Secondary Market Developments

Derivatives Trading

4.13 The most notable development concerning the secondary segment of the Indian capital market in the current financial year was the introduction of derivatives trading in June 2000. SEBI approved derivatives trading based on Futures Contracts at both BSE and NSE in accordance with the rules/ byelaws and regulations of the Stock Exchanges. While derivatives trading based on the Sensitive Index (Sensex) commenced at the BSE on June 9, 2000, derivatives trading based on S&P CNX Nifty commenced at the NSE on June 12, 2000. SIF is the first attempt in the development of derivatives trading (Box 4.3). All the open positions in the index contracts are settled daily. Both buyer and seller are required to deposit initial margin with the Stock Exchange. The value of the contract is marked to market on a daily basis and settlement is made in cash. In order to facilitate effective risk management in the derivatives segment, measures like minimum net worth requirement of broker, margining system based on Value at Risk model, position limit for various participants and mechanism for collection/enforcement of margins have been put in place. It is also proposed to introduce stock index options in the near future. Contrary to international experience, the volumes have been low in the Indian derivatives market. SEBI's Technical Group on New Derivative Products has recently examined this issue, and made the following recommendations:

- In order to generate volumes, the system of sub-brokers be used for trading in derivatives market.
- In order to facilitate free arbitrage between cash and derivatives market, financial institutions and mutual funds may be permitted to short sell in the cash market. Such short sale may, however, be restricted to the extent of corresponding exposure in the derivatives market. Moreover, such transactions can also be permitted through a separate dedicated fund.
- Arbitrage between cash and futures market will also help in better price discovery in both the markets.
- RBI has allowed FIIs to trade in derivatives market, subject to the condition that the overall open position of the FII shall not exceed 100 per cent of market value of the concerned FII's total investment. Managed future funds should be permitted to take position in the derivatives market without having any exposure in the cash market. Also, FIIs intending to invest funds in the cash market should also be permitted to take long position in the futures market to hedge their transactions.
- SEBI and RBI should jointly examine the issues concerning trading in derivatives by FIs and FIIs.

Box 4.3

Index Futures Contracts at BSE and NSE

Salient Features

Item	BSE	NSE
Date of start	June 9, 2000	June 12,2000
Security name	BSX	N FUTIDX NIFTY
Underlying	BSE Sensitive Index (SENSEX)	S&P CNX Nifty
Contract size	Sensex Value X 50	200 or multiples of 200
Tick size/price step	0.1 point of Sensex (equivalent to Rs.5)	Rs.0.05
Minimum Price Fluctuation	Rs.5	Not Applicable
Price bands	Not Applicable	Not Applicable
Expiration months	3 near months	3 near months
Trading cycle	A maximum of 3 months; the near month(1), the next month (2) and the far month (3)	As in previous column
Last Trading/Expiry Day	Last Thursday of the month or the preceding trading day	As in previous column
Settlement	In cash on T+1 basis	As in previous column
Final Settlement Price	Index closing price on the last trading day@	Index closing price on the last trading day$
Daily Settlement Price	Closing of Futures Contract price@@	Closing of Futures Contract
Trading hours	9.30 am to 3.30 pm	9.55 am to 3.30 pm
Margins	Upfront initial margin on daily basis	As in previous column

@ Computed on the basis of the weighted average of the last 15 minuts trading.

@@ Computed on the basis of weighted average of the last 5 minuts, or if the no. of trades in last 5 minuts are less than 5, weighted average of last 5 trades.

$ Weighted average price for the last half an hour's trade.

Rolling Settlement (RS)

4.14 In keeping with international best practice, SEBI introduced compulsory rolling settlement in ten select scrips on January 10, 2000. All the ten select scrips featured in the compulsory demat list and had a daily turnover of Rs. one crore or more. Though 153 more scrips have since been added to the list, none of them enjoys carry forward trading facility. The feedback from market participants as well as the results of the study undertaken by SEBI indicate the need for facilities like continuous net settlement (CNS), carry forward in rolling settlement (CFRS), and the automated lending and borrowing mechanism (ALBM) in rolling settlement for increasing the popularity of rolling settlement. As an experiment, fifteen scrips in the present compulsory rolling settlement have been allowed with the facilities of CNS, CFRS and ALBRS. Some stock exchanges have commenced these facilities.

