Panelist—"The Derivatives Marketplace: Transaction Technology in Flux"

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Introductory Comments

- Derivatives have played a central role in the development of financial theory—useful to focus more on the underlying market structure
- Interesting differences between the options and more traditional equity markets
- Considerable transition in derivatives markets

Data

- Scale of data is considerable—lots of contracts (exercise prices and expirations)—potential impediment to distribution
- Analogy to Dash 5 statistics—What is the appropriate level of aggregation?
- Recent improvement in available quote data
- Data as a potential product line for exchanges
- As in equities, will depth of book data be sold?

Data and the SEC "Disclosure" Model

- The "Disclosure" model and the "Economics" paradigm—Encouraging provision of data builds naturally on these perspectives

Evolution of Fragmentation

- Inherent sources of fragmentation--Competing exchanges and many maturities and exercise prices
- Intermarket Linkage Plan may have helped integrate the markets

What are the Implications of Fragmentation?

- Reluctance to leave limit orders on the book due to adverse selection—especially when little natural depth
- Role of technology—scale economies in quoting/trading across contracts—Importance of quoting for trading
- Bandwidth demand
- Internalization and wide spreads promoted—equilibrium “price matching”—limits liquidity

Internalization

- Boston’s Price Improvement Process (PIP)—an early push towards pennies
- Tick size and payment for order flow—large payments for order flow is systematic evidence that spreads are artificially constrained
- Exchange sponsored payments (coordination device)—marketing fees—since the orders are split across various market makers

Impacts of Penny Pilot

- Tighter spreads
- Much lower payment for order flow
- Increase in bandwidth demand from increased quoting due to decimals more modest than feared

Bandwidth

- Many of the effects would be felt downstream
- Potential solutions using technology or pricing

Derivatives and Equity Trading

- Various platforms anxious to move into spaces traditionally occupied by other platforms
- Side-by-side-trading (as in Europe) could impact value of floor access and nature of price discovery