pricing damages
An administration fee is assessed to producers subject to pricing damages on their BPC or FPC. The fee is $15 per transaction and is shown as a separate deduction from the pricing damages deduction.

FPC/BPC admin fee on buyout
An administration fee is assessed to producers who initiate a buyout of their BPC or FPC. The fee is $15 per transaction and is shown as a separate deduction from the buyout deduction.

FPC/BPC grade adjustment
A grade adjustment will be made when a producer delivers feed quality grain against a BPC or FPC. The grade adjustment represents the feed discount on the day of cash ticket settlement.

FPC/BPC transfer fee

Producer can transfer the outstanding tonnes of their PPO contract to another producer who is willing to assume the terms and conditions of the contract. There is a $15 transaction fee to transfer a contract. This fee is charged to the assignor (original contract holder).

FPC/BPC rollover fee
A $1.00 per tonne administration fee applies to basis contracts that are rolled from one futures month to another.

3. How is the pool protected?

The CWB sales program is pooled through the single desk approach, and a contingency fund financially backstops payments for the FPC and BPC programs. All gains and losses from the CWB hedging activity flow into the contingency fund along with all CWB sales revenue for the tonnage committed to the programs. A simplified example of how this works follows.

If the final pooled return for No. 1 CWRS 13.5 is $210 per tonne and the PPO contract values were $250 per tonne based on a futures component of $230 per tonne and a basis of $20 per tonne the following transactions are made to the contingency fund:

1. The CWB sold futures at $230 per tonne and buys them back at $190 per tonne, with the gain of $40 per tonne attributed to the contingency fund.
2. The revenue of $210 per tonne from CWB sales is attributed to the contingency fund.
3. The producer is paid the FPC or BPC price of $250 per tonne, which includes the $210 per tonne pooled sales revenue and the $40 gain from CWB hedging activities.

The example assumes a perfect hedge and basis risk management. There is some price risk because the CWB must execute futures transactions each morning for the PPO pricing commitments made by producers the previous day. Futures markets can open trading at lower values before the hedging position is executed. The basis cannot be hedged and managing the estimated average basis level has some risk associated with it. Part of the PPO discount is to offset this basis risk with any gains or losses attributed to the contingency fund.

4. Why aren't the BPC and FPC offered throughout the crop year?

One of the key principles in establishing the PPOs is that the programs do not adversely affect the pool accounts. Offering sign-up for the BPC and FPC programs throughout the crop year poses an arbitrage opportunity that would limit the sales revenue attributed to the pool accounts. When markets rally higher than the PRO, producers would want to enter into PPO contracts and if markets fall lower than the PRO, producers would want to participate in the pool. The arbitrage would limit the pool accounts ability to benefit from higher sales values when markets rally and fall. The CWB extends sign-up until November 1, 2006 at 7:30 a.m. for the 2006-07 crop year by managing some of the risk through the adjustment factor to account for sales already made. The adjustment factor decreases values when markets are rising and increases values if markets are falling to account for the difference between current market prices and the values of completed sales. The CWB hedges the FPC and BPC by selling futures when the producer prices the futures component of their basis contracts or locks in the flat price on a fixed price contract and by buying futures as the CWB makes sales during the crop year. At the end of the crop year, the long and short positions are offset as all CWB sales are completed.

The Daily Price Contract (DPC) for wheat offers producers a year-round price, available from August 1, 2006 to July 31, 2007. Tonnage must be committed before the start of the crop year to ensure the new crop pool account will not be arbitraged to the spot market values.

5. Why offer a futures value for the BPC in the fall?

Starting on September 1, 2006 producers can benefit by accessing the futures lock in using the BPC in the fall for the 2007-08 crop year. This will provide:

1. More certainty about margins when planning seeding intentions.
2. Producers can take advantage of future market rallies. Increase producers' ability to lock in foreign exchange rates.
3. Manage futures and foreign exchange with less complexity and at lower costs.
4. Manage smaller tonnages using the BPC (minimum 20 tonne commitment) vs. using futures contracts of 136 tonnes or 5000 bushels.

6. Why is the adjustment factor being shown separately in the basis calculation?

New for 2006-07 crop year, the adjustment factor will be shown separately as part of the basis calculation. This information will be available on the daily pricing schedules. The adjustment factor will be reflected to producers as a change to the daily-posted adjusted basis. The adjusted basis becomes more volatile as the sign-up period progresses into the crop year due to the greater impact of the adjustment factor.

