

D-CYPHA SFE  
AUSTRALIAN ELECTRICITY  
FUTURES CONTRACTS

EXCHANGE FOR PHYSICAL (EFP)  
& BLOCK TRADE FACILITY (BTF)





## EXCHANGE FOR PHYSICAL (EFP)

### WHAT IS AN EFP?

An Exchange for Physical (EFP) transaction is a futures transaction traded off-market by a SFE Full Participant or two Full Participants on behalf of the parties to a simultaneous physical transaction. The physical transaction must be for the same or similar quantity or amount of electricity, or a substantially similar commodity or instrument.

Electricity swaps, swap options and other such instruments traded in the over-the-counter market are deemed by the Exchange as 'substantially similar commodities or instruments'.

In order that an EFP transaction can take place, the physical and futures components of a proposed EFP transaction must be "substantially similar" or equal in terms of:

- > the value of the physical transaction in a commodity or instrument being similar to the value of the futures, ie a swap options position worth \$3,500,000 can be swapped for \$3,500,000 of electricity futures; or
- > the quantity of the physical transaction in a commodity or instrument being similar to the quantity of the futures, ie a 20 MW cal year swap position for a 20 MW cal year futures position

### USES AND BENEFITS

An EFP transaction has a number of uses and benefits for energy market participants:

- 1) Counterparty credit exposure can be effectively eliminated when an existing swap position is replaced with a futures position. In so doing, an EFP allows counterparties to release "credit", clearing the way for further over-the-counter (OTC) trading
- 2) Reduced balance sheet and margin requirements - by netting physical positions against futures positions margin and credit requirements can be reduced
- 3) Off-Market - EFPs are negotiated and traded between counterparties off-market with price and volume details not being reflected "on the screen"
- 4) Price Certainty - price and execution details are agreed between two parties. This can be particularly beneficial where large transactions are being contemplated
- 5) Increased Trading Opportunities - EFP transactions offer an enhanced ability to hedge and conduct basis and arbitrage trading
- 6) 24-Hour Trading - EFP transactions can be negotiated around the clock

## MECHANICS

### i. PARTIES TO AN EFP

An EFP can either be negotiated directly between two counterparties or through any organisation licensed to deal in futures/derivatives. Under either circumstance the transaction must be registered with the Exchange through an SFE Full Participant. SFE Full Participants registering EFP transactions have the responsibility of confirming and maintaining records of all details of the EFP transaction. The details of EFP transactions required for registration with the Exchange. include:

- > the quantity;
- > the price; and,
- > the identity of the counterparties' SFE Clearing Participant.

### ii. PRICING

The pricing of particular EFP transactions will depend on a number of key parameters including:

- > the valuation of OTC credit exposures
- > cash-flow funding (cost-of carry) considerations
- > the terms and conditions attached to the underlying physical transaction, including the strike price
- > the current futures price

Given the number of variables involved, EFP transactions will typically trade at a discount/premium to the original swap (physical instrument) price.

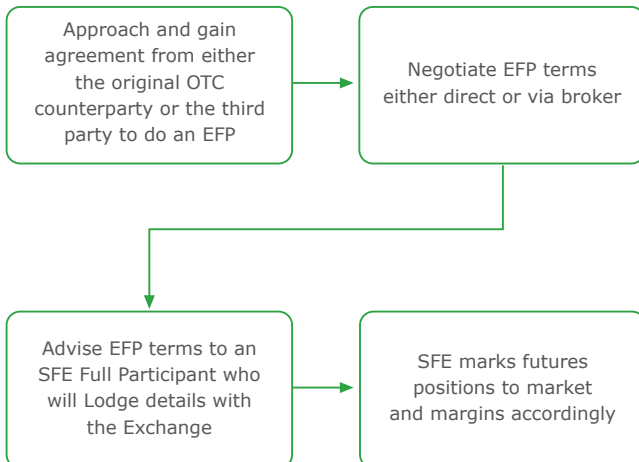
### iii. DOCUMENTATION

Counterparties to an EFP transaction must have:

- executed Client Agreement Forms and acknowledged Risk Disclosure Statements with organisations licensed to deal in futures/ derivatives; and,
- opened an account with a SFE Clearing Participant

SFE Participants must obtain or have the right to access documentation confirming the details of the 'physical' component to an EFP transaction.

