acuiti management intelligence

The Derivatives Insight Report

February 2021

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Introduction

After an unpredictable year in 2020, few would have predicted that the hottest topic of January 2021 would have been a dated US computer game retailer and a messageboard that few had heard of.

However, in the frenzied world of US options market, few things are predictable and GameStop became the hottest option in town, as retail traders exacted a punishing short squeeze and propelled the term "gamma squeeze" from the textbooks to the front pages of the mainstream press.

The cacophony of calls to take action against the retail traders rose and fell as fast as GameStop's share-price but the lasting legacy will perhaps be the spotlight shone on the Payment for Order Flow model banned in many jurisdictions but a key driver of revenues for US retail platforms.

Our hot topics survey this month asks respondents for their views on PFOF, what action could and should be taken to address the GameStop phenomenon and what impact the early days of Brexit is having on European markets.

In terms of revenues, January was a slow start to the year for many aside from pockets of volatility and high volumes including the US options markets but also found in UK interest rate and Hong Kong equity options.

Banks' revenues continue to be pulled down year-on-year by reduced income from interest on client margin. However, as the vaccine programme is rolled out globally and the economic recovery gathers strength, we may be looking at a very different picture for rates by the Summer.

SECTION ONE:

Hot topics

GameStop revives calls for PFOF ban in the US

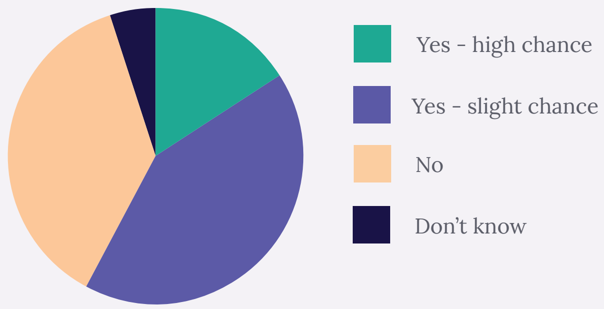
Respondents to the January Acuiti Insight survey relaxed about systemic risk and sanctions but almost half in favour of PFOF ban.

January 2021 will go down in market history as the month in which a previously little-known messageboard burst into the global Zeitgeist.

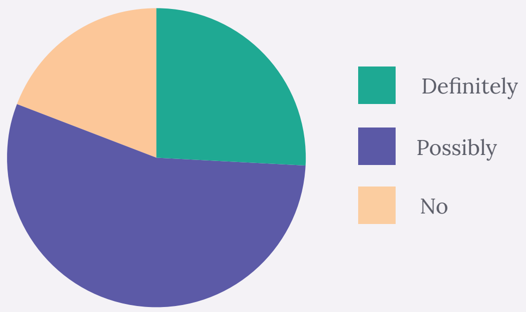
Between 12 and 28 January, the share-price of GameStop Corporation rose from under $20 to $483 on the back of frenzied buying from traders urged on by commentators on Reddit, an online message board. The accompanying short and gamma squeeze and the activities in other stocks and underlyers has been well documented by financial and mainstream media elsewhere and does not need repeating here.

Acuiti polled its network on their views on the legality of the phenomenon, the potential impact and also what, if any, sanctions should be taken. We found that market participants were generally relaxed about the potential wider systemic risk from the trading frenzy with just 16% of respondents saying the phenomenon presented a high systemic risk. The market was split on whether the trading constituted market abuse with 26% of respondents saying it definitely did, 18% that it did not and the rest saying it possibly did.

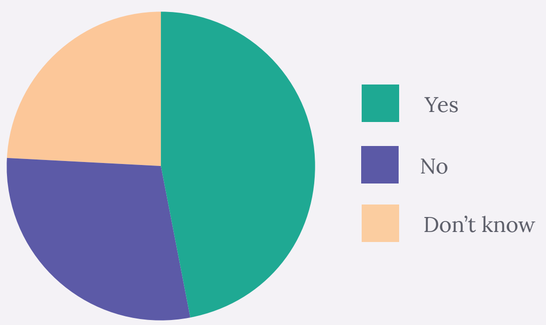
Do you think what is happening in GameStock and other US stocks could create wider systemic risk across the market?



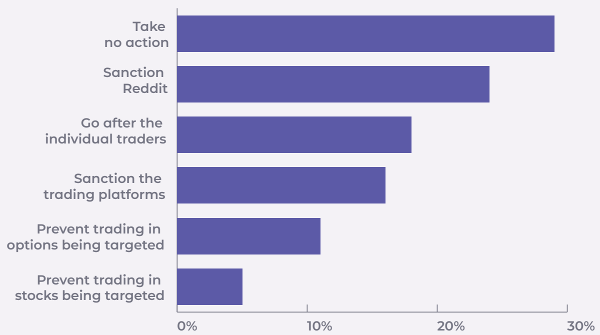
Do you think that retail traders arranging to increase the price of a stock on an online forum constitutes market abuse?



Should the SEC ban the payment for order flow model employed by retail brokerage platforms?



What action to do you think the SEC/US government should take to prevent GameStop incidents?



When it came to what action US regulators or the government should take, 29% called for no action to be taken arguing that this is just the functioning of a free market. Those who did call for action most commonly favoured sanctioning Reddit. Respondents also favoured going directly after the traders over and above the trading platforms. Smaller number of respondents suggested preventing trading in the stocks or options that were being subjected to the targeted trading.

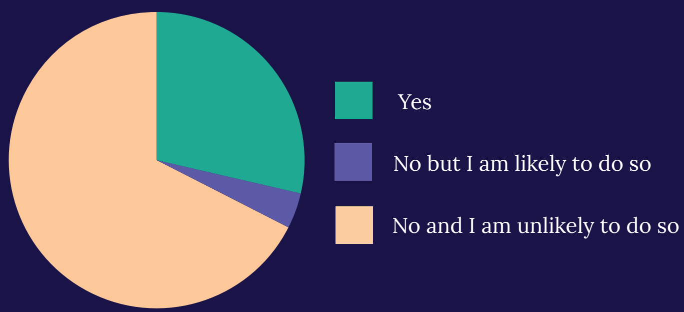
Respondents that posed their own suggestions as to what measures could be taken came up with a range of options from better education of retail investors to limits on the leverage extended to retail investors. Several respondents also suggested increasing capital and margin requirements for retail platforms to reduce any systemic risk in the market.

The GameStop phenomenon also drew greater attention once more to the payment for order-flow model (PFOF) employed by US retail platforms. PFOF, which is banned in several jurisdictions including the UK and Canada, is a major revenue generator for retail trading platforms. According to an analysis by The Economist, Robinhood alone made $196m from PFOF in Q4 2020. Advocates of PFOF claim it has brought down costs for the retail investor and improved liquidity; critics that it distorts the market and hands too much power to a small number of trading firms. The Acuiti survey found that just under half of respondents (49%) called for PFOF to be banned with 29% saying it should not be and the rest unsure.

