

ZRF China Index Option Market Preparation Guideline

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Table of Contents

Abstract.....	1
Section 1 Preparation Work.....	2
Section 2 CSI 300 Index Option Mock Trading Contract Specifications.....	4
Section 3 CSI 300 Index Option Mock Trading Statistics	5
3.1 Market Summary	5
3.2 Volume Statistics	6
3.3 Open Interest Statistics.....	8
3.4 Implied Volatility Statistics.....	8
Section 4 Rules and Regulations	9
4.1 Stock Index Option Mock Trading Rules and Regulations	9
4.2 Market-Making Rules and Regulations (Discussion Draft)	16
Section 5 Conclusion	19
Appendix.....	20

Abstract

In this guideline, we present the information needed for hedge funds to enter the CSI 300* option market, including the contract specification, mock trading statistics, mock trading rules and regulations and regulations for market-making business. Chinese futures industry has been pondering the introduction of options for couples of years as an innovational tool to stimulate and refine the Chinese capital market. The CSI 300 index futures contract has been proved as a successful instrument for investors to manage their profit and risk profiles. According to the 2013 annual report of FIA, volume of CSI 300 futures reached 193.2 million in 2013, up 83.9% from the previous year, making it the tenth most active equity index contract in the world. With the popularity of CSI 300 futures contract, we are confident that the launch of CSI 300 index options will extend the success and enrich the derivatives market of Mainland China.

The outline of this guideline is as follows: the first section reviews the primary work conducted by Chinese futures industry especially the China Financial Futures Exchange (CFFEX) to prepare and promote index options. The second section presents the specification of CSI 300 index option contract in the tabular form. The third section provides an overview of the current mock trading activities through data and statistics. The forth section presents applicable rules and regulations for investors engaged in option trading or market-making business. The last section summarizes and concludes.

*CSI 300 consists of 300 stocks with the largest market capitalization and liquidity from listed A share companies in China. For further information, please visit http://www.csindex.com.cn/sseportal_en/csiportal/zs/jbxx/report.do?code=000300&&subdir=1

Section 1 Preparation Work

Chinese futures industry has been planning to introduce financial derivatives into the capital market since 2005. After the launch of CSI 300 index futures on 16th April 2010, China Financial Futures Exchange (CFFEX) set out relevant research on stock index options. On Nov 8th 2013, CFFEX launched the CSI 300 index option mock trading across the whole market, an important step in preparation for stock index options live trading in Chinese capital market. Until now, the mock trading has been running smoothly for nearly nine months and the preparatory work for launching CSI 300 stock index options is almost complete.

The significant role that options played in the market has long been confirmed by those countries which successfully run the business. According to the annual volume survey of Futures Industry Association (FIA), the number of option contracts traded and cleared at 84 exchanges worldwide has amounted to 10,118,012,082 or 47.75% of total volume of futures and options contracts. The popularity of KOSPI 200 Index Option in the Korean market further inspired the Chinese equity market that has been awaiting resurgence since its collapse in the financial crisis of 2008. Options provide a flexible and precise approach to managing risks, speculating on directions and more importantly leveraging volatilities of underlying products. Lacking an effective risk management tool, the Chinese market is not well-functioning and exposes the market participants to a greater risk that can otherwise be hedged.

The introduction of the CSI 300 stock index options will be an important milestone in the development of Chinese financial market and is expected to bring back to life the trading activities in equity market. CFFEX has conducted a substantial amount of detailed research on options and launched stock index options mock trading on November 8th, 2013. More than 100 futures companies have participated. In addition, CFFEX has carried out a series of promotional activities as follows to warm up the market as well as educate investors and brokerage firms in an effort to prepare for the advent of option market.

- 1) Mock Trading Promotion Competition was held from March 24th to April 30th 2014, during which member futures companies competed for the success of promotional activities. All futures companies as well as their clients took part in the mock trading, which boosted trading activities dramatically in those months.
- 2) In an effort to help its member companies carry out investor education, CFFEX organized eight sessions of training courses from March 2014 to June 2014, inviting practitioners from

Asian and North American option markets to share their knowledge and experiences.

- 3) Investor Educational Product Competition was held from April 2014 to June 2014. All member futures companies participated and competed for the design of investor educational product. In the competition, products of various formats including books, videos, software, board games and etc. were designed and produced.
- 4) CFFEX held the Market Maker Mock Trading Competition from May 19th to June 20th in 2014 to exam the capability of market makers. 71 institutions participated in the competition, and were tested for their ability of providing liquidities and making profits. During the period of competition, the bid/ask spreads across whole market averaged less than 1.3 points, dropping from more than 10 points before the competition. Meanwhile, the price volatilities of various options are all reduced. The volume distributions across different contract months and degrees of moneyness are becoming more reasonable, as we will see in the later sections.

To answer CFFEX's call of promoting CSI 300 index options and educating investors, member futures companies held many mock trading competitions among their clients from late March. Consequently, the trading volume surged at a staggering rate of 23.85% per day in April, and reached a peak of 40,813,725 contracts in daily volume on April 18th. As an active participant, Zhong Rong Hui Xin Futures Co., Ltd. (ZRF) successfully held the "Talent-scout Cup of ZRF stock index options mock trading competition" from April 1st to 30th and attracted many investors to participate in the option market.

"The design of stock index options rules and regulations and the member firms' technical preparations are completed", as Dongsheng Lu, deputy general manager of CFFEX said on July 26th, "Till now, the mock trading has been running smoothly for more than eight months. The market foundation is strong enough to launch the stock index options."

Section 2 CSI 300 Index Option Mock Trading Contract Specifications

Underlying	CSI 300 index	
Multiplier	RMB100/point	
Contract Type	call option, put option	
Premium Quotation	point	
Tick Size	0.1 point	
Limit Up/Down	+/- 10% of closing price of CSI 300 on the previous trading day	
Expiration Months	Three consecutive near-term months plus the next two quarterly months from March, June, September and December.	
Strike Price Interval	Near-term months	Quarterly months
	50 points	100 points
Exercise Style	European Style	
Trading Hours	9:15-11:30, 13:00-15:15	
Trading Hours on Last Trading Day	9:15-11:30, 13:00-15:00	
Last Trading Day	Third Friday of the contract month, postponed to the next business day if it falls on a public holiday	
Expiration Day	Third Friday, same as "Last Trading Day"	
Delivery Method	Cash Settlement	
Transaction Code	IO	
The Exchange	CFFEX	

Source: CFFEX (http://www.cffex.com.cn/tzzfw/tzzfzjy/fzhyqz/201311/t20131108_17421.html), ZRF Option Division

Section 3 CSI 300 Index Option Mock Trading Statistics

The CSI 300 index option mock trading was launched in November 8th, 2013. This section provides an overview of the mock trading activities from the beginning of year 2014 to July 31th 2014. The information and data was obtained from Wind Information, the largest financial data vendor in China, and was compiled and furnished by ZRF Option Division without the responsibility for accuracy. ZRF does not guarantee the correctness of the data provided by Wind Information.

3.1 Market Summary

Exhibit 1: Options Trading Summary

	Call	Put	Total
Total Volume	303, 701, 198	154, 888, 442	458, 589, 640
Total Amount*	169, 934, 561	89, 499, 636	259, 434, 197
Open Interest**	181, 743	132, 989	314, 732

* Amount is in the units of RMB 10,000.

** Open interest is for the end of the period.

Source: Wind Information, ZRF Option Division

Exhibit 2: Options Contract Volume and Open Interest

Months	Trading Days	Contract Volume			Ave. Daily Total	Open Interest*		
		Call	Put	Total		Call	Put	Total
Jan	21	430, 382	200, 506	630, 888	30, 042	60, 627	31, 340	91, 967
Feb	16	439, 748	308, 141	747, 889	46, 743	55, 074	35, 949	91, 023
Mar	21	2, 450, 192	1, 112, 714	3, 562, 906	169, 662	280, 966	139, 881	420, 847
Apr	21	211, 508, 146	124, 055, 971	335, 564, 117	15, 979, 244	3, 414, 115	2, 821, 750	6, 235, 865
May	20	82, 043, 392	25, 042, 454	107, 085, 846	5, 354, 292	899, 979	338, 859	1, 238, 838
June	20	5, 410, 672	3, 321, 211	8, 731, 883	436, 594	235, 230	165, 331	400, 561
July	23	1, 418, 666	847, 445	2, 266, 111	98, 527	181, 743	132, 989	314, 732

* Open interest is for the end of the period.

