



中国金融期货交易所

China Financial Futures Exchange

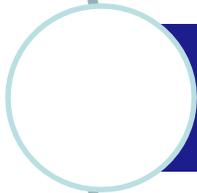
Presentation on Exchange of Futures for Physicals (EFP) on Chinese Government Bond Futures

January 2019

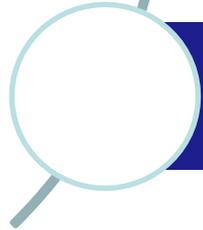
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EFP Overview



EFP Program Design

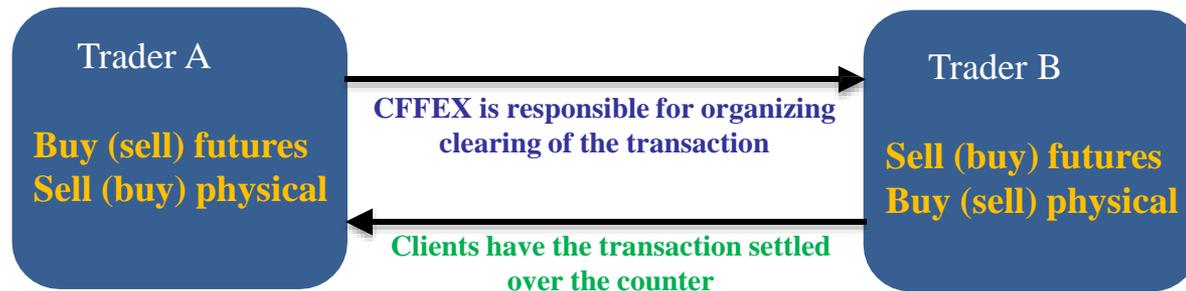


Amendments to Rules on EFPs

EFP Overview

I. Definition of EFP on Chinese Government Bond Futures

- Exchange of Futures for Physicals (EFP) :the transaction wherein, upon the mutual agreement of the parties thereto, one party is the buyer of the Exchange contract and the seller of corresponding securities or related contracts, and the other party is the simultaneous seller of the Exchange contract and the buyer of corresponding securities or related contracts.



- EFP's three characteristics:
 - An EFP transaction involves both the futures and physical legs;
 - The futures leg can be used to close out and open positions;
 - The futures and physical transactions are entered into simultaneously through negotiation.

II. Necessity of EFP on Chinese Government Futures

EFP on Chinese government bond futures is an important improvement to the existing market mechanism

As an effective complement to the delivery system, it helps to prevent delivery risks

The simultaneous execution of futures and physical transactions promotes the risk management function

It helps to avoid the impact of large orders on the market and maintain a stable market

It broadens the range of trading strategies and helps to expand the market and institutional investor base

III. EFP Permitted by Domestic and Foreign Exchanges

Exchange	Country
Dalian Commodity Exchange	China
Shanghai Futures Exchange	China
Zhengzhou Commodity Exchange	China
Multi Commodity Exchange of India	India
Eurex	Europe
CME Group (CME, CBOT, COMEX, NYMEX)	America
Cboe Global Markets (CBOE, CFE)	America
ICE Data Service (ICE Futures US, ICE Futures Europe, ICE Futures Canada)	America
Nasdaq OMX (Nasdaq OMX PHLX, Nasdaq OMX Boston)	America
TMX Group	Canada
Australian Stock Exchange (ASX)	Australia

IV. Volume of Off-book Trades in Foreign Financial Derivatives

- The percentage of off-book trades is less than 5% at CME

Year	Interest rate	Equity	Forex
2015	3%	0.45%	1%
2016	4%	1%	1%
2017	4%	1%	1%
Mean	3%	1%	1%

Source: CME Group's website

- The percentage of off-book trades at Eurex

Year	Interest rate	Equity	Forex
2015	20%	37%	0%
2016	16%	37%	0%
2017	17%	38%	0%
Mean	17%	37%	0%

