Spot Index Calculation

Financial Settlement

Definition

The name really says it all. As applied to futures trading, financial settlement means to offset an outstanding futures obligation with a financial or cash transfer, rather than a physical one. Hard Red Spring Wheat Index (HRSI), Hard Red Winter Wheat Index (HRWI), Soft Red Winter Wheat Index (SRWI), National Corn Index (NCI) and National Soybean Index (NSI) futures, which trade on December 15, on the Chicago Board of Trade's electronic trading platform — e-cbot® powered by LIFFE CONNECT® — will be financially settled to a three-day average of the spot indexes, calculated by DTN.

Physical delivery

Typically, grain and oilseed futures allow market participants the opportunity to physically take or make delivery of the specified commodity as a means of offsetting outstanding long or short positions. Holders of long and short positions at contract expiration are matched and then transfer ownership of the grain in strict accordance with an exchange's contract trading rules and regulations.

The function of a delivery system is to force convergence between cash and futures prices as the delivery period nears. Convergence between cash and futures prices is essential in facilitating the risk management function of a futures contract. For this to occur, there must be an adequate population of cash market participants who can deliver against a futures contract, thereby allowing for arbitration between cash and futures markets. However, another way to ensure convergence between cash and futures prices is through cash settled futures contracts.

Financial settlement

A financially settled futures contract is not the same as a cash contract. On the day the following last trading day of a financially settled futures contract, open positions are simply marked-to-market against a settlement price that is defined in the contract trading rules. A final transfer of funds is made, as is the case with exchange's margining system on any other trading day. Once this transfer is complete, long and short market participants are relieved of their obligations.

The settlement price for MGEX agricultural index futures is a three-day average of the DTN calculated index for the last three trading days of the contract month. All index futures will be traded every calendar month. Convergence between cash and futures prices is guaranteed when a contract is financially settled. At the end of the last trading day, the futures settlement price *becomes* the average of the spot index.

Settlement Index

Selection of the index used for financial settlement of futures contracts is critical. The index must contain prices that are truly reflective of the cash market for a specific, defined commodity and there must be broad representation of cash market participants. Most importantly, there must be no possibility of index manipulation by market participants. DTN collects approximately 700 bids each day for hard red winter wheat, 325 bids for hard red spring wheat, 550 bids for soft red winter wheat, 2,450 bids for corn and 2,250 bids for soybeans with representation from elevators around the country.

More information

Go to www.mgex.com for basis charts, contract specifications and other information about the MGEX agricultural index futures and options, or call Joe Albrecht at 612-321-7151.

Indexes are calculated by:

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