Source: Wind Information, ZRF Option Division

Exhibit 3: Options Amount

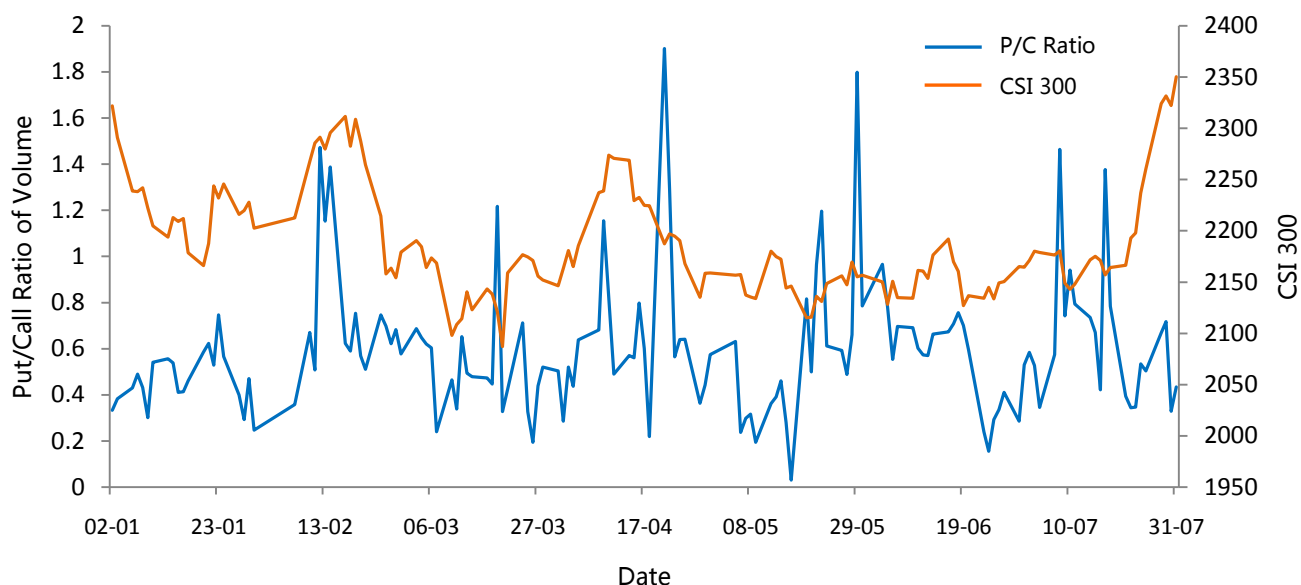
Months	Trading days	Amount*			Ave. Daily Total
		Call	Put	Total	
Jan	21	279, 019	206, 108	485, 128	23, 101. 318
Feb	16	370, 009	195, 078	565, 087	35, 317. 957
Mar	21	3, 979, 575	1, 395, 475	5, 375, 050	255, 954. 748
Apr	21	129, 845, 000	63, 075, 058	192, 920, 058	9, 186, 669. 435
May	20	31, 776, 157	22, 402, 947	54, 179, 104	2, 708, 955. 181
June	20	2, 803, 210	1, 915, 756	4, 718, 966	235, 948. 318
July	23	881, 591	309, 213	1, 190, 805	51, 774. 110

* Amount is in the units of RMB 10,000.

Source: Wind Information, ZRF Option Division

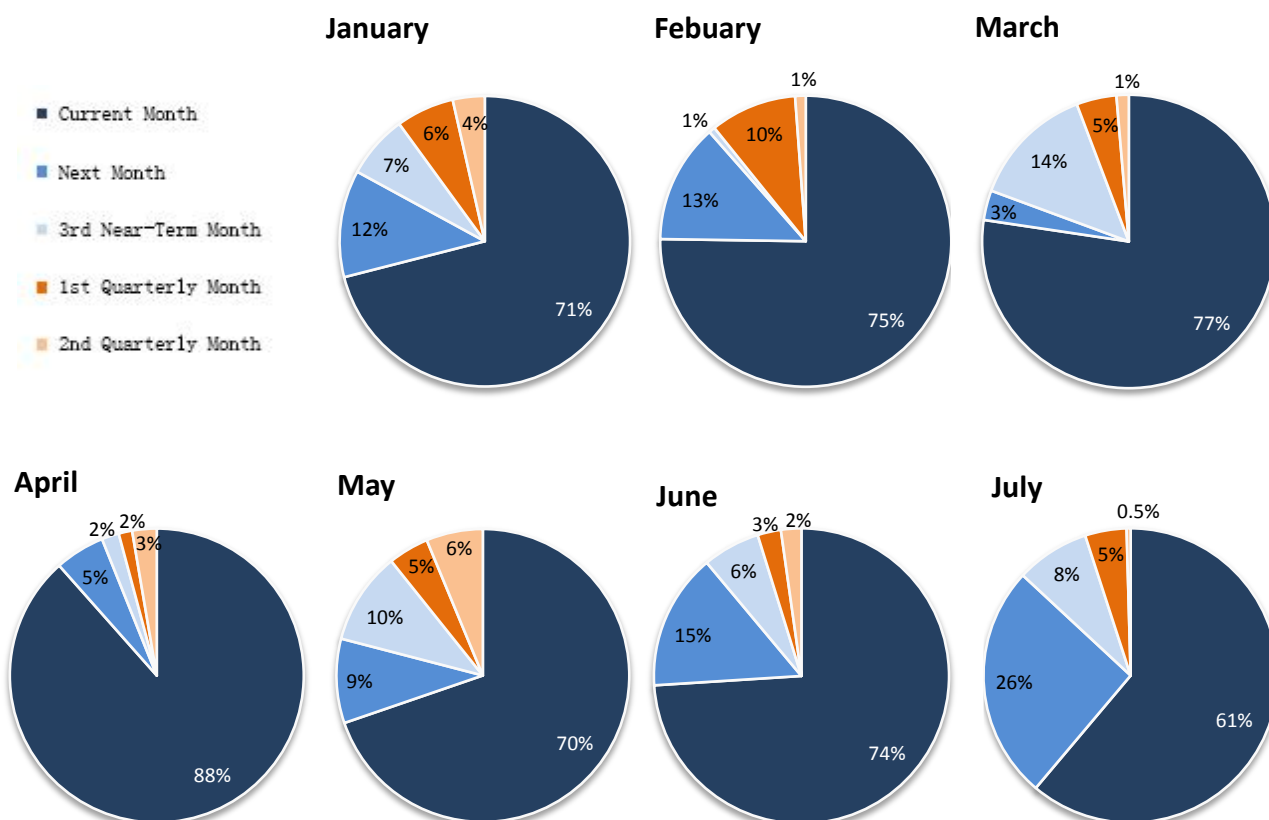
3.2 Volume Statistics

Exhibit 4: Daily Put/Call Ratio and CSI 300 Index



Source: Wind Information, ZRF Option Division

Exhibit 5: Volume Distribution Over Near-Term and Quarterly Month Contracts



Source: Wind Information, ZRF Option Division

Exhibit 6a: Call Volume Distribution Over Various Degrees of Moneyness

Note: Degree of moneyness is defined as CSI 300 index/strike price

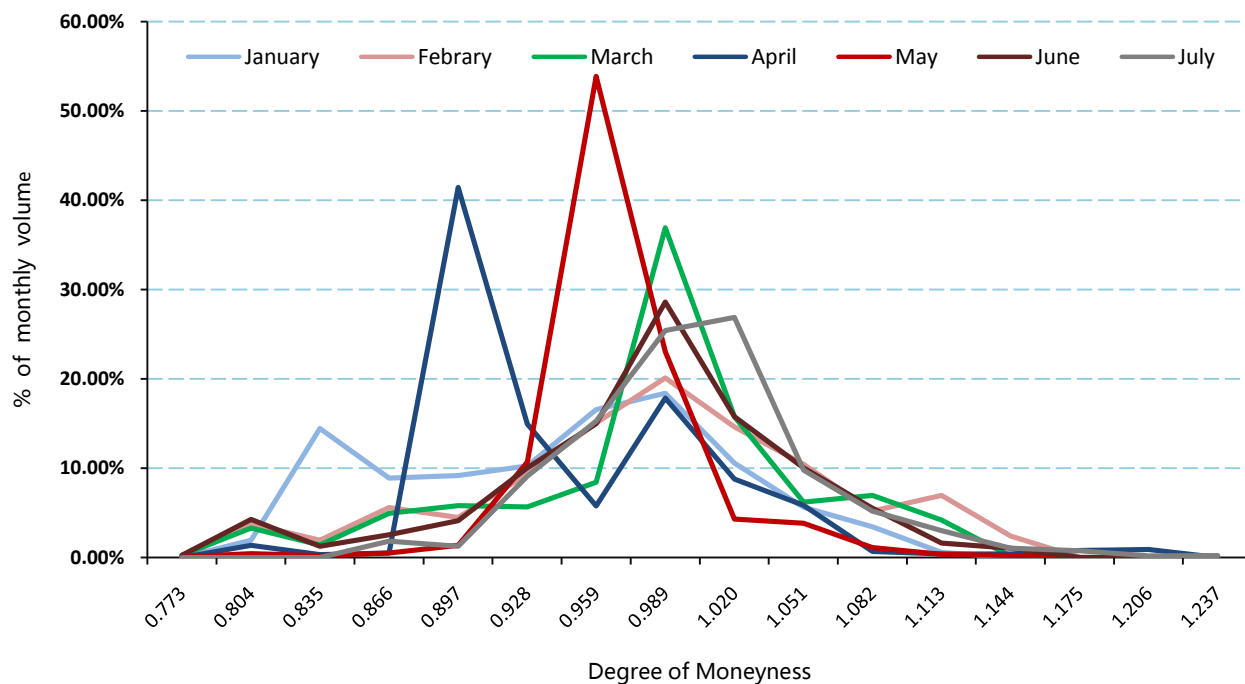
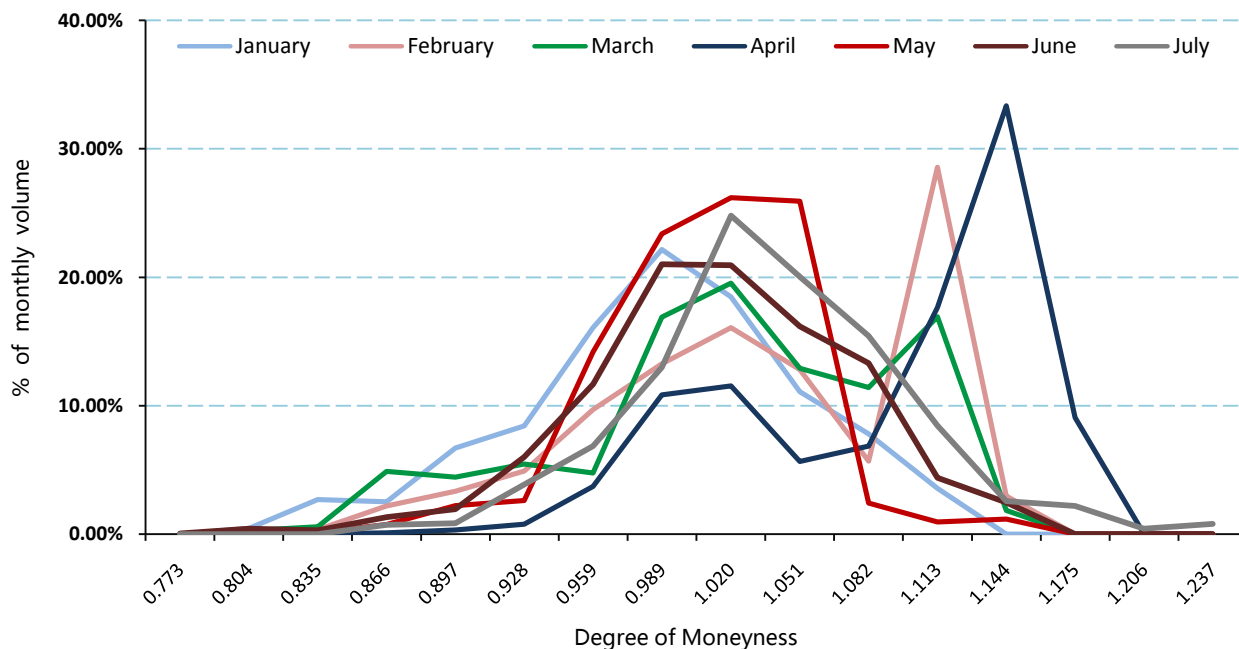


