

SUBMISSION COVER SHEET

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Registered Entity Identifier Code (optional): 15-328

Organization: Chicago Mercantile Exchange Inc. ("CME")

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 07/17/2015 Filing Description: Request for Non-Material Agricultural Rule Change – Amendments to Settlement Procedures for Live Cattle Futures

SPECIFY FILING TYPE

Please note only ONE choice allowed per Submission.

Organization Rules and Rule Amendments

- Certification § 40.6(a)
- Approval § 40.5(a)
- Notification § 40.6(d)
- Advance Notice of SIDCO Rule Change § 40.10(a)
- SIDCO Emergency Rule Change § 40.10(h)

Rule Numbers:

New Product

Please note only ONE product per Submission.

- Certification § 40.2(a)
- Certification Security Futures § 41.23(a)
- Certification Swap Class § 40.2(d)
- Approval § 40.3(a)
- Approval Security Futures § 41.23(b)
- Novel Derivative Product Notification § 40.12(a)
- Swap Submission § 39.5

Official Product Name:

Product Terms and Conditions (product related Rules and Rule Amendments)

- Certification § 40.6(a)
- Certification Made Available to Trade Determination § 40.6(a)
- Certification Security Futures § 41.24(a)
- Delisting (No Open Interest) § 40.6(a)
- Approval § 40.5(a)
- Approval Made Available to Trade Determination § 40.5(a)
- Approval Security Futures § 41.24(c)
- Approval Amendments to enumerated agricultural products § 40.4(a), § 40.5(a)
- "Non-Material Agricultural Rule Change" § 40.4(b)(5)
- Notification § 40.6(d)

Official Name(s) of Product(s) Affected: CME Live Cattle Futures

Rule Numbers: CME Rules 10103.A and 10103.C.5.e

July 17, 2015

VIA ELECTRONIC PORTAL

Mr. Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: CFTC Regulations 40.4(b)(5) and 40.6(a): Request for Non-Material Agricultural Rule Change – Amendments to Settlement Procedures for Live Cattle Futures. CME Submission No. 15-328

Dear Mr. Kirkpatrick:

Chicago Mercantile Exchange Inc. (“CME” or “Exchange”) pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulations 40.4(b)(5) and 40.6(a), is requesting a determination of non-materiality for amendments to CME Rules 10103.A (“Sources and Calculation of Adjustment Factors”) and 10103.C.5.e (“Quality Grade Deviations”), which govern the settlement procedures for the CME Live Cattle futures contract (CME Rulebook 101; Clear Code: LC; CME Globex Code: LE; CME ClearPort Code: 48). Pursuant to Regulation 40.4(b)(5), changes to enumerated agricultural products may be implemented under Regulation 40.6(a) if they are “required to comply with a ... regulation ... of another Federal regulatory authority.” The rule amendments in this submission will allow these Exchange rules to be consistent with Official United States Standards for grades of Carcass Beef promulgated by the Secretary of Agriculture under the Agricultural Marketing Act of 1946 (60 Stat. 1087; 7 U.S.C. 1621-1627), as amended. The proposed amendments shall become effective on Monday, August 3, 2015 and shall apply to all contract months.

Explanation of non-materiality:

CME specifies particular quality and yield grades¹ for live and carcass delivery on its Live Cattle futures contract, which are designed to facilitate beef marketing by separating a highly variable population of beef carcasses into groups which are more uniform in quality and composition. Specifically, these standards are defined by the United States Department of Agriculture (USDA) in either the "Official United States Standards for Grades of Slaughter Cattle"² or "Official United States Standards for Grades of Carcass Beef" initially promulgated by the Secretary of Agriculture, June 3, 1926, as the Official United States Standards for the Grades of Carcass Beef.³ These rule changes refer to carcass beef only.

The Live Cattle futures contract mandates that grading is performed by an employee of the USDA, working independently of both the producer and packer. This independent USDA grading system has been relied upon by CME in the delivery procedures for its Live Cattle Futures contract since its inception

¹ 55% Choice, 45% Select, Yield Grade 3 live steers or live heifers.

² <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELDEV3062519>

³ <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELDEV3002979>

in 1964 to ensure that an objective third party determines the quality of the product being delivered under the terms and specifications of the contract. The Live Cattle futures contract, as is typical of most futures contracts, also includes a schedule of discounts and premiums in Rule 10103, applicable when there are deviations from the par deliverable grade.

