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AGGREGATING ORDERS FOR ENTRY INTO SYCOM® AND ALLOCATING TRADES ON A PRO-RATA BASIS

Following recommendations resulting from recent discussions of the Market Practices Committee (MPC), the Exchange wishes to clarify those valid scenarios where it may be appropriate to aggregate orders for entry into SYCOM® and allocate trades on a pro-rata basis. Participants should note that the advice outlined below represents a revision of SFE's previous interpretation, therefore this Bulletin replaces SFE Circular No. 231/00 'Aggregating Orders' (issued 22 December 2000).

Recognising that in certain circumstances it may be necessary to aggregate orders to enable their expeditious execution, the following sets out the Exchange's view of the only types of orders which, when received, may be aggregated for placement into SYCOM®:

- All Futures or Options orders received when the market is neither open, nor in pre-open, or otherwise unavailable;
- Spread or Custom orders received during the pre-open phase of the market;
- All Futures or Options orders received and recorded at exactly the same time; and
- Orders that, by definition, cannot be entered upon receipt, for example Market On Open or Market On Close.

Orders outside this scope should be entered separately, upon receipt, and any trades executed for the order should be allocated to the Client for whom the order was entered (and reflected in the account or Client ID fields), otherwise the maintenance of a complete and accurate audit trail will be compromised and Clients potentially disadvantaged.

In regard to allocating trades on a pro-rata basis, the Exchange and the MPC has determined that it is appropriate only where orders have been aggregated for placement into SYCOM® in line with one of the above scenarios, and where it is undertaken on a fair and equitable basis.

Furthermore, as requested by the MPC, the Compliance and Surveillance Department obtained feedback from Participants in regard to methods believed to be 'fair and equitable'. The feedback largely supported the Volume Weighted Average method of allocating trades on a pro-rata basis, however the Percentage method is also believed to offer advantages (and examples of both methods are outlined below). Accordingly, it has been determined that

Participants may choose one of the options (and <u>one only</u> for all futures business) and strictly apply it to orders allocated on a pro-rata basis.

An example of the Volume Weighted Average method of allocation is as follows:

Where a Participant holds 3 orders of 50 lots, 50 lots and 100 lots for Clients and these are aggregated into 200 lots for entry into SYCOM® and a 40 lot trade is executed, the orders must be allocated 10 lots each in respect of the first 2 and 20 lots for the other.

An example of the Percentage basis of allocation is as follows:

Where the same percentage of volume executed is applied regardless of the size of the order, for example, where 3 orders of 100 lots, 75 lots and 25 lots make up an aggregated 200 lots, and 30 lots are executed, then each order receives an allocation of 10 lots. This is believed to reduce the incentive for Clients to place large orders in order to receive a greater allocation to the detriment of the smaller Client, and will also offer the added benefit of filling smaller orders faster.

Participants are advised that the following Business Rules relate to this matter:

General By-Law G.26(d) states that:

"Instructions received from Clients and orders for its own account shall be executed by a Participant in the sequence in which they are received and recorded unless it would be fair and equitable to allocate contracts obtained in respect of similar orders on the same day on a different basis."

Furthermore, General By-Law G.26(d) states that:

"Where a different basis is used it shall be the responsibility of the Participant to clearly define that basis and apply it to all instructions and orders without giving any preference and in particular without giving preference to any order for its own account."

Should Participants not wish to follow either method outlined above, then they must allocate in strict sequence of order receipt. Participants must never allocate trades to aggregated orders on an ad-hoc basis, and where a Participant is found to have failed to allocate trades to aggregated orders in a manner that is deemed 'fair and equitable', they will be found in breach of General By-Law G.26(c).

Participants should advise Clients where they intend to allocate other than in strict sequence of receipt. Furthermore, Participants must document and communicate to Clients their commercial policy in respect of pro-rata allocations. This can be achieved by way of a separate letter for existing Clients, however for new Clients it would be prudent for it to be included in the Client Agreement Form. In this regard, in light of the upcoming expiry, Participants should decide and put into practice the method of allocation that is appropriate for them, however, Participants must provide the Exchange with a copy of the letter sent to Clients outlining their policy. It is requested that this be forwarded to the undersigned by no later than 5:00pm, Friday 4 April 2003.

In addition, in order to maintain an accurate audit trail when entering aggregated orders, Participants must either enter each Client ID into the relevant field or denote 'split' in the Client ID field and ensure that manual order records reflect each order making up the aggregated amount.

<u>Issues Related to Queue Position</u>

Participants should note that promoting orders within a SYCOM® queue to take the place of orders that have been cancelled is not allowed. This situation may arise when a Participant attempts to exploit a favourable queue position where the Client has cancelled the original order. If a Client cancels an order it is against the sequencing provisions of the Law and the Business Rules to leave that order in SYCOM® and promote another Client order to take its place, or indeed to solicit another Client order to take its place.

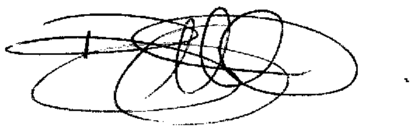
In short, if a Client cancels an order, the Participant must cancel that order in SYCOM®. If the order was entered as part of an aggregated order in SYCOM®, then the Participant must reduce the volume of the aggregated order by the amount remaining of the cancelled order. The broking or offering of a favourable queue position is a breach of the Rules, in particular General By-Law G.3.14(b) (failure to deal in a proper and efficient manner), and accordingly will be referred to a disciplinary committee for its consideration.

In addition to Rules outlined in this Bulletin, the following also relate to this issue:

Trading Rule TR.11.1 states that instructions received from Clients and orders for a Participant's own account shall be executed in the sequence in which they are received and recorded unless it would be fair and equitable to allocate contracts obtained in respect of similar orders on the same day on a different basis.

General By-Law G.3.14(b) A Full Participant shall at all times deal in Futures or Options Contracts in a proper and efficient manner.

Should you have any queries please contact Bronwyn Hill, Manager, Compliance & Surveillance on 9256 0699 or at bhill@sfe.com.au



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