

CME Group Planned Changes to Live Cattle Futures Contract Specifications

Summary

The Chicago Mercantile Exchange Inc. (“CME or Exchange”), based on discussions with market participants and with the USDA, intends to implement amendments to its Live Cattle futures contract to alleviate delivery capacity constraints impacting the contract after last trade date. The Exchange intends to implement the amendments, summarized in Items 1 – 8 below, as quickly as possible, and potentially beginning with the October 2017 expiration, and seeks industry feedback on the roll-out of the following amendments:

1. Amend the last day on which a seller may tender a Certificate of Delivery (“Last Tender Date”) to no later than 10 a.m. on the Business Day following Last Trade Date (“LTD”).
2. For Certificates of Delivery tendered to the Exchange on Last Tender Date, live-graded delivery may occur on Business Days eight through eleven of the succeeding calendar month, inclusive.
3. For Certificates of Delivery tendered to the Exchange on Last Tender Date, if the seller is unable to obtain clearance from an approved livestock yard for Business Days eight through eleven of the succeeding calendar month, or if a USDA grader is unavailable for grading at the designated livestock yard for Business Days eight through eleven of the succeeding calendar month, the Exchange may extend the delivery period up to an additional three Business Days (i.e., up to the 14th Business Day of the succeeding calendar month).
4. For Certificates of Delivery tendered to the Exchange on Last Tender Date, if the assigned buyer elects carcass-graded delivery, the slaughter shall take place on a Business Day chosen by the buyer between the fourth Business Day and the eleventh Business Day, inclusive, of the succeeding calendar month.
5. For Certificates of Delivery tendered to the Exchange on Last Tender Date, if the seller was granted an extension by the Exchange to deliver past the eleventh Business Day of the succeeding calendar month (pursuant to Item 3 above), and if the assigned buyer elects carcass-graded delivery, the slaughter shall take place on a Business Day chosen by the buyer between the fourth Business Day of the succeeding calendar month and the Business Day on which the extension was granted, inclusive.
6. Increase the penalty for failing to present a complete load of steers or heifers from \$0.015 to \$0.030 per pound each Business Day until proper delivery is made.
7. Implement a penalty of \$100 for each animal rejected by the USDA grader commencing with the fourth rejected animal per tendered load. Penalty shall be assessed on a per day basis across all loads until proper delivery is made.
8. Amend timing deadlines associated with tender, demand, retender, reclaim, and assignment of Certificates of Delivery to the Clearing House to one and a half hours earlier than is currently specified.

Feedback Item #1: Would changes 1-8 affect the economic characteristics of the Live Cattle futures contract or have an impact on the value of existing positions?

As noted above, the Exchange would like to implement amendments cited in Items 1-8 beginning with the October 2017 contract month in order to expeditiously relieve capacity constraints, improve the timing of deliveries by making the USDA grading process more efficient, and provide additional time for the buyer to secure a reservation at a slaughter plant should they elect carcass-graded delivery after Last Tender Date.

In determining whether it is appropriate to implement change on contracts with open interest, the Exchange considers whether the changes would be considered material (have an effect on the economics characteristics of the product), would have the potential to impact the value of existing positions, and/or whether they are consistent with other, similar changes that have been applied to contracts with open

interest. The Exchange invites comment as to whether the changes in 1-8 above would be material or have a price impact. Please be clear in your explanation.

Quality Specifications - Additionally, the Exchange intends to amend the par delivery grade (Item 9 below) concurrent with the listing of the October 2018 expiration and resume normal listing schedule for Live Cattle futures expirations on a rolling basis.

9. Amend the contract specifications regarding the Choice/Select percentage spread from 60% Choice / 40% Select to 65% Choice / 35% Select for live- and carcass-graded steers and heifers.

Feedback Item #2: The Exchange invites comment as to whether increasing the quality grade would make the Live Cattle futures more consistent with the commodity transacted in normal cash marketing channels.

The comment period is open through May 31, 2017 and respondents may submit written feedback in response to the Items above to the CME contacts listed herein.

Background

Currently, a short position holder as of expiration on the Last Trade Date (“LTD”) may tender a Certificate for Delivery to the Exchange up to the third Business Day following LTD and live-graded delivery occurs on the eighth Business Day following tender. For example, under current rules, if a short position holder as of expiration on LTD tenders on the third Business Day following LTD, live-graded delivery must occur on the 11th Business Day of the succeeding calendar month (i.e., the 8th Business Day following tender).

Under the proposed amendments, a short position holder as of expiration on LTD may tender a Certificate for Delivery no later than 10 a.m. on the Business Day following LTD. Additionally, under the proposed amendments, delivery on Certificates tendered on or after LTD may occur on Business Days eight through eleven of the succeeding calendar month, inclusive with the seller having the option to choose the delivery day. For example, if a short position holder as of expiration on LTD tenders a Certificate for Delivery anytime on LTD and up to 10 a.m. on the Business Day following LTD, live-graded delivery may occur on Business Day eight, nine, ten or eleven of the succeeding calendar month. If the short position holder is unable to obtain clearance from an approved livestock yard for Business Days eight through eleven of the succeeding calendar month, or if a USDA grader is unavailable for grading at the designated livestock yard for Business Days eight through eleven of the succeeding calendar month, the Exchange may extend the delivery period up to an additional three Business Days (i.e., up to the 14th Business Day of the succeeding calendar month).

