CONFERENCE PROCEEDINGS

The AFM Annual Conference was proceeded by a W**orkshop focusing on Clearing Services** (March 2, 2011). The objective of the workshop was to examine through presentations, discussions and questions and answers the topics to enlighten and broaden the understanding of the subject of clearing.

In his introduction Roderick-Gravelet Blondin of JSE, moderator of the workshop compared Clearing and Settlement to a Hippopotomus – "it clears you out and away and that settles it". A good definition was given by Craig Pirrong, Professor at the University of Houston: "Clearing, a centralized mechanism for confirming and guaranteeing trades in securities and derivatives markets, is often likened to the plumbing of the financial system: it is ignored when it works and can cause serious problems when it doesn't". Therefore it is of utmost importance that emerging markets set up the clearing mechanism properly.

The workshop touched upon three main aspects of Clearing Services:

Session I: Pros and cons for in-house vs. outsourced clearing and settlement services

Horizontal or vertical? That depends on the viewpoint: the exchanges prefer vertical as they can capture the revenue flow and keep control of the positions, clients prefer horizontal as it reduces their margins, systems required and creates many other synergies.

Lidia Adamska, Warsaw Stock Exchange, prefered the vertical model as their business model asks for a capture of all revenue streams. Also it facilitates for an exchange to achieve the key points for success: transparency, credibility and investors protection. But she agreed that there was no clear solution. Success depends on historical, local and regulatory background.

Toma Dosteteanu, Romanian Clearing House, has a very local organization, 40% of the clearing house is owned by the exchange (SIBEX). It is basically open to others, but Romanian solution so far is to have a separate clearing house.

Michael Jesch, BankOn Management Consulting, maintained that the products offered influences decision, as could matureness of market. Joining another clearing house involves giving up some individual preferences and solutions. Key, however, is to follow your (potential) customers.

Clive Furness, Contango Markets, saw various shades of grey, or otherwise put there is not clear answer as so many different things play an important role, complexity of product being a key one. “If you have ambitions to offer products internationally it may be better to outsource”. Important is that clearing is all about risk management, not marketing! He made two closing points: “Lots of vertical silos do not lead to cross asset efficiencies. Vertical is more capital intensive.”

Session II: Risk Management on Exchange Level: What risk controls can and should the exchange be responsible for implementing? How should these risk controls be implemented?

Daniel Tzang , Eurex Clearing, maintained that risk management is more important than ever. DMA and HFT have changed the risk landscape completely, therefore Eurex Clearing provides online risk measuring complete with warning and stop buttons.

Mazlan Yahya, Bursa Malaysia Derivatives, saw a shift from post-trade to pre-trade risk management. For clearing house risk management involves not only positions, however, but also collaterals, banking facilities and operational processes. “If you cannot afford it, don’t do it”.

Dr. Gang Shyy, Fubon Securities, explained the Chinese market monitoring model. The regulator also controls account opening and assigns account not to be used for all trades. This way the regulator has access to consolidated trade data.

Jörgen Brodersen, Nasdaq OMX, mentioned the various challenges for clearing and settlement – trading, clearing, regulation and legislation. Expansion of business increases complexity – it may be worthwhile to spin and use special solutions (NasdaqOMX offers 4 different clearing solutions). Current improvements includes expansions of instruments and asset classes, risk management, intraday margining, volatility pricing for options and real time risk monitoring as well as client services such as client segregation or collateral management.

Session III: Enhancing the clearing process, risk management, clearing operations and delivery of the clearing house

Tae Yoo, CME Group, maintained that there is a clear need to increase capital efficiency to lower overall cost (the CME/CBoT arrangement in 2004 save the industry about USD 1,5 bio in margins!). for this is not necessary to give up vertical silos – this can be achieved via co-operations and better cross-margining rules.

Paul Constantinou, Trayport Exchange Systems, questioned whether the coming push for OTC clearing should be left to large exchanges. It can be a good source of revenue but takes lots of technology and know-how. Asian markets should ask themselves whether providing technology should be key or doing the clearing.