7. When will the CWB start calculating the adjustment factor to adjust the basis for sales made to date?

The CWB will calculate the adjustment factor once enough forward sales commitments are made to affect the pooled basis. The December basis will be adjusted daily, to reflect the percentage of the pool sold. The incorporation of the adjustment factor generally coincides with the start of the crop year on August 1.

8. Why are pricing damages assessed on a BPC if only the basis level is locked in when the buyout is initiated?

The BPC is subject to pricing damages when the basis level on the day the buyout is initiated is better than the contracted basis level. The BPC is a pricing commitment and the producer is charged the arbitrage to the pool as they would benefit from the higher average basis level through the pool accounts. The producer is no only participating in the pool when making a BPC commitment. The principle of the BPC is to offer a pricing alternative, not to provide an avenue to speculate on the markets while benefiting from the risk management provided through the pool account. The $15 per transaction administration fee is charged to cover the cancellation cost on all buyouts.

9. Why does the CWB use settlement prices for pricing off the futures markets?

The CWB offers a value based on the market close due to the ease of administration using current systems. Investing in advanced technology that provides instant communication of transactions from producers would require the CWB and brokers to provide live trading opportunities. With e-trade and CWB e-services, this opportunity could be provided in the future. Posting the closing futures value with a 7:30 a.m. CT sign-up dealine ensures the CWB has accurate tonnage information for risk management activities.

10. What are the tonnage limits on the FPC for feed barley, selected barley and durum?

The tonnage limits for the FPC programs are 200,000 tonnes each for feed barley and selected barley, 100,000 tonnes for durum. The limit for BPC for selected barley is 50,000 tonnes. Wheat has no tonnage restriction. These limits are in place to enable the CWB to adequately manage the risk associated with offering a fixed price for these crops.

11. Why does the producer have to provide the contract number and designate the delivery upon settlement at the elevator?

The producer is entering into a pricing agreement with the CWB. The pricing transaction is confidential and the producer is making a financial decision upon settlement against the PPO. The producer is responsible to provide elevator agents with the contract number and to designate the delivery upon settlement of the initial payment. Producers may have multiple PPO contracts, initial grade spreads, feed discounts and other financial implications to consider before making settlement.

12. Do I need a PIN before I make a commitment using a fax application?

Producers do not need an active PIN to make a commitment by fax. The PIN is required for transactions over the telephone or through E-services.

13. What influences the Canadian futures price the CWB offers daily?

The daily settlement prices for Minneapolis, Chicago and Kansas are posted in U.S. dollars per bushel. Daily trading on the relevant market will influence the futures values, with the overall change for the day reflected upon market settlement. Using the U.S. futures markets for price setting, the CWB must also monitor fluctuations in the Canadian dollar daily. The futures contract months offered through the programs are forward months. The Bank of Canada forward exchange rate to convert the U.S. futures values to Canadian values is matched to the futures contract month. A conversion rate of 36.7437 bushels to one tonne for wheat is used in setting Canadian, per-tonne values.

14. Why do producers have to sign a delivery contract for the grain contracted on a PPO?

PPO contracts are pricing options only and do not have any delivery terms associated with them. Completion of a delivery contract in the fall is required. This principle maintains equal access to grain delivery opportunities for both PPO and pool participants throughout the year. Producers who participate in the PPO programs do not displace delivery opportunity for producers who choose the pool.

15. Can a producer deliver grain against delivery calls and apply the deliveries to a BPC that has not had the futures component locked in?

Yes, a producer can deliver grain against regular delivery calls issued by the CWB and apply the delivery to their BPC when settling the initial payment. The delivery is applied against the BPC contract. The CWB additional payment is issued to the producer when they price the futures component.

16. If a producer wants to apply feed grade wheat against a BPC or FPC or feed durum against an FPC, what discount is used and when is it deducted?

Deliveries of Canada Feed, No. 4 CWRS, No. 4 CWHWS, No. 3 CWSWS, No. 4 CWAD and No. 5 CWAD are subject to the posted feed discount on the day the delivery is settled and the producer certificate is reported to the CWB. Starting August 1, the feed discount for each class of wheat is posted on the pricing schedule to reflect the current market value of feed. The CWB deducts the feed discount from the producer's additional payment.

