

It's NYSE to Have Options

Transcript

Adam Bass (00:03):

This is MSCI Perspectives. I'm your host, Adam Bass, and today we'll be talking about how this year has been a turbulent one for investors. And it's been so in ways that have forced a lot of them to rethink assumptions that they've held for quite a long time. Assumptions about concentration, about where risk actually lives in a portfolio and what tools are available to help them move forward when the map they've been using is sadly out of date. Today, we're going to talk specifically about options. That's options linked to international equity indexes from MSCI. So let's start at the beginning. With the indexes themselves, what types of indexes are available to underpin a derivatives market? I put that question to our first guest.

Vas Koutsoulis (00:57):

My name is Vas Koutsoulis. I'm based in London. I look after the listed F&O and OTC derivatives product in EMEA. The first ingredient is investability. The index must represent the universe that investors can actually replicate or hedge against. So MSCI's Global Investable Market Index methodology, or GIMI as we call it, explicitly screens for tradability, for free float and liquidity and size. So market makers need to be able to hedge their delta, which means they need to be able to trade the underlying. So that's vital. The second is representativeness. So the index needs to be the definite benchmark for the asset class. When MSCI ACWI or EM is the index that many institutional international managers are measured against, the demand for derivatives on that index is structural.

(01:50):

The third is market maker engagement. They need the index to be rules-based, replicable and transparent, as we say so they can hedge efficiently. So that transparency is foundational. And fourth, it's size and national calibration. So MSCI EAFA and EM options are large notional contracts designed for institutional portfolio management, not retail speculation. So that attracts serious institutional market makers who are comfortable with the size and they bring genuine depth to the market.

(02:24):

When you trade the MSCI index toolkit, you're trading a family of indexes that are designed to be mathematically consistent with each other. So MSCI World is the aggregation of its country blocks, for example. MSCI ACWI, what we call ACWI, the All Country World Index, is World plus EM. So if a liquidity provider, like a bank or a market maker has a client who is long ACWI, for example, and then they have other clients who are short World or EM separately, the Delta One trading desk can net those positions perfectly. And that translates to tighter pricing for end clients. And at the base of the whole ecosystem is listed futures and options.

(03:09):

So let me give you some numbers. These four indexes, ACWI, World, EM and EAFE, they have approximately \$15 trillion of assets tied to them as of the end of 2025. So all the MSCI indexes have more than \$21 trillion, for example. This is across both active and passive funds, including ETFs. So the derivatives ecosystem that is linked to these indexes has been growing considerably over the past years as investors use futures and options on these indexes for the usual use cases for futures and options like tactical allocation, managed rebalancing risk and hedging in real time.

Adam Bass (03:49):

For further insight into this foundational question, namely the criteria for the indexes, we turn to our second guest.

Brian Gilbert (03:57):

Hi, I'm Brian Gilbert, head of options markets development at New York Stock Exchange. The first thing that I would be looking at is a liquid, viable, healthy Delta One or equity or futures market. A different way to think of that as simply as a hedge asset for the market makers. All market makers typically delta hedge all their option orders. And when they do that, they need a Delta One stock, synthetic stock, future, something that is not vol-related that simply gives exposure to the underlying asset in a directional manner. We were super excited to launch MSCI products because we already know that their futures trade super liquidly, high volume every single day on ICE Futures U.S. So we can be confident bringing an index product to market when we know that we have two things, a liquid, deep, tradable hedge asset, and then market makers who are cognizant of and aware of their options, no pun intended, for how they might hedge these trades.

Vas Koutsoulis (05:09):

The key catalyst is market maker participation. So when you have serious institutional market makers committed to a product on a credible exchange with a functioning price improvement mechanism, you get tighter spreads, you get better depth and more reliable execution actually. So particularly on the larger block size trades our institutional clients are dealing with on a daily basis, this is where we expect the real liquidity improvement to show up.

Adam Bass (05:39):

Our third guest today...

Wes Mathews (05:41):

My name is Wes Matthews and I'm the senior managing director head of investment strategy for NEOS Investments.

