

Advisory Notice

Clearing House

TO: Clearing Member Firms
Chief Financial Officers
Back Office Managers

FROM: CME Clearing

DATE: April 3, 2008

ADVISORY #: 08-66

SUBJECT: **Clearing and Bookkeeping Processing for Hurricane Binary Option Contracts**

On April 14, 2008, CME will list for trading binary (digital) options on the CME Carvill Hurricane Index™. This advisory describes these contracts and special processing associated with them. Note that in many respects these contracts behave in a manner similar to that of the CBOT binary options on the Fed Funds Target Rate.

For a given hurricane that makes landfall, the Carvill Hurricane Index is calculated and represents the intensity of that particular storm.

For these particular option contracts, we are listing **seasonal binary contracts** and **seasonal maximum binary contracts** for each of six different coastal geographic regions: Gulf Coast, Florida, Southern Atlantic, Northern Atlantic, Eastern U.S., and Galveston-Mobile Cat-In-A-Box:

- The underlying of the seasonal contracts, is the sum of the Carvill Hurricane Index values, for all hurricanes that made landfall in the specified region during the specified season.
- The underlying of the seasonal maximum contracts, is the largest of the Carvill Hurricane Index values, for all hurricanes that made landfall in the specified region during the specified season.

Because these contracts are for the entire hurricane season in the U.S., there will be only one expiration listed per year -- a November series, expiring this year on December 2, 2008.

The fixed payout for these options is \$10,000. The long will either receive \$10,000 or nothing, and the short will either pay \$10,000 or nothing.

Only calls will be listed. Note also that these are **American-style** options, and may be exercised at any time prior to expiration provided that the underlying index value is greater than or equal to the strike price. At expiration, all options for which the final value of the underlying index is greater than or equal to the strike, will be automatically exercised.

(By contrast, the CBOT Fed Funds digital options are European-style, and can only be exercised at expiration. Also, the Fed Funds digitals must be at least one-tick in the money to be exercisable.)

Exactly as with the Fed Funds binary options, these will be treated in the clearing system as options on a non-tradeable synthetic underlying future. When an option is exercised, the fixed payout will be obtained by creating the transaction in the synthetic underlying future at a price of 1.0 below the underlying futures settlement price.

The underlying index ticks in 0.1. A typical final settlement value might be 12.1. The contract value factor for the synthetic underlying future will be 10,000, resulting in the fixed payout of \$10,000.

The option itself ticks in 0.01, with prices ranging from 0.01 to 100.00, representing the probability in percent that the option will end up in-the-money. The contract value factor is 100. For example, if the option traded at 100.00, the premium would be 100 times 100, or the \$10,000 equal to the amount of the fixed payout.

Like all CME weather options, these options will trade on the floor and/or via block transactions. Some strikes will be pre-listed, and others will be created dynamically in response to market demand. Strike prices will be integers, for example, 10, 11, 12, etc.

For more information, please see:

- New Product Advisory 08-01, at <http://www.cme.com/clearing/clr/npadv/files/NPAdv08-01.pdf>
- Clearing Advisory 06-154, published June 19, 2006, providing a similar explanation for the CBOT Fed Funds binary options, at <http://www.cme.com/files/Chadv06-154.pdf>