Innovations in Accessing Asia:
Listed Equity Derivatives and Delta One Products

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Executive Summary

As investment managers look for ways to outperform their competition, they are turning to new regions around the world in a search for opportunities that offer the potential for greater returns. It is clear that opportunities in Asia are squarely in the eyes of traders both in and outside the region, as these markets remain an integral component of global investment strategies looking for higher alpha and outsized returns.

The challenge remains one of access, with many of Asia's markets closed to direct foreign investment. It is this regulatory isolation that provides an opportunity to the region's highly competitive exchanges seeking to expand their franchises. And there is substantial pent-up demand for instruments that can provide precise exposure to a specific company domiciled in the closed markets of Asia.

Listed derivatives are among the logical choices to gain access to these markets but the need to be able to narrowly define exposures and/or have access to sufficient liquidity can restrict this choice. This is where the OTC market has thrived. Investors can choose from among a variety of OTC instruments to gain exposure, including simple contracts for difference (CFDs), equity swaps, participation notes, or even more customized and structured OTC agreements.

And investors are using all of these tools. However, regulators are becoming increasingly disenchanted with many of these instruments, especially OTC agreements that exist outside of their purview. The global regulatory effort to lower counterparty risk is the chief driver behind this push, with centrally cleared or exchange-traded products being their preferred mechanism for trading. Not only are regulatory efforts around the globe pushing OTC instruments onto exchanges and central clearing mechanisms, but investors are also looking for new and better ways to attain desired exposure.

Asian exchanges can be expected to aggressively seek out new opportunities for growth through innovative product launches seeking to capture the attention of investors. Exchanges will look to launch products that replicate the characteristics of plain vanilla OTC instruments such as equity swaps and CFDs that can provide exposure to single stocks or broad market indices. As liquidity in these instruments coalesces around regional financial hubs, trading interest will build from both outside and within the Asian region. Standardized trading protocols and denominations that mitigate currency and exchange risk will be an added benefit, lowering costs for investors.

The TABB Group Vision Note **Innovations in Accessing Asia: Listed Equity Derivatives and Delta One Products** examines the factors influencing demand for Asian market exposure and the instruments they are using to gain access to the regions rapidly expanding markets. It also explores how the credit crisis has shifted investor preferences to centrally cleared and exchange traded instruments and also examines how global regulatory pressures to increase transparency and reduce risk will reinforce the trend. This vision note is based on conversations with key participants in the global derivatives markets including sell side brokers, market makers, hedge funds, asset managers, exchanges and technology vendors.

Table of Contents

Table of Exhibits