

**Accelerating
the future:**

**next steps in the path
to futurization**

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This report features in tandem with Eurex's recent 'Focus Day on Futurization' webcast with speakers:



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Introduction

The concept of futurization began in 2008 when Eurex launched its first dividend futures referencing the EURO STOXX 50[®] index. The new product offered dividend swaps users an exchange-traded alternative to the OTC market, bringing transparency, standardization, and capital and margin efficiencies to the trading ecosystem.

As the financial industry recovered from the global financial crisis, these efficiencies only increased in importance. Regulators made transparency and central clearing key pillars of a more secure derivatives market and constructed new rules based on those principles.

Uncleared margin rules are one of the main features of this new regulatory environment, which underwent a multi-year phase-in from 2016 until 2022. These rules have significantly increased the costs of trading OTC markets, with non-deliverable forwards, forwards, swaps, swaptions and FX options, among other OTC products, all coming under scope.

In this new world, futurization is an increasingly urgent theme for derivatives users. More market participants are seeking listed alternatives to OTC instruments. In the same year that UMR began, Eurex launched its first total return futures (TRFs) referencing the EURO STOXX 50[®] index. An alternative to the vibrant total return swaps market, these new products proved extremely popular with a sell-side focused on maximizing initial margin management.

These developments have essentially formed the first chapter of futurization – a move to listed equivalents of OTC instruments that increased the standardization and central clearing of derivatives markets as a whole. In dividend derivatives, this transformation has been so complete that the market is now widely recognized as an asset class in its own right.

However, no market stands still, and after the initial growth phases of dividend derivatives and TRFs, futurization now enters its next stage of development. As the market adapts to the dynamic needs of investors, new products will be launched.

There are already examples of this happening. In February 2024, Eurex launched mid-curve options as a listed alternative to swaptions – adding to the burgeoning dividend option market. However, the trend is also on the cusp of new and innovative directions. Investors increasingly demand exposure to non-European regions and customizable instruments, two areas expanding the exchange-traded format frontier.

In this whitepaper, published in tandem with Eurex's recent 'Focus Day on Futurization' webcast, we take a deep dive into these issues and cover the development of futurization and the effect it has on the dividend and total return markets, as well as its future paths for growth.

The recent path of development

Both the dividend derivatives and TRF markets have diversified exponentially from their foundations. In its first growth phase, the dividend futures market primarily consisted of hedge funds taking the other side of hedging flow from bank exotics desks' issuance of price return structured products. While TRFs also function as an important hedging tool for structured product issuers' long forward exposures, they initially emerged as an instrument for reducing sell-side firms' initial margin obligations.

However, use cases have expanded in the years since each product's launch. For dividend derivatives, a new turn for the market came in the aftermath of COVID-19 and the shock it delivered to structured products and their risk management. The market's risk profile shifted, and with more focus on risk management of shorter-term maturities, more investors began to use the derivatives as an alternative exposure to equity market performance.

"When you look at how the dividend market has behaved," says Antoine Deix, Head of Dividend & Repo Solutions at BNP Paribas, "notably during the COVID-19 crisis and subsequent recovery, dividend futures behave in their own way and with their own flows. That is a real sign that this has become an asset class in its own right."

For TRFs, the initial use case of regulatory management has broadened as more investors use the products to generate returns.

"UMR has made trading swaps more expensive, as market participants are required to post initial margin, which wasn't necessary before the regulation," says Damien Zinck, Vice President, Equity & Index Sales America at Eurex.

"In the case of total return swaps, the market looked for an alternative to the OTC model, so we designed TRFs with this in mind. The listed format allows market participants to have the same exposure they would get through swaps but through a more efficient and less expensive product."

"Also, even if you were not hit by this regulation, the ease of TRFs is attractive on its own. TRFs have all the characteristics of listed futures contracts, such as ease of trading, on-screen prices and cross-margining benefits. This ease drives adoption beyond the regulatory aspect."

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Head of Dividend and Repo Solutions, BNP Paribas

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Vice President, Equity & Index Sales America, Eurex

“Finally, many investors who could not trade swaps because they didn't have ISDA agreements and counterparty risk limits in place are now able to trade TRFs, so there has been adoption by these market participants too.”

As more market participants use TRFs, the number of trading strategies in which they are incorporated has grown as well. Hedge funds, for example, historically participated in the market by absorbing structured product hedging flows, like in the dividend futures market. In recent years, the diversity of hedge fund strategies in the market has grown, but the use of relative value strategies has also increased.

