

CIRCULAR



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**To: All Members
SYCOM Traders**

No: 323/98

Electricity Strip Trading

The Market Practices Committee (MPC) and the Screen Dealing Committee (SDC) have considered the issue of legging risk in trading Electricity Strips on SYCOM® and has found that Members are, at times, forced into a position of executing what are essentially prearranged trades.

This situation arises from the fact that the current SYCOM® system allows only the entry of a strip into the system in its individual legs, thereby exposing the Member to the risk of being hit on one leg only. In order to circumvent this risk, the only practical alternative available to Members is to pre-determine the price of each leg of the strip and find the opposite side before taking the orders to the market. However, such action compromises the Member's compliance with the Exchange's Rules regarding prearrangement, withholding and disclosure.

The SDC considered this issue and agreed that owing to the inadequacies of the current system, the trading of electricity strips on SYCOM® does expose Members to "legging risk".

In the absence of any viable alternative and until the introduction of SYCOM® IV which will allow for the trading of electricity strips (up to 4 legs), the MPC has agreed to a recommendation made by the SDC. The MPC has determined it is appropriate to extend the existing moratorium on the enforcement of the prearrangement, withholding and disclosure rules in so far as they relate to option strategy trades on SYCOM® to trading electricity swaps. This view has been taken in an effort to promote the electricity market. Accordingly, where breaches of these rules are identified no disciplinary action will be taken. However, the Surveillance Department will continue to monitor such trading and if abuses are identified resulting in participants being disadvantaged then the moratorium will be withdrawn.

Members should note however that there are still inherent limitations in the execution of these trades on market using SYCOM® in that there will still be a legging risk in the execution, together with the inability to execute a leg in front of standing bids and offers in the market. The practice which will be employed will be that Members with an interest will be required to send a message to the SYCOM® Control Centre indicating the interest and this will be onsent to the market place for consideration.

Should the initiating Member be hit on a leg during the subsequent execution of the strip, the Exchange will cancel the subject trade as the market place was aware of strip interest through the previous message. Initiating Members will also have to take into account the standing bids and offers in the market as they will not be able to jump the queue in the execution of the strip. Additional procedures regarding the trading of strategies and electricity strips on SYCOM® are contained within Screen Dealing Bulletin No. 17/98.

Bearing these limitations in mind, further investigation will be carried out to establish procedures

whereby participants will be able to trade strips and other strategies in excess of 4 legs off-market following notice to the market and a period of time in which other Members can participate.

Deborah Horne
GM - Compliance & Surveillance

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