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**CIRCULAR (05/2001)**



New Zealand Futures & Options  
Exchange Limited  
Level 12 – Telstra Business Centre  
191 Queen Street, Auckland 1036  
Telephone +64-9-309 8308  
Fax +64-9-309 8817  
Email: [info@nzfoe.co.nz](mailto:info@nzfoe.co.nz)  
Web site: <http://www.nzfoe.co.nz>

## **INTRODUCTION OF A BLOCK TRADE FACILITY FOR 3 & 10 YEAR GOVERNMENT STOCK FUTURES CONTRACTS**

### **Introduction**

On the 11<sup>th</sup> of April 2001, NZFOE indicated its intention to introduce a Block Trade Facility (BTF) to facilitate off-market trading of large volume transactions in NZFOE products.

Having successfully passed all necessary regulatory stages, NZFOE is pleased to announce that it will introduce a **BTF for 3 & 10 Year Government Stock Futures Contracts at 8.00 am on Wednesday, 16 May 2001.**

**The minimum thresholds for 3 & 10 Year Government Stock Futures Contracts will be 100 lots and 50 lots respectively.** This is in line with the request by New Zealand Financial Markets Association (NZFMA) for such a facility and complements existing exchange trading mechanisms.

### **Rationale for introducing the BTF**

NZFOE is launching BTF's in direct response to NZFMA's request and encourages the trading of 3 & 10 Year Government Stock Futures Contracts by enabling single large orders to be transacted with certainty. As requested by NZFMA the Block Trade Facility will be available for 4 months and may be extended for a further 3 months depending on its success. This facility is accompanied by a fee reduction for the 3 & 10 Year Government Stock Futures Contracts on the proviso that a combined market average of 2,000 lots per day is traded in these contracts.

BTF's have been successfully introduced at other exchanges globally and have been found to increase liquidity, improve execution quality and reduce market transaction costs. Similar to the EFP facility offered by NZFOE, the BTF helps bridge the gap between derivative, cash and OTC markets and is consistent with Exchange objectives to service customer needs as they relate to investment and risk management activities. Significantly, the BTF rules are consistent with those available in the underlying cash market.

In response to these observations and recognition of the varying needs of our customers, NZFOE is implementing the BTF to enable customers to arrange and execute transactions (greater than the minimum threshold) away from the central NZFOE SYCOM® market. NZFOE therefore expects the BTF to facilitate an expansion in its customers' business opportunities.

### **Implementation and ongoing monitoring**

NZFOE will monitor all trading (including Block Trading). Furthermore, consultation has indicated that potential BTF users are well equipped to assess the risk characteristics of a BTF order to be transacted on their behalf. Regular review of BTF rules and minimum thresholds will be undertaken to ensure that the BTF does not diminish the role of the existing SYCOM® market, which will continue to be the primary method for trading the Exchange's products.

**Postal Address**  
PO Box 6734 Auckland 1036  
New Zealand

## **Further Information**

Appendix 1 presents key information about the BTF.

Appendix 2 presents Market Practice Note No. 2 to assist Trading Permit Holders in interpreting the Trading Rules for Block Trading (also attached).

Appendix 3 presents the Trading Rules for BTF.

Appendix 4 presents the Schedule to the Trading Rules applying to the BTF.

Appendix 5 presents the Specified Block Trading Facility Registration Form.

### **For all trading related enquiries, please contact:**

David Raper,  
Deputy Manager, Trading Operations  
Tel: +61 2 9256 0554  
Email: draper@sfe.com.au

#### *Key Information:*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_keyinfo.htm](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_keyinfo.htm)

#### *Applicable Contracts and Minimum Thresholds*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_thresholds.htm](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_thresholds.htm)

#### *Block Trade Examples*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_examples.pdf](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_examples.pdf)

### **For all surveillance or rule interpretation enquiries, please contact:**

Mark Floyd,  
Acting Manager, Surveillance  
Tel: +61 2 9256 0477  
Email: mfloyd@sfe.com.au

#### *Trading Rules:*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_rules.pdf](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_rules.pdf)

#### *Market Practice Note:*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_practicenote.pdf](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_practicenote.pdf)

### **For all NZFOE enquiries, please contact:**

Greg Boland,  
General Manager, NZFOE  
Tel: +64 9 309 8308  
Email: greg@nzfoe.co.nz

