

Related Security Spread (RSS) Futures

Listed futures on the spread of related securities

October 2020



Agenda

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- 2 RV strategy embedded in an index
- 3 Offer cash settled RSS futures
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Relative value trading

Current landscape and potential market size

Relative value trading

- Relative-value arbitrage is an investment strategy that seeks to take advantage of price differentials between related securities
- By simultaneously buying one security and selling the related security, investors seek to profit from a move in the 'relative value' of the two securities
- Dual Listed Companies (DLC), Share Class (Ord / Pref), Ord / ADRs, but also M&A etc.
- Trading relative value spreads is a core strategy for many hedge funds and props

Current landscape

- In the OTC market, brokers disseminate spread levels and trade ideas
- Client orders are executed as two legs of the spread and may include a simultaneous FX trade
- In DLC and other highly liquid names “risk-free” markets exist, where the spread is brokered as a package with a firm level
- Banks quote cash-settled instruments in any spread with significant interest e.g. during CAs

Market size

- ~1,165 relative value HFs globally, of which over 180 pure relative value arbitrage*
- 20-30 brokerage desks
- 25 core names account for over \$100mn daily turnover per leg (over \$400mn for all names)

*According to Prequin Hedge Fund Report 2016

RV strategy embedded in an index (1/2)

STOXX spread ratio indices as underlying

Address current limitations

- Executing the components of a spread exposes end users to market moves, requires sophisticated execution systems and has high trading and holding costs
- Instead, the relative value spread price can be defined and indexed as “100 +/- % spread”, subsequently used as underlying for listed futures

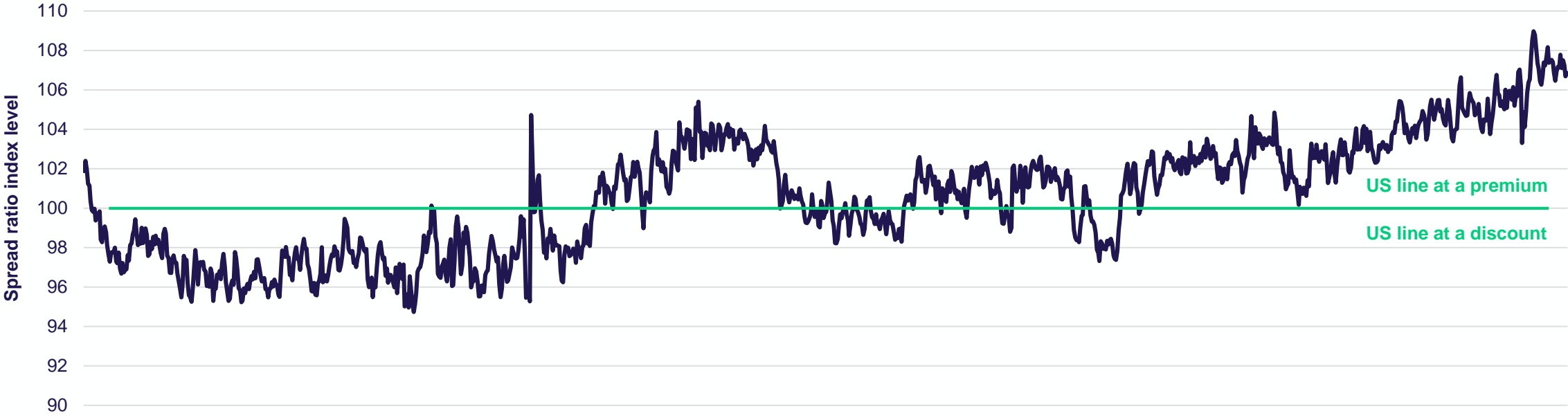
Constructing the index

- STOXX to disseminate spread indices in line with current cash spread practice
- **Spread index** = $\frac{Price_A * FX_A}{Price_B * FX_B} * 100$ (where A is conventionally the cheaper leg)
- Index level of 100 if spread at parity; index level of 115 if spread at 15% premium
- No intraday index levels – only end of day values at the close of trading in underlying securities
- Use a 5-day moving average to ease pressure on the expiry mechanism and the FSP

RV strategy embedded in an index (2/2)

