Global Comprehensive Options TCA Panel Discussion

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&
Brett MacLeod – Managing Director – Abel Noser Solutions

Welcome. This transcript is taken from a recent public webinar on global options TCA between Abel Noser's Peter Weiler and Brett MacLeod. The live panel discussion, moderated by Abel Noser's Head of Marketing, Jerry Boak, centered on the value of TCA-powered analytics for all option strategies, from covered calls to complex spread strategies. Peter, Abel Noser's Co-CEO, is a registered options principle, while Brett heads the company's sell side division. Both have been with Abel Noser for many years, and both have vast experience in the equity options derivative space.

QUESTION: What was the impetus behind Abel Noser developing a comprehensive options TCA tool? Was there a particular catalyst, a change in market forces, improved technology--or all three?

Peter Weiler:
The short answer is all three. But the real catalyst was client demand. Also, adding options TCA to our lineup continues the evolution of our product suite. As the top independent provider of truly multi-asset TCA in the marketplace, extending into options analytics is consistent with our missional DNA. Up until now, it was very difficult and costly to source market data for this purpose. But after much thought and numerous development meetings, we've found a way to do it. The other catalysts, I think, include the market structure itself. As we've seen, options volume and options activity has proliferated not only in the retail market, but in the institutional marketplace as well. I think we all understand that this has been caused by changing investment mandates over the last number of years. Some of the more typical – we can call 'plain vanilla' – investment managers now have more latitude as to what type of hedging techniques and what type of securities or derivatives can show up in their portfolios.

Brett MacLeod:
I agree. As TCA providers, we've seen all asset classes go through some sort of natural transparency evolution. This is no different for options than it has been for other non-equity asset classes. As intermediary systems, such as OMSs and EMSs, are more able to furnish solid transactional details that we can recreate and provide true workflows out of, the more things you can do when that data capture expands. And when this happens, your behaviors change, and regulators then have the opportunity to evaluate whether those behaviors are good or bad. As a TCA provider, the scope of what we can do with this data increases. As such, we must follow with expanding our services.

QUESTION: **What are some specific use cases with your Options TCA offering, including some of the things that you've been working on with clients?**

Peter Weiler:
In terms of use cases, there is a wide spectrum. Take a traditional asset manager who is conducting somewhat typical option strategies; say, buy rights. For example, a manager will certainly want to know

about the execution quality of their options. They will also want to understand what type of executions their brokers were providing them, because we may have found that option spreads, unlike the underlying securities, are much higher. They'll also want to uncover information about commission rates. What do the commission rates depend upon? These typically vary based upon the price of the option. So, what is the typical cost, based on volumes and price of an option, that somebody should be willing to pay in today's environment?

The second case, I would say, is when we have somebody who does a lot of option overlays for people, often utilizing rather complex strategies. I think they would want to prove to their clients that these strategies are working, that they are getting best execution, and show they are reducing the costs as much as they can, both implicitly and explicitly.

Brett MacLeod:
Speaking from my view, representing the general sell side, I've found that the broker dealers I deal with have two core use cases for options TCA evaluation. Essentially, internal evaluation and external reporting. You're going to internally evaluate your routes and your behaviors and try to optimize for the sake of doing the best job you can for your clients. But then you also might want to be able to report that externally.

I have seen an ongoing massive evolution in the equity space, and many of our clients actually did use these reports and analytics to drive more flows, as well as manage them on their own desks. So, to my mind, this is the core use case. And from there, going back to what I mentioned earlier about a natural data evolution, and a seemingly unending increase in regulation and oversight. There are several global regulations that firms need TCA data to comply with. In terms of global regs, there's quite a few including MiFID 2 (including the RTS 28), & PRIIPs; in Australia there's RG 97.

