PBOT PHILADELPHIA BOARD OF TRADE

This circular replaces PBOT Circular 14-07-R, which is withdrawn.

EFP Eligible Futures Contracts: Currency Futures Contracts

Designated Contracts

Through this Notice to Members and pursuant to the Philadelphia Board of Trade ("PBOT") Rule E38, PBOT designates currency futures contracts as being Exchange of Futures for Physicals ("EFP") eligible. The Euro Currency Future and British Pound Currency Future contracts, currently listed, are EFP eligible. Any new currency futures contracts listed by the PBOT will also be EFP eligible.

EFP characteristics

An EFP involves simultaneous transactions in the futures and cash commodity markets. The futures market transaction consists of a noncompetitive transfer of a futures position between the parties to the EFP. Thus one party buys the physical commodity and simultaneously sells (or gives up a long) futures contract while the other party sells the physical commodity and simultaneously buys (or receives a long) futures contract.

EFPs on the PBOT must be *bona fide*. The Commodity Futures Trading Commission ("CFTC") has stated that for an EFP to be *bona fide* it must have the following three essential elements: (i) a futures transaction and a cash transaction which are integrally related; (ii) an "exchange" of futures contracts for cash commodity, where the cash commodity contract provides for the transfer of ownership of the cash commodity to the cash buyer upon performance of the terms of the contract, with delivery to take place within a reasonable time thereafter in accordance with prevailing cash market practice; and (iii) separate parties to the EFP, where the accounts involved have different beneficial ownership or are under separate control. The CFTC has also identified other indicia to be considered in determining whether an EFP is *bona fide*. These include: (i) the degree of price correlation between the futures and cash legs of the EFP; (ii) the prices of the futures and cash legs of the EFP and their relationship to the prevailing prices in their respective markets; (iii) whether the cash seller has possession, the right to possession, or the right to future possession of the cash commodity prior to the execution of the EFP; (iv) the cash seller's ability to perform on his delivery obligation in the absence of prior possession of the cash commodity, i.e., the cash seller's access to the cash market; and (v) whether the cash buyer acquires title to the cash commodity.

Member firms may facilitate, as principal, the cash commodity component of an EFP on behalf of a customer provided that the member firm can demonstrate that the cash commodity transaction was passed through to the customer that received the futures position as part of the EFP.

In EFP transactions, the associated cash product must be the commodity underlying the futures contract or a derivative, by-product, or related product that is reasonably correlated to the futures being exchanged. The parties to the transaction may be required to demonstrate that the cash and futures products being exchanged are reasonably correlated.

The futures exchanged in an EFP must be outright futures contracts. Futures combinations are not a permissible component of an EFP. The quantity of futures exchanged must be approximately equivalent to the underlying quantity of the cash product being exchanged. The parties involved may be required to demonstrate such equivalency.

Transitory EFP characteristics

EFPs in foreign currency futures where the parties immediately offset the cash leg of the transaction separate from the EFP are called "Transitory EFPs." Unlike other EFPs, Transitory EFPs involve a cash transfer immediately prior to (or simultaneously with) an EFP in which the cash position acquired is reconveyed incident to the EFP. The transfer of ownership (title) of the cash commodity is a key indicator as to the *bona fide* quality of a Transitory EFP. The cash transfer must be able to stand on its own (be severable) as a commercially appropriate transaction, with no obligation on either party to carry out the EFP.

Prohibited EFP practices

EFP transactions shall not be used to circumvent traditional order flow and access.

Contingent EFPs are prohibited. A contingent EFP is a transitory EFP in which the EFP and the cash transfer, are tied together so that the cash transfer cannot stand on its own and where title is not transferred in the initial cash market. In a contingent EFP the transactions are not severable but are contingent upon each other.

The terms and structure of the cash portion of the transaction should be substantially the same in all material respects as other cash commodity transactions in the market in order to avoid characterization of the EFP as a contingent EFP. By way of illustration:

- If the price of the cash commodity is not determined in the same manner as for other cash market transfers engaged in by the participants, the cash transfer may not be commercially appropriate apart from the EFP.

- If a lower level of capitalization is required of the customer for the cash transfer than would normally be required to engage in cash market transactions with the opposite party, there would be an indication that there was no intended cash transfer but rather that the cash purchase and sale was used as a pretext for establishing a futures position.

EFP Documentation

Member and Member firms must fully document Foreign Currency Futures EFP transactions. All documents typically generated in accordance with cash market conventions must be generated and retained. EFP confirmations should at a minimum include: identification of all cash and futures legs of the EFP, the name and or identity of the counterparty principal to the transaction, the account controller, or any other Person acting on behalf of a third party, the name of the third party's Carrying Clearing Member and the third party's account number (or other account specific documentation).

The execution time (representing the actual time the negotiation was concluded) shall use Eastern Time (ET) and the corresponding date for reporting purposes.

Records of the cash portion of EFP transactions must be readily available for SRO audit purposes.

Permissible Counterparties

EFPs may be executed between two accounts provided that one of the following applies:

- The accounts have different beneficial ownership.
- The accounts have the same beneficial ownership, but are under separate control.
- The accounts are commonly controlled, but involve separate legal entities, which may or may not have the same beneficial ownership.

In cases where the parties to a transaction involve the same legal entity, same beneficial owner, or separate legal entities under common control, the parties must be able to demonstrate that the EFP was a legitimate arm's length transaction.

The term "same beneficial ownership" refers to a parent and its wholly owned subsidiaries or subsidiaries that are wholly owned by the same parent.

If you have questions regarding this circular, please contact Dennis Boylan at the PBOT Market Operations Desk at 888-353-8114