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A Mecca for financial derivatives

By Dr. Jörg Franke

Europe

When the first European derivatives exchanges were established at the turn of the decade from the seventies to the eighties, Europe had to make up considerable ground against its U.S. counterparts, which already had a long track record at that time. This is true, in particular, for the CBOT, which celebrated its 150th anniversary last year and, until the end of 1998, had been the biggest options and futures exchange around the globe.

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But as the successful launch of derivatives markets in the "Old World" has demonstrated, **Europe** also had a significant need for exchange-traded forward contracts. Propelled by annual growth rates clearly exceeding those in the U.S., Europe had managed until the mid-nineties to evolve from a "developing country" into a real alternative for derivatives traders operating on a global scale. Average growth in trading volume at **U.S. and European exchanges** has seen a steady convergence since 1996, albeit on a low level (see diagram).

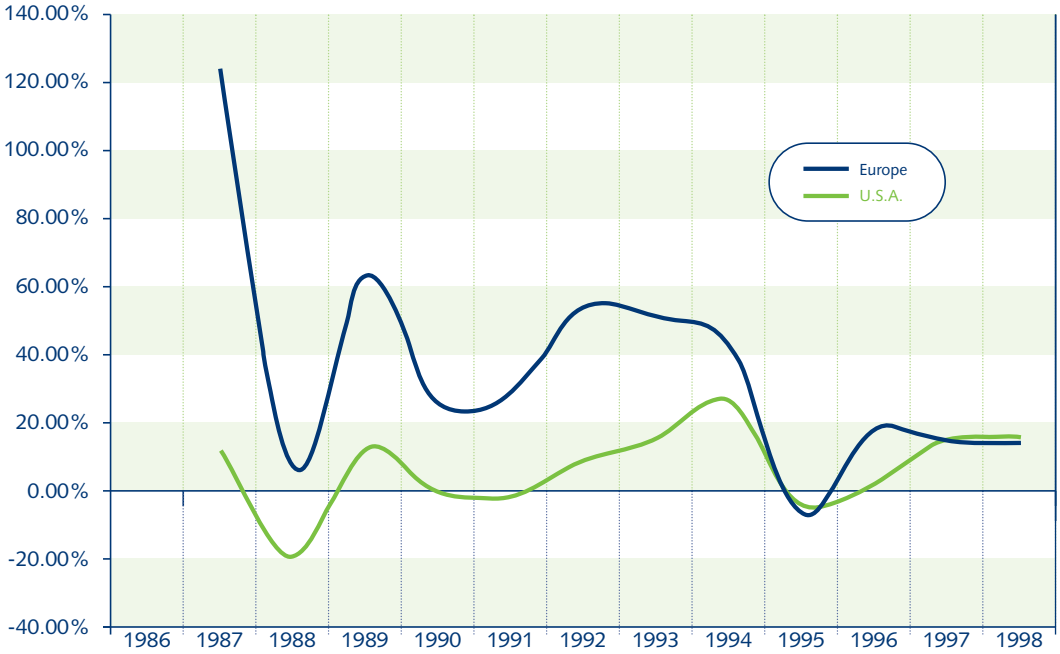
In Europe, the period of growth was superseded by intensifying, predatory competition. This consolidation process was mainly driven by the implementation of the Investment Services Directive (ISD), which paved the way for a "European passport" for financial institutions, and the introduction of the euro. The changing environment for **European financial markets** caused financial intermediaries from EU member countries to compete head-on with each other, with the corresponding squeeze on margins forcing them to realize cost-cutting potential. Moreover, the advent of globalization served to erode exchanges' traditional monopoly function within their respective national markets, as their participants now became able to choose the most favourable trading opportunities from a range of different markets.

Consolidation among international exchanges promises synergies in two respects: On the one hand, the resulting concentration of trading volume leads to a much better utilization of the various technical systems of an exchange, thereby facilitating the realization of cost-cutting potentials. On the other hand, focusing trading volumes enhances liquidity, usually also involving lower transaction costs.

