

# Changes to the ASX ETO Market Making Scheme; Key differences before and after 28 March 2011



ASX

AUSTRALIAN SECURITIES EXCHANGE

## Background

Market Makers play an important role in the ASX options market. Market Makers compete against one another while trading on their own account and at their own risk. Under contractual arrangements with ASX, they are incentivised to achieve benchmark quoting requirements.

The quoting requirements are to ensure liquidity in the market, so that traders are more easily able to trade into and out of options positions and also so that other traders and investors are more easily able to price and value options positions.

Liquidity is assisted when there are multiple Market Makers covering each stock. ETO Market Makers are contracted into one or more Classes (representing each underlying security) in which they must meet ASX's volume and spread requirements with maturities going out one year. This involves quoting buy and sell prices for a certain number of series (i.e. an individual options contract), and/or responding to quote requests from other Market Participants for prices.

ASX has made a number of fundamental changes to the ETO Market Making scheme specifically designed to improve ETO market quality by;

- Encouraging competition between Market Makers
- Providing ETO market users with more quotes, in more series, in more expiry months, for a greater percentage of the trading day
- Rewarding those Market Makers (by way of lower fees) who are willing to partner with ASX in the delivery of a better quality ETO market

In conjunction with other changes that ASX is delivering to the ETO market it is hoped that as market quality improves so will liquidity and trading opportunities for ETO users.

Recent changes to the ASX ETO market include;

- Rationalising the "Universe" of ETO Classes and ensuring that ETO Classes are not listed without contracted Market Makers
- Rationalising the expiry months in which ASX will list ETO series
- Subscribing to **Markit** dividend estimates for use in the ASX ETO pricing model (used for ETO settlement price deeming)
- Announcing that the ASX ETO contract size will be reduced from 1000 Shares per contract to 100 Shares per contract in May 2011

Proposed future changes to the ASX ETO market include;

- Improvements to the ASX automated ETO listing infrastructure
- Thereby listing even more series in ETO Classes with added strike granularity

- Transitioning the ASX ETO market to the “European Fair Value” settlement methodology used by Eurex and Euronext as a means of calculating ETO settlement prices when the stock has been taken over (subject to certain conditions).

### Description of the previous Quoting Requirements for Market Makers

Previously a Market Maker had 3 quoting electives to choose from. They can be summarised thus;

- Continuous - the Market Maker is obliged to continuously quote 18 strikes around the money comprising 3 calls & 3 puts in any 3 of the first 6 expiry months.
- Quote Response - the Market Maker is obliged to make markets upon the receipt of a Quote Request asked with a length to maturity that does not exceed 9 months.
- Hybrid - the Market Maker is obliged to continuously quote 12 strikes around the money comprising 3 calls & 3 puts in any 2 of the first 6 expiry months-and make markets upon receipt of a Quote Request asked with a length to maturity that does not exceed 9 months.

In reality, most Market Makers chose the continuous quoting elective, which was suboptimal.

The following tables highlight these quoting requirements. In these examples XYZ is trading at \$37.45. The expiry months are represented along the top of the table (e.g. April 2011 & May 2011 etc). The strike prices are represented down the table (e.g. \$37 & \$37.50 etc).

### Previous “Continuous” quoting requirements

- Required to continuously quote strikes highlighted in red
- Required to quote to this standard for 50% of the trading day
- Previously Market Makers chose the Continuous quoting requirement in 162 instances

Apr 11	May 11	Jun 11	Jul 11	Aug 11	Sep 11	Dec 11	Mar 12	Jun 12
3500	3500	3500	3500	3500	3500	3500	3500	3500
3550	3550	3550	3550	3550	3550	3550	3550	3550
3600	3600	3600	3600	3600	3600	3600	3600	3600
3650	3650	3650	3650	3650	3650	3650	3650	3650
3700	3700	3700	3700	3700	3700	3700	3700	3700
3750	3750	3750	3750	3750	3750	3750	3750	3750
3800	3800	3800	3800	3800	3800	3800	3800	3800
3850	3850	3850	3850	3850	3850	3850	3850	3850
3900	3900	3900	3900	3900	3900	3900	3900	3900
3950	3950	3950	3950	3950	3950	3950	3950	3950
4000	4000	4000	4000	4000	4000	4000	4000	4000
4050	4050	4050	4050	4050	4050	4050	4050	4050
4100	4100	4100	4100	4100	4100	4100	4100	4100
4150	4150	4150	4150	4150	4150	4150	4150	4150

As most Market Makers chose the Continuous quoting requirement, this resulted in many instances where it was difficult to receive a response to a Quote Request.



