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A PUBLICATION OF INSTITUTIONAL INVESTOR, INC.

DECEMBER 3, 2007
VOL. XXXIX, NO. 48

Time's A Wastin'

When will the **Nasdaq** get its controversial options market approved for launch?

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23rd Annual Futures & Options Expo

See coverage, pages 8-10

NASDAQ COUNTERS NYSE'S PLAN FOR OFF-EXCHANGE BIZ

The **Nasdaq** Stock Market is firing back at the **New York Stock Exchange** by doubling the amount of tape revenue it shares with large brokerages to 100%. The move preempts a similar plan by the Big Board. Exchanges earn an estimated $25 million per year for reporting to the **Consolidated Tape Association** or the **Nasdaq Securities Information Processor** information on trades that occur at brokerages or alternative trading systems.

(continued on page 12)

<u>Trying To Keep Edwards Brokers</u>

WACHOVIA BRIBES RECRUITERS, WHO TAKE THE MONEY AND LAUGH

Wachovia Securities is upping commissions by 67% for independent recruiters who agree to stop poaching **A.G. Edwards**' brokers. The deal, first reported last week by *Investment News*, is seen as an early Christmas gift by several recruiters. Happy to take the extra cash, they laughed at Wachovia's seemingly desperate attempt to retain fleeing A.G. Edwards brokers. A Wachovia spokesman did not return calls by press time.

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<u>SEC: Not So Fast</u>

TRADERS BLAST NASDAQ OPTIONS MARKET ON LAUNCH EVE

Traders and exchange executives blasted the **Nasdaq** Stock Market's plan to run its options market with hidden penny orders at last week's Futures & Options Expo, saying it could lead to the demise of transparency in the entire market. **Securities and Exchange Commission** officials in attendance appeared to be uncomfortable with the concept as well, indicating that many more questions would have to be answered before it signs off on its launch. Though

(continued on page 11)

<u>Scared Straight</u>

MORGAN STANLEY USES FELONS TO DETER INSIDER TRADING

Morgan Stanley is looking to the most unlikely suspects—convicted criminals—to help it prevent insider trading, according to *WSL* sister publication *Compliance Reporter*. The firm on Nov. 19 hosted a live presentation and Web cast to all Morgan Stanley investment management affiliates around the globe. The session, titled "Barred

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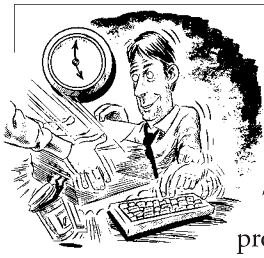

At Press Time

NYSE To Pay Bond Liquidity Providers

The **New York Stock Exchange** plans to credit liquidity providers $20 a pop for some bond trades executed on its NYSE Bonds system during the next four months. Under the pilot program, the liquidity provider must post an order larger than 20 bonds on the book, but a trade of fewer than 20 bonds must trade against it to get the credit. For example, a liquidity provider will not receive credit if a contra side order comes in for 50 bonds and it posts an order for 100 bonds. The provider will, however, be compensated if a contra side order comes in for 10 bonds against its 100 bonds.

The proposal comes in response to best execution concerns because liquidity providers offset clearing costs by pricing them into the bid and offer, which distorts best price. Clearing costs increase with smaller orders, which might compromise best execution, NYSE said in a related rule filing.

AXES Extends Overseas Access

Peter Gaffney

AXES, a New York-based agency brokerage, is partnering with **Trading Screen**, a global execution and order management system, to extend its trading capabilities in emerging markets. The firm, which offers direct market access and research in 104 markets, will enable roughly 860 of Trading Screen's institutional clients to access niche growth markets, and the two systems will be partnering to extend access further, said **Peter Gaffney**, president of AXES. "The partnership will help expedite growth. Though we can already execute overseas, some asset managers are used to executing all their trades on one system, and this would immediately unable them to trade in places they haven't been before," he said. The alliance is expected to expand AXES' client base by 35-40%. The firm has also been making headway with bulge bracket firms by offering access to hard-to-reach markets such as Zambia and Nigeria.

Regional Bank Refocuses On Retail

Bruce Nollenberger

Nollenberger Capital Partners, a San Francisco-based investment bank, shuttered its equity capital markets business last week and plans to refocus on growing its brokerage staff. Twenty-seven jobs in equity research, sales and trading and support have been eliminated. The idea is to be able to put more money and resources toward growing its advisory and banking services. "We made the decision to focus on the profitable side of the business. Investment banking and advisory services are robust and growing, so it just made sense," said CEO **Bruce Nollenberger**.

The private client wealth management division has about 23 financial advisors in three offices in California. "We will be hiring financial advisors in our San Francisco, San Jose and Newport Beach offices over the next year," Nollenberger said. The firm is looking to hire experienced financial advisors whose clients have $2-20 million in assets.

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Trading

Nasdaq To Launch Options Data

The **Nasdaq Options Market**, set to start trading on Dec. 7, will be releasing two proprietary data feeds at the launch. The Best of Nasdaq Options (BONO) feed will include best bid and offer quotes it reports to the Options Price Reporting Authority as well as trade data. Market participants requested the proprietary feed because real-time delivery is faster than getting quotes from other distributors, several traders said. The second feed, NOIView, will carry data from the opening and closing auctions. While the same types of feeds are offered at competing exchanges, the Nasdaq is planning to introduce depth-of-market data and analytical feeds based on customer demand, officials said. Currently, only the **International Securities Exchange** provides depth-of-market data, which shows all of the trades on the book beyond those at the NBBO. Such data is used by electronic trading firms to model algorithms and other automated trading strategies. Pricing will be available at a later date.