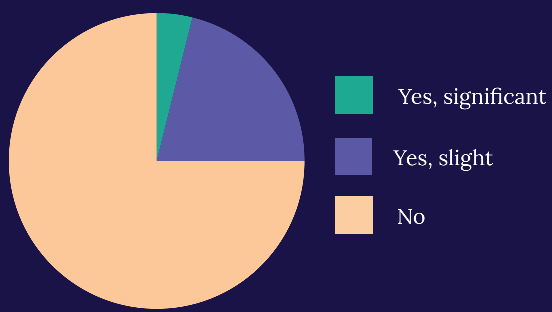
Brexit impact felt across instruments

The UK formally left the EU on 31 January 2020 but the "honeymoon" officially ended on 31 December when the new trading deal came into force (a deal that does not currently cover financial markets). Acuiti found that 29% of respondents with business operations in the UK or EU had changed where they clear or execute some of their positions or clients' positions as a result of Brexit. Significantly this was seen across instruments. While the majority of respondents that had changed jurisdictions had done so in the clearing or execution of swaps, with activity shifting from the UK to the EU or to the US, several proprietary trading firms indicated that they had changed or would soon change where they traded listed futures and options as a result of Brexit. These firms were based both in the UK and EU. In terms of liquidity, around a quarter of respondents reported a deterioration of liquidity in listed derivatives since January 1 as a result of Brexit. All respondents reporting a decrease in the quality of liquidity were based in the UK and the majority were proprietary trading firms.

Have you changed the exchange/CCP at which you trade or clear any derivatives instruments as a result of Brexit?



Have you seen any reduction in liquidity "quality" for exchange traded derivatives since 1 January as a result of Brexit?



SECTION TWO:

Revenues

Hong Kong and US options drive revenues in January

Revenues last month in the global derivatives markets were defined by strong trading in a small number of markets while banks continued to be weighed down by lower revenues from interest on margin held.

The US options market continued its upward charge with record volumes in January as retail traders continued to pile in to the market creating pockets of extreme volatility in addition to lifting overall volumes.

HKEx also saw sharp increases in options trading volumes as investors repositioned in anticipation of a strong Chinese recovery, a sentiment that also saw strong trading in global commodity markets.

The UK also saw vibrant trading in interest rate options as Bank of England warnings over negatives rates conflicted with a brigtening outlook in the wake of an effective vaccine programme. These sharp macro trends lifted revenues for brokers and some proprietary trading firms and CTAs active in those markets.

Overall year-on-year performances however were dragged down by weakened trading across banks and non-bank FCMs as lower interest rates sharply reduced income from client margins, a trend that is likely to dominate at least the first half of 2021.