### Previous Hybrid quoting requirements

- Required to continuously quote strikes highlighted in red
- Required to respond to Quote Requests highlighted in yellow
- Required to quote to this standard for 50% of the trading day
- Previously Market Makers chose the Hybrid quoting requirement in 62 instances

Apr 11	May 11	Jun 11	Jul 11	Aug 11	Sep 11	Dec 11	Mar 12	Jun 12
3500	3500	3500	3500	3500	3500	3500	3500	3500
3550	3550	3550	3550	3550	3550	3550	3550	3550
3600	3600	3600	3600	3600	3600	3600	3600	3600
3650	3650	3650	3650	3650	3650	3650	3650	3650
3700	3700	3700	3700	3700	3700	3700	3700	3700
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3800	3800	3800	3800	3800	3800	3800	3800	3800
3850	3850	3850	3850	3850	3850	3850	3850	3850
3900	3900	3900	3900	3900	3900	3900	3900	3900
3950	3950	3950	3950	3950	3950	3950	3950	3950
4000	4000	4000	4000	4000	4000	4000	4000	4000
4050	4050	4050	4050	4050	4050	4050	4050	4050
4100	4100	4100	4100	4100	4100	4100	4100	4100
4150	4150	4150	4150	4150	4150	4150	4150	4150

The new quoting requirements improve on-screen quoting by mandating a Market Maker to be a “Hybrid” quoter in all instances.

## New mandatory Hybrid quoting requirements

- Required to continuously quote strikes highlighted in red
- Required to respond to Quote Requests highlighted in yellow
- Quote request response requirement expanded from 9 months to 12 months
- Required to average a combined 70% between the continuous quoting benchmark and the quote response benchmark
- Market Makers are now contracted to these requirements in 396 instances

Apr 11	May 11	Jun 11	Jul 11	Aug 11	Sep 11	Dec 11	Mar 12	Jun 12
3500	3500	3500	3500	3500	3500	3500	3500	3500
3550	3550	3550	3550	3550	3550	3550	3550	3550
3600	3600	3600	3600	3600	3600	3600	3600	3600
3650	3650	3650	3650	3650	3650	3650	3650	3650
3700	3700	3700	3700	3700	3700	3700	3700	3700
3750	3750	3750	3750	3750	3750	3750	3750	3750
3800	3800	3800	3800	3800	3800	3800	3800	3800
3850	3850	3850	3850	3850	3850	3850	3850	3850
3900	3900	3900	3900	3900	3900	3900	3900	3900
3950	3950	3950	3950	3950	3950	3950	3950	3950
4000	4000	4000	4000	4000	4000	4000	4000	4000
4050	4050	4050	4050	4050	4050	4050	4050	4050
4100	4100	4100	4100	4100	4100	4100	4100	4100
4150	4150	4150	4150	4150	4150	4150	4150	4150

## Summary of Key Changes;

- Market Makers are no longer given 3 different quoting electives
- All Market Makers must quote into each Class as a hybrid quoter with a Continuous quoting requirement and a Quote Response quoting requirement.
- The quoting requirement has been expanded from ETO series with expiries not exceeding 9 months to ETO series with expiries not exceeding 12 months.
- A Market Maker's fee is dependant upon their quoting performance in their portfolio of Classes not just their quoting performance in any one Class.
- Market Makers can not submit resignations in a Class at any time. They must contract into Classes for given time periods (i.e. 12 months).
- The benchmark quoting response time has increased from a minimum of 50% to a minimum of 70%.