Internet Trading

4.15 The SEBI Committee on Internet-Based Securities Trading recommended internet trading through order routing system for execution of trade on the existing stock exchanges. Both BSE and NSE have allowed their brokers, who are registered with SEBI, to start internet-based trading. SEBI has prescribed minimum technical standards to be enforced by the stock exchanges for ensuring safety and security of transactions via the Internet. NSE is reported to have granted permission to 18 members to commence internet trading. During the first six months of the current financial year, trades worth Rs. 767 crore have been executed through the internet at the NSE.

Investor Protection

4.16 In order to further strengthen investor confidence and market safety, the Central Coordination and Monitoring Committee (CCMC) has been set up as a joint mechanism to initiate actions against companies which do not comply with the conditions of the listing agreement and which are not physically traceable at the registered office address. CCMC reviews periodically the various actions initiated against defaulting companies. Under Section 11 B of the SEBI Act, SEBI has so far debarred 61 companies and 235 Directors from associating themselves in every respect from capital market related activities. The Department of Company Affairs (DCA) initiated prosecution for non-filing of information in respect of 108 companies and had undertaken inspection under Section 209-A of the Companies Act in respect of 61 companies. Both SEBI and DCA have referred the cases of defaulting companies to respective State Governments for strict action under the IPC or under the Investor Protection Act, if any. As regards grievances of investors, SEBI has a separate Investor Grievances and Guidance Division at Head Office. The grievance letters received by this Division are classified under different categories like non-receipt of dividend, non-receipt of share certificates/bonus shares, collective investment schemes etc. It has been decided to setup an Investor Grievance Redressal Cell (IGRC) in the Department of Economic Affairs (DEA), which will coordinate efforts of the regulatory agencies, *viz.*, RBI, SEBI and Department of Company Affairs to redress investor complaints.

Share Prices

4.17 The current financial year witnessed considerable increase in stock market volatility vis-à-vis the previous financial year. The increase in volatility noticed in the Indian capital market in the current financial year has been observed in the capital markets abroad. Volatility has been an international phenomenon, particularly due to increased influence of the new economy stocks in the markets (Fig. 4.1 and Table 4.2). Table 4.2 shows volatility as measured by coefficient of variation with respect

Table 4.2

Coefficient of Variation (Per cent)

Month	Sensex 1999-2000	Sensex 2000-01	Nifty 1999-2000	Nifty 2000-01
April	3.23	6.61	3.17	5.59
May	5.49	5.13	5.30	4.12
June	2.42	2.69	2.36	2.59
July	3.98	6.05	3.90	5.99
August	2.78	2.24	3.19	2.03
September	1.45	5.73	1.44	5.63
October	3.35	4.85	3.42	4.32
November	2.25	1.66	2.19	1.68
December	2.35	3.18	2.15	3.02
January	1.41	2.96	1.38	2.75

Fig.4.1 **Percentage Change in Month-end Closing at BSE & NASDAQ**
April-January 2000-2001

