CHAPTER 8
SUMMARY, CONCLUSIONS AND SUGGESTIONS

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8.1 Introduction:

The introduction of financial derivatives and specially the equity derivatives on the exchange traded platform have revolutionized the landscape of financial industry across the globe. The Equity derivatives have gained extremely significant place among all the financial products. Derivatives are risk management tools that help in effective management of risk by various stakeholders. Derivatives are used to transfer risk, from the risk averse to the one who is willing to accept it at a cost.

The growth of derivatives market in India has been phenomenal in a short span of just over a decade. Derivatives are now widely used as a risk management tool that helps in effective management of risk by various classes of investors. After introduction of derivatives market, in a span of three years the derivatives turnover in the equity derivatives market surpassed the total turnover of its underlying that is of the equity market. Overall, the Indian Equity derivatives market found the experience to be extremely encouraging and successful. The turnover of equity derivatives in India increased from Rs. 2,365 crores in 2000-01 to Rs. 31,349,731.74 in 2011-12. The growth of equity derivatives market again emphasizes the strengths of India’s securities markets, which are based on nationwide market access, anonymous safe and secured electronic trading. There has also been a shift observed post 2008 market fall to the preference given to Stock index options, which proves that the Indian investors are increasingly using derivatives as a tool for hedging and to de-risk their current investments. Even though we have seen the growth in the derivatives market, the steps taken towards opening of the market is considered to be slow. Also the steps taken to develop the market are considered to be reactive than the proactive. Even today, there have been a large number of investors who are not completely aware of derivative products, their usage, benefits and various strategies that can be used in the derivatives markets. Thus, there is a need to take aggressive and rapid steps to educate investors.
across nukes and corners of the country. Factors like the growing integration of national financial markets with international markets, development of more sophisticated risk management tools, wider choices of risk management strategies to economic agents and innovations in financial markets space, robust risk management, strong participation in the market by investors institutional as well as retail, and supportive regulatory framework have been driving the growth of financial derivatives worldwide and as well as in India. The conclusions drawn and recommendations made from the research study are brought down below:

8.2 Conclusions:

1. Exchange traded derivatives market helps investors in many different ways in planning the finances, hedging/mitigating various risks, appropriate price discovery, arbitrage opportunities, ease of speculations etc. There are various strategic applications, uses and benefits of the equity derivatives market in the Indian Markets in today’s economic scenario such as providing efficiency to capital markets, helping investors in mitigating risks, providing equitable price discovery, comforting foreign investors, creating jobs and developing human capital, preserving value of assets during stressed market scenario and many more ways.

2. In comparison with the equity segment, currency derivatives and interest rate derivatives, the turnover of equity derivatives clearly shows that equity derivatives have become very prominent in the recent years. Equity derivatives market in India has grown in leaps and bounds and is poised to grow further. The progress of the derivatives market in India has been quite satisfactory and it grew at very fast pace. The equity derivatives volume has grown at an average annual growth rate of 107% year on year since 2001-02 till 2011-12.

3. Equity derivatives turnover has surpassed its underlying turnover in the financial year 2003-04 and today stands far taller than its underlying turnover. The equity derivatives turnover was 12.66% of its underlying equity market turnover in the year 2001-02. Today, in 2011-12, the equity derivatives turnover is 924.51% of its underlying equity market turnover.
4. Derivatives market growth has continued irrespective of equity cash market turnover growth. Equity market turnover has grown by 4.24 times during the period from 2001-02 to 2011-12, whereas during the same period the equity derivatives market turnover has grown by 310 times. The equity market turnover has shown intermittent declines in the turnover recorded on the equity exchanges whereas during the same period the equity derivatives turnover has continuously been steadily rising.

5. Even though at the time of launch of equity derivatives trading in India in 2000, BSE was having market share of around 45% and NSE was having market share of 55%, the market share in the equity derivatives was cornered by one stock exchange. Equity derivatives business is highly concentrated on only one Exchange in India which is NSE which accounted for more than 97.5% of the total turnover in the equity derivatives market in India. Thus, NSE has always remained the market leader in the equity derivatives market for providing the trading platform in Equity Derivatives market in India.

6. In 1994-95 in the equity segment, BSE had 97.40% of market share and NSE has 2.60% market share. NSE slowly and steadily gained market share and reached a market share of 55% in 1999-2000 and BSE’s market share was reduced to 45%. After the introduction of Equity derivatives in 1999-2000, the market share of NSE in equity has slowly grown further and in 2011-12 it has gone up to 80.81% and BSE’s market share has reduced to 19.19%. One of the reasons for this growth in the equity market share of NSE during the period from 2000-01 till 2011-12 can be the high concentration of equity derivatives business on NSE.