Derivs E-Trading Plateaus As Capital Commitment Rises

The growth of electronic futures and options trading has been flat for the second straight year as more institutions have been asking for capital commitment on their derivatives trades, according to a recent **Greenwich Associates** survey. The research firm, which interviewed 148 institutions, saw the volume of futures trading via direct market access systems virtually unchanged at 22% of all trades, while options trading stayed flat at 11% for the past two years. With the launch of the **International Securities Exchange** in 2001, electronic options trading picked up sharply, and multiple exchanges and sell-side firms implemented electronic platforms since, but the buyside still prefers to contact brokers by phone for the majority of its trading.

John Feng, consultant, attributed the lagging interest to a greater emphasis on capital commitment in derivatives than in any other instrument. Because derivatives are more numerous than equities, they are also less liquid, which means the broker has to take the other side of the trade more often. Nearly 85% of all institutions said that they require brokers to commit capital on equity derivatives trades, up from 78% in 2005. Capital commitment on options trades increased to 48% from 46%.

"Almost all hedge funds now demand broker capital for some options trades and hedge funds attach the requirement to well over half of their options trading volume," Feng wrote in the report. More than half of the institutions surveyed cited the willingness to commit capital and competitiveness in options pricing as the key attributes of their brokers. Execution quality lagged far behind with only 27% naming it as the most important criteria. Derivatives research is also becoming more important, with 31% of institutions awarding business to brokerages based on their calls, up from 24% last year.

Sellside Set To Splurge On Faster Tech

Sell-side firms are expected to spend $500 million by 2010 on low-latency technology to handle increasing volumes and message traffic, according to a recent TABB Group report. Low-latency technology reduces the time it takes to process messages, which in turn speeds up trading. The research firm estimates daily message traffic at global equities and options markets to 128 billion in 2010 from 7 billion this year.

The implementation of Regulation NMS, lower spreads and increased market data on listed options have all contributed to the need to invest in the technology, said **Kevin McPartland**, author. Firms have already spent $300 million this year on message buses, feed handlers, ticker plants, complex-event processors, physical transport data storage and integration and customization of internal and external applications. Spending on messaging was $95 million this year, demonstrating that it is only part of the lifecycle, McPartland said.

Many investment banks plan to double or triple their technology budgets to focus on internal development projects, enhancing existing applications, producing new algorithms and improving trading tools. A third of low-latency budgets are spent on vendor solutions, but that should increase as certain solutions become more commoditized, said McPartland.

CBOE Leaves off FLEX Surcharges Until Next Year

The **Chicago Board Options Exchange** has decided to not add any surcharges to fees on trading FLEX options through the end of the year to promote its newly-launched FLEX Hybrid Trading System. FLEX options are customized index or equity options contracts that let traders specify strike prices, exercise styles and expiration dates, among other terms. CBOE has been trading the options for a decade, but introduced a system where brokers, liquidity providers and customers can negotiate options terms electronically only last week. Open outcry trading will continue to be available. The system is expected to reduce the time lag and complexity of the negotiations.

The exchange will end a 10-cent surcharge to FLEX trades executed on the system in January. It will apply to the first 2,500 contracts of trades executed by public customers, and to every contract for brokerage and market maker orders. Firms will also be charged $100 a month for each trading member, through firms that have more than five traders executing on the systems will only have to pay for the first five. The surcharges and fees are expected to help CBOE offset development costs, officials said, declining to discuss how much the exchange spent on development.

Arca Adds Blind Orders

NYSE Arca is enhancing its equities trading system, and has added a blind limit order type to facilitate trading for those that want more anonymity. Arca already lets traders file limit orders that would automatically execute against the book, but only lead market makers can post orders without displaying the price. Rival **ISE Stock Market** allows traders to post orders without displaying the price and executes them at the midpoint between the best bid and offer, but the NYSE is still in the process of developing its anonymous crossing capabilities with **BIDS Trading**.

Arca plans to adjust the execution price limit for the order as the national best bid and offer moves to deliver the best price, as long as the limit price is still within the BBO range. However, if the NBBO moves far away from the limit price, the order could become visible. For example, the best bids and offers range from $22.15 to $22.17 cents. If a blind order was entered at $22.20 cents, it would set a new best price, so it would become displayed. The orders would follow strict price-time priority.

FINRA To Push Back Changes To Trading Ahead

The **Financial Industry Regulatory Authority** plans to delay compliance with recent changes it made to minimum price improvement standards and trading ahead restrictions until Jan 14. The rule set extends trading ahead restrictions for market makers to over-the-counter equity securities. In February, the Commission approved these changes, which would have been implemented last week. FINRA wants the regulator to give more time to consider provisions it added to the rule set in June.

The delay involves minimum price improvement standards a firm must apply to trade ahead of an unexecuted customer limit order. Under the previously approved changes, firms were required to provide a minimum of a penny in price improvement for customer limit orders that are at or inside the best bid and offer. Under the June provisions, FINRA has proposed to adjust the minimum to include a measure based on the inside spread. The restrictions do not apply to securities priced under $1.

Knight Direct To Integrate HotspotFX Onto Platform

Knight Direct, an electronic platform that provides DMA and access to multiple trading venues, plans to integrate **HotspotFX**, its FX trading platform, onto its front-end during the first quarter of next year. The integration will enable firms to execute across multiple asset classes, such as global equities, options, futures and foreign exchange, through one desktop application, said **Bill Cronin**, managing director.

