



AgClearing Update

Presentation Outline

1. Why is Clearing Important?
 - initial assumptions / rationale.
2. Business Development Approach
3. Current Status &
What We Have Learned
4. Where to From Here.

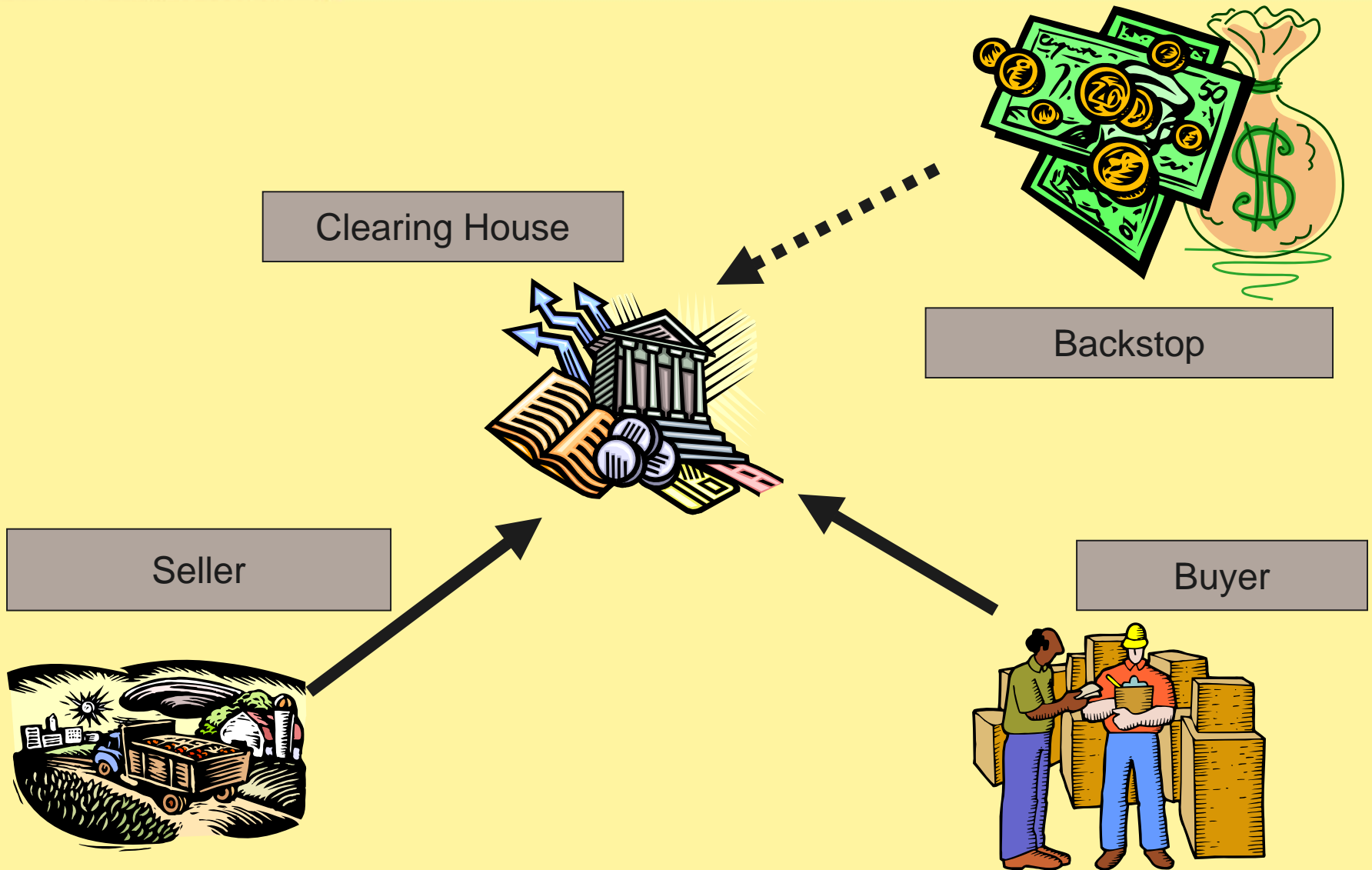
What is a Clearinghouse?

- A separate, independent corporation.
 - assures contract performance
 - delivery and settlement
 - collecting and maintaining margin monies
 - reporting trade data.
- Protects buyers and sellers from financial loss.
 - standardized contracts
 - customer agreements
 - rules and regulations
 - procedures and performance standards.



A clearinghouse manages contract performance

Visual Concept



How Does It Work?

- In its simplest form, a buyer and seller register their trades with the clearinghouse.
- Then the clearinghouse reports, registers and monitors the trades until execution.
 - Clearinghouse constantly ensures the parties have the financial ability to execute in the event of any market condition – a central counterparty guarantor.
 - Credit Evaluation
 - Margining
 - Value at risk (VAR)
 - Market monitoring

Initial Drivers

Why is this project important to producers?