Exhibit 6b: Put Volume Distribution Over Various Degrees of Moneyness

Note: Degree of moneyness is defined as CSI 300 index/strike price

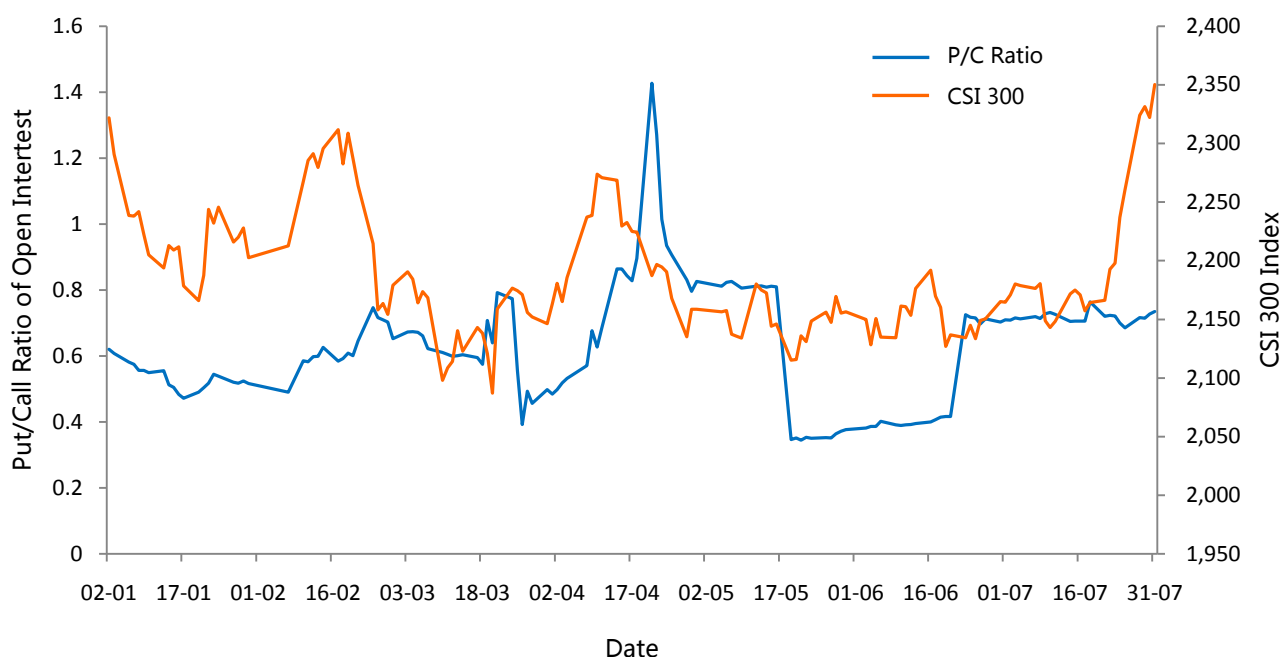


Source: Wind Information, ZRF Option Division

We didn't make distributions for total volume of all months, since the volume data of April is disproportionately large and distort the whole curve. A clearer version of Exhibit 6 with each month in one chart can be found in the Appendix for reference.

3.3 Open Interest Statistics

Exhibit 7: Daily Put/Call Ratio of Open Interest* and CSI 300 Index



*Open interest is for the end the period

Source: Wind Information, ZRF Option Division

3.4 Implied Volatility Statistics

Exhibit 7: Implied volatility on July 31th.

Value of 0 means there is no trading activity, while value of -1 means the price is below its intrinsic value.

Expiry Strike	1408	1409	1410	1412	1503
1900	0.00%	44.40%	0.00%	35.05%	0.00%
1950	-1	0.00%	0.00%	0.00%	0.00%
2000	61.12%	40.21%	0.00%	36.34%	0.00%
2050	58.19%	37.60%	0.00%	0.00%	0.00%
2100	53.53%	32.07%	0.00%	31.66%	0.00%
2150	49.14%	35.44%	-1	0.00%	0.00%
2200	33.40%	38.69%	0.00%	36.37%	19.19%
2250	31.31%	31.10%	0.00%	0.00%	0.00%
2300	32.37%	27.27%	0.00%	27.85%	11.56%
2350	28.25%	21.60%	0.00%	0.00%	0.00%
2400	13.83%	26.95%	0.00%	23.64%	38.01%
2450	0.00%	0.00%	0.00%	0.00%	0.00%
2500	0.00%	24.19%	0.00%	21.94%	0.00%

*The implied volatility presented here is derived from call options

Source: Wind Information, ZRF Option Division

Section 4 Rules and Regulations

This section offers translations of applicable rules and regulations regarding CSI 300 index option mock trading and market-making business. The original documentations are obtained from CFFEX and translated into English by ZRF option division. The English version is for the reference of foreign readers only, and ZRF does not guarantee the precision in translation.

4.1 Stock Index Option Mock Trading Rules and Regulations

Chapter I General Provisions

Article 1 The Rules are constituted to standardize and ensure the smooth operation of mock trading of stock index option organized by the China Financial Futures Exchange (CFFEX).

Article 2 The Rules applies to mock trading of the stock index options organized by the CFFEX. The CFFEX as well as its members, clients and other market participants engaged in the mock trading shall observe the Rules.

Article 3 What is not specified in this Rules should be in accordance with other related regulations made by the CFFEX.

Chapter II Qualification for Members Engaged in Mock Trading

Article 4 Technically capable futures companies may apply for members of mock trading of the CFFEX.

Applications who apply for becoming or changing memberships shall lodge written applications to the CFFEX and sign relevant agreements with the CFFEX after obtaining approvals from the CFFEX.

Chapter III Management over Seats for Mock Trading

Article 5 The trading seat of a member engaged in mock trading is the trading channel for a member engaged in mock trading to directly input trading orders and participate in auction trading of the CFFEX through the electronic communication system connected with the computer trading system of the CFFEX.

Article 6 Each member engaged in mock trading may apply for one or more trading seats to the CFFEX. Relevant application form shall be filled in the process of application.

Chapter IV Coding for Mock Trading

Article 7 The CFFEX adopts the filing system of coding for mock trading. The coding for mock trading refers to the special codes for mock trading compiled by members engaged in mock trading according to the Rules. After completion of mock trading, the coding for mock trading shall automatically cease to be in force.

Article 8 The 12-digit trading code consists of two parts, namely member number and client number. The first four digits represent the member number, while the last eight ones are client number. For example, if the trading code is 000100001535, the member number is 0001, while the client number is 00001535.

Article 9 Members and Clients who engages in hedge, arbitrage, speculation, or market making can apply for different client numbers according to their trading purposes. Clients opening accounts in different members shall have the same client number.

Article 10 Special legal entities, including commercial banks, securities companies, fund management companies and qualified foreign institutional investors who shall manage their assets in segregated accounts according to laws, administrative rules and regulations, and other applicable rules, may apply for mock trading code for the assets under segregated accounts.

