

ReadySetCrypto Income Through Options Masterclass



Module Seven_A: The Deribit Exchange

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The Deribit Exchange

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Introduction to the Deribit Exchange

The Deribit exchange is the first crypto Options exchange to come to market with Options available for the retail trader. They are based in The Netherlands, and have been in business since 2016.

As we'll see, Deribit offers Options on Bitcoin and Ethereum, with a default leverage of 10:1, and their Options are European-style, cash-settled. They frequently run several series of Options at the same time, with Options available for the front week at all times.

Liquidity is somewhat of a challenge, especially with longer-dated series, however it should improve as more and more traders discover the advantages of Options.

Deribit does not allow customers who reside in the USA to register for their service. Those who would consider breaking their Terms of Service agreement would need to register using a VPN that serves up an IP address from outside of the United States. There is no active KYC, or "Know Your Customer" at this time. In this manner, Deribit is very much like BitMEX in that they will "look the other way" if you are able to get around their registration block.

Deribit offers 2FA, or two-factor authentication which is recommended.

Deribit also maintains a "testnet" service that offers a "virtual trading" experience without losing money. We've referred to this service several times already, and is recommended for readers to sign up for this service to learn how to trade Options without risking actual capital. The testnet service is available at test.deribit.com.

Deribit Options Settlement

Deribit uses “European-style” Options which are “cash-settled” at expiration.

Let’s define these two terms so that you know exactly what they mean.

European-Style Options

An Option defined as “European-style” means that the Option cannot be exercised early against your will, and will only be “settled up” at expiration.

This is opposed to “American-style” Options which CAN be exercised against your will prior to expiration, and is a cause of great confusion to newer Options traders of the American Equities markets who awake to a new day to find that their short Option position has been exercised, and in its place is their obligation of short or long underlying stock. For most retail investors, this is not necessarily a disaster, however it means that you quickly need to come up with a plan “B” and is unsettling for most.

Not so with European-style Options. The price can go deeply “in the money” on a short Option, and the position will not get exercised early. For nearly all cases, this is a very good thing for the Retail trader.

Cash-Settlement

Recall that when you “sold to open” that Option you entered into an Obligation...either an obligation to buy or to sell depending on whether you sold a put or a call Option.

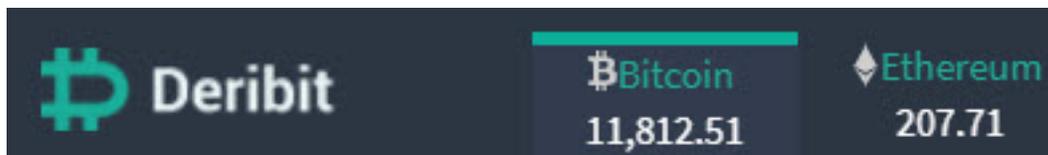
If an Option offers “physical settlement” as most American-style Options do, then after your Option “settles” at expiration, if warranted, your obligation results in you being “awarded” with the amount of the asset that you were obligated to buy. For the US Equities market selling American-style Put Options, you are obligating yourself to buy 100 shares of the underlying stock per contract. If your short put is in the money at expiration, you will be “put the stock” to the tune of 100 shares for every short contract of puts that you sold.

Cash Settlement means that you will not be “put” a new position of Bitcoin or Ethereum. If your short Option is in the money at expiration, Deribit will subtract the difference between the strike price that you sold and the actual settlement price, and will “debit” that amount from your account, multiplied by the number of contracts that you sold.

Per Deribit, “expiration” occurs at 0800a UTC on the day of expiration, and the settlement price is derived from their BTC or ETH index price at that moment.

Listed Options

At the current time, Deribit lists Options on Bitcoin and Ethereum.



By selecting the tabs at the top of the main trading interface, one can select whether you are trading BTC or ETH Options.

You must deposit Bitcoin if you wish to trade Bitcoin options, and Ethereum if you wish to trade Ethereum options. The deposit currency does not cover both instruments.



Once you select which underlying coin that you wish to trade options on, a list of Option Series will be listed on the left-hand sidebar.

The first three instruments in the list are actually Bitcoin Futures & Perpetual “swaps.” These are directional derivative instruments and beyond the scope of what we’re trading in this program.

The Options are listed next; notice that there are a list of different “series,” with expiration dates that start at “front week” (or the next weekly series) all the way out to a series that might be several months from expiration.

