



Small exchanges make rivals sit up

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FRONT STORY TRADING PLATFORMS

Tera expects to go live in April

Nodal ups ante with new power contracts

Tera, Nodal, Nadex, and Eris aren't exactly household names, but they are headed to be the next generation of exchanges after all of the smoke from the Dodd-Frank regulation settles.

The firms are not going to replace the volume seen on larger derivatives exchanges such as the Chicago Mercantile Exchange's NYMEX or the IntercontinentalExchange in the immediate future, but they are not aiming to either.

Instead, they are more interested in filling a niche for derivative products and trade execution that is otherwise left unfulfilled by larger rivals in this regulation-heavy environment. And in the process, they are forcing their more traditional exchange brethren to play catch up.

TeraExchange, for one, will go live in April with one of the first electronic central limit order books for swaps and other cleared over-the-counter derivatives, which includes interest rate swaps, credit default swaps, energy swaps, agricultural swaps and eventually equity swaps.

Dodd-Frank has mandated that OTC derivatives, such as swaps, if deemed clearable, should trade on a swaps execution facility (SEF) that uses either a central limit order book (CLOB) or a request for quote mechanism (RFQ).

"In the central limit order book fashion, we recognise that not every OTC product is tailor-made for a central limit order book, but those that are, that is our value proposition," said Christian Martin, CEO of TeraExchange, which has filed to be an SEF. The CLOB model allows customers to trade with other customers and not be limited by RFQs.

Inherent transparency

"Most entrants into SEFs are using RFQ models – we're the minority in that regard. It makes the market really an indication of interest [IOI] market rather than a firm market," added Martin. "The pricing transparency inherent to a central limit order book model should encourage a broader range of market participants, which will in turn drive a more liquid marketplace."

A key component of TeraExchange's platform is having a pre-trade credit check ability for swaps – a risk management tool that ICE Clearing just warmed to earlier this month when it announced its own pre-clearing credit check execution for OTC swaps.

Smaller exchanges often have the ability to come to market more quickly with an innovative execution style or product, particularly in the OTC swaps market, noted one credit-focused portfolio manager, adding: "If they can get it up and running, others will follow."

Nodal Exchange, for example, is another innovator in the power space that already has been using trade risk limit checks as a platform selling tool. Nodal, which boasts the largest product set of cleared contracts for power basis trading, has brought more than 3,800 cleared power contracts to market since 2009.

"Before we came out there [were] basically 11 pricing hubs for power that were offered by ICE and CME's NYMEX. You could trade Western Pennsylvania, Southern California, etc, but there [were not] a lot of locations," said Paul Cusenza, CEO of Nodal Exchange.

"When we launched, we offered 1,800 different locations that actually represent all of the different generation nodes, pricing zones and hubs in the four eastern organised markets."

Prior to Nodal Exchange, a power generator in Milwaukee, for example, had to trade the price of power in Western Pennsylvania since that was the closest market, though he would rather hedge in Milwaukee to be really reflective of true basis risk.

ICE and CME's NYMEX have since expanded to more than 40 power pricing hubs. As of last month, Nodal had 12% of the total cleared open interest for power futures. For new location zones, though, it is more dominant.

The firm also offers a complement to the Financial Transmission Rights (FTR) market that was not available previously.

"You could have auctions almost daily so you wouldn't have to wait [until] once a month as you do in the FTR markets," added Cusenza.

Last year, Nodal launched 32 new power contracts that appealed to those looking to hedge power in the off-peak hours, such as weekends, with contracts settling on Electric Reliability Council of Texas (ERCOT) locations.

Product innovation

Eris Exchange, which has made a name for itself as a futures exchange, has also become a derivative products innovator that others are watching.

In 2010, it opened the OTC derivatives market to a new product – interest rate swap futures. (See ["Trading platforms are next OTC battleground,"](#) IFR 1875.)

Since then, the Eris SwapBook electronic trading platform has become quite popular. Earlier this month, at the request of CME, Eris began distributing the market data from its SwapBook to CME's Market Data Platform. The streaming quotes will assist with providing live bids and offers on OTC interest rate swap futures as opposed to indicative quotes.

The quotes are also discounted using the overnight indexed swap rate, which provides another layer of clarity for users, according to an Eris official.

Additionally, “there is no dealer last look in the Eris platform. It increases the integrity of the data when you know that if you click on that price, you know you are going to get sold at that price,” he added.

Similarly, Nadex, the North American Derivatives Exchange, is another exchange that has garnered interest in its products. The online futures exchange, which targets retail investors, is best known for its binary contracts, which are all-or-nothing contracts that pay out a fixed amount to those that end up in-the-money.

Last year, meanwhile, the Chicago Board Options Exchange launched a revival of credit event binary options on its exchange by initially offering 10 single name credit event options contracts.

TeraExchange, Nodal Exchange and Eris Exchange all maintain partnerships, though, with the leading clearers, such as LCH.Clearnet, CME Clearing, and ICE Clear. Nadex, which is owned by spread betting firm IG Markets, has been designated a derivatives clearing organisation by the Commodity Futures Trading Commission.