Source: Eurex's website

V. Volume of EFP Transactions on Domestic Commodity Futures

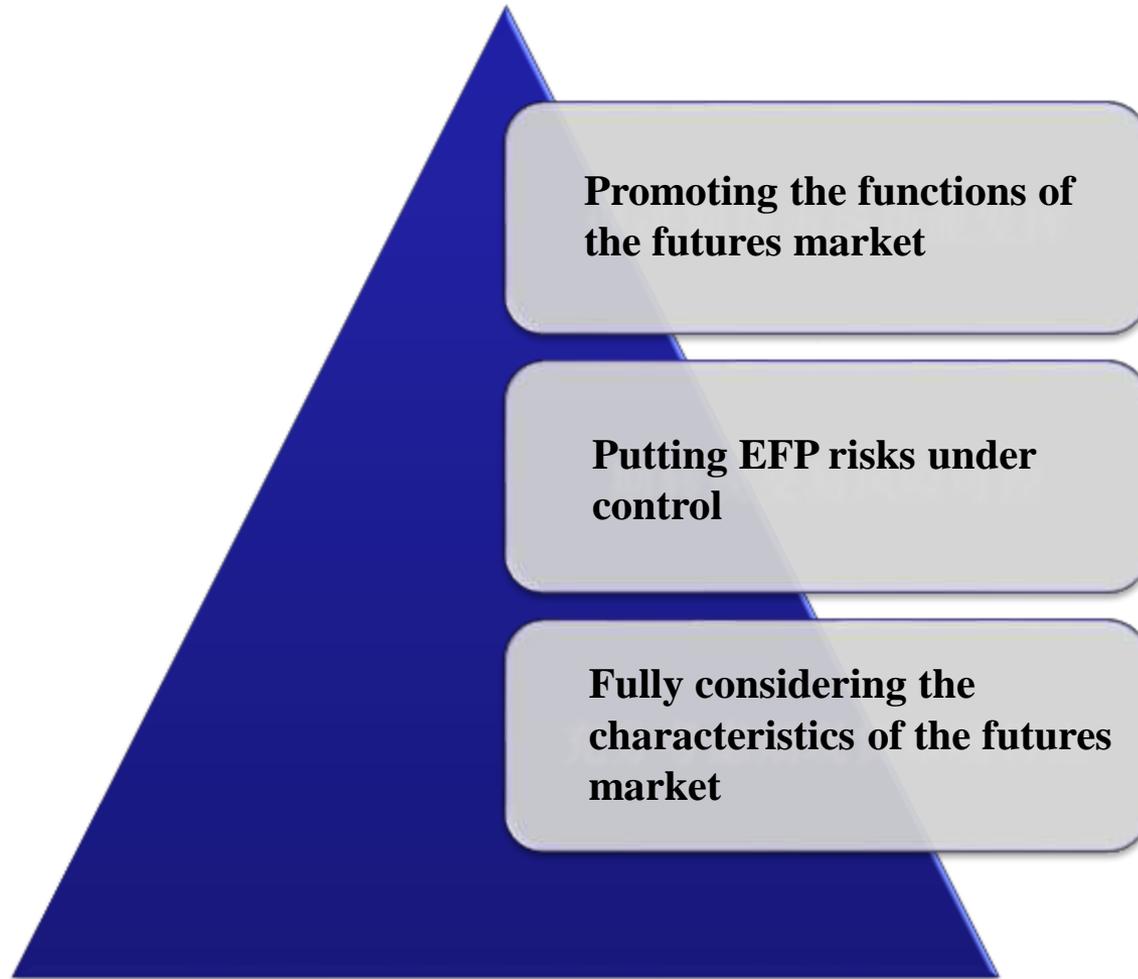
Percentage of EFP Transactions on Domestic Commodity Futures in 2017

Exchange	Shanghai Futures Exchange	Zhengzhou Commodity Exchange	Dalian Commodity Exchange
EFP Volume	9,578	40,008	2,049
Trading Volume (excluding EFP volume)	1,364,243,528	584,577,755	1,101,280,152
Physical Delivery Volume (excluding EFP volume)	674,584	324,492	224,071
Ratio of EFP Volume to Trading Volume	0.0007%	0.0068%	0.0002%
Ratio of EFP Volume to Delivery Volume	1.42%	12.31%	0.91%

Source: Their websites

EFP Program Design

I. Principles for Design of EFP on Chinese Government Bond Futures



II. Pre-EFP Management

To enhance pre-EFP management, the following two measures have been adopted:



- Effective from January 2, 2019, the Exchange began to accept registration applications from members and participants
- Information about members providing EFP services is available at:
<http://www.cffex.com.cn/qzxhyxx/>

