ICE Futures Europe EFP, EFS, Soft Commodity EOO, EFRP and Basis Trade Policy

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EFP, EFS, EFRP, Soft Commodity EOO and Basis Trade Policy

This policy provides details and requirements regarding the use of the Exchange for Physical ("EFP"), Exchange for Swap ("EFS"), Exchange for Related Positions ("EFRP"), Soft Commodity Exchange of Option for Option ("EOO") and Basis Trade facilities for ICE Futures Europe ("IFEU") contracts, and the factors to be considered when bringing bilateral positions on-exchange.

1. General

1.1 Members should ensure that they have appropriate systems and controls in place to ensure that EFPs, EFSs, EFRPs, EOOs and Basis Trades are registered in accordance with Exchange Regulations. Failure to do so may render the Member liable to disciplinary action by IFEU and potentially other regulatory authorities.

1.2 IFEU may require Members to supply evidence of the underlying physical, cash or swap transaction either prior to or following registration of the trade and reserves the right, at its discretion, to unilaterally refuse registration. Documentation relating to the physical or OTC component of the EFP, EFS, EFRP, EOO or Basis trade must be retained by the Member. If the Member is not directly responsible for the execution, it must have in place appropriate arrangements to promptly provide IFEU with the required information.

1.3 IFEU may request further documentation or request sight of evidence in support of the registration as outlined in Rule F.5(e) and F.5.C(c) (whether by sight of contract notes or otherwise) to confirm the legitimacy of the underlying transaction. Members will appreciate that the processing of such trades will be significantly quicker on most occasions if such documentation is available at the time of requesting the registration. Notwithstanding any such request, IFEU may retrospectively audit and inspect a random sample of accepted EFP, EFS, EFRP, EOO and Basis Trades to ensure that there was a legitimate underlying transaction.

2. Definitions

2.1 An EFP is a transaction involving the simultaneous exchange of an IFEU futures position for an equivalent physical position. A hallmark feature of the EFP is that each party to it ends up with the other's original position. A Basis Trade, used for financial instruments, is similar. An EFP does not have to be in the same commodity as the future. However, there would be an expectation that the physical and future would be in the same asset class or be plausibly related. For example, it is acceptable to give up crude futures against physical fuel oil, if the fuel oil has been priced in relation to crude.

2.2 An EFRP is a transaction where the equivalent position that is being exchanged for futures is not physical. For example, this could be a position in units of a related index with an equivalent value to the underlying futures product.

2.3 An EFS is a transaction involving the conversion of an OTC exposure into a futures exposure. A hallmark feature of the EFS is that the originating party ends up in the *same* position as before, save that where the exposure was previously bilateral and OTC, it has now become futures. Alternatively, the effect of the EFS may be the reverse, i.e. to move an on-exchange position off-exchange. Whether it has this effect depends on the opening OTC and futures positions at the time of the trade.

2.4 An EOO is a transaction involving the simultaneous exchange of an IFEU options position for a corresponding OTC option position.

3. Permitted use of EFP, EFS, EOO, EFRP and Basis Trading Facilities

3.1. The key uses of the EFP, EFS, EFRP and Basis Trading facilities are as follows:

- To permit bilaterally traded physical and paper transactions to be hedged using ICE Futures Europe 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 or as an alternative example where the seller of cocoa becomes the buyer of Cocoa Futures and the buyer of cocoa becomes the seller of Cocoa Futures).
- To enable holders of bilateral swap or option positions to replace them with the equivalent in ICE Futures Europe contracts, or the reverse.
- To facilitate hedging: by enabling the organisation of simultaneous transactions in a financial asset or instrument and an appropriate number of offsetting futures contracts (e.g. a SONIA Future traded against a standard plain vanilla OTC swap).

3.2. Participants involved in an EFP, EFS, EOO, EFRP or Basis Trade must be separately controlled (see Appendix 1 for further details).

3.3. For EFP, EFS and EFRP trades in contracts which are subject to a Position, Expiry or Delivery Limit[1], with the exception of ICE Permian WTI Storage Futures (Contract Code “HOS”) and Options, there must be evidence of a bona fide pre-existing physical or swap agreement that is capable of being independently settled on its own terms, i.e. its completion is not directly dependent on the transaction being registered on ICE Futures Europe.