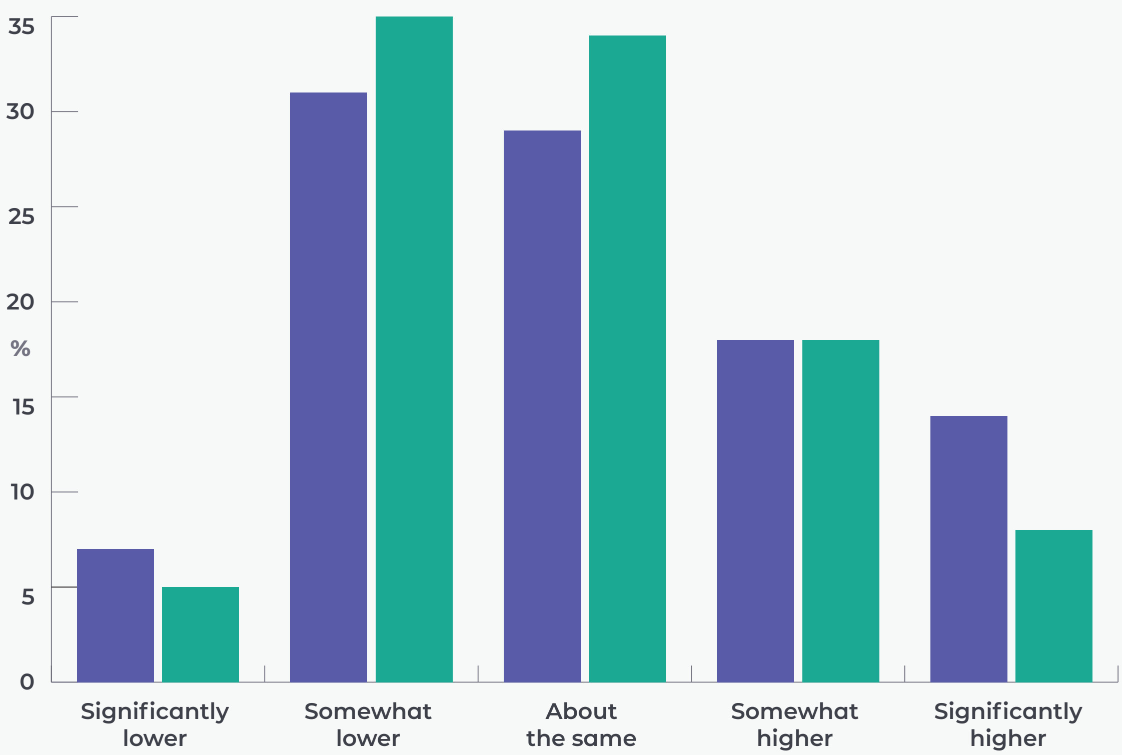


FIGURE 1: Overall revenue change in January

KEY:
Month-on-month
Year-on-year

Historical revenue growth

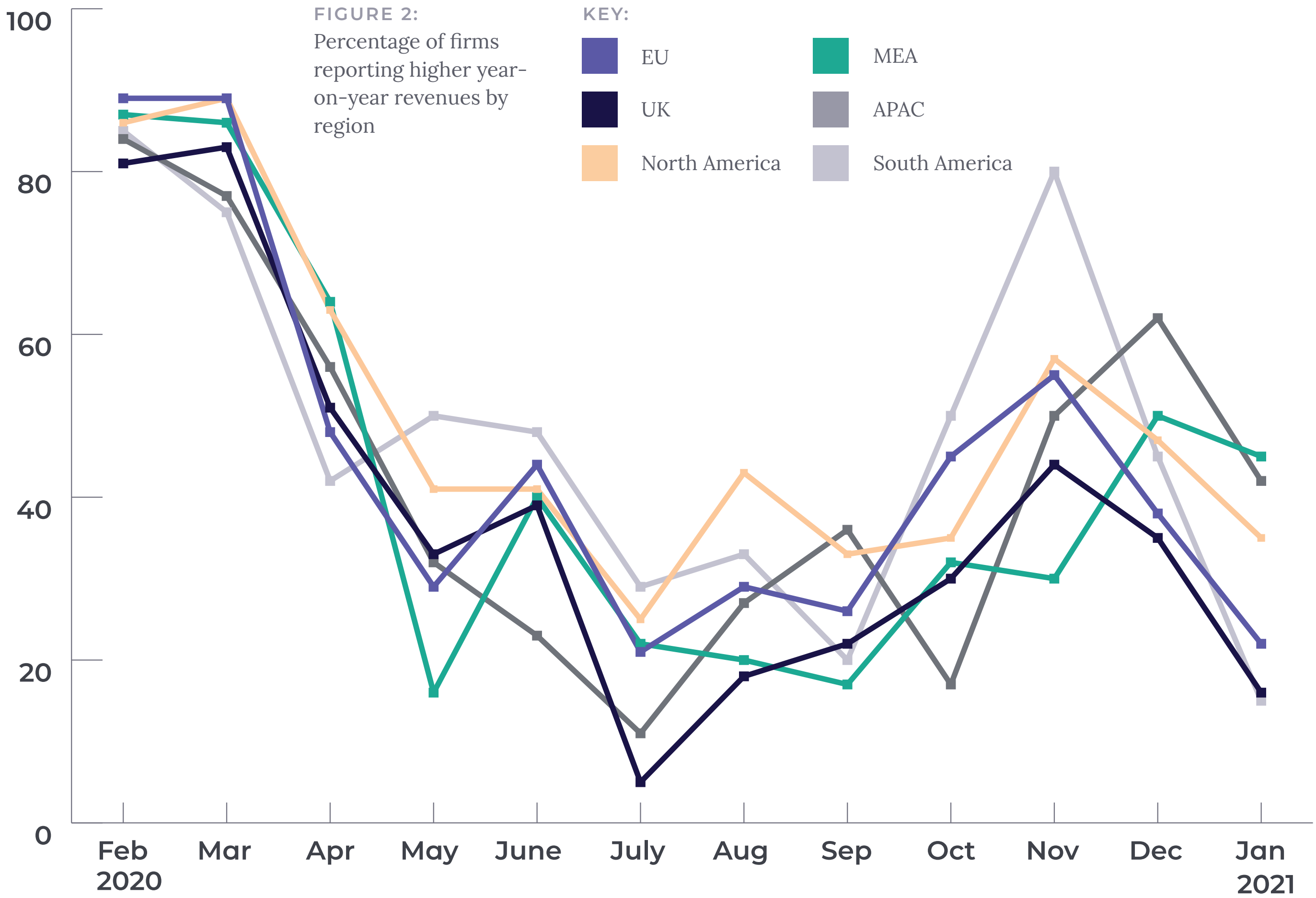


FIGURE 2:
Percentage of firms reporting higher year-on-year revenues by region

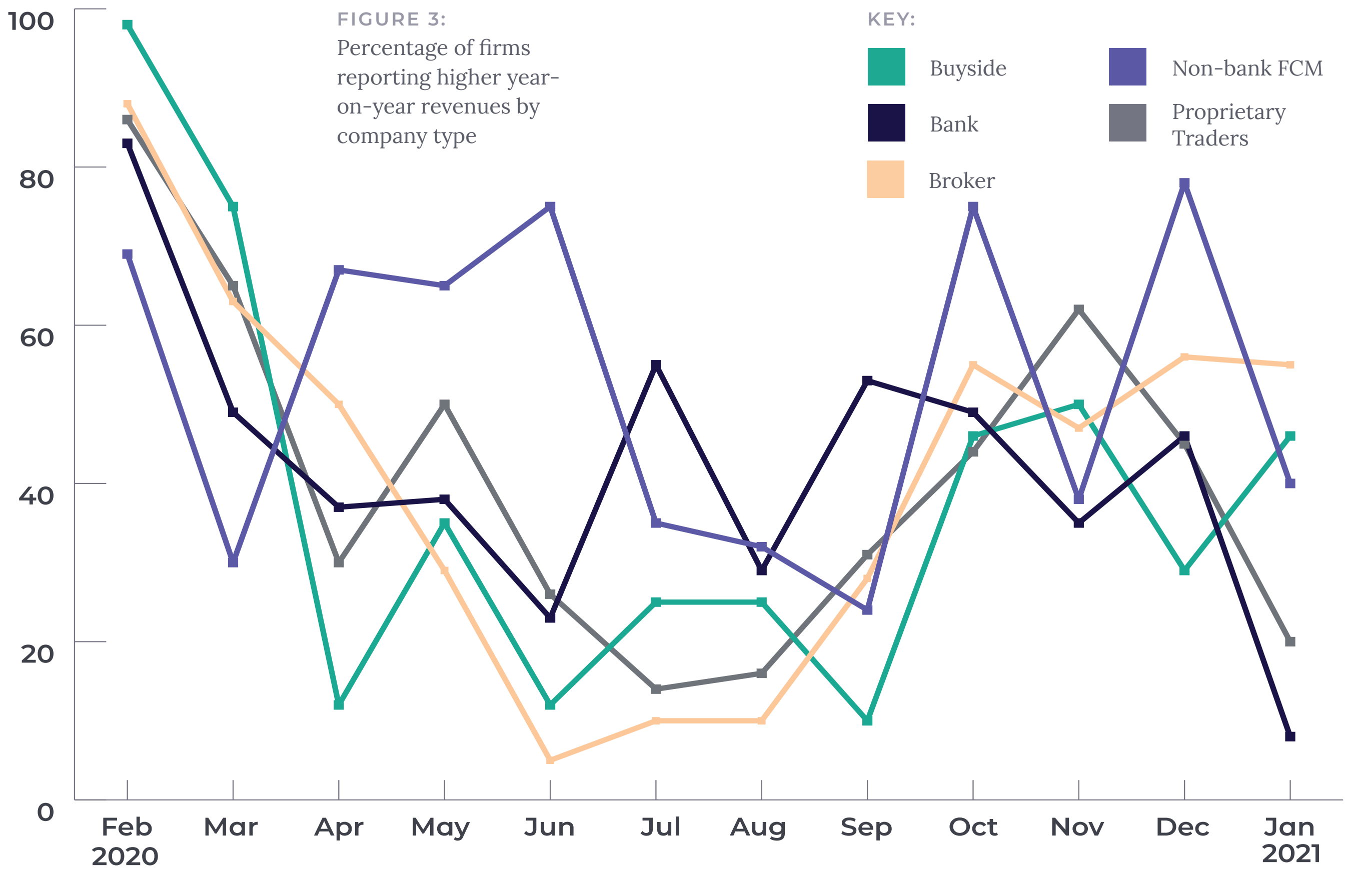


FIGURE 3:
Percentage of firms reporting higher year-on-year revenues by company type

