Takeaways of the Eurex Derivatives Forum Amsterdam

Event date: 11 July 2024

Location: Gustav Mahlerlaan 10 (ABN Amro Headquarters)

Hosted by: Eurex AG and ABN Amro Clearing Bank

Documentation by: Ardi Kaars

Date of release: 15 July 2024

Introduction

The Eurex Derivatives Forum is an annual event [1] and in fact one of the more prominent occasions in finance to discover the latest market trends, in this case for derivatives trading and its user applications. Though mainly focused on European markets, the US and sometimes developing regions also receive attention. One of the hot topics of this year is regulatory equivalence versus differences between the EU, US and Asia, and benefits (as well as risks) of using derivatives. Several industry insiders, regulatory officials and other company representatives share their experiences and views on how to make the best possible use of the derivatives market. Below you can find several highlights of the day. I have used Roman numbers to rank each part, with the corresponding topic. I have summarised the insights of each part of the event in accordance with the Chatham House Rule, based on my notes on the conversations that took place, yet without directly quoting or otherwise referring to individual speakers.

Part I. Welcome
Part II. Fireside Chat: Market Drivers - Market Challenges
Part III. Panel: Trends in Derivatives Trading
Part IV. Fireside Chat: How to build trust for retail investors in the EU capital markets?
Part V. Panel: Capital Market in Europe - how to make markets more attractive to retail participants?
Part VI. Fireside Chat: A deep dive into the STOXX Europe 600 in light of the current economic environment
Part VII. Panel: Zooming into energy derivatives - significance, trends and market dynamics
Part VIII. Fireside Chat: Solving the prudential puzzle: How European derivatives markets will benefit from meaningful change in IFR / IFD
Part IX. Panel: Have Dutch buy-side firms embraced the use of derivatives in their investment strategies?

---

[1] https://www.eurex.com/ex-en/find/forum

Part I. Welcome

- It is elections season in Europe
- EMIR still needs to be worked out
- Compliance with DORA is another challenge
- Consolidated tape is still there
- There is a new upcoming legislative period, so what will it bring? And what is the market impact?

- One golden lion is not enough to beat three nominal ones
- The Netherlands is very much relevant for Eurex -> 20% of the business
- Regarding working at a German exchange versus a Dutch clearing bank, the topics are similar, yet Germany is really a bit different -> Germans take punctuality to a next level
- 49% of Eurex colleagues are German
- Sometimes, Dutch people are perceived by them as too eager to push forward ideas
- Customer choice is to be cherished in any case

- Key priorities of Eurex involve equity investing, for example the expansion of benchmarks around STOXX 600, as well as experimentation with new maturities in derivatives
- For ABN Amro Clearing, there is a larger constituency than for Eurex, namely Europe, US and Asia (Pacific) versus only Europe
- In Europe, Clearing needs to work hard to make sure clients keep coming to the market

Part II. Fireside Chat: Market Drivers - Market Challenges

- There is momentum now for the Capital Markets Union
- Several items have been flagged
- The missing piece is that there is a lot of different regulations in different countries, and different approaches
- A Single Rulebook is high on the agenda
- The Listing Act is coming up, which is there to reduce barriers

- There is a lot more transparency now
- The latest proposal of ESMA is very much macro-oriented
- Market infrastructure is complicated
- Research from FIA: 33% of European market participants believe regulatory burden is the number 1 barrier -> 45% of those find the regulatory requirements disproportional
- The structure of products matters too
- There are lots of ongoing discussions around T+1 settlement

- All policy makers are aware of a need to take action
- It depends on political will to solve the problems
- Political volatility does not affect ABN Amro Clearing much
- T+1 is likely to happen -> ESMA and the European Commission are working on this
- In the US there are no big issues with T+1
- Eventually the system will likely adopt T+0
- The main driver of ESMA is to make EU markets more competitive vis-à-vis the US
- Before having moved to T+1, the US treasury market already used T+1
- Settlement efficiency stands at 95% today
- (some) Platforms in crypto already use T+0
- T+1 will serve as a first step toward approaching T+0
- T+1 can save Europe €2 billion, so it is definitely worth the try

