

GENERAL NOTICE NO: 1420

ISSUE DATE: 19 May 1999
EFFECTIVE: 25 May 1999

EXTENSION OF BASIS TRADING FACILITY

- **INDEX FUTURES AGAINST A “BASKET” OF SECURITIES**
- **BOND FUTURES AGAINST STANDARD OTC SWAPS**

1. Introduction

1.1 In response to member demand, LIFFE’s Basis Trading Facility (“BTF”) is being extended to include transactions comprising index futures against a basket of securities, and to include transactions comprising government bond futures against standard OTC swap contracts.

1.2 Accordingly, this General Notice:

- (i) confirms those contracts that are designated by the Board as capable of being traded under the BTF against a basket of securities or against standard OTC swap contracts;
- (ii) confirms the required characteristics for approved baskets of securities and for standard OTC swap contracts transacted under the BTF;
- (iii) amends the LIFFE CONNECT™ for Futures Trading Procedures to reflect these changes (Attachment 1); and
- (iv) issues a revised version of the BTF slip (Attachment 2), which members are asked to photocopy and make available to relevant staff.

1.3 These additions to the BTF and amendments to the LIFFE CONNECT™ for Futures Trading Procedures take effect from **Tuesday 25 May 1999**.

2. Index Futures Basis Trades

2.1 It has been determined that the following contracts may form the futures leg of a basis trade against a basket of securities:

FTSE 100 Index future
 FTSE 250 Index future
 FTSE Eurotop 100 Index future
 FTSE Eurotop 300 Index future
 FTSE Eurotop 300 ex. UK Index future
 FTSE Eurobloc 100 Index future
 MSCI Pan-Euro Index future
 MSCI Euro Index future

2.2 Any member may arrange a basis trade involving the simultaneous transaction of Index futures contracts against an approved basket of securities, provided the member has in place arrangements for the execution of the futures leg of the basis trade via a member holding the relevant trading right. The Board has determined that an approved basket of securities must have the following characteristics:

- (i) In respect of a basket of securities traded against the FTSE 100 Index future or the FTSE 250 Index future:
 - (a) each security must be listed on the London Stock Exchange;
 - (b) the number of securities contained in each basket must total at least 25 in relation to a FTSE 100 Index futures basis trade, and 62 in relation to a FTSE 250 Index futures basis trade (NB. the securities in the basket need not themselves be constituents of the Index); and
 - (c) no single security should account for more than 25% of the value of the basket (and, if the security is a constituent of the Index, no more than its index weighting +5%, whichever is the higher).
- (ii) In respect of a basket of securities traded against one of the European Index futures:
 - (a) each security must be listed on a European stock exchange on which the index constituent securities are listed;
 - (b) securities from a minimum of three constituent countries must be represented in the basket;
 - (c) the number of securities in the basket must total at least 25% of the number of index constituents for the relevant index (NB. the securities in the basket need not themselves be constituents of the index); and

- (d) no single security should account for more than 25% of the value of the basket (and, if the security is a constituent of the index, no more than its index weighting +5%, whichever is the higher).

- 2.3 Members are required to attribute a unique identifier to the cash leg (i.e. the basket of securities). The executing member must retain complete details of the cash leg transaction, including evidence of trade settlement, and make such information available to Exchange Officials on request. Where the executing member is not directly responsible for the execution of the cash leg of the trade, arrangements must be in place with the party executing the cash leg such that details of the securities basket transaction can be made available to the Exchange.
- 2.4 The basis trade should be organised so that the hedge ratio should equate the traded value of the basket of securities and the underlying value of the futures contracts traded. Where the hedge ratio differs from this approach, the executing member may be required to justify the method employed.
- 2.5 Members should note that all other aspects of the BTF Trading Procedures remain unchanged.

3. **Government Bond Futures Basis Trades**

- 3.1 It has been determined that any of LIFFE's government bond futures, excluding the Japanese Government Bond contract, may form part of a basis trade against approved standard "plain vanilla" OTC swap contracts.
- 3.2 The required characteristics for OTC swap contracts approved for basis trading against government bond futures (excluding the Japanese Government Bond) shall be the same as those that apply for the trading of OTC swap contracts against LIFFEFB futures. Accordingly, a swap contract must be a spot, forward-starting or existing plain vanilla OTC swap contract written under the terms of an ISDA Master Agreement and comprised of regular fixed rate payments against regular floating rate payments, both of which regular payments are denominated in the same permitted currency (see paragraph 3.4 below) and are represented as a percentage of a fixed nominal amount.
- 3.3 Members should note that, in addition to the information required on the basis trade registration slip, the executing member is required to retain complete details of the cash leg transaction, and to make this information readily available to Exchange Officials on request. Where the executing member is not directly responsible for the execution of the cash leg, the member must have arrangements in place to obtain such information, so that it can be provided promptly to the Exchange.

3.4 The permitted currencies for the OTC swap contract leg of a basis trade are as follows:

- (i) Euro;
- (ii) Sterling;
- (iii) Japanese Yen;
- (iv) Australian Dollar;
- (v) Swiss Franc;
- (vi) Greek Drachma;
- (vii) US Dollar;
- (viii) Swedish Krona; and
- (ix) Danish Krone.

3.5 Members should note that all other aspects of the BTF Trading Procedures remain unchanged.

4. **Publication of basis trade activity**

4.1 Members should note that, in addition to the publication of details of the futures leg of a basis trade on the relevant trading platform for the futures contract concerned, details of the futures leg will also be distributed to Quote Vendors, marked with the trade type indicator “J”.

5. **Further Information**

5.1 Members seeking further information in relation to this General Notice should contact Richard Stevens (ext. 2840) or Nimish Thakker (ext. 2230) at LIFFE.

BY ORDER OF THE BOARD

N E Carew Hunt
Market Secretary

Changes to LIFFE CONNECT™ For Futures Trading Procedures

(Additions underlined, deletions ~~struckthrough~~)

Definitions

1.2.2 In these Trading Procedures, unless otherwise expressly stated:

approved basis trade instrument	means a security, <u>a basket of securities</u> or an OTC instrument approved for the time being by the Board in relation to a basis trade Exchange Contract specified by the Board;
---------------------------------	--

.....

4.16 Basis Trading Facility

4.16.1 The Exchange provides a Basis Trading Facility (“BTF”) which allows members to organise and execute, subject to Trading Procedure 4.16.2, transactions involving a combination of an approved basis trade instrument and an appropriate number of offsetting Futures Contracts. For the purposes of these Trading Procedures such transactions are called “basis trades”. The Trading Procedures relating to the futures leg of a basis trade contained in Trading Procedures 3.1 – 4.15 (except 4.1) do not apply to basis trades except where such an application is explicitly stated.

4.16.2 Any member is permitted to arrange basis trades, subject only to the member having in place arrangements for the execution of the futures leg of a basis trade via a member holding a relevant trading right (“the basis trade executing member”) to trade the basis trade Exchange Contract.

4.16.3 A basis trade may be organised only during the trading hours of the Futures Contract concerned, as published by the Board from time to time by General Notice.

4.16.4 Basis trades may be transacted only in Exchange Contracts which have been designated by the Board for that purpose. Such designations will be published, from time to time, by General Notice. Basis trades are not permitted in a delivery month of a designated contract which has never traded. In respect of any Gilt-based contract, the Basis Trading Facility can be used in respect of a delivery month for a futures contract on any trading day up to and including the business day preceding the First Notice Day of that delivery month. In respect of all other designated contracts the Basis Trading Facility can be used in respect of a delivery month for a futures contract on any trading day up to and including the business day preceding the Last Trading Day of that delivery month.

4.16.5 The basis trade executing member is responsible for assigning the price of the futures leg of a basis trade. For this futures leg to be authorised, this

price must be at the level trading on LIFFE CONNECT™ for Futures at the time the basis trade registration slip is submitted for execution, as specified in Trading Procedure 4.16.9 and 4.16.10, or within the high/low traded price that occurred on LIFFE CONNECT™ for Futures in the preceding 30 minutes. In the event that no trade has occurred in the relevant delivery month on that day at the time the basis trade registration slip is submitted for execution or in the preceding 30 minutes, the price of the futures leg of the basis trade must be at or within the high/low traded price calculated by the algorithm published, from time to time, by the Exchange for that purpose.

~~4.16.6 (a) Basis trades involving those bonds that are approved basis trade instruments against government bond futures contracts or LIFFE~~EFB~~ futures contracts:~~

~~The basis trade executing member must, in relation to a bond forming the cash leg of a basis trade against a government bond futures contract or a LIFFE~~EFB~~ futures contract, provide the Exchange with the clean cash price of the bond, as specified in Trading Procedure 4.16.9.~~

~~(b) Basis trades involving standard plain vanilla OTC swaps that are approved basis trade instruments against LIFFE~~EFB~~ futures contracts:~~

~~No price is required to be provided to the Exchange in relation to a swap which forms the cash leg of a basis trade against a LIFFE~~EFB~~ futures contract.~~

~~4.16.7 LIFFE price factor and duration based approaches are acceptable methods for constructing a hedge ratio in respect of deliverable bonds against bond futures contracts. A duration based method must be used to construct a hedge ratio for other bonds against government bond futures contracts. For standard plain vanilla OTC swaps forming the cash leg of a basis trade against a LIFFE~~EFB~~ futures contract, a method which is based upon the ratio of the basis point values of shifts in the yield curve of respectively the relevant cash and futures legs would provide an acceptable hedge ratio. Where a hedge ratio differs from such methods, the member who is presenting the trade for authorisation (see Trading Procedure 4.16.8) may be required to justify the method employed.~~

4.16.6 In relation to a bond forming the cash leg of a basis trade against a government bond futures contract or a LIFFE~~EFB~~ futures contract, the basis trade executing member must provide the Exchange with the clean cash price of the bond, as specified in Trading Procedure 4.16.9. The Exchange does not require the provision of the cash price of any other type of security or OTC instrument, which may form the cash leg of a basis trade.

4.16.7 The following approaches to the construction of hedge ratios for basis trades are considered acceptable:

(a) Deliverable bonds against bond futures contracts:
A price factor or duration based method;

- (b) Other bonds against bond futures contracts:
A duration based method;
- (c) Standard plain vanilla OTC swaps against bond futures contracts or LIFFEEFB futures contracts:
A method which is based upon the ratio of the basis point values of shifts in the yield curve of respectively the relevant cash and futures legs; and
- (d) Baskets of equity securities against equity index futures contracts:
A method based on the relative value of the basket of equity securities and the nominal underlying value of the equity index futures contracts.

Where a hedge ratio differs from such methods, the member who is presenting the trade for authorisation (see Trading Procedure 4.16.8) may be required to justify the method employed.

- 4.16.8 After a basis trade has been organised the member, or where the basis trade has been organised between two members, the member who will be the seller of the futures leg of the basis trade, must execute the futures leg of the basis trade as a cross transaction, as specified in Trading Procedures 4.16.9 – 4.16.13, or must procure that the futures leg of the basis trade is so executed by another appropriately authorised member.
- 4.16.9 Where a basis trade involves a government bond futures contract or a LIFFEEFB futures contract against a cash bond, in respect of each basis trade, the following details must be recorded on a basis trade registration slip by the basis trade executing member:
- (i) time of organisation;
 - (ii) executing member mnemonic;
 - (iii) Futures Contract in which the BTF is being transacted;
 - (iv) delivery month;
 - (v) agreed futures price;
 - (vi) number of Futures Contracts;
 - (vii) cash bond ISIN number;
 - (viii) clean cash price;
 - (ix) hedge ratio methodology (for government bond futures contracts against deliverable bonds only);
 - (x) name and signature of individual presenting the trade;

- (xi) time stamp (at point of completion of the trade registration slip);
and
- (xii) fax number of basis trade executing member.

In addition, the basis trade executing member must retain, in an easily accessible form that can be audited by the Exchange, documentary evidence of the following information:

- (a) coupon and maturity of the cash bond;
- (b) frequency of coupon payments;
- (c) currency of cash bond; and
- (d) nominal value of cash bond.

All information required to be retained by the basis trade executing member, pursuant to this Trading Procedure 4.16.9, must be retained by the member for 3 years. If the basis trade executing member is not directly responsible for the execution of the cash leg of the basis trade, he must have appropriate arrangements in place with the party organising/executing the cash leg such that the information in (a) – (d) above can be provided promptly to the Exchange.

4.16.10 Where a basis trade involves a government bond futures contract or a LIFFEEFB futures contract against a plain vanilla OTC swap the following details must be recorded on a basis trade registration slip by the basis trade executing member:

- (i) time of organisation;
- (ii) executing member mnemonic;
- (iii) Futures Contract in which the BTF is being transacted;
- (iv) delivery month;
- (v) agreed futures price;
- (vi) number of Futures Contracts;
- (vii) name and signature of individual presenting the trade;
- (viii) time stamp (at point of completion of the trade registration slip);
and
- (ix) fax number of basis trade executing member.

The basis trade executing member must also record on the basis trade registration slip the **unique identifier/reference number of the swap**

transaction. The basis trade executing member must retain, in an easily accessible form that can be audited by the Exchange, documentary evidence which contains the following information:

- (i) the cash market counterparty identifier(s) for the cash leg;
- (ii) fixed rate of the swap, including accrual convention;
- (iii) floating reference rate of the swap;
- (iv) termination/maturity date;
- (v) effective (start) date of the swap;
- (vi) next fixed and floating reset dates of the swap;
- (vii) replacement/liquidation value of the swap;
- (viii) frequency of payments;
- (ix) currency of floating and fixed legs of the swap; and
- (x) nominal value of the swap.

All information required to be retained by the basis trade executing member, pursuant to this Trading Procedure 4.16.10, must be retained by the member for 3 years. If the basis trade executing member is not directly responsible for the execution of the cash leg of the basis trade, he must have appropriate arrangements in place with the party organising/executing that leg such that the information in (i) - (x) above can be provided promptly to the Exchange.

4.16.10A Where a basis trade involves equity index futures contracts against a basket of equity securities, the following details must be recorded on the basis trade registration slip by the basis trade executing member:

- (i) time of organisation;
- (ii) executing member mnemonic;
- (iii) Futures Contract in which the BTF is being transacted;
- (iv) delivery month;
- (v) agreed futures price;
- (vi) number of Futures Contracts;
- (vii) a unique identifier/reference number for the basket of equity securities transaction;

- (viii) name and signature of individual presenting the trade;
- (ix) time stamp (at point of completion of the trade registration slip);
and
- (x) fax number of basis trade executing member.

In addition, the basis trade executing member must retain, in an easily accessible form that can be audited by the Exchange, documentary evidence of the following information:

- (a) the identity and volume traded of each equity security comprising the basket;
- (b) the price (including currency) at which each equity security was traded; and
- (c) any supplementary cash payment made in conjunction with the transaction.

All information required to be retained by the basis trade executing member, pursuant to this Trading Procedure 4.16.10A, must be retained by the member for 3 years. If the basis trade executing member is not directly responsible for the execution of the cash leg of the basis trade, he must have appropriate arrangements in place with the party organising/executing that leg such that the information in (a) - (c) above can be provided promptly to the Exchange.

4.16.11 The completed basis trade registration slip must be faxed to the Market Control Centre by the basis trade executing member within 30 minutes of the time at which the basis trade was organised. No basis trade can be submitted for execution later than 15 minutes prior to the close of trading of the Futures Contract in which the basis trade is being transacted. An exchange official will check the validity of the details submitted on the basis trade registration slip. If the exchange official is satisfied that all such details are valid, he will declare that the futures leg of the basis trade is executed. The exchange official will then add the following information to the basis trade registration slip:

- (i) time stamp (at point of execution);
- (ii) signature of exchange official; and
- (iii) basis trade identifier (unique alpha-numeric code given to the trade by the Exchange).

4.16.12 The Exchange will retain the authorised basis trade registration slip and will return by fax a copy of the authorised basis trade registration slip to the basis trade executing member. Details of the executed futures leg of a basis trade will be input to TRS by the Exchange. Details of the futures leg of a

basis trade cannot be entered into TRS via DMI, or by submission of a trade registration slip to the Exchange TRS area.

- 4.16.13 Authorisation by an exchange official of a transaction does not preclude the Exchange from instigating disciplinary procedures in the event that the transaction is subsequently found to have been made other than in compliance with Exchange Rules and Trading Procedures.
- 4.16.14 The following information with respect to the futures leg of a basis trade will be published on LIFFE CONNECT™ for Futures:
- (i) Futures Contract and delivery month;
 - (ii) futures price; and
 - (iii) volume of futures traded.

In addition, these details will be distributed to Quote Vendors, marked with the trade type indicator “J”.

For each Exchange Contract, the cumulative volume of futures traded as the futures leg of basis trades during the day will also be published.

- 4.16.15 Both the long and short positions associated with the futures leg of a basis trade will be entered into TRS and matched under the basis trade executing member’s mnemonic.
- 4.16.16 Upon request by the Market Supervision Department the basis trade executing member must produce satisfactory evidence that the basis trades have been organised in accordance with the Rules and Trading Procedures. Basis trade executing members must, therefore, be in a position to supply documentary evidence in connection with a basis trade, including, but not limited to, evidence confirming the cash leg of basis trades.

Basis trade executing members may also be required from time to time by the Market Supervision Department to request, and copy to the Exchange, confirmation of the details of the cash leg of a basis trade where another party was responsible for the execution of the cash leg.

Failure to provide satisfactory evidence in accordance with these Trading Procedures may result in the instigation of disciplinary action under Section 5 of the Rules. Sanctions available under Section 5 of the Rules rise to the suspension of some/all of a member’s rights.

BASIS TRADE REGISTRATION SLIP**(Effective 25 May 1999)**Slip must be faxed to Market Control Centre on **0171 329 3976/7**

To be completed by member	
Time Stamp	
Time of Organisation	
Executing Member mnemonic	
Contract Code	
Delivery Month	
Futures Price	
Number of lots	
FOR BOND & LIFFEFB FUTURES	
For bond cash legs:	
Cash Bond Code – ISIN only	
Clean cash price	
Hedge Ratio <i>(for government bond futures contracts against deliverable bonds only)</i>	Price Factor / Modified Duration (Delete as appropriate)
For swap legs:	
Unique swap identifying number	
FOR EQUITY INDEX FUTURES	
Unique stock basket identifying number	
Individual presenting Basis Trade – Name	
Signature	
Fax number of basis trade executing member	

To be completed by Exchange Official	
Basis Trade Identifier	
Trade Authorisation - Signature	
Time Stamp	

Copies of this must be held as follows:
 1 – Retained by Exchange
 1 – Retained by Executing Member
 1 - Passed to Clearing Member of Executing Member