Revenue change by company type

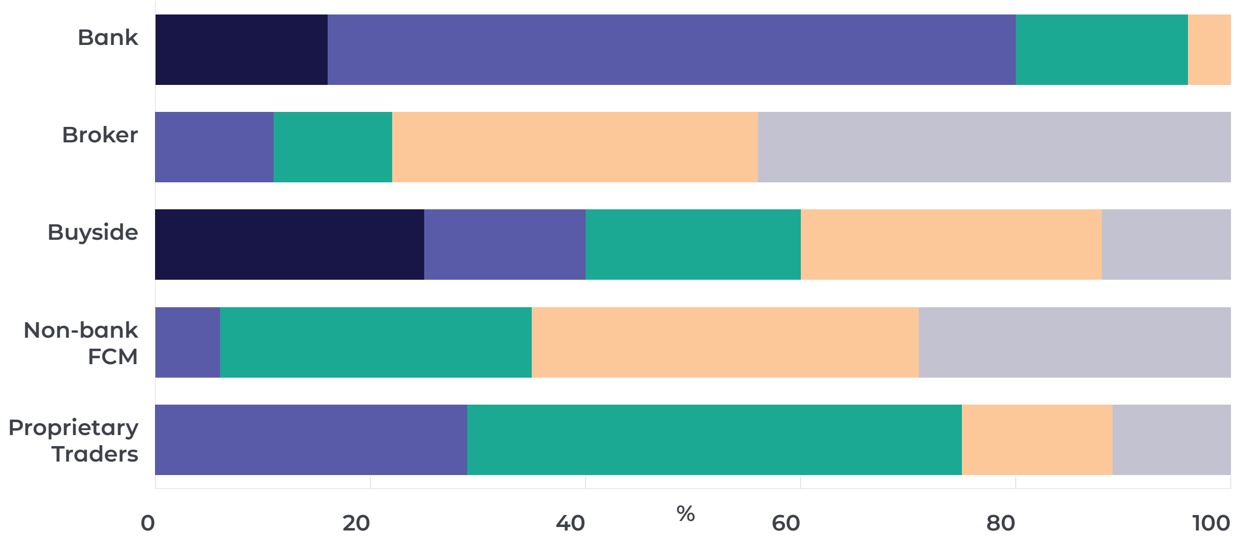


FIGURE 4:
Month-on-month revenue change by company type

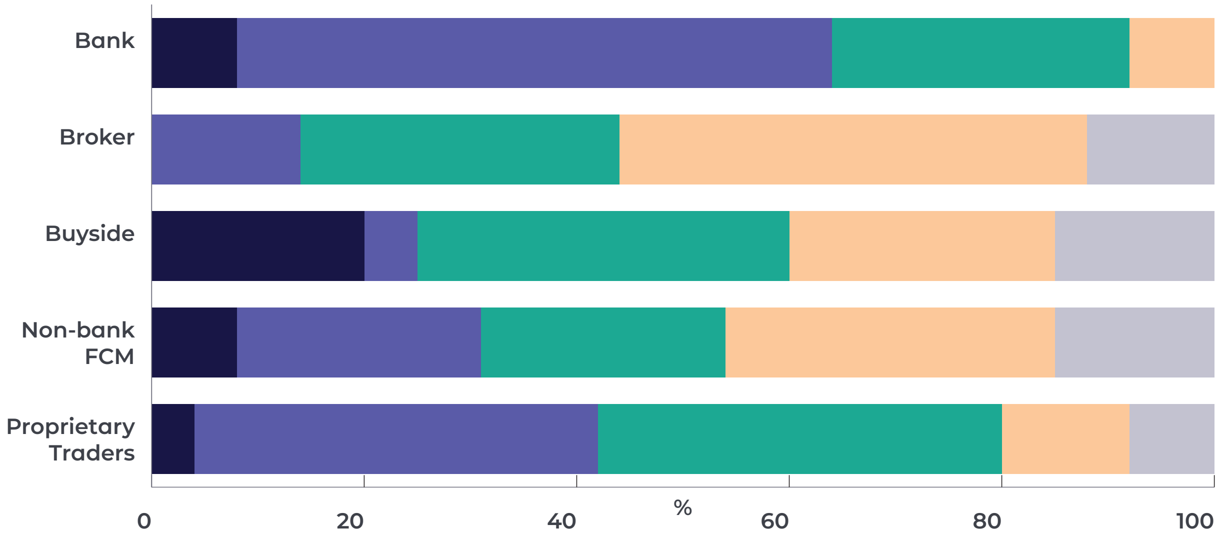


FIGURE 5:
Year-on-year revenue change by company type

KEY:
Significantly higher
About the same
Significantly lower
Somewhat higher
Somewhat lower

Tough month for banks as low rates and volumes hit revenues

Banks underperformed other company types last month both year-on-year and month-on-month as reduced revenues from interest on margin held on behalf of clients combined with lower volumes to impact overall performance.

Non-bank FCMs were also hit by lower rates but for some this was offset month-on-month by a strong performance in regional markets and specific asset classes, notably in commodities and ags.

Buyside performance was sharply polarised with some firms experiencing heavy losses but other strategies performing well. Proprietary trading performance was also polarised with US and Asian options firms performing strongly year-on-year and month-on-month while almost all other proprietary trading firms struggled.

Brokers performed relatively strongly compared with other company types with interest rate and commodity specialists doing particularly well as volatility in both the US and UK rates markets returned in January.

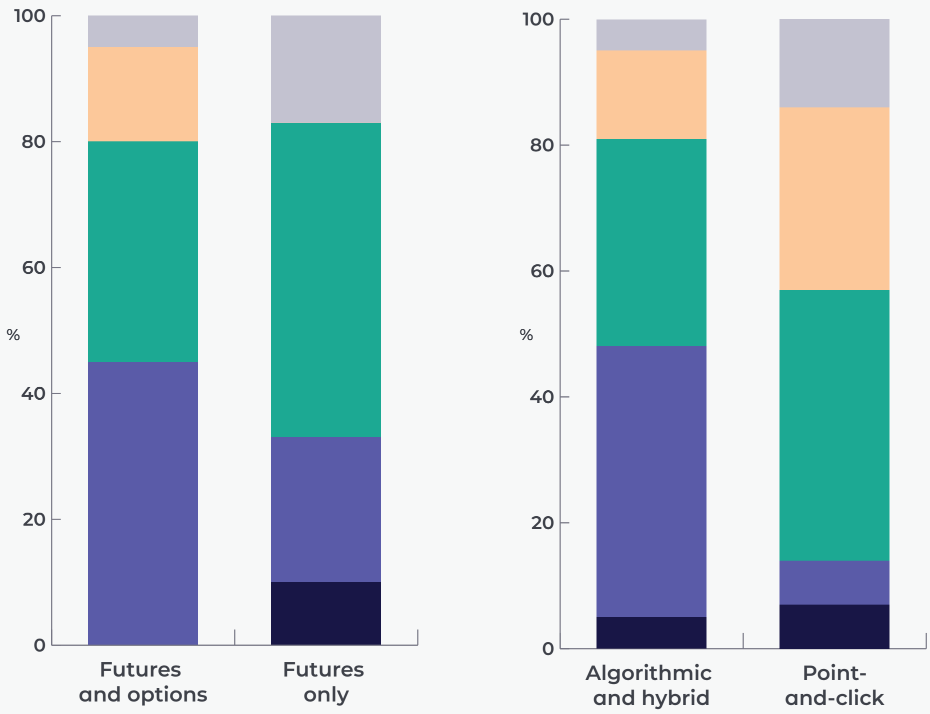
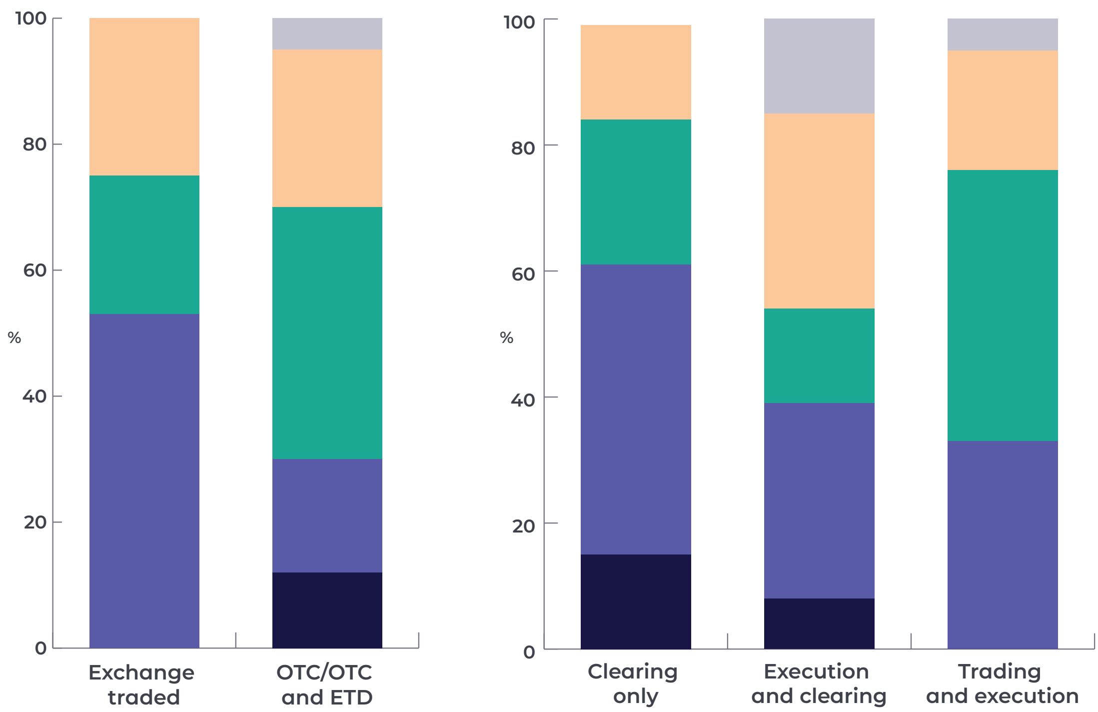