A clearinghouse is capable of:

- Providing neutral price discovery for nearby and forward markets.
- Expanding markets and trading opportunities.
- Assuring delivery and payment.
- Offering fairer, more balanced contracts.

Additional Benefits

Why is this project important to producers?

A clearinghouse is also capable of:

- Introducing a superior and more cost effective alternative to CGC bonding.
- Securitizing trades (and inventory) enabling banks to increase financing at reduced rates.
- Facilitating a process to capture larger margins through deferred trades and carrying charge earnings.

Development Process

Work plan 1

April 2005.....March 2006

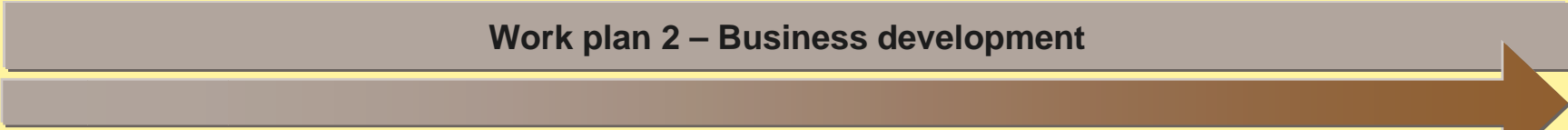
Work plan 1 – Generic Model / Market Assessment / Simulations and modeling



