EURONEXT'S CASH-SETTLED COMMODITY FUTURES CONTRACTS

Physically delivered contracts or cash-settled?

Euronext currently operates a suite of commodity contracts that are all physically delivered. This means that at the expiry of a futures contract the underlying goods described in the contract specification are transferred from the seller to the buyer.

In a liquid contract, such as the Euronext Milling Wheat contract, this way of settling is very effective. It ensures that the price of the futures contract trading on the exchange converges with the price of the actual physical goods, at the time of delivery.

This natural unity occurs as any difference between the physical price and the futures price at expiry would be taken advantage of by either the buyer or seller, and therefore the futures' prices naturally move towards the physical price.

Why aren't all commodity contracts physically delivered and why is Euronext also launching cash-settled contracts?

While physically delivered contracts are very effective, there are also challenges with them, especially when a contract is for a commodity where:

- Physical delivery is difficult
- The liquidity of the contract is not at the highest level
- Or where the underlying volumes of the commodity are low

For this reason, most commodity exchanges operate a combination of physically delivered contracts and financially "cash-settled" contracts.

With a cash-settled contract, at the time of contract expiry, instead of goods being transferred from buyers to sellers, an assessment is made of the actual price of the physical goods described in the contract specification on the physical market. This price is known as **the Exchange Delivery Settlement Price (EDSP)**. It is then used by our Central Clearing Counterparty (CCP) to compensate buyers and sellers with the difference between the EDSP and the previous days settlement price.

What are the advantages of cash-settled contracts over physically delivered ones?

The advantages are that the participants hedging the risk of the underlying are protected from price movements as effectively as a physically delivered contract and that users do not have to organise sometimes difficult and complex deliveries of goods. However, a key element is that a financially settled contract is only as effective as the accuracy of the assessment of the price of the underlying goods at expiry.

How the settlement price works for Durum Wheat?

THE DAILY SETTLEMENT PRICE
THE DSP

The DSP for Durum Wheat, and all Euronext cash settled contracts, is calculated in the same way as our physically delivered contracts. The DSP is calculated by the exchange based on:

- The trading of the futures contract during the day
- In normal trading circumstances, it is a closing price based on a volume weighted average of a maximum of the last ten minutes of exchange based trading for the futures contract
- This price is then used by the CCP to calculate a profit and loss difference from the previous day's DSP for those with long and short positions in the contract. The DSP is used on a daily basis to provide a daily profit or loss on the futures contract for anyone with an open position

THE EXCHANGE DELIVERY SETTLEMENT PRICE
THE EDSP

The price assessment for the Euronext Durum Wheat contract is provided to Euronext by Sitagri Index services, a Price Reporting Agency (PRA). As a regulated contract, the way in which Sitagri assess the price has to follow a process described in the European Benchmark Regulations (BMR) which is enforced by the regulator in the country the benchmark is produced.

Sitagri supplies Euronext with a price every business day, reflecting the physical market for the price of Durum Wheat. At the end of the month as the futures contract for Durum Wheat expires, Euronext uses those supplied prices to calculate an EDSP for the contract in that month.

Euronext takes the price over a period of 1 month and then average that price to give the EDSP.

This technique is most commonly used for commodity exchanges as it reduces any risk of price manipulation in the index price as the manipulation would have to be made over a long period.

Market participants have access to the Sitagri index price throughout this period and there is a natural convergence of the futures contract towards the EDSP as a contract month draws to a close.

The CCP then uses the EDSP to make a final settlement for the price difference between the EDSP and the previous DSP.

Price convergence to the physical market

The credibility of a cash-settled contract is reliant and linked to the credibility of the index price and how accurately that reflects the real physical price of the underlying goods. Where there is confidence in the index price, then the union of the futures contract to the EDSP is as effective as with a physically delivered contract.

Another advantage of the cash-settled contract is that there is less need for traders, particularly financial organisations, to trade out of short or long positions just prior to expiry as the end result is a financial movement, rather than a need to organise delivery of physical goods.

The Price Reporting Agency (PRA) and the Durum Wheat index

Based on a daily assessment of the Durum Wheat Composite Index provided by Sitagri Index Services, the index is based on weighted average prices from 6 references:

- In France: DAP Port-La-Nouvelle, DAP Rouen and DAP La Pallice
- In Italy: DAP Bologna, DAP Altamura and EXW Foggia
- Traded in flat prices on the Euronext Central Order Book (COB)
- 4 contract expiries with up to 2-year trading: September, December, March and May

Find out more
Contact us to find out more about our plans around cash-settled commodities.

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