And in the U.S., there's been a broad initiative over the last several years titled, "reg best interest," which has a market integrity component to it and speaks directly to the transactional data which we manage for our clients. Specifically, within that market integrity subgroup there are a few categories with different reports that can be helpful for each event. There's also SEC Rule 606 which requires public reports for some options flow for given dealers, showing outwardly where they're routing, as well as what some of the economic incentives for that routing behavior are, including the requirement for very specific disclosures. But since neither of those actually speak to execution quality itself; this is where the job of the FINRA 5310 rule for best execution comes into play. Best ex is broadly viewed; there are many interpretations as to what it actually means. But for brokers, FINRA lays it out quite concretely. It is a documented program that ensures a regular and robust review of execution quality to ensure that broker dealers are working diligently to get the best price for their clients. As such, this is a core function of our TCA options portal--to ensure that these requirements are met, and met consistently, and then create a process so best ex can be demonstrated outwardly to prospective clients, and potentially more importantly, to a regulator, should they come knocking. All in all, I see multiple use cases for options TCA, as well as a real evolution from where we were, say, 5-10 years ago.

QUESTION: With everything you've said, if someone on the sell side is not conducting some sort of definitive, easy-to-explain reporting (along the lines of what options TCA provides), are they potentially setting themselves up for a regulatory issue?

Brett MacLeod:
Yes, I believe so. For most broker dealers, there's too much data to manage on their own. And there are many aspects to managing it. As Peter mentioned earlier, the market data side is a bit of a bear. There's often thousands and thousands of different contracts to be evaluated, and then cross-referenced properly within a client's unique workflow. Then the data needs to be digested, reformulated and categorized into easy-to-read reports so key stakeholders can make heads or tails of the results, all in the effort of simply getting and, of course, proving best execution. This is where our service culminates in a process that is manageable, repeatable, and demonstrable. To my mind, an options TCA platform makes this process more efficient and economical. So, yes, it's essentially required.

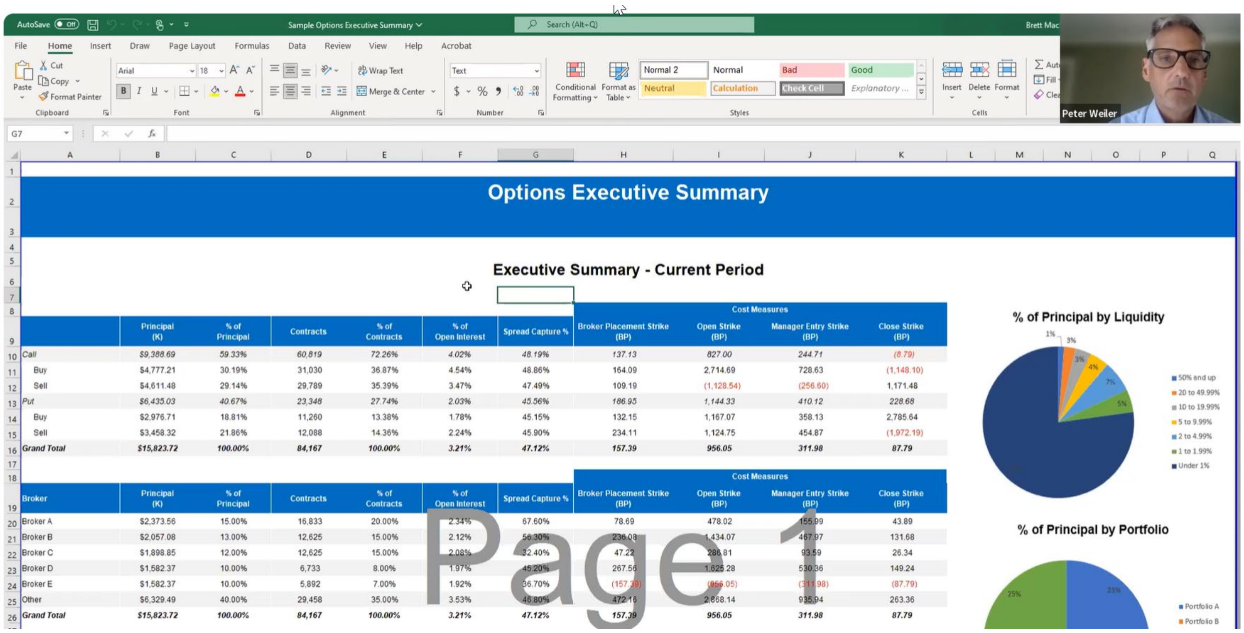
QUESTION: Does this remind you a bit of the early days of equities TCA where some firms were trying to do it in house, but ultimately the realization of 'economies of scale' hit? Then someone like Abel Noser comes in and offers a good, organized, clear, and affordable solution?