Once you select that series, it will show how many months/days/ hours/minutes left to the actual expiration date/time for that Option.

Trade Entry

What are the mechanics of entering a trade? Let's first pull up a series/chain on BTC, and focus on selling a put option:

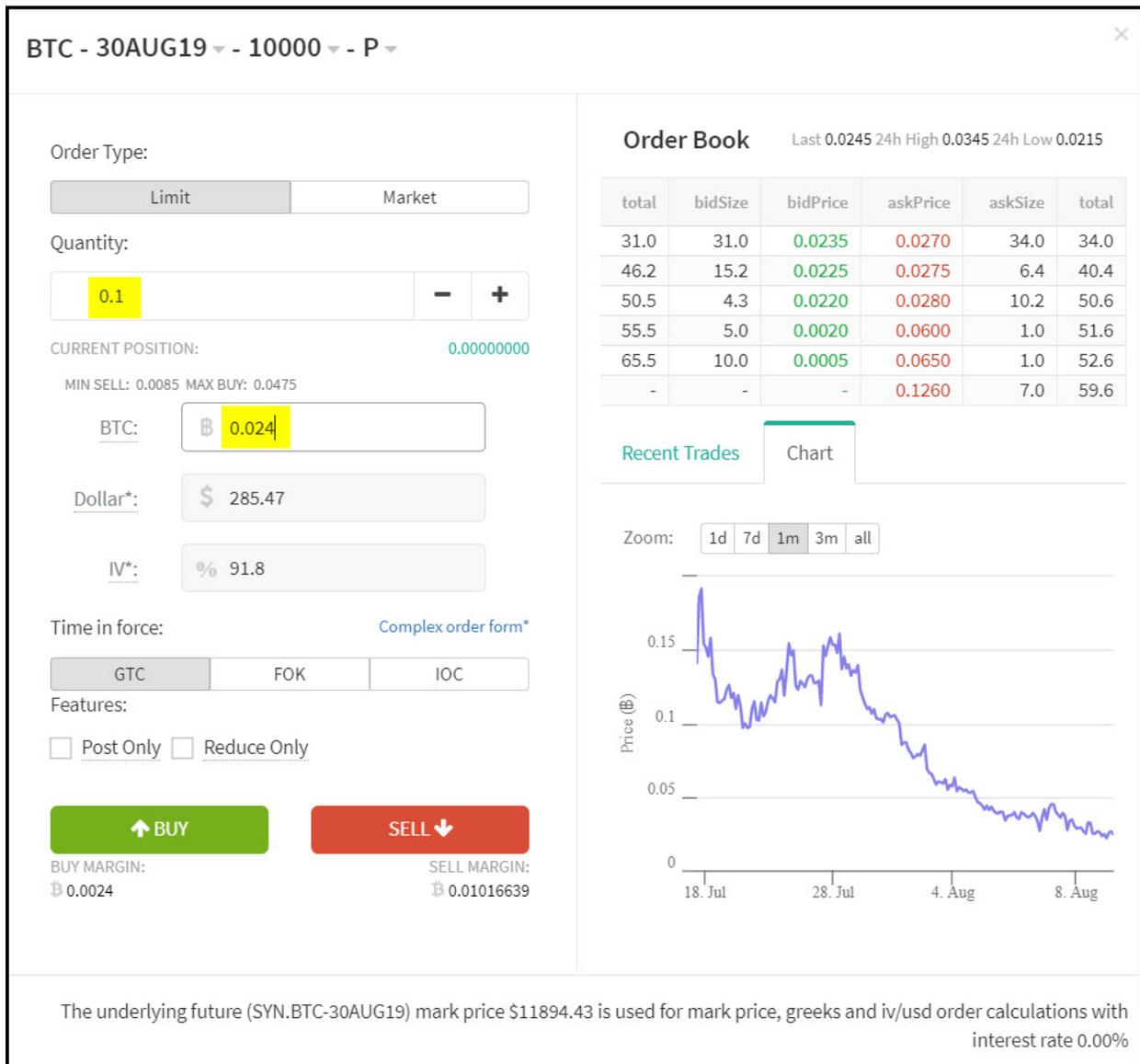
Figure 1

30 Aug 2019		Expires In 20d 12h 15m		Puts	
Strike	Size	Bid	Ask	Size	
6000	-	-	0.0010 \$11.91	4.8	
7000	3.0	0.0015 \$17.87	0.0025 \$29.79	44.1	
8000	2.0	0.0040 \$47.66	0.0045 \$53.62	3.1	
9000	10.0	0.0100 \$119.14	0.0115 \$137.01	40.0	
10000	31.0	0.0230 \$274.01	0.0265 \$315.71	34.0	
11000	35.3	0.0480 \$572.15	0.0535 \$637.70	34.0	
12000	2.0	0.0890 \$1060.60	0.0945 \$1126.14	18.0	
13000	-	-	-	-	
14000	-	-	-	-	
15000	1.0	0.0200 \$238.30	-	-	

Let's say that we wanted to sell the \$10000 put option. The option is currently going for .0230 bid x .0265 ask BTC. Let's not sell it at .0230 BTC, but rather at the midpoint between those two values, or about .02475. Normally it's a challenge to get a midpoint fill, so we might have to back it down to .024 to entice someone to take our bid price.

To select the order entry field, we'll simply click on the green ".0230" number or the bid side; in some brokers this will automatically bring up the "sell to open" option but not with Deribit. Up pops the order entry screen and we need to fill in a couple of fields, which I've highlighted in yellow in Figure 2:

Figure 2



The last step to entering the position would be to click on the red “sell” button to initiate the order in their system. You can also see the order book which shows the “depth” of the market. The more order depth, the better. You should avoid entering positions that have NO order depth; you don’t want to be the only one at the party. Liquidity allows entering AND exiting successfully, without being held hostage in a position that you cannot exit.

What about EXITING the position? If you want to close a position, you must enter a REVERSE ORDER which would “nullify” the current position. If you’ve sold the position to open it, then you must enter an opposite order on the same option to buy-to-close.

Position Size, Leverage, and Margin

Traders will be excited to learn all about Deribit's 10x margin which allows you to trade in position sizes larger than your account can support. I'm not going to be popular for saying this but I think that using "margin" as a "stop loss" is a recipe for account destruction, especially for a new Options trader who is learning the ropes.