Adam Bass (05:47):

Concurs about the elements that make up the qualities needed for an index within this particular ecosystem.

Wes Mathews (05:55):

Liquidity is always the first thing. We need market makers that are comfortable. We need liquidity so that we can get pricing that we're comfortable with as well. We also wanted broad representation. We wanted to partner with an index and a provider that really captured a fair international developed market exposure, like you all have done. And then we want to be able to deliver predictable yield. So when we tell our investors, our guidelines and targets for distributions, we want to make sure that everything is in place from an infrastructure standpoint.

Adam Bass (06:27):

For those of you who may not be familiar, NEOS is...

Wes Mathews (06:31):

An ETF shop based out of Westport, Connecticut that really focuses on managing the next generation of covered call strategies, income producing strategies. Our goal is really to help

investors tackle modern challenges of income generation amidst a world of increasing volatility and interest rate uncertainty. We try to generate high monthly income, helping investors basically not sacrifice performance for yield.

Adam Bass (06:57):

And covered calls are...

Wes Mathews (06:59):

Typically used as a way to generate income in a portfolio on asset classes that may not always generate income or may not generate sufficient levels of income for folks. A covered call is essentially, you have exposure to a given index, set of equities or single names even sometimes, and then you sell a call, so you're selling away part of your upside potential in exchange for a premium that somebody else is paying you. And so when you do that, you are generating this regular premium that you can then pass along to the investor in exchange for a little bit of give up. And a lot of times that's used for folks to live off of from an income standpoint, or it's used to offset maybe in a flat market, you're generating income or in a down market, it can help offset some of those losses.

Adam Bass (07:48):

So we've heard from Wes about what NEOS does and how they fit into this conversation. But the truth is that we haven't spoken a lot on this program about the role of exchanges. Entities such as the New York Stock Exchange play a very important role in this ecosystem of options, futures and ETFs.

Brian Gilbert (08:10):

At its highest conceptual level, the role of an exchange is to match interested buyers and sellers.

Adam Bass (08:17):

In addition, Brian said that exchanges create liquid, well-defined electronic marketplaces. These are the market maker quotes so that...

Brian Gilbert (08:28):

Customers can see markets, trade against markets and have confidence that those markets are functioning and have a reasonable size and reasonable beta spread.

Adam Bass (08:38):

We'll return to this idea, the specific role played by exchanges. But for now, let's get some additional context. In February of this year...

Vas Koutsoulis (08:50):

MSCI, EM and EAFA options launched at NYSE in February 2026 that is reaching U.S. equity options participants who might be trading, for example, MSCI index-linked ETF options at NYSE, but were asking for index options for various reasons. So index options are larger in size, for example. So you get a bigger bang for your trading commission. Index options are also cash settled and European in expiry. They're not American style. So you're not in danger to be obliged to buy, or even worse, borrow the ETF for delivery, for example, right?

Adam Bass (09:28):

Okay, wait, American style, European style. What does that mean?

Brian Gilbert (09:34):

So putting on my ex-market maker hat because I was an options market maker at Belvedere Trading in Chicago for over 10 years, most options are American options, which means that the owner or the holder of that option has the right, but not the obligation to early exercise that option at any point in time. With European options, you can only do that on the day of expiration. And additionally, when something goes into cash settlement, it has to go into cash settlement for an index. Because if you think about it, an index is simply a number that's computed from the basket of stocks that comprise it. So you can't functionally have any other settlement for an index specifically except for cash. The other benefit of that for institutional traders and for customers is that, as soon as those options settle, they simply settle in cash from the OCC from one account to another, and the investor essentially, should they have made money on their options trades, would just have that capital back as tradable USD in their brokerage account.

Adam Bass (10:41):

One other important aspect to note here is that, for investors who already held these options at CBOE, the transition required essentially nothing from them. Brian explains why.