Article 11 Special legal entities applying for opening an account shall submit application materials as required by the CFFEX, and ensure the truthfulness, accuracy and completeness of those materials.

Chapter V Mock Trading Contracts

Article 12 Stock index option contract refers to the standardized contract designed by the CFFEX that gives buyers the right to buy/sell the underlying index at a specified strike price on a future date.

Article 13 Stock index option contracts are classified into call option contracts (hereinafter referred to as call option) and put option contracts (hereinafter referred to as put option).

Call options are the contracts that give buyers the right to buy the underlying at a specified price on a future date.

Put options are the contracts that give buyers the right to sell the underlying at a specified price on a future date.

Article 14 Options are described as in-the-money, at-the-money and out-of-the-money according to the relationship between the strike price and current underlying asset price.

In-the-money option refers to the call option whose strike price is below the current underlying asset price, or put option whose strike price is above the current underlying asset price.

At-the-money option refers to the option whose strike price is equal to the current underlying asset price.

Out-of-the-money option refers to the call option whose strike price is above the current underlying asset price, or put option whose strike price is below the current underlying asset price.

Article 15 The basic items about stock index option contract include: underlying asset, multiplier, contracts type, unit, tick size, daily price limit, contract month, strike price interval, exercise style, trading hours, trading hours for the last trading day, last trading day, expiration day, delivery method, transaction code, and the exchange.

Article 16 The underlying index of the mock trading contract is CSI 300 index, which is compiled and launched by China Securities Index Co., Ltd.

Article 17 The transaction code of CSI 300 Index option is IO, with contract code IOYYMM-C/P-XXXX, where YYMM refers to contract month, C refers to call, P refers to put and XXXX refers to the strike price.

Article 18 CSI 300 Index option is quoted in the units of point.

Article 19 The contract multiplier of each contract is RMB100 per point.

Article 20 The minimum price change (tick size) in the contract trading is 0.1point.

Article 21 The contract months of CSI 300 Index option are three consecutive near-term months and two quarterly months from March cycle. March cycle refers to March, June, September and December.

Article 22 The last trading day and the expiration day are the same, which is the third Friday of contract month. The last trading day can be postponed in case of public holidays to the next trading day.

Article 23 The trading hours of the contracts are from 09:15 to 11:30 and from 13:00 to 15:15. The trading hours of the contracts on the last trading day are from 09:15 to 11:30 and from 13:00 to 15:00.

Article 24 The daily price limit of the contract is $\pm 10\%$ of the closing price of CSI 300 Index on the previous trading day.

The daily up(down) limit price is equal to the settlement price of the option contract on the previous trading day $+(-)$ 10% of the closing price of CSI 300 Index on the previous trading day. If the down limit is smaller than tick size, then tick size shall be the down limit. If the up limit of a put option is above its strike price, then the strike price shall be the up limit.

Article 25 The trading unit of each contract is lot, and the trading shall be carried out in integral multiple of the trading unit.

Article 26 The strike price interval of each contract is 50 points for the three near-term months, and 100 points for the two quarterly months.

Article 27 The exercise style of the CSI 300 index option is European. The exercise day is the same day as expiration day.

Article 28 The contract is settled in cash upon expiration.

Chapter VI Mock Trading

Article 29 Clients can apply to the CFFEX for client numbers to participate in stock index option mock trading.

Article 30 The mock trading orders can be classified into limit order and other orders regulated by the CFFEX.

Article 31 Limit order refers to the orders, under which the deal is made according to the specific price or better offer. In the process of buying, the deal shall be made at the specific price or a price lower than the specific price. In the process of selling, the deal shall be made at the specific price or a price higher than the specific price. The limit order is valid on the very day. Those, under which no deal is made, can be cancelled.

Article 32 The minimum quantity of orders placed under limit order each time is one lot. The maximum quantity of orders placed under limit order each time is 100 lots.

Article 33 Call auction and continuous auction are adopted in the stock index option mock trading. The rules for auctions are the same as in the CSI 300 index futures.

Article 34 The CFFEX will determine newly listed contracts for the next trading day based on the following rules:

(1) The strike price of at-the-money option for each contract month is determined as the closest number, divisible by strike interval, to the daily closing price of CSI 300 Index. If there exist two choices, the smaller shall be chosen.

(2) Given strike price interval, at least 3 contracts shall be listed on each side of the at-the-money strike (below and above) for the near-term month (current, and the next two months), and at least 2 contracts on each side for the next two quarterly months.

The CFFEX is entitled to adjust the number of listed contracts in response to market conditions.

Article 35 The CFFEX will publish in advance the theoretical price of the newly listed contract, on which the price limit of the new contract on the first trading day is based.

Chapter VII Clearing of Mock Trading

Article 36 Clearing refers to the businesses of calculation and transfer of members' trading margin, premium, commission and other relevant amount according to the trading results and relevant regulations of the CFFEX.

Article 37 The CFFEX adopts the clearing member system, whereby the CFFEX conducts the settlement for its clearing members, who in turn conducts the settlement for its clients and trading members, who conducts the settlement for its clients.

Article 38 All the contracts whose bargain was struck through the trading system of the CFFEX shall be settled through the CFFEX.

Article 39 The buyer of stock index options pays premium when opening a position and receives premium when closing a position.

Article 40 The seller of stock index options receives premium when opening a position and pays premium when closing a position.

Article 41 In the process of clearing, the CFFEX calculates the trading margins for option sellers according to the settlement prices of the contracts, strike prices and the daily closing price of the underlying index.

Article 42 The daily settlement price of stock index option is calculated as the volume-weighted average premium within the last hour. The result is rounded to one decimal place.

If there is no trading for some day or the calculated settlement price is far from reasonable, the CFFEX will determine the settlement price for that day.

Article 43 The CFFEX will charge the commission based on trading volume and is entitled to make adjustments.

Article 44 In the process of daily settlement, if the trading margin required exceeds that on the previous trading day, the excessive part shall be deducted from the settlement margin. If the trading margin is less than that on the previous trading day, the excessive part shall be transferred into the settlement margin.

The receipts or payments of premiums shall increase or decrease the settlement margin.

Other fees including the commissions and taxes shall be deducted from the settlement margin.

Article 45 The specific formula for the balance of the settlement margin is as follows:

Balance of settlement margin on the current day = balance of settlement margin on the previous trading day + trading margin on the previous trading day – trading margin on the current day + premium proceeds – premium payments + profit/loss on the current day + deposit – withdrawal – commissions, etc.

Chapter VIII Exercise of Mock Trading Contract

Article 46 The buyers of stock index options are entitled to exercise the option within a certain period. For options eligible to be exercised, the sellers are obligated to settle by cash according to the final settlement price, and all open positions shall be settled up.

Clients who choose to exercise options shall lodge an exercise application to the CFFEX through the members.

Article 47 Members upon their clients' requests shall lodge the application to the CFFEX within a certain period. Positions eligible to be exercised will be done automatically by the CFFEX except when clients apply for giving up exercise. Positions that are not eligible will not be exercised regardless of clients' application for exercising.

Article 48 On the last trading day, the CFFEX will treat the long positions in stock index option as follows:

- (1) In-the-money options whose ITM value exceeds the exercise commission regulated by the CFFEX will be exercised automatically except when the buyers apply for giving up exercise before the time set by the CFFEX.
- (2) Out-of-the-money, at-the-money options and in-the-money options whose ITM value does not cover the exercise commission regulated by the CFFEX will not be exercised regardless of option buyers' application.

On the expiration day, options can be classified as in-the-money, at-the-money or out-of-the-money based on the strike price and final settlement price. ITM value for a call option is: $\max((\text{final settlement price} - \text{strike price}) \times \text{contract multiplier}, 0)$; ITM value for a put option is: $\max((\text{strike price} - \text{final settlement price}) \times \text{contract multiplier}, 0)$.

Article 49 For long positions eligible to be exercised, the CFFEX will choose corresponding short positions based on the position size. If a client holds both long and short positions in the same contract under the same member, the size of short positions to be exercised will be deducted by the size of long positions that are exempt from exercise.

Article 50 The final settlement price of stock index option is the arithmetic average price of the underlying index over the last 2 hours on the last trading day. The result is rounded to 2 decimal places.

The CFFEX is entitled to adjust the final settlement price in response to market conditions.

Article 51 The exercise profit/loss of stock index option is included in the daily profit and loss, with the profit transferred into settlement margin and the loss deducted from settlement margin.

$$\text{Profit/loss} = \sum[(\text{final settlement price} - \text{strike price}) \times \text{exercised amount of longing call} \times \text{multiplier}] + \sum[(\text{strike price} - \text{final settlement price}) \times \text{exercised amount of longing put} \times \text{multiplier}] - \sum[(\text{final settlement price} - \text{strike price}) \times \text{exercised amount of shorting call} \times \text{multiplier}] - \sum[(\text{strike price} - \text{final settlement price}) \times \text{exercised amount of shorting put} \times \text{multiplier}].$$

Article 52 The CFFEX charges the exercise commission pursuant to rules and regulations, based on the exercised amount of stock index options on the current day.

The CFFEX is entitled to adjust the exercise commission in response to market conditions.