### iv. PROCESS FLOW



## **v. COSTS**

The electricity futures contracts registered with the SFE via an EFP transaction will incur the standard per contract side Exchange fee.

In addition to the relevant Exchange fee, the counterparties to an EFP will typically incur brokerage and clearing fees.

A registration fee of \$100+GST per Clearing Participant counterparty to an EFP will be levied by SFE for every EFP transaction.

## **WORKED EXAMPLE OF AN EFP TRANSACTION**

### **SCENARIO:**

Party (A) is long a 20mw base load Q1 2003 CFD @ \$30.00. The market is currently trading at \$32.30 for this position. This position is now \$99,360 in the money ( $20 * \$2.30 * 90 * 24$ ) meaning Party (A) is now exposed to the original counterparty for this amount. Party (A) now wishes to exchange this position for an equivalent futures position.

Party (B) who sold the original CFD to Party (A) is short the 20mw base load Q1 2003 CFD @ \$30.00.

Party (A) has approached Party (B), who has agreed to transact an EFP (ie swap the physical position into an equivalent futures position) for the 20mw position.

### **STEP 1: NEGOTIATION**

Party (A) and Party (B) must negotiate to establish an appropriate price for both legs of the EFP transaction. This may be conducted through a broker or directly between the parties. Assume the parties agree on a price of \$30.30 in this case.

### **STEP 2: REVERSAL OF PHYSICAL POSITIONS**

Party (A) sells the 20mw Q1 2003 to Party (B) at the original \$30.00 price.

Party (B) buys the 20mw Q1 2003 (back) from Party (A) at \$30.00

Party (A) will issue a standard confirmation to confirm the OTC sale to Party (B)

### **STEP 3: SIMULTANEOUS FUTURES EXECUTION**

Having already agreed a price for the EFP transaction (Step 1), both parties will now execute (through a broker) opposing futures transactions to replicate their (now reversed) 20mw OTC positions.

Party (A) buys 20 Q1 2003 futures at \$30.30

Party (B) sells 20 Q1 2003 futures at \$30.30

To complete this transaction, the broker (or the parties themselves if no broker is involved) will provide all relevant information to an SFE Full Participant who will in turn notify the Exchange that an EFP has taken place. Information furnished will include the price and full details of both sides of the transaction (ie both the futures and the physical legs). This information will not be reported to the market. However the next day an EFP total market volume number will be published.

#### STEP 4: CASH FLOWS

Assume the end of day futures price is \$32.30

At the end of day one, the Exchange will margin the parties as follows:

Party (A)	Initial margin due:	20* \$2000 <sup>1</sup>	\$40,000
	Variation margin credited	20*(32.30-30.30) *2160 <sup>2</sup>	\$86,400
	Net account credit		\$46,400
Party (B)	Initial margin due:	20* \$2000	\$40,000
	Variation margin debited	20*(32.30-30.30) *2160	\$86,400
	Net account debit		[\$126,400]

NB In addition to the above cash flows, brokerage, Exchange fees and an EFP registration fee will be payable.

#### AFTER AN EFP:

Neither party now has any credit exposure to the other. They have replaced (netted) an earlier swap agreement for an open futures position. Party (A) has the benefit of immediate cash receipts and Party (B) has received a benefit represented by a margin to the original traded price. Both parties now have freed-up credit lines with each other to conduct further OTC business if required.

**Note:** It is also possible to execute an EFP in the reverse direction of the above example.

To do this you must find a counterparty that wishes to do the same. You can do this either directly with a counterparty or instruct a broker to find you someone who wants to do this deal.

<sup>1</sup> Assumed margin

<sup>2</sup> The number of hours in a Q1 2003 base load futures contract

## **BLOCK TRADE FACILITY (BTF)**

### **WHAT IS THE BLOCK TRADE FACILITY?**

Similar to the existing Exchange For Physical trading mechanism, SFE's new Block Trade Facility (BTF) is an entirely off-market (i.e. non-SYCOM®) trading facility, that will enable SFE Participants to bilaterally arrange large volume transactions, that might have otherwise negatively impacted normal market quality, away from the SYCOM® market.

### **WHY INTRODUCE THE BTF?**

The BTF has been introduced to offer customers certainty of price and immediacy of execution in the transaction of large orders. The BTF will facilitate greater market efficiency through increased liquidity, improved execution quality and lower market transaction costs for large orders. Block Trading is not expected to diminish the role of the existing automated trading systems (SYCOM®), which will continue to be the primary method for trading SFE's products.

### **HAS THE BTF BEEN EMPLOYED ELSEWHERE?**

Yes. The BTF is consistent with successful precedents set at other exchanges globally such as ASX, LIFFE, CME, CBOT and SGX and has been found to substantially enhance market efficiency through increased liquidity, improved execution quality and lower market transaction costs.

### **WHO CAN USE THE BTF?**

The BTF is available for use only by Participants of SFE and by Participants on behalf of their clients.

### **WHEN CAN THE BTF BE USED?**

Block Trades are to be executed within normal contract trading hours plus 10 minutes after the close. For example, normal SYCOM® trading hours for **d-cypha** SFE Australian Electricity contracts are 10:00am to 4:00pm. Block Trades could therefore be executed 10:00am to 4:10pm. The additional 10 minutes is a practical consideration to enable Block Trade orders dependent upon a closing futures price to be transacted.

The BTF may only be used to arrange and execute trades equal to and above pre-defined volume thresholds; the BTF threshold for the **d-cypha** SFE Australian Electricity futures is 50 lots. For example when executing a block trade, this requires a minimum of 50 lots each quarter, not an aggregate across the strip.

## BLOCK TRADE FACILITY - SUMMARY INFORMATION

### TRADING HOURS

All Block Trades to be executed within normal contract trading hours (10:00am – 4:00pm), plus an additional 10 minutes at the end of each SYCOM® session.

### REQUIRED INFORMATION

Participant(s) mnemonic (buyer and seller), contract, contract quarter(s)/strip(s), price (of individual legs), number of lots (each leg), time of trade agreement and name of individual authorised by the Participant(s) to submit Block Trades.

### TRADE EXECUTION

A Participant to Participant transaction (cross transaction for a single Participant on behalf of a client(s)) submitted to the Exchange only via the SYCOM® message facility immediately after the agreement of all details of the proposed Block Trade. All Participants to the transaction then have a further 5 minutes to submit a completed official Block Trade Facility Trade Registration Form to the Exchange.

### TRADE APPROVAL PROCESS

Upon receipt of the Trade Registration Form, Exchange staff will validate the following:

- 1) the difference between the time of trade agreement (as per the SYCOM® message) and the time of receipt by the Exchange (as per the Trade Registration Form);
- 2) whether the trade meets the minimum size threshold requirements for the prescribed contract(s);
- 3) the trading rights of the Participant(s);
- 4) the price of the contract(s).

### TRADE PUBLICATION

Subject to validation, the Exchange will disseminate Block Trade information from 9:30am on the following business morning. Information disseminated by the Exchange will be in the form of contract, expiry month(s)/year(s), price, volume, Participant(s) and time of trade.

#### **CONDITIONS OF TRADING**

Participants may not aggregate separate orders to meet minimum threshold requirements. However, Participants may aggregate any orders greater than or equal to the minimum threshold. For example, if the minimum threshold is 50 lots, a buy order for 200 lots may be satisfied on the sell side by four 50 lot orders.

There are no explicit price limits attached to Block Trades. Block Trades may legitimately occur at prices different to the SYCOM® market price for the relevant contract at the time of trade agreement. Volume-Weighted Average-Price (VWAP) trading is therefore permitted via the BTF.

#### **EXISTING TRADING RULES**

All trades executed pursuant to the Trading Rules for Block Trades will be deemed to have been made in accordance with the standard contractual and clearing structures of the market. However, Participants should note that the prohibitions under the Operating Rules relating to withholding of an order to cross, disclosing information and pre-arrangement will not apply to transactions executed pursuant to the Operating Rules for Block Trades.

#### **MINIMUM THRESHOLDS**

Minimum volume thresholds will be set on an individual contract basis and monitored with a view to maintaining a desirable balance between Block Trade business and that executed through the SYCOM® mechanism for any given contract. The current threshold for the **d-cypha** SFE Australian Electricity Futures contracts is 50 lots.

<sup>1</sup> For example, if the minimum threshold is 50 lots, a buy order for 200 lots may be satisfied on the sell side by four 50 lot orders.

## Q&A

### **HOW ARE THE MINIMUM VOLUME THRESHOLDS FOR THE BTF DETERMINED?**

The purpose of the minimum threshold is twofold:

- 1) to protect the existing SYCOM® market by encouraging all but genuine 'large' orders to be transacted in the central market; and
- 2) to define in advance, which orders are considered of sufficient size to potentially qualify as a Block Trade.

Minimum thresholds are determined by investigation plus consultation with Participants and other market users. Minimum volume thresholds will be set and monitored with a view to maintaining a desirable balance between Block Trade business and that executed through SYCOM®.

### **CAN ORDERS LESS THAN THE MINIMUM THRESHOLD FOR A CONTRACT BE AGGREGATED TO FORM A BLOCK TRADE?**

No. Participants may not aggregate separate orders to meet minimum threshold requirements. However, Participants may aggregate any orders individually greater than or equal to the minimum threshold. For example, if the minimum threshold is 50 lots, a buy order for 200 lots may be satisfied on the sell side by four 50 lot orders.

### **DO THE COUNTERPARTIES TO THE BLOCK TRADE HAVE FREEDOM TO DETERMINE THE PRICE OF THE TRANSACTION?**

Yes. There are no explicit price limits attached to Block Trades. Block Trades may legitimately occur at prices different to the SYCOM® market price for the contract at the time of trade agreement.

### **HOW IS THE BLOCK TRADE EXECUTED?**

A Block Trade is executed as a Participant to Participant transaction (or a cross transaction for a single Participant on behalf of a client) submitted to SFE via the SYCOM® message facility immediately after the agreement of all details of the trade. Participants to the trade then have a further 5 minutes to submit a completed official Block Trade Facility Trade Registration Form to SFE to confirm the proposed transaction.

Participants should not submit the proposed Block Trade to the Exchange for validation until all details of the trade have been agreed. As an example, Market-On-Close orders cannot be submitted until the close of the market because of the dependence on the closing price.

### **WHAT INFORMATION DOES SFE REQUIRE?**

Participant mnemonic (buyer and seller), contract, contract quarters(s)/strip(s), price (of individual legs), number of lots (each leg), time of trade agreement and name of individual authorised by the Participant(s) to submit Block Trades.

### **WHAT IS THE NATURE OF THE TRADE APPROVAL PROCESS?**

Upon receipt of the Trade Registration Form, SFE staff will validate the following:

- a) the difference between the time of trade agreement (from SYCOM® message) and the time of receipt by SFE (from Trade Registration Form)
- b) whether the trade meets the minimum size threshold requirements for the prescribed contract(s)
- c) the trading rights of the Participant(s)
- d) the price of the contract(s)

### **AFTER THE TRADE IS AGREED BETWEEN PARTICIPANTS, HOW LONG DOES SFE REQUIRE TO PROCESS AND PUBLISH THE TRANSACTION?**

Subject to validation, SFE will disseminate Block Trade information at 9:30am on the following morning. Validated Block Trades will be published to the market via the SYCOM® message facility. Executing Participants will however be informed immediately after SFE has validated the Block Trade.

### **HOW / WHAT BLOCK TRADE INFORMATION IS PUBLISHED TO THE MARKET?**

Following transaction validation, Block Trade information is disseminated to the market via the SYCOM® message facility and data vendors.

Information disseminated by SFE will be in the form of contract, expiry quarter(s)/strip(s), price, volume, Participant(s) Participant information will only be disseminated to SFE Participants(s)<sup>2</sup> and time of trade.

### **ARE PARTICIPANTS REQUIRED TO ADHERE TO STANDARD DISCLOSURE/PRE-ARRANGEMENT/WITHHOLDING BUSINESS RULES WHEN EXECUTING A BLOCK TRADE?**

No. All trades executed pursuant to the Operating Rules for Block Trades will be deemed to have been made in accordance with the standard contractual and clearing structures of the market. However, Participants should note that the prohibitions under the Operating Rules relating to withholding of an order to cross, disclosing information and pre-arrangement will not apply to transactions executed pursuant to the Operating Rules for Block Trades.

### **CAN A BLOCK TRADE AFFECT SYCOM® PRICES/ VOLUMES/SETTLEMENTS?**

No. As an off-market trading facility, the BTF will not interact with the SYCOM® market. Block Trades will therefore not affect any open/high/low/close/volume information in the SYCOM® market nor will Block Trade prices be used for settlement purposes. However, Block Trade volumes will be included in all SFE market data reporting.

### **WHAT SFE FEES ARE CHARGED FOR BLOCK TRADES?**

Validated Block Trades will attract the standard trading and clearing fees relevant to the executing Participant. In addition, Block Trades (like EFP transactions) will attract an additional, one-off charge. Further information on SFE fees can be found on SFE's website: [www.sfe.com.au](http://www.sfe.com.au)

## **BLOCK TRADE FACILITY - WORKED EXAMPLES**

### **EXAMPLE ONE**

#### **10:00AM (TRADE NEGOTIATION)**

Client A places an order with Participant A to fill a 100 lot buy order in Q4 03 **d-cypha** SFE Australian Electricity futures via the BTF. On this occasion, Participant A contacts a House trader from a division within the Participant firm, who is able to take the sell side of the proposed transaction at a price of \$32.50.

#### **10:10AM (TRADE NOTIFICATION)**

The two parties to the BTF agree on all trade details by 10:10am. As the initiating Participant (and the only Participant to the trade), Participant A notifies the Exchange of the proposed Block Trade via the SYCOM® message facility.

#### **10:15AM (TRADE CONFIRMATION)**

On behalf of Client A, Participant A confirms the proposed Block Trade to the Exchange via the official Block Trade Registration Form ("Trade Registration Form").

#### **10:20AM (TRADE VALIDATION)**

After receipt of all details of the Block Trade, the Exchange validates the trade with the executing Participant.

#### **9:20AM ON THE FOLLOWING BUSINESS DAY (TRADE PUBLICATION)**

The Exchange disseminates information regarding the transaction to the market.

## EXAMPLE TWO

### 10:00AM (TRADE NEGOTIATION)

Client B places an order with Participant A to fill a 175 lot sell order in Q3 02 **d-cypha** SFE Australian Electricity futures via the BTF. Participant A is not able to obtain a counterparty to its Client's Block Trade order from within its internal or external client base, and thus proceeds to contact other Participants and clients.

### 10:40AM (TRADE NOTIFICATION)

By 10:40am, a House trader from Participant B has agreed to buy Q3 02 **d-cypha** SFE Australian Electricity futures contracts at \$33.75 from Participant A's customer (Client B). As the initiating Participant, Participant A notifies the Exchange of the proposed Block Trade via the SYCOM® message facility.

### 10:45AM (TRADE CONFIRMATION)

On behalf of Client B, Participant A notifies the Exchange of the proposed Block Trade via the Trade Registration Form.

On behalf of its internal client (House), Participant B confirms the proposed Block Trade to the Exchange via the Trade Registration Form.

### 10:50AM (TRADE VALIDATION)

After receipt of all details of the Block Trade, the Exchange validates the trade with the executing Participant.

### 9:20AM ON THE FOLLOWING BUSINESS DAY (TRADE PUBLICATION)

The Exchange disseminates information regarding the transaction to the market.

### **EXAMPLE THREE**

#### **10:00AM (TRADE NEGOTIATION)**

Client C places a market-on-close order (defined in this case as the 4:00pm price between the counterparties) with Participant A to fill a 75 lot buy order in Q1 03 **d-cypha** SFE Australian Electricity futures. On this occasion, a House trader from another division of Participant A is able to take the sell side of the proposed transaction.

#### **4:00PM (TRADE NOTIFICATION)**

Following receipt of the closing price of \$34.00 at 4:00pm, all details of the proposed trade have now been agreed. As the initiating Participant, Participant A notifies the Exchange of the proposed Block Trade via the SYCOM® message.

#### **4:35PM (TRADE CONFIRMATION)**

On behalf of Client C, Participant A confirms the proposed Block Trade to the Exchange via the official Trade Registration Form.

#### **4:40PM (TRADE VALIDATION)**

After receipt of all details of the Block Trade, the Exchange validates the trade with the executing Participant.

#### **9:20AM ON THE FOLLOWING BUSINESS DAY (TRADE PUBLICATION)**

The Exchange disseminates information regarding the transaction to the market.

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Regulatory approvals for the Australian Electricity Futures Contracts are yet to be obtained. The listings and form of the Contracts are subject to those approvals and may be subject to change.

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