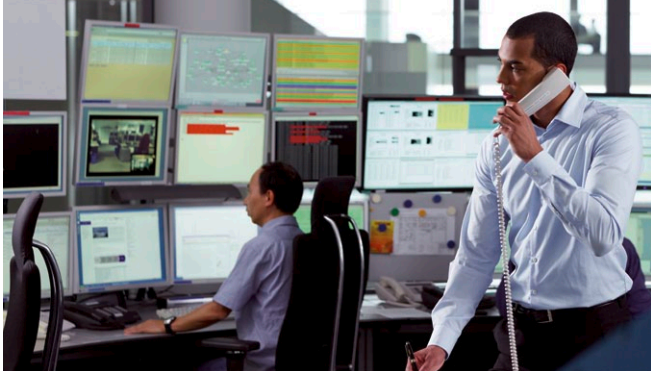


XETRA | DEUTSCHE BÖRSE GROUP

Cut your Pin Risk down to Size!

Managing the delta hedge dilemma on Option Settlement Days with the Xetra® Strike Match Order

As a trader working both the cash and the forward markets you know the situation all too well: it is option settlement day, the decision whether to exercise a specific option or not is at hand. Usually the choice is easy, since in most cases the option will be clearly in or out of the money. But every now and then an option threatens to settle at the money. Especially if you respectively the traders you sold options to want to stay delta-neutral, the situation can very fast become very tricky. Until now, there is no order – or a combination of orders – that enables you to fully implement an effective counter-trade. The only means to prevent an undesired inventory in your portfolio is now to watch the indicative price very closely so you can enter a respective order once the indicative price crosses the strike price. Well, this is ancient history now.

The Xetra Strike Match Order

With the Xetra Strike Match Order, Deutsche Börse offers a new, intelligent order type enabling you to reduce pin risk most effectively. At the same time, trading on option settlement days will be more efficient since you won't have to observe the indicative price of at-the-money options during closing auctions anymore. Also, the risk associated to implementing delta neutral hedging strategies will decrease – as will the allocation risk which can arise when a competing order with older timestamp is available.

How the Xetra Strike Match Order works

Since the closing price of Eurex single stock options is determined using the Xetra Closing Auction, the Strike Match Order serves as a bridge between Xetra and Eurex. This innovative order type is applicable exclusively during closing auctions for stocks traded in continuous trading. The Strike Match Order offers the possibility to set an additional limit – in combination with a limit order or a market order. The additional limit determines the minimum price for a buy order respectively the maximum price for a sell order. The Strike Match Order will be executed if the price satisfies the restrictive additional limit as well. Thus, your situation regarding your pin risk will improve significantly since you will be able to enter the Strike Match Order long before the indicative price of an option crosses the strike price.

Xetra Strike Match Order

All advantages at a glance:

- The innovative order type is available for all Eurex single stock options on Blue Chips during Xetra Closing Auction
- Highly effective reduction of pin risk of equity options quoted at the money
- Decrease of risk for implementation of delta neutral hedging strategies
- Reduction of allocation risk – which usually occurs when a competing order with older timestamp is available – since traders can enter orders before the indicative price crosses the strike price
- Considerable increase of trading efficiency since traders will not have to observe the indicative price of at-the-money options during closing auctions anymore
- Given reduced risk and increased efficiency, more aggressive trading strategies can be implemented
- Reduction in volatility of indicative prices during call phase of closing auctions will lead to more efficient price determination

Example: How to solve the Delta Hedge Dilemma with the help of the Xetra Strike Match Order

Initial Situation

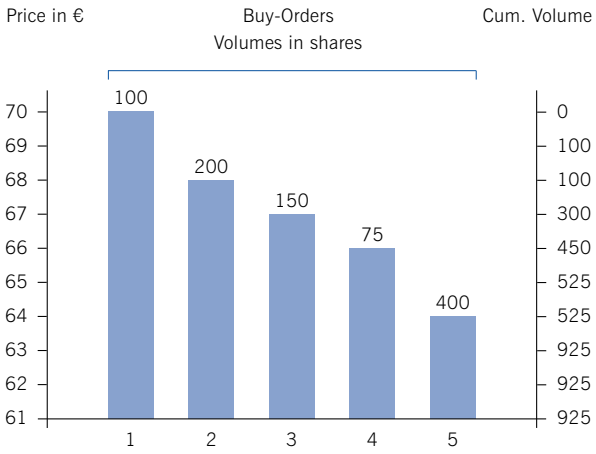
- Trader Inventory: 1 Short Call in a stock worth a 100 shares with a strike price at € 65.00
- The last traded price is € 65.01 before it went in the final closing auction.
- Trader wants to keep a Delta-Neutral Position (i.e. unaffected by price changes in the underlying)
- Thus, if the price is greater € 65.00, trader wants to buy 100 shares, otherwise, trader wants to stay flat

1. Outcome with the Order Book today

Main Assumption:

- Limit price equals worst price possible. Trader is willing to trade at any better price.
- e.g.: Order#2: Any price ≤ € 68 is acceptable

Example auction Order Book

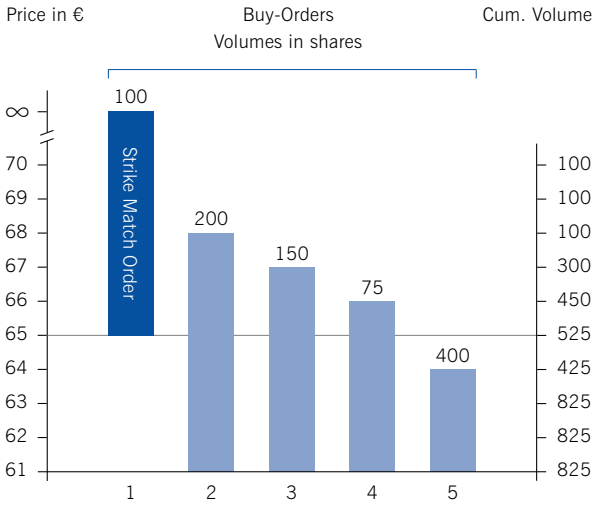


2. Outcome with the Xetra Strike Match Order

Definition: Strike Match Order

- Order#1 is a Strike Match Order that allows to define an additional restricitive Minimum Limit (€ 65) to a market order
- Order is only executable, if price is above the minimum limit

Auction Order Book with a Strike Match Order



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