Dividend derivatives have also attracted interest from market participants drawn to the advantages of the listed environment. However, growth in activity has also come from more investors seeking to strip out the price exposure in equity performance and create a return profile based on earnings alone.

The rising popularity of earnings exposure is buoyed by the growing presence of new sectors in the dividend ecosystem. While the European banking sector has historically dominated the dividend derivatives market, oil & gas have become an increasingly important part of the complex in recent years. These and other sectors have contributed to the strong performance of the European dividend complex in recent years.

“After being overall stable in the last decade, the shock of the pandemic led to a complete reset in SX5E dips in 2020,” says Nikita Chhabra, Associate Manager, Dividend Research at S&P Global Market Intelligence.

“Thereafter, steady growth was seen from 120 in 2022 to 160 in 2024. This growth was driven by the banking, oil& gas and automobile sectors, benefiting from high interest rates, elevated oil prices and a transition to electrification.”

“Buybacks have also been a tailwind to support dividend per share growth. However, the outlook for SX5E dips is now less positive. Several sectors are reaching a peak in their distributions, linked to flat or decline in profits.”

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Nikita Chhabra
Associate Manager, Dividend Research, S&P Global Market Intelligence

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Kevin Soyer
Director, Equity Research, S&P Global Market Intelligence.

Dividend investors looking ahead to next year should also be aware of changes in the frequency of dividend payments, a trend that has strengthened recently. Dividend frequency is driven by a mix of issuers' desire to smooth out the cash flow coming from dividends, compliance with shareholder preference for more regular payments and following peers.

“When trading dividend derivatives, there is a short-term impact on single stock and index dividend futures,” says Kevin Soyer, Director, Equity Research at S&P Global Market Intelligence. “If a company switches from annual to semi-annual distributions, the annual contract will then include a new interim payment as well as the previous annual dividend, leading to a short-term increase.”

“This year, we have seen this trend in the banking sector with UniCredit, Mediobanca and Caixabank. We believe this could lead smaller-sized peers to follow those firms' example.”

That said, some big banks, like those in France, remain committed to their annual dividend payments, and we do not expect them to change in the short term, as they believe the annual cycle is the best reference period for assessing their performance.

“This shows an interesting divergence of cultures among different countries in Europe. In the Nordic and Southern Europe regions, companies increasingly move to more frequent dividend payments, particularly from annual to semi-annual.”

While the outlook for 2025 looks more flat, the overall track record of the market has been attractive enough to bring in new flows in recent years. Many new entrants have been real money investors, such as asset managers, insurance companies, pension funds, and family offices.

This segment of the investor base typically uses dividend futures either as a risk management tool for longer-term liabilities or as a beta replacement vehicle to express a long-term view of the market's direction while locking in an equity risk premium.

While the amount of trading strategies that employ dividend derivatives has increased in recent years, it's worth noting that hedging flow still constitutes an important source of flow to the market. In the aftermath of the COVID-19 pandemic, the rise of decrement indexes received much attention.

These synthetic total return indexes deducted dividend payments from their forward price by fixed amounts, thus stripping out dividend risk for issuers, who could set dividend payments in advance. With issuers able to cut their dividend exposures, there was less need to hedge positions by selling dividend futures. While this has reduced hedging flow somewhat, it has not had as dramatic an effect on the dividend futures market as some had feared.

“There are still hedging needs, and while decrement indexes' market share has grown, there is still large supply coming from the more traditional structured product issuance,” says Lorenzo Longo, Equity Portfolio Manager at Kedalion Capital.

“That typical demand and supply imbalance that has existed since the introduction of asset classes is still there. However, compared to the past, it's less prevalent and drives less of the current flows.”

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Lorenzo Longo
Equity Portfolio Manager, Kedalion Capital

New products blossom

The reduced structured product flow may once have seriously threatened the overall dividend market. However, as the strategies and products used to execute those strategies multiply, the market’s flow structure has become more diverse. A key factor in this development has been the growth of dividend options trading.

With Eurex’s successful launches of new dividend options, directional options and gamma trading strategies have become increasingly important in the market. The rise of EURO STOXX 50® index options has been especially significant, with a 15% year-on-year increase in activity for 2024.

“Options will naturally be in demand once a product is established as an asset class,” says Antony Harden, Executive Director, Sales Trader at Goldman Sachs. “Dealers will want to offset their gamma, so naturally, there will be better bidding for calls and puts, albeit with a preference to own downside.”