## **Description of New Quoting Requirements for Market Makers** (effective 28 March 2011)

For each option Class in which a Market Maker is responsible there are three quoting benchmark requirements. The Market Maker's quoting benchmarks are judged on their performance in making markets in certain series on a Continuous Basis **and** on making markets in response to Quote Requests in certain series.

- Minimum of 50% on the required Continuous Quoting benchmark;
- Minimum of 50% on the required Quote Request Quoting benchmark; and
- A combined minimum average of 70% on Continuous Quoting **and** Quote Request Quoting

### **Continuous Quoting Benchmark;**

The Market Maker is required to provide continuous orders in eighteen series encompassing three calls and three puts in three of the next six expiration months. Each order must be for at least the minimum quantity, and at or within the designated maximum spread requirements.

### **Quote Request Quoting Benchmark;**

The Market Maker is required to provide orders on request for all series with up to twelve months expiration maturity in the minimum quantity and at or within the maximum spread.

### **Market Maker Fees**

The Market Maker fee incentive is dependant upon the number of options Classes they contract to make markets in with ASX. The more Classes that they are responsible for the lower the trading fees are when they achieve the required quoting benchmarks in that Class. When a Market Maker does not meet the minimum required quoting benchmark/s they are charged higher fees by the ASX. Furthermore their fee incentive is based across the portfolio of Classes in which they are contracted. This means that a poor quoting performance in certain less liquid Classes may result in the Market Maker paying a higher fee in the more liquid Classes.

To maintain their fee incentives before and after the introduction of the new scheme most Market Makers have significantly increased the number of ETO Classes that they cover.

## Market Maker ETO Class Coverage Before and After 28 March 2011

ETO Class	Continuous Quoters	Quote Responders	Hybrid Quoters	Hybrid Quoters under the new scheme
AGK	1	2	0	8
AIO	2	0	1	5
AMC	1	1	1	6
AMP	3	0	1	9
ANZ	8	0	1	9
ASX	1	1	1	4
AWC	4	1	1	8
AXA	1	0	1	4
BHP	7	0	1	8
BLD	2	1	1	6
BSL	6	0	1	7
BXB	2	1	1	7
CBA	6	0	1	8
CCL	1	1	1	5
CPU	1	1	1	4
CSL	1	1	1	6
CSR	3	0	1	6
DJS	1	1	1	5
EQN	3	0	1	5
FGL	3	1	1	7
FMG	2	1	1	7
FXJ	2	0	1	5
GPT	2	0	1	5
HVN	1	0	1	6
IAG	1	1	1	6
IFL	1	0	1	4
IPL	3	0	1	6
JHX	1	0	1	5
LEI	1	1	1	5
LLC	0	1	1	4
MAP	0	2	1	5
MQG	3	0	1	6
MYR	1	1	1	4
NAB	7	0	1	8
NCM	5	1	1	8
NWS	2	1	1	7
ORG	2	0	1	8
ORI	1	1	1	6
OSH	4	0	1	7
OST	2	1	1	6
OZL	5	0	1	7
QAN	3	0	1	7
QBE	6	0	1	8
QRN	3	0	1	5
RIO	2	1	1	7
SGM	1	0	1	4
SGP	2	0	1	5

### Market Maker ETO Class Coverage Before and After 28 March 2011(continued)

ETO Class	Continuous Quoters	Quote Responders	Hybrid Quoters	Hybrid Quoters under the new scheme
STO	5	0	1	9
SUN	3	0	1	8
TAH	1	1	1	5
TCL	2	0	1	5
TEN	1	0	1	5
TLS	9	0	1	10
TOL	1	1	1	6
TTS	1	0	1	4
WBC	6	0	1	8
WDC	2	1	1	6
WES	2	1	1	8
WOR	1	1	0	5
WOW	6	1	1	9
WPL	4	1	1	8
WRT	1	0	1	4
XJO	6	0	1	8
<b>Total</b>	<b>162</b>	<b>31</b>	<b>62</b>	<b>396</b>

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