Peter Weiler:
Sure. It's always the question of 'buy versus build.' One of the things I should mention is the utility of peer universes – Abel Noser's being the largest multi-asset trade universe in the industry with over $30 trillion in annual trade data. Obviously, when a firm is building out their own proprietary system, they don't have the luxury of having those peer universes.

QUESTION: What are the main reports available in Abel Noser's Options TCA interface?

Peter Weiler:
We have many different canned reports in our report library. In addition to the canned reports, we also provide a custom report writer so a client can create their own customized reports. With so many different factors at play, a client can segment data any which way they want. They can even put their own label on it if they're considering white labeling.

But back to the reports library, starting with a more basic one, below is an example of an executive summary report:



	Principal (K)	% of Principal	Contracts	% of Contracts	% of Open Interest	Spread Capture %	Cost Measures: Broker Placement Strike (BP)	Open Strike (BP)	Manager Entry Strike (BP)	Close Strike (BP)
Call	$9,388.69	59.33%	60,819	72.26%	4.02%	48.19%	137.13	827.00	244.71	(8.79)
Buy	$4,777.21	30.19%	31,030	36.87%	4.54%	48.86%	164.09	2,714.69	728.63	(1,148.10)
Sell	$4,611.48	29.14%	29,789	35.39%	3.47%	47.49%	109.19	(1,128.54)	(256.60)	1,171.48
Put	$6,435.03	40.67%	23,348	27.74%	2.03%	45.56%	186.95	1,144.33	410.12	228.68
Buy	$2,976.71	18.81%	11,260	13.38%	1.78%	45.15%	132.15	1,167.07	358.13	2,785.64
Sell	$3,458.32	21.86%	12,088	14.36%	2.24%	45.90%	234.11	1,124.75	454.87	(1,972.19)
Grand Total	$15,823.72	100.00%	84,167	100.00%	3.21%	47.12%	157.39	956.05	311.98	87.79

Broker	Principal (K)	% of Principal	Contracts	% of Contracts	% of Open Interest	Spread Capture %	Cost Measures: Broker Placement Strike (BP)	Open Strike (BP)	Manager Entry Strike (BP)	Close Strike (BP)
Broker A	$2,373.56	15.00%	16,833	20.00%	2.34%	67.60%	78.69	478.02	155.99	43.89
Broker B	$2,057.08	13.00%	12,625	15.00%	2.12%	56.30%	236.08	1,434.07	467.97	131.68
Broker C	$1,898.85	12.00%	12,625	15.00%	2.08%	32.40%	47.22	286.81	93.59	26.34
Broker D	$1,582.37	10.00%	6,733	8.00%	1.97%	45.20%	267.56	1,625.28	530.36	149.24
Broker E	$1,582.37	10.00%	5,892	7.00%	1.92%	36.70%	(157.39)	(956.05)	(311.98)	(87.79)
Other	$6,329.49	40.00%	29,458	35.00%	3.53%	46.80%	472.16	2,868.14	935.94	263.36
Grand Total	$15,823.72	100.00%	84,167	100.00%	3.21%	47.12%	157.39	956.05	311.98	87.79

This, in use, is really like peeling an onion in order to view the highest level of calls versus puts and buying and selling. And then, of course, having particular metrics next to it, the number of contracts by popular demand. People want to know what percentage of open interest their order represented. They also want to understand spread capture very closely, as well as look at particular strike prices in time. If you're an investment manager releasing an order to a broker, that's what we refer to as the placement strike point.