#### *Q&A:*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_qanda.pdf](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_qanda.pdf)

#### *General Information:*

[http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz\\_intro.asp](http://www.sfe.com.au/index.html?page=/site/html/blocktrading/nzfoe/btnz_intro.asp)

**GREG BOLAND**  
**GENERAL MANAGER**

**9 MAY 2001**

## Block Trade Facility Key Information

<b>Trading Hours</b>	Block Trades to be organised and reported within normal contract trading hours (including the night session).
<b>Required Information</b>	Trading Permit Holder mnemonic (buyer and seller), contract, contract month(s)/year(s), price (of individual legs), number of lots (each leg), time of trade agreement and name of individual authorised by the Trading Permit Holder(s) to submit Block Trades.
<b>Trade Execution</b>	A Block Trade is executed as a Trading Permit Holder to Trading Permit Holder transaction (or a cross transaction for a single Trading Permit Holder on behalf of clients), submitted to the Exchange via the SYCOM <sup>®</sup> message facility immediately after the agreement of <b>all</b> details of the proposed Block Trade. Trading Permit Holders to the transaction then have 5 minutes to fax a completed official Block Trade Facility Trade Registration Form to the Exchange.
<b>Trade Approval Process</b>	Once receiving the Trade Registration Form, Exchange staff will validate the following: 1) the difference between the time of trade agreement (from SYCOM <sup>®</sup> message) and the time of receipt by the Exchange (from the Trade Registration Form); 2) whether the trade meets the minimum size requirements for the contract(s); 3) the trading rights of the Trading Permit Holder(s); 4) whether the price is within any tolerance levels determined by the Exchange.
<b>Trade Publication</b>	Subject to validation, the Exchange will disseminate Block Trade information approximately 5 minutes after receiving the Trade Registration Form. Validated Block Trades will therefore be published to the market approximately 10 minutes after the initiating Trading Permit Holder informs the Exchange of the intended transaction via the SYCOM <sup>®</sup> message facility. The Exchange will disseminate the following information: contract, expiry month(s)/year(s), price, volume, Trading Permit Holder(s) <sup>1</sup> and time of trade.
<b>Conditions of Trading</b>	Trading Permit Holders may not aggregate separate orders to meet minimum threshold requirements. However, Trading Permit Holders may aggregate any orders greater than or equal to the minimum threshold <sup>2</sup> .  There are no explicit price limits attached to Block Trades other than that they should be 'fair and reasonable'. The Exchange reserves the right not to validate a Block Trade if it is deemed to fall outside what is 'fair and reasonable'. This is done by taking into account a range of factors including (but not limited to); the current price and volume on SYCOM <sup>®</sup> of the same contract at the relevant time; the liquidity of the market; and general market conditions.  For 3 & 10 Year Government Stock futures contracts, the BTF will only be available for the 'spot' contract. Block Trades will not be permitted in a contract with five business days or less to expiry/delivery. Consequently, upon five days to expiry, the 'spot' contract will become the next expiry month, thereby facilitating continuous use of the facility.  Block Trades are not permitted in those expiry month(s) of contract(s) which have never traded.
<b>Existing Trading Rules</b>	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, Trading Permit Holders should note that the prohibitions under Trading Rules TR.17.1(c)(v) (Withholding in Order to Cross), TR.18 (Disclosure of Information) and TR.19 (Pre-arrangement), will not apply to transactions executed pursuant to the Trading Rules for Block Trades.
<b>Minimum Thresholds</b>	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 <sup>®</sup> mechanism for any given contract.

<sup>1</sup> Trading Permit Holder information will only be disseminated to NZFOE Trading Permit Holders.

<sup>2</sup> Eg if the minimum threshold is 100 lots, a buy order for 250 lots may be satisfied on the sell side by one 100 lot and one 150 lot order.

**PRACTICE NOTE**

**SUBJECT:** Block Trade Facility

**RELEVANT BUSINESS RULES:** Trading Rule TR.20.A

**ISSUED:** 9 May 2001

**PRACTICE NOTE NO:** 2

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**INTRODUCTION**

'Block Trades' are individually large volume trades made up of orders that fall within the Minimum Volume Threshold for contracts prescribed by the Board, Chief Executive or his Delegate. Initially the Block Trade Facility will be restricted to 3 Year Government Stock and 10 Year Government Stock futures contracts only, with minimum volume thresholds of 100 and 50 lots respectively.