The underlying physical contract must be properly documented and available for production to IFEU on demand in order to validate its legitimacy. In this context, proper documentation is a legally binding bilateral contract between market participants. The contract should be either an industry standard contract, or one whose terms are of an equivalent standard identifying:

- the underlying product being traded;
- the price or prices involved; and

[1] **https://www.ice.com/publicdocs/futures/Position_and_Expiry_Limit_and_Accountability_Levels.pdf**

- the arithmetical reconciliation of the underlying to the futures regarding the quantity and the price of the futures being posted.

3.4. For EFS trades in all other commodity instruments (including options), the underlying contract requirement may be satisfied by providing order documentation such as, but not limited to:
- order slips (either trader or broker);
- confirmation notes;
- copies of electronic confirmations (email, instant message);
- copies of a trader's blotter.

The futures or options traded need not be in the same month as specified in the original contract, but where a different month is used - for example, because of unanticipated delays in making a delivery - the change in the futures or options to be used should be noted in an update to the underlying contract.

3.5. The EFP, EFS, EOO, EFRP and Basis Trade facilities may not be used with the intent to:
- facilitate the transfer of funds between parties and/or locations whether for money laundering or resolution of errors;
- transfer sums of cash from one party to another as a means of payment;
- allocate gains and losses between the futures and cash or OTC derivative components of the EFP, EFS, EFRP and Basis Trade;
- evade taxes;
- circumvent financial controls by disguising a firm's financial condition;
- accommodate any other unlawful or non-commercial purpose.

3.6. If IFEU is not satisfied that there is a legitimate commercial rationale for the EFP, EFS, EOO, EFRP or Basis Trade, registration may be refused.

3.7. If the price at which an EFP, EFS, EOO or EFRP to be registered is not at current market price or within the high/low range of the day, IFEU may request further information to ensure that the transaction is a legitimate use of the facility.

3.8. The price of the futures leg(s) of a Basis Trade must be within the high/low traded price that occurred on the ICE platform in the preceding 30 minutes. If no trade has occurred in the relevant delivery month in the preceding thirty minutes, the price of the futures leg(s) must be within a price range determined by IFEU. In all cases, the price of the futures leg must represent a fair market value. In exceptional circumstances, IFEU may, at its absolute discretion, authorise a Basis Trade where the price of the futures leg(s) is outside the parameters set out above. Prior to authorising such Basis Trades, IFEU may request additional information from the executing Member.

3.9. Members should ensure they hold sufficient funds at ICE Clear Europe to offset any negative variation margin which results from the posting of an EFP, EFS, EFRP and Basis Trades. ICE Clear Europe may also require that sufficient funds are held on account to meet any consequential change to initial margin. Failure to do so may result in a refusal by ICE Clear

Europe to register the trade in accordance with ICE Clear Europe General Regulation 9 (c). To ensure that this requirement is fulfilled, relevant IFEU staff will examine all EFP, EFS, EFRP and Basis Trades as they are presented for registration and if necessary registration may be delayed until both IFEU and ICE Clear Europe are satisfied that funds in the relevant Member's ICE Clear Europe account are adequate.

4. Factors to be considered

4.1 EFP

IFEU will accept that an EFP trade may not have a 'like for like' physical contract against the futures. An acceptable example would be a 'basket of refined physical products' (e.g., Fuel Oil, Gasoil, and Naphtha) being collectively hedged via EFP using Brent Crude Futures. In such scenarios, the documentation must outline the arithmetical reconciliation of the underlying to the futures regarding the quantity and the price of the futures being posted, i.e. how the price and quantity of the futures correlates to the price and quantity of the physical legs.

4.2 EFS

EFS transactions in respect of options for an expiring contract month cannot be registered after the cessation of trading for the relevant expiring contract month.

Underlying swap contracts cannot be 'contingent' on acceptance by IFEU. For example, the underlying swap contract must not be retrospectively cancelled out by a further linked swap that comes into effect if the trade is not accepted by IFEU as an EFS.

'Transitory' EFSs, where the original underlying swap contract is offset/cancelled by a back-to-back swap and then replaced by a futures position as part of the same strategy, are permitted. Each swap contract must be able to stand alone if executed singly and must bear genuine economic risk.

4.3 EFRP / EOO

For Soft Commodity EFRPs and EOOs, **Trading Procedure 16B.3A** outlines permissible approaches for the construction of hedge ratios on. Where a hedge ratio differs from such methods, the Member who is reporting the trade is required to seek approval from IFEU and justify the method employed in advance of such submission.

Satisfactory documentary evidence containing the information specified in Trading Procedure 16B, must be retained. There must be either evidence of the underlying physical contract or of the price-fixation confirmation together with a directly related contract demonstrating the price differential or ratio used.