In response to the dollar plummeting, customers have a greater awareness of the need to hedge out their global currency exposure, he said. When trading U.S. or non-U.S. securities, firms can auto-hedge execution real-time in the currency pairs HotspotFX supports, he added. Typically a broker chooses the foreign exchange rate, which is less favorable than the wholesale spot rate Knight will offer, he said.

BNP Paribas To Clear For European Dark Pools

BNP Paribas Securities Services is starting to partner with crossing networks and matching engines to provide clearing and settlement for trades. **Jason Nabi**, head of financial intermediaries for the United Kingdom at BNP Paribas, said the implementation of the Markets in Financial Instruments Directive has provided an opportunity for multilateral trading facilities, which can be crossing networks or matching engines that are operated by an investment firm or a market operator.

Under a recent strategic agreement, BNP Paribas Securities Services will provide clearing and settlement for **Euro Millenium**, a neutral dark pool that will be launched by **NYFIX** the first quarter of next year. The firm has recently entered into other agreements with crossing networks.

Research

Indie Reaches Hiring Goal, Sets Another

Peter Sidoti

Sidoti & Company has hired its 60th analyst this week, meeting its year-end goal, and will continue bulking up its research staff next year. The new hire, **Steve O'Hara**, will cover the transportation sector. The firm has hired about 10 analysts in the past six months. The small-cap research indie will offer coverage of at least 150 more stocks next year to total 600 covered companies. About half of Sidoti's analysts cover only seven companies or fewer, so most of the increase will come from incumbent analysts building up their coverage. "We hire a lot of young analysts and train them from the beginning," said CEO **Peter Sidoti**. This accounts for their slow accumulation of coverage, he said.

Pacific Growth Expands Healthcare Coverage

Pacific Growth Equities, a regional investment bank, has added coverage of the regenerative medicine and convergent technologies sectors with the hire of a new senior analyst, **Caroline Corner**. Research Director **Rich Horn** said the firm has had coverage of some names in this sector before, but Corner's hire will increase that coverage substantially because she will be the firm's first analyst to specialize in the sector. The firm wanted to expand coverage because regenerative medicine and convergent technologies stocks could be good investments. "The industry is definitely starting to come into its own," Horn said, referring to how fast the emerging sector is growing. Corner will likely launch coverage before the end of the year.

Horn said he plans to hire two more senior analysts before the end of this year, or at the latest, the beginning of next year. "We don't really look at the calendar or the trends; we are opportunistic in hiring," Horn said. Other firms are scaling back, which makes more senior analysts available. Pacific Growth's equity research department specializes in healthcare research and now has six senior healthcare analysts and four in other industries.

Sterne, Agee Adds Footwear Research

Sterne, Agee & Leach has brought on a new analyst to step up its coverage of the footwear sector. The firm's general retail analyst **Ron Bookbinder** covered the growing sector in limited capacity until his September departure. **Sam Poser**, analyst, launched recommendations on four footwear stocks Tuesday and will be rolling out more coverage soon, focusing on the sports footwear sub-sector. His coverage so far includes **Wolverine World Wide**, **Deckers Outdoor Corp.**, **Columbia Sportswear** and **Skechers USA**. With the retail and consumer spaces being a large focus of Sterne, Agee, the firm thinks that increased exposure to the footwear sector will be a good addition, Poser said.

Poser will not take over all of Bookbinder's coverage.

Poser worked in the shoe industry for more than 20 years and was working at **Sports Authority** when he decided to go into research four years ago. "Hopefully my experience in the industry will give me a different perspective than what other analysts have," he said. Poser was a non-publishing researcher before joining Sterne, Agee in June. He declined to make a prediction on the industry's growth prospects.

Bear Stearns Strengthens Med Tech Team

Institutional Investor-ranked analyst **Rick Wise** has added a new analyst to his medical supplies and devices research team. **Raj Denhoy**, a former **Piper Jaffray & Co.** analyst, joined Wise's team at **Bear Stearns** recently and launched coverage on medical supplies stocks. He is replacing **Milton Hsu**, who left equity research in May to move to the banking side. Denhoy has launched coverage on **Stryker Corp.**, **Smith & Nephew** and **Zimmer Holdings**. He covered the same types of companies at Piper Jaffray.

Retail Brokerage

Jefferies Gets Cookin' Down South

Charles Baber

Jefferies & Company has made its way down south, opening its first private client office in the region in Atlanta. "The economics in that area are quite robust. Most firms have grown recently in that arena, and we have been looking into it over the past year," said **Charles Baber**, head of Jefferies Private Client Services. He last week hired two high-net-worth financial advisors to launch the office. **Jack Carvalho** and **S. Whit Yates** are coming from **Credit Suisse**. Though they are the only team in the South, there are more than 40 financial advisors working in Jefferies private client services nationwide.

When Baber came on board about two years ago, his goal was to expand, possibly double, the size of the group in a year or two. Since then, the advisory staff has more than doubled. "Our strategy has been to attract high-end teams in major marketplaces, and this team [in Atlanta] is a great example of that," Baber said.

UBS Targets Private Airports

UBS has launched a branding and marketing initiative targeted at high-net-worth travelers and corporate executives in private airport terminals. UBS has teamed with **Panorama Flight Service**, a private aviation company, to receive private branding rights at **Westchester County Airport** in White Plains, N.Y. The Westchester County Airport caters to individuals and companies flying in and out of the New York area by private jet.

