

Advisory Notice

Clearing House

TO: All Firm Personnel
Service Bureau Representatives
Independent Software Vendors

FROM: Clearing House Department

ADVISORY #: 05-26

DATE: Originally published February 4, 2005 --- **Updated March 15, 2005**

SUBJECT: **Clearing Processing for New European-Style CME Currency Options**

IMPORTANT NOTE:

Due to market demand, several changes have been made to trading hours for these new options. As previously described, floor trading will cease at 2pm on Thursday preceding the Friday expiration day. **Trading on GLOBEX will continue, however, until 9am on the Friday expiration day, and block trades may be reported to the GLOBEX Control Center until 4pm on the Friday expiration day.**

Accordingly, there will be no special outtrade session for these options either Thursday afternoon or Friday morning. Any outtrades remaining will be resolved in the normal Friday afternoon session. Similarly, firms will have until the normal 7pm cutoff time Friday evening to get all block trades matched and to get all giveups accepted.

The final determination of which options are in-the-money or not will use the special 9am fixing price of the underlying future – **not** the end-of-day settlement price for that future – exactly as previously described. **In the clearing system, however, exercise-and-assignment processing for these options will be performed in the Friday end-of-day settlement cycle** – not, as previously published, at the intraday cycle.

On the evening of Sunday April 3rd, CME will launch trading in European-Style Options on Euro FX and Japanese Yen futures. The key distinguishing feature of European-style options versus American-style options is that European-style options may be exercised only at expiration, whereas American-style options may be exercised on any day that the option is traded. The press release for this announcement is at <http://www.cme.com/about/press/cn/05-14%20EuroFXOptions11692.html>.

These European style FX options will trade side-by-side on the trading floor and on CME Globex during Regular Trading Hours (RTH) and on CME Globex during Electronic Trading Hours (ETH). The trading of the existing American-style options on the same underlying futures are unchanged (traded on the trading floor from 7:20 a.m. to 2:00 p.m. and on CME Globex from 2:00 p.m. to 7:05 a.m. the next day.) The European style FX options will be essentially identical to those American-style options except as follows and also noted above:

- Both the American-style options and the European-style options will expire on the same day, namely the second Friday preceding the third Wednesday of the contract month.

- Unlike the American-style options, which trade until 2 p.m. on the expiration day, the European-style options will cease floor trading at 2 p.m. **on the business day before the expiration day. On GLOBEX, the new European-style options will continue trading until 9 a.m. on the Friday expiration day, and block trades may be reported to the GLOBEX Control Center until 4pm on the Friday expiration day.**
- For the American-style options, the final price for the underlying future which determines which options are in-the-money, is the end-of-day settlement price for that future on the expiration day. **But for the European-style options, this final price is not the end-of-day settlement price, but rather a special, 9:00 a.m. Central time "fixing" of that underlying futures price on the options' expiration day ("CME currency fixing price").**
- Unlike the American-style options, for the European-style options, contrary option instructions (out-of-the-money exercises and in-the-money abandonments) will not be accepted. All final positions for options which expire at least one tick in-the-money will be exercised, and all such short positions will be assigned. The determination of which options expire in-the-money will be done using the special 9 a.m. fixing price.
- Settlement variation resulting from option exercise and assignment processing for the European-style options will be banked at the final end-of-day settlement cycle.

To summarize for the European-style options: they will cease floor trading on the day before the expiration day, and electronic trading at 9am on the expiration day immediately before the special fixing price is determined. All in-the-money positions will then be automatically exercised or assigned at the end of day settlement cycle on the expiration day, based on ending the special 9 a.m. fixing of the underlying settlement price.

There are several reasons why we believe these options should be attractive to the market, but the key point is that the underlying price at which options exercise processing will be done, is known when the underlying foreign exchange futures and spot markets are open and liquid. Thus, a short option holder who wishes to hedge their exposure to market risk on the resulting underlying futures transaction, may immediately take market action. These exercise procedures have been designed to be compatible with exercise procedures for the over-the-counter (OTC) foreign exchange options market.

For clearing firm bookkeeping systems, the impact of these new options should be very slight. Basically, firms will need to be able to run exercise and assignment processing for their positions, based not on the end-of-day settlement price for the underlying future, but on the special 9 a.m. CME currency fixing price.

So the bookkeeping system impact of these new options should be limited to obtaining the special fixing price, and using it to determine which option positions are in-the-money. These special CME currency fixing prices will be published (a) as special text messages over the CME ticker, and (b) in the daily CME-CBOT SPAN files. On expiration day, they should be available beginning in the first intraday SPAN file (the "am file", denoted as **ccl.a.pa2**), published at approximately 10:30 a.m.

We have actually made this as a generic enhancement to the type "B" records provided in the SPAN file for each option series, in three new fields provided at the end of the record. With this enhancement, the price of the underlying future used to determine whether expiring options are in-the-money or not, can be determined by looking only at the option series record, without having to look at the underlying futures record.

In particular, on the type "B" record provided for each option series, three new fields have been added at the end of the record:

- The **Option Expiration Reference Price Flag** in byte 120
- The **Option Expiration Reference Price** in bytes 121-127
- The **Option Expiration Reference Price Sign** in byte 128

Before the expiration day of an option series, the Reference Price Flag field will contain **N**, meaning that the reference price is not yet available. Even on expiration day, if the reference price is not yet available, this field will contain **N**.

On the expiration day, however, if the reference price is available, the Flag will contain either a **Y** or an **S**:

- A value of **Y** means that the reference price for the underlying future is available, and that this price is the actual end-of-day settlement price for that future.
- A value of **S** (Special) means that the reference price for the underlying future is available, but that this price is different from the end-of-day settlement price for that future, which itself may not yet be available.

The reference price itself will be formatted in the manner used for the underlying instrument, which may be different than the manner used for the options. The sign of the reference price is provided (either as a plus or minus sign) because for options on spreads, the underlying price may be either positive or negative.

So on the expiration day, for the European-style options, the Reference Price Flag will be provided as **S** for Special, and the special 9 a.m. fixing price will be provided in the Reference Price field, beginning with the 10:30 a.m. SPAN file.

For the American-style options, by contrast, the Reference Price Flag will be provided as **N** (meaning not-yet-available), for the a.m. and intraday SPAN files. But beginning with the "early" settlement SPAN file, available at approximately 3:30 p.m., the Reference Price Flag will be provided as **Y** and the Reference Price will be provided as the end-of-day settlement price for the underlying future.

This enhancement is available today in the production CME-CBOT SPAN files, and pertains to all CBOT and CME options.

For contract specifications for the new European-style Euro FX and Japanese Yen options, please see New Contract Advisory Notice 05-03 (www.cme.com/clearing/clr/npadv/12111.html).

A sample SPAN file containing these options is available at:

[ftp.cme.com/pub/span/data/ccl/test/eurostyle-fx-opt.pa2](ftp://cme.com/pub/span/data/ccl/test/eurostyle-fx-opt.pa2).

The file contains contracts for monthly options YT and YJ, and weekly options 4T and 4Y.

Information about the SPAN file enhancement described herein was previously published in Clearing Advisory 05-09 (www.cme.com/clearing/clr/clradv/11419.html). For the record layout for the type "B" record in the expanded-format SPAN file, please see www.cme-ch.com/span/span131b.htm.