The amendments to the delivery rules to (1) require all delivery tenders be submitted no later than 10:00 a.m. on the first Business Day following LTD, (2) allow live-graded delivery on Certificates tendered on LTD through 10 a.m. on the Business Day following LTD to occur on any Business Day between Business Days eight through eleven of the succeeding calendar month and (3) add the option to be granted up to three additional Business Days after Business Day eleven of the succeeding calendar month to procure a reservation at an approved livestock yard (i.e., expanding the live-graded delivery window after LTD to a total of up to seven Business Days (delivery on Business Day 8 – 14 of the succeeding calendar month)), shall alleviate live-graded delivery constraints after contract expiration. Similarly, the amendments will allot the buyer additional time to obtain a reservation at a slaughter plant should they choose carcass-graded delivery. These changes, combined with the addition of new delivery point livestock yards, will increase delivery capacity.

The implementation of a per head rejection penalty and the increase of the penalty for not presenting a full load at delivery is intended to further alleviate delivery congestion by encouraging sellers to present steers and heifers that have been properly sorted prior to arrival at the delivery point livestock yard and are suitable for delivery on the date and place specified in the Certificate of Delivery. The Exchange shall implement a penalty of \$100 for each rejected animal by the USDA grader commencing with the fourth rejected animal per tendered load and shall increase the penalty of not presenting a full load at delivery from \$600 to \$1,200 per load. Using CME Live Cattle delivery data from 2004 to the present, the average number of head per load that are removed because they are too heavy (greater than 1,050 lbs. carcass or 1,550 lbs. live) is 1.9 head. **Exhibit 1** illustrates the number of head considered to be “too heavy” per load and broken down by territory. The Exchange recognizes that cattle may be injured and rendered non-deliverable in transit or

after delivery to a livestock yard and therefore incorporated allowing 3 rejections per load prior to implementing the per head rejection penalty.

Trading ceases in CME Live Cattle futures and options at 1:05 p.m. daily and at 12:00 p.m. on LTD. To inform the marketplace in a more timely and efficient manner, all times associated with tender, demand, retender, reclaim, and assignment of Certificates of Delivery will be moved to one and a half hours earlier.

Exhibit 2 illustrates how the average Choice grade percentage over the past three years has continued to move higher. Specifically, the three-year average of all cattle transacted on a negotiated basis from the USDA LM_CT180 (5 Area Monthly Weighted Average Direct Slaughter Cattle – Negotiated) report shows that 44% of all 5-Area negotiated transactions fall into the category of 65-80% Choice. Additionally, the USDA NW_LS196 (USDA National Steer & Heifer Estimated Grading Percent Report) report shows that the National three-year average grade is 68% Choice grade. Starting with the October 2017 contract, the Choice/Select spread will be amended to 60% Choice / 40% Select. To ensure that the contract specifications of the Live Cattle futures continue to reflect the types of transactions in the underlying cash market, starting with the October 2018 contract the Choice/Select spread will further be amended to 65% Choice / 35% Select.

CME welcomes comments and feedback from the cattle industry and from participants in our Live Cattle Futures market. Comments may be sent to:

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Exhibit 1: Average Numbers of Head Too Heavy Per CME Delivered Loads

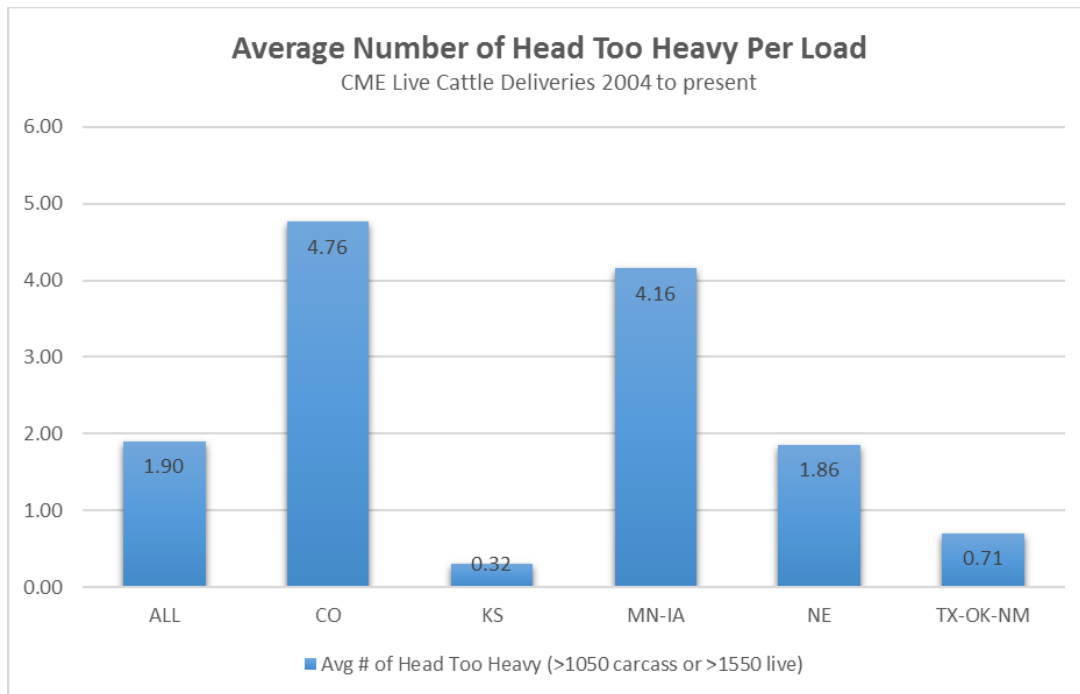


Exhibit 2: Yearly Average Percentage Choice Grade by Category

