THE WALL STREET JOURNAL. ONLINE

January 24, 2006

TRACKING THE NUMBERS

Street Sleuth

Old and New Secure A Place at Options Table

Upstarts' Gains Level Off As Traditional Exchanges Learn to Compete Online

By PETER A. MCKAY
Staff Reporter of THE WALL STREET JOURNAL
January 24, 2006; Page C3

A few years ago, electronic upstarts looked likely to take control of the options industry because they offered investors a way to buy and sell these financial contracts without the overhead of a trading floor and other costs.

But since then the options business has surged, and the balance of power has leveled off among leading players. Case in point: The Chicago Board Options Exchange. The trading venue's recent success comes at a time of increasing investment in exchanges of various kinds as businesses in their own right.

The options industry's other leading player and former upstart, **International Securities Exchange** Inc., went public in a stock offering last year, and it now controls roughly the same slice of the industry as the much-older CBOE does. Other exchanges may go public in the near future, including the New York Mercantile Exchange, a key energy-trading marketplace, and CBOE itself.

"It's more difficult for the ISE to continue poaching volume at this point," said market consultant Diego Perfumo of Efficient Frontiers LLC. "They had a natural advantage the first few years of their existence, just by being an online exchange. But that's changed as the other exchanges, especially CBOE, have changed their access models and invested in technology."

For the second straight year, in 2005 CBOE and the online ISE each garnered about 30% of all options volume, in a field that comprises six exchanges. Options are contracts conveying the right to buy or sell an underlying asset at a fixed price before a certain expiration date. They can be used to speculate on market swings, or to guard against unexpected price moves for the underlying item.

To be sure, CBOE's business increasingly relies on exclusively licensed contracts linked to indexes like the Standard & Poor's 500 and the Dow Jones Industrial Average, which is owned by The Wall Street Journal's parent company, Dow Jones & Co. In the market for options on individual stocks -- arguably a more wide-open arena -- ISE pulled ahead with a share of 32.5% to CBOE's 25.8% in 2005.

Each option on an individual company -- say, Microsoft Corp. or General Electric Co. -- conveys rights on 100 shares. Index options work in a similar way, except they are settled upon expiration by delivery of a sum of cash based on the index.

CBOE's volumes put an end to its members' doomsday scenarios, which seemed all too likely when the ISE launched in 2000 and almost immediately began grabbing market share. At the time, some traders and analysts worried that the low-cost trading via the online ISE could cause the CBOE -- which was founded in 1973 and maintains both a trading floor and online platform -- to wither or even fold.

"What we have now is a new hybrid system that is working well for our members and customers," said William Brodsky, CBOE's chairman and chief executive.

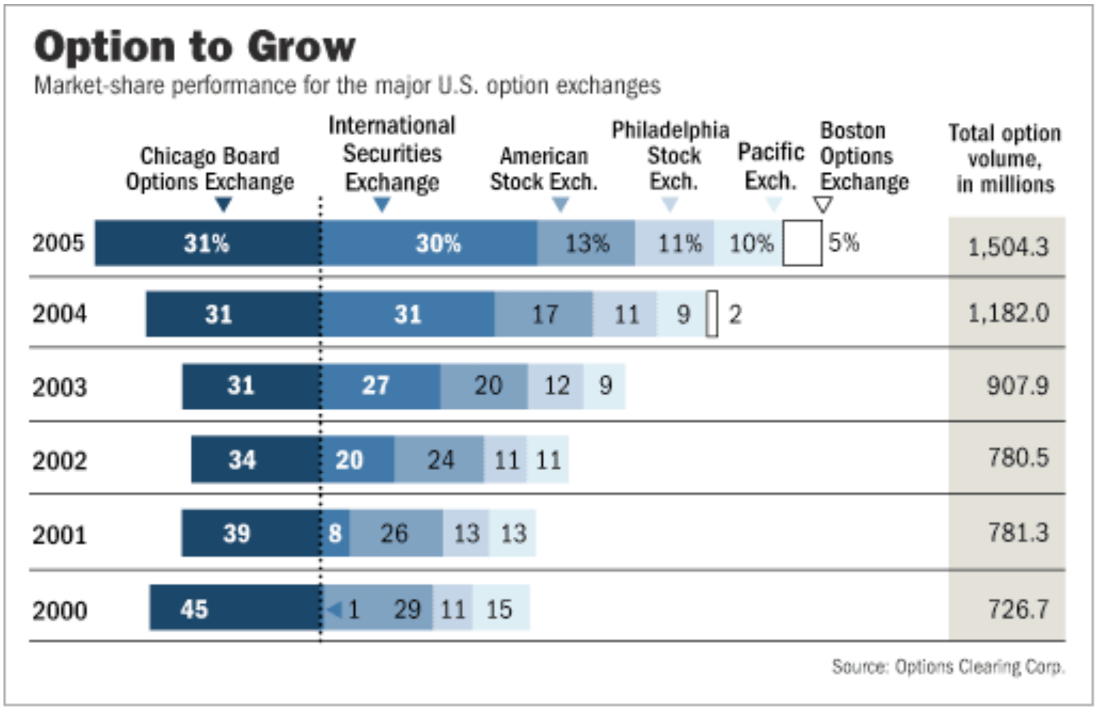
Mr. Brodsky acknowledged, however, that competition from ISE prompted his exchange to revamp its online platform, a process that lasted about 18 months, ending in late 2004. "It took us a while to get up to speed, because [ISE] had a natural advantage in technology," he said.

Bruce Goldberg, ISE's senior vice president, said his exchange has sought to increase its volume by attracting new trading activity and participants, not by stealing anyone else's existing business. Indeed, annual options volume, including all exchanges, has more than doubled to 1.5 billion contracts since 2000, a trend that veteran traders and even ISE competitors, credit in part to the online exchange's launch.

Because of the jump in overall activity, every marketplace except the American Stock Exchange has gained trading volume since 2000, no matter whether its market share went up. For instance, CBOE's share has fallen from near 45% in 2000, but the number of trades executed on its markets annually has jumped 43.5% to a record 468.2 million contracts.

Since ISE's first full trading year in 2001, its volume has soared more than sevenfold to 448.7 million contracts, and its market share is up from 8.4% of all products.

ISE has also petitioned regulators for greater freedom to list index contracts, and fought off several lawsuits from index providers, with mixed success. "It's a bloody monopoly," under the current licensing agreements, Mr. Goldberg said. "We don't think that's fair." But he added: "We're happy with the growth we've seen in the issues we do have."



Write to Peter A. McKay at peter.mckay@wsj.com[1]

URL for this article:
http://online.wsj.com/article/SB113807218347754395.html

Hyperlinks in this Article:
(1) mailto:peter.mckay@wsj.com