You may want to look at a reference point of stagnant price and time, or the open of the trading day, or perhaps the closing of the trading day. Also, if there is that lag time between when an order is actually entered into an order management system, perhaps from a buy side, and then passed along to a broker, we can capture that as well.

Just moving down the line. We show the particular brokers, so again, a client will have the ability to take a look at individual traders if they're on the sell side. And it could be either portfolios or clients. We think it's important to break out an executive summary page as such. That said, we're consistently tweaking our reports and adding functionality as requested by our clients.

Next up is liquidity. Again, people want to understand what percentage they are of the particular number of contracts that trade in a particular day. And, they want that expressed not only as a number of contracts, but as a percentage of open interest. We also show a kind of order summary. Are the orders market orders? Are they limit orders? Are you trying to leg into a position? Are you trying to leg into a position with the underlying security? Or maybe you're trying to leg into a multi-legged strategy of options themselves. And then the expiration period that people want to understand a little bit more about in terms of how they're doing as they get closer or further away from expiration.

There's also the implied volatility, a measure that very early on people said they really needed to have. We've calculated implied volatility using the same factors a Black-Scholes model would use. Factors such as interest rates and dividend cash flows, and obviously the volatility of the underlying security. And what we do is we simply take that value – that execution price – and we can compare that execution price, then we calculate the implied volatility.

Lastly, the report shows the top five trades and the bottom five trades. We want to be able to share where maybe the impact trades are. What are the tails potentially? We look at all those and break it down a little bit more, identifying that security, identifying that broker or trader, and trying to understand a little bit more about how far away they were from that midpoint of the trades. But that's just simply looking at the bottom trades in terms of highest cost trades for any particular period.

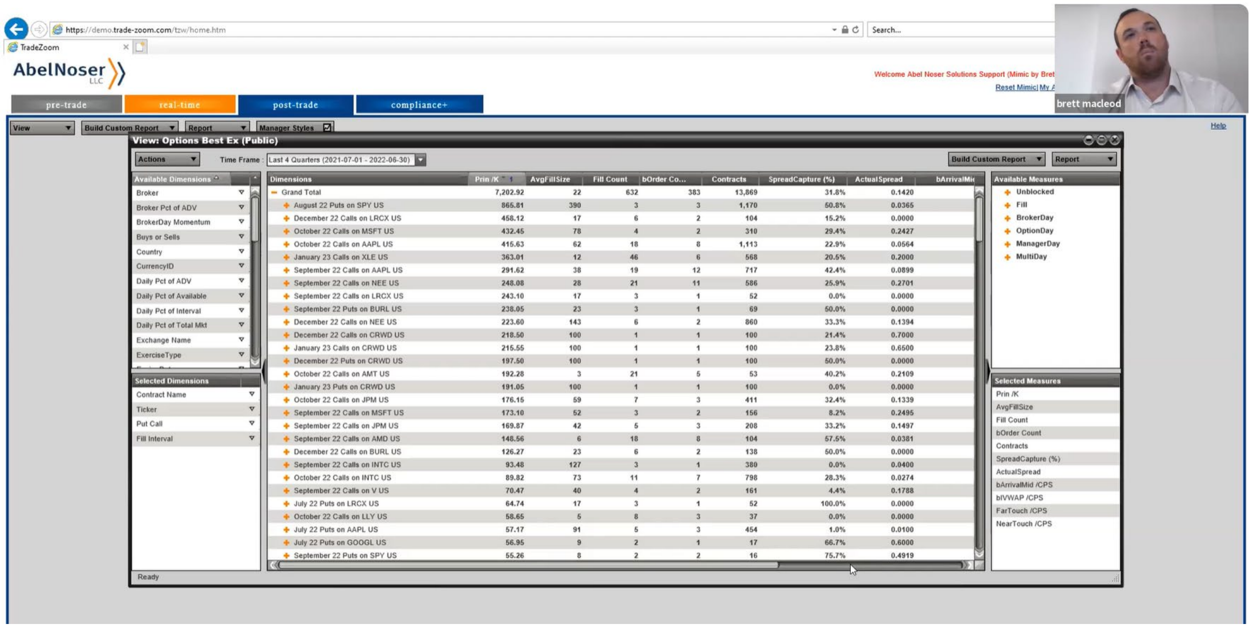
Of course, for anyone interested in this type of report, we're happy to set up a demo of the product.