Work plan 2

April 2006.....March 2007

Work plan 2 – Business development



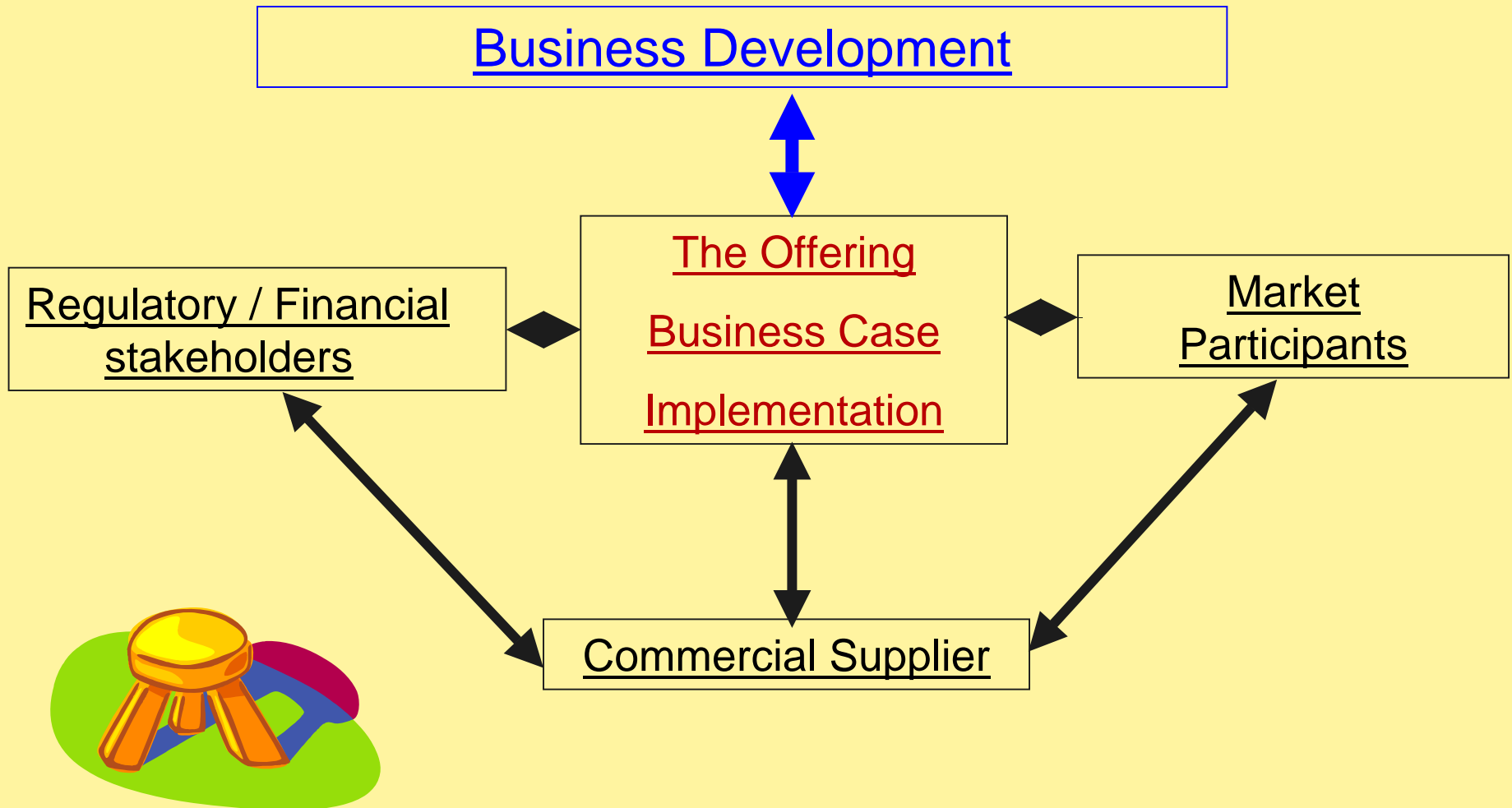
Work plan 3 - *if necessary*

April 2007.....March 2008

Work plan 3 – Start up & Implementation



Business Development Framework



1. Improved transactional security and contract execution were needed by farmers and buyers in the ag industry
2. Initial volumes of forward contracts that buyers and sellers would agree to clear would demonstrate business feasibility of clearing to a service provider, and volumes / breadth of commodities would grow over time.

3. Growth of forward contracting was likely given structural changes in the industry, further increasing the importance and value of clearing to all industry participants.
4. Benefits associated with clearing would out weight costs with a likelihood of a return on investment for individual participants (buyers and sellers).

5. The financial community would recognize the value of clearing in respect to contractual risk management and offer incentives for participation.

6. Clearing would offer a more comprehensive and less expensive alternative to the CGC's existing bonding service.



Workplan 1 Review

Review of Workplan 1

- **Generic Model** was developed that could serve as the basis for the development of an operating clearinghouse.
- **Simulations and Modeling** demonstrated that there are some very real benefits and that a clearinghouse would be a viable business entity.
- **Outreach Sessions** demonstrated that there is openness to the concept of a clearinghouse from grain producers.



Workplan 2 Review

Workplan 2 Objectives

- Validate the benefits associated with clearing and the implications to participants.
- Validate producer interest and acceptance for clearing.
- Gain “Formal support” from the buy side that we can demonstrate to a service provider, the CGC, financial institutions.

Workplan 2 Objectives

- A formal commitment from the CGC to allow the utilization of clearing as a replacement for bonding.
- **Gain** formal commitment from financial institutions to utilize clearing to secure inventory financing at reduced costs to clients.
- **Develop** a Business Case for the clearinghouse “that could be supported” by a service provider.

Workplan 2 Deliverables

- Demonstrate that a clearinghouse is feasible (there is a business case) for select applications and commodity areas and outline the business plan and implementation strategy.

and / or

- Show that a clearinghouse may be difficult launch for a service provider at this time, but show under what strategies, offerings and structure an agricultural commodity clearinghouse would be feasible

Achievements

- Conducted comprehensive producer meetings across western Canada
- Held extensive meetings with:
 - Producer & commodity associations
 - Grain handlers and processors
 - Banks and other lenders
- Presentation to Compas Review
 - Resulted in a recommendation going forward to federal government re: CGC

Achievements

- Article and editorial in Western Producer
 - August 2006
- Presentation to CWB Task Force
 - Resulted in endorsement from their members
- Concept recommendation from Standing Committee on Agriculture to CGC

Support by Sector

Group / situation		Current Position	Objective with strategy
Producers	Green	Generally supportive and want to see tangible benefits	Solidify broad support with producer groups – coalition of key organizations
Grain Handlers	Red	Majors generally unsupportive, some support within sectors	Try to quantify specific benefits and demonstrate real value
CWB	Yellow	Uncommitted either way – aware of CH	Demonstrate the value / necessity of the CH to their operations
End Users & processors	Green	Generally supportive – would like to understand better and consider pros/cons	Try to quantify specific benefits and demonstrate real value
CGC	Green	Interested – need to / understand the implications to their current operations / mandate	Develop a proposal / ongoing discussions as clearing as an enhancement to bonding
Financial Institutions	Green	Interested – need to see / understand implications to their business	Maintain neutrality / get more formal commitment on their intent to utilize the CH to provide inventory financing / cost of borrowing reductions

Producer Focus Groups



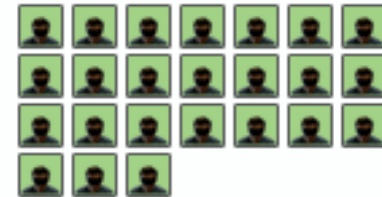
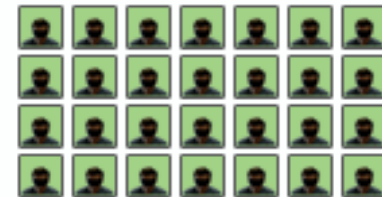
AGCLEARING CONCEPT EXPLORATION - 2006

PRODUCER RECOMMENDATIONS

- Should The Clearinghouse Move Forward or Not? -

- No -

- Yes -



Video **8**

Video **62**

AGCLEARING



**What Have
We Learned?**

What Have We Learned?