7. Since 2001-02 there has been shift in the trend of preferred product types in the market. There has been a slow and steady shift of the preference of investors from Stock Futures to Stock Index Options after the market crash in 2008. In 2001-02, turnover in Stock Futures accounted for 50.04% of the total turnover, followed by Stock Options accounting for 24.34% and then by Index Futures accounting for 21.91% of the total turnover. The Index Options accounted for only 3.71% then. The Stock Futures continued to dominate till 2007-08 followed by Index Futures.
However, post market crash in 2008 the trend changed. Index Options which accounted for hardly less than or near about 10% till 2007-08 started gaining prominence. In the financial year 2011-12, the Index Options became the most preferred product in the equity derivative markets accounting for 72.57% of the total equity derivatives turnover, followed by Stock Futures with 12.70% and then the Index Futures with 11.68% of the total equity derivatives volume. Stock Options hardly accounted for 3.04% of the total equity derivatives turnover in the financial year 2011-12. This can probably be assigned to the cautious approach of the investors now to hedge their positions against any sharp and sudden fall in the equity market.

8. Globally in the financial derivatives, in 2011 the equity derivatives accounted for almost 70% of the contracts in terms of volume, followed by Interest Rate derivatives accounted for 16% and the Currency derivatives accounted for 14% of the total global derivatives contracts volume. The equity derivatives have seen the 13.7% growth in 2011 over 2010 driven by index and ETF derivatives. Similarly the interest rate derivatives grew by almost 8.9% in 2011 over 2010. The currency derivatives witnessed the highest growth rate of 24.4% in 2011 over 2010 and whereas the commodity derivatives contracts saw decrease of 34% in volumes in 2011 compared to 2010. Hence, globally the equity derivatives are the most preferred investment products amongst all the exchanges traded derivatives.

9. Globally, Asia Pacific region has a whopping share of 83.05% in the Index Options, followed by Stock Futures with 30.54%, then the Index Futures with 24.28% and then the Stock Options with 7.18% of the total global contracts traded in the respective equity derivatives products. In terms of the turnover in the equity derivatives product, again Asia Pacific region has a leading share of 62.21% in the Index Options, followed by Stock Futures with 30.87%, then the Index Futures with 25.83% and then the Stock Options with 5.44% of the total global turnover in the respective equity derivatives products. It is also pertinent to note that this whopping market share is attributed to the Index Options trading on the NSE.
10. Equity Derivatives Market in India is a force to reckon and has become one of the important parts of the global derivatives market and gained considerable market share as the Indian Equity Derivatives Market developed over a period of time. NSE is ranked 2\textsuperscript{nd} in Index Options, 4\textsuperscript{th} in Index Futures and 5\textsuperscript{th} in Stock Futures in terms of number of contracts traded globally in the calendar year 2011 as per World Federation of Exchanges. Also, Nifty Index Options have been ranked the world’s 2\textsuperscript{nd} most traded option in calendar year 2011 as per Futures Industry Association.

11. Globally, since 2010 several exchanges have started offering trading services allowing domestic investors to trade foreign stock index options and futures. In 2010, Eurex started offering KOSPI 200 index options. In October 2011, Honk Kong Exchanges and Clearing, BM&FBOVESPA, National Stock Exchange of India, Bombay Stock Exchange, Johannesburg Stock Exchange Micex and RTS decided under an alliance agreement to cross-list each other’s stock index options and futures contracts. This trend of cross listing is gathering momentum and at this stage it is too early to make any comment on whether they would attract significant volumes in those indexes.

12. Indian equity derivatives markets have grown in last decade in leaps and bounces. It is now going globetrotting with the stock indexes getting listed on other exchanges and also attracting the foreign investments in India by providing them another tool in the form of equity derivatives to hedge their positions and provide the much required liquidity to support their investments and exits with the market which can facilitate the same at the much lesser cost and impact than the actual underlying equity cash market. Even though the Indian stock exchanges, especially NSE, has been featuring in the top 10 exchanges globally in terms of Stock Index Options, Stock Index Futures and Single Stock Futures, the Exchanges are still to make inroads in the top 10 exchanges in terms of trading in Single Stock Options in terms of number of contracts traded globally.

13. Since beginning of the equity derivatives market, SEBI has set up a stringent regulatory framework on the basis of the reports from various committees such as Dr. L.C. Gupta committee and Prof. J.R. Varma
committee. SEBI has laid down the criteria for forming equity derivatives exchanges and clearing corporations, market structure, risk management system, sales practices, client registrations, trade guarantee fund, investor grievances, arbitration mechanism, margining system, collateral management, capital management, admission of brokers, net-worth criteria, position limits, inspection of brokers, product specifications and corporate actions etc. SEBI has also made changes in the risk management framework, collateral management, client registrations etc as and when the need arose. SEBI as a regulatory body has played very important role in developing the equity derivatives market in India. The regulatory body has also ensured putting in place a robust risk management system that the equity derivatives market in India has been less prone to manipulation.