QUESTION: What about sell-side reports?

Brett MacLeod:
I do find that, within my constituency, we tend to focus more on the end execution. As in "where were you within the spread as physically displayed over here?" But just as important to that is the core idea... you have to execute the spread in most circumstances and recreate the workflow of the parent order or child order. Maybe you've received multiple fills. You want to aggregate that compared to various market data or volume and price points.

For this, we tend to direct clients more towards our web portal itself, which is where, as many of our clients know, we cover everything. Equities and FX, fixed income, futures, and now options. We also do a lot of execution consulting type work. But specifically on the options front, there's an array of measures that best fit the 'best ex' need and at its most basic is an evaluation of spread. But, as Peter mentioned, bringing in implied volatility to understand whether you're creating a net value add against certain benchmarks could also be important and another good way to not only meet the best ex mandate, but to outwardly demonstrate to your clients that you're adding a bit of value to the transaction, and then, conversely, from the asset management side down, evaluating one's brokers as such.

Just to give a brief idea of how this actually comes to be, below is the output or initial stage of the output where the users can access all of their data over elongated, or abridged periods (again, all customizable).



Essentially, we are taking in raw transactional extracts, merging it with our market data feed, recreating workflow and measuring it in several thousand different ways. And here you'll be able to create the perspectives that are unique and helpful to you and your execution process. For instance, here we've first contracted this by contract name, we could also evaluate with a longer period of time.

You can also expand upon these and see the underlying tickers then ask “What were you doing with it? What was it, a put or a call? Were you buying or selling?”

On the sell-side, I see many of my clients use this as a client management tool to understand who is sending them what types of flows, and then, subsequently, what the execution quality they're actually receiving might be. One concept, perhaps, somewhat new to the option space, is that we're assessing versus individual fills, we’re assessing versus individual orders, and creating a real stage perspective to an entire workflow. In other words, we actually take a parent order, we've worked it in three various child pieces through various sub-brokers, which are contracted out to actually execute the trades, and then we’ll evaluate it down to the fill.

Abel Noser hasn’t seen much of this within our competitive landscape. We think that being able to create a customized version of this process, per client, best meets their needs, as well as the regulator’s.

Our Options TCA is an ultra-transparent tool in that you can delve into individual transactional data points. Sometimes it's required by underlying clients to send that across, and you can do that just by shifting the date range. Or by viewing the transaction on an individual fill-by-fill basis against the actual charts of the market data. You can look at the individual fills like “there's the bid, there’s the ask, the sell.” Or you can aggregate it across any of the stitch levels that I mentioned before and see the totality of the level at which you've executed your position against aggregated market data points.

It has very similar functionality to what we developed initially in the equity space. Just being able to visualize the individual data points, that is, everything that we collect from our clients from timestamps through data points from our market data, can be very helpful.

We even furnish the math for all of this. It's all very transparent, and something our clients can manage in their front end. Getting the data out of portals like these often can be a bit of a challenge. So, as Peter mentioned, we have a full custom report building facility where you can choose your favorite color scheme, upload your own title, build, save and launch individual reports.

One of the other core use cases in my group is the ability to have reports auto delivered on a predetermined basis. So, if I were to bring up a report that's already pre-canned, say an outlier report, you can use the launcher to simply set it up. I've got clients that do upwards of a thousand of these on a monthly basis.

The reports go directly to the client, and they're dependable. If a firm wants it once a month, or once a quarter, or perhaps every morning at five a.m., they can have those reports and do with them what they will.

