Accessing Asia Pacific Liquidity: Capitalising on Opportunities in a Rapidly Evolving Landscape

The Realization Group

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*In comparison to relatively stagnant rates of growth in the US and Europe, the dynamics of the Asia Pacific markets hold an obvious appeal. Financial institutions are increasingly keen to capitalise on these opportunities, while exchanges and trading venues are exploring practical ways they can increase and deepen levels of liquidity provision. In this report, Nicola Tavendale and Mike O'Hara of The Realization Group speak to **Brian Schwieger** of London Stock Exchange Group, Singapore Exchange's **Alex Lenhart**, **Paul MacGregor** of Berkeley Futures, Hong Kong Exchanges and Clearing's **Chris Lee**, **Jon Vollemaere** of R5FX, Pico's **Roland Hamann**, **John Knuff** of Equinix and Telstra's **Andy Mather** about the drivers behind these liquidity shifts and how technology and connectivity services are contributing to the region's prospects for growth.*

Introduction

The Asia Pacific growth story has been drawing the attention of the global financial markets for decades, with trading communities both inside the region and from other markets equally keen to capitalise on its ongoing evolution. Yet the area also presents a unique challenge for those seeking to access liquidity and for the firms who facilitate that access. Liquidity in the region is far from static, with significant differences not only in terms of country or regulatory regime, but also between instruments, asset classes and trading venues.

Even so, the rate of growth in nearly all exchange-traded instruments across the area outpaced that of many other global markets in 2018, according to data compiled by The World Federation of Exchanges (WFE)[1]. For example, currency futures volumes increased globally on the back of heightened volatility, with the largest year-on-year increase from the Asia-Pacific area at 65.9 per cent. The number of ETFs traded also rose across all regions, with the largest increase again coming from Asia-Pacific venues with volumes up 90.2% for the year, while the area accounted for over 50 per cent of global IPO listings (60.2 per cent) as well as investment flows (50.8 per cent).

The increase in global volatility over the past year has translated into a rise in trading volumes across nearly all Asia Pacific venues, with the Singapore Exchange (SGX) noting significant growth and seeing an increased level of interest from foreign participants wishing to access and manage Asian risk, says **Alex Lenhart**, Chief Representative US and UK at SGX. "This includes those hard to access jurisdictions, China and India, where we have a sizeable equity derivative futures footprint," Lenhart says. "If you juxtapose the growth in India, China and some of the other Asia regions with the growth rates in Europe and even the US, then you can understand why international investors are looking to explore and capitalise on some of those Asian opportunities by accessing derivative contracts in the various Asian jurisdictions."

[1] www.world-exchanges.org/news/articles/world-federation-exchanges-publishes-2018-full-year-market-highlightspressrelease

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SGX has increased its physical presence in the US and Europe in order to be able to access and educate potential investors. It has also extended its derivative contract trading sessions, which are now open during European and US trading hours, including the US close, according to Lenhart. “International participants can transact on SGX throughout their own trading day, which has in turn contributed to an increase in activity on SGX out of the West,” he explains.

“The past three to four years have also seen healthy growth in the number of international proprietary trading and market making firms trading into Asia”, adds **Chris Lee**, Managing Director, Hong Kong Exchanges and Clearing (HKEX). “We have seen a very steady growth in new firms coming to trade on our market from overseas,” Lee says. “Market hours have been extended across exchanges in Asia, including HKEX. That makes it easier for US and European prop firms and the buy side to trade our night session, which is their day session, and we only see that participation increasing.”

Open for business

HKEX has also made a number of structural changes in a bid to help facilitate access for hedge funds to access its markets, particularly equities. “China A share inclusion is a big driver for funds - especially passive funds that track indicies like MSCI Emerging Markets,” Lee adds. “The drivers for the cash market are still there while the derivative market is healthy in terms of growth of products as well as the number of new participants and firms that are looking to enter the space. All the winds are blowing in the right direction at the moment for Asia.”

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It is not only the exchanges located in Asia that have a vested interest in seeing this trading ecosystem continue to develop. London Stock Exchange Group (LSEG) has a long-term commitment to developing financial links with the Asian markets and with China in particular, says **Brian Schwieger,** Global Head of Equities and Co-Head Equity, Funds and Fixed Income, LSEG. The exchange group’s partnership with China has developed over the years to include a broad range of asset classes and securities, he says. “LSEG is a natural partner for China and Asia in terms of acting as a go-between for Western and Asian finance,” Schwieger explains. “In China, we have been focused on initiatives such the inclusion of Chinese A-Shares in FTSE Russell indexes and have recently started a new promotion for our real-time data services, aimed at Asian retail investors.”

