90 Day Bank Bill Futures Consultation

Response to consultation feedback

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1.0 Introduction

1.1. Purpose of this paper

The purpose of this paper is to provide a summary of the feedback received during the recent consultation on the 90 Day Bank Bill Futures and to outline the changes that ASX intends to implement.

1.2. Background

On 30th January 2019, ASX released a consultation paper seeking feedback on proposed changes to the 90 Day Bank Bill Futures contract specification and functionality. The consultation paper was initiated in response to requests from market participants to change the expiry settlement method of the Bank Bill Futures contract. The proposed change to the contract was to cash settle the contract against 3 month BBSW in order to broaden market participation and reduce settlement risk at expiry.

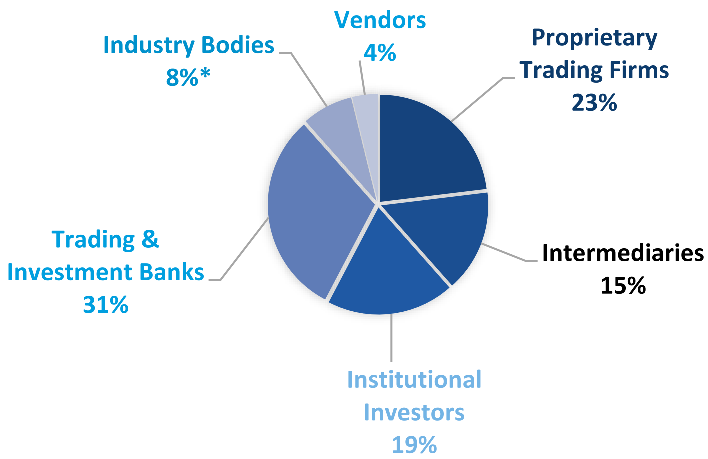
In May 2018, the BBSW methodology underwent significant reform based on the recommendations of the Council of Financial Regulators (CoFR) and in accordance with global best practice principles. ASX agreed to review the Bank Bill Futures expiry settlement method following a 6 month period of the reformed methodology being in place. This would allow for participants to assess the robustness of the new methodology and governance process and subsequently make an informed decision on the proposal to change the expiry settlement method.

A number of other changes were proposed as part of the consultation, including serial Bank Bill Futures[1], reduced tick increments, order size changes and Good Till Cancelled functionality on combination orders.

1.3. Overview of responses received

26 written submissions were received from a wide range of market participants including trading and investment banks, proprietary trading firms, buy side institutions and back office service providers, as well as industry bodies who submitted on behalf of their members.

BREAKDOWN OF RESPONDENTS



*Industry bodies responded on behalf of members

[1] Serial futures are quarterly expiring contracts listed on the non-financial months. Financial months are defined as March, June, September and December.

1.4. Summary of topics included in the consultation paper

The consultation paper sought feedback on the following proposals and implementation methods:

Proposed Contract Specification Changes:

- Changing the settlement method from deliverable to cash settled using 3 month BBSW as the settlement rate
- Preferred transition approach to changing the settlement method
- Setting Expiry Position Limits on cash-settled Bank Bill Futures
- Reducing the minimum tick increment size from 1 basis point to 0.5 basis points for the front contract(s)
- The listing of serial Bank Bill Futures contracts

Proposed Functionality Changes:

- Increasing the current maximum order size of 9,999 lots
- Implementing Good Till Cancelled (GTC) functionality

ASX would like to thank all those who responded to the consultation and appreciates the time and effort spent in coordinating each response.

2.0 Planned changes and preliminary implementation schedule

2.1 Planned changes and timeframes

ASX plans to implement the following changes in a phased approach, subject to regulatory clearance:

- Change the settlement method of the existing Bank Bill Futures (IR) from deliverable to cash settled using 3 month BBSW as the settlement price
- Existing Bank Bill Futures contracts that have more than one year of duration before expiry will be cash settled at expiry (expected to be September 2020 onwards). Contracts with a shorter duration (less than one year) will remain physically settled at expiry
- Set position limits on the front cash-settled Bank Bill Futures contract into expiry
- List two serial Bank Bill Futures. The following diagram illustrates when serials are made available during a calendar year, based on two serial months being listed at any one time

- Reduce the minimum price increment on the front two financial quarter months and serial Bank Bill Futures contract from 1 bps to 0.5 bps

ASX will further investigate implement approach and timing for GTC functionality on Bank Bill Futures spread orders.

