

Schaeffer's Guide to The Options Symbology Initiative (OSI)

Examining the upcoming industry changes and what they mean to you

Andrea Kramer (akramer@sir-inc.com)

Over the past couple of decades, the rapid evolution of the Internet, the accessibility of educational resources like SchaeffersResearch.com, and a growing need for portfolio protection have formed a potent cocktail to lure investors to the options pits. However, the flourishing popularity of equity options, combined with the escalating complexity of these derivatives, has resulted in several unavoidable speed bumps for the options industry.

Most notably, the current option symbol configuration – in use for over 25 years – is often considered confusing, and presents a plethora of limitations to the future of the options market. That's why, a few years ago, the folks at the Options Clearing Corporation (OCC) joined forces with a number of industry representatives to devise the **Options Symbology Initiative (OSI)** -- a plan to transform enigmatic option codes in two primary phases.

However, before the current codes become extinct, the major industry players must jump through a series of technical hoops to prepare – a process some are comparing to the pre-millennium turmoil ahead of Y2K. What's more, many broker/dealers resisted the idea of a standard sequence for the new option symbols – meaning brokers and data vendors will wind up displaying different symbols for the same option.

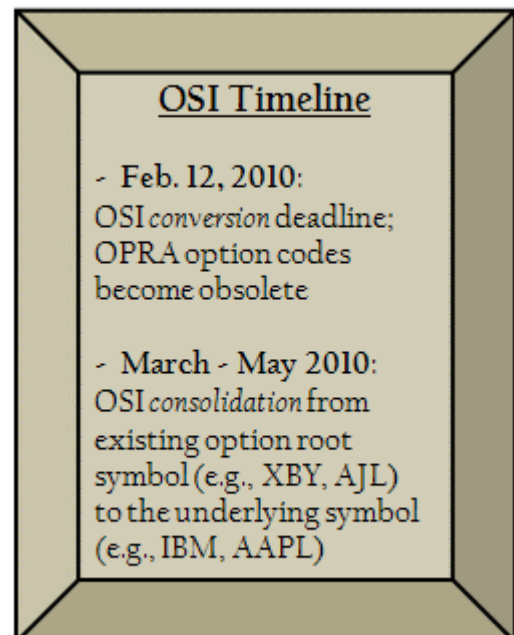
Ahead of this historic industry facelift, we've decided to take an exhaustive look at the changes: what they are, why they were needed, how brokerages are dealing with them, how they will affect the individual options trader, and the technical hurdles that must be overcome to make these changes a reality.

The Initiative

First, the OSI calls for the current four- and five-character Options Price Reporting Authority (OPRA) symbols to be rendered obsolete by **Feb. 12, 2010**, replaced with a new, lengthier Symbology Key.

Second, the "facelift" should make equity option codes more easily decipherable to the naked eye, with existing option root symbols consolidating to the underlying equity symbols from March to May 2010. (In other words, instead of Apple Inc.'s options beginning with "APV," they'll start with the actual stock symbol of "AAPL.")

Plus, the post-consolidation symbols – which feature a visible, specific expiration date – are expected to



increase compatibility with some Long-term Equity Anticipation Securities (LEAPS), Flexible Exchange (FLEX) options, and shorter-dated options with multiple expiration dates. Unlike the old symbols, which indicate the options' expiration date using a letter code, the new option symbols will display a specific expiration date.

For example, under the current OPRA codes, the symbol for Apple Inc.'s July 250 put is **AJL SE** - completely obscure to the average option trader. However, in the aftermath of the OSI conversion, the OSI-suggested symbol for the same option would look like this: **AAPL 10 07 17 P 00250 000** - much more detailed and less cryptic, highlighting the underlying stock symbol, specific expiration date, type of option, and strike price.

Current OPRA Configuration		
<i>Apple Inc. (AAPL) July 250 put</i>		
Option Root Symbol (3 characters)	Exp. Date and Call/Put Indicator (1 character)	Strike Price Symbol (1 character)
AJL	S	E

Suggested Post-OSI Symbol						
<i>Apple Inc. (AAPL) July 250 put</i>						
Symbol (Up to 6 characters)	Expiration Year (2 characters)	Expiration Month (2 characters)	Expiration Day (2 characters)	Call/Put Indicator (1 character)	Strike/Dollar (5 characters)	Strike/Decimal (3 characters)
AAPL	10	07	17	P	00250	000

The Popularity of Options

What made this change necessary? Let's start with the growing popularity of options. Options were once regarded as a somewhat exotic investment vehicle, but they are increasingly seen as a mainstream part of the portfolio. In 1973, there were fewer than 1.2 million equity options traded, according to data from the OCC. Within 10 years, the options market had expanded exponentially, with roughly 135.7 million equity options crossing the tape in 1983. By the new millennium, the options arena had crossed the half-billion marker in annual volume. Furthermore, since 2002, the popularity of these derivatives has more than quadrupled, with 2009 marking yet another record year.

