

## Frequently Asked Questions Options on Futures

### Trading / Product

#### **1. Why is the expiry day set on the 3<sup>rd</sup> Friday of the contract month?**

- a. We have referenced some liquid contracts for OOF on other exchanges – It is a global common practice for OOF to have 3<sup>rd</sup> Friday as expiry;
- b. This is common practice that is familiar to international investors.

#### **2. Why are there no contrarian (overriding) instructions upon automatically exercising the in-the-money options on expiry?**

- a. Enablement of contrarian (overriding) instructions would (1) put burden on end client / participants to enter instructions within a short time frame, and (2) lead to absence of execution certainty for option seller. Under the current setup, participants will know whether it will be exercised by around 5pm when the Official Settlement Price is released, before T+1 session opens;
- b. This is also common international practice (no contrarian instructions for European style options).

#### **3. Will there be weekly HSI/HHI options on the expiry day (3<sup>rd</sup> Friday)?**

- a. Yes, there will be weekly options on OOF expiry day;
- b. These two products are used by users with different trading strategies and position management needs

#### **4. Why is the availability of contract month for OOF is different from its underlying (futures)?**

- a. The contract months are set referencing the OOI and the futures will come available well before options expiry
- b. OOF are European options which exercises can only be made on the expiry date – and futures would have become long available by then
- c. According to market feedback received, we understand most of the time, the risk is being managed using the most liquid spot month futures (instead of the far-month expiries)

**5. Given this is the first options on HKFE delivering physical Futures position, is there anything that participants need to be aware of?**

Exchange Participants are advised to notify their staff and all interested clients the details of the Contracts. Please ensure that their trading, clearing, and back office systems, including OAPI program and other operational arrangements are ready in order for a smooth operation upon the introduction, specifically to the options exercise event. In addition, staff should be fully aware of the above and should exercise caution when dealing with the Contracts and when advising their clients.

Participants should ensure the following before engaging in trading or offering Options on Futures products to clients:

- a. Ensure systems (including front office and back office systems) and operational readiness and complete a Readiness Test successfully in the HKEX testing environment
- b. Necessary measures taken to ensure the end users/clients understand the settlement mechanism and risk involved in the new product (e.g. Client-facing staff / clear client interface and client education)
- c. Thorough and effective communication made to the clients prior to offering, specifically, on the differences between Options on Index and Options on Futures products.

**Settlement Price**

**1. How is the official settlement price (“OSP”) determined for OOF?**

Official Settlement Price of OOF will be determined by taking the simple average of 5-minute snapshots on the spot month future throughout the expiry day from 9:30 a.m. (9:30:00.000 – 9:34:59.999) to 4:00 p.m., excluding lunch breaks where the market is closed. i.e. applying the Estimated Average Settlement (“EAS”) calculation method on the futures price.

**2. What time will the Official Settlement Price (OSP) be announced?**

The OSP circular will be published at HKEX web site by 17:00 HKT on expiry date (around 1 hour after OOF last trading time).

**3. Why did the Exchange choose the EAS methodology to calculate the OSP for OOF?**

- a. Similar to all physically-settled options, the OSP is a reference level to fairly reflect the value of an asset (in this case, the futures) on the expiry date for delivery purposes;
- b. In the process of evaluating the value of the asset, the Exchange's primary considerations are to utilize a method which is most familiar to participants and resilient to manipulation. After evaluating a number of different methodologies and consulting with market participants, the Exchange selected the EAS method for the OSP calculation;
- c. OOF will be auto-exercised. The auto-exercising of options is a common approach used by international exchanges. All at-the-money and out-of-the money options will not be exercised. (Neither the call or put are deemed to be in-the-money when the official settlement price equals the strike price.)

## Clearing

### **1. Is the premium paid upfront or held until expiry?**

The option premium is not paid up front but marked to market on daily basis. During the life of the OOF (including initiation and the exercise/expiry day), the buyer pays (receives) any decrease (increase) in the option's premium as a variation margin.

### **2. How will the exercise event be triggered upon auto exercising of the in-the-money options when there is no acceptance of overriding instructions?**

The exercise event will be triggered and futures positions generated during HKCC day end batch on the expiry day. The day batch usually completed by 21:00 HKT.

### **3. Is the support of zero or negative price be feasible when it is theoretically possible that an option can be priced negatively?**

Price would be floored at zero and negative prices are not supported for outright contracts.

### **4. Can the delivered Futures be traded in the market as early as the immediate T+1 session of the same day?**

The delivered Futures can be traded out after the day end batch processing, ie. after 9:00pm.