FIGURE 6 & 7:
Proprietary trading revenues by contract type and execution method (year-on-year)

FIGURE 8 & 9:
Sellside revenues by service and instrument type (year-on-year)

KEY:

- Significantly higher
- Somewhat higher
- About the same
- Somewhat lower
- Significantly lower



Revenues by region

% reporting month-on-month revenue rise:

22%

Top performing company type (month-on-month):

Brokers

EU

Revenue growth in the EU remained challenging for a second month with under a fifth of respondents reporting higher month-on-month revenues after a similarly tough December.

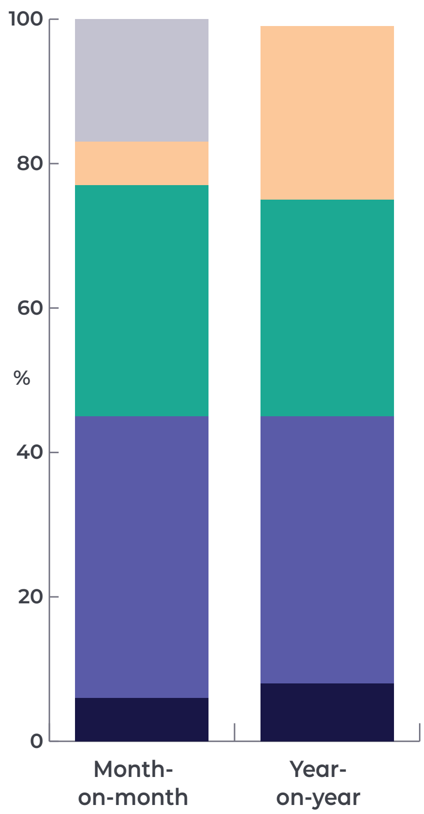
Banks reported the most challenging environment with 84% reporting lower month-on-month revenues and just over half reporting a worse year-on-year performance. Non-bank FCMs and brokers reported more favourable conditions as commodity volatility boosted revenues.

Performance from proprietary trading firms remained relatively weak with around half reporting similar month-on-month performance and a third reporting lower revenues. Year-on-year, only 10% reported higher revenues and two thirds experienced weaker trading conditions compared with January 2020.

Surging trading in commodities lifted volumes on Euronext last month and boosted broker performance. Commodity volumes on Euronext were double December's and up 41% year-on-year. Volumes on Eurex were more muted with equity index volumes down 21% year-on-year and interest rates up 5%. However, Eurex continued to grow its Euro-clearing market share, which stood at 20% in January.

KEY FINDINGS

- **Challenging month for banks as low rates hit revenues**
- **Hedge fund performance mixed as some CTAs struggle**
- **Proprietary trading performance remains relatively weak**



84%

of banks reported lower month-on-month revenues

FIGURE 10:
Revenue performance in EU

KEY:

- Significantly higher
- Somewhat higher
- About the same
- Somewhat lower
- Significantly lower

United Kingdom

Surging interest rate options volumes boosted revenues for some in the UK last month as the Bank of England warned on negatives rates while strong progress on the covid-19 vaccine programme lifted hopes of a rapid recovery in the second half of 2021 creating uncertainty in the outlook.

The uncertain outlook lifted interest rate options volumes on ICE Futures Europe to over 7m, the second strongest month since the March 2020 spike in volatility.

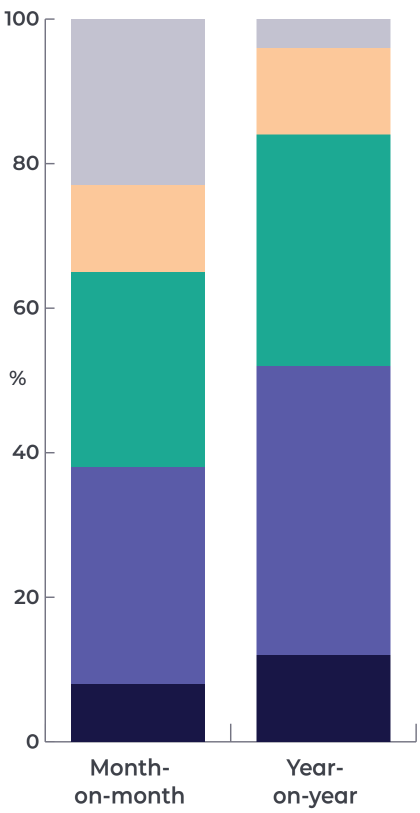
Brent futures and options were also up sharply as confidence grew in the global recovery. Interest rate futures volumes, however, remained flat while equity derivatives volumes fell.

Non-bank FCMs and hedge funds reported the strongest month-on-month increases in revenues with 60% of non-bank FCMs and two thirds of hedge funds reporting better revenues. Year-on-year revenue growth for non-bank FCMs was, however, muted with 25% reporting lower revenues last month when compared with January 2020.

As in the EU, banks had a tough month with 63% reporting lower month-on-month revenues, 70% reporting lower year-on-year revenues and none reporting a better year-on-year performance. Proprietary trading revenues were generally flat month-on-month and negative year-on-year with options traders faring better than futures-focused firms.

KEY FINDINGS

- Non-bank FCM revenues improve after poor December
- Another tough month for banks both m-o-m and y-o-y
- Options trading firms significantly outperform futures



60%

of non-bank FCMs reported higher month-on-month revenues

FIGURE 11:
Revenue performance in the United Kingdom

KEY:

- Significantly higher
- Somewhat higher
- About the same
- Somewhat lower
- Significantly lower

% reporting month-on-month revenue rise:
37%

Top performing company type (month-on-month):
Non-bank FCMs

North America

The ongoing surge in retail trading contributed to significant year-on-year revenue growth for many firms in the US last month. The Options Clearing Corporation reported record monthly volumes with over 840m contracts cleared, up 62% on January 2020 and almost 150m contracts more than the previous record set in June 2020.

The strong equity options performance contrasted with flat futures markets year-on-year. Across the CME Group, strong trading in ags and equity futures was offset by declines in interest rates in terms of year-on-year volumes. Month-on-month performance was stronger with interest rates up 31% and metals up 27%.