EFRP transactions are also permissible in Energy contracts. For example, an EFP trade may be used to hedge a transaction in an Index with exposure to crude oil. For such transactions, the underlying physical contract must evidence arithmetical reconciliation of the value of the Index units to the futures regarding the quantity and the price of the futures being posted.

4.4 Basis Trade

The approved Basis Trade instrument would be:

- a cash bond;
- an OTC swap;
- a forward rate agreement ("FRA");
- a basket of stocks; or
- such other instrument as designated by IFEU.

Trading Procedures 16A outlines permissible approaches for the construction of hedge ratios. Where a hedge ratio differs from such methods, the Member who is reporting the trade is required to seek approval from IFEU and justify the method employed in advance of such submission.

5. Reporting time requirements

5.1 EFP/EFS/EFRP/EOO

Where an EFP in Low Sulphur Gasoil Futures (contract code "G") is reported after the cessation of trading on expiry day (after 12.00 noon and by no later than 1.00pm London Time), IFEU will require the reporting party to present the underlying pre-existing physical contract for any EFP no later than 30 minutes after the submission of the EFP to IFEU, or by 1.30pm, whichever is earlier.

In the event that a physical contract is produced that was agreed after cessation of trading (12.00 noon) on the relevant expiry date, Members should provide an explanation of how the physical contract would be settled, given that the contract would relate to an expired futures contract. This explanation should detail how the underlying physical contract is not an illegitimate contingent agreement. The registration of the EFP may be rejected by IFEU if no such valid documentation is produced.

EFPs for Midland WTI Futures (contract code "HOU") can be initiated following the expiry of the contract. However, these must be reported at any time after the close of trading until 1.00pm Central Time/7.00pm London Time on the next Business Day following the Last Trading Day.

With the exception of the expiring G and HOU contracts as referenced above, EFPs, EFSs and EFRPs may only be organised during the trading hours of the related futures or options contract.

EFP, EFS and EFRP trades for all eligible futures and options contracts may be reported to IFEU at any time during trading hours and for 30 minutes or, in the case of Electricity and Natural Gas Contracts, one hour after the close of the relevant individual Contract (or the close of the ICE Post Trade and Clearing Systems, whichever is the earlier).

On expiry day, for all IFEU futures contracts (except HOU and IFEU Emissions and Soft Commodity contracts), EFP, EFS and EFRP trades in respect of the expiring contract must be reported within one hour after the expiry of the contract. In the case of Emissions contracts, EFP, EFS and EFRP trades must be reported within 30 minutes after the expiry of the relevant contract. For Soft Commodity EFRP trades, the final submission for registration must be within 30 minutes after expiration of the relevant contract.

On the expiry day for all IFEU options contracts, EFSs or EOOs may be reported up to the end of the designated settlement period of the underlying futures contract.

5.2 **Basis Trades**

Basis Trades may be organised only during the trading hours of the relevant futures or options contract.

The Basis Trade details must be reported to IFEU by the executing member through the ICE Block facility as soon as practicable and accepted within 15 minutes of the time at which the Basis Trade was agreed.

6. Minimum Volume Thresholds

For Minimum Volume Thresholds in relation to Basis Trades please refer to: **Appendix C - Fixed Income Contracts** and **Appendix D - Equity Contracts**.

Members shall be able to request or make contingent quotes or agree to facilitate contingent orders from a client in the same series, delivery month or strategy which may have the effect of achieving a transaction at an aggregate or average price inside the minimum price movement of the contract concerned provided that each component is greater than or equal to the relevant Basis Trade minimum volume threshold. Furthermore, the average price may only be derived from two price levels which are one price level apart.

7. Reporting to IFEU

EFPs, EFSs, EOOs, EFRPs or Basis Trades may be reported to IFEU by Members through the ICE Block facility. Affiliate or group companies may be eligible to trade on behalf of an Exchange Member if they have specific written permission from the Member, which has been provided to IFEU.

Where the trade is agreed between two different Members, one inputs its own side to the deal and alleges it to the counterparty. The counterparty to the deal is required to accept the alleged trade in ICE Block. Once accepted by the counterparty it flows through to the clearing system in the normal manner.

Unless otherwise agreed by the relevant Members, trades in single contract months shall be entered by the buyer of the futures. Where there is a multi-legged strategy, the trade should be entered into ICE Block by the buyer of the front month future.

