Saudi Exchange

Derivatives Trading Guide

Content

Introduction

The Saudi Exchange 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, Saudi Exchange 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 fast-growing Saudi economy, the largest and most liquid in the MENA region.

This document serves as a guide for those who intend to learn more about trading Derivatives.

Difference between trading Stocks and trading Derivatives contracts

Differences	
Stock Trading	**Derivatives Trading**
Owning a stock represents ownership in the company	Owning a contract does not represent ownership in the underlying company
Perpetual ownership with no expiry date	Derivatives contracts have maturities that are finite- they have an expiry date
Requires an investor to pay 100% cost of the stock price to own a share	Allows investors to gain exposure to the underlying with only the Initial Margin (a percentage of the notional value of the contract)
Needs to own stock before selling	Gains exposure to the downward price movement by Short selling without owning the underlying

Saudi Exchange Derivatives Market

Our Market

The Derivatives Market is a transparent market with a centralized order-book. The contracts trade like other financial instruments. However, there are specific characteristics of Futures trading where the trade is funded with initial margin.

This guide will explain these dynamics in more detail.

Our Products

1. **MT30 Index Futures:**
   Our debut product, the MT30 Index futures contract, is a cash settled product that is based on the underlying MSCI Tadawul 30 Index.

2. **Single Stock Futures (SSFs)**
   SSFs is the second in a series of derivatives products to be introduced in the Saudi capital market, and it derives its value from underlying stocks.

Every derivatives product has a specification document.
Please visit our website: www.saudiexchange.com for the full product specifications and more interesting details.

Below are some of the key elements from MT30 Index Futures and SSFs specifications.

	MT30 Index Futures	SSFs
Contract Code	SF30	Codes will be based on the underlying stock
Multiplier (Contract Size)	SF30 multiplied by SAR 100	100 * share price (per undelying company)
Daily Price Limits	20%	
Daily Settlement Price	Daily settlement price of the futures contract shall be based on: - The VWAP (volume weighted average price) of last 10 minutes, of the trading day, subject to a minimum of 10 trades in last 10 minutes. - And if there are less than 10 trades in last 10 minutes then the Exchange shall use the Theoretical Futures Price (TFP) to compute the fair value of the contract at the market close	
Price Decimals	2	
Final Settlement Price	Based on formula determined by the Saudi Exchange	Closing price of undelying
Contract Months	Current month - next month - the next two quarters	
Negotiated Deals[1]	Yes	
Trading Hours	Pre-open (opening auction): 9:00 a.m. - 9:30 a.m. Market Open (trading): 9:30 a.m. – 15:30 p.m.	
Contract Expiration	Third Thursday of the expiry month. If it is a holiday, then expiry will move backward to the previous trading day	

1 "Negotiated Deals occur when both sellers and buyers determine the quantity and price of the listed securities involved in the transaction". Trading and Membership Procedures, Saudi Exchange.

Difference between Index Futures & SSFs

	Index Futures	SSFs
Underlying	Indices	Stocks
Trading	They are both traded the same way	
Clearing	They are both cleared the same way	
Corporate Actions	No impact	Impact on price, contract size and code. After the adjustment takes place, the contract's notional value will be maintained.

Why Trade Derivatives?

Hedge
To protect the portfolio from an price movement.

Capital Efficiency
By depositing only the Initial Margin, which is only a fraction of the value of the trade.

Leveraged Trading
Futures provide a leverage factor, as the value of the contract can represent multiples of the initial margin (IM) deposited.

Profiting from bearish market opportunities
By short selling Futures contracts.

How to start trading?