ASX plans to deliver these changes in a couple of phases. The following table outlines the intended scope of each phase. Key deliverables and target dates for Phase 1 are provided in section 2.3.

2.2 High level scope for phased changes

Delivery Phase	Scope
Phase 1	Cash settlement for September 2020 90 Day Bank Bill (IR) Futures contract month and onward Expiry Position Limits put in place for the first cash-settled expiry onward
Phase 2	Reduction in minimum tradeable tick increment for front two financial quarter and two serial contracts Listing of serial Bank Bill Futures

A later phase will assess the implementation approach and timing for GTC functionality on 90 Day Bank Bill Futures spread orders. Market participants should note that all proposed changes are subject to regulatory clearance and dates may change.

2.3 Phase 1 key activities and target dates

Subject to market readiness and regulatory clearance, ASX is targeting the following dates for the key activities in Phase 1.

Activity	Responsibility	Target Dates
ASX 24 Operating Rules - Regulatory review and approval of rule amendments and proposed Expiry Position Limits	ASX and ASIC	Q4 2019 – Q1 2020
BBSW Methodology – Consult on removal of Bank Bill Futures price reference from the BBSW calculation waterfall	ASX Benchmarks	November – December 2019
ASX 24 Operating Rules - Publish ASX 24 Operating Rule amendments and Expiry Position Limits	ASX	March 2020*
Benchmark Service Release – Bank Bill Futures component of BBSW waterfall removed	ASX Benchmarks	May 2020
Participant Documentation - Update internal processes and procedures for change to Bank Bill Futures cash settlement process and new Expiry Position Limits	Market Participants	June 2020
Testing – Availability on ASX 24 external customer development environment	Participants	July – September 2020
Implementation - Effective Date for Expiry Position Limits	ASX and Participants	September 2020*
Implementation - First cash settlement	ASX and Participants	September 2020*

*Subject to Regulatory clearance

ASX will provide further information on the timeline for phase 2 of the Bank Bill Futures enhancements initiatives at a future date.

3.0 Summary of consultation feedback on proposals and ASX response

3.1 Settlement method – change from a deliverable to a cash-settled contract

Do you support changing the settlement method to cash settlement using 3 month BBSW as the settlement price?

There was unanimous support for changing the settlement methodology from deliverable to cash settled using 3 month BBSW as the settlement rate. The main reasons cited in support of making the change were:

- Alignment of the futures and the underlying hedged contracts and reduction of potential mispricing;
- The marked decrease in Bank Bill Futures taken to delivery in the last few years;
- A cash-settled contract may increase trading activity and liquidity into and throughout expiry;
- Reduction in risk of failed settlement into expiry; and
- Robust BBSW methodology /waterfall in place.

ASX response: ASX plans to change the settlement methodology for the Bank Bill Futures contract from deliverable to cash settled. The settlement rate will be 3 month BBSW. ASX will discuss with market participants on which published rate is the most appropriate to use, for example the rate calculated on the Expiry Settlement Day (T) or prior day (T-1) or day after the expiry (T+1).

The expiry date for the cash-settled Bank Bill Futures will use the current expiry schedule, that is, the first Thursday following the first Friday of the settlement month. ASX will discuss with participants on whether the expiry should continue to occur at 12pm.

ASX Benchmarks will consult separately on the removal of the 90 Day Bank Bill Futures algorithm from the BBSW calculation waterfall on those days that BBSW is used to determine the futures expiry price. The algorithm is currently included as stage three of a five stage fall-back methodology that is activated in the event that a BBSW rate or rates fail to form under either the VWAP methodology. ASX believes it is necessary to remove this layer from the BBSW calculation waterfall to avoid any potential circularity when cash settling the Bank Bill Futures against 3 month BBSW where the rate may be derived using the Bank Bill Futures prices. ASX Benchmarks will consult on changes to the BBSW methodology in late 2019.

