

Advisory Notice

Clearing House

08-188

TO: Clearing Member Firms

FROM: CME Clearing

SUBJECT: **Announcing Hurricane Risk Landfall Options -- HuRLOs™**

DATE: 08/20/2008

On **Thursday, August 28**, CME will begin clearing trades in **Hurricane Risk Landfall Options – HuRLOs**. This innovative new product is offered by **Weather Risk Solutions, LLC (WRS)** and is part of CME's **Clearing 360** initiative.

HuRLOs are commodity options on which coastal region along the U.S. Atlantic or Gulf coast a hurricane will make landfall first. For example, the Dec 08 W2FBW HuRLO is automatically exercised and pays to the buyer if the second storm of hurricane-strength following the HuRLO product launch on August 28 makes landfall in Broward County, Florida.

In 2008, seventy-nine different HuRLOs will be available in two series. The first series corresponds to the first storm of hurricane-strength to make landfall on the U.S. Atlantic or Gulf coast, and the second series corresponds to the second such storm to make landfall. If two hurricanes make landfall, then additional series will be listed.

Within each series, there are seventy-eight different HuRLO options, each corresponding to the hurricane making landfall in a specified coastal county or region. In the northern areas, where hurricane landfall risk is low, the regions may be relatively large – for example, the entire coastline of New York and Connecticut. In areas where hurricane landfall risk is high, like south Florida, the regions may be as small as an individual county.

Within each series there is also a special “No Landfalls” HuRLO option. This option represents the event that no next hurricane makes landfall in the enumerated coastal counties or regions for the rest of this hurricane season. For example, if only one storm of hurricane strength made landfall for the rest of 2008, then in the second series the “No Landfalls” option would pay. If no storms of hurricane strength made landfall, the the “No Landfalls” options would pay in both the first and second series.

Trading in HuRLOs takes place through the WRS Electronic Trading Platform™, a web-based interface provided by WRS, and is available on a 24 by 7 basis. At each moment, the platform shows you the current price for each individual HuRLO, which is based on the collective trading judgments of market participants, and an estimated settlement amount for each HuRLO if there were no further trading and the next hurricane made landfall in the county or region for that HuRLO. (For example, if you bought a HuRLO for Dade County and the next hurricane made landfall first in Dade County.)

Prior to the opening of trading in each series of options, WRS or a third party will “seed” each HuRLO series by purchasing HuRLOs in each series according to their historical risks. This establishes the initial market price for each HuRLO, which thereafter changes as a result of market activity.

Announcing Hurricane Risk Landfall Options -- HuRLOs

08/20/08

Page 2 of 6

All original trades in HuRLOs are **purchases** opposite the Clearing House. This is called the “primary market”. There is a secondary market where you can sell HuRLOs you have purchased to other market participants at whatever price you negotiate, but you can only sell HuRLOs that you have already purchased. There is no short selling allowed.

As a hurricane-strength storm approaches the U.S. Atlantic or Gulf coast and is expected to make landfall in less than a day, WRS will announce that trading is suspended for the primary market in one or more HuRLO series for public safety reasons. (Trading in the secondary market continues.)

Once a storm makes landfall, WRS determines, based on data from the National Hurricane Center, whether the storm made landfall as a hurricane. Once this determination is made, primary and secondary market trading in the corresponding HuRLO series is terminated and if applicable, trading in remaining series resumes. If WRS determines, based on NHC data that no landfall occurred, primary trading in the suspended series resumes. Once trading is terminated as a result of a hurricane making landfall, WRS determines, based on National Hurricane Center data the location where it made landfall. Once the location is determined, in the clearing system, then:

- The total premium paid for all HuRLOs in the primary market in the applicable series, is divided *pro rata* among purchasers of the particular HuRLO corresponding to the region where the storm made landfall.
- All other HuRLOs in the series expire worthless.

Suppose only one hurricane makes landfall in a given year. In that case, for the remaining series, the “No Landfalls” HuRLO(s) are automatically exercised and settled as of December 15, and all other HuRLOs in those series expire worthless.

Note that in a particularly busy hurricane season, additional series may be listed as needed. Each series corresponds to a particular position in the **order** in which storms come ashore – the first, the second, etc. – not to any particular named hurricane.

Clearing and bookkeeping processing for HuRLOs is simple:

- The contract month will be December of the year of the hurricane season. For example, all HuRLOs this year will be Dec 08 options.
- The product code consists of a **W** (to identify it as an WRS HuRLO transaction), a digit to identify the series (**1, 2, 3**, etc.), and an abbreviation to identify the region. For example, **W2FBW**.
- All HuRLOs are calls, with a strike price of zero, on a non-tradeable synthetic underlying “future” with the same code.
- The contract multiplier is **1.0**, and the minimum price fluctuation is **0.01**. In SPAN files, all prices for HuRLOs options and their synthetic underlying “futures” will have **two** implied decimal places.