Under the USDA standards applied during the CME Live Cattle delivery process, scores from quality grading (i.e., "Prime," "Choice," "Select," etc.) are adjusted downward depending on the degree of hardbone or dark cutter (HB/DC) characteristics:

"Dark-cutting beef" is believed to be the result of a reduced sugar content of the lean at the time of slaughter. As a result, this condition does not have the same significance in grading as do the darker shades of red associated with advancing maturity. The dark color of the lean associated with "dark-cutting beef" is present in varying degrees from that which is barely evident to so-called "black cutters" in which the lean is actually nearly black in color and usually has a "gummy" texture. Although there is little or no evidence which indicates that the "dark-cutting" condition has any adverse effect on palatability, it is considered in grading because of its effect on acceptability and value. Depending on the degree to which this characteristic is developed, the final grade of carcasses which otherwise would qualify for the Prime, Choice, or Select grades may be reduced as much as one full grade.

To estimate maturity, a USDA grader evaluates the cartilage associated with the backbone (spinal column) and the color and shape of the ribs. When a beef animal is harvested, the carcass is split down the spinal column. When the carcass is split in half, the grader can evaluate cartilage associated with the spinal column and the shape and color of the ribs. At the dorsal (backside) end of each vertebra is a section of cartilage, which is referred to as the cartilaginous tips or buttons. As cattle age, these tips ossify or change from soft, pearly-white cartilage to hard, porous bone. Maturity is then estimated based on the status of these buttons and the degree to which they are ossified. The rib bones are quasi round with a red, youthful appearance in young cattle. As cattle age, the ribs flatten out and develop a white appearance. Carcass maturity is scored using letters A through E, with A's being the least mature and E's being the most mature. Carcasses displaying advanced skeletal maturity are referred to as "hard bones."

A lower quality grade results in a lower monetary valuation for the carcass. When the Live Cattle futures contract, and specifically CME Rules 10103.A and 10103.C.5.e, were amended on March 17, 2014, to incorporate heifer delivery⁴ the amended rules inadvertently included hardbone and dark cutter (HB/DC) characteristics as if those characteristics would be valued separately from an evaluation of the overall carcass quality grade when in fact those characteristics are incorporated into the scoring process used in determining the quality grade as described above. In other words, because HB/DC characteristics are incorporated into the overall USDA quality grading procedures as stated above, the USDA does not have a procedure to evaluate or apply any additional discounts for HB/DC characteristics.

The rule amendments establish that adjustments will be made per USDA quality grading factors and delete the references to HB/DC as standalone adjustment factors. It is imperative to make these changes prior to the first day for the submission of delivery certificates on the August 2015 Live Cattle futures contract (August 10, 2015) when heifer delivery is permitted in order to provide certainty to the market. The rule amendments are provided in Appendix A in blackline format.

CME fully believes that USDA grading standards help stabilize market conditions by providing producers, packers, wholesalers, retailers, and others with accurate, timely, unbiased, and uniformly understandable

⁴ <http://www.cftc.gov/ucm/groups/public/@rulesandproducts/documents/ifdocs/ru1022814cme002.pdf>
<http://www.cftc.gov/ucm/groups/public/@rulesandproducts/documents/ifdocs/ru1022814cme003.pdf>

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market information. To achieve this objective, USDA uniformly applies familiar standard class and grade terminology. USDA grading standards provide this terminology and are an effective means of establishing a trading base in the cash and futures markets price discovery processes. Most retailers and restaurateurs require their product to be USDA graded and they use the USDA grades in their marketing. Therefore, it has been in the best interest of packing companies to use USDA grading services to gain access to all markets. If a uniform trading base (i.e., USDA standards) were not used, it also would be more difficult for producers to compare prices offered among packers. Buyers of products could be faced with a similar problem: having to compare many descriptions of product when making their purchase decisions. Privatized grade standards could be used, but if the grade standards are not uniformly applied nationwide, valuations will differ leading to uncertainty about the price discovery process.

The Exchange reviewed the designated contract market core principles (the “Core Principles”) as set forth in the Commodity Exchange Act (“CEA” or “Act”) and identified the following Core Principles as potentially being impacted:

- Availability of General Information: The Exchange shall publish on its website information in regard to futures contract specifications, terms and conditions, and any changes to the delivery procedures. In addition, the Exchange will issue a Special Executive Report (“SER”) regarding these amendments to the marketplace. The SER will also be posted on the Exchange’s website.

