

SFE NOTICE NO. 59/06

Date of Issue: 1 June 2006  
Effective Date: 1 June 2006

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## SFE New Zealand 90 Day Bank Bill Futures – Market Information Update

### JUNE 2006 CONTRACT EXPIRY

The June 2006 expiry of the SFE New Zealand 90 Day Bank Bill Futures contract takes place on Wednesday 14 June, 2006 at 12:00 noon (New Zealand time). The settlement price for this contract is drawn from the 3-month FRA settlement rate published on the Final Trading Day by the New Zealand Financial Markets Association (NZFMA). The price is disseminated, amongst other data vendors, by Reuters on page 'BKBM' (the name by which the rate fix is commonly known.)

The Exchange wishes to ensure that its Participants are aware of the potential for increased price volatility at futures expiry. As a result, Participants may wish to advise their clients, particularly retail clients, of the issues involved.

During some recent quarterly SFE New Zealand Bank Bill (NZBB) futures expiries, characteristics and constraints particular to the underlying physical bank bill market have led to price movements during the period in which the futures expiry settlement price is determined. In light of continuing strong growth in NZBB futures volumes and open interest, similar potential for increased volatility exists for upcoming futures contract expiries and market users who are unwilling to accept the risk of such volatility should look to roll or exit futures holdings prior to each contract expiry.

### NZBB REVIEW PROCESS

As Participants may be aware, in late 2005 the Exchange commenced a review of its NZBB contract which included discussions with the NZFMA. The objective of the review was to identify enhancements to the settlement process in order to preserve the integrity of the NZBB futures contract.

As part of its review, the Exchange considered the following enhancements:

- **Adoption of an alternative rate set mechanism to the 'BKBM'**  
This would involve identifying an alternate OTC product or independently-sourced rate fix that would meet the Exchange's requirements for the NZBB expiry price calculation;
- **Introduction of a new deliverable contract and progressive de-listing of the NZBB**  
This would replace the existing cash-settled product and, by being physically delivered, would not require the use of the 'BKBM' price;
- **Listing of an Official Cash Rate futures contract**  
The new contract would be based on the New Zealand Official Cash Rate to provide an additional and complimentary hedge mechanism for users to manage short-term New Zealand interest rate risks; and

- **Implementation of Expiry Position Concentration Limits (EPCL)**

Similar to the EPCL already in place for the SFE Commonwealth Treasury Bond futures contracts,<sup>1</sup> the EPCL would be applicable at the close of trading on the day prior to expiry and enforceable intra-day for the contract's remaining life (i.e. during the last trading day). Applicable to all market users,<sup>2</sup> the EPCL would be defined in numbers of net open spot month positions and would also be subject to ongoing review, relative to prevailing market conditions.

## CONCLUSIONS OF THE REVIEW

With the increasing levels of trading and open interest in the NZBB contract, the Exchange considers it necessary to implement enhancements for the September 2006 expiry. However, the limited size, limited turnover and lack of fungibility of physical issuance and the absence of an alternative rate setting mechanism suggests that neither the introduction of a deliverable contract, nor the use of an alternative mechanism are feasible. With this in mind, and having given due consideration to the practicality of the options described above, the Exchange intends to take the following actions:

1. **List the SFE New Zealand Official Cash Rate Futures Contract in August 2006**

Further details regarding contract specifications and the listing date will be provided in due course. The transaction fee will be set at NZ\$1.75 per side (ex GST), which is lower than the current NZBB transaction fee of NZ\$2.00 per side (ex GST).

2. **Introduce EPCL following the September Expiry**

Following the September 2006 expiry, EPCL will be introduced and will take effect for the December 2006 expiry. Further details on the operation of EPCL and initial limit levels will be provided in due course. The EPCL will supplement existing quarterly surveillance procedures and will assist the management of any position concentration which has the potential to impact the orderliness of the expiry process.

Whilst the introduction of such limits should represent no constraint on the trading activities of the vast majority of market users, the Exchange acknowledges that the EPCL for the NZBB contract will likely be set at a level which may impact upon some users' current expiry-day holdings. However, consistent with its licence obligations as the market operator and supervisor, the Exchange currently considers the introduction of EPCL as a necessary measure to enable effective ongoing management of the NZBB.

## POSSIBILITY OF ALTERNATIVE ACTION

The Exchange wishes to provide every opportunity for the market to identify an effective alternative to the EPCL measures. Any further option(s) that can be practically implemented in time for the December expiry will be given serious consideration, provided that submissions are made to the Exchange no later than 30 June 2006. SFE continues to work with NZFMA and the Australian Financial Markets Association (AFMA) in this regard.

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<sup>1</sup> Refer to SFE Bulletin 47/04 for additional indicative context and detail on EPCL.

<sup>2</sup> The EPCL will be imposed at the level of trading by a corporate entity, subject to potential granting of an exemption in appropriate circumstances – where, for example, trading is conducted by two arms of an entity for separate purposes with firm chinese walls between them.

In the meantime, should you have any queries in relation to the launch of the SFE New Zealand Official Cash Rate Futures contract, please contact Maurice Farhart on +612-9256-0483 or at [mfarhart@sfe.com.au](mailto:mfarhart@sfe.com.au) .

Should you have any queries in relation to the proposed Expiry Position Concentration Limits, please contact Nick Gaut on +612-9256-0414 or at [ngaut@sfe.com.au](mailto:ngaut@sfe.com.au) .



Anne T. Brown  
General Manager, Risk and Compliance

SFE Corporation Limited  
30 Grosvenor Street  
Sydney Australia  
+612 9256 0555  
[www.sfe.com.au](http://www.sfe.com.au)  
ABN 74 000 299 392