

(香港交易及結算所有限公司全資附屬公司)

HONG KONG FUTURES EXCHANGE LIMITED

(A wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited)

通告 CIRCULAR

Subject: Enhancement Measures in Stock Index Options Market

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The Exchange is pleased to announce that the following enhancement measures in the stock index options market will be implemented on **Tuesday, 1 November 2016**:

1. Introduction of Fourth Calendar Month Contract

The Exchange will introduce the fourth calendar expiry month contract for Hang Seng Index Options (HSI Options) and H-shares Index Options (HHI Options) to facilitate trading close to 3-month maturity. For the month of November 2016, the fourth calendar expiry month refers to options contracts with expiration in February 2017.

2. Revision of Market Making Obligations for Market Makers that Provide Continuous Quotes (CQMMs) and Market Makers that Respond to Quote Requests (QRMMs)

The market making obligations will be revised as follows:

- (a) The number of option series assigned to CQMMs will be increased: (i) from 24 series to 50 series for HSI Options and HHI Options; and (ii) from 12 series to 25 series for Mini Hang Seng Index Options (Mini-HSI Options) and Mini H-shares Index Options (Mini-HHI Options) which will commence trading on 5 September 2016;
- (b) The maximum bid/ask spreads and minimum quote size requirements for both CQMMs and QRMMs will be also revised to cater for the newly introduced fourth contract months and additional obligations for CQMMs; and
- (c) The reference for market makers that may update its quotes will be revised from “change in the level of the underlying index” to “change in the price level of the Spot Month Futures Contract of the same underlying index” so as to reflect market makers’ actual risk profile and market making practice.

Please refer to Attachment I for details of the revised market making obligations for CQMMs and QRMMs.

3. Introduction of Primary Market Maker Program

A Primary Market Maker (PMM) program for HSI Options and HHI Options will be introduced to improve the price visibility of the stock index options market and to facilitate investors' trading and the key features of this PMM program are as follows:

- (a) PMMs will be required to provide continuous quotes (CQ) in not less than 100 option series for a minimum percentage of the trading hours determined through a bidding process and respond to at least 70% of the quote requests (QR) per calendar month; and
- (b) The number of PMMs will be limited to 5. PMM status will be granted to selected applicants through an annual bidding process, primarily based on their commitments in terms of quote spreads and quote sizes.

Please refer to Attachment II for details of the PMM program. The application deadline for the PMM program will be 31 August 2016. Interested parties should contact, by email, Ms. Rina Ku by (RinaKu@hkex.com.hk) or Mr. Frederick Yim (FrederickYim@hkex.com.hk). The appointment of PMMs will be announced in due course.

4. Enhancement of Market Making Support for CQMM and PMM

There will be waivers on monthly OAPI sub-licence fees and additional technical support including market maker protection function, increased mass quote ratio from 1:6 to 1:10 and more flexibility in the OAPI settings. Please refer to Attachment III for details of the market making support.

For technical support, please contact HKATS hotline: 2211-6360.

Relevant rule amendments will be announced via a separate circular. Participants are requested to notify their staff and all interested clients about the upcoming initiatives and ensure that their back office systems are ready to support their trading.

Li Gang
Co-Head
Market Development Division

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This circular has been issued in the English language with a separate Chinese language translation. If there is any conflict in the circulars between the meaning of Chinese words or terms in the Chinese language version and English words in the English language version, the meaning of the English words shall prevail.

Revised Market Making Obligations for Market Makers Providing Continuous Quotes (CQMMs) and Market Makers Responding to Quote Requests (QRMMs)

1. The number of option series assigned to CQMMs and the number of options series available for selection (i.e. selection pool) will be increased.

CQ Selection Pool (for HSI Options and HHI Options):

		Original		New	
No. of Assigned Options Series		24 series		<u>50 series</u>	
CQ Selection Pool:					
Contract Month	Moneyness	Call	Put	Call	Put
Spot month	Nearest OTM	5	5	<u>10</u>	<u>10</u>
	Nearest ITM	3	3	<u>2</u>	<u>2</u>
2 nd Calendar Month	Nearest OTM	6	6	<u>10</u>	<u>10</u>
	Nearest ITM	2	2	<u>2</u>	<u>2</u>
3 rd Calendar Month	Nearest OTM	3	3	<u>10</u>	<u>10</u>
	Nearest ITM	1	1	<u>2</u>	<u>2</u>
4 th Calendar Month (new)	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
1st Quarter Month	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
2nd Quarter Month	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
3 rd Quarter Month	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
Total		40		<u>144</u>	

CQ Selection Pool (for Mini-HSI Options and Mini-HHI Options):

		Original		New	
No. of Assigned Options Series		12 series		<u>25 series</u>	
CQ Selection Pool:					
Contract Month	Moneyness	Call	Put	Call	Put
Spot month	Nearest OTM	5	5	<u>10</u>	<u>10</u>
	Nearest ITM	3	3	<u>2</u>	<u>2</u>
2 nd Calendar Month	Nearest OTM	6	6	<u>10</u>	<u>10</u>
	Nearest ITM	2	2	<u>2</u>	<u>2</u>
1st Quarter Month	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
2nd Quarter Month	Nearest OTM	-	-	<u>7</u>	<u>7</u>
	Nearest ITM	-	-	<u>2</u>	<u>2</u>
Total		32		<u>84</u>	

2. The maximum bid/ask spreads and minimum quote size requirement for CQMMs will be revised. The requirements for QRMM will also be revised to align with CQMM.