14. SEBI has also allowed introduction of new products such as stock futures, stock options, mini derivatives contracts on indexes, long dated options, interest rate futures, currency futures, physical settlement of stock options and futures, derivative contracts on foreign indices on Indian Exchanges etc in order to provide a further fillip to the market and ensure that the market keeps pace with global developments.

15. The regulatory authorities and the exchanges have been encouraging the corporatization of the brokering industry. As a result, a number of broker-proprietor firms and partnership firms are getting converted into corporate bodies. At the end of December 2011, 814 brokers out of total 903 on BSE and 1149 brokers out of total 1329 on NSE representing 90.1% and 80% were corporate entities. This reflects the conscious decision of the Exchanges and regulators to ensure quality broking services in India.

16. There has been increasing trend of clients using screen based trading or internet trading. This empowers the clients by way of comfort and confidence upholding price information and trading activity.

17. Today, with the advent of technology and increasing competition, broking services are offered to clients at very low cost which is even less than 0.1% of the total traded value. This used to be as high as 1% or more during 2000-01. The brokerage rates have come down considerably and
today the customer in true sense has become king in the financial services sector.

18. Even though the brokerage rates have been slashed, the broking companies are increasingly facing the heat of competition and are providing value added services such as access to global trading platforms, research services, analytical tools etc in order to retain the clients and discouraging them from migrating to the competitors. Further, with the margins more or less continuously under pressure, brokers have been reducing overheads, which largely translate into cutting staff. We have been reading about this in the media and have seen this happening in last few years.

19. The old structures of brokeship organizations and exchanges are disappearing and derivatives exchanges are merging or forming alliances due to increased competition for its survival globally. The trend has been seen in Currency Derivatives in India. Now, with the entry of the third equity derivatives exchange, the dynamics may undergo change and may see some changes in the exchange structures. There are few other exchanges that are looking forward to equity derivatives membership. We have already seen the changes in the structure of other market intermediaries where they are increasingly getting into diversified businesses to keep themselves afloat where the income from the pure broking activity has taken a huge deep. There has been increasing interest by large brokers in focusing on their clearing services to generate profits from this sector.

20. Cross margining benefits available to clients for trading in equity market and the derivatives markets of the same exchange are also leading to concentration of trading activity on one exchange. NSE has been controlling almost more than 97.5% of the market share in the equity derivatives market in India. We have seen over a period of time, the underlying market share of NSE going up to 80% and BSE being reduced from around 40% to 20%. One of the reasons for the shift of volume can be attributed as cross margining benefit available to clients on NSE as shifting their regular equity trading activity NSE can help the clients manage their capital efficiently.
21. Technological advancement in terms of internet trading, Direct Market Access (DMA) to institutional clients including FIIs, Co-location facility where broker can have a server located in the exchange premises, algorithmic trading, mobile trading etc are gaining prominence day by day and volumes are getting shifted to the users of these technologies.

22. With the persistence of the changed industry dynamics, market players continuously focus on containing costs, restructuring business models and relatively larger players with access to capital are exploring alternate sources of revenue and profits. The last few years have also seen a more focused attempt by brokerage houses to de-risk business models by continued diversification into many related as well as unrelated businesses like commodities broking, currencies broking, commodities and currencies proprietary trading, capital market financing, mortgage financing and gold loans. However, the smaller players have not been able to come out of the bad situation which started taking a toll on them since 2008.

23. With regard to the requirement that only Equity Derivatives Certified person should operate the trading terminal, almost 80% of the broker respondents felt that the terminals should be operated by certified dealers only. The main reason for large number of broker respondents feeling the need is that any misconduct or mistake of the dealers, the broker is liable for his/her action. It is also understood that the chances of certified dealers doing the mistake are less or gets reduced than the completely naïve dealer operating the terminal. However, it was also felt by almost 63.80% broker respondents that the Equity Derivatives Certificate requirement for the dealing terminals used for Algorithmic trading should be relaxed.

24. 71.30% broker respondents felt that there should be a basic assessment by way of test taken up of investors before being allowed to trade in the equity derivatives market for the first time. The test may cover various aspects like products in the equity derivatives, margin requirements, their rights and obligations, risks associated with derivatives trading etc.