The program, in the works for over a year and launched earlier this month, provides travelers with WiFi access, an interactive plasma wall, and kiosks with free internet access in terminals. The UBS slogan "Available in two locations, everywhere right next to you," is visible on external light box posters as well as decals on runway stairs. Additionally, UBS has built a conference room for travelers to use.

"We know they're big travelers and they're using private air travel more than ever because they can afford to do so," said **Nadine Genet**, head of global advertising. Similar branding partnerships are being rolled out in Biggin Hill in the United Kingdom and Beijing, with plans for more as the initiative progresses, said Genet, who declined to comment on cost specifics.

Goldman Snags HSBC's LatAm Chief

Goldman Sachs has hired **Beatriz Sanchez**, former head of Private Banking for Latin America at **HSBC**, as regional manager for its Private Wealth Management business in Latin America. Sanchez, who will be based in Miami, will oversee the firm's growing Private Wealth Management business in Latin America in a new role. She will join Goldman next spring.

Goldman has made significant strides in Latin America over the last few years, particularly in Mexico and Brazil, which prompted the launch of a dedicated PWM office in Miami, according to a spokeswoman. Many Latin American families prefer to bank outside of Latin America, making a Miami hub a logical choice. The company is also planning to open a brokerage operation in Brazil.

Sanchez, who reports to **Peter Scaturro**, has over 24 years of experience in private banking, including senior positions at HSBC in Geneva and **Republic National Bank of New York.** Calls to an HSBC spokeswoman regarding replacement plans were not returned by press time.

Deutsche Bank To Expand Across The South

Cynthia Norville

Deutsche Bank Alex. Brown is planning to build up its private client services group with the hire of regional manager **Cynthia Norville**, a 21-year **Morgan Stanley** veteran. She will be based in Atlanta and will spearhead the firm's expansion across Georgia, Tennessee, Alabama, North Carolina and South Carolina. "The Atlanta market is the hub of the South," Norville said, adding that the Southeast is a good area to expand in because there is a lot of money coming into the region as more companies move in due to a lower cost of living and taxes.

Because she has worked in Winston-Salem, N.C., Memphis, and Atlanta, Deutsche Bank is counting on Norville's client relationships in the region to drive its growth in that market. For the past nine years, **Don Milich** held the job, but he is stepping down to be a financial adviser. The bank has about 70 high-net-worth and ultra-HNW client-facing professionals in its two Southern offices in Atlanta and Winston-Salem. But Norville plans to increase that number. "To grow our assets under management, we need to grow out talent," she said.

Regulation

NYSE Reg To Overhaul Education Program

NYSE Regulation is planning to overhaul its continuous education lecture program in favor of a series of online seminars traders could complete faster next quarter. The exchange requires all holders of trading licenses to attend its Floor Member Continuing Education Program lectures at a learning lab within 120 days of being scheduled for continuing education. Because the exchange had to assemble large groups of people to take the training, it has been offered on a semiannual basis, and usually takes place outside normal business hours. The exchange wants to let traders access Web-based interactive programs from their own offices to eliminate having to schedule specific training times.

"Participants will be able to access the FMCE Program from their member organization offices, under the supervision of their member firm at a time that is mutually convenient for the participant and the member organizations," officials wrote in a related rule filing. As a result of the changes, courses would be offered on a rolling basis, so the exchange's program will be able to keep up with contemporary regulatory changes, officials said. There is a catch: members will have to complete their continuing education requirements within 60 days of obtaining a trading license. "It would be easier to get it over with than have to wait in line," one trader observed.

Industry Lobby To FINRA: Drop Trade Report Proposal

The **Securities Industry and Financial Markets Association** is urging the **Financial Industry Regulatory Authority** to abandon a proposal to require firms to provide information that would allow it to link exchange-traded and OTC execution reports of riskless principal trades.

FINRA is considering requiring firms to include the same unique identifiers on tape and off-tape reports for the same transaction, which would allow it to recreate a firm's market activity with greater accuracy. The requirement would also help ensure that firms are not using non-tape transactions to avoid compliance with other rules, such as limit and market order protection rules.

SIFMA complained that firms would have to devote significant time and resources in reprogramming their systems due to redundancies and inconsistencies in trade reporting requirements among regulators. The proposal also raises concerns over the structuring of a linkage system. For example, firms often do not know at the time they are executing an order whether or how much of the order will be considered executed on a riskless principal basis, according to a SIFMA comment letter.

Consequently, firms are unable to identify a riskless principal trade, which will prevent them from attaching the correct identifier or control number on a real-time basis.

It encouraged FINRA to hold off on its linkage proposal until an industry-wide review can be conducted. The lobby group has formed an ad hoc committee to come up with a more uniform approach for trade reporting.

People & Firms

Morgan Stanley Nabs Smith Barney Advisor Team

Morgan Stanley has brought on a team of **Smith Barney** financial advisors to its Chesterfield, Mo., office. **Larry Miller**, **Kevin Miller**, **William Murphy**, **Charles McAlpin** and **Laurence Diamond** have a combined production of almost $2.7 million and assets of about $311 million. The team will report to branch manager **Jason Turkin**.