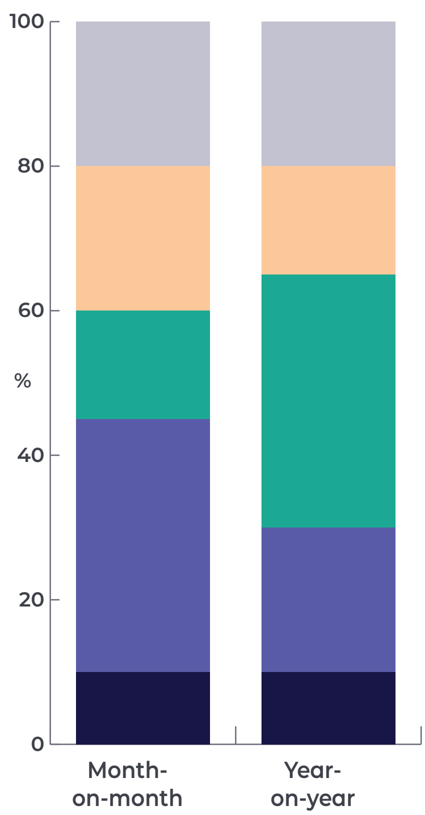
Unsurprisingly, firms involved in options trading significantly outperformed others, a fact particularly evident among proprietary trading firms.

As in other regions, banks generally experienced tough trading conditions with 88% reporting lower month-on-month revenues. However, the 12% that reported higher revenues reported them to be significantly higher as a result of options clearing operations.

Brokers reported a strong month with all reporting higher month-on-month revenues and 70% higher year-on-year revenues driven by energy, commodities and, to a lesser extent, rates. CTAs had a sharply mixed month with several reporting significantly lower revenues.

KEY FINDINGS

- **Options volumes soar as retail traders drive volatility**
- **Banks experienced tough conditions but brokers recover**
- **Sharp differences in performance from CTAs**



88%

of banks reported lower month-on-month revenues

FIGURE 12:
Revenue performance in North America

KEY:

- Significantly higher
- Somewhat higher
- About the same
- Somewhat lower
- Significantly lower

% reporting month-on-month revenue rise:
43%

Top performing company type month-on-month:
Brokers

Asia-Pacific

Revenues in APAC remained steady last month despite a sharp fall in bank revenues after a strong December.

While banks were the worst performing company type in Asia, as in other markets, revenue falls were not as sharp as elsewhere with 25% reporting flat month-on-month revenues. Year-on-year performance for banks was also stronger than in other regions with just 20% reporting revenue declines and 15% reporting higher revenues.

Non-bank FCMs reported mixed revenues with generally flat month-on-month and higher year-on-year performance.

Proprietary trading firms were the strongest performers with 75% reporting higher month-on-month revenues and two thirds a better year-on-year performance driven by a strong market in India and Hong Kong.

Volumes in Hong Kong soared off the back of an accelerating Chinese recovery with stock options volumes up 72% compared with January 2021 and total volumes up by 33%. Volumes on the Singapore Exchange reached a 4-month high off the back of strong trading in the China A50 futures contract, which rose 20% year-on-year.

KEY FINDINGS

- Stong performance in India and Hong Kong lifts revenues
- Chinese recovery drives volumes across the region
- Banks struggle but proprietary traders perform well

% reporting month-on-month revenue rise:
38%

Top performing company type (month-on-month):
Proprietary trading firms

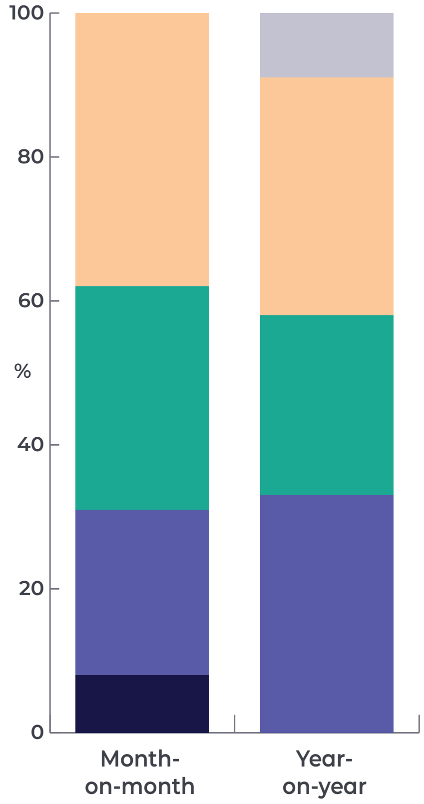


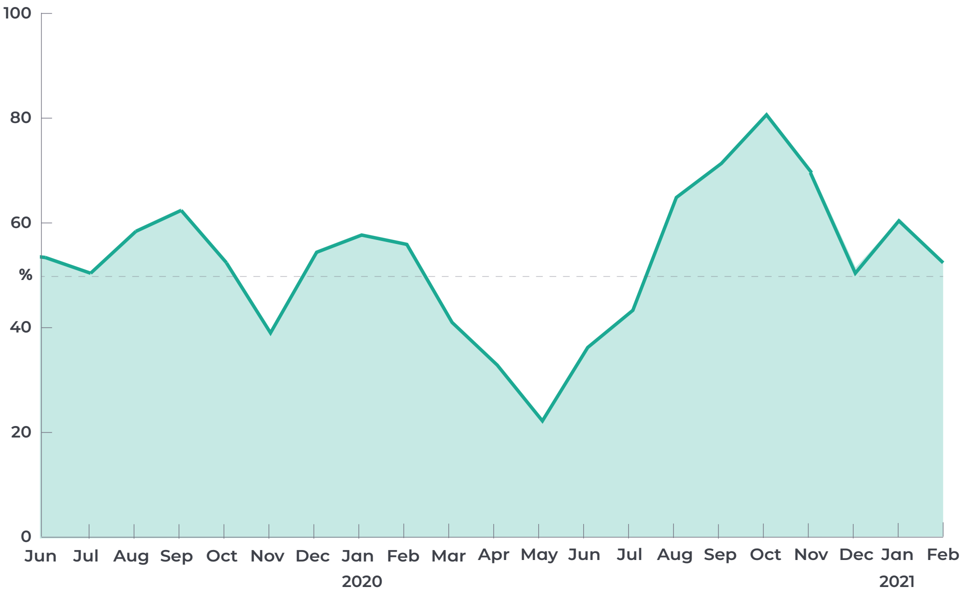
FIGURE 13:
Revenue performance in Asia Pacific

KEY:
Significantly higher
Somewhat higher
About the same
Somewhat lower
Significantly lower

SECTION THREE:

Outlook

Outlook over the next three months



Acuiti Derivatives Sentiment Index

Sentiment across the market fell last month but remained in positive territory. While the overall reading dropped marginally to 52% of respondents predicting improved trading conitions, the number of respondents predicting worsening conditions also fell as more respondents forecast stable revenues over the next three months.