This Practice Note provides some guidance regarding the Trading Rules relating to the Block Trade Facility and the procedures for executing a Block Trade Order. It should be noted that this Circular should be read in conjunction with the Trading Rules.

**Block Trade Order versus Block Trade Interest**

A Trading Permit Holder must be holding an order that meets the requirements of a Block Trade Order before it can solicit counterparties in accordance with Trading Rule TR.20.A.1(h). It is insufficient to only have 'interest' from the originating client before the Trading Permit Holder attempts to determine whether there is opposing interest from other market Trading Permit Holders.

**Block Trade Order Recording**

Although Block Trades are executed off-market they are still subject to the requirement to maintain internal records of instructions received from Clients. Brokers should refer to Prescription 35, Dealing Records, which outlines these requirements.

**Authorisation by Client to Execute Block Trade Orders - Trading Rule TR.20.A.4**

Trading Permit Holders must be authorised in writing by the Client to execute a Block Trade Order on their behalf, either specifically or generally. This may be included in the Client Agreement Form between the Trading Permit Holder and the Client or may be obtained by a separate written authorisation.

**Block Trade Fair and Reasonable Pricing - Trading Rule TR.20.A.2**

It is the Trading Permit Holder's responsibility to ensure when arranging, organising or executing Block Trade Orders, that the price of any Block Trade Order being quoted, and which may be subsequently executed, is 'fair and reasonable' taking into account, but not limited to, the current price and volume on SYCOM® of the same contract at the relevant time, liquidity and general market conditions.

On each occasion when quoting a price for a Block Trade Order, the Trading Permit Holder must explain to the potential counterparty that the price quoted for the Block Trade Order may or may not be the prevailing market price; that the price at which the Block Trade is executed will not be used in establishing settlement prices; and that Block Trades will have no impact on current SYCOM® market data.

The Exchange reserves the right not to validate a Block Trade if it fails to reflect 'fair and reasonable' pricing.

### Aggregation of Orders - Trading Rule TR.20.A.1(g)

Trading Permit Holders cannot aggregate smaller orders to make up a Block Trade Order, to satisfy the Minimum Volume Threshold. Block Trade Orders may only be aggregated where each individual order meets or exceeds the Minimum Volume Threshold.

### Non-Availability of Block Trading - Trading Rule TR.20.A.1(d) & (e)

Block Trades will not be permitted in a contract month where there is five (5) business days or less remaining until expiry/delivery. The rationale for this is that users rely on open positions and daily traded volumes when either rolling or exiting contracts close to expiry. The integrity of the market may be compromised by allowing Block Trades to be executed within this period as a Block Trade may have a significant impact on the open interest, but because the SYCOM® volume is not updated, the market will be unaware of the potential effect on the open interest.

Block Trades are also not permitted in those delivery or expiry months of a Contract which have never traded.

### Spread Trading

The Board has prescribed that only the spot expiry of the 3 Year Government Stock and 10 Year Government Stock contracts may be executed through the BTF, therefore, Trading Permit Holders will be unable to execute orders for intra-commodity spreads through the Block Trade Facility.

Trading Permit Holders should note however that as Trading Rule TR.20.A.1(e) provides for the inability to trade the spot contract when there is only 5 business days remaining to expiry, on the fifth business day out from expiry, the next delivery month effectively becomes the 'spot' month.

### Sequencing

Block Trades are subject to sequencing provisions, that is, orders must be executed and trades allocated in the sequence in which they are received and recorded. It is not appropriate to 'pro-rata' volumes executed amongst clients. Trading Permit Holders should refer to Rule 33.2 for sequencing provisions.

### Procedures upon Execution of a Block Trade - Trading Rule TR.20.A.3

Where a Block Trade Order is to be crossed, a SYCOM® Trader of the executing Trading Permit Holder must send a text message to SYCOM® Operations briefly outlining the details of the Block Trade via the message facility immediately upon agreement of the details of the Block Trade. The time on this message will be the official time stamp used by the Exchange for the purpose of this Trading Rule.

Where two or more Trading Permit Holders are involved in a Block Trade, a SYCOM® Trader of the initiating Trading Permit Holder must send the text message to SYCOM® Operations immediately upon agreement of all details of the Block Trade. The SYCOM® Trader of the initiating Trading Permit Holder must also include details of the counterparty(s). Again, the time stamp on the message will be the official time stamp used by the Exchange.

