

Guidance Note

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07 June 2019

Version: 3.2

Key concepts:

EFPs

Related information:

FGL Operating Rule

4.6

FGL Procedures

4.6

FEX Guidance Note

GN 45 – Fair and Orderly Pricing for Block Trades and Exchange for Physical Transactions

ASIC Market Integrity Rules (Futures Markets) 2017

Part 3.5

Recommended Audience:

Trading Managers

Derivatives Staff Members

Compliance Managers

Previous Issues:

Nil

GN 24 – Exchange for Physicals

Introduction

The FGL Trading System provides the functionality for Trading Participants to lodge and either “approve” or “reject” the Individual FGL Product leg of an Exchange for Physicals (EFPs) transaction, as defined in the FGL Operating Rules.

A Trading Participant will use the “approve or reject” function to confirm the details of an EFP lodged by another Trading Participant that identifies the confirming Trading Participant as the counterparty.

The EFP, as per the Operating Rules, will also be required to be approved by FGL after counterparty confirmation has been received. These transactions, as they are transacted away from the underlying Individual FGL Product market, require FGL to ensure that the prices agreed upon and recorded are deemed Fair and Orderly.

Additionally FGL must ensure that the specific details of the underlying physical leg associated with an EFP are acceptable in relation to the terms of the EFP.

Guidance

An EFP transaction may only be requested where there is a clear and documented intention between two beneficial owners to transfer a physical position for an Individual FGL Product position. This transaction must be performed by Trading Participants on behalf of the beneficial owners and these Trading Participants must be able to identify and maintain documentary evidence of both the Individual FGL Product leg and the underlying physical leg of the EFP transaction requested.

Any use or attempted use of this facility for another purpose will be deemed a breach of the FGL Operating Rules and Part 3.5 of the ASIC Market Integrity Rules (Futures Markets) 2017 by the Trading Participants, with commensurate disciplinary action resulting.

Process

As described within the FGL Operating Rules and FGL Procedures there are three main steps to the EFP process:

- 1 A Trading Participant, being the seller of the Individual FGL Product, requests an EFP by lodging details with the Exchange and in the manner required by the Exchange.
- 2 The counterparty Trading Participant, being the buyer of the Individual FGL Product, upon notification of a lodged EFP, confirms the accuracy of the details.
- 3 FGL Market Control verifies the confirmed details of the EFP with respect to the current market prices and details of the underlying physical transaction.

Upon verification and approval by FGL the EFP created is forwarded as an EFP Trade to the Clearing House in the normal manner.

Where a single Trading Participant is acting for both the buyer and the seller of the EFP, they will still need to confirm details for the buyer in the normal way even though they lodged details for the seller. The Trading Participant, as the counterparty, will receive a notification in the normal way.

Key Transaction Details

Prior to requesting an EFP there is an obligation upon the Trading Participants to check that the details of the transaction should pass the Exchange verification step.

The key aspects that a Trading Participant should have examined prior to requesting an EFP include, but are not limited to:

- 1 The Physical leg of a transaction must take place at the same time as the Individual FGL Product leg in an Individual FGL Product. That is, the transaction must be completed as both an EFP trade and a Physical trade. If one of the legs of the transaction (Physical or Individual FGL Product) had not been completed neither of the legs should be completed.
- 2 The Physical leg must be of a substantially similar nature to the Individual FGL Product. That is the underlying price determinants of the Physical leg must be the same as or highly correlated to the price determinants of the Individual FGL Product.
- 3 The Physical and Individual FGL Product legs must be of similar value. That is, the notional value of the Individual FGL Product trade must be similar to or the same as the value of the physical trade. The Physical leg does not have to be in the same currency as the Individual FGL Product leg, but the price of the Physical leg denominated in another currency must be highly correlated, in FGL's view, to the price of the Individual FGL Product leg. The value of the Physical position will be converted to the currency of the Individual FGL Product at the relevant prevailing exchange rate and must be substantially similar or the same.
- 4 The Beneficial Owners of the Individual FGL Product trade must be the same as the parties to the Physical trade.
- 5 The Beneficial Owners of the EFP must have the intention to immediately complete the physical transaction and have no intention to reverse the transaction at the time of entering the EFP details into the Trading System. Note that this does not mean that an opposite EFP transaction cannot happen in the future on the basis of some trigger in the future but that an opposite EFP transaction cannot be arranged prior to or at the same time as the original EFP transaction.
- 6 The Trading Participants must keep records to demonstrate that the Physical trade is as described to the Exchange and that both legs of the transaction did take place as a single coordinated transaction.

Key Verification Focus

FGL Market Control will review the lodged details prior to approving or rejecting an EFP. The review will seek to ensure that:

- 1 The price at which the two parties have agreed upon can be considered as Fair and Orderly by comparing the entered price details against a FGL-determined set of pricing ranges for the relevant contract (for further guidance see GN45 - Fair and Orderly Pricing for Block Trades and Exchange for Physical Transactions.);
- 2 The value and nature of the two legs of the EFP correlate to each other;
- 3 The Beneficial Owners are involved in both legs of the transaction and are different entities from each other (i.e. change of ownership will occur); and
- 5 The transaction is a valid Off-market trade and not part of a broader scheme to use Off-market capabilities to manipulate Individual FGL Product positions.

FGL Compliance Officers will review in detail each EFP, and the records kept to support the transaction as an element of the regular audits of Trading Participants.

Where a Trading Participant observes that any of their intended Off-market activity may be of interest to the FGL Compliance Team, the Trading Participant is strongly advised to discuss the details of this activity with their Compliance Officer before entering a request for an EFP.

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