

# Cash Settlement

## Definition

MINNEAPOLIS GRAIN EXCHANGE

The name really says it all. As applied to futures trading, cash settlement means to offset an outstanding futures obligation with a cash transfer, rather than a physical one. National Corn Index (NCI) and National Soybean Index (NSI) futures, which will begin trading on *MGExpress* (the Minneapolis Grain Exchange's electronic trading platform) early in 2002, will be cash settled to a three-day average of the National Corn Index and the National Soybean Index, calculated by Data Transmission Network (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.

### Cash settlement

On the day following last trading day of a cash 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 NCI and NSI futures is a three-day average of the National Corn Index and National Soybean Index, respectively, for the last three business days of the contract month. NCI and NSI futures will be traded every calendar month.

Convergence between cash and futures prices is guaranteed when a contract is cash settled. At the end of the last trading day, the futures settlement price *becomes* the average of the cash index.

### Settlement Index

Selection of the index used for cash 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. Corn and soybean bids collected by Data Transmission Network (DTN) represent over 90 percent of all elevators in the U.S. and the largest single owner of the bids submits less than 4 percent of the total bids in each of the indices each day.

### More information

Go to [www.mgex.com](http://www.mgex.com) for basis charts, contract specifications and other information about NCI and NSI futures and options, or call Teri Huffaker at 612-321-7140.

NCI and NSI are calculated by:

