

## **IPE CIRCULAR 05/34 G01**

22 March 2005

To: All Members

Copy to: The Financial Services Authority  
LCH.Clearent Limited

Dear Member

### **Guidance on the Exchange for Physical (“EFP”) and Exchange for Swaps (“EFS”) trading facilities**

Following the announcement of the transition to full electronic trading, the Exchange has received a number of requests from Members to re-issue guidance on the registration of EFP and EFS transactions. This guidance updates that issued in Circulars 02/05 dated 11 January 2002 and 04/74 dated 29 October 2004 and contains a summary of each facility followed by detailed updated guidance on the EFP/EFS facilities.

#### **Executive summary of EFP and EFS facilities**

- The EFP facility allows Members to register futures trades linked to physical and forward transactions.
- The EFS facility allows Members to register futures trades linked to swap transactions.
- EFP/EFSs must be faxed to the Exchange using one of the standard forms (attached) to fax numbers +44 (0)20 7265 3694 or +44 (0)20 7265 3690.
- The Brent leg of an IPE Brent/Nymex WTI trade may be registered using the EFS facility.
- EFP and EFS transactions may be submitted to the Exchange at any time during trading hours and up to 30 minutes thereafter.
- On the day of expiry of a contract, EFP and EFS transactions in respect of the expiring contract date/month may be submitted up to one hour after the official cessation of trading for that contract date/month for transactions in the IPE Brent Crude futures, IPE Gas Oil futures and the IPE UK Electricity futures Contracts, and up to 30 minutes after the official cessation of trading for the IPE Natural Gas futures contract.
- EFS transactions in respect of traded options cannot be registered after the cessation of trading for an expiring contract.

- The Exchange may require Members to supply evidence of the underlying physical or swap transaction either prior to or following registration of the trade and may refuse registration in its sole and final discretion.

### **Procedures in respect of the registration of EFP and EFS transactions**

Reporting of these transactions may take place at any time for all eligible contracts during trading hours and for 30 minutes after the close of the individual contract. On expiry day, the IPE Brent Crude futures, the IPE UK Electricity futures and the IPE Gas Oil futures EFP/EFSs in respect of the expiring contract date/month may be reported up to one hour after the expiry of the contract date/month. In the case of the IPE Natural Gas futures Contracts, EFP/EFSs may only be reported up to 30 minutes after the contract expiry. Further details are set out in Rule F.5.

Both parties to the EFP/EFS, must complete, as appropriate, one of the two EFP/EFS forms attached. The completed form must be faxed to +44 (0)20 7265 3694 or +44 (0)20 7265 3690 at any time during trading hours or by the deadlines described above. Members trading from Exchange premises may also submit forms by hand to IPE ETS Market Supervision.

### **Permitted use of EFP/EFS facility**

The two key uses of the EFP/EFS facility are as follows: -

1. To permit bilaterally traded physical and paper transactions to be hedged using IPE contracts in a single contingent transaction (e.g. where the seller of a crude oil cargo becomes the buyer of futures and the buyer of a crude oil cargo becomes a seller of futures).
2. To enable holders of OTC swap positions to replace them with the equivalent in IPE futures.

In certain circumstances the Exchange recognises that transitory EFPs are a legitimate trading tool for users of the Market at times when futures cannot be traded on the Exchange. The Exchange requires that they should not be used for improper purposes and should not be traded during Exchange opening hours.

There are a number of pricing mechanisms that are used OTC which the Exchange will accept on an EFP/EFS registration basis.

These include, inter alia

<ul style="list-style-type: none"><li>• BWAVE - Brent Weighted Average price</li><li>• GWAVE - Gas Oil Weighted Average price</li><li>• MOPs - Mean of Platts price</li><li>• IPE marker prices</li></ul>	When an OTC swap or physical transaction is based on the IPE BWAVE, the IPE GWAVE, IPE marker or MOPs and the OTC contract has been executed contingent on its conversion into IPE Futures at an agreed time, date or trigger point subsequent to the trade.
<ul style="list-style-type: none"><li>• OTC Options</li></ul>	When an OTC option can expire into IPE Futures at the strike price at expiry or other agreed trigger point.
<ul style="list-style-type: none"><li>• IPE Brent/Nymex WTI arbitrage</li></ul>	Where the IPE leg of an arbitrage trade can be converted into the IPE Brent Crude futures where it has been traded as a contingent arbitrage trade as opposed to legging across the two Exchanges.

The Exchange considers these and similar instruments to be legitimate OTC transactions, the crucial factor being that they are not tradable on the Exchange and therefore are eligible to be registered on the Exchange using the EFP/EFS facility.

As OTC transactions, the trading of such instruments is outside the jurisdiction of the IPE Regulations until they are brought onto the Exchange. For the avoidance of doubt the negotiation of the purchase or sale of such instruments will not be considered by the Exchange as a breach of Rule G.4 which prohibits prior arrangement, nor will the negotiation be considered as a breach of Rule E.8 (d) which prohibits the sale of goods other than authorised energy products.

Obviously Members and clients will need to ensure that, in bringing the contracts on-exchange, they comply with all applicable IPE Regulations. In addition, Members and clients should also satisfy themselves that the relevant requirements of the Financial Services Authority's Code of Market Conduct are satisfied.

## **Factors to be considered when bringing an OTC position on-exchange**

The limiting factors on acceptance of EFP/EFS registration are:

- In the case of EFP transactions, the underlying OTC contract must be properly documented and available for production to the IPE compliance department on demand in order to validate its legitimacy. In this context proper documentation is a legally binding bilateral contract between market participants - who may be Members or not. The contract should be either an industry standard contract or one whose terms are of an equivalent standard identifying the OTC product being traded, the price or prices involved and the mechanism by which the contracts may be converted into IPE Futures. In the case of EFS transactions for instruments such as IPE markers and/or the IPE Brent/Nymex WTI arbitrage, this requirement may be satisfied by providing order documentation such as order slips, confirmation notes or copies of a trader's blotter;
- The facility is not designed or intended to allow users of the market to circumvent the normal trading Rules and therefore the Exchange will not authorise the use of the facility for look-alike contracts;
- The facility is not designed or intended to facilitate the transfer of funds between parties and/or locations whether for money laundering, resolution of errors or any other purpose other than as a consequence of normal commercial activity. If the Exchange is not satisfied that there is a legitimate commercial rationale for the EFP/EFS, registration will be refused;
- If the registration price is not at the current market price or is outside those parameters announced by the Exchange from time to time, the Exchange must be satisfied that the transaction is a legitimate use of the facility before registration can take place. The Exchange may request sight of evidence to confirm the legitimacy of the underlying transaction whether by sight of contract notes or otherwise. In any event the Exchange will retrospectively monitor a random sample of accepted EFP/EFSs to ensure that there was a legitimate underlying transaction behind the EFP/EFS.

These parameters are currently at, or within, the following differentials from the previous day's official settlement price:

IPE Brent Crude futures:	Plus/minus \$0.30 per lot
IPE Gas Oil futures:	Plus/minus \$3.00 per lot
IPE Natural Gas futures:	Plus/minus £0.01 (1.0 pence) per lot
IPE UK Electricity futures:	Plus/minus £1.00 per lot

The Exchange may amend the parameters at any time as necessary;

- Any EFP/EFS to be registered which falls within one of these limits will be automatically accepted for registration by the Exchange. Those outside these parameters will require approval from the compliance department who may ask for further documentation in support of the registration as outlined in Rule F.5(e). Members will appreciate that the processing of such trades will be significantly quicker on most occasions if such documentation is provided at the time of requesting the registration; and
- Members should ensure that LCH.Clearnet Limited ("LCH") holds sufficient cover to offset any negative variation margin which results from the posting of an EFP or EFS. LCH may also require that sufficient cover is held on account to meet any consequential change to

initial margin. **Failure to do so may result in a refusal by LCH to register the trade in accordance with LCH General Regulation 9 (c).** To ensure that this requirement is fulfilled, relevant Exchange staff will examine all EFPs and EFSs as they are presented for registration and if necessary registration may be delayed until both the Exchange and LCH are satisfied that funds in the relevant Member's LCH account are adequate.