25. The contract design employed in the equity derivatives market in India has been a spoilsport in terms of keeping away the retail investors from larger participation in the equity derivatives market. Almost 50% broker
respondents felt that there is a need to reduce the contract size value of the
derivatives contracts existing today from Rs. 2 lacs. Out of these 50% broker respondents, 28.8% felt that the contract size value should be in
the range of Rs. 1 lac to Rs. 2 lacs and 20% felt that the contract size value should be in the range of Rs. 50,000 to Rs. 1 lac. Further, 92.4% of
the investor respondents felt that the contract size should be reduced from
the existing contract size value of Rs. 2 lacs. Out of total investor respondents 35.5% felt that the that the contract size value should be in
the range of Rs. 1 lac to Rs. 2 lacs, 32.2% felt that the contract size value should be in the range of Rs. 50,000/- to Rs. 1 lac and 26.1% felt that the
contract size value should be in the range of Rs. 10,000/- to Rs. 50,000/-.  
26. 71.30% of the broker respondents and 85.6% of the investor respondents feel that both the Indian Equity Derivatives Exchanges should start the
physical delivery derivatives contracts.  
27. The use of the capital deployed by the brokers by the exchanges is largely adequate and the same is effectively used and 88.80% broker respondents are satisfied with the same.  
28. 68.8% broker respondents feel that the margins charged in the equity derivatives segment are excessive. It was also understood from some of
the brokers that sometime in the past, the exposure margin charged was
even higher than the initial margin collected on some of the scrips which
should not have been the case since Initial margin covers 99.99% risk. 68.9% of the investor respondents feel that the margins levied in the
equity derivatives market are excessive.  
29. 13.8% broker respondents feel that the risk management system adopted by the exchanges is excellent, 66.3% broker respondents consider it to be
strong and 18.8% consider it to be medium strong. Thus, largely the broker respondents feel that the risk management system adopted by the
equity derivatives exchanges is adequate.  
30. There are various risks that are embedded in the equity derivatives segment namely Systemic risk, Market risk or Price risk or Potential Loss
risk, Settlement risk, Credit risk or Counterparty Default risk, Liquidity
risk, Operational risk and Legal risk. Almost, 41.3% broker respondents
felt that the Market Risk/Price Risk/Potential Loss Risk is of a prime
concern to them, 37.5% broker respondents felt that the Systemic Risk and 10% broker respondents felt that the Operational Risk is of a prime concern to them. Similarly, 56.9% investor respondents felt that the Market Risk/Price Risk/Potential Loss Risk, 29.2% investor respondents felt that the Operational Risk, 12.5% investor respondents felt that the Systemic Risk and 1.2% investor respondents felt that the Liquidity Risk is of a prime concern to them.

31. SEBI had laid down the criteria for inclusion of stocks in the equity market derivatives and the same has been modified from time to ensure the integrity of the market. At the time of introduction of the equity derivatives on the single stocks in 2001-02, there were 31 stocks included in the list which subsequently went up to more than 250 stocks. The list of stocks in the equity derivatives was subsequently brought down to 151 as of today. 55% broker respondents feel that the criteria for selection/inclusion of the stocks in the equity derivatives market should be relaxed. Out of remaining broker respondents, 50% (i.e. 22.5% of total respondents) feel that the criteria should remain as it is and 50% (i.e. 22.5% of total respondents) feel that the criteria should be made stricter.

32. Since the launch of equity derivatives in the Indian markets, there have been limited products on the stock exchanges available for trading to the investors. 75% of the respondents feel that it is ripe time now to introduce the other complex products like exotic derivatives, ETF derivatives, interest rate options, structured products etc. in the equity derivatives market. However, they also felt that these products should be restricted to only banks, financial institutions, FIIs, Sub-accounts, Mutual Funds, Insurance companies etc and not be extended to retail investors. 87.2% of the investor respondents feel that the time is ripe to introduce the above mentioned complex products in the market. However, they are also of the opinion that this should be extended to only banks, financial institutions, FIIs, Sub-accounts, Mutual Funds, Insurance companies etc and not to the retail investors.

33. Indian markets are increasingly getting integrated with the global markets. It was observed that the foreign institutional investor exposure to Nifty futures traded on the Singapore Exchange (SGX) had hit a record high in
the month of October 2012 overtaking the Open Interest on the NSE. This export of Indian equity derivatives market has been attributed to various factors such as difficulties in doing business in India, higher transaction costs, currency risk, lack of clarity on some taxation and regulatory issues. 93.8% of the broker respondents feel that the export of volume and trading activity to the offshore exchange mainly SGX can be attributed to higher transaction costs in India compared to those on the offshore markets.