Chapter IX Risk Control in Mock Trading

Article 53 The CFFEX adopts the margin system for the stock index option mock trading. The buyers of options are exempt from posting margins. The specific formula for margins that sellers shall post is as follows:

Trading margin for a call option = (daily settlement price of option contract \times multiplier) + max(daily closing price of underlying \times multiplier \times margin adjustment coefficient - OTM value, minimum requirement coefficient \times daily closing price of underlying \times multiplier \times margin adjustment coefficient).

Trading margin for a put option = (daily settlement price of option contract \times multiplier) + max (daily closing price of underlying \times multiplier \times margin adjustment coefficient - OTM value, minimum requirement coefficient \times strike price \times multiplier \times margin adjustment coefficient).

Here, multiplier = 100, margin adjustment coefficient* = 15%, minimum requirement coefficient* = 0.667, OTM value for a call = max ((strike price – closing price of underlying) \times multiplier, 0), OTM value for a put = max ((closing price of underlying – strike price) \times multiplier, 0).

After the bargain is struck, the CFFEX will ask the seller to post trading margins according to trading margin per contract and the trading volume.

Article 54 The CFFEX adopts the price limit system. The price limit will be fixed by the CFFEX, who can adjust the price limit of an options contract in response to market conditions.

Article 55 The CFFEX adopts the position limit system for the stock index options mock trading. The unilateral position limit of a certain contract series is 1800 lots. Hedgers, arbitrageurs and market maker are not restricted by the unilateral position limit.

Position limit refers to the maximum position of a certain contract series that can be held by the member or the client in a unilateral way according to the regulations of the CFFEX.

The contract series refers to the collection of all contracts of the same underlying and the same contract month.

The total open position of a client, who opens positions at different members, in a certain contract series cannot exceed the position limit on one client.

The unilateral open position is calculated as the sum of open positions in long-call and short-put and the sum of short-call and long-put respectively.

*The margin adjustment coefficient and minimum requirement coefficient will be adjusted to 10% and 0.5 respectively.

Article 56 The CFFEX adopts the large position report system. The CFFEX may announce the standard for position report according to the market risk.

The member or the client, whose open position reaches the standard for report as regulated by the CFFEX, or who is required by the CFFEX to report, shall report to the CFFEX according to the regulations of CFFEX in risk management.

Article 57 The CFFEX adopts the risk alert system. The CFFEX may take, when necessary, one or more than one such measures as reporting, interview for reminding, written warning and issuing risk warning notice to caution against and dispel risks.

Chapter X Penalties for Violations

Article 58 All members and clients engaged in mock trading shall participate in the principles of active participation and honest trading, and shall not conduct the following violations:

- (1) Members engaged in mock trading persuading its clients to gamble with real capital by leveraging the price information in mock trading;
- (2) Manipulating market price;
- (3) Other conditions violating the regulations of the CFFEX or the principle of good faith.

Article 59 If members and clients engaged in mock trading are suspected of violations, before the violations are confirmed, the CFFEX may impose the following temporary measures on the parties under investigation to prevent further expansion of the consequences of violations and ensure the execution of penalties:

- (1) Stopping accepting applications for new mock trading codes;
- (2) Limiting deposits;
- (3) Limiting withdrawals;
- (4) Limiting position-opening;
- (5) Lowering position limit;
- (6) Closing position within stipulated time limit

Article 60 If members or clients engaged in mock trading violate the regulations of the CFFEX, the CFFEX shall order them to make corrections and may impose measures including interview for reminding, written warning, criticism by circulating a notice, public censure, limit on position opening, forced liquidation, trading suspension, disqualification from mock trading, business suspension or limit, and adjustment or cancellation of member qualification for mock trading on them according to the seriousness of the circumstances.

Chapter XI Supplementary Provisions

Article 61 The interpretation right of the Rules resides in the CFFEX.

Article 62 The Rules shall take effect as of November 8, 2013.

4.2 Market-Making Rules and Regulations (Discussion Draft)

Chapter I General Rules

Article 1 In an effort to ensure the liquidity of financial futures market, improve the operating efficiency of financial futures market and standardize the management of market-making business of the China Financial Futures Exchange (CFFEX), this approach is designed according to the <China Financial Futures Exchange Trading Rules> and other applicable regulations.

Article 2 Market makers refer to legal persons or other economic organizations recognized by the CFFEX that provide continuous quotations or response to the enquiries for specific option contracts.

Article 3 Market makers engaged in market-making business in the CFFEX shall observe this approach.

Chapter II Market-Maker Qualification

Article 4 The CFFEX adopts hierarchic system in market maker qualifications management. Legal persons and other economic organizations qualified for market-making business may apply to the CFFEX for the qualification for primary market makers or secondary market makers.

Article 5 The following conditions shall be satisfied when applying for market maker qualifications:

- 1) For primary market makers, the registered capital shall not be less than RMB100 million; while for secondary market makers, the registered capital shall not be less than RMB50 million.
- 2) Possessing a good reputation and business record, with no bad record, serious violations or punishments by futures exchanges or stock exchanges within the last year.
- 3) Prepared with a detailed business execution plan, a sound system of internal control and risk management.
- 4) Equipped with professional personnel and technical systems for conducting market-making business.
- 5) Other requirements prescribed by the CFFEX.

Article 6 Applicants for market-making business shall submit the following materials to the CFFEX:

- 1) Market-maker application form signed by the legal representative with official seal.
- 2) Copies of business license and duplicate certificate of organization code with official seal.
- 3) Profile of the head of market-making business and relevant business personnel configuration.
- 4) The business execution plan, internal control system and risk management system.
- 5) Preparation of relevant technical systems for market-making business.
- 6) Other materials required by CFFEX.

Article 7 For applicants who meet application requirements and with materials prepared, CFFEX will, according to the market conditions, application materials and applicants' credit stands, inform the applicants of the decisions of approving market-maker qualification within 30 trading days upon receipts of application materials.

Article 8 Applicants who obtained market-maker qualification shall sign an agreement and go through relevant procedures with CFFEX within 30 trading days upon receipts of notice from CFFEX. Those who miss the due date will be regarded as forgoing their applications.

Article 9 Market makers who are no longer qualified or planning to terminate market-making business shall apply for terminating market-maker qualification 30 trading days in advance as required by CFFEX.

Article 10 Market makers who apply for termination shall submit the application for terminating market-maker qualification and other materials as required by CFFEX.

Article 11 The CFFEX shall inform the applicants to go through relevant procedures after approving the applications for terminating market-maker qualification.

Market makers shall close related positions regarding market-making business and go through other matters required by CFFEX within 30 trading days upon the notice of terminating market makers qualification.

Chapter III Market-Making Business

Article 12 Market makers shall use its own funds to conduct market-making business in accordance with the business execution plan.

Article 13 Market makers shall use special transaction code to conduct the market-making business.

Article 14 Market makers shall observe the Market-Making Rules and Regulations and the agreements signed with CFFEX, possessing the rights while fulfilling the obligations as regulated.

Article 15 Market makers may have all or some of the following rights:

- 1) Fee deduction;
- 2) Margin system applicable for market makers;
- 3) Other rights in market-making agreement.

Article 16 Primary market makers shall perform the following obligations:

- 1) Continuous quotation;
- 2) Response to investors' enquiries
- 3) Other obligations regulated by the CFFEX and stipulated in the market-making agreement.

Secondary market makers shall perform item 2) and 3) mentioned above.

Article 17 The CFFEX may free market makers from all or part of obligations in extraordinary market conditions, or when force majeure or accidents hinders normal trading activities.

Article 18 Market makers shall keep the enquiry response time, quotation lasting time, quoted quantity and quotation spread in accordance with the provisions of this Rules and market-making agreement.

Article 19 Market makers can obtain market-maker position limits fixed by CFFEX. Market-maker position limits is classified into option position limits and futures position limits. Option position limits refers to the maximum unilateral position regarding option contracts. Futures position limits refers to the maximum unilateral position regarding futures contracts.

Article 20 Market makers may submit an application to the CFFEX for increasing position limits as considerations for business needs.

Article 21 The CFFEX will, according to the market conditions, application materials, applicants' credit stands, and trading records, review the application for increasing market-maker position limits. The CFFEX is entitled to adjust the market-maker position limits.

Article 22 The CFFEX is entitled to require market makers to quote for specific contracts.

Article 23 Bilateral quotations of market makers shall observe applicable rules of the CFFEX. Quotations that participate in trading process shall conform to the principle of order matching stipulated by the CFFEX.

Chapter IV Supervision

Article 24 If the quoted price provided by market makers does not conform to the regulations of CFFEX, the CFFEX may require market makers to make an explanation or require them to adjust the quoted price. Significant changes or adjustments of market makers' organizational structure, funds, personnel, business execution plan and technology system shall be immediately reported to the CFFEX in a written form.

Article 25 The CFFEX can supervise and examine market makers' operating conditions, credit stands and trading activities. Market makers shall assist and cooperate with CFFEX.

The CFFEX can require market makers to report their market-making business conditions, examine trading records and risk management records.

Article 26 The CFFEX shall regularly evaluate market makers' performance on fulfilling market-making obligations. If market makers conduct the following behaviors, the CFFEX is entitled to revoke all or some of their rights, adjust market makers' position limits, suspend or terminate their market makers qualifications:

- 1) Failure to perform the duty of market making without proper reasons;
- 2) Serious violations of this rule;
- 3) Other situations identified by the CFFEX.

Article 27 Market makers whose market-making qualification is terminated or canceled shall not reapply for market-makers qualification within 1 year.

