

Combo Linked to Future (CLF)

The Combo Linked to Future strategy type

The “Combo Linked to Future” (CLF) is a new strategy type that is available for trading in two segments. It will incorporate both, a Related Futures Cross (RFC) on MIAx® for the options component and an Exchange of Contract for Related Position (ECRP¹) on MGEX for the futures component. These simultaneous execution types allow for the exchange of SPIKES® (SPK) futures for SPIKES option combinations. Other highly correlated futures may also be eligible for trading versus SPIKES option combinations. The CLF strategy type will need to be executed by a broker, with the RFC component entered on MIAx and the futures side submitted to MGEX Clearing as an ECRP. As long as the order is represented with the correct parameters, it will be crossed at 100%. Please see [MIAx](#) or [MGEX](#) rulebooks for additional details

Definitions

Exchange of Contract for Related Position (ECRP): A transaction that involves a privately negotiated off-exchange execution consisting of two separate, but related transactions between two separate parties. It includes a long (short) futures contract in exchange for a short (long) “related position” on the opposite side of the market. The term “related position” will include, but not be limited to, a security, derivative, or any commodity as such term is defined under the Commodity Exchange Act, or a group or basket of any of the foregoing. For the purpose of this document, the “related position” is a SPIKES Combination which will trade on MIAx. For further information, please see: [MGEX](#)² and [CFE](#)³.

Related Futures Cross (RFC): A SPIKES Combination order traded in exchange for an opposing position in SPIKES futures. May also include other related futures, such as VIX. See the MIAx [rulebook](#) for further details.

SPIKES Combination: The purchase (or sale) of a SPIKES call option and sale (or purchase) of a SPIKES put option with the same expiry and strike price.

Should a market participant seek to transfer a position and/or delta risk to (from) a volatility future from (to) a SPIKES option position, they can use the Combo Linked to Future strategy to trade the SPIKES option combinations against their volatility futures (SPK or VIX) position. The trade would consist of a buy (sell) of SPIKES option combination and the sell (buy) of an offsetting future, initiated as a CLF strategy at a net price.

Examples:

Buy 10 SPIKES combos⁴ and sell 1 SPIKES future, 50 times for a net credit of \$0.05.

Buy 10 SPIKES combos and sell 1 VIX future, 10 times for net \$0.00.

Buy 1 SPIKES combo and sell 1 VIX Mini future, 5 times for a net debit of \$0.02

¹ Market participants looking to execute an ECRP transaction at MGEX must have an account or an omnibus relationship with an existing MGEX Clearing Member.

² MGEX: Minneapolis Grain Exchange

³ CFE: Chicago Futures Exchange

⁴ Combo(s): Abbreviated term (slang) used by market participants to represent the purchase (or sale) of a call option and sale (or purchase) of a put option with the same expiry and strike price.

The CLF may be entered as a paired order, where a contra order to take the other side already exists, or entered using an agency broker who can attempt to find an off Exchange counterparty to take the other side. Once there is a negotiated trade, the actual execution is done in two parts:

1. The option combination portion is executed on MIAX using the RFC order type.
2. The futures portion is submitted to the appropriate futures exchange.
 - a. An ECRP on MGEX if using SPIKES futures.
 - b. An ECRP on CFE if using VIX futures.

What are the benefits of the Combo Linked to Future strategy type?

With the evolution of derivatives trading expertise from market participants, the introduction to numerous tradeable instruments each year, and the constant need to reduce risk and costs associated with trading and investing, the CLF strategy may have several beneficial uses. The following are some potential uses as well as some trade examples:

- 1) Ability to reduce/collapse positions across products:
 - a) Viable tool for shifting delta exposures between products.
 - b) Will aide in the reduction of margin and/or haircut requirements as well as reduce balance sheet usage.
- 2) Centralize clearing under one clearing entity:
 - a) SPIKES futures (SPK) clear through the MGEX Clearing House.
 - b) SPIKES options, VIX options and VIX futures clear at The Options Clearing Corp (OCC).
- 3) Mitigate exposures:
 - a) Basis⁵ risk.
 - b) Mark-to-market P&L volatility.
- 4) Low Fees:

SPIKES combo exchange fees are a mere \$.01 per leg, per side (\$.02 per combo) and SPIKES futures fees are also highly competitive making the decision to collapse positions across products and clearing entities a much easier decision.
- 5) Potential to add to overall market liquidity:

Hedging across products and later trade a CLF strategy to collapse the position.

Hypothetical trade examples^{6,7}:

1) SPK future versus a SPIKES option combination. Why? Move all clearing to one clearing entity which may result in a reduction of margin requirements.

Suppose a client has 10 short SPK contracts and is long 200 of the SPIKES 50 delta calls. The options will clear through the OCC and the futures through MGEX Clearing. The client may need to post margins on both clearing entities. Client may trade a CLF strategy to collapse this margin treatment. Order: Buy 10 SPK futures and sell 100 SPIKES combos (sell call/buy put). This will result in no position in the futures and long 200 SPIKES calls delta hedged with 100 short combos (short call/long put). This will eliminate the need for margin posting at the MGEX Clearing House and some relief may now be given by The OCC as the new position in the SPIKES options has some offsetting delta risk.

⁵ Basis risk: Potential for two highly correlated instruments to deviate in price from one another. This could be due to unusual market close, short term supply/demand imbalances, etc.

⁶ SPK and VIX futures both have a 1000 multiplier while SPIKES options have a 100 multiplier. For this reason the trades will be 1x 10 ratios.

⁷ Discuss any such scenarios with your account representative at your clearing house.

2) VIX future versus a SPIKES option combination. Why? Move all positions into one underlying and one product which may result in a reduction of margin, haircut and/or capital usage.

Perhaps a client was hedging the purchase of 50 deep in the money SPIKES options by selling 5 VIX futures. The client can now use the CLF strategy, buying the 5 VIX futures and selling 50 SPIKES combos. The result will be no futures positions and 50 long deep-in-the-money SPIKES calls hedged with a short position of 50 SPIKES combos.

3) VIX future versus a SPIKES option combination. Why? Cost savings.

An advisor to a private fund or an exchange traded product, such as an exchange traded note (ETN) with a mandate is to have long exposure to a volatility index, i.e. SPIKES and/or VIX. The account currently holds VIX futures. For significant cost savings due to the fee differential, the advisor may use the CLF strategy and move the long VIX futures to SPIKES option combos. As the combos are a synthetic for the futures they should have a like performance. Going forward, the fund may now trade SPIKES futures and/or SPIKES combos, rolling the position accordingly to keep exposures consistent with the fund's mandate all while having the benefit of reduced costs.

In today's market environment, liquidity providers such as market makers, a bank's trading desks, a hedge fund and other professional traders may be trading multiple products and tickers. This activity will end up in a portfolio with many moving parts. Quite often traders will find themselves in a situation where they must make an immediate decision for the best possible trade to express a view and/or to trade a hedge. These trades may not always fit the profile the trader wants. The trader may have executed a VIX future rather than the preferred SPK future. With the CLF strategy type the delta exposure can now be closed in VIX futures and moved into SPIKES combos. Strategies such as the CLF, as discussed, are one piece of the puzzle to help the liquidity providers to reduce exposures which by default could also increase liquidity and tighten the bid/offer spread in similar products.

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