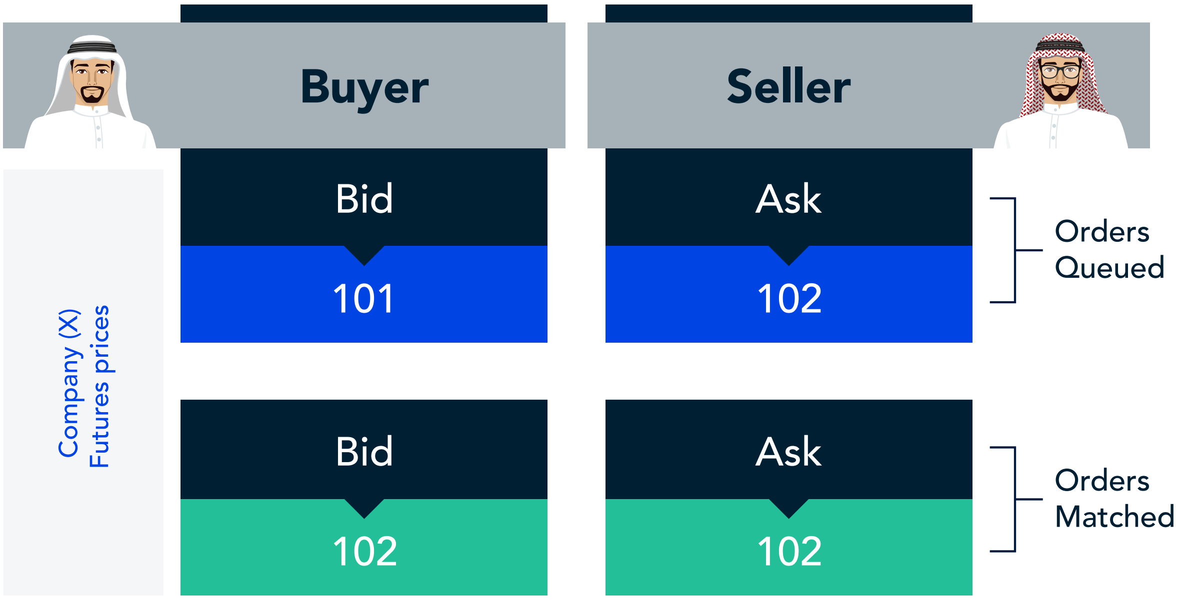
Similar to the Equity Market, any trader of derivatives will have to open an account with a licensed Derivatives Exchange member. A full list of Derivatives Exchange members can be found on our website (Link). Derivatives contracts trade in order books on the screen just like equities.

How does a trade work?

1. After opening an account, Futures trader must deposit the Initial Margin (IM) required to open a position.
2. The Initial Margin amount is automatically determined by the Securities Clearing Company (Muqassa) based on potential volatility of the underlying and adheres to international standards and methodologies.
3. The broker can request additional margin above IM based on the trader/ client risk profile and suitability.

Trading Example

Order book - Buyer opens 1 Company (X) October 22 contract

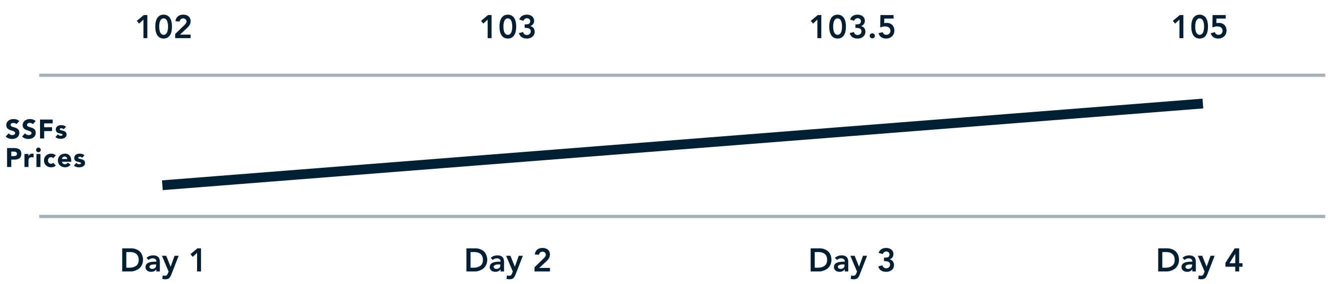


- The buyer and the seller orders match electronically, they do not know each other.
- The seller does not need to own the contract to open a sell position.
- A trader who takes a long position believes that price of underlying will increase, while a trader who takes a short position believes that price will decrease.
- Once the transaction is matched at SAR 102, there will be one open position for the buyer and one for the seller.

- The value of the position is determined by multiplying the contract size (the multiplier outlined in the product specs) * the contract price = 100 * 102 = SAR 10,200.
- However, the trader only needs to deposit the Initial Margin with their broker to begin trading.
- In this example, let's assume initial margin is SAR 2,000 per contract. This must be maintained at the initial level continuously.
- Both the buyer and seller each pay SAR 2,000 to open their positions.

How to calculate daily gains & losses?

