

Commodity Broking Services Pty Ltd

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PRODUCT DISCLOSURE STATEMENT ("PDS")

PART 2

AUSTRALIAN FINANCIAL SERVICES

LICENCE NO: 280372

DATE: 30th July 2006

The information and any general advice in this PDS do not take into account your personal objectives, financial situation and needs. Before trading in the products referred to in this PDS you should read this PDS and be satisfied that any trading you undertake in relation to those products is appropriate in view of your objectives, financial situation and needs as well as considering the risks associated with dealing in those products. You should read all sections of this PDS before making a decision to acquire the financial products described herein.

We recommend that you consult your financial adviser or obtain other independent advice before trading in the products referred to in this PDS.

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PART 2

1. *Introduction*

This Part 2 of our PDS is for exchange traded derivatives, which is a type of financial product. Exchange traded derivatives contracts are more commonly known as:

- Futures contracts (both deliverable and cash settled);
- Futures options (which are options on a futures contract); and
- Exchange traded options (which are options directly over say a bank accepted bill or gold for example).

Derivatives exchanges (a type of financial market) are also known as futures exchanges (and some stock exchanges which also offer derivative products).

2. *Benefits of Futures and Options Contracts*

What are exchange traded futures contracts?

An exchange traded futures contract is an agreement, traded on a derivatives exchange, to deliver or take delivery of a specified amount of a security, financial instrument, stock index or a commodity of a given grade or quality, or to make a cash adjustment based on a change in the price of the security, financial instrument, stock index or commodity, at an agreed time in the future.

One purpose of exchange traded futures contracts is to provide those who deal in the traded securities, financial instruments, stock indices and commodities with a facility for managing the risks associated with changing prices for those investments. These people are known as hedgers. There are also those who trade in anticipation of profiting purely from changing prices in the traded securities, financial instruments, stock indices or commodities i.e. speculators. The risk of losing money is generally greater for the speculator.

Types of exchange traded futures contracts

There are two main types of exchange traded futures contracts. One is an arrangement under which the seller agrees to deliver to the buyer, and the buyer agrees to take delivery of, the quantity of the commodity described in the contract. Such contracts will be described in this Part 2 of our PDS as deliverable contracts. The other is an arrangement under which the two parties will make a cash adjustment between them according to whether the price of a security, financial instrument, stock index or commodity has risen or fallen since the time the arrangement was made. Such contracts will be described in this Part 2 of our PDS as cash settled contracts.

The terms of an exchange traded futures contract are generally set out in the Operating Rules of the exchange on which the contract is made. Derivatives exchanges exist in a number of countries, notably the United States of America, Japan, UK, Germany and Australia. The material in this Part 2 of our PDS is intended to refer to any exchange traded futures contracts traded on a computer based exchange unless otherwise indicated, but there may be differences in procedure and regulation of markets from one country to another and one exchange to another. For example, some futures exchanges operate through open outcry rather than being computer based. Open outcry means that each bid to buy or offer to sell must be stated aloud in such a manner that it may be heard by all other traders in the pit trading that particular futures contract. All those present then have an equal chance to accept the bid or offer. If a trader wishes to accept a bid or offer they must state aloud their confirmation. At that point the futures contract is concluded. The quantity must be included in any bid to buy or offer to sell.

Exchange traded futures contracts are made for periods of up to several years in the future, although most are for settlement within 6 months of the contract being made. Part of the standardisation of exchange traded futures contracts is that the time of delivery or settlement is one of a series of standardised maturity times. For example, in the SPI-200® cash settled contract traded on the Sydney Futures Exchange (“SFE”), contracts can be made for settlement at the end of any month of March, June, September or December during a period of 18 months from the time of the trade.

Deliverable contracts involve an obligation to deliver for the seller of the contract or take delivery at maturity for the buyer of the contract. If you are speculating it is not advisable to enter into such contracts in the last weeks before maturity unless actual delivery is contemplated. If you intend to make or take delivery first check with us or your Clearing Broker.

Exchange traded derivatives contracts are standardized

Exchange traded derivatives contracts, more specifically futures and option on futures contracts, which are traded on derivative markets are standardised and fungible. Fungible means that because futures contracts of a particular class are perfect substitutes for each other they can be closed out against an opposite position in the same class. A consequence of contract standardisation is that the price is the only factor that remains to be determined in the marketplace (other than volume and contract month).