(I) Member Registration Management

- EFP transactions at the Exchange shall be conducted through **clearing members** who meet the requirements of the Exchange for EFP services. A member who intends to provide EFP services shall meet the following requirements:

having the personnel necessary to facilitate EFP transactions

having the technical systems necessary to facilitate EFP transactions

having sound EFP management systems

meeting other requirements as prescribed by the Exchange

- A member who intends to register with the Exchange for EFP services shall submit the following documents to the Exchange via the **member service system**

Registration Application

Statement on Preparedness

other documents or materials as required by the Exchange

(II) Participant Registration Management

■ **To enter into an EFP transaction, a client shall meet the following requirements:**

- (1) be a securities company, fund management company, trust company, bank or other financial institution, or a social security company, qualified foreign institutional investor (QFII) or any other special institutional client that is required by laws, administrative regulations, or ministry-level rules to manage assets in separate accounts;
- (2) be permitted to trade Chinese government bond futures contracts on the Exchange;
- (3) have opened a bond account at China Central Depository & Clearing Co., Ltd. or a securities account at China Securities Depository and Clearing Co., Ltd; and
- (4) meet other requirements prescribed by the Exchange.

(II) Participant Registration Management

■ EFP participant registration management

- Securities companies, fund management companies, trust companies, banks and other **financial institutions** shall directly register with the Exchange through their carrying members
- **Management institutions** of social security companies, qualified foreign institutional investors (QFIIs) and other special Institutional clients that are required by laws, administrative regulations and ministry-level rules to manage assets in separate accounts shall register with the Exchange through their carrying members

Registration Application

the member's letter of undertaking for providing EFP services or the brokerage contract containing an undertaking for providing EFP services; and

other documents or materials required by the Exchange

- Members shall submit participant registration materials via the **member service system** and duly review such materials to ensure they are truthful, accurate, and complete

III. EFP Program Design

Restrictions on execution of EFP transactions by their participants

Scope of eligible marketable securities and related contracts

Trading venues for the physical leg

Range of execution price

Criteria for the equivalence of the value of the futures and physical

Reporting and confirmation of EFP transactions

Time window for reporting and confirmation of EFP transactions

Clearing, fees and EFP information disclosure

Examination and supervision for authenticity of EFP transactions

(I) Scope of Eligible Marketable Securities or Related Contracts

■ Eligible Marketable securities or related contracts include

1. Book-entry treasury bonds with a fixed coupon rate;
2. Book-entry local government bonds with a fixed coupon rate;
3. Book-entry financial bonds with a fixed coupon rate issued by the China Development Bank, Agricultural Development Bank of China, or Export-Import Bank of China;
4. Bond forwards with the foregoing bonds as the underlying; and
5. Other marketable securities or related contracts prescribed by the Exchange.

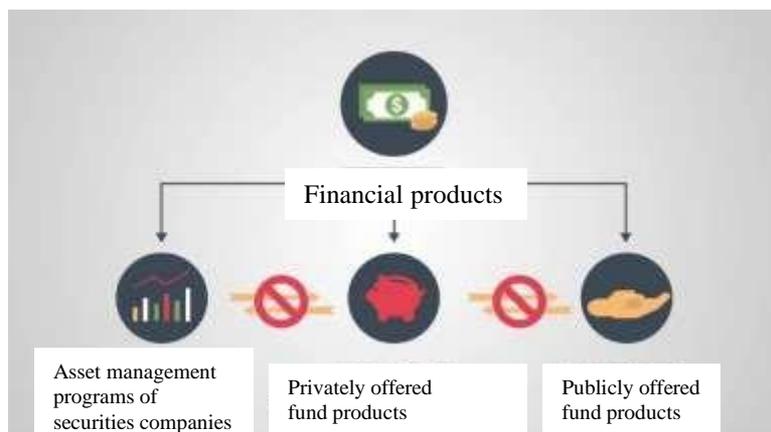
Where Chinese government bond futures are exchanged for corresponding bond forwards in an EFP transaction, the settlement date of such bond forwards shall be no later than the last trading day of the Chinese government bond futures contract.

