

OIC European Market Survey

European perceptions of the US Options Industry

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Contents

- Executive Summary
- Introduction
- The Market
- Findings along Key Themes
- Summary of Conclusions/Recommendations

Executive Summary

Preface

Caveat: As is the case with all qualitative surveys, these findings represent the views of a small number of qualified participants and should be interpreted with respective care. This survey is not intended to provide results with any statistical accuracy but rather to provide directional information on opinions, perceptions and attitudes.

Executive Summary

- The overall objective of this survey was to obtain an additional and independent view of the status quo, needs and requirements of European financial intermediaries in relation to their US exchange-traded options activities and plans. Specifically, the aim was to validate current activities and underlying drivers, determine potential barriers for participation in the US exchange-traded options market, and examine as to whether a stronger US options industry representation in Europe is warranted
- To conduct the survey 20 financial intermediaries based in key European financial centers were interviewed. The participant types ranged from Broker/Dealers to Banks to Asset Managers of various size
- In summary, the survey participant interviews/discussions confirmed that between 15-20% of total US exchange-traded options volume originates out of Europe, but there is scope for additional growth provided the industry addresses existing barriers and creates a better understanding of the different needs that exist among the different client segments in Europe
- The balance in the US options market is currently heavily tilted towards large FCMs who have the resources necessary to deal with a complex and sophisticated trading environment. Encouraging greater volume from smaller Europe participants will require improved access to technology, process harmonization and enhanced information/education activities

Executive Summary (cont.)

- Keeping up with industry technology requirements is very costly. Large firms seek further standardization and conformity with European market practices, particularly on the clearing side. Many smaller firms find it either difficult or impossible to bear the technology costs that are necessary to participate in the market
- US regulation is perceived as more complex than European regulation, leading to a reduction in potential order flow, especially from the smaller European firms. Help in clarifying and navigating through US regulations would contribute significantly to alleviating this burden. In the long run, European participants believe that US regulation should be simplified and relaxed in order to attract (further) and retain business
- The information requirements of the various types of European participants vary and need to be fully understood. A more proactive approach must be taken towards client base segmentation and information dissemination by the US options industry to leverage the short term potential resulting out of information/education demands from segments for which the options business is rather new (i.e. Asset Managers, Insurance/Pension Funds) and smaller/medium sized market participants in general

Introduction

Objectives & Scope

Objectives

- The overall objective of the survey was to obtain an additional and independent view of the status quo, needs and requirements of European financial intermediaries in relation to their US exchange-traded options activities and plans. Specifically the aims were to:
 - validate and better understand current activities and underlying drivers
 - determine whether market participants refrain from participation (or greater participation) in the US options market as a result of certain barriers
 - determine whether stronger US options industry representation and activities in Europe is warranted
 - trigger lobbying work by conducting the study
- Conclusions/recommendations were then made on the basis of conducted interviews with the aim of further increasing volumes in US exchange-traded options

Scope

- European financial centers: Amsterdam, Frankfurt, London, Paris, Zurich and Geneva
- Participant types: Broker/Dealers, Banks and Asset Managers including Tier 1 and Tier 2 institutions as well as regional participants and/or opinion leaders in their respective markets
- Interviewees: 20 market participants
- Trading behavior: Both active and non-active trading participants in US exchange-traded options
- Value chain: Trading and clearing covering activities of all six US options exchanges (AMEX, BOX, CBOE, ISE, NYSE Arca, PHLX) and OCC

The Market

Survey findings support the view that currently 15% - 20% of the US exchange-traded options volume originates out of Europe... and business demand continues to grow

- Overall, equity options remain the most actively traded US options product, but growth in both equity and index contracts traded on US options exchanges has been consistently high. Index options have seen a five year CAGR of 27.3%, equity options 22.5%
- The US listed options markets have become increasingly global
- The survey participants provided various levels of detail regarding their current/planned activities and trading volumes
 - Most spoke openly and shared information
 - A few were either unable (difficult to extract details) or unwilling (viewed as disclosing commercially sensitive information) to share actual volume details
 - Most of the Tiers 2/3 Broker/Dealers and Buy-Side participants provided volume information, and while it reinforced market trends, the absolute figures were not significant
 - Importantly, the clearest statement of actual volumes came from three Tier 1 Broker/Dealers, who also represent leading, global option trading houses
- From the discussions and information received, it is a fair assessment that currently somewhere between 15 – 20% of the US exchange-traded options volume originates out of Europe
- Across all survey participants, it is envisaged that the Europe-originated US exchange-traded options business will grow further, with specifically some larger institutions reporting a planned individual company growth rate in excess of 20%
- From a products perspective, larger European institutions are seeing a stronger growth for their use of US equity options rather than index options
- Total ETF (Exchange-Traded Funds) options volume is minimal
- Interest from institutional clients and asset managers is slowly increasing due (possibly) to greater education

The Market

Europe is a heterogeneous marketplace with various types of end users. In order to increase their order flow, one needs to understand and address the nuances of their specific requirements

Asset Managers

- Due to the recent introduction of UCITS III and associated regulation, derivatives are still relatively new for this sector
- Asset managers are currently Europe-focused but have clear growth expectations towards the US market
- French asset managers have been identified as some of the most active US options participants

Retail/Private Wealth Clients

- Middle East and Swiss clients seem to be particularly active/interested in US options
- For this client segment, volumes are greater in equity (single name) options rather than index options