For example, the **Dec 08 W2FBW zero call** on the **Dec 08 W2FBW synthetic underlying “future”**.

See the table below for the complete list of HuRLOs product codes and regions.

All trades will be **OPNT**'s – generic over-the-counter privately-negotiated trades. As trades occur on the WRS Electronic Trading Platform, the clearing system will capture them, and transmit standard FIXML

Announcing Hurricane Risk Landfall Options -- HuRLOs

08/20/08

Page 3 of 6

trade confirmation messages to clearing firms so they can be loaded to books. The opposite side of every trade will be the CME Clearing House, specified as firm 996.

After trading has terminated in a particular series, and the location where a particular storm made landfall has been determined, the expiration date will be moved up for all HuRLOs in that series. The final price for the underlying "future" will be the exact settlement amount for the HuRLO in the region where the hurricane made landfall, and the final price for the underlyings for all other HuRLOs in the series will be zero. In other words:

- All HuRLOs in the series except the one corresponding to the region where the storm made landfall, will have their final underlying value of zero. This will match their strike price of zero, and hence they will expire worthless.
- Positions in the HuRLO where the storm made landfall, will be exercised automatically, and a synthetic "futures" transaction will be created at the strike price of zero. This in turn will immediately be marked to the final price for the underlying, causing the settlement amount to be paid to the clearing firm.

HuRLOs and PCS:

Clearing firms should submit Position Change Specification (PCS) data for HuRLOs positions normally. Note, however, that because individual customer account positions can only be long, we would never expect the clearing-level position to be simultaneously long and short.

HuRLOs and SPAN®:

Positions in HuRLOs will be processed in SPAN normally. In particular, SPAN will calculate a risk requirement, but because customers will only have **long**, fully paid-for positions in HuRLOs, these risk requirements will be capped at the positions' current market value.

Bottom line: **the total performance bond requirement (risk less available net option value) for HuRLOs will always be zero.** There will be no requirement beyond the initial payment of premium.

You can expect to see about 80 new combined commodities in the SPAN file, one for each region. For example, the **W1TCM** combined commodity will contain all options and all synthetic underlying futures for HuRLOs for the the TCM region – for example, **W1TCM** futures and options, **W2TCM** futures and options, etc.

Sample SPAN files including HuRLOs are available daily from the Clearing "New Release" testing environment at: <ftp.cmegroup.com/pub/span/data/ccl/cert>.

HuRLOs and Fees

Fees for HuRLOs are embedded in the option's trade price.

Fees for HuRLOs will be set initially at 1.5% of the premium amount. These will be calculated by the WRS Electronic Trading Platform at the time the trade is executed, and embedded in the price.

So purchasers in the primary and secondary markets will pay the premium, plus the small embedded fee. Sellers in the secondary market will receive the premium they have negotiated, but are not charged a fee.

There are no other WRS or CME fees for HuRLOs, and they will not be processed in CME's Exchange Fee System.

HuRLOs, Customer Registration and Credit Limits

In 2008, HuRLOs are offered on CME Alternative Marketplace Inc.'s "exempt board of trade", and may be traded only by Eligible Contract Participants (ECP's) under the terms of the Commodity Exchange Act.

Clearing firms will register each account for which they wish to clear HuRLOs, and will specify a daily credit limit specific to HuRLOs for each such account. The WRS Electronic Trading Platform will reject orders to the extent that the premium obligation would exceed the customer's programmed credit limit. The platform will, however, partially fill orders to the maximum extent allowed by the credit limit.

Because the WRS trading platform will enforce the credit limit that the clearing firm has specified for each registered customer, there is no need for the clearing firm to manually accept HuRLO's trades. They are considered cleared, matched trades at the moment the clearing system has received and accepted them.

Beginning on Friday, August 22, Eligible Contract Participants may sign up to trade HuRLOs at the WRS website, at: www.HuRLOs.com or at www.WeatherRiskSolutions.com

Once the participant has signed up, the clearing firm must register the account using the new, online **Clearing 360 Account Registration** application. Using this application, the firm specifies that the account may trade HuRLOs, and the credit limit for HuRLOs. As stated above, the WRS trading platform for HuRLOs will guarantee that the customer will not purchase HuRLOs within a clearing business day with an aggregate premium obligation in excess of the specified limit.

The firm must also execute the **Clearing 360 Clearing Firm Agreement** if it has not already done so. For more information, please see Clearing Advisory 08-178 at www.cme.com/clearing/clr/clradv/files/Chadv08-178.pdf

HuRLOs are "non-seg" products

Consistent with the regulatory status of HuRLOs, they are "**non-seg**" products.