The Main Conference (March 3-4, 2011)

Alan van Griethuysen, NYSE Liffe and acting Chairman of AFM, welcomed everyone to Taipei to the 14th Annual AFM Conference. In his opening speech he reflected on last year's keynote address by George Möller, Chairman of the Dutch Financial Supervisory Board who said that one of the reasons for the financial crisis was the irresponsible behavior of people. Basic mistakes were made, often lead by greed. There are plenty of lessons to be learned. As Mr. Möller said future crises can only be understood and controlled through an assessment and judgment of how people should behave. This idea brought Alan to the purpose of the annual AFM conference. The Association of Futures Markets aims for the global promotion and the creation of new derivatives markets. AFM members in emerging markets learn a lot from the experience and practices of the AFM members of the more established markets.This conference presents a chance to socialize with those who share your interests and expertise, a chance to pick up new ideas or share the latest thinking on some critical aspect of the business, and a chance to present your colleagues with some of your own experience and expertise. "It would be difficult to come away from this conference without having learned something" he added.

Closing his speech he handed over - as a token of the official transfer of his chairmanship to Dr. Tony Fan, Chairman of TAIFEX - a statue of Mercury. Mercury, the god of merchants, travellers and profit, is a figure from Roman mythology. Through business contacts, Mercury has spread over the rest of Europe through the centuries, where a large number of small bronze statues of the god can be found. Mercury is depicted here with symbols that indicate speed, as the winged sandals and winged helmet show. Because he uses his winged attributes constantly to hover in the air, aided by a mild south wind, he became known as the god of traffic and trade. May this symbol help the new AFM Chairman to spread AFM's derivatives message over the world.

Dr. Tony Fan expressed his happiness that the conference is taking place in Taipei und appreciated the opportunity to be chairman of AFM for the coming year.

The keynote address was held by Mr. Tang Chieh Wu, Vice Chairman of the Financial Supervisory Commission, the regulator for financial markets in Taiwan. He explained that the financial markets are facing a lot of challenges also in Taiwan. He added that Taiwan is continuingly opening markets to foreigners and therefore the market place is growing constantly. In financials currently 13 Futures and 8 Options contracts are very active, with 139 Mio contracts traded in 2010. 1.4 mio accounts are open. There is a safety mechanism in place thanks to pre-margining. Fees have been reduced and margining facilitated (securities can now also be used for margining). Increasingly the FSC is working together with the mainland regulators to assure proper co-operation and regulation.

Panel 1 – Taiwan, the interplay of the local financial markets

The first panel is traditionally devoted to the host country and this panel gave some very interesting glimpses on a market not sufficiently known to many.

Michael Lin of the Taiwan Stock Exchange (moderator of the panel) started with some interesting numbers. The cash market experienced some 110% increase in the past 10 years., there is a 32% steady increase in the dividend yield. Futures trading is done on TAIFEX with an overall volume of 140 million contracts. TAIFEX (founded 13 years ago) is #17 among the world's top derivatives exchanges. Foreigners have now a market share of 32%. The Taiwan market is very retail oriented. There are 15 Mio accounts with brokers (whereof 1,4 Mio with Taifex) with a total population of 23 Mio! Still the market is not growing as fast as others – some of the reasons are the high transaction tax and Central Bank involvement is not always market friendly.

Charles Lui, Optiver Taiwan, pointed out that part of the Taiwan success story is the fact that the underlying markets were solidly built before derivatives were added. And that market is expanding slowly but steadily. It started with one index future and options followed once the futures were fairly active. There is a strong retail base which is handling investments personally. Trading taxes have come down but are still too high. One of the major issues waiting for resolution is the ban on give-ups. There has been a lot of IT development in the past 6 years, thus brokers can see prices 4 times per every minute.