Total Equity-Based Option Volume Since 2000

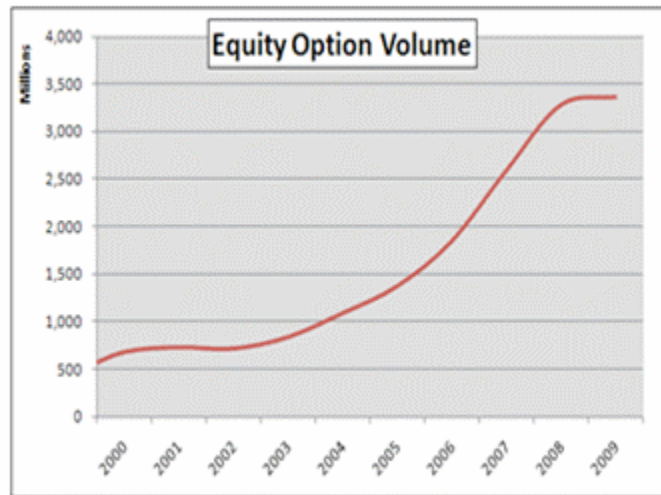


Chart courtesy of Options Clearing Corporation

Boasting a front-row seat to the evolution of the options arena has been the Chicago Board Options Exchange (CBOE). "Entering 2009, CBOE experienced five consecutive years of record trading," stated Edward Provost, Executive Vice President, CBOE. "During this span, total volume grew from 361 million contracts in 2004 to 1.2 billion contracts in 2008, an increase of approximately 230%."

Echoing that sentiment was David Harrison, Vice President of Member Services at the OCC. "We've seen [option volume] growth rates in the double-digit percentages," he noted, adding, "Last year was a record volume year, and the year before that was a record volume year."

But what has *fueled* the escalating demand for these unique derivatives? Industry veterans have offered up a plethora of theories, but most agree on three primary catalysts: advancements in technology, the need for portfolio protection, and the availability of educational resources.

The Age of Technology: Highlighting technology's role in the expansion of the options industry, Harrison says one of the primary advantages of the so-called information superhighway is that traders now have easier access to options. Plus, thanks to the whirlwind growth of the Internet, a bevy of market-focused Web sites and online brokers – like OptionsHouse or OptionsXpress – have become staples on the Street, making it less time-consuming for investors to research picks and place orders.

"The evolution in trading technology has led to a democratization of the markets," said Provost. "Investors now have more access to market news and data than ever before, while the ability to 'point and click' has made trading more convenient."

Furthermore, more mainstream financial media outlets like *The Wall Street Journal* have started to recognize the rapidly growing popularity of options. "If anyone had said even 10 years ago

that there would be a front-page article in *The Wall Street Journal* [September 2009] that featured the mechanics of selling equity option strangles, no one would have believed it," CBOE Chairman and CEO William Brodsky told the audience at a recent industry conference in New York.

A Growing Need for Protection: Plus, as the Internet and financial institutions have started pushing options into the mainstream, the "Average Joe" trader has become less intimidated by these unique derivatives. In fact, as OptionsHouse CEO George Ruhana pointed out, during the past few years, "options trading volume has grown at a higher clip than stock volume."

In light of this increasing exposure, investors have begun to recognize the many advantages of trading options – not only in the leverage they provide, but also in their role as portfolio protection.

The growing need for risk management is even more evident when looking at option volume trends since 2000. As highlighted in the chart below, at the height of the financial crisis in late 2008, exchange-traded fund (ETF) and index options – which are often utilized as stock-portfolio hedges – were actually more popular than equity options for the first (and only) time on record. In other words, in the wake of broad-market and economic uncertainty, traders rushed to protect their investments by employing options.

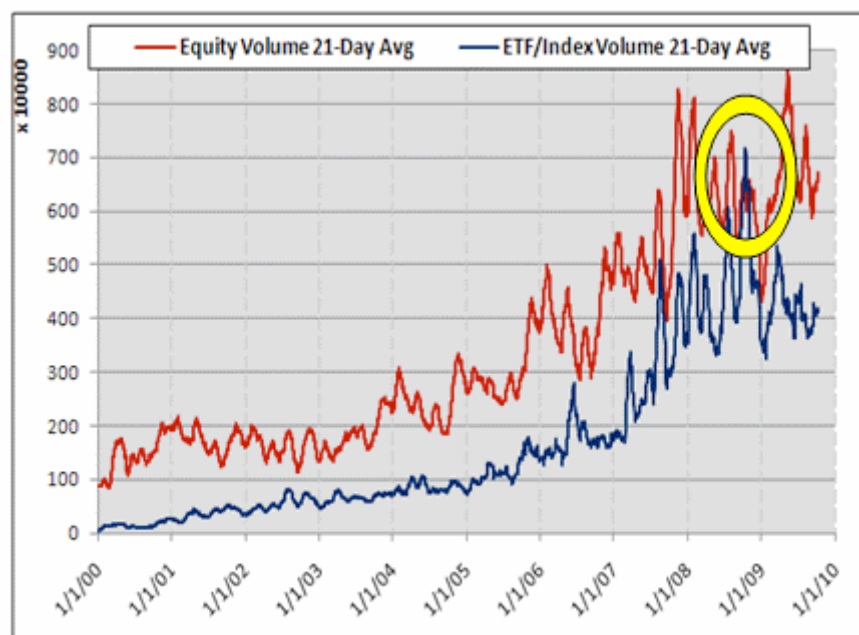


Chart courtesy of Options Clearing Corporation

Educating the Masses: Finally, the majority of seasoned option players also attribute the rapid growth of the options industry to the accessibility of educational resources. Over time, "there has been more and more options education available to the market – like the information you provide at Schaeffer's," Harrison noted in a recent interview.