Let's use an example to illustrate; let's say that you have .2BTC to put into your Deribit account. At today's prices, that is not an insignificant amount of capital, roughly \$2400 if Bitcoin is \$12000. You sell a \$10,000 put option and select "1 BTC" as the position size; as long as you have enough initial margin you can place the trade, and as long as your maintenance margin is satisfied, you can stay in the trade.

Let's say that the price falls to \$9000 at expiration; you will be cash-settled for a \$1000 loss or equivalent value in BTC from your account. With BTC now being priced at \$9000, you have less than .1 BTC left. One trade has wiped out more than half of your capital. Guess who won't be selling any more puts any time soon?

Consider using the minimum position size of .1BTC until you get some more "headroom" in your account where you can truly manage the risk on any one position to no more than 2% of your account balance.

You might also consider trading ETH Options, which have significantly less capital requirements, yet are also somewhat more illiquid and lightly-traded vs. BTC options. As of this writing, Ethereum has much lower volatility/movement so risk premiums are lower as well.

You can read all about Deribit's Initial Margin and Maintenance Margin rules here: <https://test.deribit.com/pages/docs/options>

Summary - Deribit

As I write this in 2019, Deribit is quite clearly the best choice to trade Options with, however that might change before long as major U.S. firms penetrate the space. Just a few notes about Deribit to wrap up this module:

- Deribit does not perform “KYC” other than checking the IP address of the applicant, and then *only during registration*.
- Shorter-term Option series have much more liquidity/volume than the longer-term series. This is consistent with all other listed Options everywhere.
- Negotiate the bid-ask spread. Never hit the bid to sell nor lift the offer to buy.
- Closing the position manually is accomplished by submitting an opposite order against the same Option.
- Use minimum position size until you’ve earned the right to be able to size the position correctly to risk no more than 2% of your capital on that trade.
- Use Deribit’s testnet account to learn the ropes first.
- European-style Options (good) and Cash Settlement. I never allow the broker to “force-settle” me, I prefer to exit myself under my own power. There is a separate Settlement fee as well.
- At the time of this writing, Implied Volatility is a field that can be displayed in the Options Chain, however it’s not tracked/charted. This you must do yourself if you are seeking to sell “relative high” IV.