

CBOE to Offer Benchmark Trades

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By Nina Mehta

In another sign the options market is following in the steps of the equities market, the Chicago Board Options Exchange is betting that institutions will embrace benchmark trading as an efficient way to execute large trades. This effort is driven by penny quoting in options, which has shrunk the inside market and is forcing firms to spread orders out over a longer period of time.

The CBOE in May inked a deal with broker-dealer 3D Markets to be the exclusive provider of a benchmark crossing product based on 3D's GWAP, or gamma-weighted average price, benchmark. The GWAP benchmark is one of several 3D products. This arrangement allows the CBOE to offer institutions a way to avoid the market-impact concerns of executing throughout the day.

"GWAP is intended to provide something similar to what VWAP provides for stocks, which is the ability for institutions trading options to purchase or sell a substantial number of contracts at a benchmark price," said Ed Provost, executive vice president of business development at the CBOE. The exchange expects to launch the electronic product later this year.

CBOE's GWAP crossing facility will electronically match buy and sell options orders for the full-day GWAP right around the time the market opens, according to Provost. The system's launch will mark the first time options trades occur on an exchange based on an average price, rather than a market price at a specific moment in time. The parties to the trade will be told the price of the trade as soon as the market closes and the day's GWAP is calculated.

CBOE members and their clients will be able to use 3D's Archangel crossing platform to cross block trades, Provost said. The CBOE expects the minimum size for the cross to be at least 1,000 contracts.

The exchange needs approval from the Securities and Exchange Commission to roll out these benchmark trades. Provost said the CBOE plans to submit a filing to the SEC about this crossing product before the end of the summer. He hopes the product will be available toward the end of the third quarter or early in the fourth.

Jeromee Johnson, president of 3D, based in New Hope, Pa., expects market makers and liquidity providers to line the GWAP crossing book with two-sided orders. That would increase the likelihood of crosses for institutional flow. Provost agreed. He noted that the CBOE may launch an electronic solicitation mechanism to encourage liquidity providers to submit two-sided orders to buy and sell the GWAP in various options series, based on interest in the book from institutions, prior to the cross occurring.

The GWAP benchmark in options is just one of 3D's institutional options products. 3D also has a Blind Bid product, often characterized as a dark pool, that allows upstairs dealers to bid on block orders based on their decomposed risk profiles. Those crosses are brought to an exchange for execution. The Blind Bid product has been live since February, but hasn't yet executed a significant amount of volume.

According to Johnson, the trades are currently being executed on the CBOE, the International Securities Exchange and the Boston Options Exchange, since those exchanges have electronic crossing facilities. Unlike GWAP benchmark trades, these crosses are allowable in the current regulatory environment, but they can be broken up on an exchange once they're exposed to the exchange's market.

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