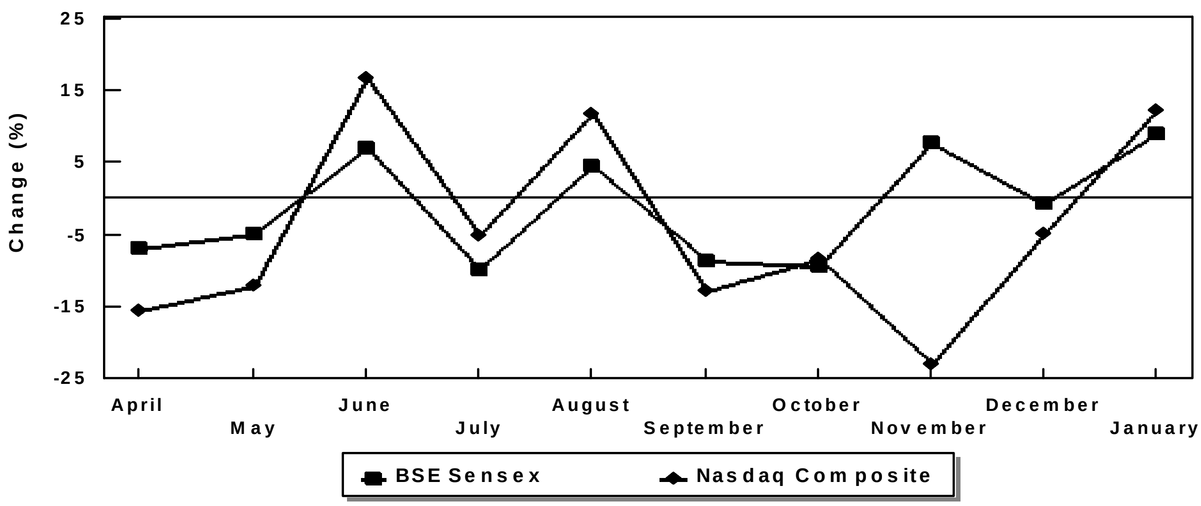


TABLE 4.3

Stock Market Indicators

Sensex	Index[1] Sensex	S&P CNX Nifty	P/E Ratio BSE	P/E Ratio NSE	ADT BSE (Rs crore)	ADT NSE (Rs crore)	MC BSE (Rs billion)	MC NSE (Rs billion)
1999-2000								
1999-2000								
April	3451	994	13.77	15.26	1421	1797	4882	4453
May	3880	1110	15.76	17.25	1725	2393	5609	5039
June	4067	1165	16.53	17.79	1511	1840	5847	5294
July	4526	1295	18.40	19.60	2220	2521	6489	5936
August	4663	1344	19.87	20.38	2273	2441	7109	6681
September	4725	1385	20.41	21.37	2218	2660	7045	6867
October	4835	1434	21.01	22.34	2885	3439	6734	6700
November	4589	1365	19.99	21.28	2456	3159	7096	7264
December	4802	1436	20.91	23.16	3566	4481	8033	8529
January	5407	1608	23.34	26.16	3658	4297	9273	9517
2000-2001								
April	4905	1469	27.79	22.81	2478	3333	7559	8463
May	4253	1313	28.86	20.33	2631	3852	7027	7904
June	4675	1452	29.39	23.68	3922	5426	7932	8525
July	4647	1445	28.51	22.33	3826	5241	7208	7464
August	4331	1351	25.25	20.54	4207	5697	7666	7945
September	4417	1371	24.47	20.84	5721	7123	6927	7304
October	3820	1202	19.57	18.21	3633	5088	6534	7071
November	3928	1241	19.90	18.77	3953	5578	7006	7642
December	4081	1291	20.84	19.59	4959	6570	6926	7604
January	4152	1317	NA	NA	NA	NA	NA	NA

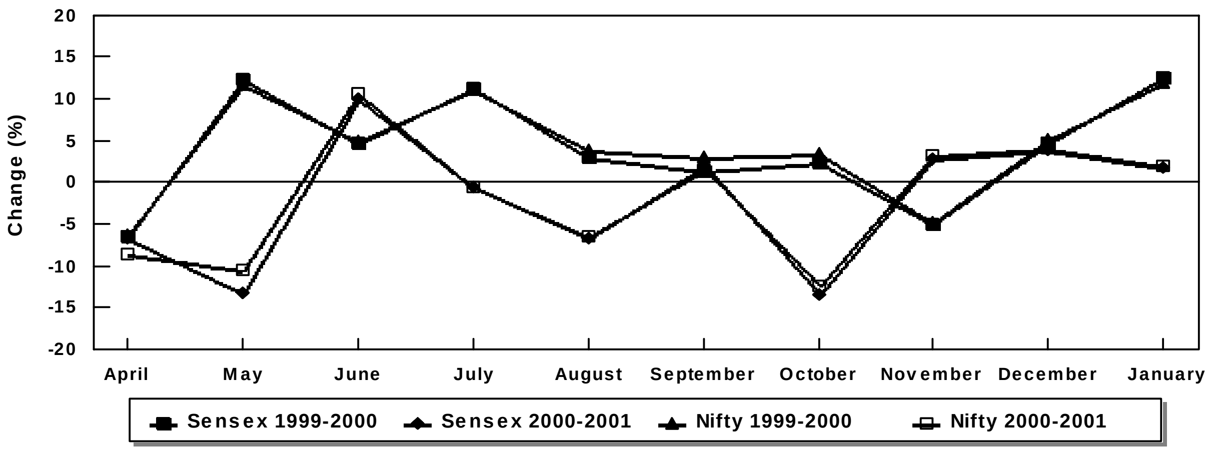
1. Average daily closing: Sensex (1978-79=100) and S&P CNX Nifty (1995=100) ADT : Average Daily Turnover MC : Market Capitalisation
Source : SEBI

to the average daily closing (simple average of daily closing values in each month) of the Sensex at BSE and the Nifty at NSE during the first ten months of the current financial year vis-à-vis the corresponding period of the previous financial year.