Since all exchange traded derivatives contracts for a given future month in the same market are fungible, obligations under those contracts are easily transferred from one party to another. A client who holds a futures contract to buy may cancel this obligation by taking a new futures contract to sell in the same month, a process known as offsetting or closing out the contract. In the same way, the holder of a contract to sell can close out by taking a new futures contract to buy. In each case there will be a profit or loss equal to the difference between the buying and selling prices multiplied by the standard contract amount, minus (or plus in the case of a loss) any transaction costs.

In practice, the vast majority of derivatives contracts are offset in this manner, the remainder being fulfilled by delivery or by mandatory cash settlement where no provision for delivery exists.

Closing-out

Closing-out can be achieved without reference to the original party with whom the derivatives contract is traded because of a system of novation or substitution of one contracting party for another. The clearing house of the derivatives exchange stands between the buying and selling brokers guaranteeing contract performance to each of them (but not to clients who rely on the financial integrity of their broker). The clearing house is able to substitute a new buyer as the contract party when an existing buyer sells to close out their position. This can be represented by the following simplified example (which ignores transaction costs):

A sells to B at \$100 per unit;
B sells to C at \$120 per unit;
B has quit the market and has a profit of \$20 per unit;
At maturity, A (seller) is matched with C (buyer).

In effect C has replaced B as the buyer of the contract from A. The contracts which B held (one to buy and one to sell) have been settled in cash; B simply receives a profit. Any profit due to B is paid out by the clearing house in cash, even though the original seller (A) remains in the market. The clearing house ensures that it is able to pay such profits by calling initial margin (also referred to as a deposit) and variation margin (also referred to as additional deposit or additional margin) to cover any unrealised losses in the market.

Variation margin must be paid or satisfied (by lodging collateral or approved securities with us) by any client whose derivatives contract is showing a loss i.e. if the market falls after a purchase or rises after a sale. If a client enters a derivatives contract to buy an SFE SPI 200 Index futures contract when the price is 3,500 points and on the day after the SFE SPI 200 Index futures price decreases by 125 points to 3,375 points, the client will be required to pay a margin of 125 points times \$25 (tick value) or \$3,125. Each SFE SPI 200 Index futures contract is valued at \$25 per index point. Therefore, a one (1) point movement in a futures contract equates to \$25 in contract value.

Variation margin ensures that if the holder of the opposite contract wishes to offset the obligation before you, the clearing house will need to have cash on hand to pay the resulting profit. If the market fails to recover before your contract matures, this margin will not be recovered; the amount would then become a realised loss.

Exchange Traded Futures Options

What is an option?

The following explains the nature of an option contract and the obligations assumed by a person who instructs a broker to enter into an option. Several facts referred to previously are applicable to options, for example, the concept of closing out. These facts are not repeated, but only the facts particularly relevant to futures options are discussed below.

Looked at from the buyer's viewpoint a futures option (whether it is a call option or a put option) is the right, not the obligation, to enter into a futures contract (bought in the case of a call option and sold in the case of a put option) at the exercise price of the futures option granted in return for a premium. Looked at from the seller's viewpoint the seller has no right as such (other than a right to the premium). The seller will be under an obligation to enter into a futures contract (sold in the case of a call option and bought in the case of a put option) at the exercise price of the futures option if the option is validly exercised. Like futures contracts, options are standardised so that having bought an option it is possible to sell it later to a third party and vice versa.

You must distinguish between futures options and exchange traded options. If a futures option is exercised it results in the establishment of a futures contract. If an exchange traded option is exercised it results in making or taking delivery of the actual commodity underlying the option, or making a cash adjustment based on a change in the price of the commodity or on the movement in an index. The following matters can apply both to futures options and eligible exchange traded options but the discussion will centre on futures options.

European and American options

European options can only be exercised on the expiry date, not before.

American options are tradable and can be exercised at any time up to the date the option is due to expire.

Options traded on the SFE may be exercised at any time before the expiry date. As noted, because SFE options can be exercised at any time before the expiry date, the seller (also referred to as the writer or grantor) of an option must be prepared for that option to be exercised any time before the expiry date.

Call and put options

A call option is an option to buy in the derivatives market at a designated price (also known as the exercise price or the strike price) at any time before the expiry date (commonly known as American options). A put option is an option to sell in the derivatives market at the exercise price. Each call or put option has a buyer and a seller.