Morgan Joseph Promotes Trader, Hires Ops Head

Morgan Joseph & Co., a New York-based investment bank, has promoted trader **Michael Racaniello** to senior v.p. in its equity trading team. His responsibilities will not change. The promotion comes in recognition of six years of services, a spokesman said. Prior to Morgan, he worked at **Brokerage America** and **Ladenburg Thalmann & Co**. The company also hired **Margaret Guzman** as head of operations in a new position. Prior to her appointment, she was chief operating officer at **Barclays Capital** in the information technology group. She had also been chief administrative officer at **Instinet**.

Smith Barney Wins Over Morgan Stanley FA

Douglas Ball, a **Morgan Stanley** financial advisor, has moved to **Smith Barney**'s Sea Girt, N.J., office. He has produced about $800,000 in the past 12 months, managing a little more than $200 million in assets. He will report to the branch manager **Charles Belluardo**. Ball was with Morgan Stanley and **Dean Witter**, before it merged with Morgan Stanley, for about 27 years. For 14 of those years he was a branch manager.

Celent Hires Banking Analyst

Celent, a New York-based consultancy and research firm, has hired **Walter O'Haire** as a senior banking analyst in its San Francisco office. He covers treasury management systems, B2B payment platforms, document management systems and business process management, including offshoring and mortgage lending technology. He previously worked at **Catapult Advisors**, a San Francisco-based capital raising and advisory firm focused on emerging growth software companies as principal in charge of the financial technology practice, since 2004. Prior to that, he worked at **U.S. Bancorp Piper Jaffray**.

Future IP Exchange Brings On Consultant

The **Intellectual Property Exchange International**, due to launch in 2010, has brought on consultant **David Silverman** as chief operating officer to oversee day-to-day operations and development. The exchange will focus on trading opportunities around intellectual property. Silverman had been trading for over two decades, starting on the floor of the **Chicago Mercantile Exchange** and running various electronic trading ventures such as **Aspire Trading Company**, which he founded in 1999.

Merrill Snags U.S. Trust Manager

Merrill Lynch's Private Banking and Investment Group has tapped **Maria Brisbane** as a private wealth manager from **U.S. Trust**. Brisbane spent 13 years at U.S. Trust, most recently as a senior portfolio manager working with ultra-high-net-worth clients, said **Steve Schroko**, resident director. She is based in Merrill's Fifth Avenue office in Manhattan. Calls to U.S. Trust about Brisbane's departure were not returned.

23rd Annual Futures & Options Expo

*About 5,000 attendees gathered at the **Hyatt Regency** hotel in the Windy City last Tuesday for the 23rd Annual Futures & Options Expo for three days of discussions, parties and networking. The exhibition hall featured 150 exchanges and brokerage firms from over 20 countries in one of the largest turnouts in event's history, jointly run by the **Futures Industry Association** and the **Options Industry Council**. Managing Editor **Veronica Belitski** covered the event for WSL.*

Eurex Set To Close ISE Deal Shortly

Andreas Preuss

Eurex and **International Securities Exchange** officials expect to receive regulatory approval for their merger in the next two weeks, which would allow the transaction to close before year's end. In July, the two announced their intent to merge. The deal would be the first step in allowing U.S. and European options traders to access markets cross-border. "We are confident we'll close the transaction in December," said **Andreas Preuss**, Eurex ceo. Eurex U.S. is set to sign on 50 new trading firms by the year's end, increasing its customer base 25%. The two exchanges are planning to cross-market futures and options contracts and develop new contracts. Trading them may not come until next year, when the **Securities and Exchange Commission** is expected to relax cross-border trading standards.

Exchange CEOs Cite SEC/CFTC Merger As Chief Fear

Craig Donohue

Exchange executives cited the possibility of the **Commodity Futures Trading Commission** being merged with the **Securities and Exchange Commission** as the biggest possible impediment to the continued growth of the futures market. The CFTC has for some time been criticized by politicians and lobbyists as too lax, but futures traders and exchange ceos alike defended the agency's principles-based approach. The issue is coming up now because the CFTC is being reauthorized.

"The futures market is competitive on a global basis because the approach to regulation is similar and it's been easy for exchanges to grow in the U.S. and the U.K. because we don't have to follow the archaic system that exists on the securities side," said **Craig Donohue**, ceo of **CME Group**. For example, under CFTC rules, exchanges don't have to go through a lengthy review process to launch a new contract, as they have to on the securities side. As a result, more than 7,300 new contracts launched in the past nine months, while the options exchanges have lagged far behind with only several hundred listed.

At the same time, exchange leaders called for a better system of risk management the futures industry itself needs to develop. The **Futures Industry Association** has been working with **Deloitte** on a set of best practices to better manage risk. "I worry about a runaway algorithm that can make thousands of trades before any of us can step in and take action. We need a more intimate with people who back the credit," said **Jeffrey Sprecher**, chairman and ceo of the **IntercontinentalExchange**, referring to better vigilance in clearing. **Andreas Preuss**, ceo of **Eurex**, echoed the premise, saying that risk management has to become the industry's highest priority.

Traders Struggle To Automate Futures Options

Automating options on futures, one of the fastest-growing segments of the listed derivatives market, is proving to be tougher than traders had thought. Despite the fact that most futures trade electronically, only 10% of options on **CME Group**'s Eurodollar futures trade electronically, said **Edward Gogol**, director of systems development at CME Group. Most complex strategies are still traded in the pit, and little progress has been made at the exchanges to move the project forward, brokerage executives charged. "At the **Chicago Board Options Exchange** or the **International Securities Exchange**, I can send in a multi-legged strategy, have them put up for auction, and have the order filled in three seconds. I'd love to see the CME take a lead on this," said **Dan O'Neil**, executive v.p. of futures at optionsXpress. CME already trades some user-defined strategies electronically, but reception has been uneven.

