Futures Expiry Supervision Guide

ASX
AUSTRALIAN SECURITIES EXCHANGE

What is this guide about?

This guide provides an overview of the supervision process that ASX Markets Supervision (ASXMS) conducts at a futures expiry. It explains what we do, why we do it, and what is expected of you as a Participant. This guide will help you to comply with your obligations around the futures expiry process.

What is futures expiry?

All futures contracts are quoted with an expiry month. For example, SFE SPI 200® futures have expiry months of March, June, September and December. The exact day when the future expires is known as the expiry date or "expiry".

Why do we supervise expiry?

ASX is required by the terms of its Australian Financial Services Licence to ensure that its markets are fair, orderly and transparent. As a Participant, you are obliged to trade in a manner consistent with this obligation.

To meet this obligation, we monitor conduct in relation to our markets, supervise the markets to ensure compliance with our Rules, and refer any suspected breaches of the law to the Australian Securities and Investments Commission (ASIC).

We monitor price discrepancies and unusual behaviour because these may indicate the development of an undesirable market situation.

Expiries provide particular opportunities for markets to become unfair or disorderly. This is because the boundary of settlement provides no opportunity for prices to normalise after a run, and volume driven into the physical market by the futures expiry can cause prices to behave abnormally when the settlement price is determined.

How do we supervise expiry?

Throughout the life of a futures contract – and especially as each expiry approaches – we monitor the speed and nature of price convergence, as well as traders' holdings and trading patterns, looking for anything that appears to be outside regularly observed patterns.

Holdings are drawn from Participants' Daily Beneficial Ownership Reports (DBORs) which show the underlying holder of each position. We combine these reports to ensure that holdings can be tracked across multiple Participants. We then model this data to gain insight into how the market is likely to react to an upcoming boundary condition – such as an expiry – and whether pressures could exist that might threaten the fair, orderly and transparent nature of the market.

To help our analysis, we will seek further information, which often involves speaking to the trader controlling a position, or their Participant.

Typically, we speak to anyone who is holding a large position as expiry approaches or who is trading in a manner that isn't consistent with their typical strategy.

We might also ask for input from traders who are holding smaller positions. This is because a number of traders acting independently (and usually without any intent) have the potential to affect the determination of a settlement price.

How do we contact you?

Typically, we approach you or your compliance staff in the first instance by telephone.

While we generally ask questions over the telephone, we may invite you to attend a meeting. Due to the confidentiality of this information, we won't ask you to send it by unencrypted e-mail, and we may not be able to send you these questions by e-mail without a specific request.

What questions do we ask?

We may ask questions such as:

- Who is responsible for a given position?
- Is that person responsible for the entire position or is responsibility spread across multiple desks?
- What is that person's current intention in terms of trading? What constraints (e.g. risk- or concentration-based limits) might restrict that person's trading strategy?
- What is that person's trading strategy as expiry approaches (e.g. roll the position into the next contract, exit before expiry or run to expiry)?
- What might change this view? For example, if prices or spreads were to increase, what would the person do? What other factors are likely to impact on the person's intended strategy?

Why do we ask you these questions?

By asking these questions about a position, we are not asking you to trade out of a position. Nor are we suggesting that the size of your position gives you particular power in the market, or is too big for the market.

We ask these questions in order to refine our model of what is likely to happen at expiry, especially with regard to whether it will be possible to achieve a fair and orderly settlement.

Once we have refined our model – having received information from many traders – we assess whether the expiry process is likely to be fair, orderly and transparent.

Should we have any concerns that this might not be the case, we may seek further information, or take action to prevent an undesirable market situation from occurring.

What action can we take to ensure an orderly process?

Under the rules, we can take action to correct an "undesirable situation or practice" which might threaten fair, orderly and transparent trading. Examples include a squeeze or a settlement price that does not reflect genuine (i.e. not futures-driven) activity in the underlying market.

Should we feel that an undesirable situation is likely to occur, our actions could potentially include issuing a Notice to inform the market that increased volatility may occur over expiry, or determining a settlement price if we believe that the one that has been arrived at is the result of an undesirable market situation.

We prefer to prevent undesirable market situations from arising, rather than taking disciplinary action after the fact.

However, we will take disciplinary action against a Participant, if it is warranted. Any suspicion that there has been a breach of law will immediately be reported to ASIC.

Do you have to answer our questions?

Yes. Participants are required by the Rules to answer ASX's queries. Further, all Client Agreement Forms confirm that clients will provide all information relevant to their trading and that their Participant is entitled to pass that information to ASX.

Being up-front with us can minimise the intrusiveness of such queries. It can also prevent any misinterpretation of your intentions, especially if that might lead us to take action to defend the integrity of the expiry process.

You or your clients may have genuine confidentiality issues and would prefer not to discuss these questions with your Participant. If this is the case, you or they might wish to contact us directly.

Can you change your trading strategy?

Yes. We are looking to establish a model of what is likely to occur at expiry. We recognise that this can only be based on what is known at a point in time. We are not looking for a commitment, unless we explicitly ask for one – only a good-faith view of what you are looking to do at the time that we ask you.

A response that says simply – “we don’t know what we want to do, it all depends on the market” – is not considered to be a reasonable response to these queries.

If you change your strategy drastically from the one that you had when you spoke to us, please tell us so that we can adjust our model accordingly.

If we see you trading in a manner that is not consistent with the information we have, we may need to speak to you again to find out what has changed.

Is your information kept confidential?

Yes. Your information is kept confidential. It will not leave ASX Futures Supervision – even to go to other parts of ASX – unless we are required to provide it to ASIC.

In accordance with industry practice, telephone conversations are recorded. We may provide these records to ASIC as part of an investigation if we are required to do so.

When should you contact us?

If you are pursuing a new trading strategy, especially one characterised by aggressive trading in either the futures or underlying market around expiry, we strongly encourage your compliance department to speak to us regarding queries that might arise as expiry approaches.

You should understand that this sort of strategy requires heightened surveillance by your compliance department, your Participant and ASX. This should not be considered an indication that such trading is fundamentally unsound; simply that it does carry an increased level of risk to the market.

About us

As one of the world's top 10 listed exchange groups, measured by its market capitalisation, ASX group was created through the merger of the Australian Stock Exchange and the Sydney Futures Exchange.

ASX group operates under the brand Australian Securities Exchange.

The Australian Securities Exchange spans the markets for corporate control, capital formation and price discovery and functions as an operator, supervisor, central counterparty clearer and payments system facilitator.

Underpinning ASX's activities as a market operator is the quality of its supervision. This is critical to market confidence and the maintenance of fair, orderly and transparent markets. Confidence in the integrity of ASX markets and clearing and settlement facilities is reinforced by the supervisory activities of its wholly-owned subsidiary, ASX Markets Supervision (ASXMS), and by the regulatory oversight of the Australian Securities and Investments Commission (ASIC) and the Reserve Bank of Australia (RBA). ASIC also supervises ASX's own compliance as a public company with the ASX listing rules.

ASXMS is the separately managed and funded supervision subsidiary of the ASX group. ASXMS was established to enable ASX to perform its core supervisory functions independently from its commercial operation, and to provide greater accountability for and transparency of the group's supervisory activities.

More information on ASX can be found on our website www.asx.com.au

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This guide was prepared with the assistance of the Australian Financial Markets Association (AFMA).