In fixed income, the first offshore China RMB bond was issued in 2014 on London Stock Exchange, which has since become the leading hub for renminbi bond issuance in the western world. There are also about 20 ETFs listed on London Stock Exchange, providing access to the Chinese equity and fixed income markets.

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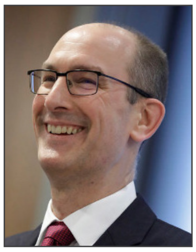

LSEG is also getting ready to launch its London-Shanghai Stock Connect project with the Shanghai Stock Exchange. The project is a two-way fungible depository receipt programme where Chinese issuers can raise capital in London and international brokers and investors can trade these instruments during the UK time zone, and vice versa. Schwieger adds that the sell-side and buy side community are ready to use the initiative as another efficient channel to access China. London Stock Exchange now has over two dozen brokers in China and Hong Kong who are interested in connecting to the exchange as to access underlying shares in each other’s markets. “They are actively engaging with us in order to be part of the bigger story of China’s process of economic reform.” he adds. “This only serves to demonstrate the importance of building relationships and taking a long-term view when dealing with the Asian capital markets. Many of the innovations we see underway today actually have roots going back some 20 or 30 years, and now markets and players have started to benefit from these innovations.”

Creating opportunities

Despite such initiatives, many of mainland China’s markets remain closed or difficult to access to non-domestic participants, warns **Paul MacGregor,** Derivatives Sales at Berkeley Futures. Yet he adds that there is also a growing dominance in Asia in the commodities space, with Berkeley Futures seeing strong demand from clients wishing to access these markets. “If you want to trade commodity derivatives on the Shanghai Futures Exchange or the Dalian Commodity Exchange, your only options are to be a physical hedge player, which would mean you could get domestic access, or to physically go to the country and register yourself as a local hedge fund,” he explains. “But there are still currency restrictions, making it difficult to move funds or profits out of the country. That is always going to be a challenge.”

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According to MacGregor, China is now slowly starting to internationalise some key contracts, with foreign participants able to partner with a domestic broker to trade Shanghai crude futures or iron ore on the Dalian Commodity Exchange. But India, the other large domestic commodity market in the region, is in many ways even more closed than China, he adds. “Even if you are a physical hedger selling products into the country, it is very difficult to get access,” MacGregor says. “You can however get a foreign participant’s license to trade the domestic equity index and FX markets. As an organisation, we have partnerships in place to allow us to facilitate access to some of the main offshore markets, such as equity derivatives or FX.”

Berkeley Futures also offers swaps as another solution to enable price exposure to most of China’s domestic commodity futures. “In India, because the London Metal Exchange (LME) and the Multi Commodity Exchange (MCX) lists the same metal contracts, we are able to facilitate a number of arbitrage opportunities between the two,” MacGregor adds. “In addition, we can look for FX opportunities between the price differentials on dollar-rupee derivative contracts available on the Dubai Gold and Commodities Exchange and SGX.”

Removing the barriers

Western firms are also keen to access Chinese capital through initiatives such as the RMB-denominated 'Panda bonds', bonds issued by foreign companies and sold in China. In 2018, Panda bond issuance reached 150 bonds, which was a significant increase in itself, says **Jon Vollemaere**, CEO at R5FX. "The other big development was the large number of Panda bonds issued by Australian banks, with Australian institutions now using the Chinese market for fundraising or capital raising," he adds.

However, many of these programmes involving London, not just from China but across the whole Asia region, are on hold pending the outcome of Brexit negotiations. "Firms haven't abandoned their plans as such, they are probably waiting for the dust to settle," Vollemaere adds. "But political stability and connectivity are an even bigger part of that story and will be essential to creating China's digital 'silk road'." This connectivity is already in place, but needs to continue to adapt and evolve in line with the technology developments elsewhere, Vollemaere explains. An important example of this is that China does not currently use FIX, but instead utilises its own version of the trading protocol. "Chinese systems don't communicate easily with other systems, because they aren't currently connected with these internationally used utilities," he adds. "The situation is similar to 10 years ago, before FIX became standard practice. There's a huge opportunity for firms to work with Chinese financial institutions, but it is dependent on the development of data centres, cross-connects and internal plumbing that does not exist yet."

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Jon Vollemaere, R5FX

In addition, the way firms want to access liquidity is very different and they do not all have the same requirements in terms of connectivity. For example, smaller trading firms in Asia are looking for easy access to European or US liquidity, says **Roland Hamann**, Managing Director, Global Head of Product, Head of APAC at Pico.