Brian Gilbert (10:54):

All options in the United States clear at the OCC, the Options Clearing Corporation. And when a competitor exchange may have opened an interest in that product and it's only singly listed on a single exchange, then anything that trades on it would have to trade on that exchange, but it would all clear at the OCC. So in early 2026, we announced our partnership with MSCI, taking that over from one of our competitors. We also have a super strong relationship with MSCI futures trading over a hundred different types of MSCI index futures on ICE Futures U.S. And so what we did was we had Amex and Arca, our two options exchanges, become a valid trade source for those products. And the way that we're able to do that is that we adopted contract specifications that were exactly what the contract specifications were on the [inaudible 00:11:53] exchange.

Adam Bass (11:54):

That's really interesting. Does that structure remain or was it only for the transfer?

Brian Gilbert (12:02):

Amex and Arca remain valid trade sources, so they each can print electronically or on the floor, currently MXCA or MXCF. We are actually excited to be launching three more index products May 1st. We have market makers who are helping us make sure that we have screened markets for these products. And I guess one important thing for your listeners to understand is that you can never compress or get rid of open interest that sits with the OCC unless it's traded out of. So it's not as if multiple exchanges would have open interest and then some open interests would disappear via an exchange transition.

Adam Bass (12:44):

Let's step back and do another recap here. So far, we've talked about the criteria for indexes. In this case, focusing on emerging markets as well as developed markets outside the U.S., where an exchange like the New York Stock Exchange fits in and the switch of options on MSCI indexes moving to that exchange. But why now?

Vas Koutsoulis (13:09):

This has been a brutal year for options traders, very difficult year. In some cases, profitable, I suppose, but very difficult year. The data reflects it. We have seen average daily volumes across the MSCI index options complex surge materially because vol has not just picked up. It has moved to a completely different regime. Europe was the first surprise. So the energy shock in Q1 hit harder and faster than most of us expected, I think. And then in emerging markets, specific countries, particularly across Asia, took the full force of the energy pricing. So compare that to the pre-conflict narrative, if you want. During 2025, U.S. equity markets became the primary source of global volatility, both implied and realized. What's more, the sensitivity of EM-implied vol to U.S.-implied vol fell to 0.4 in 2025. So that's the lowest reading we had since 2019.

(14:11):

So what this tells me is that the markets were pricing international equity risk increasingly dependently of what's happening in the U.S. So that vol mechanism has now shifted back and forth in the span of the last six to nine months with the Iranian conflict in February. So here's why it matters for anyone running a derivatives book. There are live meaningful dislocations between U.S. vol and EAFE vol and between U.S. vol and EM vol. Those spreads move portfolios. So if you are benchmarked against the MSCI ACWI or the MSCI World or the MSCI Emerging Markets Index, for example, and you're hedging with MSCI USA options, you have a basis risk full stop. You're not hedging your benchmark. You are running a correlated proxy that diverges precisely when you need it the most.

Adam Bass (15:08):

And that spread, that's the volatility risk premium?

Vas Koutsoulis (15:11):

That's right. So the vol U.S premium at its core is the spread between implied vol, i.e., what is priced for future volatility, and then realized vol, what is actually materializing. So sellers of options are compensated for betting uncertainty basically. And over time, implied vol has historically exceeded realized vol. That gap is the premium basically, and it's a structural edge that systematic option sellers have been harvesting for decades. The options market for U.S. equity indexes is incredibly mature. So it is deep, it is efficient, and the vol risk premium is well known and heavily arbitrated. So the compression of that premium in the U.S. markets is a natural consequence of intense competition, for example, between sophisticated participants. That makes sense. International equity options markets, specifically those linked to MSCI EAFE and MSCI EM are structurally less crowded. So our research shows that systematic option strategies like buy right strategies, put right

strategies, protective put, linked to MSCI EM and EAFE indexes have consistently generated lower risk and lower drawdowns compared to the parent indexes.

Adam Bass (16:36):

That's where an investment provider like NEOS comes in.