Exercising call and put options

The diagram below sets out the results from the buyer's and seller's viewpoint when the buyer is likely to exercise a call or put futures option:

Buyer	Seller
Bought call option -> Bought futures (at the exercise price of the option)	Sold call option -> Sold futures (at the exercise price of the option)
Bought put option -> Sold futures (at the exercise price of the option)	Sold put option -> Bought futures (at the exercise price of the option)

For further information concerning derivatives contracts traded on the SFE you are referred to the brochure "Introduction to Futures and Options" found on the SFE website at www.sfe.com.au/index.asp?dispage=/site/html/trading/products/intro.asp

For further information concerning derivatives contracts traded on other exchanges you are referred to the website addresses set out in Part 5 of this PDS.

Please contact us if you do not have access to the internet and we will provide you with any relevant information free of charge.

3. *Basic Risks Explained*

The risk of loss in trading in exchange traded derivatives contracts can be substantial. You should carefully consider whether trading is appropriate for you in light of your personal and financial circumstances. In deciding whether or not you will become involved in trading, you should be aware of the following matters:

- (a) You could sustain a total loss of the initial margin that you deposit with your broker to establish or maintain an exchange traded derivatives contract.
- (b) If the exchange traded derivatives market moves against your position, you may be required, at short notice, to deposit with your broker variation margin in order to maintain your position. Those additional funds may be substantial. If you fail to provide those additional funds within the required time, your position may be liquidated at a loss and you will be liable for any shortfall in your account resulting from that failure.
- (c) Under certain market conditions, it could become difficult or impossible for you to close out a position. This can, for example, happen when there is a significant change in prices over a short period.

- (d) Under certain market conditions, it could become difficult or impossible for you to manage the risk of open positions by entering into opposite positions in another contract month.
- (e) Under certain market conditions the prices of exchange traded derivatives contracts may not maintain their usual relationship with the underlying market.
- (f) Trading in exchange traded derivatives involves risk and there is no trading strategy which can completely eliminate the risk. The placing of contingent orders (such as a ‘stop-loss’ order which is an order that becomes a market order and thus executable when the exchange traded derivatives market reaches the designated price of the order) may not always limit your losses to the amounts that you may want. Market conditions may make it impossible to execute such orders.
- (g) A “spread” position (i.e. the holding of a bought futures contract for one delivery or settlement month and a sold futures contract for another delivery or settlement month) is not necessarily less risky than a simple “long” (i.e. bought) or “short” (i.e. sold) position.
- (h) Where you have a position in a deliverable contract and you continue to hold this position going into the delivery period, you may be required to effect physical delivery of the underlying commodity if your position is not closed out.
- (i) The high degree of leverage that is obtainable in trading exchange traded contracts because of small margin requirements can work against you as well as for you. The use of leverage can lead to large losses as well as large gains. Trading in exchange traded derivatives may result in unlimited losses that are greater than the amount you deposited with your broker.
- (j) If you propose to trade in futures options, the maximum loss in buying an option is the amount of the premium, but the risks in selling an option are the same as in other futures trading i.e. they are unlimited.

4. Amounts Payable

Commission or Brokerage

You are referred to Part 5 of this PDS for details of commission, fees and other expenses charged by *CBS*.

Margins

To protect the financial security of both the broker (us) and the clearing house until variation margins are paid, you will be required to pay initial margins. Initial margins are set by the clearing house or the derivatives exchange or both with respect to each contract type. Initial margin may vary from time to time according to the volatility of the market. This means that an initial margin may change after a position has been opened, requiring

a further payment (or refund, where applicable, on request). Initial margins are carefully calculated to cover the maximum expected movement in the market from one day to the next. A broker is entitled to call a higher initial margin than the minimum set to protect its personal obligation incurred when dealing on a client's behalf. Liability for initial margin occurs at the time of the trade and should be paid to the broker before any trading is conducted on the client's behalf.

Client's can incur losses before a contract is closed out. The variation margin liability is incurred at the time of the occurrence of any movement in the market that results in an unrealised loss, regardless as to when the call to pay is made by the broker on the client.

Initial and variation margin must be paid immediately after the call. This is generally taken to mean within 24 hours of the call although in times of extreme price volatility this may mean as little as 1 hour. If you do not pay a margin, we are entitled to close out your position and deduct the resulting realised loss from the initial margin. If the realised loss exceeds the initial margin you are required to pay the excess to us. Derivatives markets can be highly volatile and you should ensure that you are always contactable by *CBS*. If you are unable to be contacted for the purpose of *CBS* making the call, we may close out your derivatives contracts without actually speaking to you.

The initial margin for each SFE contract can be found on the SFE website at <http://www.sfe.com.au/content/clearing/operations/marginrates.pdf>

The initial margin for futures contracts traded on other exchanges can be found at the websites set out in Part 5 of this PDS.

If you do not have access to the internet we will provide you with a copy of this information for your review free of charge.