He felt “we should take challenges as opportunities”, help FCMs to go international and make Taiwan more interesting to foreign investors. According to him Taiwan is an excellent learning spot before you go to the mainland.

Rosemary Wang, FSC, also stressed the nature of the Taiwan market – it reflects Taiwanese entrepreneurship, fear of debt and fear of unnecessary risks. FSC is also supporting markets by educating institutionals. She stressed the safety of the risk management system and as a result there has been no major defaults in the market. She felt that markets should concentrate on successful products and delist those that are not doing that well. Reflecting on the transaction tax rate she pointed out that it has been reduced 3 times already.

Maurice Lu of Yuanta Futures stressed the transaction tax as well and compared it with the tax free status of Hong Kong and Korea and said that the decrease is a must for the market. He pointed out that the Taiwan Central Bank is very controversial. He listed the pre-margin system as a barrier to the growth of the futures market and again mentioned Hong Kong and Korea who provide waivers for pre-margins. He said that since 63% is high-frequency trading cost is very important for these traders. Finally he stressed the competition from Singapore, the REACH programme announced by Singapore will allow access to platforms in Singapore thus TAIFEX should be more aggressive.

Daniel Yang, Polaris Intl Securities Investment Trust, felt that transactions cost should be viewed in a broader picture – there is no capitals gains tax in Taiwan. He praised the appropriate trading volume structure and the liquidity supported by the retail users. They have launched the first ETF’s which are fairly successful.

Austin Hsu, Deutsche Securities Taipei, felt that Taiwan should apply more international standards to attract more foreign investors. The ban on give-ups, not listed trades and after hours trading is hurting business.

Answering the question of expected future achievements Charles Lui mentioned the need for blending with other markets and trading opportunities for linkages – for the benefit of brokers. Daniel Yang called for government pension and insurance funds into the futures markets.

There was general agreement that there is a strong appetite for China opening its doors for Taiwanese investors and brokers, thus the main focus currently is China. Taiwan could be a stepping stone for others to enter China. Since the Chinese regulation is very similar to the Taiwanese one, Taiwan could be a good learning programme for those who want to enter China.

Panel 2 – Developments in the Derivatives Industry of the Asia Pacific Region

Tom McMahon, Singapore Mercantile Exchange, started the discussions with pointing out that “we sit in a securities world in Asia yet it is the most commodity dependent area of the world”. This brings lots of challenges and opportunities that best can be met by building relationships and working closely together. There is very little ability to hedge commodities in the region, however there was very vibrant commodity trading until around 1967. Cotton is a global commodity today but it is virtually un-headgable. He thought Singapore is the most open economy in Asia.

Megain Widjaja, ICDX Indonesia stressed that Indonesia is blessed with lots of commodities He mentioned that they do not really want to compete with other markets but complement them. They are working on standardizing Indonesian OTC market and reducing counterparty risks. Their markets are for both locals and internationals. They are working on a coal contract.

In Indonesia the president defines products that can be listed, this is in the process of being changed. Indonesian regulators, in general, are open to change. ICDX is very active in education as they realize this is the only way to grow the markets.

Mark Holder, HongKong Mercantile Exchange stressed the rapidly growing commodity consumption of Asia, especially the rapid growth in China. He felt one of the main problems in the area is the regulatory structure. Too many regulators do not understand derivatives. There is room for interest rate futures in Asia also no real market for government papers exist – still, companies have interest issues. He was confident that the product mix will change in the region to more consumer related products and energy. Like in other countries he sees a growing need for education to assure that investors are using the products properly.

Tae Yoo, CME Group, mentioned that Asia has 70% of the world' population, yet only 30% of the land mass which is a fundamental basis for trading. Economy is export driven but consumer consumption is rising fast. This will lead to increased imports, imbalances of supply/demand. There are many inefficiencies in Asia that create opportunities for derivatives. He sees education as no 1 priority to grow markets. Except for Hong Kong and Singapore Asia has very local markets. They need to open up with co-operations and partnerships with larger exchanges.