Wes Mathews (16:40):

The interplay between volatility and these types of strategies is very closely linked. There's a lot of unrest and geopolitical risk at this point in time. And so we have seen some increase in volatility. That is typically a tailwind for these types of strategies since we are selling options. That usually commands a higher premium. For us, that's a good thing. We like the fact that we can actually sell less of your notional exposure and less options to get the premium we need to make those distribution targets. That's a benefit to a holder because it leaves more of your money exposed to the upside from a non-covered standpoint.

(17:19):

And what's interesting about international valuations too is that it hasn't quite had the same volatility of some of the domestic markets. The international market has been a little less volatile and a little bit more sideways. And some of these sideways markets, it's been a really great strategy to be able to add some premium by selling calls. So we were able to partner with MSCI and bring this to market, and this maybe is a little bit in the weeds, but it's okay because it's not too complex. So we start by providing long exposure to the international markets, and we're actually doing that by using an ETF. We're actually currently using IEFA. So it's an iShares ETF as our underlying holding within the fund. That gives you one-to-one exposure to that MSCI EAFE.

(18:04):

Then what we do is we target a specific level of distributions that at this point in time is about 8-10% annually. We then are selling laddered calls. So we're selling two different strikes that are out of the money using MXEA options, like I mentioned earlier. Who it's for is really probably more so income focused, people who are either in retirement or getting close to retirement, looking to diversify away from the traditional U.S. equity or high yielding bonds allocations. I would say most folks that we talk to are really just trying to replace some of their fixed income with something like this because this allows you to have pretty high levels of distributions that helps you achieve a lot of those targets without as large of an allocation as something else with a lower yield would take.

Adam Bass (18:55):

So not a full replacement for fixed income, but an alternative within that sleeve for what it is trying to accomplish. Is that accurate?

Wes Mathews (19:04):

Yeah, I would say so. And I think having it on international is interesting too, as you think about diversification of income sources. We have domestic equities. We actually do have some of our own fixed income products as well that look to enhance yield, but this is a way to sprinkle income generation across other parts of their portfolio holdings.

Adam Bass (19:24):

But what signals do the platform providers, the exchanges, look for to gauge whether the interest is there? Brian?

Brian Gilbert (19:32):

One is you're going to have to partner with market-making firms that you know have the ability and the interest to price these indices. They can hedge them with futures, they can hedge them with ETF, they can hedge options with options if they wanted to. So you also want to make sure there's a liquid underlying, and there is for these index products. And our futures trade hundreds of thousands of contracts a day. The next piece is to know that you would have customer interest and institutional interest as well. We've reached out in the last few months to a large number of sell-side banks, of order float providers and wholesalers, and other members of the U.S. derivatives industry who would have institutional-type clients that may be looking to trade these products because they have a mandate to or because they have an interest in diversifying, for example, out of some U.S.-only indices and getting exposure to more international index products.

(20:38):

On launch of these products, we want to make sure that there are lit screens with bids and offers, with listed expirations and series and strikes, and that allows us, in having those strong market-making partners, to confidently roll out a product into production, into a tradable environment. The quoting obligations is actually 90%, but we expect them to be there 100% of the time and they are. And so, in having them, you then can build additional interest, you can capture additional trading. It

could be Chatim, it could be an electronic order that just originates simply out of someone's brokerage account and their personal account. It could represent before tax or after tax money. These index products, they fulfill a demand that no other product can vis-a-vis the ability to trade implied vol on an international basket, but have the confidence in the NYSE name brand and the confidence in the OCC that their trades will always be guaranteed.

(21:45):

Certainly having the ability to trade it on the floors or electronically is important. And we've seen a number of trades come down to both of our floors, Amex and Arca, and trade in open outcry. And that gives the ability for possibly a better price from the market makers. We also have a mechanism on Amex or American options where a two-sided, paired order can come into an auction, also called CUBE. CUBE is an acronym that stands for customer best execution. And the customer is exposed to any market makers that would want to be listening to our prop market data feed. And if they want to improve the price that the customer is getting, they have the ability to do so in a 100-millisecond electronic auction.

