

Exchanges

FIA Boca: Our 9 biggest takeaways from the three-day conference

Industry Overview

Attending the 49th Annual FIA Boca conference

Last week, we met with dozens of exchange executives, industry experts, securities practitioners and investors at the Futures Industry Association's 49th annual conference in Boca Raton, Florida. FIA Boca is one of the largest annual gatherings of trading executives and features presentations on the hottest topics in the market structure universe. Over the course of the week, we attended meetings/presentations with the Commodity Futures Trading Commission (CFTC) Chair Rostin Behnam, TastyTrade (IGG), Intercontinental Exchange (ICE), Hong Kong Exchanges & Clearing (388-HK), Cboe Global Markets (CBOE), BGC Group (BGC), Tradeweb (TW), Nasdaq (NDAQ), Flow Traders (FLOW), Virtu (VIRT), CME Group (CME), TMX Group (X), the London Stock Exchange (LSEG), Euronext (ENX), EDX Markets, Google, Microsoft, and more.

1) Significant obstacles to near-term exchange M&A

While recognizing that there are significant obstacles, there was much discussion among conference participants on the opportunities for exchange M&A. Although ex-US derivative volume was up 78% y/y in 2023 (mainly APAC), exchange executives noted that protectionism and fragmented regulatory regimes have made cross-border M&A increasingly challenging. Meanwhile, anti-trust regulators at home have been very active in countering large transactions. The federal government has filed a record number of antitrust challenges under the Biden Administration, and notably, they held up the ICE-BKI acquisition for 16 months. NDAQ, ICE, CBOE and VIRT all reiterated their disinclination toward M&A. NDAQ has ruled out any significant deals for the foreseeable future, and it will instead be focused on deleveraging. While open to small bolt-on deals, ICE has also prioritized deleveraging post-acquisition. CBOE is focused on integrating its existing businesses and again noted that the company is no more “for sale” than it was prior to CEO Fred Tomczyk’s appointment in September. Lastly, VIRT indicated that share repurchases are likely to be a better use of capital given its low stock valuation and noted the difficulty in finding a target with a good fit.

2) Fixed income e-trading could be an M&A bright spot

By contrast, fixed income e-trading could be more fertile territory for deals. Both MKTX and TW have plenty of capacity for M&A (no debt) and could benefit from new capabilities. TW is attempting to gain traction in emerging markets while MKTX is trying to kickstart growth after three consecutive years of sub-4% organic revenue growth. Both firms have been active acquirers recently; MKTX acquired Pragma in October while Tradeweb closed on YieldBroker in August. ICE has also publicly discussed its interest in building out institutional connectivity for its fixed income e-trading platform. Relatedly, we note that Bats Global Markets was sold to CBOE while current MKTX CEO Chris Concannon was at the helm.

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Glossary

ODTE: Zero days till expiration
AI: Artificial intelligence
BKI: Black Knight
ETF: Exchange-traded fund
FICC: Fixed Income Clearing Corporation
MIAX: Miami International Holdings

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Additional details

3) The retail toolkit is becoming a lot larger

ODTE has arguably been the hottest trend in retail investing for the past couple years, but with ODTE now comprising 50% of all SPX volume, there was significant investor focus on what will capture retail investors' attention next. We think ODTE will continue to spread into new symbols. CBOE recently launched ODTE on the Russell 2000, and the rollout of single stock ODTE is viewed as likely. Alternatively, crypto is making a comeback. After two years of declining volumes, spot crypto activity has finally inflected upward with volumes increasing 90% q/q in 4Q23. Additionally, the new spot Bitcoin ETFs have raced to \$11B in assets in under a month and have been green lit at several wirehouses. These products have proved to be highly profitable for electronic market makers (VIRT) since they can serve as a wholesaler, authorized participant and approved counterparty. Lastly, there is a fair amount of investor anticipation around the success of micro futures (CME) on retail platforms. Webull rolled out futures trading last Monday, and Robinhood and Plus500 will launch futures later this year.