As with any such OTC, "non-seg" product (for example, CBOT OTC ethanol contracts), firms may choose to identify HuRLOs trades for their customers with the **C** (for customer) origin code.

If firms do so, however, because of the products' non-seg status, these positions will be held in the clearing system in special "D" house (proprietary) position accounts.

For more information:

For more information about HuRLOs, beginning on Friday, August 22, please see the WRS website at: www.HuRLOs.com or at www.WeatherRiskSolutions.com

Or contact WRS at: **888-8HURLOS (888-848-7567)**

For more information about clearing and bookkeeping processing for HuRLOs, please contact CME Clearing at 312-207-2525.

Announcing Hurricane Risk Landfall Options -- HuRLOs

08/20/08

Page 6 of 6

WRS HuRLOs Clearing Product Codes

The **W1** identifies a particular code as being for the **first** hurricane to make landfall in a given season.

W2 identifies the code as for the **second** hurricane to make landfall, etc.

<u>Code</u>	<u>#</u>	<u>State</u>	<u>Region</u>	<u>Code</u>	<u>#</u>	<u>State</u>	<u>Region</u>
W1XLF	0	-	No Landfalls	W1FPI	40	FL	Pinellas
W1TCM	1	TX	Cameron	W1FMH	41	FL	Manatee + Hillsborough
W1TWI	2	TX	Willacy	W1FSA	42	FL	Sarasota
W1TKE	3	TX	Kenedy	W1FCH	43	FL	Charlotte
W1TKL	4	TX	Kleberg	W1FLE	44	FL	Lee
W1TNU	5	TX	Nueces + San Patricio	W1FCO	45	FL	Collier
W1TAR	6	TX	Aransas	W1FMO	46	FL	Monroe
W1TCL	7	TX	Calhoun + Refugio	W1FMD	47	FL	Miami-Dade
W1TMA	8	TX	Matagorda + Jackson	W1FBW	48	FL	Broward
W1TBR	9	TX	Brazoria	W1FPB	49	FL	Palm Beach
W1TGA	10	TX	Galveston + Chambers	W1FMA	50	FL	Martin
W1TJE	11	TX	Jefferson	W1FSL	51	FL	St. Lucie
W1LCA	12	LA	Cameron	W1FIR	52	FL	Indian River
W1LVE	13	LA	Vermilion	W1FBV	53	FL	Brevard
W1LIB	14	LA	Iberia	W1FVO	54	FL	Volusia
W1LSM	15	LA	St. Mary	W1FFL	55	FL	Flagler
W1LTE	16	LA	Terrebonne	W1FSJ	56	FL	St. Johns
W1LLA	17	LA	Lafourche	W1FDU	57	FL	Duval
W1LJE	18	LA	Jefferson	W1FNA	58	FL	Nassau
W1LPL	19	LA	Plaquemines	W1GCA	59	GA	Camden
W1LSB	20	LA	St. Bernard + Orleans + St. Tammany	W1GGL	60	GA	Glynn
W1MHA	21	MS	Hancock + Harrison	W1GMC	61	GA	McIntosh
W1MJA	22	MS	Jackson	W1GLI	62	GA	Liberty + Bryan
W1AMO	23	AL	Mobile	W1GCH	63	GA	Chatham
W1ABA	24	AL	Baldwin	W1SBE	64	SC	Beaufort + Jasper
W1FES	25	FL	Escambia	W1SCO	65	SC	Colleton
W1FSR	26	FL	Santa Rosa	W1SCH	66	SC	Charleston
W1FOK	27	FL	Okaloosa	W1SGE	67	SC	Georgetown
W1FWL	28	FL	Walton	W1SHO	68	SC	Horry
W1FBA	29	FL	Bay	W1NBR	69	NC	Brunswick
W1FGU	30	FL	Gulf	W1NNH	70	NC	New Hanover
W1FFR	31	FL	Franklin	W1NPE	71	NC	Pender
W1FWK	32	FL	Wakulla	W1NON	72	NC	Onslow
W1FJE	33	FL	Jefferson	W1NCA	73	NC	Carteret
W1FTA	34	FL	Taylor	W1GNC	74	Group	Rest of *NC* and VA except Northampton + Accomack
W1FDI	35	FL	Dixie	W1GNJ	75	Group	Northampton + Accomack VA; and MD, DE, *NJ*
W1FLV	36	FL	Levy	W1GNY	76	Group	*NY* and CT
W1FCI	37	FL	Citrus	W1GMA	77	Group	RI, *MA*, NH, York + Cumberland + Sagadahoc ME
W1FHE	38	FL	Hernando	W1GME	78	Group	*ME*, from Lincoln to Canadian border
W1FPA	39	FL	Pasco				