Ted Peng, TAIFEX, saw steady growth in Single Stock Futures, but face hurdles especially concerning corporate actions. The Taiwanese market is different from most others "in many markets retails investors are the lubricant, in Taiwan they are the gasoline that drives the engine". He praised the exchange's promotional activities which is mirrored today by a daily volume of 57.000 contracts.

Taiwanese investors can trade any market that has been approved by regulators.

Panel 3 – Commodities: Products, Developments in Physical Settlement and the Political Environment; How Market Participants Can Gain Access to Smaller More Restricted Markets

Paul Meier, Swiss Futures and Options Association, pointed out the long history of commodity derivatives (compared to the short history of financials). He also pointed out that derivatives have changed the financial markets completely in the last 30 years, a fact still not realized by many. Those markets have changed from a long-term to a trading bias. Commodity Markets are a natural for emerging markets – but only if the cash market functions properly!

Chris Sturgess, JSE Limited, picked up the point of a working cash market and the need for the futures markets to become a part of the value chain. In their market they have 198 delivery points for their wheat market to make it easier for the cash market to used futures properly. Now the derivatives add value to the cash market.

Mark Holder pointed out that it is very important that products are accepted by cash market. Often there are missing standards for warehousing. Benchmarking is very difficult in many countries. Demutualisation was good for owners but bad for education, as those budgets were slashed regularly.

Megain Widjaja, ICDX Indonesia, stressed that exchanges have to be open to change contracts if they do not work. They have done that successfully on a couple of occasions and now the futures are becoming the benchmarks. This is also helped by strong education efforts , where they use Facebook among others.

Clive Furness, Contango Markets, felt that in many cases ETF markets have grown out of proportion and are a potential danger to futures markets.

Thursday afternoon was spent with a very interesting city tour, visiting among others the residence of ChangKai Tchek and ending with a visit of the National Palace Museum including sumptuous dinner and entertainment.

After a short review of the pre-conference workshop three more panel discussions took place on Friday.

Panel 5 – Technology: Exchange Considerations When Looking to Select and/or Implement New Technology

Barry White, Patsystems Asia Pacific, questioned whether trading is not getting too fast for processing. Do we need a horizontal market to assure proper clearing?

He believed in-house development does not make sense – it is too expensive and time-consuming and often ineffective.

David Tsoi, Techlink Systems, Hongkong, pointed out that Asian Markets are different from Western Markets – they seldom have competing platforms.

He also felt exchanges should not insource – it takes too long, it is too costly and ineffective and often lacks expertise.

Paul Constantinou, Trayport, agreesd– Asia is building technology to satisfy local markets.

In his opinion it may be in the interest of the exchange to have its own trading IT solution, but not the rest.

Nils-Robert Persson, Cinnober Financial Technology, maintained too many are copying the old floors and are still not using IT as an effective tool, e.g. for pre-trade management.

Realtime back-up solution is a must and critical to a successful, fair and orderly market.

Louisjan Bonthuys, STT South Africa, brought up Cloud computing – a concept “that is around since electricity” – it may bring solutions for small users.

Thomas McMahon was critical on cloud – most are owned by US companies which are subject to the Patriots Act which creates a lot of security risks. Panel agreed that risks are high. Isolated environments may be a solution, but there are quite some doubts…

Panel 6 – Outlook for Eastern European and African Markets

David Setters of Contango Markets suggested looking at certain patterns for these two regions, in particular: what new exchanges are emerging, what trading platforms are used and what cooperations exist? In Africa the pan-African initiatives went quiet, there has not been much movement. In East Africa there is some kind of an alliance getting together.

