ISDA has long had a strong presence in the Asia-Pacific region, and our attention to this dynamic part of the world continues to grow, as does the importance of the region in the global OTC derivatives markets.

You probably know we have three offices in Asia. We opened in Tokyo and Singapore in 2000, and in Hong Kong in 2007. But perhaps you don’t know how much wider a net we cast in the region. Our Asia-based members, who comprise about 9-10% of our membership, come from more than a dozen countries. These members cover a broad range of market participants, including corporations, investment managers, governments, supranational entities, insurance companies, commodities firms and banks. We have had directors on our ISDA Board from Japan, Hong Kong, Singapore, China and Australia.

ISDA holds a full slate of events in Asia-Pacific every year, including three large annual member “regionals”, as well numerous courses and symposia in cities throughout the region. We held the 2009 annual meeting in Beijing and, as you know, the 2006 event in Singapore.

Many of you here have met or worked with Keith Noyes, our Regional Director for Asia Pacific, who moderated yesterday’s Business Issues panel. He and his team are tireless in their work on behalf of our members across the region.

We would like to use the occasion of the AGM to introduce the new Asian OTC Derivatives Markets report, prepared by Oliver Wyman’s Celent division. It’s an excellent look at the size and characteristics of the region’s markets.

Celent analyzed the available data and spoke with a representative range of active Asia market participants to gather information for the study.

The study looks at the OTC derivatives markets in Australia, China, Hong Kong, India, Indonesia, Malaysia, New Zealand, Singapore, South Korea and Taiwan. It is available to anyone who wants to download it with a simple registration at ISDA.org.

I’d like to take a few minutes to highlight some of the findings of the study.

In 2012 there was $42.6 trillion in notional outstanding of derivatives in the Asian financial markets. This figure includes OTC derivatives in FX, Interest Rates, Equity Linked, Commodities and credit default swaps, but does not account for portfolio compression.

The market was adversely impacted for most countries in 2009, the immediate aftermath of the crisis. As you can see in the bar chart, growth has picked up again in earnest over the last year or so, with a 25 percent increase in notional outstanding from 2011 to 2012.

Turnover is largely in two asset classes, though FX derivatives make up more than three-quarters of the Asian OTC market. The multiple sets of rules and regulations in each country -- most importantly in the areas of currency regimes, capital control and currency management -- drive the need for hedging currency exposure and thus for foreign exchange swaps. Also, many global and regional firms in Asia
have operations in and financing needs from other countries, and this provides an additional impetus for FX.

Interest rate derivatives, the largest asset class in the rest of the world, are the second-biggest in Asia.

The OTC derivatives market, like other Asian financial services markets, is fragmented, with different countries having unique characteristics and varying levels of maturity. Singapore, Australia and Hong Kong, three countries with well-developed financial markets, are the leaders in OTC derivatives.

Driven by favorable regulations and its “offshore” status, Singapore is the dominant player in FX derivatives, the region’s biggest product. This city also accounts for the highest turnover in total across all OTC derivative products.

Australia is especially strong in interest rate derivatives, and across asset classes has roughly twice the derivatives turnover of Hong Kong. Australia’s FX derivatives trade is active in repatriating funds from offshore bond issues, and that is also a major driver of the country’s OTC business.

Hong Kong is the regional leader in the smaller asset class of equity-linked derivatives, followed closely by Singapore.

As you can see from this table, these three markets account for a minimum of 81% of the turnover in every asset class -- in commodities and CDS they essentially comprise the entire market. The other countries in our study each account for no more than 6% of product turnover in any given asset class.

A look at how corporates use derivatives sheds a little more light on how the use of these products more broadly reflects the real economy. This chart uses data from the five leading corporations in each market who also appear in the Fortune Global 500, a total of 25 firms. For the purposes of the analysis, banks in Australia, China and India were excluded, in order to get a clearer sense of non-financial market participation.