17. Why doesn't the CWB pay out futures gains if I decide to buy out of my BPC or FPC?

The purpose of the BPC and FPC programs is to provide marketing choices for producers, not for grain market speculation. If the FPC or BPC program permitted the payout of futures gains, the programs could be used as a speculation tool whereby producers could enter into a futures position for the sole purpose of later buying back the position in an attempt to earn a trading profit. To discourage this practice, any potential hedge gains resulting from buy-outs will be placed into the PPO contingency fund. Producers wishing to profit from a futures position may want to consider pricing a futures position with their own broker. By doing this, they can buy back their futures position at any time. If they later want to deliver against this position, they can sign a BPC, and using the CWB exchange for physicals program, transfer their futures position into the BPC.

18. Why is the CWB offering a "force majeure" clause within BPC/FPC contracts?

Producers have expressed a desire to be able to have their pricing damages under a BPC/FPC contract covered in the event that circumstances arise which are beyond their control and which limit their ability to perform under such contract.

A force majeure clause commonly known as an "Act of God" clause is useful in lessening a producer's production risk. A force majeure clause will benefit producers who experience an event, which is beyond their control that greatly limits or wipes out their crop production. It can waive any damages that are payable under the BPC/FPC contracts as a result of non-performance to the extent of the loss. This clause cannot be invoked if an event occurs that results in a milling class of grain being downgraded to a feed grade.

19. Why can't old crop-new crop settlements be applied against new crop FPC/BPC contracts?

As PPO contract programs become more fully established, it is necessary to further refine them to ensure that they work for producers who choose them and do not negatively affect the pool accounts. When tonnage committed to the old crop pool is priced against a new crop FPC or BPC, deliveries applied against these contracts are attributed to the new crop sales program thereby negatively affecting the old crop pool account. In a rising market, producers who delivered to the pool account early in the year could see their ability to benefit from higher prices later in the crop year diminished.

Additionally, the FPC and BPC provides producers with three price signals: the FPC/BPC, old crop PRO and the new crop PRO. The ability to choose between three prices provided a cost free option to producers which would not otherwise exist in the market. In essence, producers could buy an "in the money" call option at no cost. Given that this cannot be hedged by the CWB, this cost must be borne by the pool account.

20. Can I still settle old crop deliveries against the new crop pool account and why is this still permitted?

Producers will still have the option to settle storage tickets for 2005-06 deliveries against the 2006-07 pool account, after August 1, 2006. The option to use the 2006-07 EPO program will also be available, to address cash flow requirements.

Producers who choose to apply their stored deliveries between pools are still basing their decision on forecasted price signals using the PRO, meaning they are individually choosing to assume risk when making this decision.

21. How do I take advantage of the pricing opportunities provided by the PPO contracts on grain I currently have in the bin?

Producers can still price this year's crop using the 2006-07 FPC and BPC as long as the grain has not been committed to a 2005-06 delivery contract. By carrying the grain on farm until the new crop year, they can then enter into a 2006-07 delivery contract and apply these deliveries against an FPC or BPC. The new policy means that delivery and settlement under the FPC and BPC must occur within the crop year the program is offered.

22. Why can't I lock in the grade and/or protein spreads when I sign my PPO contract?

When producers deliver against a BPC/FPC contract the price is adjusted by the CWB's grade and/or protein spread between initial payments for any difference between the reference grade and the actual grade on the settlement date.

The initial payment spreads are used to reflect the pooled basis for the delivered grade at the time of settlement. Adjustments to the initial payment spreads will reflect changes to the PRO, therefore widening or narrowing grade spreads at the time they become effective based on market conditions. Using the initial payment spreads manages basis risk as market conditions change throughout the crop year.

Producers should keep this in mind when applying deliveries to their BPC or FPC contract, especially if they have a range of grades and/or proteins available. Depending on the crop year and the timing between adjustment payments (changes to the initial prices) this can have a positive or negative effect on the final farm-gate price that a producer will receive. The PRO is released monthly and will reflect the spread changes between grades. Producers can use the PRO to make decisions about adding deliveries to their PPO contracts to take advantages of spread changes before adjustment payments.

To offer producers the opportunity to lock in grade and protein spreads, the producer would have to guarantee delivery of the grade and protein locked in. If the delivered grade differed from what was locked in, a set of discounts/premiums would apply. The spreads would have to reflect the quality uncertainty at the time. This would ensure the basis risk could be managed and a sustainable program could be maintained. This option is being reviewed for further enhancements once all the pros and cons can be evaluated.