4.18 As the above Table shows, volatility in 7 out of the first 10 months of the current financial year was higher than that in the corresponding months of the previous financial year at both BSE and NSE. The relaxation in price band from 8 to 4 per cent after half-an-hour cooling period has been working well and helps in providing exit and trading flexibility.

4.19 Table 4.3 and Fig. 4.2 show the trends in average daily closing indices (simple average of daily closing values in each month) of both BSE (Sensex) and NSE (S&P CNX Nifty). A few important characteristics like price-earnings ratio and average daily turnover are also given in Table 4.2.

Fig. 4.2 **Percentage Change in Average Daily Closing of Sensex & Nifty**
April-January 1999-2000 & 2000-2001



Margin System

4.20 SEBI has put in place an elaborate risk management system in consultation with both stock exchanges and market participants. However, over time the system acquired complexity and rigidity. SEBI therefore constituted a Committee to review the entire risk management system comprising the margin system, exposure norms, circuit filter, capital adequacy, etc. and make recommendations designed to simplify the system without in any way diluting safety and efficiency aspects. The salient features of the system implemented by SEBI based on the recommendations made by this Committee are the following:—

- Price band of 200 scrips and scrips under the compulsory rolling settlement has been relaxed to 16 per cent.
- Scrip-limit in carry forward position under the Modified Carry Forward System (MCFS) or on the trade positions in the Automated Lending and Borrowing Mechanism (ALBM) has been placed at Rs. 5 crore per scrip for a member in account period and also in rolling settlement.
- Member-wise carry forward position under MCFS or on the trade positions under ALBM has been raised from Rs. 20 crore to Rs. 40 crore as an aggregate exposure of account period and rolling settlement.
- The slabs for volatility margins and the margin rates for account period have been revised: for volatility range of more than 80 per cent but up to 100 per cent at 10 per cent, more than 100 per cent but up to 150 per cent at 15 per cent and more than 150 per cent at 25 per cent.
- No volatility margin has been prescribed under compulsory rolling settlement system.
- The minimum cash component to be deposited by the broker has been fixed at 30 per cent of the total margin.
- To encourage delivery-based transactions, it has been decided that the margins can be provided as bank guarantee; cash component need not be insisted.

Market Capitalisation

4.21 The period April-December, 2000 witnessed serious decline by nearly 25 per cent in market capitalisation at BSE from Rs. 9,128 billion in March, 2000 to Rs. 6,926 billion by December 2000. At the NSE also, market capitalisation declined by around 25 per cent from Rs. 10,204 billion to Rs. 7,604 billion during this period. The fall in market capitalisation has been more serious in the companies of the new economy.

Turnover and Delivery Pattern

4.22 There has been remarkable improvement in the dematerialized segments at both BSE and NSE. The proportion of delivery in total turnover in the dematerialized segment was 97 per cent at BSE as well as NSE. However, the per centage of delivery to total turnover was significantly lower at 13.2 per cent and 6.4 per cent respectively at BSE and NSE during April-December, 2000 (Table 4.4).

TABLE 4.4

Turnover and Delivery Pattern

(April-December, 2000)

(Rs. crore)

Item	BSE	NSE
(a) Total Turnover	738584	1108570
(b) Total Delivery	97437	70388
(c) % of (b) to (a)	13.19	6.35

Source : BSE & NSE

Dematerialization

4.23 SEBI continued with its efforts aimed at accelerating the process of dematerialization of shares. Based on the recommendations of the Working Group of SEBI on dematerialization of securities, the number of scrips for compulsory demat trading by all investors increased from 462 as on March 31, 2000 to 1413 as at the end of October, 2000. It has been decided to achieve compulsory trading in demat form in respect of all actively traded scrips by March 31, 2001. As per the data furnished by the National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL), there has been significant progress in dematerialization. The number of companies that signed agreement with the Depositories increased from 1013 as on March 31, 2000 to 1790 by November 15, 2000. The number of depository participants offering depository services increased from 150 to 170 during this period. Also, the centres with depository services increased from 1000 covering 200 cities to 1875 covering 335 cities in this period. The number of dematerialized shares increased from 1500 crore to 2619 crore during April-November, 2000. This has been accompanied by a steep increase in the beneficiary accounts opened with depository participants from 25,00,000 to 33,00,000 in this period.