FIGURE 14:
Three month revenue outlook by region

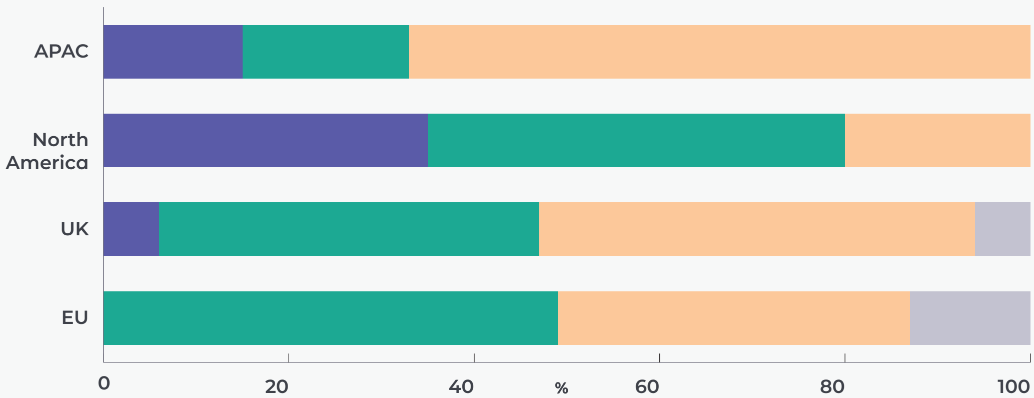
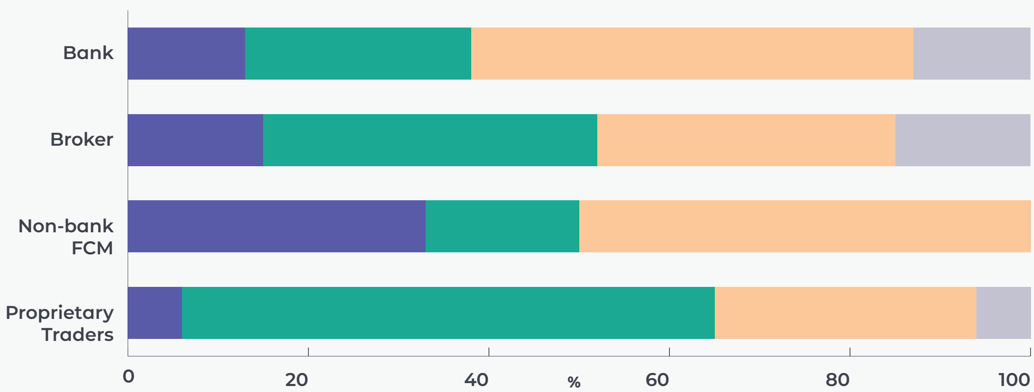


FIGURE 15:
Three month revenue outlook by company type

KEY:
- Increase significantly
- Increase somewhat
- Remain about the same
- Decrease somewhat
- Decrease significantly



SECTION FOUR:

Contracts and Volumes

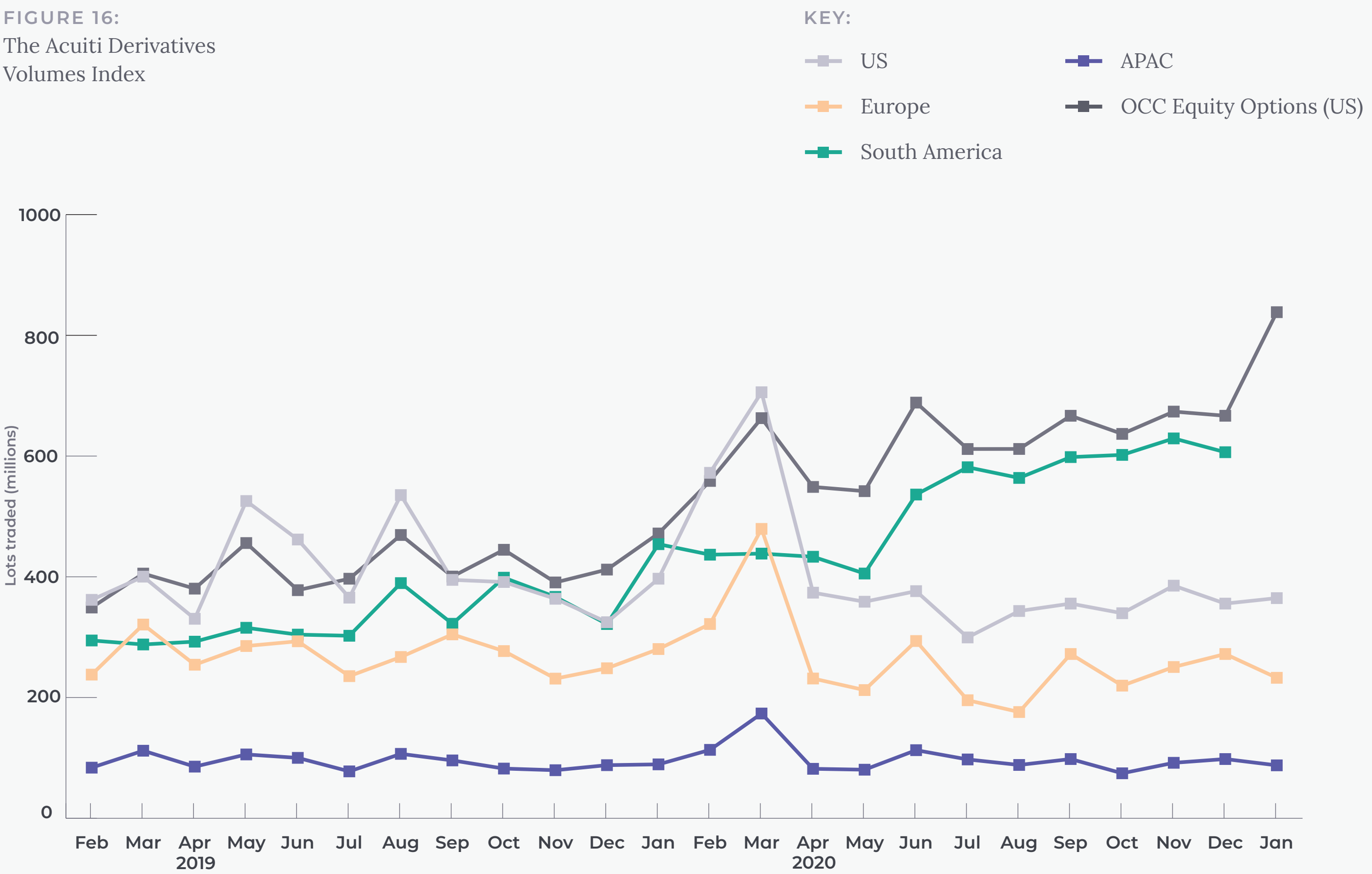
Trading volumes in January

The Acuiti Derivatives Volumes Index is compiled by reference to the overall trading volumes on a series of benchmark, internationally traded, institutional exchanges or CCPs, in each jurisdiction.

The benchmark is designed to provide a measure of overall volumes in each region against which to measure and contextualise regional performance reported in the monthly survey.

Overall volumes in last month were generally flat or negative with the exception of the US equity options market which soared to record levels.