Kristian Schach Moller, ACE Africa, is still in a situation of trying to organize working cash markets. This situation is faced in most African countries. “Unfortunately Aid agencies are not interested in bricks, they carry too many white elephants”. Still, many central African states are active and growing positively. First step will be to organize local exchanges, although regionals would make sense. They will probably follow in a second step via mergers. Listing a few countries he spoke of Zambia where plans were announced for a derivatives exchange within 5 years, in Zimbabwe there is a new exchange operating under the Ministry of Trade following the example of the Ethiopian exchange, in Tansania there is a mandated exchange while in Nigeria they are kicking off a warehouse receipt system. Most of the countries are trying to find grounds but the problem is that each country wants its own exchange. Still, he is very positive on Africa, as international efforts (World food program) is showing some positive results. But “a prognosis is difficult, especially to the future”.

Rod Gravelet-Blondin of JSE added that the lack of storage facilities is a clear barrier in the region, thus a handful of traders are collecting the production from the farmers. He said that lot of African companies are looking to South Africa for their experience. He stressed that they would love to be more involved in Africa especially in the cash market but the political situation and the infrastructure is a major hurdle in most countries. Other obstacles are the lack of interest in transparency and existing currency controls.

Turning to Eastern Europe David Setters mentioned the possible merger between the 2 Russian exchanges. Both exchanges have strong links with other regions such as Kazakhstan or Ukraine. He stressed that the EUREX system is expanding to the region. He stressed the independence of Poland.

Sergey Mayorov, MICEX Russia, explained briefly the history of derivatives in Russia. Hundreds of exchanges existed in Russia in the 90’s now they are down to a few. The two biggest, MICEX and RTS, have 90% of the market share and today are in merger talks. There was a non-binding agreement signed in January, the result should be clear by late April. There is some opposition to the merger (especially from the broker community), but he was confident of its success.

Vladzimir Torchyk, BUCE Belorussia, explained that they are in the phase of building up a well functioning spot market (agricultural, metal and timber products) before later expanding into derivatives. Their current turnover is 1.2 billion Euro. Most of the companies are government owned. The exchange’s mandate is to start trading futures from 2012. Unfortunately corprorate managers and government officials lack understanding of the markets.

Darius Cipariu, Sibiu Exchange, Romania, has seen many markets vanish in Romania, but a strong local flavor remained. SSF’s are main trading product. 20% of the volume comes from DJ products licenced from CME. As in many other markets retail investor is main user of the Sibiu Exchange, there is still a big challenge to attract local and international institutions. 50 years of communism erased the financial culture and it is difficult to rebuild, especially for a small exchange. He also stressed the need for financial education.

Summarising the possible landscape for Eastern Europe for the next 5 years there was general agreement that there is going to be strong consolidation with less exchanges, higher number of investors and higher number of products.

Panel 7 – Working Together to Improve Liquidity

Tae Yoo, CME Group, stressed co-operations – listings on Globex allow off-hours trading. "the 24hr market is an efficient risk management tool". Listing Malaysia on Globex helped Algo access and spreading against bean complex.

Lidia Adamska, Warsaw Stock Exchange, preferred one trading platform "Alternative trading platforms split liquidity".

Thomas McMahon, Singapore Mercantile Exchange, stressed building relationships for distribution and education. Also the creation of regulatory frameworks. "Try to get Asia to trade with Asians"

Bella Chiu, NYSE EUronext, Singapore, felt it is important to introduce additional products to satisfy demand -> go where the client is! One problem is that sometimes Regulators inhibit liquidity schemes.

A question from the floor asked whether derivatives markets can be bigger than cash markets. Consensus was clearly no – volumes may be higher but at the end of the day the underlying market has to be able to absorb the settlements.

After the closing remarks Taiwan Stock Exchange and Taiwan Depository and Clearing Corporation invited all participants to a closing city tour with a visit to Taipei 101 where the conference closed on a great note with another fantastic dinner with entertainment and a spectacular view from the 85th floor from the once highest building in the world.

In closing a big thank you goes to TAIFEX and all its members as well as all other organizations that supported the conference in many ways.

Written by Krisztina Kasza, Secretary, AFM