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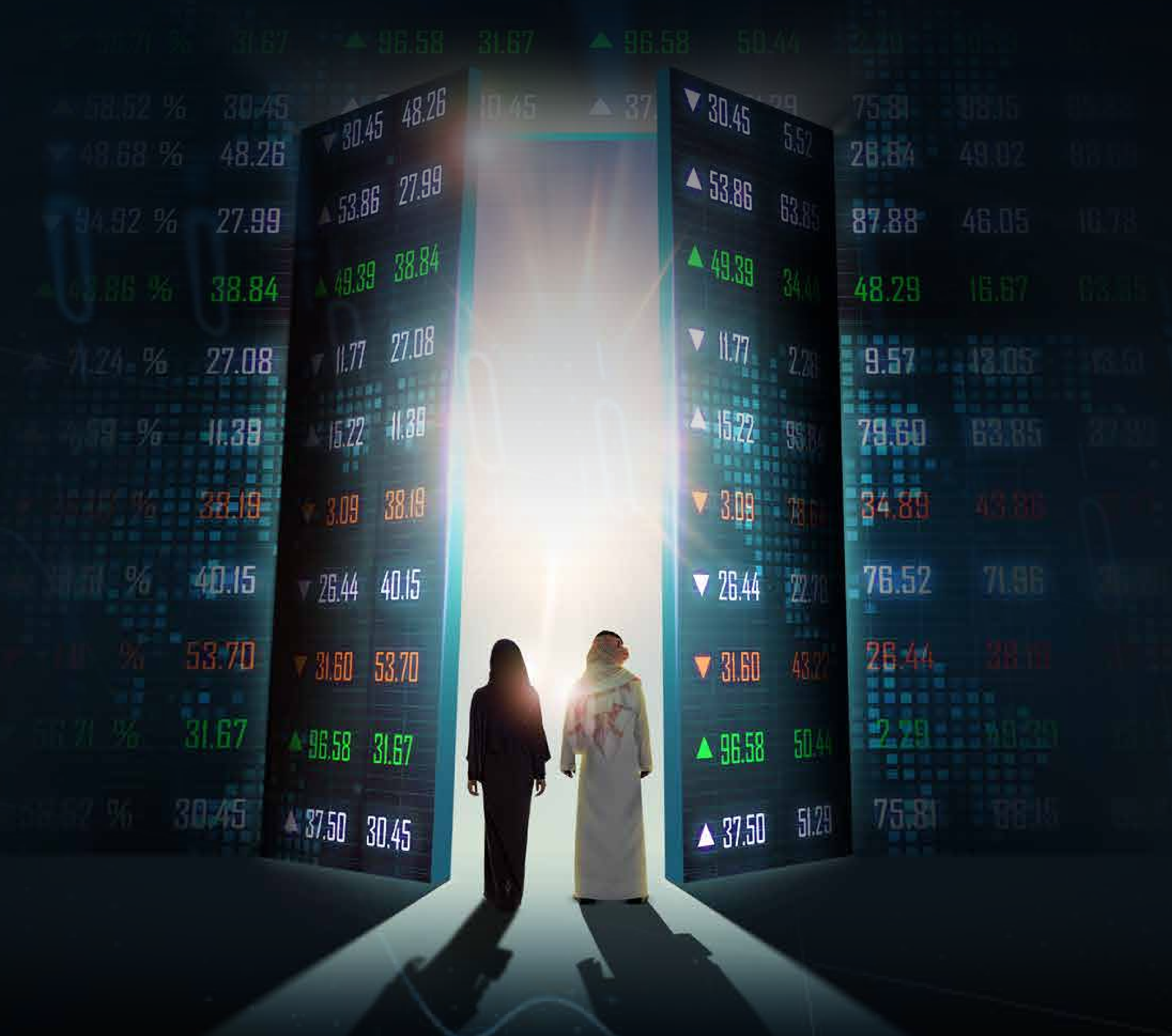
Tadawul

DERIVATIVES MARKET



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السوق المالية السعودية
Saudi Stock Exchange

Introduction

The Saudi Stock Exchange (Tadawul) derivatives market represents a key milestone in the development of an advanced capital market in Saudi Arabia, and is central to the realization of the Financial Sector Development Program (FSDP) to build a thriving economy under Vision 2030.