My question: How does T+1 affect harmonisation between Middle-East and EU / US?
Answer:
- Due to the different regulatory context, it is hard to determine the exact impact for now

- Europe has good networking, there is a lot of info sharing
- In value chains you can affect each other quite easily
- Network effects are not really new in Europe
- It is a liability for Board Members, and on an individual basis it is there already, so it is unclear why it should be made more explicit
- What matter is how Clearing makes sure it takes the right implementation of DORA in the coming 7 months
- There is minimum amount of time necessary to prepare -> 9 months in advance for several IT projects

Part III. Panel: Trends in Derivatives Trading

- Regarding collateral, the main challenge is prompt settlement
- You want collateral to be available immediately, hence T+1 is a good development
- Eurex has a good position in optimising collateral regarding margin requirements

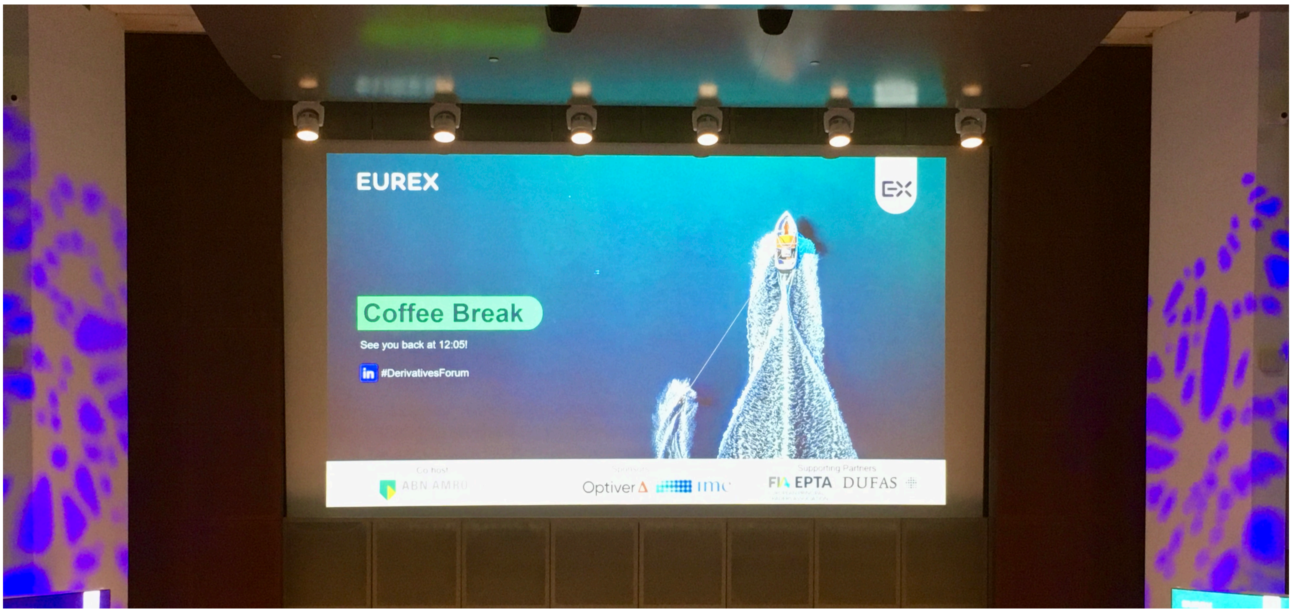
- With regard to to pension reform from defined benefit to defined contribution, what counts is how it affects liabilities
- Contracts now typically have a a shorter maturity curve of 30 years instead of 50 years
- Overall it is positive to see the growth of the derivatives market yet Europe is lagging behind a bit
- In Europe, the majority of revenue from derivatives comes from the energy sector
- Europe underperforms compared to the US
- Accessibility of retail in equity markets is key
- Twice, around year-end, you see a sudden movement in market liquidity
- From an insurance company perspective, client hedges are pretty much in place

