What does a futures transaction look like?

Futures are standardized contracts for the purchase and sale of physical commodities for future delivery on a regulated commodity futures exchange. A futures contract **locks in the price** of a commodity for delivery, or cash settlement, at a future date. By smoothing out the price a business pays or receives for coal, its costs, revenues and profits will be more predictable. The party who is the natural coal seller, the producer, would sell futures (short position) and the party who the natural coal buyer, such as a power generator or exporter, would buy futures (long position). Illinois Basin Coal Futures will be listed for 30 months, so market participants will have the ability to lock in prices up to two and half years in the future. Illinois Basin Coal Futures is a contract listed on the New York Mercantile Exchange (NYMEX) under CME Group.

As Illinois Basin Coal Futures is a **physically-delivered futures contract**, buyers of the contract who hold the contract until termination will be obligated to receive delivery of coal, and sellers of the contract will be obligated to make delivery. If participants do not want to make or take physical delivery, they may exit their positions by taking an equal and opposite position prior to termination.

In a **standardized delivery**, NYMEX matches sellers and buyers with open positions to make and take delivery. Deliveries occur at approved delivery facilities along the Ohio River between mile markers 776 and 918 during the delivery month as defined by the contract rules. The delivered coal must comply with the contract rules and the quantity must correspond to the parties’ open futures positions. Following the NYMEX match of open delivery positions, futures market participants are obligated to make and take delivery according to the rules of the contract. If buyers and sellers mutually agree, futures market participants that are matched in the standard delivery process can terminate the standard delivery obligation through the Alternative Delivery Procedures (ADP). As with Exchange for Related Positions (described below), standard deliveries terminated with alternative delivery rule are no longer subject to exchange oversight which will expose the matched participants to each other’s credit and performance.

If buyers and sellers agree, they may settle their open futures positions through a customizable delivery process, called **Exchange for Related Position** (EFRP). The EFRP market is a bilateral, off-exchange market. EFRPs allow market participants to exchange their positions in the Illinois Basin Coal Futures market for a position in the physical coal market, plus a differential can be positive or negative. Customers may want to use an EFRP because they prefer to select the counterparty with which they will be matched for physical delivery, their coal quality differs from that specified in the futures contract, or they would like to deliver at a dock that is not an approved delivery location. Submitting an EFRP means the Exchange does not guarantee the physical positions held by the two participants who will now be exposed to each other’s credit and performance, while the futures component of the EFRP is cleared by the Exchange. Parties to an EFRP must maintain all records relevant to the Exchange contract and the corresponding related position transaction, including any records required to be kept pursuant to CFTC Regulation 1.35.

I already buy or sell coal in the Illinois Basin. Why would I want to use futures?

Illinois Basin Coal Futures will allow your company to lock in prices, protect against counterparty risk and bring liquidity to the market. Also, futures are traded in an open and transparent marketplace which provides the market with price discovery information.

Futures help companies **hedge their price risk**. Futures protect coal sellers, such as producers, against the risk of falling prices and coal buyers, such as utilities and exporters, against the risk of rising prices.

Futures protect companies from **credit and counterparty risk**. CME is the counterparty to every trade, removing the risk that a counterparty will default or not meet the agreed upon terms of a trade such as price, quantity, quality and timing of delivery.

As a standardized contract, Illinois Basin Coal Futures will encourage liquidity in the market. The greater the market’s liquidity, the easier it is to buy and sell, and the better prices will reflect supply and demand in the market.
I am active in the Illinois Basin coal market, but my coal has different quality specifications than those listed in the futures contract. Are futures relevant to my business?

Yes, even if the quality of your coal differs from the Illinois Basin Coal Futures, futures are still an effective tool to help you manage your price risk. For example, if you are a utility that buys coal with a lower sulfur spec than that in the futures contract, buying Illinois Basin Coal Futures allows you to lock in the price of a highly correlated product, letting you hedge most of your price risk.

To address the quality difference, market participants may also choose to enter into an EFRP (described on page 1). For example, a utility fuel buyer who would like to buy physical coal that does not meet the Illinois Basin Coal Futures specification may enter into an EFRP. The utility fuel buyer and its counterparty (likely a major coal trading company) would negotiate a differential between the futures market and the underlying physical market. The trading company would sell coal to the utility fuel buyer, and the utility fuel buyer would sell futures to the trading company plus some negotiated differential, which may be positive or negative. The utility fuel buyer would then need to buy futures to offset the short position.

I am a producer, but do not have a dock within the delivery zone. How can Illinois Basin Coal Futures help me?

Producers with docks outside the delivery zone can use the Illinois Basin Coal Futures contract to hedge their coal price and may also make physical deliveries through the EFRP process.

Market participants wishing to transact outside of the delivery zone may choose to enter into an EFRP (described on page 1). For example, a coal producer who would like to sell physical coal but does not have access to a dock approved by the Exchange may enter into an EFRP. The coal producer and its counterparty (likely a major coal trading company) would negotiate a differential between the futures market and the underlying physical market. The producer would sell coal to the counterparty and the counterparty would sell Illinois Basin Coal Futures to the producer plus some negotiated differential, which may be positive or negative. The coal producer can then sell the Illinois Basin Coal Futures contracts to receive cash.
How Do I Get Started?

ILB trades on CME Globex, the foremost global electronic trading system for futures and options with true intraday-pricing transparency. Cleared OTC trades can be executed on CME ClearPort. Both CME Globex and CME ClearPort may be accessed via CME Direct, our free execution platform.

CME ClearPort

The U.S. coal market has historically traded off-Exchange through brokers who clear trades through ClearPort.

In a typical CME ClearPort transaction, trader A and trader B reach a deal, often through the inter-dealer broker market, or via phone or IM. Once a deal is reached, the traders have three options for reporting the trade for clearing through CME ClearPort:

1. Directly submit their trades to CME ClearPort
2. Have trades submitted for them by voice brokers who are registered and authorized to submit such trades.
3. Over the phone to the CME ClearPort Facilitation Desk

To get started using ClearPort, you must establish an account with a NYMEX Clearing Member. Next, complete the online Exchange User License Agreement located on cmegroup.com/clearport. Once you have received your credentials from the CME Clearport operations team, your Clearing Member will establish your market permissioning, credit and which OTC brokers should be allowed to enter trades on your behalf.

CME Globex

CME Globex is the foremost global electronic trading system for futures and options on futures. To access CME Globex, customers must have: a relationship with a CME Clearing Firm or Partner Exchange clearing firm and a CME Group-certified trading software application. We encourage individual traders to connect to CME Globex through their futures broker. Brokers can provide both the required clearing firm guarantee and trading infrastructure.

CME Direct

CME Direct is CME Group’s internet-based front end trading platform that provides access to futures, options and OTC markets all on one screen. CME Direct supports all trade types and Time in Force orders on CME Globex and provides enhanced block and swap submission on CME ClearPort. CME Direct also provides real-time Excel integration and option analytics from QuikStrike.

Learn more about CME Group’s coal products at cmegroup.com/coal.