“Investors now can hedge their dividend exposure or express a directional view via options. However, given the directional volatility positioning of bank exotic desks, investors might decide that the premium from selling puts outweighs the comfort of buying calls, depending on the investor’s risk appetite. We will continue seeing this dynamic evolve as clients get more comfortable with the market.”

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Antony Harden
Executive Director, Sales Trader, Goldman Sachs

“ The ecosystem of mid-curve options that began with dividend futures is continually growing, offering a wider array of strategies that allow market participants to position more precisely



Lorena Dishnica
Vice President, Equity & Index Product Design, Eurex

The growth trajectory of EURO STOXX 50® index dividend options has been supported by strong liquidity in the futures and well-calibrated market-maker schemes. These features have built the foundations for a liquid market and reliable trading book.

The latest addition to the product suite has been the mid-curve option, a listed alternative to the swaption. In OTC markets, this was traditionally a fast money product, and that market segment has already established itself as a reliable source of liquidity provision to the exchange.

The mid-curve option offers swaptions traders an operationally simpler alternative to the OTC market, with more secure novation and the benefits of initial margin offsets.

Since their February launch, more than 160,000 mid-curve options on the EURO STOXX 50® index dividend futures have been traded. Traders are already comfortable using the product to trade anticipated economic events and corporate actions. Around 80% of trading activity is driven by market makers, with a smaller slice coming from agency

activity. The heavy presence of market makers indicates the liquidity and transactional ease that new entrants to the market can expect.

“The ecosystem of products that began with dividend futures is continually growing, offering a wider array of strategies that allow market participants to position more precisely,” says Lorena Dishnica, Vice President, Equity & Index Product Design at Eurex. “These new products allow traders to manage short-dated dividend risk and convex risk on long-dated dividends, providing more precise risk management tools in an accessible central market and having the flexibility to express their views on long-term dividend expectations using shorter expiry options, which is useful for anticipating changes in dividend expectations over the next five years.”

The rising drumbeat for customization

While the dividend derivatives market offers an increasing array of ways to fine-tune exposure, the TRF market embraces rising investor demand for customizability.

This trend initially contrasted with standardization, a fundamental principle of the exchange-traded offering. However, through innovation, Eurex merged the two concepts in the 2020 launch of equity and basket TRFs. Building on the success of the index TRF, the ETRF brought futurization to the single stock level, while the BTRF introduced OTC-style flexibility to the exchange environment.

ETRFs were built to replicate the return profile of an equity swap referencing an index-eligible company's shares. The futures can then be packaged together to form a BTRF, allowing multiple equity TRFs to be traded at the same maturity and spread.

Both products have provided sell-side equity financing desks with transparent, standardized and balance sheet-efficient instruments to manage their funding and sourcing needs.

"As a lender of stock and financing, we are perfectly placed to give cash to the market," says Grégoire Froehlich, Stock Lending Trader at Natixis CIB.

"While there is certainly balance sheet efficiency to be achieved with BTRFs, there are also gains from credit limit monitoring and standardization."

"When we operate in this market, we find that the balance sheet efficiency advantages are not as considerable as those from credit limits. These benefit us, as we are always trying to expand the array of products we offer to the market."

"Getting into BTRFs makes sense because it provides an actual solution to an actual problem – managing the balance sheet and credit limits for long-term, slow rotation financing positions."

These features allow for the classic benefits of listed instruments – a lighter documentation load and greater operational ease than the OTC market. These features also allow for greater automation compared to the TRS market. At a time when the sell-side is seeking to maximize workflow efficiencies across the trade cycle, the ability BTRFs offer to "trade and forget," as Froehlich puts it, is extremely attractive.

"Standardization and automation generally go hand in hand – you can't really have one without the other," says Tina Goldarreh, Trader at Goldman

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Stock Lending Trader, Natixis CIB

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Trader, Goldman Sachs

Sachs. “Credit risk, RWAs and margin – whichever metric you look at, the more you can centralize on one exchange, the better it is for you as a firm. The BTRF is the first product allowing the banks to centralize their funding requirements alongside their index products or single stock futures and client business. In terms of margin netting, this is obviously very significant.”

The cross-margin efficiencies that BTRFs offer are a first in the listed space. By allowing traders to cross-margin against multiple products and multiple counterparties, the instruments offer significant cost savings to their users.

Together, these features have opened the path to greater adoption of TRFs. As more market participants engage with exchange and clearing technology and workflows, futurization should inexorably grow as the format’s advantages become clear.

“As soon as the whole market is ready to adopt and work on those structures, there should be a natural shift from TRS to TRF because of the RWA benefits and balance sheet efficiencies,” says David Raccat, Co-Founder & Chief Revenue Officer at Wematch.live. “The industry will naturally require simplicity and standardization offerings.”

