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Overview

- Derivatives for a wider variety of underlying assets should be listed in the exchange.
  - Especially, for long-term assets.
  - Ex. 30-year KTB futures

- Derivatives with long-term maturity have to be activated.
  - The liquidity provision is too concentrated on nearby contracts.

Out of global trend?

- There is also a sluggish trend in global derivatives trading from 2011 to 2017.
  - It is not significantly different from the trend in the Korean derivatives market.

- The sudden increase of global derivatives trading in 2018 may be abnormal.
  - The sharp increase in stock index derivatives and currency derivatives trading volume associated with high U.S. stock market volatility mainly contributes to this sudden increase.

- Actually, commodity derivatives led the recovery of global derivatives trading from 2011 to 2017.
  - One of the main reason of the slow growth in Korean derivatives trading is that commodity derivatives account for only a small portion of Korean derivatives trading.

Breakaway of retail investors

- A primary cause of low trading volume in the Korean derivatives market is the decline in KOSPI 200 index derivatives trading.
  - Mainly due to the breakaway of domestic investors, especially retail investors.
  - The trading volume of KTB futures has been maintained since 2011.

- The sluggish Korean derivatives market is a rebound of the abnormally large trading volume of retail traders in the past.
  - We can overestimate the potential demand for derivatives if we overlook the roll of retail investors.

Conservative view on new derivatives

- It is true that long-term investment is becoming important.
  - However, this would not lead to actual demand for new derivatives on long-term assets.

- The very long term bond might not be important for domestic institutions yet.
  - The average duration of Korean insurance companies' portfolio is still about 5 to 8 years.
  - Nevertheless, there is no transaction of 5-year KTB futures.

- Still, the main interest rate derivatives in the U.S. market are 5-year and 10-year treasury futures, not 30-year treasury futures.
  - Rather, 30-Days Federal Funds futures is more actively traded than the long-term bond futures.
  - Therefore, the demand for short-term KTB futures may be more significant than long-term KTB futures.

- The trading volume of the Eurostoxx 50 index futures listed in Korea derivatives market is extremely low, despite of the large demand of Korean institutional traders.

Demand of retail investors

- It is dangerous to prejudge institutions’ demand for derivatives.
  - We may consider the demand of retail investors more.

- Most of them have moved to overseas derivatives.
  - Their overseas derivatives trading has steadily increased since 2011.
  - As of 2018, retail investors mainly trade crude oil and U.S. stock index futures.

- The actions to prevent speculation in Korea derivatives market may induce transfer of retail investors.

Importance of ETPs

- ETPs including ETFs and ETNs can be an effective way to stimulate overall derivatives trading.
  - The size of ETP market has increased steadily.
  - Retail investors support this growth.

- It can supplement a lack of commodity derivatives in Korean exchange.

- It could result in consequent hedging demand and stimulate trades of other related derivatives.
  - Ex. Demand transfer sin Hu (2014)

- Development of appropriate benchmark index
  - Expanding incentives for liquidity provision in the ETP market.

Introduction of weekly derivatives

- Most of the trading volume is concentrated in nearby contracts, even in the U.S. derivatives market.
  - An effective way is to introduce weekly derivatives to spread transactions of nearby month contracts.

- VKOSPI calculation could be changed based on liquid weekly options expired in just before 30 days and just after 30 days.
  - It is similar to VIX calculation.
  - It could increase the reliability of VKOSPI and improve VKOSPI futures trading volume.

High frequency liquidity providers

- There are many studies support the positive effect of high frequency liquidity provision.
  - As suggested by Conrad, Wahal, and Xiang (2015) and Menkveld and Zoican (2017), high-frequency market makers can improve market efficiency.
  - Dobrev and Schaumburg (2017) indicate that HFT is consistent with prudent market making rather than predatory trading.
  - Korajczyk and Murphy (2019) show that high-frequency trading is associated with lower transaction costs for small, uninformed trades.

- We may change the present continuous trading into frequent batch auctions to avoid unnecessary speed competition between high frequency market makers as proposed by Budish, Cramton, and Shim (2015).