Derivatives used by the 25 top corporates in Asia not only reflect the broad importance of FX to the region, but also the importance of commodity derivatives given that large corporates are major participants in the energy and manufacturing sectors of the real economy. While commodity derivatives account for only around 3% of total turnover, they are a full third of corporates’ use by fair value.

Interest rate derivatives, which are significant for service firms such as telecoms, retain the roughly 28% share with corporates that they hold for the overall market. Credit and equity-linked derivatives, small in the overall picture, are virtually unused in the corporate context.

So that’s where we are today. Here’s where we’re going.

A majority of respondents to the Celent survey, 57%, predicted that their use of OTC derivatives would increase, and more than a third said it would stay the same. A few were unwilling to hazard a guess, but most telling, none said their use of derivatives would decrease.

One regional sell side firm that responded to the survey thinks turnover will increase primarily through customer activity. As corporates expand and grow more sophisticated, their need for risk management will also increase, creating a demand for legitimate hedging. The region’s fundamentals are fueling
growth. As that happens, the many uses of OTC derivatives will become relevant to more and more financials, corporates, and other non-financials.

Respondents also shared their views on the impending regulations related to OTC derivatives and the potential impact on their business. Only 8% felt that global regulations like mandated central clearing would negatively impact their use of OTC derivatives. 58% said there would be no impact and 34% said they were likely to trade more.

Among the range of responses, one securities firm said the regulations will increase the cost of doing business, and therefore potentially reduce market liquidity. They thought clients may get slightly more expensive contracts, and the market might become slightly more volatile. However, in their opinion, it is such a young market, and is being supported by net growth in the underlying economic activity, so the firm expects the demand for hedging will outweigh the regulatory burden.

Market participants also confirmed that a relatively small portion of transactions are being centrally cleared at the present time, as you can see in the blue pie chart on the left. Almost half claim that no transactions are centrally cleared, and 31% claim that less than a quarter of transactions are cleared, which means that three-quarters of the market does not actively clear transactions at the present time. A small percentage, 8% is very active in clearing OTC derivatives transactions, with over half of their transactions cleared.

But looking forward, market participants expect central clearing to be an operational reality. 46% expect to use local and regional clearinghouses, while 38% think it will be global clearinghouses. A further 8% see using both types as likely.

One Australian bank said that even though there currently is no Australian clearing house for OTC derivatives, they expect in the future to use a mixture of local and global CCPs. The criteria will be first that they have a level of comfort with the risk management position of the clearinghouse. Second is that the amount of volume going through the CCP is satisfactory – they want to go where the liquidity is.

This willingness to adapt to the uncertainty of the coming shape of the market – whether local, regional or global CCP -- was echoed by several other respondents to the survey.

These two pie charts reflect expected usage of centrally cleared derivatives on the left, and non-centrally cleared on the right.

Almost a third stated that they expect their use of centrally cleared OTC derivatives to increase, while nearly half expect it to stay the same. In other words, 77% of respondents believe their use will either stay the same or increase, pointing to healthy adoption of CCPs in the future. Only 15% expect usage of centrally cleared derivatives to decrease and only a small fraction are unclear or not sure.

However, 31% of respondents expect that their use of non-centrally cleared OTC derivatives will decrease in the future. This reflects the potential rise of more standardized products in the region. Curiously, an equally large percentage expects it to increase or stay the same. It appears there’s some uncertainty about the future of non-centrally cleared products in the marketplace, or at least healthy disagreement on the topic.
So while some uncertainty remains about the structure of the OTC derivatives markets in the years ahead, there seems to be strong anticipation that the market will grow and central clearing will be an important part of it.

This region is indeed poised for growth. ISDA, in turn, is positioned to nurture that growth through standardizing documentation for the region, engaging in regulatory outreach, educating market participants and guiding the development of the market’s infrastructure. Your presence and participation, whether through committee representation or attendance at events like these, is crucial to the process.

I want to thank you for that, and for your time this morning.