34. 87.5% of the broker respondents are of the opinion that the Custodial Participants and other big clients bringing in collateral of more than Rs. 1 crore should be permitted to directly pledge the collateral with the Clearing Corporation of the Exchanges. This would be giving the brokers a huge relief in utilization of their capital and the funds which are currently being placed as a back to back arrangement with the Clearing Corporation to get exposure limits for the collateral received from the Custodial Participant and the big clients which is just kept as security or margin requirement without getting any economic benefits out of the same thereby increasing cost of capital to the brokers.

35. The market participants normally complain about the regulators being very strict and do not act taking into consideration the practical aspects of implementation of directives they issue to the exchanges and the participants. One of the strongest criticisms against the SEBI is that it adopts rule based regulations. There is a plethora of rules that the intermediaries in the system are required to adhere. Principle based regulation points to the success that the Financial Service Authority (FSA) has had in UK. It is said that FSA will intervene only if a situation warrants such intervention, say, if certain undesirable outcomes have resulted. Almost, 70% of the broker respondents feel that there is a need for the regulatory body to shift from rule based regulation to principle based regulations.

36. A large number of investors who invest in derivatives market are well educated persons. It can be seen that 98.5% of investor respondents are graduates and above, whereas only 1.4% investors are below graduation.
37. 66.9% of investors have not undergone any training before starting the derivatives trading activity either from the exchanges or broking entities or any other body. SEBI had made it mandatory only for the employees of the brokers who are manning the dealing terminals to obtain Equity Derivatives Certification. 33.1% of investors in the equity derivatives market had undergone some training. This could be due to since there are many brokerage houses which offer online trading platform to clients have been training the clients on how to use their trading website and imparting training on various products including the equity derivatives products. However, a whopping 96.4% of total investor respondents felt that there is a need for all the investors to undertake some training before starting the equity derivatives trading activity.

38. There are a large number of investors who might be staying away from investing in the equity derivatives market due to lack of knowledge of derivatives. There is a need to focus on investor education to make them understand the pros and cons of the equity derivatives, its benefits and usages to be spread to the general public at large to get larger participation from the retail investors and educate them about equity derivatives being another investment avenue which can help them in protecting their assets in the event of any sudden big falls or unforeseen events affecting the securities markets adversely.

39. The most preferred product by the investors is Index Options. Almost 50.7% of the respondents conveyed the Index options as the most preferred product. Further, normally it found that the large number of investors carry out the trading activity in the equity derivatives trading for speculation, followed by index futures and then the stock futures. The investors largely do not use any strategy. The trading activity carried out by the investors in the equity derivatives market is of a generic nature without knowing which strategy is being used by them. Further, contracts expiring in One Month, i.e. current month, are found to be most frequently used contracts by the investors at large in the equity derivatives markets in India.
40. Largely, retail investors are found to be using the derivatives products for the purpose of hedging and speculation. It is seldom found that the retail investor uses the derivatives platform for arbitrage purpose.

8.3 Suggestions:

1. Even though today, many large issues are being addressed by the Government and the regulatory body, it is perceived that the regulatory body is moving at a snail’s pace in terms of liberalizing the equity derivatives market and making it accessible to large number of investors with bouquet of products to invest or trade. It has been often seen globally that the strongest barriers to derivative markets are often government policies or regulatory restrictions. Thus, the openness of the government and the regulatory bodies to quickly comprehend the pace required for the derivatives and adapt to the quick changes happening in the derivatives market is primary thing required to give a further boost to the existing derivatives markets. There is a need felt to expedite the regulatory clearances and clear Government policies in order to give further fillip to the growth of the equity derivatives market in India.

2. Many times, the decisions by the regulatory authority are driven by the pre-conceived notions coupled with the fear of taking a decision which may boomerang. Thus, the regulatory body tends to take a very cautious approach with focus on avoiding controversies and to safeguarding themselves from any CAG or Parliamentary questions. This leads to either indecisiveness or formulating stringent norms for the market without having any practical approach but which is rather governed by the conservative approach. Thus, it is felt that the government should give appropriate comfort to the regulatory bodies to encourage quick and practical regulatory approach to remove indecisiveness and conservative approach to decision making.

3. Regulators are normally considered to be risk averse. Due to nature of derivatives products, there is fear that it causes an exponential upsurge of risks and exposures which may lead to causing systemic collapse, derivatives stimulate price speculation resulting in increased volatility, derivatives market substitutes the underlying market etc. All the above
factors force government body and the regulators to be apprehensive about the derivatives markets and in turn affect the decision making. Thus, it is felt that the regulatory bodies should take more pragmatic approach to equity derivatives and rather than looking at the disadvantages of derivatives products should look at the advantages and usage of derivatives product while taking the decisions with regard to equity derivatives market.