In terms of assessing best ex, the tool offers a lot as well. You can compare your given routes. Then compare the actual execution quality received. You could create a function that has a little bit more of an outlier focus. For instance, you could build a couple of hidden GUIs that enable you to create thresholds to enable delineation of data points that could be deemed anything from normal execution quality to outlier execution quality by simply considering, "okay if I'm some amount of value from a given market data point, then I, as a compliance officer, decide that this is worth reviewing." You could decide that anything twenty-five basis points worse than the mid at the time of the fill might be worth reviewing. And by changing the timeframe, you can see the totality of orders that qualify as these outliers over a year. Or we could drill into them and investigate further. Or raise them with the desk and do what is needed, essentially creating that process that FINRA and the SEC and everybody else requires.

QUESTION: Speaking of SEC Rule 606, does your tool capture fee and rebate info as well as provides a venue analysis?

Brett MacLeod:
Rule 606 obviously already has options in its scope. As part of our tool's functionality, in order to provide that service to clients, the integration of fee and rebate data has to be accommodated. It's similar to how we handle commissions for our asset owner and asset management clients. So yes, we're able to handle commission data.

It's a whole other conversation on the 606 side. Certainly, through FINRA's enforcement of it, they expect some real granularity in terms of what the fee and rebate and economic incentives are between the broker or the introducing program and executing broker or exchange. What they really are, and what it really adds up to. . . we've had to do is some fairly intricate look-through work in that space. Yup, it's been a "fun" ride. . .

QUESTION: How frequently can Abel Noser's options TCA output be delivered?

Brett MacLeod:
Our options platform functions like all of our other asset classes, where the typical use case that we see these days would be a nightly data dump, and next morning processing that could be done regionally, depending on where you are on the globe since everyone has a different morning. As such, as long as the data comes in on time, we can push it out on time.

QUESTION: We've all watched the progression of equities TCA and more recently fixed income TCA, with more electronification of the markets. Where do you see options TCA evolving from here? Not just with Abel Noser, but industry-wide?

Peter Weiler:
We're probably in the bottom of the first inning of a nine-inning game. I think in the future we certainly have a roadmap where, as I alluded to earlier, having a pure universe, and as our client base grows—and it's growing rapidly in this area—we will be able to have all those composite universes that people are used to with the other asset classes.

Also, this is maybe more of a limitation on the OEMS, or perhaps a client's ability to tag orders but to have a total cost score that would take into account an option strategy along with the underlying security, or a multi-leg type of option strategy. Again, taking a look at what the costs are, whether that's midpoint pricing, or whether that's looking at implied volatility, it seems to me we'll eventually see cross asset class integrations. Abel Noser has started with global equities options, but we'll be moving on to the other asset classes very quickly. And along with that, we're planning advanced surveillance. I would expect that to be part of the offering as we move forward.

Brett MacLeod:
I think the crystal ball generally agrees with Peter. We're getting to that point, with all these asset classes and all the data floating around, of this progression that he predicted. If we are provided with the right ways to essentially link data sources, multi-asset TCA is essentially the goal line and has been for all TCA providers since Gene Noser got involved with it forty years ago. I do foresee that within the coming years, as a real possibility, being able to provide clients across our constituencies from asset owners all the way down to asset managers and brokers a comprehensive cost picture would be very valuable. Especially when dealing with derivatives, we're only going to see one slice of the trade as it comes in. But to be able to cross those across platforms? I think that could be very interesting, and we already have some clients talking to us about ways for crossing our own asset class measurements, and potentially integrating the use of APIs to do so. I think that is the future. Past that, there will probably be more regulations. After all, there are always more regulations. So, we'll handle those as they come.

QUESTION: Any final words?

Brett MacLeod:
For anyone that's new to the Abel Noser platform, you probably noticed that on the UI, everything's there. The different asset classes are available, our compliance trade surveillance platform is there. So a user is not having to move from one app to another to another just to do their job.

Peter Weiler:
If you are actively thinking about options TCA, Abel Noser offers a free analysis and trial. And as has been our practice for a long time, there's no cost or obligation. As for the other asset classes and derivatives, we'd love to be able to do that for you as well. Thank you very much for taking time out of your busy day to learn about what we're doing here.

For more information about Abel Noser's Options TCA offering, visit our website, download a brochure, or contact us at info@abelnoser.com.

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