(II) Trading Venues for the Physical Leg

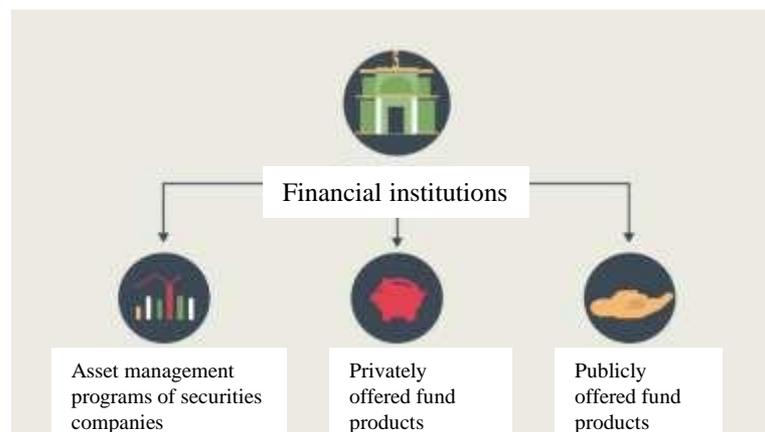
- **The physical or related contracts traded on the following markets are eligible for EFP transactions on Chinese government bond futures:**
 - Shanghai Stock Exchange and Shenzhen Stock Exchange
 - Interbank market

(III) Restrictions on Execution of EFP Transactions by Their Participants

- The participants of EFP transactions on Chinese government bond futures include: financial institutions and their separately managed products.
- Restrictions on execution of EFP transactions:
 - Non-corporate clients, such as asset management programs of securities companies and fund management companies as well as private investment funds registered with the Asset Management Association of China, shall not enter into any EFP transactions directly with each other.

