EXAMPLE - POLICY AND PROCEDURE

Risk Policy Definitions

Product and volume: The volume of product and fungible type of product must be identified. For example, distillates of any kind are considered a fungible product even though the grades may differ. ULSD (Ultra Low Sulfur Diesel) is the proxy hedge for any distillate in the inventory.

Inventory: Current inventory is the volume last measured within the last 3 days in the system as a whole (this could mean multiple sites or floating product) Inventory is considered any product that has been priced and is owned by Clients, regardless of location.

Limits: Limits for the physical, hedge or aggregate position as defined by the company hedging policy.

Position: The position is the aggregate size (volume) of all physical product, paper hedges (futures, options, swaps) or physical product that has price and volume fixed (financial risk)

Expected position: Hedging decisions may be made in advance of physical risk being taken. The expected position Monday will include cargo loaded Saturday or Sunday.

Price mechanism: Purchased product pricing may differ between Sellers and depend on calendar irregularities. For example, product loaded on a Sunday could price on the prior Thurs, Friday and following Monday. Alternatively, it could price using 2/3 of the Friday Settlement and 1/3 of the Monday settlement.

Settlement: the price Settlement is the daily or monthly average price calculated by the CME or the local price index such as Platt's or similar. In the case of Client's the settlement for hedging products is based on the exchange published data.

Stress Limits: The stress limit is the net position when a price scenario of +20% or -20% is applied. If the position is current net +10,000 bbls at current market, the stress position will indicate what the position will look like on a rapid change in prices higher or lower.

Target position. The target position is the net inventory position, long or short, at any time using the aggregate of wet barrels and financial positions (paper)

Hedging Policy for [Fuel Client]

Purpose: The purpose of hedging is to reduce the overall financial risk of the company. However, total risk may swing between long (bullish) and short (bearish) depending on market conditions. Limits on the hedge position, physical and total position (hedge plus physical) may be limited independently as well as in aggregate.

Target position: Client's chooses to to maintain a target net long position at all times to allow for ongoing sales.

Target volume: 10,000-20,000 bbls (approx. 15,000,000 litres-30,000,000 litres) on a fully hedged basis.

Stress limits (See Appendix for calculation example)

Short: The low stress limit is:	-10,000 bbls (-15 MN litres)
Long: The high stress limit is:	30,000 bbls (45 MN litres)

If the position breaches the high or low barrier, the responsible trader should act to modify the position to reduce total risk and achieve the **target position**.

Approved hedging product:

For Home HO, Jet, MDO:	CME ULSD as defined by CME.
For Gasoline:	NY RB as defined by CME.

Approved hedging tools:

Average Price Options ("Asian"): These options are financially settled automatically using the calendar average of daily settlements by the exchange. There is no "delivery" except for a cash flow from to or from the hedge counterparty. Client's has approved to use call options ("price cap") and put options ("price floor").

Calendar Swaps ("swaps"): Swaps are calculated based on the difference between an agreed fixed price and average price of the month of the swap. They can be referred to as "contract for differences". Clients has approved to use swaps to hedge its position.

Trade execution
Indications, orders and trade confirmations should be kept by Clients and saved for audit and compliance purposes. Phone orders may be recorded however confirmations must be approved in writing.

Trading and position changes
Positions should be applied as close to settlement as possible to match new physical risk unless the position is being modified on purpose. Large new cargoes priced over three days should be hedged on a pro rata basis (1/3 per day).

Approved orders
Most orders should be made as Fill or Kill (FOK) or Good Till Cancelled (GTC) with specification to kill end of day. It is important to avoid allowing the counterparty or dealer to “hold” or “work” your order. This can lead to poor pricing or surprise fills on market price volatility.

If orders are left GTC with the dealer, it is imperative to inform a second person within the Client’s approved trading team that this order is in place.

As policy, it is recommended that all orders be reviewed at the end of the business day, killed or kept with clear instructions to the Client’s team.

Execution and Trade Fills
All trade fills are immediately reported to Client and by email. The executing trader, broker or a Client executive must approve accuracy on same day or at trade fill.

Approved traders for Client’s account:
Chris Thorpe, CFA acts as a licensed Commodity Trading Advisor and can execute trades through approved counterparties.

Other executives of Client’s (or affiliates) authorized to trade are:
UPDATE

Appendix

Approved Dealer / Counterparties:
At present, Client's trades with a single counterparty over-the-counter ("OTC"). The current counterparty is [Counterparties]:

Key Contacts:
Head of Trading:
Trader (NY)

Back Office

Trade Capture

The following assumes a basic knowledge of derivatives calculus for the calculation of position risk.

Calculating position
Net position: Physical position + net delta position
Net delta: Net delta is the aggregate long and short position modified by any option delta given current volatility in the marketplace.

Example:

	Position	**Net delta**	**Max**
Long physical:	30,000 bbls	30	+30
Long puts (25D)	30 lots	-7.5	-30
Short calls (25D)	30 lots	-7.5	-30
Total		+15	

Stress position: The stress position is calculated with a 20% price move higher and 20% price move lower.

Example (Stress 20% Higher):

	Position	Net delta	
Long physical:	30,000 bbls	30	+30
Long puts (10D)	30 lots	-3.0	-30
Short calls (90D)	30 lots	-27.0	-30
Total		+0	

Calculating hedge in the averaging period (mid month)

For an average price option or calendar swap, every business day will erode the position by 1/(days in that month). For example, mid month a position of 50 lots will only be hedging 25 lots equivalent. If the physical sales are rateable, then the hedge should be matching the physical drawdown of the inventory. Reviewing the mismatch is required at least weekly to ensure the risk limits have not been breached.