Block Trade Fundamentals

Various global exchanges permit their market participants to enter into Block Trades subject to specific rules set by the relevant exchange and regulators. As demand for Block Trades has increased, firms have expressed an increasing need to understand Block Trades and to be conversant with clients and other market participants in this type of transaction. To assist firms, this document identifies certain general characteristics and requirements that may govern a firm's execution of Block Trades, as well as potential good practices in relation to such activities. In preparing this document, we have consulted the public rules and guidance of CME Group and ICE Futures Europe exchanges, where Block Trades in derivatives are commonly executed in the United States and Europe. It is important to recognise that Block Trades are subject to specific rules of the relevant exchange and applicable laws and regulations. Market participants therefore should carefully consult applicable rules, laws and regulations before facilitating or engaging in Block Trades.[1]

1. What is a Block Trade?

A Block Trade is a privately negotiated futures, options or combination transaction[2] that meets certain quantity thresholds as predetermined by an exchange or trading venue and that therefore may be executed away from the central marketplace under applicable regulations. Block Trades are traded bilaterally, with a customer typically asking another party to make a market for a specified number of contracts above the Block Trade volume threshold, and subsequently reported to the exchange for clearing purposes.

2. What General Requirements Apply to Block Trades?

Exchanges have specific rules governing Block Trades. In general, Block Trades are subject to certain eligibility, disclosure, price, volume threshold, time of execution, reporting and books and records requirements. We summarise these requirements below:

- **ELIGIBILITY:** Some exchanges only permit members to facilitate Block Trades. Accordingly, parties wishing to negotiate, execute, or report Block Trades should refer to the relevant exchange regulations for applicable eligibility requirements.

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[1] DISCLAIMER: This document is provided for informational purposes only and does not constitute legal advice or a full description of the applicable legal or regulatory requirements of Block Trades. Accordingly, it remains incumbent on each member firm and/or market participant to independently assess the applicability of relevant rules, as well as applicable laws and regulations, and the appropriate application of this document when measured against its business profile (principal or agency trading) and trading strategy. Although care has been taken to assure that the contents of this document are accurate as of the date of issue, FIA specifically disclaims any legal responsibility for any errors or omissions and disclaims any liability for losses or damages incurred through the use of this document. FIA undertakes no obligation to update this document following the date of issue.
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[2] As used here, a "combination transaction" refers to a trade which consists of two or more contract months from the same instrument or different instruments. Note that some exchanges have rules about which combinations are permissible as a Block Trade. Market participants should consult the exchange rulebook as appropriate.

- **DISCLOSURE:** Parties involved in the solicitation and negotiation of Block Trades may not disclose details of those negotiations to any other party, other than to facilitate the execution of the Block Trade, unless otherwise specified in the exchange rules.
- **PRICE:** On each occasion when negotiating Block Trades, parties must inform the customer that the price being quoted relates to a Block Trade, and not the prevailing market price. Block Trades must be transacted at prices that are deemed fair and reasonable given the level of risk that a party is engaging in to provide the other side of the Block Trade. Block Trades must adhere to the minimum tick and price validation requirements of the relevant exchange and may not be split unless prescribed in the exchange rules.
- **VOLUME THRESHOLD**: Block Trades must meet the minimum volume thresholds, and parties may not aggregate separate customer orders to achieve the required minimum threshold.
- **TIME OF EXECUTION:** Execution occurs when material terms are agreed and usually triggers the counterparties' respective reporting obligations. Counterparties to a Block Trade may start to hedge or offset risk following the execution of the Block Trade. Pre-hedging may be permitted under certain circumstances (see Section 4).
- **REPORTING:** Block Trades must be reported within the prescribed time period and via the price reporting method specified by the relevant exchange. Generally the seller (unless otherwise agreed to by both parties to the Block Trade) or, in the case of a brokered transaction, the broker (agent) facilitating the Block Trade must report each Block Trade before the mandated deadline. The reporting method varies by exchange (*e.g.*, via phone, exchange electronic Block Trade reporting facility, or e-mail).
- **BOOKS AND RECORDS**: Documentation and accurate records must be created and maintained pursuant to specific exchange and regulatory requirements. The time of execution of the Block Trade must be recorded. Paper or electronic order tickets (which may be negotiated via an electronic messaging system) are typically sufficient to meet exchange requirements for order ticket requirements.

  Block Trade order tickets may differ according to specific exchange and regulatory requirements, but typically should:

  - Clearly identify the trade as a Block Trade; and
  - Contain a minimum of three time stamps, namely:
    a) When a firm order is received;
    b) When the Block Trade is executed; and
    c) When the trade was reported to the exchange.

  Block Trades books and records should be treated in the same way as all other books and records for an exchange and should be retained for the appropriate time period according to specific exchange and regulatory requirements.

3. Are Pre-Execution Discussions Permitted?

Only with the permission of the customer may a party negotiating Block Trades on their customer's behalf disclose the identity of the customer to potential counterparties, including the counterparty with which the Block Trade is executed.

- **Two-sided quote**: A person solicited to provide a two-sided market for a Block Trade is not deemed to be in possession of material non-public information, provided that the side of market interest is not disclosed in the context of the solicitation or otherwise known.
- **One-sided quote**: A person privy to the direction of a Block Trade is considered to be in possession of material non-public information. This person is prohibited from trading in the same product or a closely-related product, for the purpose of taking advantage of such information, prior to the details of the

Block Trade being disseminated to the marketplace by the relevant exchange, or the information otherwise being demonstrated to have become stale or obsolete, unless exchange rules expressly allow otherwise (see next section).

4. Is it Permissible to Pre-Hedge or Offset Risk Associated with Block Trades?

Under certain circumstances, depending on applicable exchange rules, pre-hedging or anticipatory hedging (including offsetting risk) of any portion of a Block Trade may be permissible.

As of the publication of this document, there are various exchanges including CME Group[3] which permit a counterparty to a potential Block Trade to pre-hedge a position that they believe in good faith will result from the consummation of the Block Trade when the party will be acting in its principal capacity to make a market for the Block Trade.

In assessing whether pre-hedging is permissible, parties should consider whether they are acting in a principal or agency relationship in the relevant Block Trade transaction, and should follow any exchange guidance regarding what may or may not be allowed under that relationship, including any impact that acting as an agent may have on a subsequent counterparty to the Block Trade.

Sources:

ICE Futures Europe- Market Resources – **"Block Trade and Asset Allocations Policy"**

CME Current Market Regulation Advisory Notices (MRANs) – **"Block Trades"**

[3] Firms are advised to check exchange rulebooks when (if and how) pre-hedging is permissible.