Chapter V Supplementary Provisions

Article 28 For those in violation of the rules, the CFFEX will deal according to this approach and the relevant provisions in <the China Financial Futures Exchange default method>.

Article 29 The CFFEX is responsible for interpreting the rules.

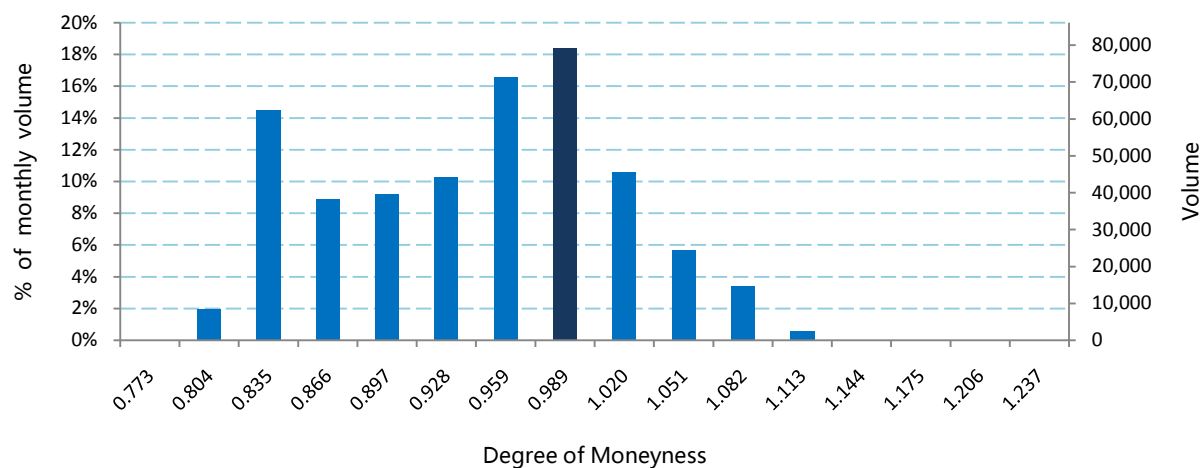
Section 5 Conclusion

This report briefly presents the preparatory situation of Chinese option market. As we have seen, the futures industry has put in a lot of effort to promote the launch of CSI 300 Index option contracts. At present, the design of contracts, rules and regulations, technical systems and market-making business management are complete. In addition, the statistics of mock trading suggest that the market has been improving since the commencement and is running stably with reasonable distributions of volumes. At the moment, the whole market is waiting for the arrival of the new trading tool.