What is your preferred method to transition to a cash-settled contract?

Respondents were largely supportive of changing the settlement methodology for those contracts with existing open interest (presented as option 3 in the consultation paper). ASX sought feedback on the impact of changing the settlement method for the existing Bank Bill futures where open interest exists. Respondents noted that cash settlement changes the economic value of the existing Bank Bill Futures relative to the existing deliverable contract.

Respondents pointed out that Single Period Swaps / Exchange For Physical (SPS / EFP) basis, which trades swaps as a basis to Bank Bill Futures, converges to zero around the one year mark. As a result, most respondents expressed support for a transition at the one year forward point on the Bank Bill Futures yield curve. This would have the effect of applying the change in settlement method for the 5th listed futures contract month and all subsequent contracts. There was very limited appetite for running two parallel curves due to increased operational risk and reduced cost efficiencies.

ASX response: ASX plans to change the settlement methodology for the existing Bank Bill Futures including those with open interest from a forward point on the yield curve greater than one year. ASX currently intends to cash settle the first Bank Bill Futures in September 2020, subject to market readiness and regulatory clearance.

3.2 Expiry Position Limits

Do you support imposing position limits on cash-settled Bank Bill Futures into expiry?

The majority of respondents were supportive of applying Expiry Position Limits into expiry, suggesting that limits preserve the integrity of the market and reduce the risk of large positions being held into expiry.

A number of respondents noted that a T-1 approach is more operationally feasible and would allow for flexible risk management practices. T-1 Expiry Position Limits are currently applied to the 3, 10 and 20 Year Treasury Bond Futures. Some respondents supported a T-5 approach emphasising that this would assist in ensuring orderly trading into the expiry period. However, it was also highlighted that a T-5 approach may be operationally difficult to implement and monitor.

Those not supportive preferred no Expiry Position Limits for any cash-settled futures product and questioned applying Expiry Position Limits to the 90 Day Bank Bill Futures and not to the 30 Day Interbank Futures product.

Expiry Position Limits are intended to provide additional confidence in the integrity of the futures market by constraining position concentration. ASX applies position limits on a T-1 basis for the 3, 10 and 20 Year Treasury Bond Futures. ASX considers position concentration to have a potential negative impact on market orderliness at expiry.

ASX response: ASX plans to implement Expiry Position Limits on a T-1 basis for the front Bank Bill Futures contract when it transitions to a cash-settled product.

What would be the potential impact of having no position limits into expiry where the contract is cash settled?

Respondents noted that imposing Expiry Position Limits would preserve the integrity of the market and may reduce any residual impact on the setting of BBSW. Further to this, respondents commented that having no position limits for the Bank Bill Futures into expiry could lead to large futures positions influencing the BBSW rate set without being bound by the conventions that govern trading in the underlying physical bill market.

Several respondents noted that Expiry Position Limits are a valid risk management practice that decrease the potential for unintended price discrepancies.

3.3 Price increment and order size

Should a finer tick increment be applied to the Bank Bill Futures? If so, which expiry months should be amended?

The majority of respondents were supportive of reducing the current tradeable tick increment from 1 basis point to 0.50 basis point on the front contract months.

ASX received varying views on how many contract months the finer tick increment should be applied to. Some respondents were supportive of reducing the tick increment for the front four contracts, while other respondents supported the front contract only. There were a few respondents who did not support the tick increment reduction.

Those supportive of the reduction noted that it would reduce hedging costs at the front of the curve bringing the ASX into line with international equivalent short term interest rate products. Some respondents noted that it would further encourage activity from a wider range of participants who factor transaction costs into their models.

Those who were not supportive of the reduction highlighted that it may force liquidity providers to reduce their presence in these contracts, potentially affecting liquidity. Some respondents commented that the reduction could have a negative impact on trading activity as the proposed change may reduce the attractiveness and economic viability of the product from a strategic trading perspective.

ASX response: ASX plans to reduce the tick increment from 1 basis point to 0.5 basis point on the front two financial quarter months and two serial Bank Bill Futures. ASX intends to review the liquidity of those reduced tick products 12 months after implementation to consider whether further changes would be appropriate.