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Contract Volume Growth (in %)

Europe versus U.S.A.



continued

Looking at the distribution of turnover among the **various European exchanges**, there is no longer a uniform concept for equity and interest rate products. As for the latter, which consists of capital market and money-market products, traded volumes are clearly concentrated on just a few exchanges, whereas equity/index-based products are more broadly distributed, with just the latest Euroland index products the exception.

Convergence – the reduction of interest rate differentials between the various member states of European Monetary Union, which had set in considerably even before the actual launch of the euro – was a catalyst for the consolidation of capital and money-market derivatives. Market participants' turning to only a few benchmark products can thus be regarded as a logical consequence.

In contrast, trading in equity and index derivatives as well as their underlying cash market products is still subject to greater national fragmentation in **Europe** than in the **U.S**. However, cost-cutting pressures on intermediaries here will also lead to a concentration of trading volumes. And since investors increasingly tend to focus on European benchmark products for their equity operations, this process is likely to gain additional momentum.

In future, **Europe** will probably no longer see any strong growth rates in volume, especially in the areas of capital and money-market derivatives. Though individual exchanges have been able to record sharp increases in turnover for capital market products during recent years (for instance, between 1997 and 1999, **Eurex** could raise its trading share in European capital market products from 27.1% to 87.4%), on a pan-European level, there was hardly any such growth (in 1997, the volume traded amounted to 235 million contracts; on the basis of overall transaction volumes between January and August, a projected turnover of 234 million contracts is to be posted for 1999).

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In contrast, further growth is to be expected in equity and index derivatives. The growing capitalisation of European equity markets will also have an impact on derivatives exchanges. In this respect, Deutsche Börse and Eurex are well-positioned to gain additional trading volume in equity options due to a clearly lower market capitalization than in the U.S. and the UK, respectively. The new European equity derivative instruments are therefore set to oust their national counterparts.

Of course, another way for derivatives exchanges to spur turnover is new product development. In the field of equity/index products, potential future instruments might include sector index derivatives or derivatives on the "Neuer Markt". It is, for instance, also likely that in future even global indices might serve as underlying instruments for exchange-traded products.

As far as European interest rate products are concerned, so-called basket contracts comprising different government bonds have been considered for quite a while now. Even contracts based on bond indices have been contemplated. The necessary prerequisites in the form of homogenous interest rate markets are, however, not yet available to a satisfactory extent. In any event, derivatives exchanges will have to increasingly diversify their product range in future. With the development of exchange-traded credit, insurance and energy derivatives, for example, further product segments may be opened up and new groups of participants acquired.

Is it presumptuous, then, to call **Europe** today a **"Mecca for derivatives"**? Certainly not – because if this concentration process within Europe is continuing, thus leading to a higher degree of market liquidity, European derivatives exchanges will enjoy a clear advantage in terms of efficiency over the more heavily fragmented U.S. market.





+++ Additional Service on the Eurex Website +++ Eurex Release 4.0 +++ 300 million Contracts traded +++ Eurex Internet Questionnaire +++ Dates in November and December +++

Additional Service on the Eurex Website
The Eurex Customer Service department has extended the information available via the Member section of the Eurex website **www.eurexchange.com**. From now on, the following information services are available relating to the status of your configuration:

- **Connection Monitor**
  - Between 07.00 and 19.00 CET on exchange trading days, the following information on the status of your MISS or User Device configuration is available:
  - Connection status
  - Logical Device ID and Communication Server ID
  - Operating System
- **Batch Status**
  On exchange trading days between 20.00 and 23.30 CET you can find current information on the state of progress of the Eurex batch run. Outside those hours, you can see the results of the previous batch run.
- **Configuration Diagram**
  This shows a representation of your MISS and/or User Device, and router configuration, including the gateway and IP addresses, as well as additional technical details.