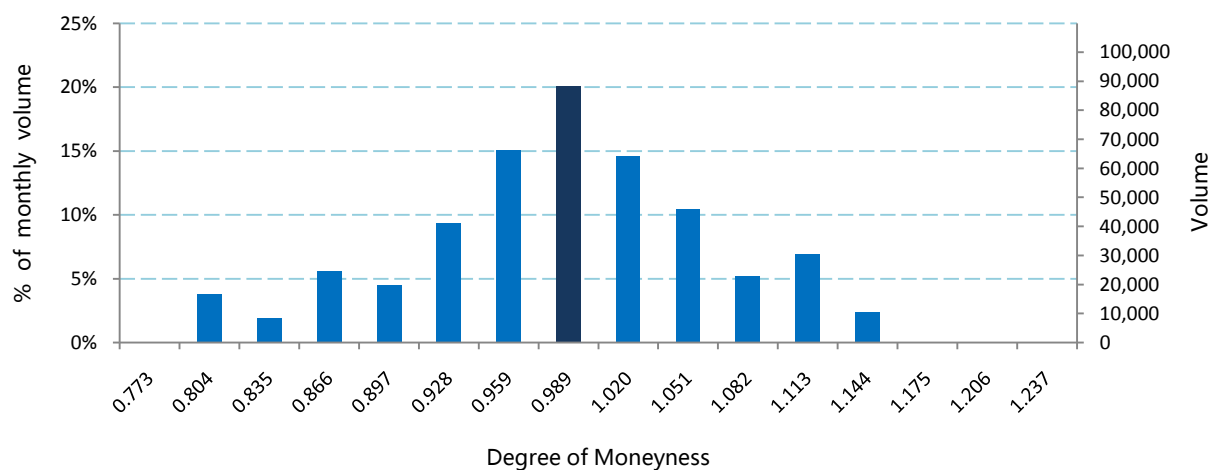
Appendix

Call Volume Distributions Over Degrees of Moneyness

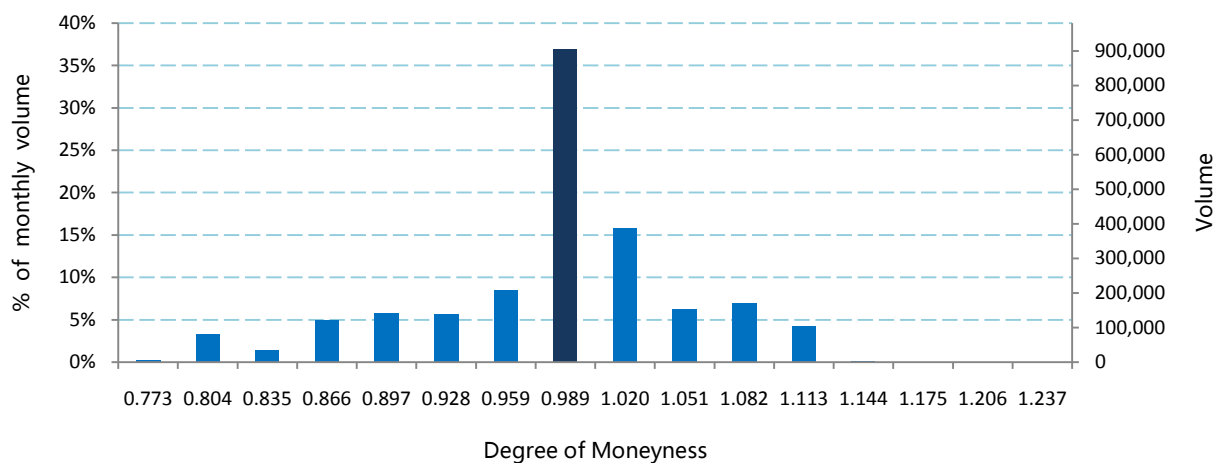
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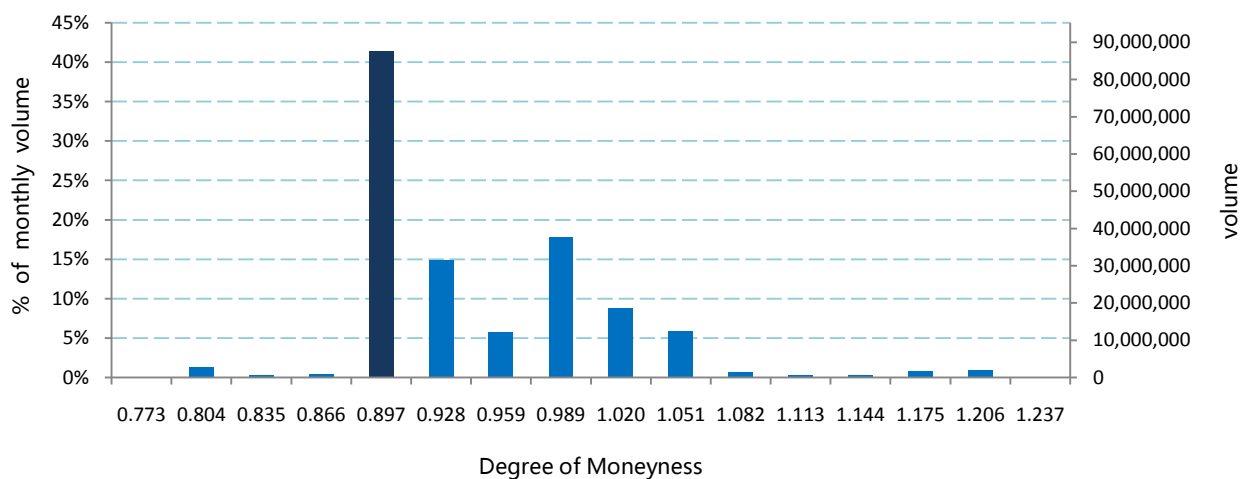
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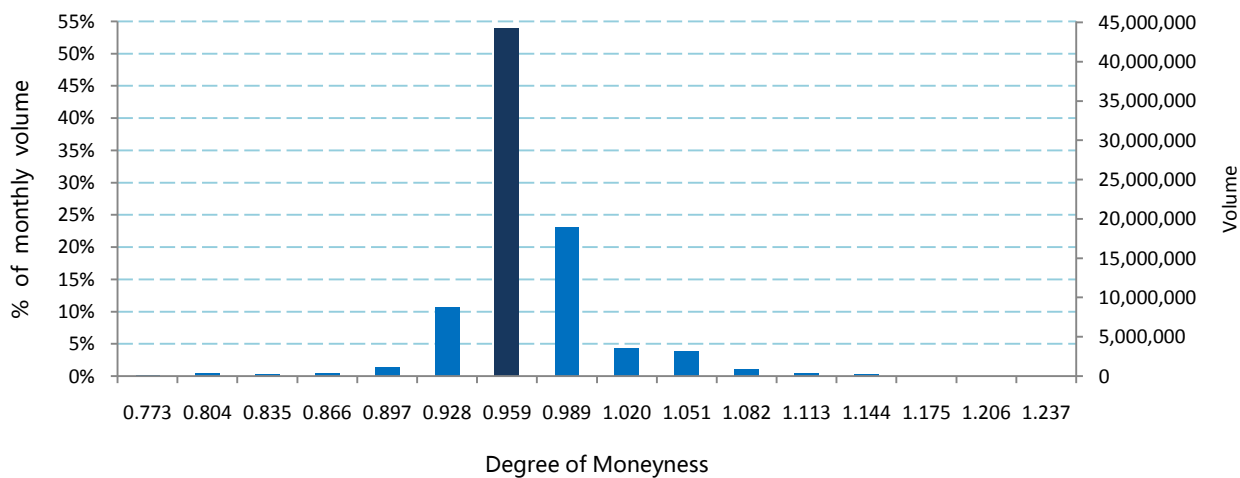
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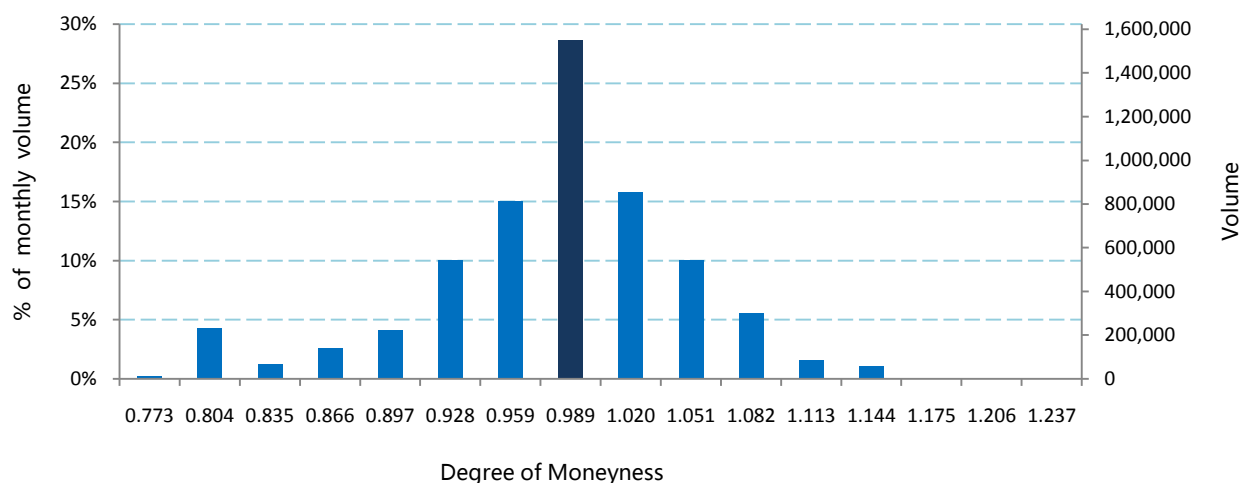
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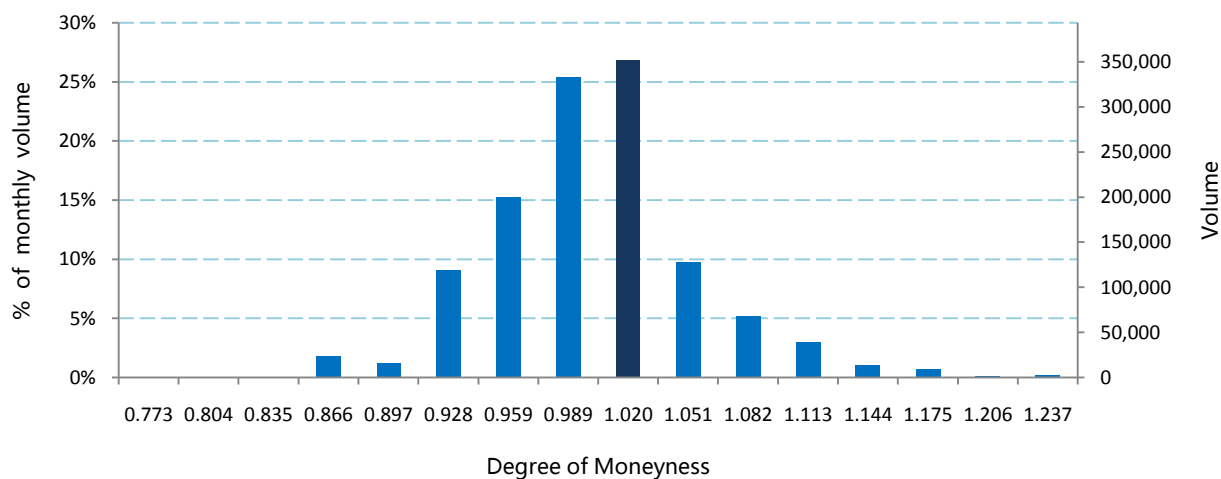
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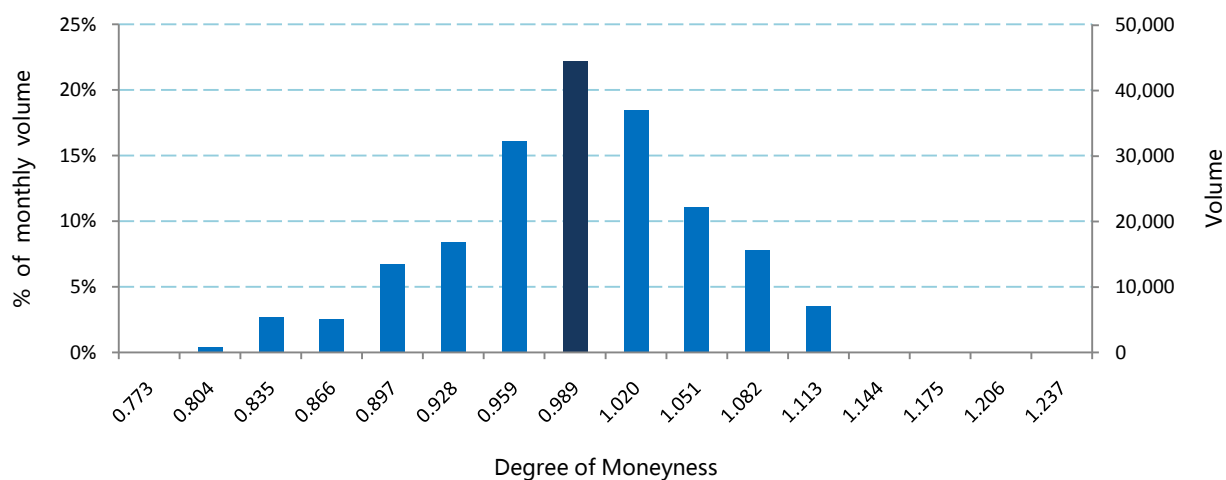


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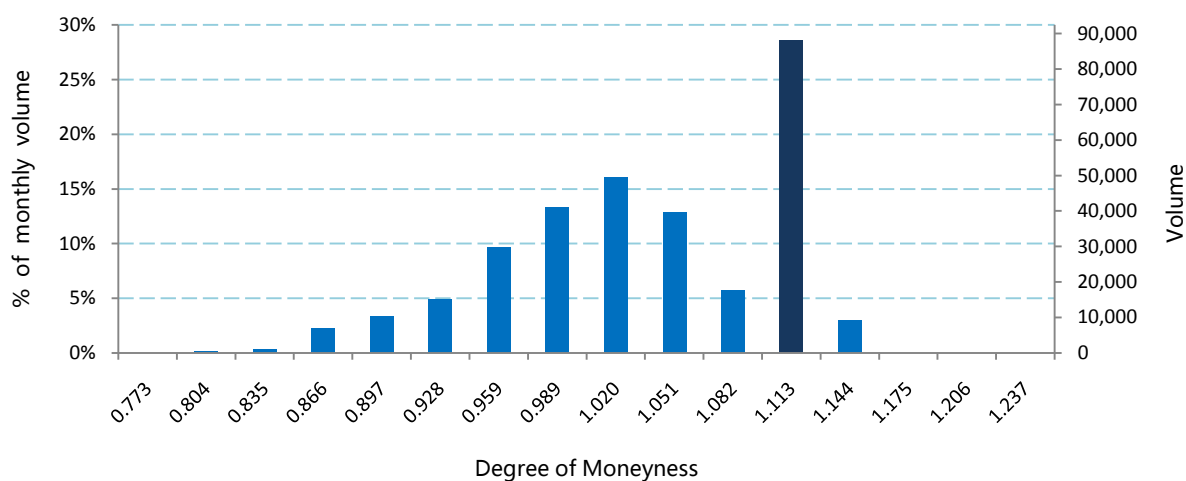