"Achieving fast and reliable connectivity globally between the three regions in a meaningful way can only be done via fibre connectivity," he adds. According to Hamann, exchanges who tend to find it difficult to attract flow outside of their home market are working with Pico to establish access points in different regions, using the firm's existing technology to help bring smaller regional players and the exchanges together. "This will create a meaningful improvement in terms of liquidity flows, particularly between the regional exchanges in Europe and Asia," he adds. Global tier 1 banks are also utilising the Global Ring and extensive data center presence of Pico to reduce their time to market for new builds in the fast growing APAC region.

Developing ecosystems

"We are increasingly seeing interest from Asian players wanting to access Malaysia, South Korea, Indonesia, and Thailand", continues Hamann. "In response, we will be building access into Thailand and South Korea in the next couple of months, followed by the other two hubs, so by the end of the year we will have created access to all three to meet our customer demand." Liquidity providers need to be aware that they will still face stiff competition, he warns, but the opportunities lie in having a good understanding of local laws, trying to find better financing for their trades and reducing clearance costs by going with the right partner.

This is also a key driver behind the popularity of hubs such as Sydney, Singapore or Hong Kong, where it is much easier to do business in English, explains Hamann. "Business friendly environments are very appealing to investment firms," he adds.

"Singapore is a good example of this, with a very forward thinking regulator who supports growth, including providing incentives for firms to locate their FX matching engines there and actively promoting fintech innovation." says **John Knuff**, Vice President of Global Ecosystems, Equinix, adding that there is a strong movement underway in Singapore to have more institutional FX trading not just sourced from Singapore, but also executed there. "This is also related to the emergence of some of the newer economies in Southeast Asia and their currencies becoming a bit more active," he says.

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Equinix is also working with several companies that are looking to improve connectivity with China and want to physically locate the trading infrastructure in Shanghai. Knuff adds: "They're trying to crack the code on how to access market data as well as connecting with counterparties. Figuring out the connectivity has been a bit of a learning curve. But in the last five years, China has also been actively changing some of the constraints that prevent international firms from accessing its markets." The broader landscape of Asia-Pacific exchanges is expected to evolve and create concentration points, such as Hong Kong and Singapore, according to Knuff. "We think the way it will play out is that some of these firms can trade in multiple countries, in multiple markets and asset classes from just one or two points, like they do now in, say, London and Frankfurt," he explains. "Equinix is helping facilitate this, for example with Nasdaq going into Hong Kong and being able to service their client base there."

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Tackling colocation costs

Market data, news and information that moves the market also needs to be available outside of the local market, continues Knuff. "The eye-opening moment for a lot of firms that have not been in Asia before is the cost to connect between the major cities and then back to their major trading hubs, like New York, London, Frankfurt, etc. Where we focus a lot of our time is in helping them with the right partners, like Telstra with their global network, and getting those new markets connected into the global backbone."

"One of the main barriers for entry that was preventing firms from being able to access new Asian markets was the cost of having to pay for bandwidth and connectivity even when not in use", explains **Andy Mather**, EMEA Financial Services Industry Specialist, Telstra. In response, Telstra has developed a consumption-based 'network as a service' solution, which provides the connection with clients only paying for their usage, even by the hour. "This removes the barrier for entry and allows firms to access markets that they couldn't afford to access before," he explains. "We also work with clients who want global visibility of their fragmented cloud computing storage, so we are helping them gain that level of transparency."

Many financial firms are refocusing on their core business activity realising that having an army of technologists isn't profitable in a new consumption-based world. "Companies who fill the need for this level of highly managed, customised service for their clients are experiencing strong growth as a result," Mather says.

Access to the base infrastructure technology but with the flexibility of having cloud-based, pay-as-you-go performance architecture is changing the business landscape. Firms want agility and much better levels of transparency in order to take advantage of the opportunities and growth available in these new markets."

"One of the main barriers for entry that was preventing firms from being able to access new Asian markets was the cost of having to pay for bandwidth and connectivity even when not in use"

Andy Mather, Telstra

Increasingly a number of firms are realising the need to have not only remote access to Asia but a physical presence there as well. "We're seeing a significant number of firms or service companies now asking for a local presence in the Asian market in order to better serve either their customer base or the clients to fulfil services with in Asia," he concludes. "They realise they must be more dynamic in their target market and there is now a widespread push, from the exchanges through to the technology providers, to facilitate that evolution."

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