Are there any downstream impacts on middle and back office system that ASX should be made aware of when determining implementation, timing and approach?

The majority of responses suggested that there would be little downstream, middle or back office system impact. A few respondents noted that some adjustments would need to be made to systems to accommodate the changes however with sufficient notice this could be easily implemented.

Respondents noted there may be a need to modify yield curve constructions. Others highlighted that trading systems, pricing engines and risk systems would either need to be redesigned or updated.

Should ASX consider increasing the maximum allowable order size from the current level of 9,999 contracts? If so, what maximum order limit would you support?

The majority of respondents were not supportive of increasing the single maximum order size above the current maximum limit of 9,999 lots, citing that the existing maximum order size was adequate enough to meet the market's current demand. Some respondents pointed out that there is the potential for larger sized orders to create a disorderly market during periods of low volatility and lead to inefficient price discovery. Liquidity providers and market makers highlighted that an increase in maximum order size would result in them making wider spreads in order to manage risk effectively against larger sized order flow. Further, a number of respondents highlighted that an increase in the order size increases order entry risk.

Respondents in support of the proposal believed that the maximum single order size should be increased to reflect greater liquidity and open interest in the Bank Bill Futures.

ASX response: ASX will keep the maximum order size of the 90 Day Bank Bill Futures at the current limit of 9,999 lots.

3.4 Serial Bank Bill Futures

Do you support ASX listing serial Bank Bill Futures?

The majority of respondents were supportive of listing serial Bank Bill Futures contracts. Serial Bank Bill Futures are quarterly expiring contracts listed on the non-financial quarter months. Financial quarter months are March, June, September and December.

Those supportive of the change highlighted that it would provide more granular risk management opportunities than currently available. They also noted that it would allow for month by month hedging over the more active months of the strip and would allow the product to be used for arbitrage purposes.

Respondents supportive of implementing serial Bank Bill Futures favoured having two serial months available at any one time, rather than having four listed. Those respondents suggested that two serial Bank Bill Futures contracts at the front of the curve would be the most supported contracts in term of liquidity.

There was agreement that listing serial Bank Bill Futures would only be beneficial if the product was to move from deliverable to cash settled.

Those not supportive raised concerns that the serial contract months may not attract the same level of volume and open interest as seen in the existing financial quarter months. Respondents noted that other exchanges' short dated contracts generally have less liquidity in the serial months compared to the financial quarter months.

ASX response: ASX plans to list cash-settled serial Bank Bill Futures on the first two non-financial months of the Bank Bill Futures strip. ASX will monitor the liquidity of the initial serial contracts post implementation, with the potential to introduce a further two serial Bank Bill Futures should there be sufficient market demand.

3.5 Good Till Cancelled (GTC) functionality for combination orders

Do you support the introduction of GTC spread order types for Bank Bill Futures?

Most respondents were supportive of ASX providing GTC order functionality for the 90 Day Bank Bill Futures. Respondents noted this order functionality would be consistent with global peers and provide improved order management.

Those supportive of the change noted that it would provide flexible order management for participants. A number of respondents noted that it may reduce the risk of execution errors by not having to re-enter calendar spread orders at the commencement of each trading session.

Respondents also noted that it may result in increased liquidity further out the Bank Bill Futures yield curve and subsequently increase traded volume. Some noted the beneficial opportunities it could create in the back month bill spreads.

Some respondents were not supportive of GTC functionality suggesting that it would reduce liquidity. Other respondents suggested it may not improve the chance of participants receiving passive fills implying that participants would still be required to cross the bid/offer spread to facilitate a trade. One respondent commented on the potential for a significant increase in the order book being pre-populated at the start of each trading session. Some participants argued that GTC functionality may also increase the cost of managing order books on a 24 hour basis.

Additional considerations

The implementation of GTC functionality would involve a significant technical build for ASX and possibly for vendors and will take considerable time to deliver.

ASX response: ASX will further investigate the implementation approach and timing of Good Till Cancelled (GTC) and Good Till Date (GTD) functionality for the 90 Day Bank Bill Futures spread market.