



13 May 2016

Mr Greg Pill
Manager, Equity Derivatives
ASX Limited
Exchange Centre
20 Bridge Street
SYDNEY NSW 2000

Dear Greg

ASX ETO Cancellation Policy - Consultation Paper March 2016

Consolidated AFMA member responses to the consultation paper are enclosed. Thank you for allowing us extra time to reply.

Please contact me on 9776 7997 or tlyons@afma.com.au if you have any queries.

Yours sincerely

Tracey Lyons
Head of Policy

Questions

1. What is your preferred approach for the time participants have to notify ASX of trades in the Qualifying Cancellation Range (QCR) and Extreme Trading Range (ETR) to be considered for cancellation for exchange traded options? Should the period:

- a. Remain consistent with other products on ASX Trade (namely equities)
- b. Be individually tailored to the needs of the ETO market

AFMA response

Members support option (b) – the period should be individually tailored to the needs of the ETO market.

If (b) should the QCR and ETR notification timeframes for ETOs be aligned?

- a. Yes
- b. No

AFMA response

Members support option (a) – yes the QCR and ETR notification timeframes for ETOs should be aligned.

Please explain your reason for this view, including any evidence where available.

The options market should be considered in isolation. The price of an option depends on many factors and errors are less clear than in other products like stocks and futures. It is not easy for participants to know whether their trade falls in the QCR or ETR so more certainty is needed. Making the timeframes the same will simplify the process.

2. Should a participant notify ASX of trades in the QCR to be considered for cancellation within:

- a. 10 minutes (i.e. no change);
- b. 30 minutes;
- c. 45 minutes; or
- d. 60 minutes

AFMA response

Members support option (b) – 30 minutes or alternatively option (d) – 60 minutes.

Note: the above times would not affect the end-of-day cut-off for cancellation requests which will remain within 10 minutes of the open session state closing. Please explain your reason for this view, including any evidence where available.

In general 30 minutes is more than enough time to allow a participant to identify an error and contact ASX to request cancellation. There needs to be certainty about whether a not a trade is cancelled and longer periods of uncertainty do not help. However 10 minutes may not be enough time in some instances. A participant will generally need to hedge their option trade, but if their trade could potentially be cancelled it is not in their interest to do this – but if they don't hedge and the trade stands they could be left with an unwanted exposure. It is also

possible that a participant may choose to do a trade in the QCR as part of risk management or if it is an unprofitable leg of an otherwise profitable combination strategy.

It can be difficult to work out the prices of multi-legged options strategies if there is an issue. Markets may not be present in a series which will require a participant to call market makers for prices. Minutes can elapse before an error is identified. There could potentially be multiple counterparties to a transaction.

3. For errors in the QCR should at fault brokers have the ability to directly contact other parties to the trade to seek cancellation in addition to ASX contacting counterparties?

- a. Yes
- b. No

AFMA response

The majority of members who provided comments support option (a) – yes, at fault brokers should have the ability to directly contact other parties to the trade to seek cancellation.

If you answered Yes, note there would still be a requirement to notify ASX within the specified timeframe. There may also be a need to extend the time for counterparties to accept errors, and subsequently report acceptance of cancellation to ASX, as multiple counterparties would require multiple phone calls. Would you prefer that the period to inform ASX of acceptance be:

- a. 5 minutes (i.e. no change);
- b. 30 minutes; or
- c. extended to 4.30pm on the same trading day.

AFMA response

Members who support option (a) above agree that the period to inform ASX of acceptance should be extended to (c) 4.30pm on the same trading day.

Please explain your reason for this view, including any evidence where available.

The at-fault party should be able to negotiate to have a trade in the QCR cancelled throughout the day provided the exchange has been informed within 30 minutes. This gives the exchange the opportunity to contact the other side who can then give proper consideration. If this was to be done it would only be on the basis that the other side agrees to be contacted, if they disagree then the trade should not be cancelled. If they do agree the deadline can be extended to the end of the day. Alternatively they could immediately agree to cancel the trade in which case the two participants don't need to contact each other.

In busy period such as options expiry, participants may need longer to investigate the circumstances of an error. Additionally if a counterparty agrees to cancel a trade it may take longer to effect the cancellation as market makers have previously often actioned cancellations after the options market had closed.

It was also noted, however, that the exchange handling the error once reported (rather than participants having the ability to contact one another directly) creates a level playing field for all participants.

4. Should a participant be required to notify ASX of trades in the ETR to be considered for cancellation within:

- a. 10 minutes;
- b. 30 minutes (i.e. no change);
- c. 45 minutes; or
- d. 60 minutes.

AFMA response

Members support option (b) – 30 minutes or alternatively option (d) – 60 minutes.

Note: the above times would not affect the end-of-day cut-off for cancellation requests which will remain within 10 minutes of the open session state closing. Please explain your reason for this view, including any evidence where available.

Participants should be given 30 minutes to allow for automatic cancellation upon request. This ensures the participant is given enough time to identify an error trade and gives participants on the other side certainty as soon as possible. Having said that, if a participant takes more than 30 minutes ASX should then revert to the process where the other participant is contacted and then it is up to the other side to determine if they are willing to consider cancellation and be contacted as per the proposed process for trades in the QCR.

5. Would you support an extension to notification time limits if the error in the ETR or QCR was above a significant size/value threshold?

- a. Yes
- b. No

If Yes, should the threshold be an error greater than:

- a. \$100,000;
- b. \$250,000;
- c. \$500,000; or
- d. \$1 million

If Yes, should the time added to the normal limit be:

- a. 30 minutes;
- b. 60 minutes; or
- c. 90 minutes

AFMA response

The majority of members who provided comments support an extension to notification times limits if the error in the ETR or QCR is above a significant size/value threshold. Members who support an extension think the threshold should be an error greater than \$100,000. The time added to the normal limit should be 30 minutes or 60 minutes.

Note: the times on the previous page would not affect the end-of-day cut-off for cancellation requests which will remain within 10 minutes of the open session state closing. Please explain your reason for this view, including any evidence where available.

The potential for complication is a concern to members. Changing the size complicates matters and participants may not be able to determine what ASX threshold has been reached - they may have an idea based on their P/L estimate but this could be very different to the ASX view. At the same time even with the larger size of the trade participants need as much certainty as possible and setting different time limits for different thresholds complicates the rules.

Q. Are there any further comments on trade cancellation policy that you think are relevant:

If a trade is being considered for cancellation, a message should be sent to other participants indicating that. Every time the status of the request changes, participants should be informed to ensure that all participants get the same information about a particular trade. The statuses could include:

- "cancellation received by ASX"
- "cancellation approved by ASX"
- "cancellation request forwarded to opposite party"
- "opposite party declines cancellation request"
- "opposite party accepts cancellation request"

and should obviously provide the trade identification and whether it falls in the QCR or ETR. It is also important to be clear that once the participant who receives the request makes their decision they cannot reverse it.

It has also been suggested that ASX should implement order entry controls for ETOs because this would significantly reduce the need for cancellations. It would also reduce instances of disorderly markets caused by operator/fat finger errors, and allow ASX to implement a 'no cancellation range' for ETOs which would further increase certainty for trading participants.