With the introduction of the derivatives market, Tadawul aims to diversify its offerings and create new retail and institutional opportunities for local and international investors, providing them with the necessary hedging tools to effectively manage risk and expand their exposure to the Saudi market, the largest and most liquid in the MENA region.

MT30 Index Futures is the first derivatives product Tadawul will offer. This product is a cash-settled index futures contract based on the MSCI Tadawul 30 index (MT30). The MT30 index provides investors with a benchmark of the largest and most liquid securities listed on the Saudi Stock Exchange (Tadawul).

MT30 Index Futures will be cleared and settled by the Securities Clearing Center Company, Muqassa, the only authorized entity in the Kingdom to clear securities traded on the Saudi Stock Exchange through its Qualified Central Counterparty status. Muqassa played a central role in the development of the infrastructure integral for the Tadawul derivatives market by facilitating clearing services and guaranteeing the settlement and fulfilment of obligations for all trades executed on Tadawul across all asset classes under its coverage.

General Information

What are derivatives?

A derivative is a financial contract that its value is based on, or is derived from, an underlying asset or group of assets. The most common underlying assets for derivatives are stocks, bonds, commodities, currencies, equity indices.

Derivatives can be traded over-the-counter or on an Exchange. Exchange-traded derivatives are standardized, more heavily regulated and avoid counter party risk.

Derivatives types and characteristics

Futures and options are the most common derivatives instruments traded on an Exchange. Both allow the holder of the instrument to buy or sell an underlying asset, such as equities, at a point in the future, though they have different characteristics.

Futures represent an agreement for the delivery of an asset at a certain price on a specific future date. The parties involved in the futures contract are obligated to complete the transaction. The underlying asset of a futures contract does not necessarily change hands. Many are cash-settled, meaning that the gain or loss is simply reflected in a trader's brokerage account.

Options similarly are an agreement to buy or sell an asset at a predetermined future date for a specific price. However, unlike in a futures contract, the buyer is not obliged to exercise their agreement to buy or sell. Buying an options contract represents an opportunity only, not an obligation.

General Information

Tadawul Derivatives

Saudi Arabia's first exchange-traded derivatives product that will be launched by Tadawul is the MT30 Index Futures with an underlying index (MT30) which was jointly created by Tadawul and MSCI.

Tadawul expects to add additional derivative products over time, based on market appetite and readiness. These may include index options, single stock futures and single stock options.

Benefits and risks of derivatives trading

Tadawul's derivatives products bring significant benefits to the Kingdom's Capital Market. Derivatives provide investors with hedging tools to more effectively manage risk and offer them another opportunity for exposure to the Saudi market, while promoting liquidity. Derivative products can be used to hedge a position, trade on the directional movement of an underlying asset, or leverage holdings.

The introduction of the derivatives market on Tadawul has been made possible by an extensive series of trading system, post-trade, and regulatory enhancements. Tadawul has successfully established the market infrastructure that will enable the launch of additional futures and options products covering a wide range of asset classes.

As with any financial products, there are risks in trading derivatives, but the CMA and Tadawul have established well designed and appropriate rules and regulations, in-line with global best-practices, to minimize risks. Tadawul is also undertaking educational efforts to ensure that investors fully understand the benefits and risks before making investment decisions.

These educational materials include a trading simulator, educational videos, brochures, awareness sessions for public under Invest Wisely program and welcoming questions through social media, phone, or email.

Futures Contracts

What are Futures?

Futures are standardized agreements, traded on an exchange, that stipulate the purchase of an asset at a certain price on a specific future date. The parties involved in the futures contract are obligated to complete the transaction. The underlying asset of a futures contract does not necessarily change hands. Many are cash-settled, meaning that the gain or loss is simply reflected in a trader's brokerage account.

Types of Futures Contracts

Futures contracts exist for many different asset classes such as

- Individual Equities
- Equity Indices
- Commodities
- Currencies
- Bonds

Equity Futures Types

Index futures are agreements to buy or sell a financial index at a future date and certain price. Index futures are used to trade on the direction of price movement for an index. Index futures can also be used to hedge equity positions against losses. Tadawul offers an index futures product, the MT30 Index Futures, which is based on the MSCI Tadawul 30 Index (MT30).

Single stock futures are Derivatives instruments that give investors exposure to price movements on a single underlying stock. They are contracts that gives the trader the ability to buy or sell an underlying listed stock at a fixed price on a future date.

Trading and Eligibility

How to trade?