STOXX spread ratio indices as underlying

EXAMPLE: iSTOXX Spread Ratio Carnival US/LN



Offer cash settled RSS futures

Facilitate RV trades in an innovative, efficient way

Underlying	The respective pair spread index as calculated by STOXX (Bloomberg “iSTOXX Spread Ratio ...”)
Contract value	100 USD per index point
Contract terms	One annual expiry in the December cycle
Minimum price change	0.1 index points; equivalent to 10 USD
Settlement	Cash settlement
Final settlement price	Based on the closing index level (as published by STOXX on the last trading day)
Last trading day	Third Friday of the maturity / expiration month
Final settlement day	The next exchange day following the last trading day (to cover all index close levels)
Daily settlement price	Set according to Eurex rules
Trading hours	09:00 a.m. – 10:00 p.m. CET
Eurex TES Minimum Block Trade size	100
Trading calendar	Tradable on each Eurex Exchange day
Trading fees	Orderbook/TES: USD 5.00 / 7.50

Listed futures

- Offer listed cash settled futures on STOXX spread ratio indices
- End clients benefit from ease of execution, obtain fixed notional / FX neutral exposure, reduced costs and increased transparency
- Trading facilitated by sophisticated Liquidity Providers

List of pairs to be listed in phase 1

Index name	Leg A	Leg B	Ticker	CCY	Index ISIN	Futures ISIN	Product ID
Phase 1 launch (30 March 2020)							
iSTOXX SR ATCO B/A	ATCOB SS	ATCOA SS	IXRATCBA	USD	CH0412529007	DE000A26R2G3	RFAT
iSTOXX SR BMW COM/PRE	BMW GY	BMW3 GY	IXRBMWCP	USD	CH0412529114	DE000A26R2H1	RFBW
iSTOXX SR BZU COM/SAV	BZU IM	BZUR IM	IXRBZUCS	USD	CH0412529213	DE000A26R2J7	RFBZ
iSTOXX SR EPI A/B	EPIA SS	EPIB SS	IXREPIAB	USD	CH0412529411	DE000A26R2K5	RFEP
iSTOXX SR GRF COM/PRE	GRF SM	GRF/P SM	IXRGRFCP	USD	CH0412529601	DE000A26R2L3	RFGR
iSTOXX SR HEI NV/HO	HEIA NA	HEIO NA	IXRHEINH	USD	CH0412536655	DE000A26R2M1	RFHE
iSTOXX SR HEN COM/PRE	HEN GY	HEN3 GY	IXRHENCP	USD	CH0412536697	DE000A26R2N9	RFHN
iSTOXX SR INDU A/C	INDUA SS	INDUC SS	IXRINDAC	USD	CH0412536705	DE000A26R2P4	RFIN
iSTOXX SR INVE A/B	INVEA SS	INVEB SS	IXRINVAB	USD	CH0412536721	DE000A26R2Q2	RFIV
iSTOXX SR LIS REG/PC	LISN SW	LISP SW	IXRLISRP	USD	CH0412529346	DE000A26R2R0	RFLI
iSTOXX SR MAERSK A/B	MAERSKA DC	MAERSKB DC	IXRMAEAB	USD	CH0412528934	DE000A26R2S8	RFMA
iSTOXX SR RDS A-NL/B-LN	RDSA NA	RDSB LN	IXRRDSAB	USD	CH0412536994	DE000A26R2T6	RFRD
iSTOXX SR RO BR/PC	RO SW	ROG SW	IXRROBP	USD	CH0412536960	DE000A26R2U4	RFRO
iSTOXX SR SCH A/B	SCHA NO	SCHB NO	IXRSCHAB	USD	CH0412537109	DE000A26R2V2	RFSB
iSTOXX SR SCH PC/REG	SCHP SW	SCHN SW	IXRSCHPR	USD	CH0412537158	DE000A26R2W0	RFSH
iSTOXX SR SIX COM/PRE	SIX2 GY	SIX3 GY	IXRSIXCP	USD	CH0412537224	DE000A26R2X8	RFSX
iSTOXX SR SSAB B/A	SSABB SS	SSABA SS	IXRSSABA	USD	CH0412537232	DE000A26R2Y6	RFSS
iSTOXX SR TIT COM/SAV	TIT IM	TITR IM	IXRTITCS	USD	CH0412537810	DE000A26R2Z3	RFTI
iSTOXX SR UHR BR/REG	UHR SW	UHRN SW	IXRUHRBR	USD	CH0412537729	DE000A26R204	RFUH
iSTOXX SR ULVR LN/NL	ULVR LN	UNA NA	IXRULVLN	USD	CH0412537869	DE000A26R212	RFUV
iSTOXX SR VOLV B/A	VOLVB SS	VOLVA SS	IXRVOLBA	USD	CH0412537927	DE000A26R220	RFVO
iSTOXX SR VOW COM/PRE	VOW GY	VOW3 GY	IXRVOWCP	USD	CH0412537893	DE000A26R238	RFVW