FIGURE 16:
The Acuiti Derivatives Volumes Index



Sources: Euromoney TradeData, ICE, OCC, CME, Euronext, Eurex, B3, HKEx, Japan Exchange, LCH, SGX

Most traded and fastest growing contracts

Exchange	Country	Continent	Contract	Contract Type	Instrument	Volume	Open Interest	Contract Size
B3	Brazil	South America	Mini Ibovespa	Equity	Future	321,447,041	929,922	BRL 0.2 x index
Moscow Exchange	Russia	Europe	USD/RUB	Currency	Future	74,292,142	3,217,782	RUB1000
National Stock Exchange of India	India	Asia	USD/RUP	Currency	Option	73,550,069	3,874,399	$1000
B3	Brazil	South America	Mini US Dollar	Equity	Future	71,227,685	850,884	$10,000
Korea Exchange	South Korea	Asia	KOSPI 200	Equity	Option	66,596,861	-	KRW500,000 x index

FIGURE 17:
Most traded contracts in January

Exchange	Country	Continent	Contract	Contract Type	F/O	Volume	Volume Increase	% Increase
B3	Brazil	South America	Mini Ibovespa	Equity	Future	321,447,041	52,054,711	16
Chicago Mercantile Exchange	United States	North America	Eurodollar	Interest Rate	Future	42,111,115	12,407,112	29
Chicago Board of Trade	United States	North America	10 year US Treasury Notes	Bond	Future	32,660,646	9,870,985	30
Shanghai Stock Exchange	China	Asia	CSI 300 ETF	Equity	Option	49,315,784	8,934,977	18
Korea Exchange	South Korea	Asia	KOSPI 200	Equity	Option	66,596,861	8,596,631	13

FIGURE 18:
Top volume increases in January

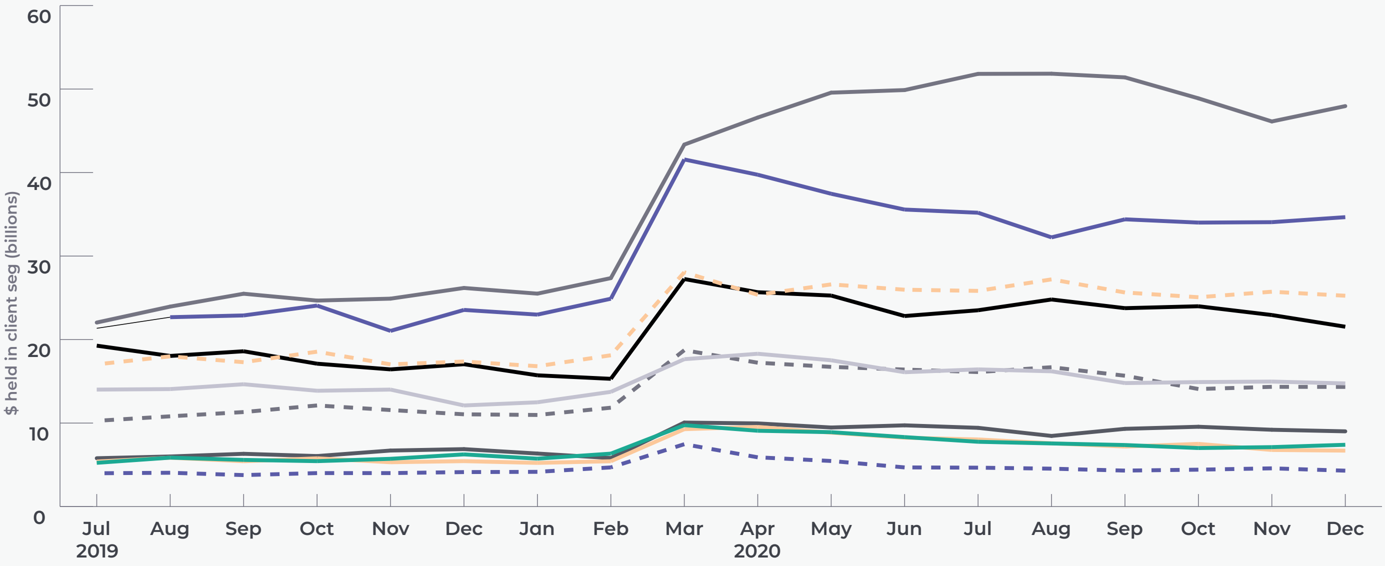
Volume data provided by:
EUROMONEY TRADEDATA

Customer assets held by US FCMs

FIGURE 19:
Customer assets in Segregated fund accounts (Banks)

KEY:
Goldman Sachs
JP Morgan
Morgan Stanley
BAML*
Societe Generale
Citi
Credit Suisse
UBS
Barclays
Wells Fargo

* Incorporating Merril Lynch Professional Clearing and BOFA Securities



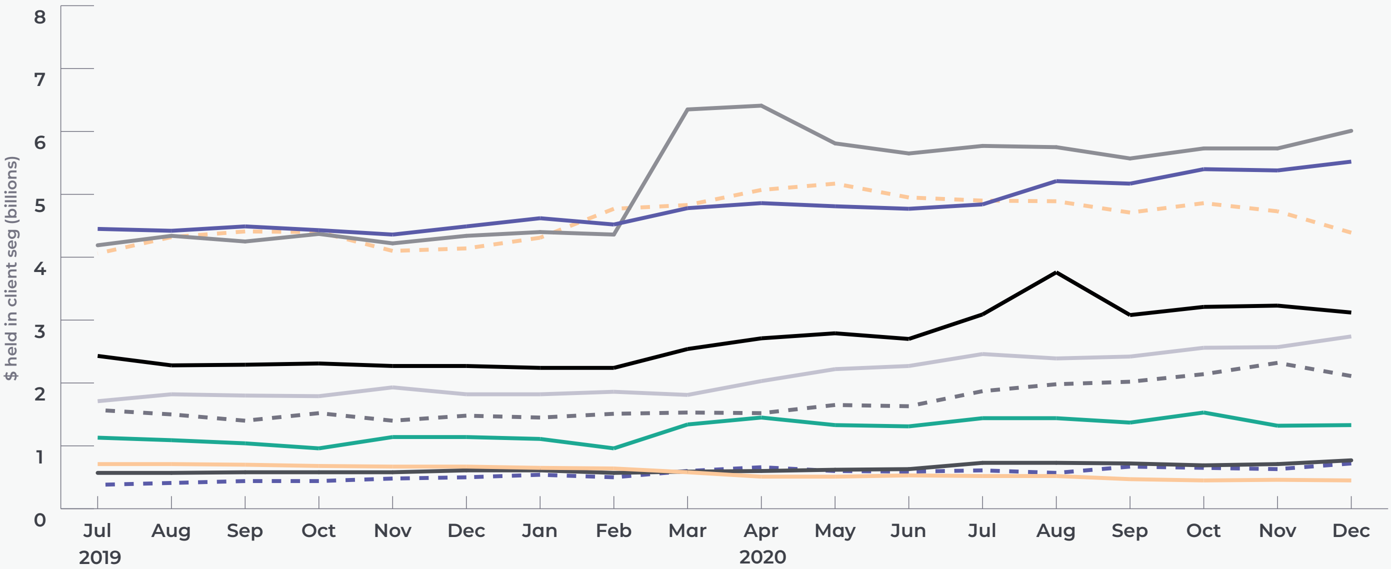


FIGURE 20:
Customer assets in Segregated fund accounts (Non-bank FCMs)

KEY:
ADM Investor Services
Interactive Brokers
RJ O'Brien
StoneX
ED&F Man Capital Markets
Marex North America*
Wedbush Securities
McVean Trading & Investments
Tradestation Securities
Phillip Capital

* Formerly Rosenthall Collins Group

Source: CFTC

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