1

Before opening a derivatives position, traders should be aware of the risks and returns associated with trading derivatives. For more information please visit our online Knowledge Centre.

2

Opening an account to trade on Tadawul's derivatives market must be done through a broker who is a derivatives member of the exchange. If investors have an existing equities trading account, they may need to sign an additional agreement with their broker to trade Derivatives.

3

Before placing an order with your broker to either buy or sell a derivatives contract, the broker will require the trader to post initial margin to their account. Typically Clearing Houses charge a percentage of the contract value as Initial Margin.

4

The broker will route your trade to Tadawul, and the trade will be executed if a matching price is available.

5

The resulting trade will be registered for clearing and settlement by the Securities Clearing Center Company, Muqassa.

6

For a futures trade, you do not pay the full value of the trade, but only an initial margin which is a percentage of the contract value. This margin will have to be maintained through the duration of the contract.

7

During the life of the contract, any profit or loss that you make on a contract due to a change in the market price has to be settled on a daily basis – this is known as the Variation Margin.

8

Traders holding futures contracts will have the option to close out an open position anytime during the life of the contract by entering into an opposite position in the same contract maturity, there is no obligation for the buyer or seller of the contract to wait of the expiry of the contract.

9

Once a position is closed, any margin related to this position after any profit or loss will be realized in the account you hold with your broker.

10

For traders holding the contract to maturity (Expiry), the contract will automatically be settled by Muqassa on the maturity day through the cash settlement method, under which the difference in the futures price and expiration price will be settled via cash payment .

Who is eligible to trade Derivatives on Tadawul?

All investors are entitled to trade derivatives, however, the derivatives members will determine the investor's suitability based on the rules and regulations published by Tadawul and the regulator, the Capital Market Authority (CMA).

Investors wishing to trade derivatives on Tadawul will need to first visit a member of the exchange to open a derivatives trading account. A list of member firms can be found on Tadawul's online Member Directory.

Before making any investment decisions, traders should be aware of the risks and returns of utilizing derivatives and should seek advice on their suitability.

Key Terms

Derivative Product Specification	**A document issued by the Exchange that outlines all details related to a specific derivatives product.**
Contract Code	The letters and numbers that specify the contract name, expiry month, and expiry year.
Contract Size (multiplier)	The amount of underlying asset covered by each derivatives contract. Contract size determines the contract value.
Contract Value	Contract value is the traded price of the future product times the contract size.
Counterparty	The person or entity taking the other side of a derivatives trade.
Expiration Day	It is the last day which the futures contract is available for trading.
Settlement	Daily settlement takes place end of day on a daily mark to market basis until final settlement on expiration day.

Key Terms

Tick Size	The minimum price fluctuation of specific futures contract which will be specified in the Listed Derivatives Products Specifications.
Tick Value	The minimum movement in notional value of the contract. It is calculated as follows: Tick size X contract size (multiplier). For example if tick size is 0.5 and contract size is SAR 100, then the tick value is SAR 50. In simple terms, when the futures price moves from 1000 to 1000.50, the profit/ loss per futures contract shall be SAR 50.
Opening Auction	The commencement of each day of trading of derivatives listed on Tadawul will take place via an opening auction where bid and ask trades are entered via market participants to establish the first traded price of the day.
Daily Settlement Price	The price at which futures contracts are settled on a daily basis and variation margin calculation is based on. The methodology of calculating the Daily Settlement Price is determined and disclosed in the listed derivatives Product Specifications on the Exchange's website.
Final Settlement Price	The price at which cash-settled futures contracts are settled at maturity (expiry date) is known as the final settlement price.

Key Terms

Volatility	A measurement of change in price of the asset over a period of time.
Hedging	A way to reduce risk exposure by entering an offsetting position in the derivatives market.
Initial Margin	The margin that is collected to cover potential changes in the value of each client position.
Variation Margin (Mark-to-Market – MTM)	Variation Margin (VM) is MTM, meaning that margin is collected on a daily basis to cover the current exposure resulting from actual changes in market prices for each position. VM is the unrealized profits / losses on open positions on daily basis.
Margin	Means total Margin and it includes Initial Margin, any applicable Variation Margin and any additional margin determined by Muqassa and the clearing member.
Margin Multiplier	Is the number by which the minimum percentage margin, required by the Muqassa, have to be multiplied to form the margin required by the clearing member from his clients for newly entered positions.

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