- At the beginning of the year, the market was anticipating huge interest rate cuts -> This turned out to be wrong
- In such situations, people have their own different assumptions -> Thus liquidity matters
- With regard to recent elections, spreads tightened just before the elections
- The impact of elections on trading volume turned out to be limited
- We need more sustainable growth
- Retail investors should not be hindered -> Europe is somewhat lagging behind compared to the US
- US elections are still a risk -> Europe is not safe from this by any means
- There are a lot of potential market fluctuations, and high chance of volatility
- Europe needs to be strong
- The US stance on Europe's safety and security matters
- Markets always offer chances
- Discussion about EU parliament equivalence is ongoing

- In the past, there was cliff-edge risk for Achmea -> Part of its exposures moved to Europe as a response
- This might change again
- Wherever there is the liquidity to best execute trades for its clients is where the insurer goes to

- At Eurex, the impact of US AI and chips on trading activity has been limited thus far
- Operational efficiency is nevertheless affected, other core systems less so

- It would be nice to see AI used for optimal data collection, and to write faster and more efficient codes
- Algorithmic trading is a work in progress
- You should focus on 'high touch' trades
- Insurance client companies look to hedge portfolios to maintain coverage ratios in position, and the same goes for rates
- Regarding regulations, the derivatives market is not a one-way market, so you need to involve participants on all sides



Part IV. Fireside Chat: How to build trust for retail investors in the EU capital markets

- With the usage of Current Market Value (CMV), we believe in an increase in retail participation
- In the past year, focus was on building trust
- To do so, we applied the Value-for-money concept, used Peer group analysis, looked into barriers to participation
- In the Netherlands there is an inducement ban, resulting in a large onboarding process
- Since the pandemic, there has been a democratisation of retail trading in the US, question is if we need more of that in the EU, as well as education on investing
- This trend is increasingly important in the EU too, due to the inducement ban, education plays an important role as well
- More young people gain traction from finfluencers -> The downside of this is the omission of information -> Recently fines have been handed out for this
- There is a high focus on internal governance (from an organisation's perspective)

Part V. Panel: Capital Market in Europe - how to make markets more attractive to retail participants?

- With regard to client journey, there is a much broader range of products to choose from in Europe than in the US
- You should bear in mind tax requirements too
- In Europe, most listed options and futures are dominated by index names, whereas in the US there are more individual names
- Since COVID, people took time to analyse stock markets
- In the US, retail volumes spiked since COVID, but not so in the EU
- With regard to options, education is very important
- DEGIRO has an immense base of option products
- In the 80s and the 90s, there was much more appetite for education in options
- The younger generation is more biased towards turbos instead
- Yet in the meme stocks period during COVID, more emphasis was put on options again
- 5-10% of retail in Europe is directly interacting with the exchange
- In terms of product choice, Euro STOXX Index is one of the main products
- Among Korean options, night sessions trading is hot at the moment
- More than 50% of retail trades in zero-day options
- In India there is much higher share in retail than in Europe
- This also applies to the US, where you have one regulator applying the same rules

- Yet if you are Dutch, rules differ from Germany, or other EU countries -> Harmonisation of rules across Europe and education are therefore important
- Harmonisation is necessary so the client in Europe can access the full scope of the market

- For retail investors, there is a deep range of product choice, and a need for harmonisation of product treatment
- Clients want to be comfortable with the product
- Democratised trading is part of the initial phase, as is pricing
- As a broker we must provide the right tools for education
- AI can tailor to clients' preferences
- There is increased activity in the options business

- When the retail boom started, Eurex worked with mini- and micro-contracts to attract clients, as well as offering cheap access to level 1 data
- Eurex offers clients access to more than 1 million assets
- If you have 100 shares, you can for example profit from 7 covered calls
- Presentations and masterclasses are used to familiarise clients, as well as partnerships with FOM
- Moreover, in-house knowledge for banking clerks, office administrators etc. is being offered

- With regard to retail clients, nobody is directly 'targeted' by brokerage services
- The role of stock exchanges in general is to take care of the cost allocation of products
- Yet retail clients are asked if they are prepared to pay a bit more for infrastructural costs