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David Raccat
Co-Founder & Chief Revenue Officer, Wematch.live

Index scope broadens

Another foundation of futurization is the index suite that references new and old products. A key indicator of the growing allocations made to the TRF market has been its growth beyond the Euro STOXX 50 product line.

This development has seen the successful growth of FTSE 100 TRFs after their 2022 launch. Likewise, the market's diversity has grown, with new investors and distinct market dynamics to the EURO STOXX 50® TRFs. While the latter's creation was closely tied to structured product flow, the FTSE 100 launch was driven by a need to hedge and the absence of a properly functioning underlying market to execute that function.

"Ultimately, there was a gap in the market with a very liquid FTSE 100 futures market and options offering," says Shawn Creighton, Director, Index Derivatives Solutions at FTSE Russell. "The market was really looking for this total return product, so it was a natural step to collaborate with the Eurex team to launch the FTSE 100 TRFs."

Momentum is clearly building in the TRF market despite the stringent conditions for launching an index TRF. Each Eurex TRF launch has resulted from extensive market consultation, which involves close collaboration with the index provider to create the underlying.

"Many items make for a successful match between an index and a TRF," says Sahand Taghizadeh, CFA, Head of STOXX Benchmarks at STOXX.

"One is the index methodology, which needs to be transparent, rules-based and replicable. Every market participant needs to understand the concept of the index and how it's constructed."

"That index also needs a well-established ecosystem, with many products tracking it. That could include futures, options, funds, ETFs or structured products. Such a system helps market participants manage their positions, and it's also a clear indication that the index is widely used and recognized in the market. That supports the final item, which is liquidity."

Since the EURO STOXX 50® and FTSE 100 TRF launches, Eurex has added MSCI and STOXX® Europe 600 TRFs to its product suite. However, expanding the range of referenceable indexes is also a trend in the dividend derivatives market. Regional expansion is likely as European dividend traders look to grow their range of exposures, with U.S. underlyings the strongest candidate for new indexes and derivatives.

The reasons for this are clear – the U.S. accounts for 70% of the market capitalization of indexes globally. European demand for U.S. exposure has

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already resulted in the creation of STOXX fixed number indexes that serve as an alternative to the high-profile classical U.S. indexes. Eurex also already hosts dividend futures liquidity in single stock names such as Apple, Amazon and Nvidia.

On top of this, a U.S. structured product market is growing, and while much smaller than the level of European issuance, it is still producing the hedging flows that form the base of a dividend derivatives market.

“Given the ecosystem that has developed around dividend derivatives and TRFs, the next step in the natural evolution of these products is the U.S. dividend market, says Serkan Batir, Managing Director, Global Head of Product Development at STOXX. “While such products will never displace the classical US indexes as the number one product for the region in the U.S., the strength of the European ecosystem can support a strong alternative to those U.S. products.”

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Serkan Batir
Managing Director, Global Head of Product Development, STOXX

Conclusion

Futurization began as a trend in 2008, as the global financial crisis began its tailspin. In the following years, regulators' desire to safeguard financial markets against a repeat catastrophe has accelerated the trend.

If the years since have been about establishment and maturity – launching dividend derivatives and TRFs on Europe's benchmark equity indexes and building reliable liquidity around those products – futurization is indisputably now entering its second phase.

This phase is one of innovation and expansion. Innovation may already be ingrained in both markets, given the technical work needed to bring complex OTC instruments into the exchange-traded environment. Certainly, the launch of mid-curve dividend options earlier this year shows that innovation is a constant feature of futurization.

However, with investors' demand for increasingly sophisticated trading strategies that require customizability, futurization is entering a new phase in which exchanges offer more flexibility traditionally associated with OTC markets while retaining the advantages of standardization and clearing.

About Eurex

Eurex stands for the leading European derivatives exchange and – with Eurex Clearing – one of the leading central counterparties globally. Being architects of trusted markets characterized by market liquidity, efficiency and integrity, we provide our customers with innovative solutions to seamlessly manage risk. On the trading side, we mastermind the most efficient derivatives landscape by pioneering ingenious products and infrastructures as well as by building 'smart' into technology – offering a global product range, operating the most liquid fixed income markets in Europe and featuring open and low-cost electronic access. As central counterparty, Eurex Clearing builds trusted relationships with and amongst market participants, enabling effective risk management and delivering high efficiencies to clients.

Architects of trusted markets

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