The problem is liquidity. Market makers usually aren't willing to put up a bid electronically unless they are certain they will find the other side and can offload what they take on quickly, which is often impossible with intricate custom strategies, said **John Coleman**, senior v.p. of futures in the fixed income group at **R.J. O'Brien & Associates**. "If you threw the order to a human, it would be much faster than looking through volatility sheets and much safer because the market makers could find buyers. Besides, as soon as something goes electronic, it's a race to the bottom in terms of pricing. What's the upside of building an expensive platform if you don't get paid?" he said. O'Neil countered that his

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customers would be willing to pay up for the ability. **Jerry O'Connor**, v.p. of API Connectivity at **Trading Technologies**, added that institutions would pay for being able to trade all related derivatives on one platform.

Analysts Preach Clearing Ownership

Brokerage and exchange analysts urged exchanges to focus on developing in-house clearing capabilities and to keep up stock prices. The clearing issue is coming up now because **NYSE Euronext** has indicated that it may buy or develop a futures exchange to develop a clearing capacity and the clearing market has shrunk with the merger of the **Chicago Mercantile Exchange** and the **Chicago Board of Trade**. Nearly all derivatives exchanges with their own clearing operations, such as the **CME Group**, have been trading at large multiples because they have been able to keep volume from leaking to other exchanges. "With clearing capability, volume doesn't move unless you're asleep at the switch and aren't trading electronically," said **Rich Repetto**, principal at **Sandler O'Neill & Partners**.

NYSE is especially vulnerable to leakage because it now owns the **Liffe** futures market, but no clearer. As long as another exchange can offer clearing, it can attract competing markets' customers, said **Ken Worthington**, senior analyst at **JPMorgan**. "The NYSE has no choice but to develop a clearing capability," he said. Moreover, OTC trading firms without clearing operations have been looking for partnerships with exchanges, and OTC growth has outpaced the listed market. OTC contracts make up more than 50% of the volume. A NYSE spokesman declined to comment.

Traders: Payment For Order Flow Here To Stay

Despite the **Securities and Exchange Commission**'s efforts to eliminate payment for order flow with the introduction of penny pricing, trading firm executives firmly believe the practice will prevail. Market makers typically pay large retail brokerages to route order flow to them through funds administered by most of the exchanges. Though the practice has left a bad taste in some mouths, market makers and order flow providers alike say it's necessary in order to upkeep education and get more i8-11nvestors into the options market.

"It costs us $3,000 to run a class for which the customer could end up paying nothing. That kind of economics isn't a great incentive to continue education, which has been behind the growth in this industry," said **Tom Sosnoff**, ceo of **thinkorswim**, a discount brokerage. Options volume grew 38% through the end of October since last year, but the order flow only makes up 10% of the overall securities market, so there is a lot of potential to expand, he added. "It costs a lot of money to educate investors, and payment for order flow subsidizes that education. People want growth to continue, so it's unlikely that the practice will ever go away," said **Matt Hulsizer**, managing member of **Peak6 Investments**, a large market making firm. Indeed, payment for order flow has declined only slightly in penny classes.

OCC To Centralize Options Listing

The **Options Clearing Corp.** plans to develop a centralized system for listing and delisting options classes next year in an effort to reduce confusion. Typically, as soon as a new options class gets listed at one exchange, it is picked up by all the others, but when different series are added, there is often a time lag during which the changes are communicated to traders. "It's time to try and centralize the process. We are looking to complete this well in advance of the changeover in options symbology in 2009," said **Mark Baumgardner**, v.p. of product and business development. The symbology overhaul, which has been ongoing since 2005, is expected to eliminate disparate ways of identifying options contracts. Centralizing listing and de-listing processes is expected to bolster that effort, as well as cut the number of excessive quotes.

They Said It…

"I am pretty convinced that it's only a matter of time before the market gets hit by an algorithm going berserk."—**Andreas Preuss**, *ceo of* ***Eurex****, on the need for better monitoring of algorithmic trading systems.*

"Sucking up to the regulators is always appreciated."—**Walter Lukken**, *acting chairman of the CFTC, on a glowing introduction he received.*

"One of the good things about the new regime at the NYSE is whenever a purchase should be made, they'll be less likely to overpay for it."—**Brendan Caldwell**, *president and ceo of* ***Caldwell Investment Management****, on* ***Duncan Niederauer*** *taking over the NYSE.*

"Dubai is like Disneyworld. It's not real. Everybody's from somewhere else and everything has been built in the last 10 years."—*Caldwell, on* ***Borse Dubai*** *needing the* ***Nasdaq*** *Stock Market to develop its financial infrastructure.*

"It would be like merging ***Ford*** *and* ***Toyota****, and putting Ford in charge."*—**Craig Donohue**, *chairman and ceo of the* ***CME Group****, on merging the CFTC into the SEC.*

23rd Annual Futures & Options Expo (cont'd)

Reporter's Notebook

No Room At The Inn

The **Hyatt Regency** hotel may have prepared its conference center to accommodate 5,000 attendees, but the same could not be said for the rooms. The hotel was overbooked for the second year in a row, but this time, instead of placing the bulk of the attendees at nearby hotels in town, the gracious hosts sent dozens to the Hyatt by the airport. That left many fighting traffic in the wee hours of Tuesday morning. "You are lucky you only spent half an hour on the road. Traffic was brutal!" exclaimed one irate attendee to another. Some were left without rooms entirely, and had to be put up in service areas. The hotel's excuse? There was a radiologist convention of 60,000 a few blocks away.