You will find this information via "Info for Members" behind the "Special/Technical Services" buttons. If you are unable to access the member section of the Eurex website please contact the Eurex Member Readiness Team on
T +49 (0)69-21 01-17 00.
For questions concerning the new information service or its content, please contact the Technical Helpdesk on
T +49 (0)69-21 01-12 00

Eurex Release 4.0
Eurex plans to introduce Release 4.0 in mid-2000. A simulation environment will be available for a suitable period in advance of the release into production. The main focuses of the new release are the extension of the graphical interface to cover a number of Clearing functions, and implementation of significant performance enhancements on the backend to support continuing growth of transaction volumes. For the GUI extensions corresponding changes have been made in the VALUES API. In order for vendors and members to make preparations for their developments on the new release we are publishing the Planning Version of the Member Front End Development Guide for Eurex Release 4.0 on our website (www.eurexchange.com) under: **Entrance Hall/Access to Eurex/Technical Infrastructure/Member Front End Development Guide Rel. 4.0**
Technical Release Notes will be distributed with a further circular before the end of the year, together with a calendar providing dates of major milestones and availability of further Release 4.0 documentation.
If you have any questions, please contact the Member Readiness Team.
T +49 (0)69-21 01-17 00

300 million Contracts traded
On October 18, 1999 Eurex reached another milestone – the 300 millionth contract was traded. Eurex is therefore the first derivatives exchange to ever achieve a yearly volume of over 300 million contracts traded.

Eurex Internet Questionnaire
Eurex has a questionnaire about its website under **www.eurexchange.com/ Entrance hall**. We would appreciate if you could take a moment to fill it in – there are 100 Eurex give aways to be won!

Dates in November and December
30. November–01. December
FOW Exhibition and Conference
Fondazione Stelline, Milan, Italy

Member Training

Date: November 08, 1999

Training and Education Derivatives Market

	Course	November	December
Traders Examination négociateur	Colloquium for de négociateur Eurex	16.11.99 **P** 17.11.99 **P** 29.11.99 **C** 30.11.99 **C**	02.12.99 **L** 03.12.99 **L**
	Eurex Traders Examination	22.11.99 **H**	Week Dec. 06 **C** 06.12.99 **P** 09.12.99 **L** 10.12.99 **L** 10.12.99 **P** 13.12.99 **P**
System Training	Eurex Functional Member Training	25.11.99 **P**	01.12.99 **C** 06.12.99 **L**
	System Training for Eurex Clearing	16.11.99 **L** 23.11.99 **P** 25.11.99 **F** 26.11.99 **P**	07.12.99 **L**
	Refresher Clearing Workshop	18.11.99 **L**	03.12.99 **C** 09.12.99 **P** 15.12.99 **L**
	Clearer Test	19.11.99 **L** 23.11.99 **H**	04.12.99 **C** 10.12.99 **P** 16.12.99 **L**
	System Training for Eurex Security		17.12.99 **L**

C Chicago **F** Frankfurt **H** Helsinki **L** London **N** New York **P** Paris

Eurex Block Trading and Basis Trading Facilities are now available in the U.S

Eurex has been notified by the CFTC that the basis and block trading facilities are now available for Eurex members located in the US.

Block Trading Facility
The Eurex **block trading** facility permits the entry of off-exchange options transactions (OTC trades) into the Eurex system. Clearing is then performed by Eurex Clearing AG.

For US based Eurex members, the block trade facility is currently available for options on the Bund (OGBL), Bobl (OGBM) and Schatz (OGBS) future.

The minimum contract size for a block trade is 250 options contracts. In order to avoid execution risk, the options trade is entered into the Eurex system on a separate screen where both legs of the options trade are executed at a price agreed to by the two counterparties. The price of a block trade has to be within a certain interval which is determined by Eurex Clearing AG.

Basis Trading Facility
The Eurex basis trading facility allows the simultaneous exchange of cash bonds and futures contracts without any execution risk.

Basis trading is available for cash transactions in German government bonds with a remaining term to maturity on the delivery day between 1 and 30.5 years. These cash bonds can be traded against the Buxl, Bund, Bobl and Schatz future. Swiss government bonds with a remaining term between 8 and 13 years can be components of a basis trade against the Conf future.

Participation in the block and basis trading facilities is granted upon application.

For further information regarding the requirements and application procedures for the block and basis trading facilities, please contact the Chicago office:
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