4. The investigation orders passed by the regulatory body so far shows that there has been large focus only on the manipulations in the equity market and the regulators are able to convict the manipulators in the equity market. There have been hardly any orders passed against the manipulations carried out in the equity derivatives market. This can be attributed to the limited knowledge of the investigating authority about the derivatives market and the instruments and also about the manipulative activities that can be carried out in the derivatives market. Thus, there is a need to increase vigilance through highly skilled employees specifically in the area of derivatives by the regulators and the self regulatory organizations to give comfort to the investors in the equity derivatives market at large.

5. There has always been ambiguity on the tax treatment for the earnings from transactions in equity derivatives. In the initial years of derivatives, there has been lot of ambiguities in terms of what taxation laws would be applicable to these types of transactions. Even though there has been some clarity available now on the treatment of income from the trading in Equity Derivatives, there are still few areas which are ambiguous and they need to be clarified. Besides this, if there are complex products which would be added to the equity derivatives market this would create further ambiguity on the tax treatment for such products. Hence, there should be clarity given by the tax authority in this regard. Also, clear and simple guidelines should be given on the tax treatment to be given to all types equity derivatives income and losses for all classes of investors be it Indian, NRI or Foreign Investor.

6. Even though the growth has been robust in the derivatives market in India, there is still lot more needs to be done to increase the participation
in the equity derivatives market by educating the investors at large. There are a large number of investors who do not invest in the equity derivatives market due to lack of knowledge of derivatives. Hence, there is far higher need to educate the general public at large about the investment avenue in the form of equity derivatives, the risks involved and its advantages, to make them understand the pros and cons of the equity derivatives, its benefits and usages etc. These steps may help in spreading the equity derivatives knowledge to the general public at large to get larger participation from the retail investors.

7. There is great need to spread the use of derivatives and its importance in order to get the larger participation in the equity derivatives market in India. The Indian investor, though familiar with forward trading under badla system, derivatives trading strategies are not yet familiar to him. There is a need felt for imparting the knowledge on the large scale to the investors about the same. For this purpose, SEBI and the Exchanges need to play bigger role in educating the public at large to increase further participation in the equity derivatives market in India.

8. Security transactions on the stock markets in India attract various taxes and charges such as Brokerage, Exchange transaction charges, SEBI Turnover Fees, Stamp Duty and Securities Transaction Tax (STT). According to an IMF paper, the trading costs in India are considered to be at the higher end of the range after China and Hong Kong. However, these countries do not have any statutory levies as high as in India, especially in the form of STT. It is also felt by the market intermediaries that high transaction cost has reduced market depth and liquidity, increased volatility and made Indian markets less competitive than its global peers. Thus, the Government and the regulatory bodies need to take steps towards rationalizing this structure to bring back the market depth and in turn the liquidity to the equity derivatives market.

9. On drawing inferences from the Korean markets which can be considered to be relevant in terms of market size and dynamics which are somewhat similar to the Indian markets. The Korean markets were of a similar size in 2003, but currently the Korean market volumes are almost five times the Indian market volumes. This has been largely attributed to various
factors including a reason that Korea does not have a STT like levy and is often cited as the reason for the large volumes. In the Indian markets, STT typically constitutes 52% of the over-all taxes and levies of a futures transaction. Thus, the Government should take steps towards either reducing STT or removing the STT in order to give further fillip to the market.

10. The treatment of profit or loss arising out of derivatives trading is not clear. Due to lack of clarity, there could be many players and investors staying away from market especially the cautious foreign players. Thus, the Government should take steps to remove this ambiguity and give a clear direction on the same.

11. Indian markets are increasingly getting integrated with the global markets. It was observed that the foreign institutional investor exposure to Nifty futures traded on the Singapore Exchange (SGX) had hit a record high in the month of October 2012 overtaking Open Interest on the NSE which clearly highlights the continued export of India's financial markets to offshore exchanges amidst relative ease of doing business and greater offshore regulatory clarity. This export of Indian equity derivatives market has been attributed to various factors such as difficulties in doing business in India, ineffective policy interventions such as transaction cost non-rationalization, not giving clarity on taxation and regulatory issues. Thus, the Government needs to take quick and concrete steps towards providing ease in doing business in India, effective policy interventions such as transaction cost rationalization, clarity on taxation and regulatory issues to stop such export of equity derivatives market activity offshore before it is too late.