No Need To Comment

Traders spent much of the conference discussing the possibility of the merger of the **Commodity Futures Trading Commission** and the **Securities and Exchange Commission**, but apparently discussing the matter with key players was not on the agenda. The chief culprit, Acting CFTC Chairman **Walter Lukken**, got a lukewarm reception at his keynote address after more than a third of the room cleared out just as he took the stage. **Richard Berliand**, managing director at **JPMorgan Securities**, who had spent much of the previous session on the matter, implored attendees to come back to hear about "the key to smart regulation" futures traders had so extolled, but to no avail. Maybe it was the early morning start.

Quick, To The Bar!

Conference organizers had to deal with some nearly empty sessions after scheduling two of them during the first hour of the exhibit floor receptions both nights. Companies rolled out all sorts of international brews, wine and scotch and. Even as **Matthew Rees**, v.p. of IT at **R.J. O'Brien & Associates**, thanked those who attended the last session on Tuesday for skipping an hour of booze, nearly a dozen people got up and headed over to the exhibit. And with good reason: besides the booze, companies put high-end prizes on display. The **International Securities Exchange** put a **Nintendo** Wii in play, while **Orc Software** went as far as to offer a free one-day rental of a **Lamborghini Gallardo** for anyone who would get a high score trading against its algorithm, Orc Liquidator.

But not everyone wanted the high life: some lined up to throw pies at **John Lothian**, founder of futures trading firm **John Lothian & Co.** The event served double-duty as a fundraiser for the **Boy Scouts** and was sponsored by **Penson GHCO**. The party continued even after the exhibit hall closed and some attendees headed off for an afterparty at **Cactus**, a local traders' bar. The pie event did not carry over.

In The Crowd

*Attendees mob the bar at the **CME** Reception at the River East Art Center*

*From left to right- **Josh Inglis, Strategics, Mark Longo, The Options Insider, Colleen Herbert, Liffe,** and **Drew Mauck,** Strategics*

*From left to right- **Lisa Morano, Linda Boland** and **Barbara Kalicki, Chicago Board Options Exchange***

*From left to right- **Phil Gocke, Options Industry Council, Jim Norman, ESW,** and **Christine Bookmeyer, Peak6***

Geralyn Endo** and **Boris Ilyevsky, International Securities Exchange

MORGAN STANLEY

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from the Business: Insights on Insider Trading," was led by CEO **John Mack** and featured talks by two people who had been convicted of insider trading, one of whom was a former Morgan Stanley employee.

According to a spokeswoman, the presentation was designed to highlight how lives can be ruined by taking part in insider trading. She added that the session also included an ethics consultant, who led a discussion on the misuse of material non-public information. The spokeswoman said the firm is looking at next steps for its anti-insider trading program, although she did not know whether the convicted felons would be involved again.

The idea has found favor with at least one senior regulator. Told of the session at the recent **Securities and Exchange Commission** CCOutreach meeting, **Lori Richards**, director of agency's Office of Compliance and Inspections, said "Bringing in convicted felons is a great, creative idea."

Michael Mavrides, partner at **Bingham McCutchen** in New York, said he thought it would be productive for convicted criminals to share stories of crimes they committed and lessons they learned. "I think it would serve as a reality check," he said. "It might stop people from pushing the envelope."

—Josh Stoffregen

WACHOVIA BRIBES

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The firm is offering recruiters 10% of brokers' trailing 12-months' production for new hires, compared to the industry's 6% norm, in exchange for backing off A.G. Edwards' brokers. The non-poaching part of the contract is not unusual, but the 10% commission is outrageous, recruiters said. They think Wachovia is trying to attract as many of them as possible to lessen the number going after its brokers. "There are a lot of us in the business, so getting a few more to stay away from their brokers isn't going to help," one recruiter who signed the contract said.

Wachovia has already agreed to move its headquarters to A.G. Edwards' hometown of St. Louis, offered a big bundle of money for the brokers to stay, went on a road show to try to woo the brokers and even agreed to keep the A.G. Edwards' branch offices, payout and name untouched until 2009. But aside from the payout, nothing has made much difference, brokers said, and other firms are coming at key brokers with knockout offers.

"Forget the recruiters, [Wachovia] should go back to the brokers and give them that money, and make it impossible for them to leave. We can't stop them from leaving. Wachovia's got it backwards," said **George Jones**, recruiter with **George Jones and Associates**. Brokers have been going to large brokerages such as Morgan Stanley and Merrill Lynch, as well as regionals such as RBC Dain Rauscher and D.A. Davidson. The start of next year is expected to bring about an exodus of A.G. Edwards' brokers to higher-paying firms, according to recruiters placing the brokers. Wachovia has said it expects it to reach no more than 10% of 6,600 brokers by the time the firms are completely merged. An A.G. Edwards office in Connecticut is said to have gone to eight brokers from 35.

Some recruiters believe the latest gambit will help a little. "They are still going to lose a considerable number of brokers, but it could've been worse," said **Rich Schwarzkopf**, recruiter with **Schwarzkopf Recruiting Services**. He said that by getting some of the top recruiters to back off A.G. Edwards, Wachovia may be able to hold on to more brokers than what it looked like a month ago. Back then the A.G. Edwards pool was a "feeding frenzy" for recruiters, he said, but since some have backed off and taken Wachovia's deal, he thinks it will calm down.