Corporate / Wholesale Clients

- In general, there has been moderate flow from this client group to date. Conservative thinking leads to gravitation to “European products”. Only larger clients make use of US options mainly for hedging purposes. Where it exists, the flow is predominantly in equity options



Proprietary Trading

- Proprietary trading and hedging currently make up the most significant proportion of European-originated US options flow. Proprietary flow is set to grow further for those already actively trading

Insurance/Pension Funds

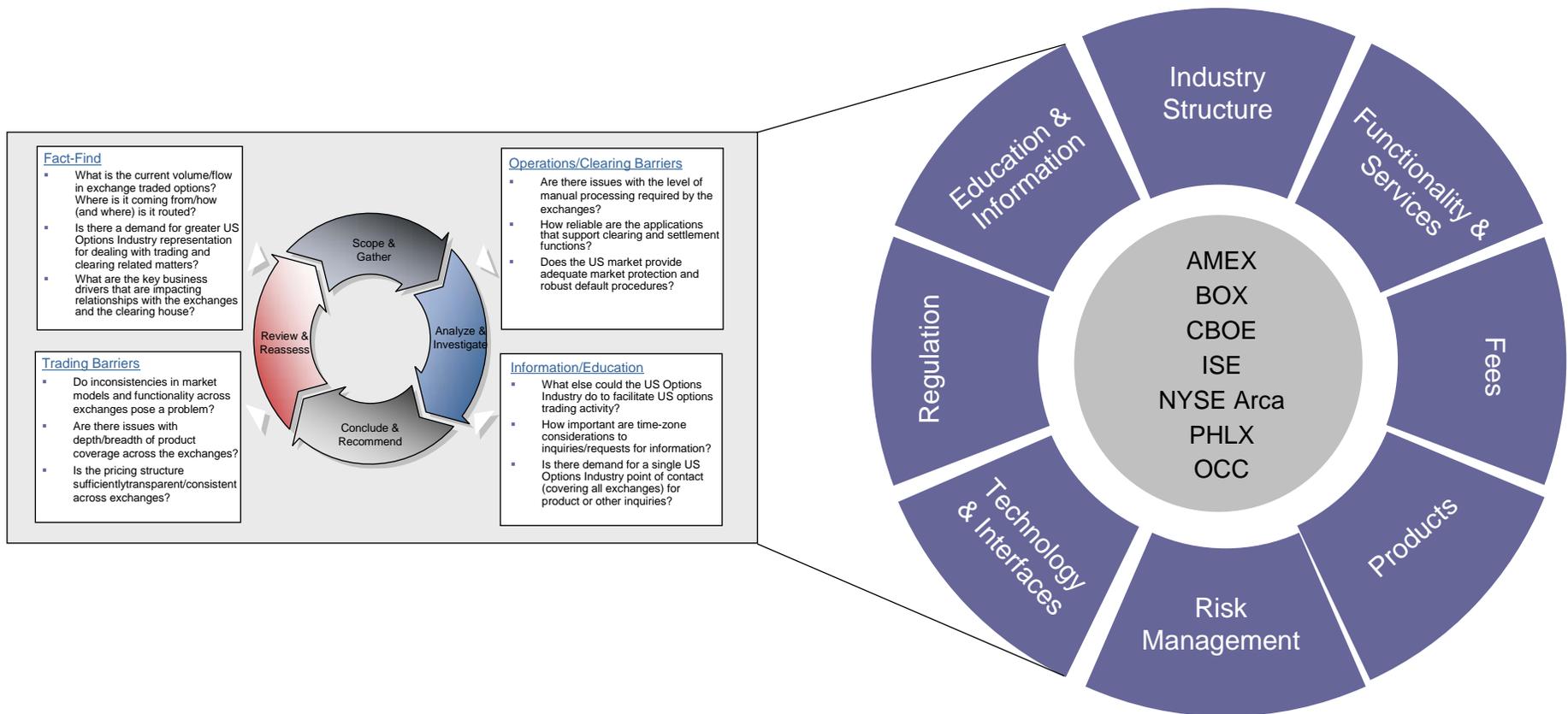
- One of the lowest contributing segments
- Strict company mandates to date have prevented active participation in derivatives markets
- In some countries, the respective insurance companies are starting to enhance their portfolios by including US options

Hedge Funds

- Activity levels are very volatile and determined by market activities/events
- Volatility and long/short equity participants are relatively active in US options markets, UK and Sweden in particular

Findings along Key Themes

From the questions and associated responses we assessed and collated the findings into eight key themes



Summary of Conclusions/Recommendations

Industry Structure	Greater harmonization and transparency would prevent the US exchange-traded options market from being perceived as a “closed club”
Functionality & Services	Current functionality and services are not inhibiting options order flow to the US exchanges. While some exchanges already offer electronic-only platforms, European users strongly prefer fully automated electronic trading platforms
Fees	Fee levels are deemed as acceptable by market participants. However, where intermediaries are used, end-clients are often unclear on cost breakdowns and transparency of fees levied
Products	Firms are pleased with the current US exchange product offerings. Exchanges should seek to differentiate themselves more so by level of service than by product offering
Risk Management	Most participants are comfortable with existing risk management capabilities, though some smaller participants perceive heightened exposure to certain operational risks
Technology & Interfaces	Technology is fundamental to enabling participation in the US options market. However, it is also cited as one of the key cost contributors or barriers to entry
Regulation	Regulatory relaxation and simplification would result in greater US options market participation by Europeans
Education & Information	A more proactive information and education program is required, particularly for the small- to medium-sized European participants