We have learned.....

- That strong support from **grain producers** has resulted in the addition of flax, wheat and canola to the original barley project.
- That **end user buyers and grain handlers** still need to be convinced of the benefits.
- A **service provider** who shares this vision must be attracted to the investment.
- **Lending institutions** are critical to the positioning of clearing as a securitization technique and marketing enhancement tool.

Concept Testing

What Did We Learn?

Clearing offers many benefits to producers, handlers and end users.

- Lower costs versus bonding
- Price discovery
- Standardized contracts
- Reductions in financing costs
- Dispute resolution
- Etc.

BUT.....

Concept Testing

What Did We Learn?

While transactional security and contract execution are important issues for participants they are **not significant enough for clearinghouse feasibility** on their own.

The real value in clearing comes from the ability to finance inventory more effectively to:

- 1) Improve margins for producers by way of forward contracting.
- 2) Increase turn numbers for grain handlers through leveraged inventory financing.

Deferred Delivery Price Gains (\$/tonne) Canola - Oct to May

Crop Year	Futures Spread (gain)	Basis gain (loss)	Net average Gain
98-99	\$16.18	\$16.99	\$33.17
99-00	\$20.61	(\$1.87)	\$18.74
00-01	\$23.65	\$11.04	\$34.69
01-02	\$1.73	\$14.61	\$16.34
02-03	\$7.25	\$1.44	\$8.69
03-04	\$15.15	\$28.78	\$43.93
04-05	\$20.49	\$12.81	\$33.30
05-06	\$32.99	?	?

Source: Sask Canola Growers PSRMP Report Jan 2006

Deferred Delivery Price Gains (\$/tonne) Canola - Oct to May

The economics of carrying grain

- Carrying Charge gains range from \$8.69/tonne to \$43.93/tonne for 8 months.
- Interest costs for 8 months represent \$10/tonne as a breakeven point. (Basis Prime at 6%).
- Any revenue over that is payment for storage.
- This has been a money making opportunity in every year but one in the past seven.
- Wheat and barley are very similar stories.

Financial Institutions

- Concept of clearing is not new to financial institutions.
- Utilization of clearing mechanisms as “collateral” in providing financing to industry is growing globally and there is good interest in its application in agriculture.
- Importantly for lenders is the ability to grow their agricultural portfolio in a secure business environment – which clearing provides.

Canadian Grain Commission

- The CGC views clearing as an additional tool for the marketplace to manage transactional risk and contract execution.
- Our research shows clearing offers precision coverage to both buyer and seller for a longer period of exposure at reduced costs.
- Clearing is currently under review by the CGC in response to the recommendations from the Standing Ag Committee.

Concept Testing

What Did We Learn?

Service Providers

1. Growth in commodity clearing in agriculture is of interest to existing clearing entities as well as some new operators.
2. Clearing in agriculture could serve as a platform for growth across other ag commodities, geographies and commodity sectors like energy.
3. The development of clearing will take time and requires a business development focus.
4. Several candidates are interested in reviewing a prepared Business Case to determine their interest in proceeding.



Next Steps

Where to From Here?

The key messages from the concept testing with stakeholders were...

- Bring benefits beyond transactional security and contract execution.
- Focus on features that are beneficial to all participants as opposed to tradeoffs within participants.
- Actively engage the financial community and the CGC in the utilization and recognition of clearing. These are where the most significant tangible financial benefits of clearing can be achieved.
- Demonstrate conclusively how clearing can improve marketing options for buyers and sellers.

Key Messages

1. Cash commodity clearing represents a vital and fundamental new mechanism to manage risk and improve profitability.
2. Changing the way we manage contracts and finance inventory introduces new security and opportunity.
3. Farmers and farm organizations have to take a leadership role in making this happen.

Key Message (Cont).

4. Canada has a world class handling and transportation infrastructure.
5. We must introduce marketing and risk management systems that compliment our advantages.
6. Our meetings to date suggest a real opportunity to differentiate ourselves by adopting good business practices from other industries.
7. Clearing is feasible.

In Summary

- To be feasible, Clearing can and must bring benefits beyond transactional security and contract execution.
- Gaining support from all participants and stakeholders is challenging and takes time – and is anchored on clear tangible benefits.
- The business feasibility is likely challenging in the short term, but clearing is going to be an important piece of infrastructure for the industry.

QUESTIONS.....

