Special Executive Report

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REMINDER: CHANGES IN MILLING YIELD PREMIUM AND DISCOUNT SCHEDULES IN ROUGH RICE FUTURES

As previously announced in SER-5369 issued on August 12, 2010: from September 1, 2011 onward, all outstanding and newly listed warehouse receipts delivered in satisfaction of CBOT Rough Rice futures will have milling yield premium and discount schedules based on USDA-CCC loan rates rather than on fixed percentages. (http://www.cmegroup.com/rulebook/files/20100812S_5369.pdf).

Rough rice trades with premium and discount schedules based on the make-up of whole kernels (head rice) and broken kernels. In the current Rough Rice futures contract, premium and discount schedules for head rice and broken kernels are based on fixed percentages. However, in the cash market, head rice and broken kernel premiums and discounts are based on the USDA Commodity Credit Corporation (CCC) loan rates. Sometimes the fixed percentages used in the Rough Rice futures contract can be significantly different from the USDA-CCC premiums and discounts used in the cash market. These differences show up in the basis. Changing the futures contract premiums and discounts to be more consistent with cash market practices will result in a less volatile basis and a more effective hedging tool.

Under current contract rules, each percent of head rice over or below 55 percent receives a 1.5 percent premium or discount respectively while each percent of broken kernels over or below 15 percent receives a 0.75 percent premium or discount respectively. For example, with Rough Rice futures prices at $14.75 per hundredweight, a Rough Rice warehouse receipt for 62 percent head rice and 8 percent broken kernels would be delivered at $15.52 per hundredweight (14.75 + (.015 * 14.75 *(62 – 55)) – (.0075 * 14.75 * (15 – 8))).

Under the revised rule, premiums and discounts would be determined from the trimmed mean of USDA-CCC loan rates for head rice and broken kernels over the past five years. Specifically, the trimmed mean from the past five years will be calculated by discarding the lowest and highest values and taking the mean of the three remaining values. Calculating trimmed means in this manner for the 2006 through 2010 USDA-CCC loan rates results in values of $10.02 per hundredweight for head rice and $6.77 per hundredweight for broken kernels. Using this premium and discount schedule on the 62-8 warehouse receipt example above, results in this warehouse receipt being delivered at $14.98 per hundredweight (14.75 + (.62 - .55)*10.02 – (.15 - .08)*6.77). The difference between the current contract milling yield schedule and the new schedule is $0.54 per hundredweight in this example.

In order to help market participants mitigate the difference between valuing warehouse receipts under the current rules and under the new rules going into effect in September, the Exchange will publish on its website a calculator that values warehouse receipts using both methods. The calculator will become available and will be announced in a future Special Executive Report that will be issued following the USDA release of 2011 loan rates.

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