—Annie Gasparro

TRADERS BLAST

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the launch is planned for Dec. 7, Nasdaq may be facing a long road in its bid to enter the business.

The central premise behind the exchange's model is that it would allow traders to enter orders in pennies even for those classes that are currently traded in nickels and dimes. To be able to route to other exchanges, Nasdaq will display the quote at the nearest nickel or dime increment, but the true price will be hidden. **Adam Nunes**, v.p. of transaction services, said the exchange has been in extensive talks with the regulator and is confident the launch will go on.

The SEC's concern is that the hidden orders would allow Nasdaq to trade far more options in pennies than has been prescribed by the penny pilot, and the regulator does not want the market to go that way yet. "If the orders were hidden in nickels, it would be simple, because that would be like just like an order being executed on the floor. We are making progress on our review but there are still concerns," **Bob Colby**, deputy director at the Division of Trading and Markets, told *WSL*. He declined to comment on the likelihood of resolving the matter in one week.

Traders spent much of the conference criticizing the plan, saying that if the Nasdaq is allowed to proceed, other exchanges will have to follow, which could cause price discovery to plunge. Among voiced concerns were excessive numbers of messages being lobbed as traders probe the market out, shrinking liquidity, and orders going over the counter entirely. "If we lose the price discovery mechanism in options, we are killing ourselves," said **Alex Jacobson**, v.p. of education at the **International Securities Exchange**. Price discovery has already been shrinking at the top of the book with the advent of pennies, as market makers have been reluctant to put up large size orders. "We used to be rewarded for posting liquidity but now we are encouraging people not to show their hand," said **Joe Sellitto**, marketing director at **Susquehanna Financial Group**.

Nunes insisted that the hidden order component, while central to the market's structure, isn't anything out of the ordinary. "It's not so different from the penny price improvement mechanisms out there. All we are trying to do is make the process more efficient," he defended as five other options exchange leaders blasted the model. Most called for SEC guidance on the matter. The regulator has been studying dark pools for a year (WSL, 10/20/06). *—Veronica Belitski*

NASDAQ COUNTERS

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NYSE officials declined to comment on what they will do, if anything, to counter Nasdaq's move.

Larger reported volume is expected to be used to advance the exchange's listing business. Nasdaq markets the internally crossed trades reported to its Trade Reporting Facility as part of the overall volume to attract listings. The exchange has been in the lead in the fight over listings for two consecutive quarters, but the NYSE has been ramping up its business as well. Nasdaq brought 56 new companies on board during the third quarter, while the NYSE brought in 17 new listings (WSL, 10/26).

The Nasdaq proposal could mean huge changes in volume if a few large firms switch TRFs, said **Julian Rainero**, partner at **Bracewell & Giuliani**. **Shane Swanson**, general counsel and chief compliance officer at **Automated Trading Desk**, said the rebates serve as an important part of a firm's routing decision. The firm, which trades about 7% of both NYSE and Nasdaq volume, is planning to evaluate all of the proposals before making any routing changes.

But Nasdaq won't be getting any volume from some of its biggest competitors, the ECNs. **Bill O'Brien**, ceo of **Direct Edge ECN**, said he does not see the Nasdaq proposal impacting market center competition because it applies only to internalized trades. The firm quotes on the Alternative Display Facility, which is run by the **Financial Industry Reporting Authority**. *—Sabrina Willmer*

Quote Of The Week

"It would be like merging Ford and Toyota, and putting Ford in charge."—**Craig Donohue**, *chairman and ceo of* ***CME Group****, on merging the* ***Commodity Futures Trading Commission*** *into the* ***Securities and Exchange Commission*** *(see conference coverage, p.9).*

One Year Ago In Wall Street Letter

Smith Barney tweaked its broker compensation plan, cutting some payouts as much as 2.7%. Some brokers were considering leaving the firm because of the cut. The savings from the change were expected to help reimburse Smith Barney for its assumption of some brokers' operating expenses. [The following week, it was announced that though cash payout was cut for brokers, Smith Barney would increase the deferred stock compensation that brokers received, bringing it back up to par with other firms.]

Five Years Ago

Lehman Brothers eliminated its presence on the floor of the **Chicago Board Options Exchange**. Other high-profile firms including **Morgan Stanley** and **Credit Suisse** had also cut their operations at the CBOE just a few weeks before. [CBOE trades nearly 90% of all of its listed contracts electronically on its Hybrid system, and recently even put some of its largest index options onto the system. They still have the option of trading in open outcry, particularly when large illiquid contracts are involved.]

10 Years Ago

Lehman Brothers lured away three *Institutional Investor*-ranked senior bank analysts from **Salomon Brothers**. **Diane Glossman**, **Michael Plodwick** and **Jeff Feiner** were offered three-year pay packages, and Lehman threw in a bonus to compensate for the bonuses the analysts would have received at Salomon Brothers. [Glossman went on to work at **UBS Warburg** and then retired from sell-side research in 2003. Plodwick became research director of **Blaylock & Partners** in 2003 but has since left the research firm. Feiner is now an adjunct professor of marketing at **Columbia Business School**.]

25 Years Ago

Merrill Lynch was considering launching a new jumbo CD participation program. It would allow investors to receive the generally higher rates on jumbo CDs ($100,000 and up) and still have their accounts federally insured.