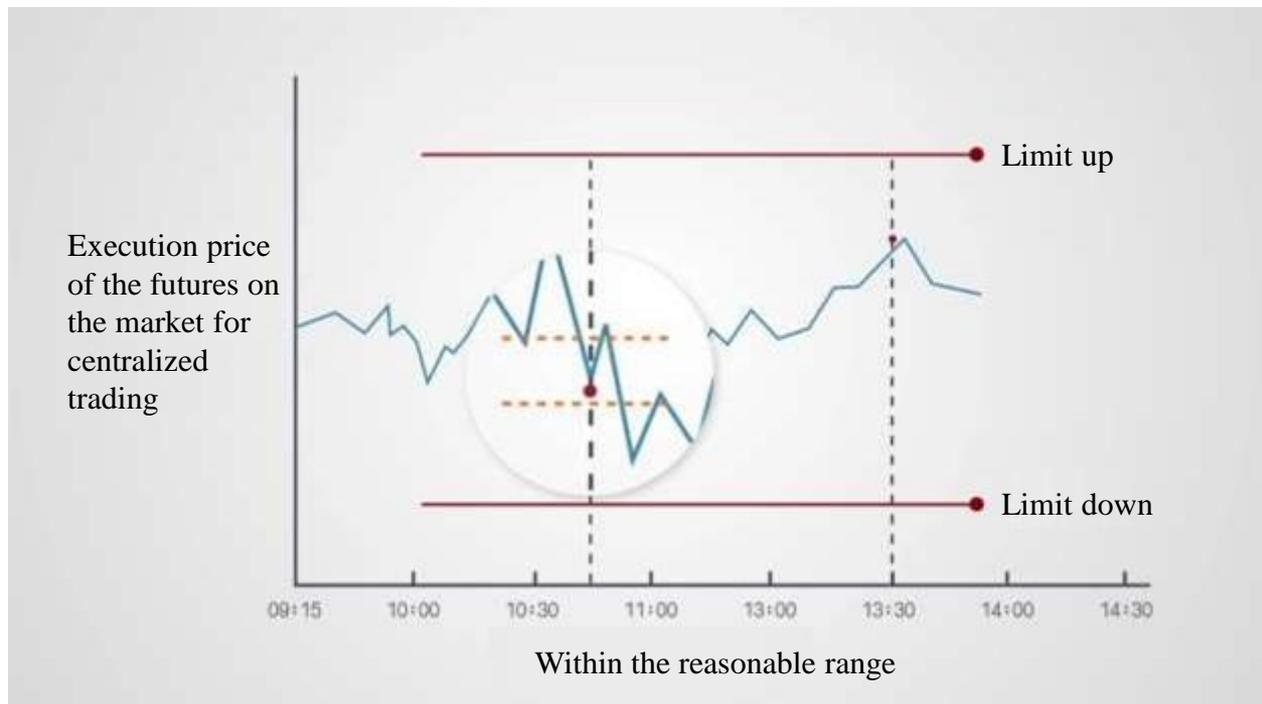


Shall not directly enter into EFP transactions



(IV) Range of Execution Price of EFP Transactions

- In an EFP transaction on Chinese government bond futures, the execution price of the futures leg shall be determined upon mutual agreement of the parties thereto, provided that such price shall be within the **price fluctuation limit** of the futures on the day the EFP transaction is confirmed by the Exchange and shall not unreasonably deviate from the prevailing market price of the Exchange-traded futures **at the time when the mutual agreement was reached**



(IV) Range of Execution Price of EFP Transactions

- **Execution price of the futures leg of an EFP transaction on Chinese government bond futures**
 - An EFP report, with the execution price of the futures leg exceeding the price fluctuation limit of the futures on the day the EFP transaction is confirmed by the Exchange, cannot be submitted
 - An EFP transaction with an unreasonable execution price of the futures leg will possibly be confirmed by the Exchange, but the relevant department of the Exchange will receive an alert and conduct a subsequent examination on the reasonableness of the execution price
 - In addition, the Exchange will compare investors' future and physical prices with the prevailing market prices

(V) Criteria for Equivalence of the Value of the Futures and Physical

■ Criteria for Equivalence of Value:

A basket of deliverable Chinese government bonds	Equivalence of risk value: Lots of traded futures \times Chinese government bond futures' DV01 \approx Physical's DV01 Equivalence of face value: Lots of traded futures \times Face value of Chinese government bond futures contract = Physical's face value
Other non-deliverable cash bonds	Equivalence of risk value: Lots of traded futures \times Chinese government bond futures' DV01 \approx Physical's DV01

- An ex ante examination of equivalence of face value will be conducted on the EFP report page
- The Exchange will not perform an ex ante examination of equivalence of risk value between the futures and physical. After the EFP transaction is entered into, the Exchange will perform an ex post verification of equivalence of risk value

(VI) Reporting and Confirmation of EFP Transactions

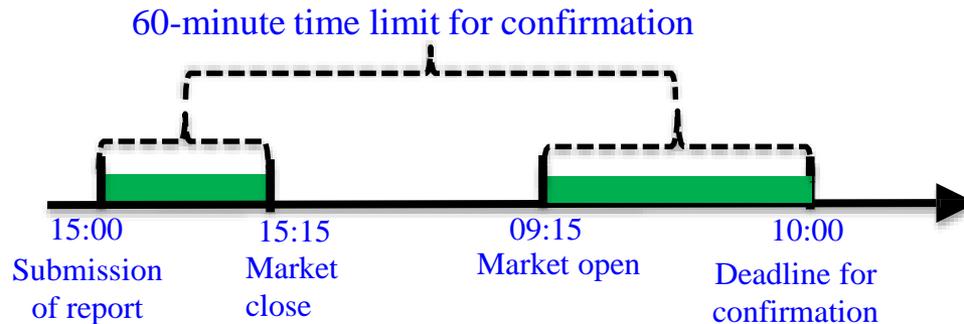
■ Contents of an EFP Report

	Contents
Transaction time and participant information	Date and time when an EFP transaction is agreed upon; seller's trader number, seller's trading code, buyer's trader number, buyer's trading code, money broker's name and number (if any)
Details of futures leg	Code, execution price, trading direction, opening and closing direction, quantity, and matching method (matching of face value or risks) of the futures contract
Details of physical leg	Name, code, transaction date, trading direction, net execution price and notional value of the bonds and the deal ticket number at the China Foreign Exchange Trade System & National Interbank Funding Center or a stock exchange

- A single EFP transaction on Chinese government bond futures may incorporate **one or multiple** transactions in marketable securities or related contracts, but **the trading directions of the bonds must be the same**

(VI) Reporting and Confirmation of EFP transactions

- An EFP transaction shall be initiated, entered into system, and submitted by the seller of the futures contract, and then, within 60 minutes, confirmed and sent to their carrying members by the buyer of the futures contract. After examining the risk control for such EFP transaction, their members shall submit an EFP report to the Exchange. The EFP report is only valid on the day of submission.