- From an exchange perspective, Eurex is part of the cost-infrastructure -> Cost-burden sharing helps
- In Germany, there is a €20000 offsetting rule (see specifics on Termingeschäfte)
- Regarding futures, clients are not allowed to lose more than a certain margin, which has resulted in higher margin requirements
- The good news is that more new products such as short put ETFs and other ones have been introduced
- Regulation is in itself a good thing, but overregulation risks putting investors into unregulated markets
- DEGIRO has a big presence in Germany, where clients are pushed into structured products
- DEGIRO is agnostic about what clients trade, yet sees a need to change based on new rules -> For example, in Spain the broker was required to adapt very fast to regulatory changes, which affected the broker and its clients negatively
- Clients should make informative, sustainable decisions -> It is preferable to offer qualified content, rather than relying on finfluencers without legal safeguards

Part VI. Fireside Chat: A deep dive into the STOXX Europe 600 in light of the current economic environment

- STOXX is different from other indices since it is a pan-European benchmark (as well as MSCI), unlike the more specific indices
- Other indices may be more biased towards small caps or other specific cap sizes
- Sustainability is included in the STOXX
- Customisation is one of the latest trends -> This is often a matter of excluding companies based on certain criteria (such as ESG)
- STOXX Europe aims to be a basis for baskets -> Goal is to obtain exposure to Europe or part of it
- A subset of derivatives can be used to hedge per factor and per basket
- If investors want to invest in Europe, they will keep using STOXX' baskets and derivatives
- Data is key for index providers, as is technology
- Regulation is a challenge too -> ESMA guidelines on funds and methodology of the funds are among those

Part VII. Panel: Zooming into energy derivatives - significance, trends and market dynamics

- Enerjisa Commodities is the largest energy commodity provider in Turkey, yet less well known in Europe
- The firm invests heavily into solar energy
- Since last year, the company has been present in Europe too, covering all aspects of the energy market -> This means coverage of several individual markets as well as the whole EU market for energy
- 2022 was a volatile year for the energy market
- In the buildup to the invasion, volatility was low, after that the volatility became immense
- Energy prices are still 20-30% above pre-war levels
- This incentivised Enerjisa Commodities to change its approach towards news headlines and changes in infrastructure
- More energy is now coming in from the US
- You can now lease at floating term -> That approach is now seen in Europe

- What happened with the energy market in 2022 was a black swan, and is not nice either as a market participant or a regulated exchange
- Enerjisa Commodities saw increased liquidity volumes again, as well as technology enhancements -> Markets are stronger now than before 2022
- At ABN Amro, this was perhaps the most stressful time ever had across all internal departments
- Improvements in the exchange regarding margin requirements could be seen
- Nobody defaulted (on the client side), yet is good to learn from the crisis
- An ongoing trend of increased liquidity can still be seen
- To keep positive momentum going, market participants are not solely focused on silos anymore
- Cross-asset classes are developing, and markets are more and more connected

- In Amsterdam, Enerjisa can very much choose its direction
- In Turkey, the company is mostly on the 'Long' side
- Companies are often late with mispricings but can prepare themselves, for example by taking into account physical delivery for derivatives
- When talking to clients, there is no direct link to physical products, provided they buy the right one
- There was a decoupling event on the spot market, investors did not see it coming -> Eurex has a responsibility to educate
- You need to use derivatives if you are to deliver utilities to customers
- Financial clients can get more than they bargained for (spark-price optionality)
- Virtual power plant is a useful tool
- Regarding the level of sophistication, we are behind 10-15 years -> 5 years ago, co-location was never a topic
- More clients (of Eurex) now look into making algorithms faster

- There is a client for whom half of the staff consists of traders, the other half of analysts, yet it is not very common
- In the end, you cannot work without the algorithm
- Eurex started with a churn-rate in the energy market of 3 to 5, and now stands at 14 already
- Algorithmic trading is an important topic
- Global interconnectivity is important too, and it is vital to understand geopolitical uncertainties

Part VIII. Fireside Chat: Solving the prudential puzzle: How European derivatives markets

- In terms of prudential regulation, a lot still applies to investments firms that does not apply to trading firms
- A cabinet of new European Commissioners will be in place soon, question is whether it leads to rectification of the above
- The European Banking Authority rectified rules in place thus far -> They want to go even further in terms of regulations for banking

- It has been recognised by policy makers that capital markets are needed to link investment to capital -> Governments cannot do this, and this should not be controversial at all
- We can learn from the US, and yet, the US is not homogeneous regarding rules and decision-making
- At least the US recognises this as an excess
- Exchange-traded derivatives are critical for market liquidity

Part IX. Panel: Have Dutch buy-side firms embraced the use of derivatives in their investment strategies?

