diffusetap
Virtual Event Series

# Structured Products... Crypto's New Frontier?

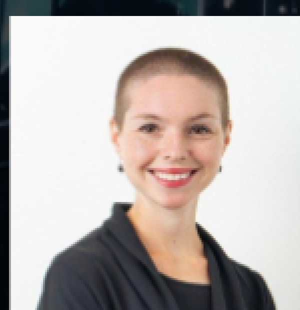
*Guest Speakers:*

Anestis Arampatzis
Co-Founder
Centaur Markets

Patrick Baker
Co-Founder
Centaur Markets

*Hosts:*

Kenny Estes
CEO & Founder
Diffuse



Ayla Kremb
COO & Co-Founder
Diffuse

# DiffuseTap: Structured Products... Crypto's New Frontier?

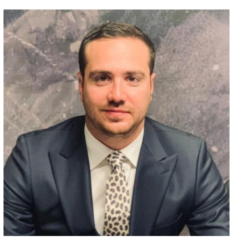
Last time on DiffuseTap, Anestis Arampatzis and Patrick Baker, Co-Founders of Centaur Markets, talked to us about how well the crypto structured products market is maturing, the type of counterparties that exist in crypto structured products, and why Bitcoin structured products have a smaller risk portfolio compared to those in TradFi.

Want to make friends from the Diffuse Fund Ecosystem? Email contact@diffusefunds.com.

## DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

## Meet the Speakers



ANESTIS ARAMPATZIS co-founded Centaur Markets, an OTC trading firm specializing in market making in options and structured products, and Sphinx Bitcoin, a crypto-focused hedge fund. Previously, he worked at StoneX (fmr. INTL FCStone), a structured product OTC trade desk.

Linkedin: @anestis-arampatzis

PATRICK BAKER is a traditional finance industry veteran with over 20 years experience as a market maker in commodity and equity options. Before co-founding Centaur Markets and Sphinx Bitcoin with Anestis, he was head of trading at StoneX for six years.

Linkedin: @patrickbaker01

## About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: Let's hear from Anestis and Patrick. Anestis, do you want to tell the good folks a little bit about your background and what you're up to over at Centaur? And then, we'll pass the mic over to Patrick.

ANESTIS ARAMPATZIS: Yeah. Hello, everybody. Nice to meet you. My name is Anestis. I'm the co-founder of Centaur Markets, a structured product desk part of the DV Trading group. Our goal is to bring structured products into the crypto space. Before that, Patrick and I had founded Sphinx Bitcoin, a crypto derivatives fund that has been live for almost three years.

Before that, I used to be the global head of cotton trading for INTL FCSstone, which now I think is StoneX. I used to trade quite a bit of size in cotton. In terms of network, I think we were the largest broker dealer, where it used to do a lot of commercial hedging, a lot of arbitrage trading, and spot versus futures both for the physical and structured products. While I was at Stone, Patrick was the market maker, the guy who was making the markets for me. That's how we know each other, but I'll let him take it from there.

PATRICK BAKER: All right, thanks for that brief intro. I'm going to go a little bit more into detail on my bio, because I think that it will help. I don't want to over-talk about myself, but I think it will help understand why we're in crypto right now when we started off in traditional finance. I've been a market maker for over 20 years. I started way back in 2001, and I've been in Chicago ever since.

Back then, I was an equity options market maker. I worked at a company called Group One, which was a great break for many reasons. Number one, it was a bunch of young, really smart, ambitious guys that took the time to train and teach me all the ins and outs. But a lot of that was pit trading, because that was all that existed when I first got out of school. I was just down on the floor. There was no electronic streaming. That was right about to come, and I had a few years before that really took off.

And so, I really learned probably the most important lesson in trading, which is that everything is about to change, and you better change with it or else you're going to be toast. If I were still in the pits right now, I don't think I would be doing so hot. Also at Group One, which I think actually relates a little bit to structured products and crypto which we're going to discuss, I watched probably the smartest trader I've ever worked with.

He had the vision for making the VIX much more of a reality, and he was the specialist in bringing that into the CBOE. I watched this product that didn't exist as far as I could understand, and then suddenly, it was this enormous product that we all know and love now, the VIX. That really put in the back of my mind that you can make a product from scratch, and you can really bring things that are not just on the exchange that there is a huge appetite for.

