Floor markets

Origins

- Most of today’s exchanges used to be floor markets.
- Brokers representing customers (and members trading on their own account) negotiated face-to-face.
- Floor markets were used for stocks, bonds, options and futures.
- They were most successful in the futures markets.
A futures pit at the Chicago Mercantile Exchange ("Merc")

... and during a trading session
Few trading floors or pits exist. So why study them?

- Floor simulations...
  - Give us a direct trading experience that isn't mediated by screens.
  - Remind us that our competitors and counterparties are strategic traders (just like ourselves).
- Many situations that we encounter in electronic trading first arose in floor markets.
- Floor simulations are still used in industry.
A futures market

The Kryptonite Market

- Citadex runs a floor market in Chicago for Kryptonite.
- Off-exchange customers communicate limit orders to the floor brokers.
- The floor brokers work the orders (attempt to fill them).
There will be six (maybe eight) market sessions.
In each market you will work one (and only one) order.
A typical order looks like this:
In market 1, ADS should try to SELL one Kryptonite contract on behalf of his customer.

- If ADS sells at price $P$, he receives $P - 23$.
  - He purchases from the customer at the customer’s limit price.
  - E.g., if ADS sells at 25, ADS receives $25 - 23 = 2$.
- Under no circumstances should ADS accept less than 23.
- There is no penalty for unexecuted orders.

Here, ADS should try to BUY on behalf of his customer.

- If ADS buys at price $P$, he receives $47 - P$.
  - I.e., he sells to the customer at the customer’s limit price.
  - E.g., if ADS buys at 40, he receives $47 - 40 = 7$.
- ADS should never pay more than 47.
- There is no penalty for unexecuted orders.
Trading procedures

- (Excerpts from the Chicago Mercantile Exchange rule book)
- Rule 520: TRADING CONFINED TO EXCHANGE FACILITIES
- All trading ... must be confined to transactions made on the Exchange; and ... must be confined to the designated trading area during Regular Trading Hours ... Any member violating this rule shall be guilty of a major offense.

Rule 521: PIT TRADING

- All transactions... shall be by open outcry in the established pit for that transaction.
  - A bid shall be made only when it is the best bid available in the pit.
    - In the Kryptonite market, the standard size is one contract. You can simply say “bidding 20” without a quantity.
  - An offer shall be made only when it is the best available offer in the pit.
    - In the Kryptonite market, you can just say “asking 22”.

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When a trader desires to buy the going offer in the pit, he shall by outcry state "buy it" or "buy them" or "buy" followed by the quantity desired, as the case may be.

- You can say “buy it” and point to indicate the seller.

When selling, the trader shall similarly, by outcry, state "sell it" or "sell them" or "sell" followed by the quantity desired.

- You can say “sell it” and point to the bidder.

Direction

- When I say “buy it” I am buying.
- When I say “sell it” I am selling.

Trade reporting

- If there is a trade, the buyer and seller both turn in a trade report.
- You write in the contra badge ID and the price, and turn in the card.

If you trade, fill in your counterparty's badge and the price. Submit report.

Smith, Adam
ADS 6835
Buy limit 47

JPM
Price 42