The Exchange wishes to emphasise that each Member should ensure that it has appropriate systems and controls in place to ensure that EFPs and EFSs are registered in accordance with IPE Regulations. Failure to do so may render the Member liable to disciplinary action by the Exchange and potentially the FSA.

Any questions arising from this Circular should be addressed to:

Marc Leppard, Director of Regulation and Compliance on +44 (0)20 7265 3608; e-mail marc.leppard@theipe.com or Michael Sayers, Head of Compliance on +44 (0)20 7265 3648; e-mail michael.sayers@theipe.com.

Yours sincerely,

**Patrick Davis**  
**Company Secretary**

<b>It is suggested that this Circular is passed to the member of your staff in charge of:</b>			
Compliance	√	Deliveries	√
Back Office	√	Technology	√
Floor Trading	√	Finance	
IPE ETS	√		
<b>Thank you for your co-operation.</b>			

**CONFIDENTIAL**

**IPE NATURAL GAS FUTURES & IPE UK ELECTRICITY FUTURES CONTRACTS  
EFP/EFS/BLOCK TRADE ENTRY FORM**

**Please fax this form to IPE Supervision: 020 7265 3694/3690**

**Member Details (Please Print)**

Member Company		Member Mnemonic	
Counterparty Company		Counterparty Mnemonic	

**Contact Details (Please Print)**

Contact Name.....	Trader Name .....
Contact No .....	Trader Mnemonic .....
Date .....	(Only required if trade to be entered under Trader Mnemonic)
Signature .....	

**Trade Details (Please Print)**

Commodity	Natural Gas / Electricity*	Trade Type	EFP / EFS / Block*
Contract Strip		Time Traded	
No of Lots		Allocate To**	
Price		Account Ref***	
Buyer or Seller	B / S*		

\* **Delete as appropriate**

\*\* Enter receiver's mnemonic if giving up trade to another Member or one of the following codes if not giving up trade H = House; S = Segregated; N = Non Segregated

\*\*\* Enter account reference or account reference details of receiving Member if giving up trade to another Member

**Please be aware of the following:**

EFPs and EFSs in respect of Natural Gas Contracts may be reported to the Exchange up to 30 minutes after the relevant time of close of IPE ETS (17:30 hours).

EFPs and EFSs in respect of Electricity Contracts may be reported to the Exchange up to 30 minutes after the relevant time of close of IPE ETS (17:30 hours) and on expiry days, for the expiring contract date, up to one hour after the relevant time of cessation of trading (18:00 hours).

Block trades in relation to Natural Gas Contracts and Electricity Contracts may take place during the hours 08:00 and 17:00 and on such business days as the Exchange may from time to time prescribe

Please call the IPE on 020 7265 3772/3707 if you have any queries on the completion of this form.



**EFP/EFS/BLOCK TRADE ENTRY FORM**

**FOR REGISTRATION OF BRENT OR GASOIL FUTURES**

COMPANY MNEMONIC: ..... NAME: .....

SIGNATURE: ..... CONTACT NO: .....

TRADER NAME: ..... TRADER MNEMONIC: .....

Please tick if you wish us to input under Company Name

DATE: .....

Please fax to IPE ETS Market Supervision on 020 7265 3694/3690

Buy(B) Sell(S) Cross (X)	Month	No. of lots	Price	Trade Type EFP (E) EFS (S) Block (K)	Contract Brent (B) Gas Oil (G)	Allocate To †	ACC Details ‡	Time Traded	Counterparty

† Enter receiver’s mnemonic if giving up trade to another Member **OR** one of the following codes if not giving up trade H = House; S = Segregated; N = Non Segregated

‡ Enter receiving Member’s acc reference details if giving up trade to another Member

**NB: The Minimum volume for Block trades are as follows:**

**Brent = 600 lots and Gas oil = 200 lots**

**Complex Strategies = 50 lots**

ANY PROBLEMS PLEASE RING: IPE ETS – 020 7265 3772/3707