- An EFP transaction shall take effect upon being confirmed by the Exchange and the parties thereto shall acknowledge the transaction result and perform their obligations. Upon confirming the EFP transaction, the Exchange will make **real-time intraday** adjustment to the positions and margin of the parties and send the execution confirmation to the parties in accordance with relevant rules.
- An EFP transaction is invalid without confirmation by the Exchange, in which case the parties thereto shall properly resolve the physical leg involving market securities and other related contracts.

(VII) Time Window for Reporting and Confirmation of EFP Transactions

- From the listing day of the contract to the trading day preceding the last trading day
- Time window for reporting and the Exchange's confirmation of EFP transactions

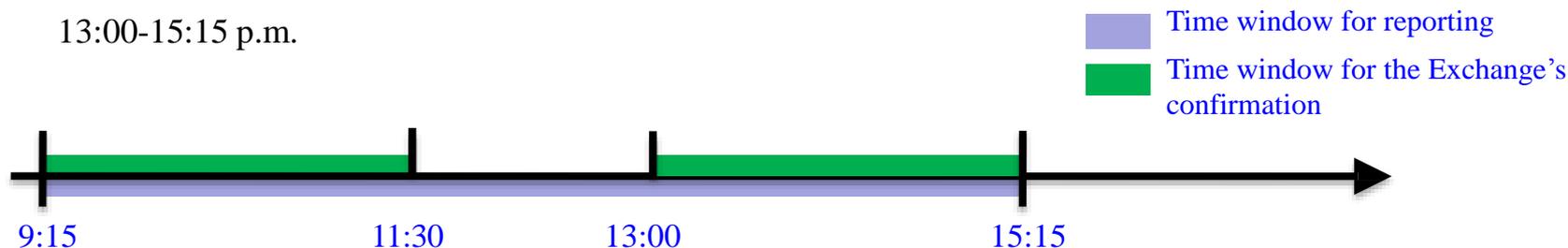
- Time window for reporting: including noontime

9:15 a.m.-15:15 p.m.

- Time window for the Exchange's confirmation: consistent with that for continuous auction of Chinese government bond futures

9:15-11:30 a.m.

13:00-15:15 p.m.



■ Reporting on T+1 day:

- The seller of the futures contract shall report the EFP transaction no later than 10:15 a.m. on the trading day immediately following the transaction day of marketable securities or other related contracts
- An EFP transaction cannot be reported on the last trading day of the futures contract