Adam Bass (22:31):

That all makes sense. So how has the approach been performing?

Wes Mathews (22:36):

The strategy is performing very well. You have one-to-one exposure on the underlying, and then you have this distribution rate that we're making on an annualized basis. And whether the individual is reinvesting those funds, using them as a buffer on the downside or living off those, the total returns have held up very closely to what the underlying is doing. I know there's never a free lunch in any options-based payoff. You are trading away some potential, however that fund is structured, in exchange for that premium. Sometimes that works out in your favor even better than the underlying. Sometimes that's a true give up that you see in the total return, but the performance of these funds we've been very happy with, which is obviously available on our website as well as other resources.

Adam Bass (23:23):

And longer term, are there signs that interest will continue?

Brian Gilbert (23:28):

Whenever you have strong outperformance in one type of equity class, whether it be U.S. equities or European equities or tech equities or any subsector that you may want to look at, that outperformance can't always be occurring. It can occur for periods, but it can't always unendingly be occurring. And when certain sectors underperform, there's even more valid reason for some asset managers, depending on their mandate, to get exposure to it, to bring it back up to where it needs to be as a percent of their total holdings. So these index products are really available to allow investors in international equities have that exposure using U.S.-traded options on NYSE, cleared by the Options Clearing Corporation. And that gives the institutional investor the ability to take whatever tracking or whatever AUM or whatever payoff profile they need. And certainly you can do that with ETF or futures, but there's definitely a need for options when it comes to international equities.

Adam Bass (24:46):

According to Vas, MSCI is right there as well.

Vas Koutsoulis (24:50):

Having both futures and options within the ICE ecosystem is a meaningful structural advantage. Think about how institutional investors actually manage their international equity books. They do not use just one tool. They use futures, for example, for broad directional exposure and tactical lead balancing. They might use options for asymmetric hedges for income generation or tailor risk protection. Historically, these two activities lived on different platforms in the U.S. with different clearing relationships and different operational workflows. This is something that is being explored and is subject to regulatory approval. But conceptually, portfolio margining between futures and options linked to the same underlying would be a significant development.

(25:39):

Right now, if you hold a long MSCI futures position and a short put on the same index, your risk is naturally offset. These positions partially cancel each other from a risk point of view, but under standard margin rules, they may be margined independently for the U.S. exchanges, which means your capital requirement does not fully reflect the net risk of the combined position. Portfolio margining would allow the OCC to recognize those natural offsets. It means lower margin requirements on a net basis, which frees up capital. And it's not novel in the U.S. domestic equity space, by the way. Portfolio margining is well established for U.S. equity options. The extension to MSCI-linked international products would simply bring the same kind of efficiency to international equity derivatives. So we are watching this space very closely.

Adam Bass (26:37):

But perhaps one of the clearest expressions of the potential impact and stickiness of these types of strategies comes from a story that Wes shared.

Wes Mathews (26:47):

Two weeks ago, I was down in Nashville for the Risk Management Conference, focused really a lot on options. And at the end of the conference, I got into an Uber and my driver was starting to ask what I did, and I told him I worked in ETFs generically, and he said, "Oh, do you know anything about the covered call strategies that are out there?" And so we had a long conversation, and he was actually very well-versed and was talking all about the trade-offs of upside and coverage and nav protection, all sorts of stuff. And so I think we're to the point now where my Uber driver is well-versed in covered call strategies like my own, that it's really reached all audiences. And so it is fun to see how much people are educating themselves on these types of strategies that I think would've just seemed scary and off-topic to too many people even five, 10 years ago.

Adam Bass (27:42):

That's all for today. Our thanks to Vas, Brian and Wes. Next up on the program, MSCI recently brought together more than 160 limited partners, or LPs, in Phoenix to discuss the state of private markets and what lies ahead. Joe and I were on the ground and we will bring you the insights that surfaced both informal conversations and those that took place on the sidelines of the conference.

(28:12):

Until then, I'm your host, Adam Bass, and this is MSCI Perspectives. Thanks for listening.

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