

APAD 2019 Special Symposium



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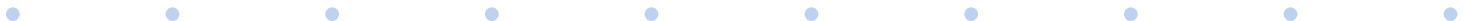
Overview

- 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).