4) CME and ICE may compete in treasury central clearing

CME announced that it would apply to become a central counterparty for treasuries, and ICE also indicated interest in doing so. We believe the moves are an opportunistic response to both customer dissatisfaction with the FICC as well as the growth opportunity presented by recent regulations. The treasury market is estimated to be only 32% centrally cleared today (including 19% in hybrid clearing), and recent SEC rulemaking will force a much larger swath into central clearing through 2025. Meanwhile, electronic market makers have cited the FICC's prohibitive clearing costs and eligibility requirements as an obstacle to their participation in the cash rates market. Cash treasury clearing is a \$400M/year market and could provide a meaningful revenue boost to CME, particularly if it also helps them grow their footprint in IRS clearing. That said, our base case is that the FICC retains its monopoly on this market given its not-for-profit structure and head start. Even so, the emergence of competition should drive down clearing costs and thereby facilitate greater participation from electronic market makers. We address the topic in more detail in [this earlier note](#).

5) CFTC to address vertical integration this summer

During his keynote address, CFTC Chair Rostin Behnam stated that he expects a rule proposal relating to derivative exchange vertical integration to be released by the summer. In the past few years, there has been several instances of a single company owning an exchange, clearing house and broker. MIAX, Coinbase and most recently Bitnomial (as of December) possess all three licenses. CME also applied to become an FCM in 2022 and has a pending application. This development upsets the longstanding system of checks-and-balances between a broker and the exchange/clearinghouse. Additionally, it creates a risk of disintermediation for futures brokers. We expect that the forthcoming rule proposal will attempt to limit conflicts of interest and minimize entanglements between the different entities.

6) AI opportunities across back & front office trading

In light of the rapid advances from OpenAI in the past year, AI was the most talked about technology of the week. There have already been several innovative product launches around AI by our covered exchanges with NDAQ being the most prolific. It has launched the first AI-powered order type (Dynamic M-ELO) and a Gen AI anti-financial crime assistant. It also leverages AI internally to determine the optimal options strikes to list as well as improve the accuracy of its anti-financial crime tools. AI is also central to ICE, TW and MKTX's efforts to electrify fixed income markets. Through its AiQ offering, ICE uses AI to help digitize mortgage documents. Meanwhile, MKTX and TW both deploy AI to help compute real-time pricing for fixed income securities (CP+, Ai-Price) as well as automate executions (Auto-X, AiEx). More broadly, financial intermediaries are awash with data, and AI is proving to be an effective tool for better

extracting insights. Not only is this creating product opportunities, but it is driving demand for exchanges' large data businesses.

7) Chair confirms view that Ethereum is a commodity

Earlier this month, the Securities and Exchange Commission (SEC) delayed the approval of the Ethereum spot ETF, but CFTC Chair Rostin Behnam stood by his agency's existing stance that Ethereum is a commodity in our meeting. This decision follows earlier statements by the SEC indicating that the vast majority of tokens (excluding Bitcoin) are securities, which could potentially imply that existing Ethereum tokens were issued illegally through unregistered securities offerings and are not suitable for use in ETFs. Unlike Bitcoin, where spot ETFs were green-lit in January, Ethereum leverages a proof-of-stake blockchain that allows users to earn a yield on their positions.

8) TastyTrade sees SPY as a better gateway than SPX

IG North America CEO JJ Kinahan indicated that SPY options are a better gateway product for active traders. He emphasized that the small size and penny spreads make them very easy to trade versus the larger SPX contract. While index options have tax advantages, he noted that it is very difficult for brokers to communicate these features to clients without running afoul of securities law related to providing investment advice. Additionally, retail investors are more familiar and comfortable with the SPDR brand. However, he noted that CBOE has made rapid progress in marketing and building out liquidity in its analogous XSP options.

9) High investor interest in the FMX Launch

There was much higher investor interest around BGC Group than in prior years due to its upcoming interest rate futures launch. Having obtained CFTC approval in January and secured a cross-margining arrangement with LCH, BGC is again attempting to break CME's hold on the US interest rate futures market. The exchange plans to compete by: (1) securing liquidity providers and brokers as strategic partners, (2) having fast and deterministic technology, (3) allowing users to mark out counterparties, (4) offering lower tick sizes, (5) enabling capital saves from cross-margining, and (6) having lower venue fees.

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