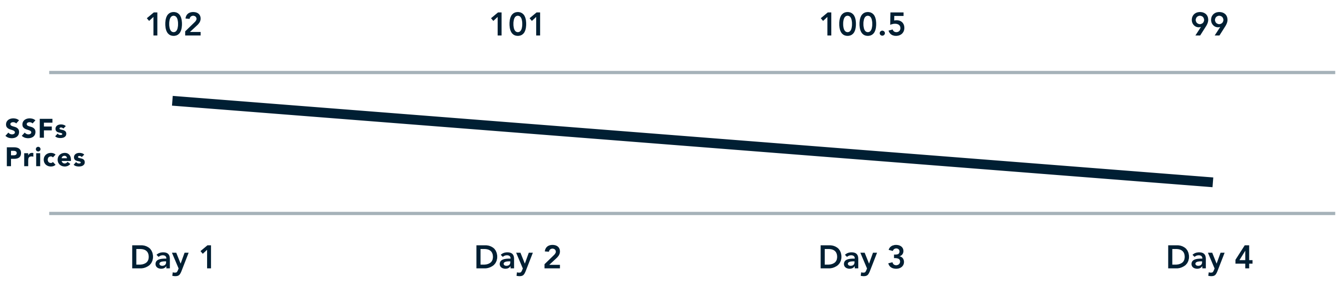
Scenario where SSFs prices are going up



		Opening position (Day 1)	End of day (Day 2)	End of day (Day 3)	End of day (Day 4)
Buyer 	Unrealized Profit & Loss	0	(103 – 102) X 100 **= 100**	(103.5 – 102) X 100 **= 150**	(105 – 102) X 100 **= 300**
	Account Balance (SAR)	**2,000**	**2,100**	**2,150**	**2,300**
Seller 	Unrealized Profit & Loss	0	(102 – 103) X 100 **= -100**	(102 – 103.5) X 100 **= -150**	(102– 105) X 100 **= -300**
	Account Balance (SAR)	**2,000**	**1,900**	**1,850**	**1,700**

How to calculate daily gains & losses?

Scenario where SSFs prices are going down



		Opening position (Day 1)	End of day (Day 2)	End of day (Day 3)	End of day (Day 4)
Buyer 	Unrealized Profit & Loss	0	(101 – 102) X 100 **= -100**	(100.5 – 102) X 100 **= -150**	(99 – 102) X 100 **= -300**
	Account Balance (SAR)	**2,000**	**1,900**	**1,850**	**1,700**
Seller 	Unrealized Profit & Loss	0	(102 – 101) X 100 **= 100**	(102 – 100.5) X 100 **= 150**	(102 – 99) X 100 **= 300**
	Account Balance (SAR)	**2,000**	**2,100**	**2,150**	**2,300**

Profits and losses are calculated based on the following formula:(the price at which the position been closed – the price at which the position been opened) X Multiplier

- The buyer and the seller can **separately close** their position by taking an **opposite** position any time after the transaction until the expiry date.

- A trader can find profiting opportunities by trading derivatives in both upward or downward price movements, for example- in **upward price** movement;
- The buyer above could **realize** his **gains** on **Day 3** by selling his contract to another different buyer, at 103.5, to realize a gain of SAR 150 (he will receive this in addition to the deposited margin of SAR 2k).
- **In this case, the initial seller (who sold on day 1) loses and will have a margin call of SAR 150.**

- In the opposite scenario, if the market drops, the seller can make profit as the price dropped from SAR 102 at **day 1** to SAR 99 at **day 4** therefore earning a profit of SR 300 (SAR 3 * 100).

How are the gains & losses realized?

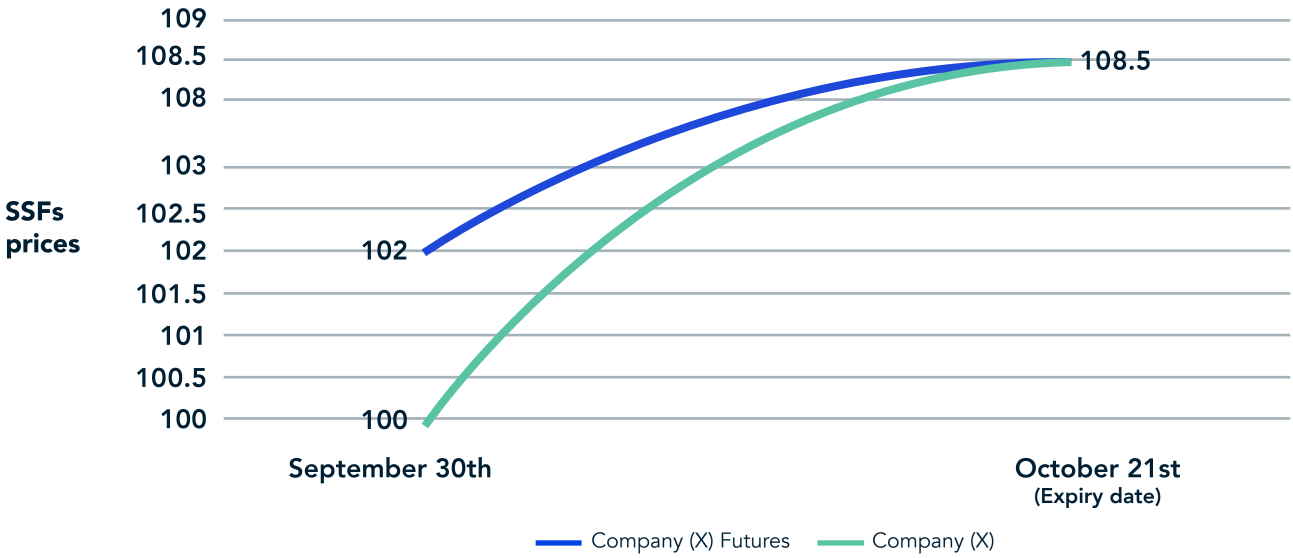
There are two ways:

1. Close the position in the market before expiry:

The buyer and the seller can separately close their position by taking a reverse position any time after the transaction until the expiry date. For example, if a buyer opens a position (goes long), he can close the position by selling the contract. If a seller opens a position (goes short), he can close the position by buying the contract in the market.

2. Wait until the contract expires:

Company (X) October 22 expires on the third Thursday of Oct (Oct 22st), where the futures price and the underlying converge. The final settlement price is calculated based on the methodology outlined in the contract specifications.



- All open positions will be automatically settled using the Final Settlement Price (FSP) on the expiry date.
- The buyer (who bought at 102), and the seller (who sold at 102) can leave their open positions until the expiry date (the third Thursday of the contract month). Muqassa will then close (settle) their open positions automatically using the final settlement price (FSP). The FSP is calculated by the Exchange as outlined in the contract specifications.
- In this example let's assume the FSP is 108.5, This will result in a realized profit for the buyer of 108.5 – 102 = SAR 650 (6.5 x 100 stocks). The Total balance in the buyer's account = SAR 2,650 (from initial margin SAR 2,000 + profit SAR 650) Meanwhile the seller will realize a loss of SAR 650 and the total balance in his account = SAR 1,350.

Useful tips to keep in mind

- Derivatives products are mainly used for trading and hedging, they are not investment products.
- Derivatives products are not an IPO.
- You can short sell in the derivatives market by buying a short position. You do not need to own any contracts to opening a short position, you only need to deposit Initial Margin (IM).
- To close the position, you will need to take the opposite side.
- Futures provide a leverage factor, as the value of the contract can represent multiples of the initial margin (IM) deposited.
- Study and learn the contract specifications before trading any product.
- Watch our introductory videos
  - What is the first product available for trading?
  - Single Stock Futures

Take into account:

Volatility

Some contracts usually experience a wider daily trading activities than others and therefore considered to be more volatile. This volatility is an important factor that determines the risk and/or profitability of an opportunity.

Liquidity

When you begin to trade, it's useful to select products that are highly liquid. which will have enough volume, for you to enter and exit your orders smoothly without dramatic price effect.

Contract size

Pick a contract that is properly sized for your account and your own trading style.

Set risk parameters

Before making any investment decisions, traders should be aware of the risks and returns. Set goals and limits to the risk that you are ready to take.

Create a trading plan

Before placing a trade, you need to have a plan to guide your trading strategy- making manner. The plan should be based on cautious analysis of the markets.

Stick to your plan

A vital part in trading is discipline, and to acknowledge when to admit loss by leaving the market or taking the risk based on what you have planned.

Diversify

Instead of trading your entire capital to a single position instantly, it is better to take smaller positions, including several trades / contracts. Also, be careful not to over diversify.

Keep up with your position

Keep track of your positions at all times, Maintain a detailed log of all transactions, Understand your broker's procedure on how to place orders and who to reach if you have a question regarding your position. Many brokers will help you in viewing the transactions that is in your statement. But it will always be your responsibility to know your position!

Additional Resources

1. General information about Derivatives Market (First Video Link).

2. For more details and characteristics on the Saudi Derivatives Market, please visit our website's Knowledge Center Knowledge Center.

3. Derivatives Market Members (Link).

4. FAQ (Link).

5. Glossary of terms (Link).

6. Securities Clearing Center Company "Muqassa" (Link).

7. Trading and Membership Procedures, Saudi Exchange (Link).

8. Derivatives products Contract Specification (Link).