**5. Will the trading out of the Futures delivered on same day T+1 session offset the margin requirement at the T session when the Futures was delivered?**

For the trade out the futures position during night session, since the trade is a T+1 trade and it has another next clearing date, such action will not affect the margin requirement at 09:15 am next morning.

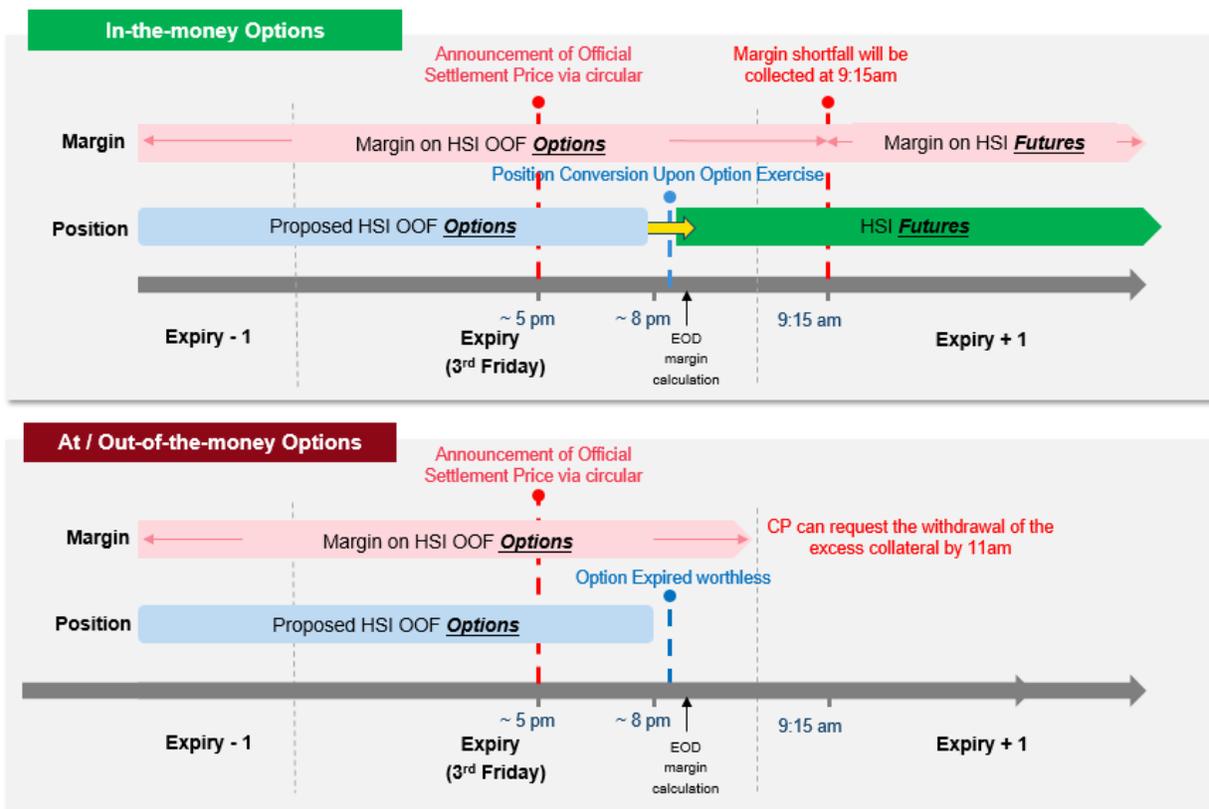
**6. How is the reporting of Large Open Positions be impacted on expiry day?**

EPs are reminded to include the delivered futures contracts from the exercise event in determining their reportable positions as of expiry day.

**7. What time will the positions be seen?**

Positions will be updated during HKCC end of day processing, usually at 9pm.

**8. What are the margin collection and settlement timeline on the exercising and expiry of OOF?**



## **NOTICE**

### **Participants should ensure the following before engaging in trading or offering Options on Futures products to clients:**

1. Ensure systems (including front office and back office systems), operational readiness and complete a Readiness Test successfully in the HKEX testing environment.
2. Necessary measures taken to ensure the end users/clients understand the settlement mechanism and risk involved in the new product (e.g. Client-facing staff / clear client interface and client education)
3. Thorough and effective communication made to the clients prior to offering, specifically, on the differentiations between Options on Index and Options on Futures products.
4. Similar to all physically-settled options, an option position holder should be aware that the final P&L of such position would be affected by the price of the underlying asset.
5. There may be cases where the delivered position will incur immediate mark-to-market gain/loss (the price of delivered position may not be the same as official settlement price).
6. Participants who do not wish positions to settle into futures could opt to square their positions before expiry or consider the cash-settled OOI.
7. Participants should closely monitor and manage their risk at all times.