12. Increasingly, there is a trend seen where the equity derivatives trading activity has been slowly and steadily shifting to the commodity markets as well. Commodity trading in India does not attract any taxes equivalent to STT like Commodities Transaction Tax (CTT). The increase in commodity derivatives volume has been seen in the last five years at the expense of equity volumes which can be largely attributed to the absence of level playing field. It is widely believed that the low cost environment of commodity trading is attracting day traders and jobbers, diluting one
vital source of liquidity in the equity markets. Thus, Government needs to take steps to provide level playing field to both these markets and allow the growth of equity derivatives market in India.

13. In India, Stamp Duty is a State subject & since all States have their own individual Stamp Act, the provisions of respective States Acts is applicable. Further, there is so much of ambiguity in terms of charging the Stamp Duty in various States in the minds of brokers due to lack of clarity and confusions created because of trading activities carried out in various jurisdictions by their clients. Due to this ambiguity, many brokers are caught on the wrong side of the law where they would be required to bear the stamp duty from their own pockets at the later stage of the claim from the State Governments. Thus, there is a need to introduce a unified rate of stamp duty on a Pan India basis and the Government needs to expedite the process of amendment of the Indian Stamp Act at the earliest. Maybe Government also ought to think on withdrawal or substantial reduction in Stamp Duty to keep the Indian Capital markets competitive in the global environment.

14. In India, FIIs are not allowed to participate in the Currency Derivatives without prior approval of RBI. Thus, FIIs who are not allowed to trade currency derivatives on local exchanges like NSE and MCX-SX access the Dubai Gold & Commodities Exchange (DGCX) to bet on the rupee versus the dollar. Besides this, there are also some taxation concerns for FIIs even if it has a presence in a country with a double taxation avoidance treaty with India. In Singapore, the tax rate is lower and an FII which creates substantial employment can even get a tax waiver. Unlike in India, an FII also saves on currency hedging costs by trading in Singapore where the contracts are dollar-denominated. Thus, the Government needs to take steps towards providing conducive environment to FIIs to do the business in India and also give them comfort in taxation issues and other levies and mandatory requirements. RBI also needs to open the Currency Derivatives market to all FIIs without any requirement of regulatory clearances as long as they are registered as FII with SEBI.
15. Broking industry in India, in addition to the high fixed costs also has high marginal cost. As a result, the cost of adding an additional customer is high and per transaction costs are limited. There is also a constant pressure on the brokerage rates. This downward pressure on the brokerage rates along with lackluster volumes and increased compliance cost has intensified the competition in the industry and also forcing some of the players to look for other sources of revenue. The steps need to be taken to comfort the broking players by giving them respite from the continuously increasing compliance costs at the same time maintaining the integrity of the markets by the regulators. There is a need to move from the rule-based compliance approach to the principle-based compliance approach. 70% of the broker respondents feel that there is a need for the regulatory body to shift from the rule-based regulation to principle-based regulations.

16. Most of the broking entities have diversified their activities in various other asset classes and becoming one-stop financial solution provider. Most of these entities are offering various other services to their clients such as Commodity Derivatives, Currency Derivatives, Insurance Broking, Portfolio Management Services (PMS), Mutual Fund Distribution, Loan Against Shares (LAS) by Non-Banking Financial Company (NBFC), selling other financial products such as personal loans, housing loans, car loans, credit cards, structured products etc. either on their own wherever permitted under the law or otherwise through their group and associate companies. However, there are multiple regulatory bodies for these multiple asset classes and multiple activities. The Government may think of a single regulatory body like FSA in UK to address the woes of these financial players.

17. There being multiple regulatory bodies, the broking entities operate in different asset classes through Group Company or their subsidiary. Hence, many times client has multiple touch points in the same group. Also, there are various requirements of funds, collaterals, margins, obligations at various points of time with these different entities. Thus, even though the client has enough margin money, securities or collateral available with one entity, the client will not be able to get the exposure on the other for
the want of fungibility of these collaterals/margins available with these various group companies. Thus, it is felt that either Government should look forward to setting up a super regulator who can take care of these various regulatory arbitrage/risk issues or there should be joint committee of all the regulatory bodies to look into such concerns of the market from overall perspective.

18. Many broker respondents felt that the Equity Derivatives Certificate requirement for the dealing terminals used for Algorithmic trading should be relaxed. The regulatory body should take steps in this direction to ease the need considering that these terminals are not manually operated by any individuals.

19. Since large number of broker respondents felt that there should be basic test taken up of the investors before them being allowed to trade in the equity derivatives market for the first time which may cover various aspects like products in the equity derivatives, margin requirements, their rights and obligations, risks associated with the derivatives trading etc. The regulator may decide on the manner in which the test can be carried out either by themselves or through the existing certifying bodies like NISM, NSE and BSE. Since this requirement should also not become a stumbling block and keep away large number of clients, the process can be made easy by allowing the clients to take up the test online and may be of a very short duration.