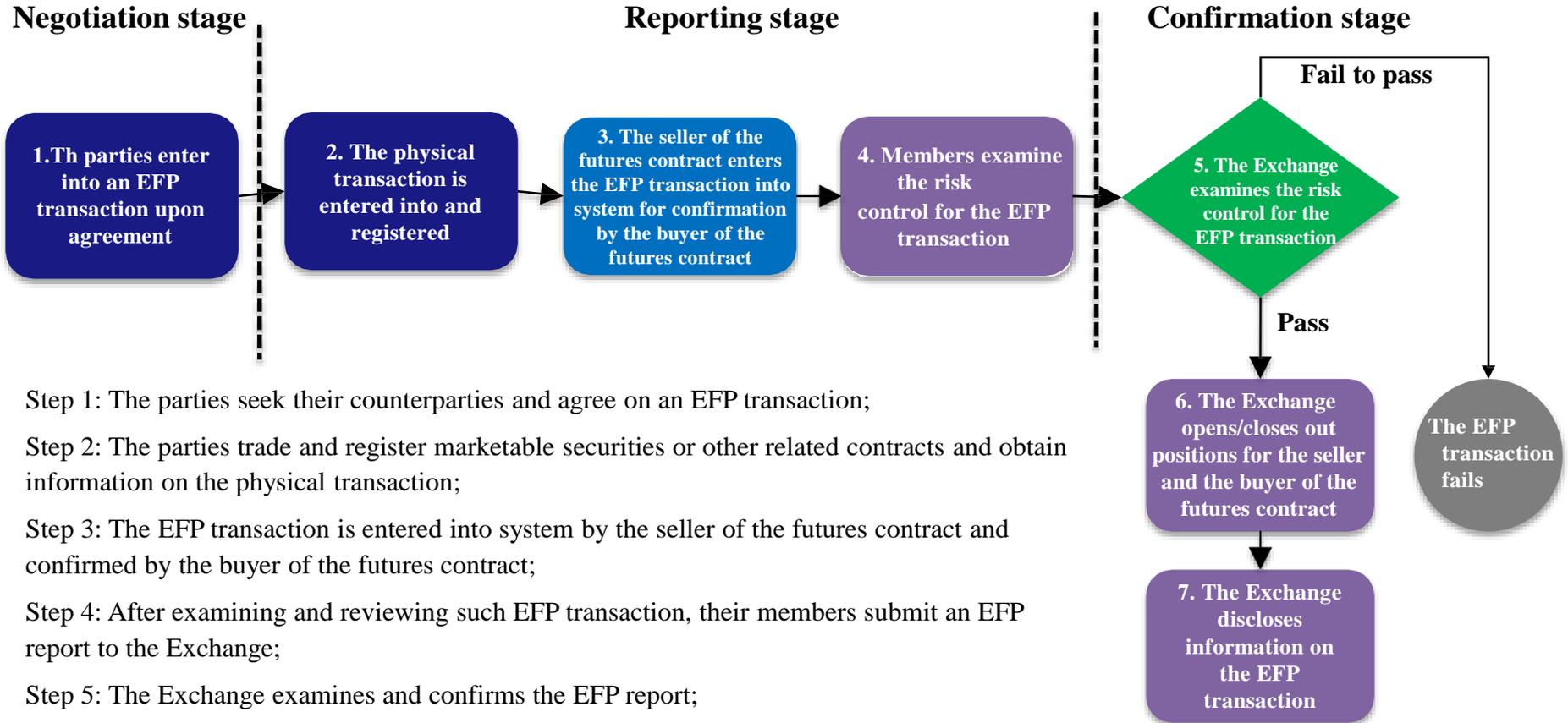
(VIII) Clearing, Fees and Information Disclosure

- **The Exchange's clearing responsibility is limited to the futures leg and does not cover the physical leg.**
- **Clearing of the futures leg:**
 - **Price:** the execution price of the futures leg of an EFP transaction shall be excluded when calculating opening price, closing price, high price, low price and settlement price.
 - **Trading volume and turnover:** they shall be included into the daily total trading volume and turnover.
 - **Open interest:** it shall be aggregated with other open interest established in other trading methods and shall be updated in real time during trading sessions.
- **Execution information disclosure:**
 - The trading volume, turnover and open interest of the futures leg of an EFP transaction shall be included into the daily **total trading volume, turnover and open interest** and published together with the real-time market data of the futures contract upon the Exchange's confirmation of the EFP transaction.
 - Information on each EFP transaction, including **contract code, date and time of Exchange confirmation, and trading volume**, shall be disclosed on the official website of the Exchange.
- **Fee standard for EFPs:** Same as that for centralized trading

(IX) Examination and Supervision For Authenticity of EFP Transactions

- The Exchange has the right to supervise EFP transactions and examine the corresponding transactions of marketable securities or other related contracts.
- Members shall review the materials relating to EFP transactions and properly retain relevant documentations including records of the transactions, trading records of the marketable securities or other related contracts, and ownership transfer certificates, to prevent the divulgation or misuse of EFP transactions data. Such documentations and records shall be kept for a minimum of 20 years for potential future inspection by the Exchange.
- The Exchange will conduct a non-periodic examination of the following records related to an EFP transaction (affixed with the common seals of the parties thereto) :
 - Record of negotiations
 - Deal ticket
 - Delivery ticket

Summary of EFP Procedures



Step 1: The parties seek their counterparties and agree on an EFP transaction;

Step 2: The parties trade and register marketable securities or other related contracts and obtain information on the physical transaction;

Step 3: The EFP transaction is entered into system by the seller of the futures contract and confirmed by the buyer of the futures contract;

Step 4: After examining and reviewing such EFP transaction, their members submit an EFP report to the Exchange;