Liability

The liability of a client under a futures contract is not limited to the initial margin which that client paid to the broker when the contracts were first opened. If, after paying the initial margin, the price moves against the client, further margin (known as variation margin or additional margin) will be called and must be paid on demand. Margin payments can therefore exceed the amount of the initial margin and any variation margin. Initial margin (unless eroded by losses) can be paid to the client on settlement of the contract. Margins that become realised losses are not refundable. Margins concerning unrealised losses are not refundable unless there is a favourable change of direction in market prices before settlement or closing out of the futures contract. The liability of a client is not limited to the amount of the initial or variation margin paid.

Profit and loss when trading futures

The diagram below sets out profit and loss situations when trading futures contracts.

Profitable Trades	Losing Trades
Buy low-Sell high	Buy high-Sell low
Sell high-Buy low	Sell low-Buy high

Margins and liability on option contracts

If a client buys a futures option, their loss is limited to the premium, which is non-refundable.

If the option buyer pays the full premium at the time the option is traded, they will not be called upon to pay “margins”. If the buyer paid only an initial deposit, they may be called upon to pay margins up to the full value of the premium (but no more). A client who sells the option has a potential liability to the holder of the underlying futures contract, that is, potentially unlimited. However, they only have limited profit potential; a seller cannot earn more than the premium for which the option is sold.

Profit and loss when trading options

The diagram below sets out profit and loss situations when trading call and put options:

Profitable Trades	Losing Trades
Buying a call option-Buy low Sell high*	Buying a call option-Buy high Sell low*
Buying a put option-Buy high Sell low*	Buying a put option-Buy low Sell high*
Selling a call option-Sell high Buy low**	Selling a call option-Sell low Buy high**
Selling a put option-Sell low Buy high**	Selling a put option-Sell high Buy low**

* Refers to the buying of the option.

** Refers to the selling of the option.

Out of the money options

This is a term used to describe an option that cannot be exercised at a profit. An out-of-the-money option is a call option whose strike price is higher than the current market level or a put option whose strike price is below market.

A client contemplating purchasing a deep out-of-the-money option (i.e. an option with an exercise price significantly above, in the case of a call option, or significantly below, in the case of a put option, the current price of the underlying futures contract) should be aware that the chance of such an option becoming profitable is generally remote.

5. *Other Significant Characteristics of Derivatives Contracts*

Dealings on foreign derivatives exchanges

Clients who deal on foreign derivatives exchanges should be aware of the following matters:

(i) Dealing subject to foreign rules and laws

Participation in transactions on foreign derivatives involves the execution and clearing of trades subject to the rules of that foreign derivatives exchange and the laws of the country in which that exchange is domiciled.

(ii) Australian regulators may not have any jurisdiction

The Australian Securities and Investments Commission does not regulate activities of foreign derivatives exchanges, including the execution, delivery and clearing of transactions, nor do they have the power to compel enforcement of the operating rules of a foreign derivatives exchange or any applicable foreign laws. Generally, the foreign transaction will be governed by applicable foreign law. This is true even if the derivatives exchange is formally linked with an exchange in Australia. Moreover, such rules and regulations will vary depending on the foreign country in which the transaction occurs.

(iii) Exchange rate risk

If a client trades in derivatives contracts denominated in currencies other than Australian dollars a client may lose money due to exchange rate fluctuations. These losses may be in addition to any losses on the derivatives contract itself.

(iv) Protection of Client monies

Clients who trade on foreign derivatives exchanges may not have the benefit of protective measures provided by the Corporations Act 2001 (Cwlth). In particular, clients' funds may not have the same protection as funds deposited in Australia in a Broker's Clients' Segregated Account or trust account, nor the benefit of the SFE fidelity fund.

Other issues

You should also be aware of the following particular issues:

(i) Clients' segregated monies

Funds deposited with *CBS* concerning exchange traded derivatives are deposited in accordance with the client money rules set out in the Corporations Act 2001 (Cwlth). The client waives any interest on funds deposited with us (or you

clearing broker), for initial or variation margins to trade exchange traded derivatives contracts, unless any written agreement stipulates that interest is to be paid on such funds. Money or property or both is invested according to the Corporations Act 2001 (Cwlth), or on the instructions of the client, and are invested at the sole risk of the client.

For money deposited, the client acknowledges that:

- individual client accounts are not separated from each other;
- all clients' funds are co-mingled into the one trust account;
- The client money provisions may not insulate any individual client's funds from a default in the trust account. Such a default may arise from any clients' trading;
- assets in the trust account belonging to non-defaulting clients are potentially at risk, even though they did not cause the default;
- *CBS* has the right to apply all clients' monies held in its trust account to meet the default in that account.