- Mint Tower Capital has existed in its current shape for about 15 years, yet its history dates back to 1990 -> The firm is therefore very familiar with market risk factors
- Before the crisis (GFC), there was a lot of development in OTC markets
- After the crisis, the market for listed derivatives developed quite well, so there was less need to go Over-The-Counter
- With a derivatives market, it it easier to rescale risk

- Van Lanschot Kempen sells structured notes/payoffs to high-net worth individuals
- With regard to liquidity, spreads indeed become wider with more exotic products such as non-callables
- With structured products of about 6 years to maturity, the OTC market is definitely something to think of
- In the early days of Mint Tower Capital, markets were doing sales with banks directly
- During COVID, spreads were wider and sometimes a quote was not even available

- For Achmea entities, the biggest portion of the portfolio is cleared
- Swaps are mostly bilaterally cleared
- Achmea uses bond and equity futures, bond futures are the more liquid ones and mostly used by government managers
- Mostly, Achmea's trading is still bilateral, and options are hardly traded for clients -> Most Board Members find options complicated

- Regarding buy-side clients, it is important to have a deep liquidity pool
- Education matters in the case of retail but also for institutional investors
- In every buy-side system, it is easy to access algorithms, yet for options this is more difficult
- A big chunk of options trading happens off-stream, there is a need to interact with the entire flow
- IMC helps traders with on-screen presence
- Activity in Scandinavia is missing, offering immense opportunities over there
- Derivatives can be very dangerous, yet can also add safety to your investments (if well-used)
- As a buyer you accept there will be a certain degree of quality, yet neither we (Mint Tower Capital Market) nor sellers always know the exact specifics
- In the US, once you are a free agent, you accept your own responsibility
- There is no need to rid all regulations, yet compared to the US, some realism in Europe would be welcome -> Compared to the US, we lost balance
- Derivatives should better be used for hedging, not for speculation -> Most of the hedging will be done using cleared swaps (interest swaps for example)
- For equities, use futures

- At Van Lanschot Kempen, offering structures are aimed at high-net worth clients -> Derivatives are good for a funding mix, which can be tailor-made
- The number 1 usage of derivatives is for risk-management; Number 2 usage is for liquidity, having the prices on screen -> Are they tradable?

- IMC trades a lot of Europe's stocks, yet clients trade on US markets a lot -> on the hedge fund side, this results in a capital move towards the US
- Eurex has no excess issues with liquidity, and its staff is well-educated in this area
- There is a certain discrepancy between visible liquidity versus actual one

- Education on excess liquidity can help with large order book trading
- An efficient order book and single marketplace works best
- In the bond market, you need to issue at least €200000
- Some options are very accessible from small to large (notional) amount
- In Europe, parts of the market have been scared away to Bitcoin and the US

- In the US and Scandinavia, names attract different investors
- When looking at options with discontinuity, beware of broader spreads
- IMC lost quite some market participants since COVID, and there is an urgent need to keep up positive trading activity
- With regard to Exchange-Traded-Derivatives (ETDs), there are no significant structural impediments, except for more exotic risks

On a final note
The Eurex Derivatives Forum was a highly informative occasion, and has increased my awareness on the usage, risks and opportunities in derivatives markets. A recurring theme has been the discrepancies between the European and US markets, with the US being the more harmonised of the two, whereas Europe seems to have more comprehensive assistance and protections in place for investors. Other prominent themes were challenges in the European energy sector, and the democratisation of financial investing during and after COVID. My gratitude goes to Eurex and to ABN Amro Clearing for organising the event, I look forward to attend the next one! For feedback or questions, please send an E-mail to quero@discounted-by-a-lightning-strike.com. Thank you for reading!

I have no interests to declare other than my attendance as a board member of investment committee Carpe Divitias.