In that same vein, the CBOE's Provost says the convenience of electronic trading, juxtaposed with the proliferation of educational resources online, make for a powerful one-two punch. The combination has "made it easier for investors to learn and become better informed," and, more importantly, "has enabled investors to become more empowered and self-directed when managing their investments."

Some could argue that the "self-empowerment" is reflected in options speculators' growing appetite for non-vanilla trading. In other words, the expanding fondness for more advanced strategies is likely attributable to the array of educational resources at the Street's fingertips, which has allowed rookie traders to become more comfortable with intricate option plays.

"We have seen more people do spread trading and other strategies that are different from the historical buy-write/protective put," said Ruhana, commenting on the recent trading trends at OptionsHouse.

Technical Tryouts

Ahead of both the Feb. 12, 2010 conversion deadline and the March - May 2010 consolidation of option symbols, the major market players must first undergo a series of scripted industry tests (SIT) to ensure their technological environments will be compatible with the new symbology. While some have feared a Y2K-esque technical backlash, Harrison said the initial phases of tests have been encouraging.

"All in all, the testing is going very well," stated Harrison, easing industry fears of any IT-related turmoil similar to the pre-millennium madness of Y2K. "We are receiving very positive feedback on the testing process and making the necessary adjustments."

How It Will Affect You

While the aforementioned technical hurdles associated with the OSI have more to do with the exchanges and various data providers, the Initiative *will* impact the Average Joe option trader, too – especially those utilizing online brokerage firms.

The sequence of the 21-character Symbology Key proposed by the OSI is merely a suggestion – meaning the vast array of brokerage firms and exchanges could wind up displaying their own symbols for the same option. "We fought hard to try to get a standard [symbol sequence]," ceded the OCC's Harrison, "but unfortunately, at the end of the day, [a lot of] firms decided they want to have the flexibility to display that information in their own manner."

However, that symbology leeway could lead to widespread confusion come mid-February. Under the OSI guidelines, as long as each firm's respective symbols include the *following four OSI elements*, it's up to them to decide how their post-conversion option codes are displayed:

- **Root Symbol:** Most likely the same as the underlying equity's ticker
- **Expiration Date:** Including the day, month and year the option expires
- **Put/Call Indicator:** Identifying the type of option
- **Strike Price:** Displayed using dollars and decimals

Plus, many major industry players are adopting OSI-compliant symbols ahead of the Feb. 12, 2010 deadline. In fact, *Thomson Reuters* -- which provides data to a plethora of bigwigs in the options arena, including the CBOE -- converted its option symbols in late November. Meanwhile, brokerage firms Charles Schwab and Fidelity are both expected to convert to their own symbol sequences on Jan. 23, 2010, according to their Web sites.

The variation among both industry constituents' new symbol formats and their respective conversion dates is better reflected in the chart below. Utilizing the **IBM April 2011 115 call**, which expires April 16, 2011, as our standard, take a look at how and when a few of the major market players will display this option symbol:

Firm	Type	OSI Conversion Date	(Expected) Post-Consolidation Symbol for IBM April 2011 115 call
Thomson Reuters	Data provider	Nov. 23, 2009	IBM1116D115
E*Trade Financial	Broker	Dec. 11, 2009	IBM Apr 16 '11 \$115 Call
Charles Schwab	Broker	Jan. 23, 2010	IBM 04/16/2011 115.00 C
OptionsXpress	Broker	Gradual	IBM Apr11 115 Call
TradeKing	Broker	Gradual	IBM Apr 16 11 \$115.00 Call
<i>**Chart represents just a sample of brokerages. Schaeffer's does not endorse or recommend any specific brokerage firm.</i>			

Unfortunately, market participants aren't required to report their specific conversion dates or post-conversion symbol formats to the OSI, leaving it up to them to communicate their specific agendas to clients directly. However, Harrison assures us that the March-May 2010 consolidation process "will be more uniform" -- which, hopefully, suggests the symbol-related confusion shouldn't spoil your summer break.

For those of you left with questions about the OSI's impact on your broker, you're not alone. As of this writing, many online brokerage sites are still undergoing tests and ironing out the details of their post-conversion plans. However, don't be afraid to contact your brokerage firm with OSI-related questions; after all, you're the client, and you have a right to know what impact the symbol switch will have on your trading routine, if any.

For more information about the Options Symbology Initiative, visit <http://www.optionsclearing.com/initiatives/symbology>.