So, as I transitioned from going off the floor, I also decided to transition from equity options to commodity options. In Chicago, that is a normal transition as you just go across the street. I started working in a place called Hanley Group. Hanley Group was much more commodities based. We started up a structured product desk for commodities. So, what was this? Well, in commodities, you obviously have a ton of liquidity on the screen on the exchange. But there is also an enormous demand for people that can provide stuff that is not traded on the exchange, and maybe use more exotic options or different expiration dates, or just offering much more, keeping in mind that there are counterparties out there that are interested in things that might not just be what you see on the CME.

We built out many different structured products that were very interesting to a lot of the different farmers or end users, or people trading commodities, especially in larger sizes throughout the world. From a trading perspective or a liquidity provider's perspective, you can build the shiniest toy in the world, but if you can't find anyone to trade with, then it's worthless, right?

So, what we did was we would trade a ton with different commodity brokers, which had networks of people. We traded so much with StoneX, which was FC stone at the time like Anestis mentioned, that eventually, we got acquired by Stone in 2011. And so, my desk became the liquidity provider market-making trade desk for an enormous brokerage. That's when I started at Stone.

I became the head of trading, and my job was, of course, to make markets. But also, it became much more relationship-based, understanding the brokers at the company, the risk management consultants, and making sure that whatever we had, that they understood what they could offer to their counterparties so that we can help manage risks.

I've worked with a ton of these brokers, but Anestis was the global head of cotton, like he mentioned earlier. He was enormous with structured products, as well as just options in general for the cotton market. We worked together day after day, with him having a relationship with counterparties and myself being a market maker.

To segue this to crypto, when you're a trader, you constantly are obsessed with not just what has been working. Obviously, you also need to think about where this business is going. And so, we see crypto as the perfect scenario. Not only do we think that this is where a lot of the money will be moving over in the coming years. It's the future. But more importantly, from our perspective or from a trading and risk management perspective, it is extremely much the past. This is over 20 years ago, in terms of when we look at the landscape, in terms of how much options are being offered right now and where it stands.

In terms of structured products, or structured notes, we feel like we know that this is going to come in. We've seen it work in the commodities markets, and farmers are very similar to miners. We have seen it work with structured notes, which are yield instruments that are going to go out there, and they are going to be for people that are looking to earn yield on their money. That's what we see throughout the SPX, let's say, in terms of building a structured note around it.

We think that we really found this wonderful place to go, where we can bridge that and bring boring old risk management and trading into the space so that people can start, and I think it's desperately needed, frankly, after what we've seen over the past year about people. We see that when we do break 50%, they put hedging solutions in place. I'll stop there.

AYLA KREMB: Yeah, we can dig straight into questions. I think you've set the stage there really nicely with your background. Where did structured products get started in crypto, specifically on more of an industry level? Is that something rather recent or has that been around for a while, just now starting to get more traction? What is the background there? Maybe that's a Patrick question as a starting point.

PATRICK: Anestis, it looks like that's yours.

ANESTIS: Yeah, I can talk about that. I would say structured products in crypto started two or three years ago on scale. In the beginning, we had very basic vanilla exchange look-alike products, where you buy spot Bitcoin and sell the covered call, or you buy futures and sell a covered call.

Later on, we got into the basic approach of buy Bitcoin, sell a strangle to collect some volatility, and sell higher or buy lower. And then, towards the past 18 months, we start showing some more exotic optionality such as no gains triggers that actually make an option valid or invalid.

But I would like to say that over the past three or four months, we've started seeing a demand for real structured products similar to accumulator structure notes, and traders across the world offering those both in the US and offshore.

If we were to look at the US equities market, structural notes five or six years ago were $5 to 6 billion, and last year there were $75 billion. We believe that crypto will catch up to this size and end up leading the way.

KENNY: Love it, and that is probably true. Chris has a framing question, which is more definitional. What is a structured product? Can you describe it in layman's terms? Patrick, maybe you could explain it for those in the audience who haven't necessarily heard about it, or what they're trying to accomplish.

PATRICK: Yeah, that's perfect. There are extreme varieties of complexity. But if you're doing the basic definition, a structured product can be as simple as a collar or a fence. I'll make that more simple. It could be that in Bitcoin, you go out and you take a futures contract, and then there are options around it. And they decide to buy a put and sell a call, which effectively is putting a price floor for the worst possible level that you could be selling Bitcoin at. And then, you sacrifice upside to do this.

So, you are effectively just taking multiple legs of options, and then putting them together for a very nice and neat, very understood risk profile that when you put together, you know exactly what your outcomes are. It's very black and white. This is just two legs. You can make this into many more steps to provide much more of a risk structure that you like. Anestis, maybe you should talk about more of this.