20. The current system effectively uses the capital deployed by the brokers is largely adequate and most of the broker respondents are satisfied with the same. However, it was also felt by some respondents that that the clearing corporation should consider passing on the interest earned on the cash deposited with them by the brokers in order to make the best use of the capital deployed by them.

21. A decent number of broker respondents and large number of investor respondents feel that the margins levied in the equity derivatives segment are excessive, the regulatory bodies should consider rationalizing the same. However, the regulatory body should take a balanced approach and has to also ensure that the collection of margin is adequate to ensure that
there are no defaults on the exchanges and this does not cause any systemic risk.

22. Largely the broker respondents feel that the risk management system adopted by the exchanges is adequate. However, the recent incident which happened on NSE on October 05, 2012 when Nifty plunged by almost 16% within two minutes and still the index filters did not get triggered thereby halting the market nor was broker’s terminal who placed the orders got deactivated in time revealed that there are still few gaps in the system and the risk management system needs to be made robust. The regulatory body and the exchanges need to take some concrete steps to plug all such loopholes to ensure that the trading system and the risk management system are strong and robust to avoid recurrence of such events in future.

23. The structure of spot market/cash market is important for the development of an efficient derivative market. Many securities listed on Stock Exchanges are not traded in the equity derivatives market. This may result in high concentration and volatility of the index as index itself comprised of those few highly traded stocks and would mainly be used for hedging the positions taken in other stocks than those available in equity derivatives. There is also slow and steady shift in the preference to Stock Index Options from other products after the market crash in 2008. Today in 2011-12, almost more than 72% of the volume happens in the Stock Index Derivatives on NSE. Further, since decent number of broker respondents feel that the criteria for selection/inclusion of the stocks in the equity derivatives market should be relaxed, it is felt that the SEBI and the Exchanges should relook at the criteria adopted today for selection/inclusion of the stocks in the equity derivatives market to include few more stocks in the list to provide additional single stock contracts to trade for the market participants.

24. There is need to introduce more equity derivatives products in India and has long strides to take in terms of providing larger liquidity and depth to the bigger market players. Many respondents feel that it is ripe time to introduce the other complex products like exotic derivatives, ETF derivatives, interest rate options, structured products etc. in the equity
derivatives market. However, they also felt that these products should be restricted to only banks, financial institutions, FIIs, Sub-accounts, Mutual Funds, Insurance companies etc and should not be extended to retail investors. Hence, the Regulatory body and the exchanges should consider introducing these complex products in the market in a phased manner restricting initially only the category of investors mentioned above and not to the retail investors.

25. There is also need to increase the basket of products for trading so as to provide the variety of avenues for investments and/or trading in the equity derivatives market. Especially, there is need to introduce more derivatives instruments aimed at retail investors to increase the larger participation in the equity derivatives market.

26. Since large number of broker respondents feel that the Custodial Participants and other big clients should be permitted to directly pledge the collateral with the Clearing Corporation of the Exchanges, the Exchange and the regulatory body should consider this option depending upon the comfort drawn by the Exchanges and also the feasibility of the structure that is conducive to the market. It may decide on the amount which may be Rs. 1 crore or Rs. 5 crores or Rs. 10 crores, whatever the Exchange and the Clearing Corporation draws comfort with for the best utilization of the collateral mechanism. This would give the brokers a huge relief in utilization of their capital and the funds.

27. Minimum contract size adopted at the time of study of Rs. 2 lacs of value is a major deterrent for small retail investors to participate at large in derivatives trading. The contract design employed in the equity derivatives market in India has been a spoilsport in terms of keeping away the retail investors from larger participation in the equity derivatives market. For a small investor who is habituated to deal in 50-100 shares such a huge quantities cause a scare and also keeps them away from a product that could give them an instrument to hedge their risks or participate in the gains with minimum investments. There is a need to reduce the contract size value to allow smaller investors to also participate in the equity derivatives market. Large number of participants felt that the current minimum contract size value of Rs. 2 lacs should be reduced to
the size of equity derivatives contracts between the value of Rs. 1 lac to Rs. 2 lac or of Rs. 50,000 to Rs. 1,00,000/-. Thus, there is a need to reduce the contract size value to allow smaller investors to also participate in the equity derivatives market.

28. Due to absence of delivery based settlement, many investors may not be participating in the derivatives market. Also, this could bring one more type of product in the basket to be offered to the market at large. Hence, NSE may look at starting the physical delivery derivatives contracts to give further fillip to volume on its exchange in particular and the Indian equity derivatives market at large.