List of pairs to be listed in phase 2

Index name	Leg A	Leg B	Ticker	CCY	Index ISIN	Futures ISIN	Product ID
Phase 2 launch (TBC Q3 2020)							
iSTOXX SR SWI A/B	19 HK	87 HK	IXRSWIAB	USD	CH0412537802	DE000A26R246	RFSW
iSTOXX SR NWS A/B	NWSA US	NWS US	IXRNWSAB	USD	CH0412536762	DE000A26R253	RFNW
iSTOXX SR LBTY A/C	LBTYA US	LBTYK US	IXRLBTAC	USD	CH0412536747	DE000A26R261	RFLB
iSTOXX SR BHP AU/LN	BHP AU	BHP LN	IXRBHPAL	USD	CH0412529155	DE000A26R279	RFBH
iSTOXX SR CCL US/LN	CCL US	CCL LN	IXRCCLUL	USD	CH0412529296	DE000A26R287	RFCC
iSTOXX SR GRF DR/LOC	GRFS US	GRF SM	IXRGRFDL	USD	CH0412536614	DE000A26R295	RFGD
iSTOXX SR RIO LN/AU	RIO LN	RIO AU	IXRRIOLA	USD	CH0412536911	DE000A26R3A4	RFRI
iSTOXX SR RYA LOC/DR	RYA ID	RYAAY US	IXRRYALD	USD	CH0412537091	DE000A26R3B2	RFRY

Key advantages of an innovative, listed product

Related Security Spread Futures

Ease of execution

- RSSF replaces the need to execute 2 stock legs simultaneously (plus an FX layer)
- Replication/hedging complexities transferred to liquidity providers, attracting more end users
- Ability to leave limit orders at set spread levels

Equal notional spread exposure

- OTC, long/short share-for-share positions expose end users to a variable notional
- In contrast, RSSF is equivalent to a daily adjusted equal notional trade in both legs

Reduced costs

- RSSF will incorporate market implied funding cost and will achieve better implied div level
- Potentially reduced stamp/FTT costs when compared to trading the underlying

Reduced regulatory capital / PB haircut

- More efficient for bank balance sheets and underlying client haircuts if positions are held via RSSF

Increased transparency

- Transparent marketplace with on screen liquidity provided by market makers
- Correct spread level is more observable in a liquid RSSF market
- Daily settlement prices provided by the exchange

Proposed LP scheme

Overview

Eurex are proposing a LP scheme to RSS Futures (incl. later launches)
 This LP scheme will offer per product as well as package incentives and would require LPs to fulfil the following quote requirements in order to be eligible for the scheme's rebates and revenue sharing

RSS Futures

Required coverage	70 percent of the trading period
Number of products	17 of the 22 futures
Quote requirements	Detailed quote requirements available in the Product Specific Supplement

LP scheme incentives

Rebates – Upon fulfilment of the quotation requirements, LPs will receive up to 90 percent fee rebate on the M-account for both off-book and on-book transactions

Revenue Sharing – Upon fulfilment of the quotation requirements, LPs may also qualify for revenue sharing

RSS Futures

Revenue Sharing Pool:	Up to 30% of the net revenues of all products in the package
Participation Condition:	Fulfilment of Package Block Requirements
Number of Participants:	Up to 3
Distribution Method:	15% / 10% / 5% of the net revenues from trading and clearing RSS Futures (order book / TES) are distributed to the top 3 Liquidity Providers, accordingly. The ranking of the Liquidity Providers takes place on a monthly basis according to their market share / trading volume in the M account. The basis is the market share / trading volume in order book / TES in RSS Futures.

Beyond conventional pairs trading

Product concept could be extended to meet more client needs

M&A activity

- Pairs universe to be extended to major M&A deals
- Clear listing framework to be defined, as time to market essential

Industry pairs

- Pairs universe to be extended to major industry pairs
- Dependent on the overall success of the product suite and subsequent client requests

Index pairs

- Pairs universe to be extended to top index pairs (e.g. EURO STOXX 50)
- Match HFs (valuation driven) against volatility desks (cross gamma hedge driven)

Relative value risk premia index

- Seek partnerships to potentially develop regional RV risk premia index
- Pitch to investors to trade vs single pairs; increase overall volume

Optionality

- List options on the spread indices (requested by end clients)
- Ability to trade the volatility of the spread; currently not available in the OTC market

Thank you!

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