Any decision by IFEU not to register an EFP, EFS, EOO, EFRP or Basis Trade is final. Registration of a transaction does not preclude IFEU from instigating disciplinary procedures in the event that the transaction is subsequently found to have been made other than in compliance with the Regulations.

For all EFP, EFS, EOO, EFRP and Basis Trades, both volume and price will be broadcast to the market.

For the trade type codes that will be used for registration see the table below:

Transaction Type	Trade Type Code
EFPs	E
EFP/EFSs (for Emission and Utility Contracts)	O
EFSs	S
Soft Commodity EOOs	Q
Basis Trades	4

Any questions arising from this policy should be addressed to:

ICE Futures Europe Market Regulation
+44 (0) 20 7065 7797
MarketRegulation-Europe@ice.com

Appendix 1 - FAQ

1. What does “separately controlled” mean?

Genuine separately controlled affiliates must be validated as consistently demonstrable across all aspects of activity. For example, business units would have to report and manage their positions separately for the purposes of position reporting and compliance with IFEU position limits. Those positions could not be netted off against each other and would be held separately (gross) to expiry and margined separately.

For example, if one unit held a long position approaching expiry and the other unit was short in the same product, each would have to trade out of the position independently (which they could legitimately do with each other via a cross). All trading activity on IFEU would likewise be treated as between separate parties. As such, these affiliate entities or business units could not undertake EFP, EFS, EFRP or Basis Trades and then subsequently split the resultant volumes between the affiliates. The expectation of IFEU is that each affiliate or business unit would also have independent management and where appropriate, articles of association.

2. Are Tri-Partite situations allowed?

Tri-party Basis, EFS or EFP Trades, where the middle party (who buys and sells the underlying (cash) to the future) is removed from the exchange-traded transaction are not permitted. In general, the principle is that the counterparties to the futures leg must be the same counterparties to those involved with the underlying basket or OTC transaction. In a tri-party situation, two separate Basis, EFSs or EFPs should be entered, with the middle party buying in one transaction and selling in the other transaction. This does not apply to brokered deals, where the middle party never owns the swap or physical.

However, IFEU is aware of circumstances where affiliates who are counterparties to the underlying Physical, Cash or OTC transaction leg may legitimately use another affiliate within the same commercial group as an agent to buy and sell the futures leg on their behalf as part of the same ultimate EFP, EFS or Basis Trade transaction. In this situation, both commercial group affiliates must have a common ultimate beneficial owner. In such circumstances the expectation would be that these entities have sufficient paperwork (such as a legal master agreement) to document the agreement that the affiliate entities transacting have title to whatever they pass. Any paperwork supporting the EFP, EFS EFRP or Basis Trade would then reference that such a transaction would be made further to that original legal master agreement.

Example: ABC Trading and Supply (ABC T & S) organizes an EFP in Gasoil with Energy Trading Inc. ABC Refining Pte (ABCR), a sister affiliate of ABC T & S, has no futures account. ABCR delivers the Gasoil to Energy Trading Inc. ABC T & S receives the corresponding futures from Energy Trading Inc.

This is acceptable, provided there is a prior agreement in place whereby either ABC entity can act as the other’s agent in respect of these trades.

3. **Is it permissible to execute an EFP based on an agreement which amends the physical contract?**

Example: Amending the pricing mechanism based on September futures instead of July futures

Yes. An EFP can still be posted using futures in a different month or quantity to that originally envisaged, provided the corresponding change in the physical terms documents this, i.e. there should be a contract amendment noting the roll of the futures. The roll can be in either direction.

4. **Is there ever an obligation to agree or post an EFP - for example, to manage a position in a physically delivered contract?**

No. An EFP is a bilaterally-arranged physical trade settled via futures. Organising an EFP is at the traders' discretion. If you expire a long (short) position in a deliverable contract without arranging an EFP, your position will be matched with a short (long).

5. **What is the difference between an EFP and an ADP (Alternative Delivery Procedure)?**

An EFP is a physical trade settled via futures that is organised *before* or just after expiry subject to IFEU rules in respect to the specific contract in question.

An ADP is an agreement after the expiry, and after the EFP posting deadline, made between two parties who have been matched according to the provisions of that contract. The parties who have been matched via IFEU can agree mutually and bilaterally to amend the terms of the delivery, but by doing so, will have been deemed to have undertaken such actions outside of IFEU's normal delivery process.

6. **Do I have to have credit arrangements in place with a counterparty if I am matched?**

No, in an Exchange delivery the clearing house stands and passes funds between you and your counterparty.

