U.S. COMMODITY FUTURES TRADING COMMISSION

Futures Contract Design in Thinly Traded Markets

Christa Lachenmayr, Division of Market Oversight

April 4, 2018

Deliverable Supply

"The Commission believes that, to meet the statutory requirement of tending ***to prevent or to diminish price manipulation,*** *market congestion, or the abnormal movement of a commodity in interstate commerce,* ***a futures contract should have a deliverable supply that****, for all delivery months on the contract, is sufficiently large and available to market participants that futures deliveries, or the credible threat thereof,* ***can assure an appropriate convergence of cash and futures prices.****"*

- *CFTC Federal Register Notice, November 13, 1997*

(emphasis added)

LIVE CATTLE FUTURES CONTRACT CHANGES

- December 2016 contract month
  - Remove Norfolk, NE, as an approved stockyard delivery location.
  - Reconfigure delivery locations from 12 individual stockyard into regional territories of Colorado, Iowa/Minnesota/South Dakota, Kansas, Nebraska, Texas/Oklahoma/New Mexico ("5 Areas" as defined by USDA) in order to allow for more efficient addition and removal of livestock yards, as well as better defining the geographic territory where price discovery occurs on the contract.
- April 2017 contract month
  - Codify requirements for CME-approved livestock yards and slaughter plants; make process for revocation, expiration, or withdrawal of regularity consistent with other CME products; and define geographical requirements for approved facilities in terms of "road" miles
    - **These amendments allowed for on-boarding new facilities at West Point Livestock, West Point, NE (+60 contract loads); Cattlemen's Livestock, Dalhart, TX (+60 contract loads); Addition of Dunlap Livestock Auction in Dunlap, IA (under consideration)**
  - Addition of a "step-down" spot month speculative position limit of 200 contracts for the last two days of trading to comply with core principles 3, 4, 5 and regulations 150.5 and 38.252
- October 2017 contract month
  - Apply discount of $1.50/cwt. to live and carcass graded cattle tendered to Worthing, South Dakota.
  - Adjust par delivery grade to 60% Choice/40% Select steers and heifers

LIVE CATTLE FUTURES CONTRACT CHANGES

- December 2017 contract month
  - Expand delivery window and allow Exchange to open up additional (increasing delivery capacity 167%)
  - Allow additional time for carcass delivery to better conform with cash market and make carcass delivery a more viable option
  - Amend tender time and other deadlines (demand, retender, reclaim) to better conform with business practices of feeders and packers
- October 2018 contract month
  - Resume the regular listing cycle for Live Cattle futures
  - Adjust par delivery grade to 65% Choice/35% Select steers and heifers
  - Increase penalty for failure to present; allow grader to assess the penalty for slowing the grading process without stopping the delivery.
    - **These amendments allowed for an existing facility to increase its capacity: Clovis, NM (+60 contract loads, under consideration)**
- Additional measures
  - CME added Live Cattle to an existing rule that caps how many order updates traders can send in relation to the number of trades that they execute (public information) in February of 2016
  - CME reduced trading hours for livestock futures and options (removing the afternoon session and coordinating the a.m. open and p.m. close/settle with grain hours), which will be 8:30 a.m. to 1:20 p.m. daily to concentrate trading activity during the day and prevent price volatility during “transitory liquidity gaps” (February 2016).

LIVE CATTLE FUTURES CONTRACT CHANGES

- December 2017 contract month
  - Expand delivery window and allow Exchange to open up additional (increasing delivery capacity 167%)
  - Allow additional time for carcass delivery to better conform with cash market and make carcass delivery a more viable option
  - Amend tender time and other deadlines (demand, retender, reclaim) to better conform with business practices of feeders and packers
- October 2018 contract month
  - Resume the regular listing cycle for Live Cattle futures
  - Adjust par delivery grade to 65% Choice/35% Select steers and heifers
  - Increase penalty for failure to present; allow grader to assess the penalty for slowing the grading process without stopping the delivery.
    - **These amendments allowed for an existing facility to increase its capacity: Clovis, NM (+60 contract loads, under consideration)**
- Additional measures
  - CME added Live Cattle to an existing rule that caps how many order updates traders can send in relation to the number of trades that they execute (public information) in February of 2016
  - CME reduced trading hours for livestock futures and options (removing the afternoon session and coordinating the a.m. open and p.m. close/settle with grain hours), which will be 8:30 a.m. to 1:20 p.m. daily to concentrate trading activity during the day and prevent price volatility during “transitory liquidity gaps” (February 2016).

LIVE CATTLE FUTURES CONTRACT CHANGES

- ***Futures Contracts Settled by Physical Delivery…***the terms and conditions of the contract should conform to the most common commercial practices and conditions in the cash market for the commodity underlying the futures contract. The terms and conditions should be designed to avoid any impediments to the delivery of the commodity so as to promote convergence between the price of the futures contract and the cash market value of the commodity at the expiration of a futures contract.

LIVE CATTLE FUTURES CONTRACT CHANGES

- ***Futures Contracts Settled by Cash Settlement.*** Evaluate the size and liquidity of the cash market that underlies the listed contract in a manner that follows the determination of DS.
  - Index should be a reliable or robust indicator of the value of the underlying commodity or instrument.
  - Potential for manipulation:
    - the volume of cash market transactions and/or the number of participants contacted in determining the cash-settlement price are very low.
    - incentive to manipulate or artificially influence the data from which the cash-settlement price is derived or to exert undue influence on the cash-settlement price's computation in order to profit on a futures position in that commodity.
- Commercially acceptable, publicly available, and timely.
- Documentation should be provided.