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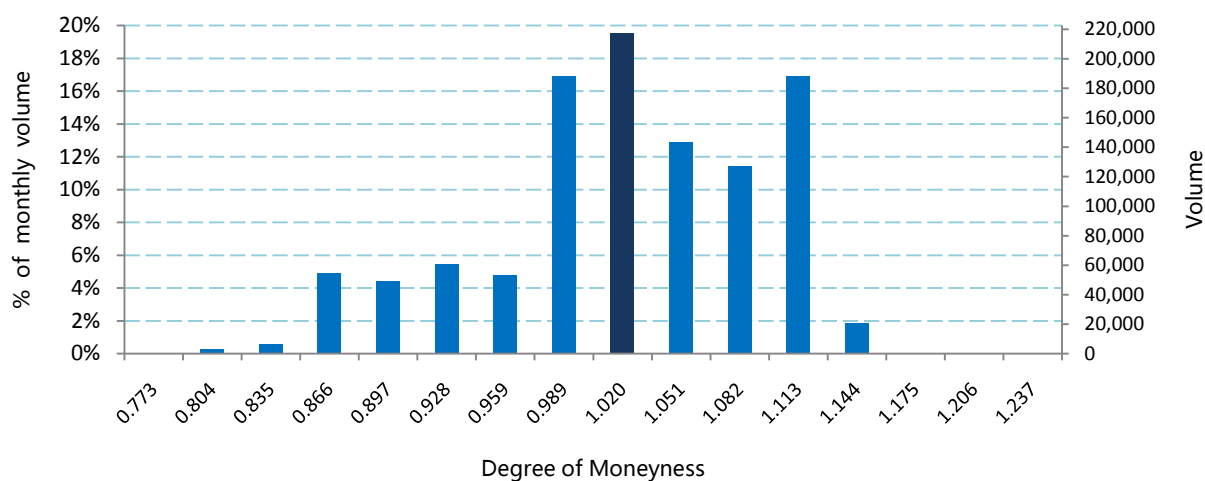
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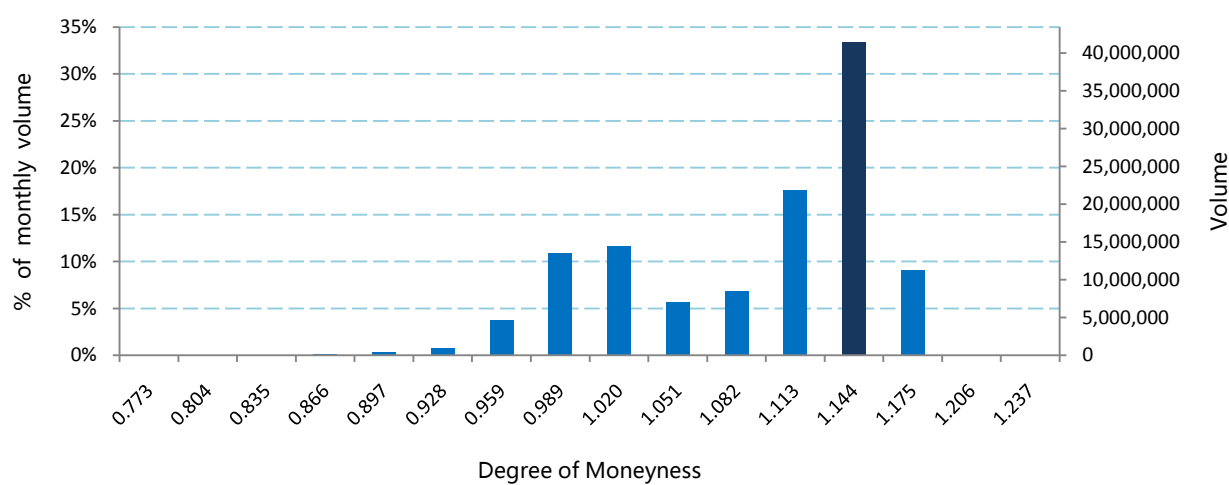
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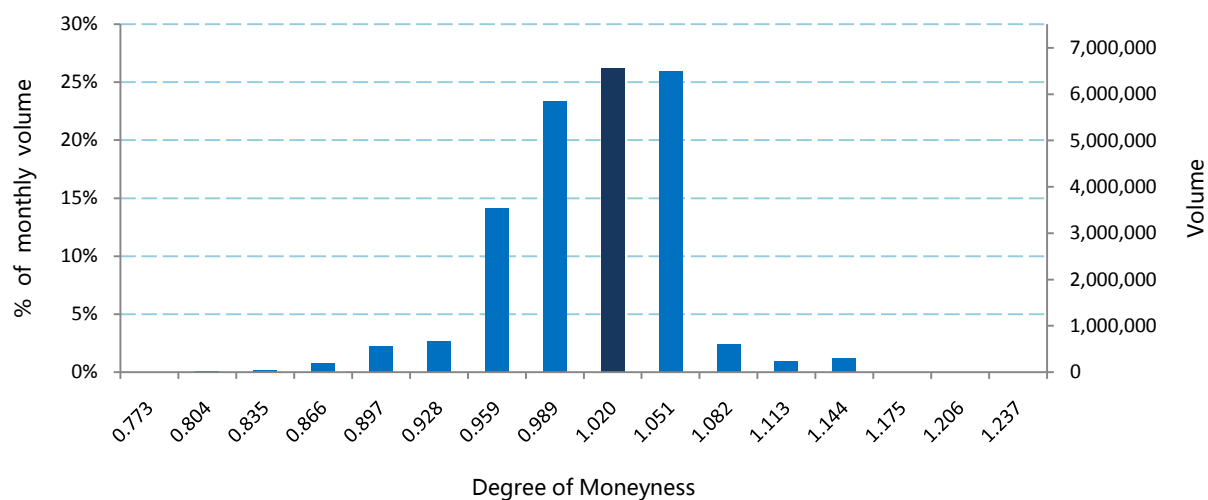
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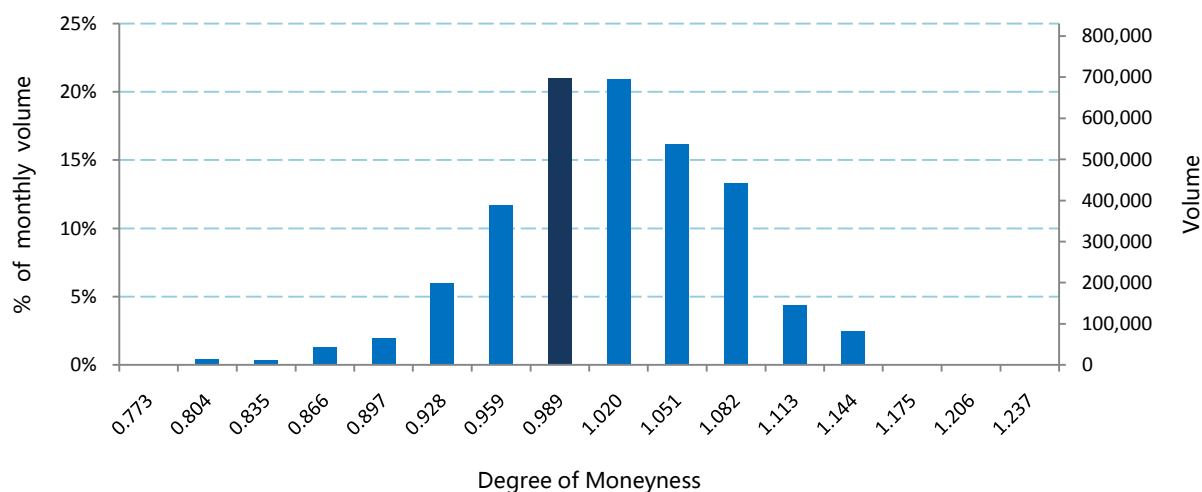
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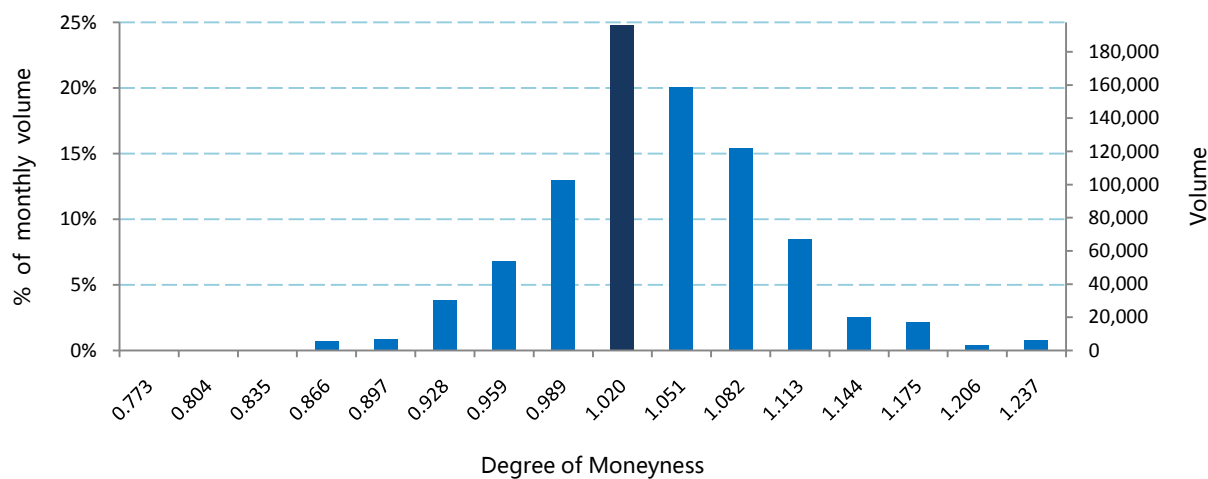
May-Put



June-Put



July-Put



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