



The ASX Equity Index (XJO) Exchange Traded Options Market

- Option Tick Size



Executive Summary

1. ASX has recently made changes to the Equity Index (XJO) Exchange Traded Options Market by increasing Market Makers obligations to facilitate a better quality market for participants.
2. XJO option trading activity has increased since this change.
3. This consultation paper seeks market views on changing the current XJO option tick size from 1pt to 0.5pt in order to facilitate a further increase in trading activity and also provide participants with a more granulated pricing range.
4. ASX welcomes comment in response to this Consultation Paper. ASX would expect Market Makers, brokers, institutional users and retail users to suggest, in detail, reasoned arguments in favour, or against the proposal.
5. Please note that different tick sizes across different pricing points for the XJO option contract will not work because of the impact on TMC functionality.
6. If ASX decides to pursue these initiatives the market will be given at least a 3 month notice period.

How to Respond to this Consultation Paper

7. Written responses should be addressed to ASX no later than 31 July 2011.
8. The identity of written responses will be kept confidential by ASX.
9. Written comments may be set:

By Mail to: Gregory Pill
Manager, Equity and Equity Derivatives
Australian Securities Exchange
20 Bridge St
Sydney, NSW. 2000

By Email to: greg.pill@asx.com.au

10. Gregory Pill is also available for face to face discussions with Sydney ETO Stakeholders. Please call Gregory on (02) 9227 0696 to arrange an appropriate time.

Background and Purpose of this Paper

11. ASX has been asked by some XJO option participants to implement a more granulated tick schedule for the XJO options.
12. This request centres on smaller premium XJO options whereby a tick can equate to more than a 10% price movement.
13. ASX cannot have differentiated tick values based on XJO option premium amounts due to the impact this has on the TMC (Taylor Made Combination) functionality. I.e. The XJO option tick value must be kept constant among all premium levels.

The Approach of this Paper

14. The second section of this paper explains the proposal of changing the XJO option tick size and the impact of this on execution and the contract specifications.
15. The third section discusses the arguments for and against introducing a more granulated tick size for the XJO option contracts.
16. The fourth section outlines the review process and implementation plan if ASX decides to implement the XJO option tick value change.

The Proposed change to the XJO option tick size and impact on execution and contract specifications

17. ASX is proposing to change the XJO option tick size from 1 pt to 0.5 pt.
18. The tick value will be changed accordingly from \$10 per tick to \$5 per tick to maintain the current level of financial exposure. I.e. Under both proposals if the XJO option moved by 5 pts this will equate to a premium value move of \$50.
19. The contract specification will change to the following:

XJO Index Options	
Underlying Index	S&P/ASX 200 Index
Security Codes	The first three characters are the ASX code e.g. XJO, the fourth and fifth characters are the clearing code randomly assigned by ASX. Certain codes include a sixth character which is always numeric.
Index Multiplier / tick	\$5 per tick. Each index point is equal to AUD \$10.
Tick Size	Quoted as the number of points of the index. (Tick size 0.5 point)
Exercise Style	European, ie. exercisable only on expiry day.
Exercise Intervals	25 Index points
Type	Call and put options
Contract Months	March, June, September, December up to six quarter months ahead and serial months up to two non-financial quarter months ahead
Expiry Day	The third Thursday of the contract month, unless otherwise specified by ASX.
Last Trading Day	Trading will cease at 12 noon on expiry Thursday.
Trading Hours	6.00am to 5.00pm and 5.30pm to 8.00pm (Sydney time)
Settlement	Index options are cash settled using the opening price index calculation on expiry morning. This means trading will continue after the settlement price has been determined.
Settlement Day	The first business day following the Last Trading Day

20. XJO option market making obligations will not change if moving to a 0.5 pt tick.
21. By changing the tick size, the potential bid ask spread (assuming 1 tick apart) changes according to the below:

OLD TICK	1 pt
NEW TICK	0.5 pt

OPTION PREMIUM (pts)	OLD TICK AS % of OPTION PREMIUM	NEW TICK AS % of OPTION PREMIUM
1	100.00%	50.00%
5	20.00%	10.00%
10	10.00%	5.00%
20	5.00%	2.50%
50	2.00%	1.00%
100	1.00%	0.50%
200	0.50%	0.25%
400	0.25%	0.13%
750	0.13%	0.07%
1000	0.10%	0.05%

This allows investors to trade at a more granulated premium amount and as such can improve pricing execution. This equates to an absolute level of \$5 per contract across all premium levels.

The arguments For and Against changing the XJO option Tick size from 1 pt to 0.5pt

22. Changing the XJO option contract to be 0.5 pt ticks will bring it inline with the SPI (AP) index option contract allowing for better hedging across similar products.
23. For all XJO options changing the tick value by half equates to halving the potential bid/ask spread. As illustrated in the second section halving the XJO option tick value for low premium value options allows for a much better pricing point entry.
24. Some believe by increasing the tick value granulation of the XJO option contract this may have the effect of reducing liquidity at each price point resulting in an increased difficulty of execution.

Review and Implementation

25. After all submissions by the market are obtained by 31 July 2011, it is expected ASX will review each response over the preceding month before making a decision.
26. Each submission will be weighted according to validity of argument/s made, market presence and XJO options usage.
27. After ASX has reviewed and made a decision - either for or against - the market will be advised accordingly. Indicative timing for notification is August/September 2011.
28. If it is decided that ASX is to change the XJO tick value to 0.5 pt the market will be given at least a 3 month notice period to organise any system changes required. Indicative XJO tick value go-live will be January 2012.