ANESTIS: Yeah. Let me jump in because I'm a little bit more used to talking with the client-facing and retail side. A basic structured product is a bilateral agreement between two counterparties. One counterparty is the market maker, and the other counterparty is the market taker. There are essentially three different types of structured products. There are structured products that take advantage of the volatility and the time to give the option, and allow you to buy a certain asset class below market with additional risks, of course.

There are structural products that allow you to sell a certain asset class to a certain level of market. And then, there are structural products that give us a goal to collect the yield generated by volatility. The goal of the market maker is to trade a series of different options that are financially engineered then pack it in a way that is very basic and have certain outcomes for the counterparty that is interested in the structure.

Those structures have a specific duration and a specific outcome. For example, I want to do a structure that is nine months old on Bitcoin and has a purpose to trade the yield, plus minus 30% in either direction. I hope this answers the question. I'm happy to go even deeper.

KENNY: It does. You mentioned bilateral, so maybe we could expand on that a little bit. The counterparties. Are these typically family offices, institutions, and miners? What are you seeing right now as the most uptake?

ANESTIS: This can go super wide. Again, there are three main counterparties here. You have the people that are actually using structured products mainly to hedge. And in Bitcoin, these tend to be miners who are always long Bitcoin, and they want to protect some of the downside. At the same time, you might have some family offices, some Bitcoin whales or funds that want to allocate into a new long Bitcoin position, but not necessarily on the current levels and not with the present risk profile.

There are certain counterparties that want to get along with the market at certain levels, and to have some excellent network protection if things go south. And finally, there are the actual products for family offices, high net worth individuals, or hedge funds, who are just trying to trade the yield in the market based on volatility.

Taking a small step back here, personally, I am always a firm believer that the sovereign bond market is not as sovereign as people claim and as we tend to realize. That yield generated by the bonds will actually be replaced by yield generated by volatility. The structural notes market in equities is a great example, where people are actually trying to gain 7 or 8%, while the NASDAQ has a net of protection versus 15 to 20% sell.

The interesting thing about Bitcoin, in my opinion, is that you have a similar risk profile. That is my own view. But because it's such a young market with the options of high frequency traders, and also quite a bit of higher volatility, you are able to reach levels that we used to see years ago in the main exchanges on the equity side, but not anymore.

AYLA: Fascinating. Let's dig into the details here. One person was asking whether these are ISDAs. Are they?

ANESTIS: Yes, they are. If you want to do it the proper way, you want to do it via an ISDA, which is a bilateral agreement that explains very specifically the terms in which the trade is taking place between the counterparties. This is potentially the most important document when you are engaging into a bilateral agreement with anyone.

KENNY: It's funny. I mentioned that structured products in traditional finance are just terribly inefficiently managed. There is a lot of Excel, and there are some companies making that play. Blockchain can be great for that, so I love what you guys are doing. To give folks some framing, and this is Chris's question again, how big is the structured product market in traditional finance? And then, where do you think we are in the crypto story?

ANESTIS: We have actually been trying to quantify that ourselves, but it's pretty hard to do because most of those products are on the OTC side. It's really hard to replicate the size. The official results we have on the US equities sides with the large banks in the US is that last year, in the US equities markets alone, structured products is a $75 billion market.

My guess is that the commodity side is equal or multiple that in the US alone. And then, if you are in Asia specially, they have dedicated, very high appetite structured products, and the market is fairly big. To take a step back, all this stuff started back in the day with the FX market, where more or less, from as basic as an MDF or optionality embedded forward, all these things are considered structural products.

KENNY: Gotcha. I appreciate it. Patrick, do you want to add to that, and just expand on the market landscape and where you guys think you are in the process?

PATRICK: Yeah, absolutely. It's great having Anestis answer all these. But yeah, we believe that when you look at crypto right now, to piggyback off of what Anestis was talking about, we are just cracking the surface. There are some FCMs out there offering these, but there are not many players that are offering these in crypto right now.

We quantified what is trading on Deribit, and it is 90% plus of the options flow. It looks to me that we are only at 5 to 10 billion on the options flow. So, just from that you can get an idea of what is going on not only in terms of what is happening with structured products, but also in terms of the market in general. It's not just price that we are so early in. We are so early right now in general, with the sophistication of all the risk tools that are out there right now.

Thank you for downloading this DiffuseTap event transcript.

Sign up for upcoming sessions and check out past features and event transcripts.

Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on

Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

JOIN US