Max Bid/Ask Spread (for HSI Options and HHI Options):

Month	Price	Original	New
1 st , 2 nd , 3 rd , 4 th calendar	1-750 points	Max (30 points, 10% of bid)	Max (30 points, 10% of bid)
	> 750 points	75 points	75 points
1 st , 2 nd quarter	1-750 points	Max (30 points, 20% of bid)	<u>Max (40 points, 20% of bid)</u>
	> 750 points	150 points	150 points
3 rd quarter	1-750 points	Max (30 points, 20% of bid)	<u>Max (50 points, 25% of bid)</u>
	> 750 points	150 points	<u>200 points</u>

Max Bid/Ask Spread (for Mini-HSI Options and Mini-HHI Options):

Month	Price	Original	New
1 st , 2 nd calendar	1-750 points	Max (30 points, 10% of bid)	Max (30 points, 10% of bid)
	> 750 points	75 points	75 points
1 st quarter	1-750 points	Max (30 points, 10% of bid)	<u>Max (40 points, 20% of bid)</u>
	> 750 points	75 points	<u>150 points</u>
2 nd quarter	1-750 points	Max (30 points, 20% of bid)	<u>Max (40 points, 20% of bid)</u>

Month	Price	Original	New
	> 750 points	150 points	<u>150 points</u>

Min. Quote Size (for HSI Options and HHI Options):

Month	Original	New
1 st , 2 nd , 3 rd , 4 th calendar	5 contracts	5 contracts
1 st , 2 nd , 3 rd quarter		<u>3 contracts</u>

Min. Quote Size (for Mini-HSI Options and Mini-HHI Options):

Month	Original	New
1 st , 2 nd calendar	5 contracts	5 contracts
1 st , 2 nd quarter		<u>3 contracts</u>

- Currently, market makers are required to display on HKATS all quotes made on the assigned option series in the stock index options unless a change in the level of the underlying index occurs during the 20 second display period, in which case, market makers may change its quotes provided the new quotes shall be subject to the same display, spread and size requirements. The reference will be revised from “change in the level of the underlying index” to “change in the price level of the Spot Month Futures Contract of the same underlying index” so as to reflect market makers’ actual risk profile and market making practice.

Primary Market Maker (PMM) Program for HSI Options and HHI Options

1. PMM for HSI Options and HHI Options will be required to:

- provide CQ for at least **100 series** out of a selection pool of 168 option series (see table below) for the minimum percentage of trading hours as determined in the bidding process; and
- respond to at least **70%** of QR issued for all expiry months (short-dated only).

CQ Selection Pool:

Contract Month	Moneyness	Call	Put
Spot month	Nearest OTM	10	10
	Nearest ITM	2	2
2 nd Calendar Month	Nearest OTM	10	10
	Nearest ITM	2	2
3 rd Calendar Month	Nearest OTM	10	10
	Nearest ITM	2	2
4 th Calendar Month	Nearest OTM	10	10
	Nearest ITM	2	2
1st Quarter Month	Nearest OTM	10	10
	Nearest ITM	2	2
2nd Quarter Month	Nearest OTM	10	10
	Nearest ITM	2	2
3 rd Quarter Month	Nearest OTM	10	10
	Nearest ITM	2	2
Total		168	

2. PMM will receive a higher system throughput rate in proportion to its obligations in order to update quotes more cost efficiently and is entitled to a waiver on the OAPI monthly sub-licence fees for up to 16 OAPIs for HSI Options and up to 8 OAPIs for HHI Options. Market maker protection will also be available.
3. The number of PMMs in each option is limited to 5. PMM will be selected through an annual bidding process:
- a. Eligibility criteria: Existing MMs of the relevant options product who have not had any MM permits revoked in any option products in the past 6 months;
 - b. Bidding level: 5 sets of obligation levels will be stipulated by the Exchange for PMM bidding. Applicants are required to indicate the obligation level they are willing to take. Each level has pre-defined obligations in terms of quote size, bid/ask spread and percentage of trading hours to provide CQ:

	Contract Month		Obligation Level for PMM Bidding				
			Level 1 (Min)	Level 2	Level 3	Level 4	Level 5 (Max)
a. Min Quote Size	Spot, 2 nd , 3 rd , 4 th calendar		3	4	5	6	7
	1 st , 2 nd , 3 rd quarter		1	2	3	4	5
b. Max Bid/ Ask Spread (BUS = Best Underlying Spread)	Spot, 2 nd , 3 rd , 4 th calendar	1-750 points	Max (60 points, 20% of bid)	Max (50 points, 15% of bid)	Max (30 points, 10% of bid)	Max (30 points, 10% of bid)	Max (30 points, 10% of bid)
		> 750 points	150 points	115 points	75 points	75 points	75 points
	1 st , 2 nd quarter	1-750 points	Max (70 points, 30% of bid)	Max (60 points, 25% of bid)	Max (40 points, 20% of bid)	Max (40 points, 18% of bid)	Max (40 points, 15% of bid)
		> 750 points	225 points	190 points	150 points	135 points	115 points
	3 rd quarter	1-750 points	Max (80 points, 45% of bid)	Max (70 points, 30% of bid)	Max (50 points, 25% of bid)	Max (50 points, 23% of bid)	Max (50 points, 20% of bid)
		> 750 points	340 points	225 points	200 points	175 points	150 points
c. Min. CQ Trading Hours			80%	80%	85%	85%	90%

- c. Selection process: Applicants with a higher bidding level will be considered first. If more than one applicant indicates a bid for the same level, existing PMMs (if any) of the relevant options with outstanding performance will be considered first. After existing PMMs are considered, existing CQMMs, followed by QRMMs will be considered. Consideration factors include applicants' past market making performance/quality and turnover. HKEX shall retain sole discretion in the selection of the applicant; and
- d. Service term: Not less than 6 months.
4. All PMMs shall have the same obligation for performance monitoring. The obligation for performance monitoring shall be determined by the Exchange, which takes into account the majority and the lowest bidding level among the selected PMMs.

Enhancement of Market Making Support for CQMM and PMM

1. There will be a waiver on monthly OAPI sub-licence fees (currently HK\$2,600 per month or equivalent per OAPI):

Products	MM Type	No. of OAPIs with Monthly Sub-licence Fee Waiver (HK\$)
HSI Options	PMM	Up to 16 OAPIs ¹ (i.e. \$41,600 per month or equivalent)
	CQMM	Up to 1 OAPI (i.e. \$2,600 per month or equivalent)
HHI Options	PMM	Up to 8 OAPIs ² (i.e. \$20,800 per month or equivalent)
	CQMM	Up to 1 OAPI (i.e. \$2,600 per month or equivalent)
Mini-HSI Options	CQMM	Up to 1 OAPI (i.e. \$2,600 per month or equivalent)
Mini-HHI Options	CQMM	Up to 1 OAPI (i.e. \$2,600 per month or equivalent)

2. In addition, the following technical support will be available to PMMs and CQMMs:
- a. **Market Maker Protection Function (MMP):** PMMs and CQMMs will be allowed to use MMP, which means the HKATS will cancel the corresponding market maker's quotes in that particular underlying should their quotes be taken by the market exceeding their pre-defined volume threshold within a pre-defined period of time;
 - b. **Mass Quote Function (MQ)** (available to PMMs and CQMMs that have total number of assigned CQ series above 100 series): MQ ratio will be increased from 1:6 to 1:10, which means PMMs and CQMMs can update bid and ask quotes of 10 option series with one message transaction instead of 6 option series; and
 - c. **OAPI Settings** (available to PMMs and CQMMs that have total number of assigned CQ series above 100 series): PMMs and CQMMs can use 5 or 10 or 20 or 50 transaction per second (TPS) per connection with MQ function, which means they will have more flexibility in reducing the number of OAPI required. The allocation of TPS with MQ will be increased in proportion to its CQ obligations so that they can update quotes more cost efficiently.

¹ HSIO PMM that fails PMM obligations but meets CQMM/QRMM obligations shall be entitled to up to 8 free OAPIs (instead of 16 free OAPIs)

² HHIO PMM that fails PMM obligations but meets CQMM/QRMM obligations shall be entitled to up to 4 free OAPIs (instead of 8 free OAPIs)

3. Below is a summary of technical facility:

MM Type	Original				New			
	TPS with MQ	MQ Ratio	MMP	OAPI Setting (TPS)	TPS with MQ	MQ Ratio	MMP	OAPI Setting (TPS)
PMM ³	N/A	N/A	N/A	N/A	No. of CQ series ÷3	1:10	Yes	5/ 10/ 20/ 50
CQMM ³	No. of CQ series ÷4	1:6	No	5/ 10/ 20	No. of CQ series ÷4			
QRMM	No	No	No	5/ 10	No	No	No	5/ 10

4. Below is a summary of the trading fee discounts for market makers:

(HK\$)

Product	Standard Fee	MM Type		
		CQMM	QRMM	PMM
HSIO	\$10.0	\$2.0		
HHIO	\$3.5	\$0.5		
Mini-HSI Options	\$2.0	\$0.4		N/A
Mini-HHI Options	\$1.0	\$0.2		N/A

³ Mass quote function and OAPI Setting will only be available to PMM and CQMM with total number of assigned CQ series above 100 series