7. **Can I deliver the physical leg of an EFP somewhere other than where the contract originally stated?**

Yes, as long as the change has been documented between the parties. Optionally, you can have a delivery location that is left open and subject to later nomination / declaration.

8. **For which contracts must there be evidence of a bona fide pre-existing physical or swap agreement that is capable of being independently settled on its own terms?**

The definitive list of contracts can be found in the table attached to the ICE Futures Europe Position, Expiry and Delivery Limits and Accountability Levels Policy, found **here**. A summary of the products is also provided below:

Contract Name	Contract Code
ICE Brent Futures	B
Midland WTI American Gulf Coast Future	HOU

ICE Dubai 1st Line Futures	DBI
ICE Low Sulphur Gasoil Futures	G
UK Natural Gas Futures	M
IFEU Dutch TTF Natural Gas Futures	TFN
ICE NYH (RBOB) Gasoline Futures	N
ICE (RBOB) Gasoline Last Day Future	NLD
ICE NYH Ultra Low Sulphur Heating Oil Futures	O67
ICE NYH Ultra Low Sulphur Diesel Futures	O62
ICE Heating Oil Futures	O
ICE NYH Heating Oil Last Day Futures	OLD
ICE WTI Crude Futures	T
ICE WTI Crude Oil Last Day Futures	WLD
Soybean Oil Penultimate Day 1st line Futures	SOY
Soybean Oil Penultimate Day 1st Line Balmo Futures	SOW
ICE London Cocoa Futures	C
ICE Robusta Futures	RC
ICE UK Feed Wheat Futures	T
ICE White Sugar Futures	W

For EFS trades in all other commodity futures and options, the underlying contract requirement may be satisfied by providing order documentation such as order slips, confirmation notes, electronic confirmations (e.g. email, instant message), copies of a trader's blotter.

9. Is it acceptable for a participant to close out an existing position at IFEU and substitute this exposure with a bilateral OTC swap?

IFEU would consider the circumstances of the provision of the OTC swap. If the *bona fide* OTC swap bears genuine economic risk and has been formally agreed with a view to enabling a customer to remove a cleared exposure, then any subsequent agreement during the same conversations by those same counterparties to submit for registration an EFS at IFEU would be acceptable. Conservation of working capital is a legitimate economic rationale for such a swap - the purpose is commercially rational and the decision to carry OTC rather than cleared exposure bears economic risk.

All details of the OTC swap, including the time agreed should be properly documented. It would not be acceptable to contingently agree such an OTC swap, pending the successful registration of the EFS trade. The OTC swap must be organised first - IFEU would accept this as meeting the stand-alone requirement.

Further to the agreement of the OTC swap, the supporting paperwork with the Swap Agreement can be transmitted to the counterparty after the registration of the EFS trade, provided it references the original time that the OTC swap was agreed. This also means that during the course of the agreement of the OTC swap, legitimate reference can be made to the subsequent intention to submit for registration to IFEU an EFS trade, provided such communications also make reference to the intention of the participant to closing out their IFEU exposure.

IFEU would expect the full swap documentation to be produced upon request, inclusive of the time and date of agreement; this time would necessarily be prior to that of the EFS registration at IFEU.

Appendix 2 - Examples

Examples of a typical direction for EFP Trading

Example 1: Participant A makes an agreement with Participant B to deliver physical crude oil, and both agree to hedge the physical position on IFEU via EFP facility. A is long a crude cargo; B has no crude cargoes.

Participant A would therefore buy futures as they would be the seller of the physical.
Participant B would sell futures, as B would be the buyer of the physical.

A now has no crude cargoes and B is now long one cargo, i.e. each now has the other's starting physical position.

Example 2:

Participant A is long 2,000 lots of crude oil futures as a hedge for a physical cargo that they plan to take delivery of.
Participant B is short 2,000 lots of crude oil futures as a hedge for production that they know they will need to sell in the prompt market.

Participant A enters into an EFP with Participant B to exchange their 2,000 crude oil futures for 2,000,000 barrels of physical crude oil loading on to their vessel at an agreed upon date range and price.

Both Participants now do not have any crude oil futures contracts and A is long their cargo of crude and B has sold their production.

Example of a typical direction for EFS Trading

An OTC swap contract exists between Participant A, the buyer, and Participant B, the seller. Therefore, there is a *bona fide* pre-existing swap agreement.

Participant A and B wish to move the OTC swap position to IFEU and utilise the EFS facility to do so.

Participant A would be buying the futures and Participant B would be selling the futures which would replicate the original OTC positions.