Agricultural Marketing Guide >>

Choosing a Commodity Broker

Introduction

Farm managers planning to use futures and options as part of their marketing plan must use a commodity broker to buy and sell their futures and options. An experienced broker, also known as a Futures Commission Merchant (FCM), can be a very valuable asset to the farm manager.

Step One in choosing a FCM is deciding what level of service and advice is needed. Some farm managers want a broker whose firm provides market background and outlook information. Other farmers don't need that because they get their market information from other sources. Trading costs are normally higher for companies who provide additional services.

Step Two in choosing a broker involves talking to several firms and their brokers either by phone or in person. Talking to several firms helps you make a choice based on each firm's required financial conditions and level of service. Talking to more than one broker at each firm helps you choose a broker you are comfortable with on a personal level, which is also important.

Some firms have several FCMs in their offices. Often each FCM has a different area of interest. Some deal mostly in industrial commodities or financial futures, while others concentrate mostly on agricultural commodities. FCMs tend to have an interest in either hedge accounts to lock in the price of a product or in speculative trades.

Client Protection

FCMs, who accept futures and options trade orders on behalf of Alberta farmers, must be registered with the Alberta Securities Commission or the Investment Dealers Association, or both. These registrations require that each FCM follow certain accounting standards and procedural practices and that the firm is financially secure. Each firm must file quarterly and annual financial statements. A chartered accounting firm also audits each firm annually.

Introducing and Clearing Brokers

There are two types of FCM firms - clearing brokers and introducing brokers.

A clearing broker is employed by a company that has holds the right to trade directly on the various commodity exchanges. That means the firm's own traders carry out futures and options buy and sell orders directly in the market on behalf of customers. The clearing broker also maintains margin accounts directly with the futures exchanges and is directly responsible for ensuring adequate funds are maintained in these accounts and if not, ensures the customer acts on margin calls.

An introducing broker takes futures and options orders from customers and relays them to a clearing firm to have the orders filled at the exchanges. The introducing broker also uses the clearing firm for depositing funds and ensuring that margin requirements of the exchanges are maintained. If an introducing broker goes out of business, the clearing broker handles customer futures and options positions.

How Trades are Carried Out

On behalf of a farm manager, a FCM with a clearing firm may either submit a trade through the firm's trading software system or phone the order to the brokerage house order desk. An introducing broker will transmit trades through the head office of his or her clearing broker. In either case, an order is filled immediately if the order is placed “at-the-market”.

Trading at ICE Futures Canada is only done on an electronic platform based at the Chicago Board of Trade (CBOT) electronic system. FCMs enter trade orders directly into the CBOT electronic trading system for ICE Futures Canada canola, barley, milling wheat and durum wheat futures or options contracts. However, at the CBOT and the Chicago Mercantile Exchange (CME), there are side-by-side electronic and pit (or open-outcry) trading for the time being. There are also electronic-only overnight trading sessions available for both CBOT and ICE Futures Canada grains. CME Feeder Cattle futures, on the other hand, trade during the same day-time hours for both the electronic system and in the trading pits, as there is no overnight electronic session.

Customers wanting to trade at exchanges where there are both electronic and pits trades have the choice of where they want their trade executed. Normally, FCMs will place orders on the electronic system unless customers specifically dictate they want their trade in the pit. Pit trading is gradually being phased out and replaced with electronic trading.

Client Financial Requirements

FCMs often require their customers to meet certain financial conditions before the firm will agree to fill futures or options contract orders. Clients are required to have a certain minimum gross income or net worth. A minimum operating line of credit or bank cash deposit may also be required. These conditions are in effect to protect FCMs from clients who are not serious or who are in financial trouble. Some of these guidelines may be reduced or waived under certain conditions, especially for clients who only plan to hedge in their trading accounts. Farm managers, who are talking to prospective FCMs, should ask for details of each firm's client financial requirements before choosing to use a firm's services.

Good Brokers:

- **understand farming** and what a farm manager is trying to accomplish by hedging. are
- **knowledgeable** about the markets without being overwhelming or overbearing.
- **keep their clients informed** about the market and the conditions of their accounts

- **do not pressure clients**, who are primarily interested in hedging, to speculate.
- **have good personal contacts** in the marketplace for agricultural commodities. Contacts may provide background information on market news that is not otherwise readily available.
- **do not necessarily offer the lowest commissions**. Generally, commissions are not a high-cost item. Compare all services offered by various companies before choosing a firm based on low commission.
- **do not** pressure clients to allow churning of accounts, which gives the broker permission to buy and sell futures and options contracts without a specific order from the client. The objective is to make a profit for the client. However, the client, not the brokerage firm, covers any losses.

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