Pursuant to Section 5c(c) of the Act and CFTC Regulations 40.4(b)(5) and 40.6(a), the Exchange hereby certifies that the amendments comply with the Act, including regulations under the Act. There were no substantive opposing views to this proposal.

The Exchange certifies that this submission has been concurrently posted on the Exchange’s website at <http://www.cmegroup.com/market-regulation/rule-filings.html>.

If you have any questions regarding this submission, please contact me at 212-299-2200, or via e-mail at CMEGSubmissionInquiry@cmegroup.com.

Sincerely,

/s/ Christopher Bowen
Managing Director and Chief Regulatory Counsel

Attachment: Appendix A – CME Rule Amendments (blackline format)

Appendix A

CME Rulebook

Chapter 101 Live Cattle

(additions underscored; deletions ~~overstruck~~)

10103. Settlement Procedures

10103.A. Sources and Calculation of Adjustment Factors

Quality grade adjustments for all delivery units will make use of the live weight equivalent of the Choice-Select boxed beef spread calculated from information reported by USDA (in \$/cwt.) for the day of tender in the National Daily Boxed Beef Cutout and Boxed Beef Cuts – Negotiated Sales – Afternoon report. This is referred to hereafter as the Live Equivalent Choice-Select Spread (LECSS) and is computed by subtracting the “Selected Boxed Beef Cut-Out Value” from the “Choice Boxed Beef Cut-Out Value” and multiplying that result by 0.0063.

The USDA By-Product Drop Value report for the day of tender shall serve as the source of information for calculating the condemned liver factor used in carcass-graded deliveries. The condemned liver factor shall equal the reported liver value (in \$/cwt.) multiplied by -0.01.

In addition, quality grade, yield grade and carcass weight adjustments will make use of factors calculated from values reported by USDA (in \$/cwt.) in the 5-Area Weekly Weighted Average Direct Slaughter Cattle – Premiums and Discounts report. The Prime, Standard, ~~Hardbone, Dark-Cutter~~, Yield Grade 1, Yield Grade 2, Yield Grade 4, Yield Grade 5, 400-500 lbs., 500-550 lbs, 550-600 lbs., 900-1000 lbs., 1000-1050 lbs. and over 1050 lbs. factors are calculated by multiplying the reported weighted average for the corresponding category by 0.0063. If a quality grade or yield grade is broken into subcategories on this report, then the factor for that quality or yield grade shall be the simple average of all reported averages for the subcategories in that category multiplied by 0.0063. The most recently issued report with respect to the day a Certificate is tendered shall be used to calculate the factors for that delivery unit. When a Certificate is tendered on the same day that a new report is issued that new report shall be used in factor calculation regardless of the time of day that the report is released.

The sub-Standard factor shall equal -25% of the tender day settlement price.

Should the USDA determine that an error exists in any of the reports used to calculate adjustment factors and subsequently issues a corrected report, that corrected report shall be used in place of the original.

10103.C Carcass Graded Deliveries

5. Par Delivery and Substitutions.

e. Quality Grade Deviations. Delivery units resulting in 55% USDA Choice grade carcasses and 45% USDA Select grade carcasses are deliverable at par. All gradeable carcasses in a delivery unit shall receive a quality grade adjustment computed from the factors described in Rule 10103.A. The Live Equivalent Choice-Select Spread (LECSS) and other factors are defined in Rule 10103.A. Per pound quality grade adjustments shall be as follows:

USDA Prime: $+0.45 \times \text{LECSS} + \text{Prime factor}$ USDA Choice: $+0.45 \times \text{LECSS}$ USDA Select: $-0.55 \times \text{LECSS}$
USDA Standard: $+0.45 \times \text{LECSS} + \text{Standard factor}$ Below USDA Standard: $+0.45 \times \text{LECSS} + \text{Standard factor} + \text{sub-Standard factor}$.

Carcasses with hardbone or dark cutter characteristics shall be deliverable at per pound adjustments in accordance with USDA grading procedures and equal to the quality grade factors described in Section 10103.A.

Carcasses deemed ungradeable with respect to quality grade by the USDA shall receive a per pound quality grade discount equal to 25% of the settlement price. The per animal quality grade adjustment shall be calculated by multiplying the per pound quality grade adjustment by the average live weight of the delivery unit.