Once the text message has been sent to SYCOM® Operations, each Trading Permit Holder involved must complete and send the BTF Trade Registration Form to SYCOM® Operations via facsimile within five (5) minutes of the text message, ensuring all relevant details have been filled out correctly and legibly. Each Trading Permit Holder must fill out their side of all trades and the Exchange will match opposing sides once received.

### Execution of Unsuccessful Block Trades on SYCOM®

Where a Trading Permit Holder is unsuccessful in obtaining counterparties to a Block Trade Order i.e., the Minimum Volume Threshold cannot be met, however counterparties wish to execute a trade for a lesser volume, a SYCOM® Trader of the Trading Permit Holder may take the orders to SYCOM® for execution. However, as the trade would essentially have been 'prearranged' the Trading Permit Holder must not attempt to execute a cross trade unless a period of sixty (60) seconds has elapsed from the entry of the originating Client order. This will enable other Trading Permit Holders to enter opposing orders into SYCOM®.

**Note: The above information is for the guidance of Trading Permit Holders and does not purport to be legal advice. Where appropriate, legal or other professional advice should be sought.**

## NZFOE Block Trading Rules

New definitions have been added to TR.1.1 as follows:

### TR.1.1.

#### **DEFINITIONS**

“Block Trade”	Any trade which is executed via the Block Trade Facility.
“Block Trade Order”	An order in a class of Futures Contract or Options Contract prescribed by the Board or the Chief Executive or his Delegate which must be executed via the Block Trade Facility.
“Block Trade Facility”	The facility described in TR.20.A. whereby Block Trades are executed.
“Minimum Volume Threshold”	The thresholds determined by the Board or its Chief Executive or his Delegate from time to time being the minimum number of lots in respect of each Block Trade.

New TR.20.A reads as follows:

#### **BLOCK TRADING RULES**

### TR.20.A1

#### **Block Trade Facility**

- (a) The Exchange shall establish a Block Trade Facility and subject to these Trading Rules, and the Rules of the Exchange, a Block Trade Order must be executed pursuant to this TR.20.A;
- (b) The Board or the Chief Executive or his Delegate may prescribe contracts which may be traded using the Block Trade Facility;
- (c) A Minimum Volume Threshold shall apply to those contracts referred to in TR 20.A1(b) and shall be prescribed by the Board or the Chief Executive or his Delegate;
- (d) Block Trades are only permitted in a delivery/expiry month and/or exercise price of a prescribed contract which has previously traded;
- (e) The Block Trade Facility can only be used where more than five business days remain to delivery/expiry of the contract;
- (f) Where a Block Trade strategy involves:
  - (i) trading two or more different contracts, the smaller of the Minimum Volume Thresholds of the contracts which comprise the Block Trade will apply to each of these contracts;
  - (ii) trading two or more different delivery/expiry months and/or exercise prices of the same contract, the Minimum Volume Threshold will apply to the lot size of each leg of the trade,
- (g) Trading Permit Holders cannot:
  - (i) aggregate separate orders in order to meet Minimum Volume thresholds; or
  - (ii) allot each individual leg of a Block Trade to different accounts .
- (h) Where a Trading Permit Holder receives a Block Trade Order from a Client, the Trading Permit Holder may:
  - (i) solicit counterparties to the Block Trade Order amongst other Trading Permit Holders;
  - (ii) withhold transmission of the Block Trade Order in order to solicit those counterparties;
  - (iii) disclose those details of the Block Trade Order as authorised by the Clients; and
  - (iv) aggregate orders where each order is greater than or equal to the Minimum Volume Threshold for that contract.

### TR.20.A.2

#### **Fair and Reasonable Price**

- (a) Trading Permit Holders must satisfy themselves when arranging, organising or executing Block Trade Orders, that the price of any Block Trade Order being quoted is fair and reasonable taking into account, but not limited to, the current bid/offer, previous traded prices and volume on SYCOM® of the same contract at the relevant time, the depth, volatility and liquidity of the SYCOM® market, the size of the Block Trade Order and general market conditions.
- (b) On each occasion when quoting a price for a Block Trade Order, the Trading Permit Holder must make it clear at that time to the counterparty that -:
  - (i) the price quoted for the Block Trade Order may or may not be the prevailing market price;
  - (ii) the price at which the Block Trade is executed will not be used in establishing settlement prices;
  - (iii) Block Trades shall have no impact on SYCOM® market data; and
  - (iv) Block Trades will be separately reported to the market.

