

Basis Contracts

This summary is for general illustration purposes only. Please contact a broker of your choice for information specific to your operation.

Description

A basis contract is also known as a "Fix Price Later (FPL)" contract. This type of contract transfers the basis risk and opportunity from the seller to the buyer on the date of the contract.

Example: On July 1, a producer sells a specified quantity for November delivery at .20 Dec. (The November 1 cash price less 20 cents).

Risk to Seller

The producer has eliminated the "basis" part of price risk, but has retained the futures risk. The seller also is subject to production risk; that is, the producer is responsible for delivering the contracted amount on the delivery date.

Risk to Buyer

The buyer accepted the basis risk at the time of the contract.

Who Might Use This Contract?

A producer who wants to retain the ability to benefit from a rising market but who wants to lock in current basis levels on July 1 might enter a basis contract. The producer should be financially able to bear the futures price risk of a market downturn.

Upside Price Potential. The producer retains the ability to benefit from higher prices at delivery in November, while transferring the risk that basis levels might widen to the buyer.

Downside Price Potential. The producer faces the risk that market prices might fall by November 1. However, the producer still has transferred basis risk to the buyer.

When Might This Contract Perform Well?

This contract will work to the producer's advantage to increase income if market prices rise between July 1 and delivery in November.

When Might This Contract Perform Poorly?

This contract will not perform as well for the producer if prices fall between July 1 and November delivery. The producer bears the risk of market prices falling, but his or her basis risk is covered.

Mention of product names or firms does not necessarily constitute endorsement by the Risk Management Agency or the U.S. Department of Agriculture over others not mentioned, and is for information purposes only.