(ii) Settlement

If you have a deliverable derivative contract open at the close of trading on the last day of trading you will be under an obligation to deliver, or take delivery of and pay the contract price in full (including all other fees and costs payable) for, the commodities described in the specifications. It is the policy of *CBS* that clients are not permitted to make or take delivery under a deliverable derivative contract.

If you have a cash settled contract open at the close of trading on the last day of trading you will be under an obligation to pay or have a right to receive an amount of money depending on the price movement.

The settlement of derivative contracts that are futures options is more complex. On the SFE all in-the-money or at-the-money options are automatically exercised by the clearing house. An in-the-money option is a put option with an exercise price above the price of the subject matter of the option or a call option with an exercise price below the price of the subject matter of the option. An at-the-money option is a put or call option with an exercise price equal to the price of the subject matter of the option. The resulting position is settled as a futures position. Not all exchanges automatically exercise at-the-money or in-the-money options at expiry, particularly US exchanges. Check with us before the expiry date or the option may lapse worthless.

(iii) Regulatory bodies

A client may incur losses that are caused by matters outside our control. For example, a regulatory authority exercising its powers during a market emergency may result in losses. A regulatory authority can, in extreme situations, suspend trading or alter the price at which a position is settled. This could result in a loss to the client.

(iv) Market disruptions / emergencies

A market disruption may mean a client is unable to deal in a derivatives contract when desired; a client may suffer a loss as a result. Common examples of disruption include the “crash” of a computer based trading system, fire or other exchange emergency, futures regulatory body could declare an undesirable situation has developed in a particular futures contract and suspend trading.

(v) Risk Capital

If you are speculating do not risk more capital than you can afford to lose. A good general rule is never to speculate with money which, if lost, would alter your standard of living.

6. *Taxation Implications*

Trading in futures and option contracts has the potential for generating substantial profits and the potential for generating substantial losses. The tax implications of such profits or losses may be significant depending on the personal circumstances of the individual client. *CBS* does not provide tax advice and we recommend you seek your own professional tax advice and the impact any profits or losses generated from futures trading may have on your overall tax position.

7. *Cooling-off Arrangements*

There are no cooling-off arrangements for exchange traded derivative contracts. This means that when *CBS* arranges for the execution of an exchange traded derivative, you do not have a right to return the product and thus, you do not have the right to request *CBS* to repay the money you have paid to acquire the product. Should you change your mind after entering into an exchange traded derivative, you should close out your position by taking an opposite transaction.

8. *Other Information Available*

Contract Specifications

Contract specifications for exchange traded futures contracts can be found on the relevant exchange's website. The contract specifications for futures contracts traded on the SFE can be found at www.sfe.com.au/content/sfe/trading/con_specs.pdf

Please refer to Part 5 of this PDS for the list of overseas exchanges (and their websites) on which *CBS* will accept instructions from you to trade futures and option contracts.

If you do not have access to the internet we will provide you with a copy of this information for your review free of charge.

9. *Other Considerations*

Exchange traded derivative contracts can be traded on Australian and overseas exchanges.

Off-Market Trading - Block Trade Facility (BTF)

The SFE offers a BTF for SPI 200 Futures contracts. The BTF is an entirely off-market i.e. non Trading Platform trading facility, enabling SFE Participants to bilaterally arrange large volume transactions away from the SFE market that might have otherwise negatively impacted normal market quality. Once fully negotiated, the initiating party registers the trade into SFE via the Trading Platform's text messaging facility.

For further information in relation to the benefits and features of the BTF, you are referred to the SFE website at www.sfe.com.au/index.asp?dispage=/site/html/trading/products/intro.asp

Exchange for Physical (EFP)

The SFE also provides an EFP facility for further flexibility in the management of price risk. An EFP allows a futures position to be exchanged for a physical position in the underlying market at a price negotiated between the counterparties.

EFPs provide a mechanism to:

- swap from a futures contract to a physical position or vice versa;
- provide off market price certainty for large physical versus futures transactions; or
- fulfill delivery commitments.

The physical and futures components must be 'substantially similar' and equal in terms of either:

- value (i.e. the value of the physical being similar to the value of the futures); or by
- quantity (the quantity of the physical being similar to the quantity of the futures)

For further information in relation to the benefits and features of EFP's, you are referred to the SFE website at

www.sfe.com.au/index.asp?dispage=/site/html/trading/products/intro.asp