### TR.20.A.3

#### **Block Trade Execution**

- (a) Trading Permit Holders to a Block Trade-:
  - (i) shall each execute a Block Trade Order in accordance with this TR. 20.A. ;
  - (ii) shall communicate the agreed terms of the Block Trade Order immediately to the Exchange;
  - (iii) must each complete a Block Trade Facility Registration Form and submit the form to the Exchange for validation.

**TR.20.A.3****Block Trade Execution (cont)**

- (b) A completed Block Trade Facility Registration Form must be submitted to the Exchange for validation by each Trading Permit Holder within five (5) minutes of the time at which the Block Trade Order was agreed. The time limit for the submission of the Block Trade Facility Registration Form to the Exchange commences as soon as the agreed terms of the Block Trade Order are communicated to the Exchange pursuant to TR20.A.3(a)(ii).
- (c) An Exchange Official may grant an extension of time of the five (5) minute period referred to in TR 20.A.3 (b) but Exchange Officials are under no obligation to grant such an extension.
- (d) An Exchange Official will assess the validity of the details recorded on the Block Trade Facility Registration Form. When the Exchange Official is satisfied that the details recorded are valid and complete, then the Exchange Official will confirm the execution of the Block Trade.
- (e) Exchange Officials are under no obligation to accept record details in accordance with TR.20.A 3(a)(iii) where the information cannot be readily and properly validated.
- (f) Subject to TR.20.A.3(c) any Block Trade which is not executed in accordance with TR.20.A shall be invalid. The decision of the Exchange Official as to the invalidity of a Block Trade shall be final. The Exchange Official shall notify the effected Trading Permit Holders of that decision and send a message to the market identifying the Block Trade concerned.
- (g) Details of all Block Trades validated and confirmed by an Exchange Official shall be published by the Exchange to Trading Permit Holders. The details published to Trading Permit Holders will include the commodity, quantity, time, expiry month(s) and price of each Block Trade and the identity of the Trading Permit Holders who conducted the trade.
- (h) The original completed Block Trade Facility Registration Form (s) will be retained by the Trading Permit Holder (s) to a Block Trade Order and a copy of the completed, validated and confirmed Block Trade Facility Registration Form will be retained by the Exchange.
- (i) Confirmation by an Exchange Official of execution of a Block Trade does not preclude the Exchange from taking disciplinary action in the event that the Block Trade is found to be other than in compliance with the Rules of the Exchange.
- (j) Where counterparties have been solicited pursuant to TR20.A1 and the Block Trade Order remains unfilled, then the Block Trade Order may revert to a permitted order ("the order") as described in TR.12 and can be executed by the Trading Permit Holder on SYCOM® in accordance with the Client's instructions. No Trading Permit Holder or SYCOM® Trader may attempt to execute a cross where that order is subsequently entered into SYCOM® unless a period of sixty (60) seconds has elapsed from the entry of the originating Client order.
- (k) For the purpose of TR.20.A in respect of any Trading Permit Holder which is a company, a "Client" shall include a related company as defined by the Companies Act 1993 or a division of the Trading Permit Holder which is - separate from that Trading Permit Holder's futures division.

**T20A.4****Authorisation to Execute Block Trades**

Before executing a Block Trade Order on behalf of a Client pursuant to TR.20.A a Trading Permit Holder must be authorised in writing by the Client to do so either specifically or generally.

**NZFOE Block Trade Facility – Minimum Thresholds**

The minimum size thresholds for all products applicable for use within the Block Trading Facility are listed below. NZFOE will monitor minimum thresholds continually and review as a matter of course on a calendar quarter basis.

**Applicable Futures Contracts:**

3 Year Government Stock futures contracts (Spot Month Only <sup>1</sup> )	100 lots (Applies to each leg of the trade)
10 Year Government Stock futures contracts (Spot Month Only <sup>1</sup> )	50 lots (Applies to each leg of the trade)

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**Applicable Options Contracts:**

None

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<sup>1</sup> The Spot month is defined as the contract month closest to expiry, except when there are 5 business days to expiry of the existing spot month. At this time, the next closest contract month to expiry becomes the spot month.