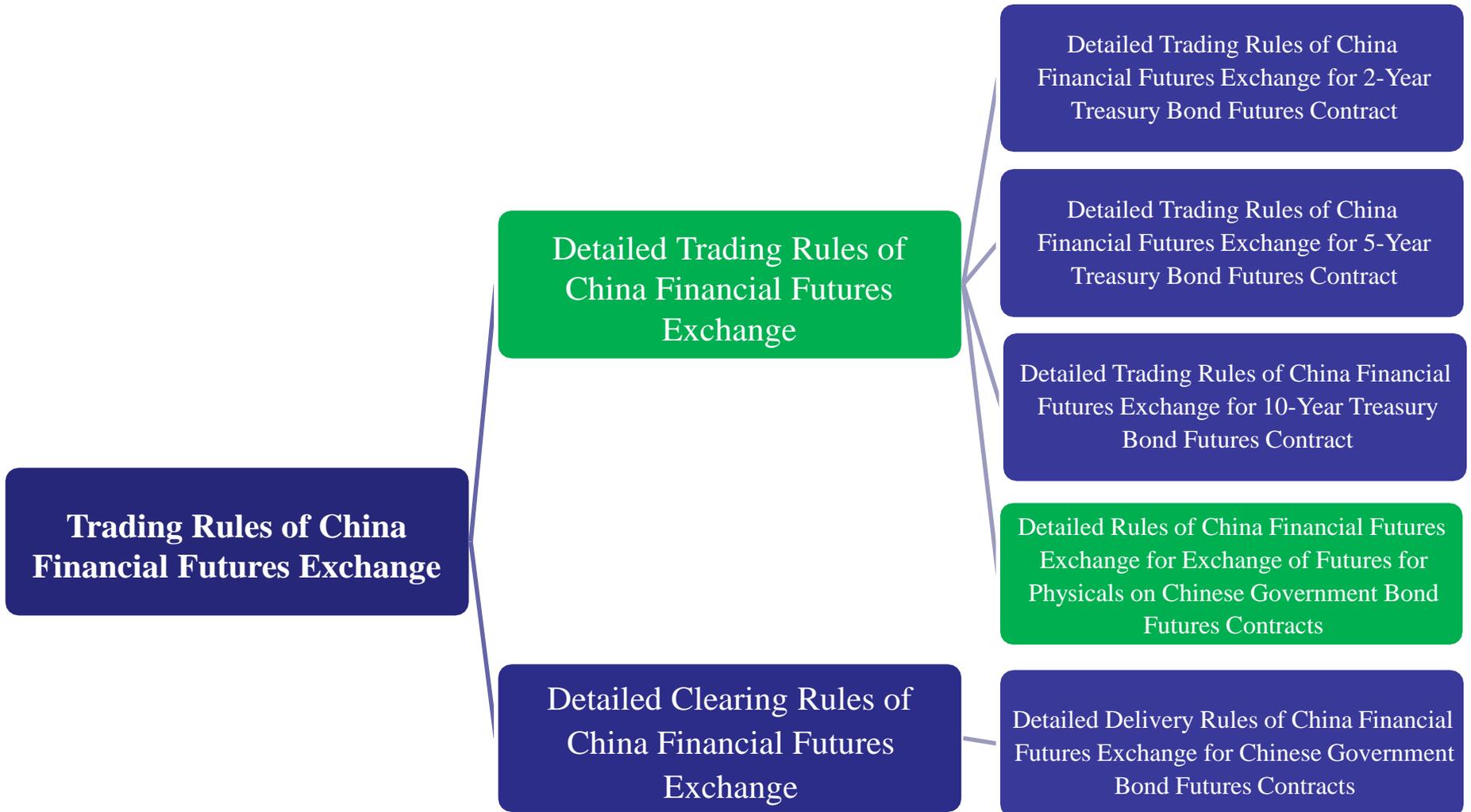
Step 5: The Exchange examines and confirms the EFP report;

Step 6: After the EFP transaction becomes effective upon being confirmed by the Exchange, the Exchange opens and closes out the positions of the parties and adjust their margin according to the quantity of the traded futures contract as reported by the parties;

Step 7: The Exchange discloses information on the EFP transaction.

Amendments to Rules on EFPs

Amendments to Applicable Rules



For more information on EFP, please scan the following QR code to visit the Innovation Column in the Investor Education section on the official website of CFFEX



CFFEX's official website

<http://www.cffex.com.cn/ywjs/>

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期转现交易咨询
电话：021-50160299
传真：021-50160298
邮件：zixun@cffex.com.cn

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