Overlook

4.53 The equity spot market has made enormous progress, with a state of the art trading system, sound clearing mechanisms, and T+3 settlement at the depository. SEBI has been working towards shortening the three-day delay between the transaction date and settlement date.

4.54 This effort is constrained by the ability of the payments system to move funds across the country, and thus awaits improvements in payments infrastructure. It also requires electronic data exchange within the securities industry, which is called "straight through processing" (STP). SEBI is working with all participants of the securities industry to establish STP. In November 2002, a first phase of the STP implementation came about, focusing on the transaction flow between institutional investors, custodian banks and brokers. As with advanced countries, STP would allow the securities industry in India to move towards T+1 settlement, where trades of a given date would settle on the next day.

4.55 One key element where new work is required on the spot market concerns facilities for borrowing of shares, which would help enhance market efficiency on both spot and derivatives markets. RBI and SEBI are jointly working on 'margin trading' mechanisms, through which customers would be able to buy or sell shares using borrowed assets, subject to putting up a 'margin' of 40 percent.

4.56 The events of 2001 highlighted the conflicts of interest in the governance of the Bombay Stock Exchange, the Calcutta Stock Exchange, etc. SEBI setup a committee headed by Justice M. H. Kania in March 2002, to evolve a roadmap for the conversion of these exchanges into new governance mechanisms, with a separation between ownership, management and trading rights. The implementation of these new governance mechanisms will take place in coming months.

4.57 In November 2002, SEBI approved the establishment of a 'Central Listing Authority' (CLA), which would centralise the listing function which currently takes place at the exchange level. Once CLA is fully functional, it may take up ongoing monitoring of compliance of listing requirements by firms.

4.58 The most difficult area in terms of obtaining a sound secondary market concerns the problems of market manipulation, and those of establishing sound procedures for surveillance. One key element for making progress in this would be a requirement that every trade should be tagged with the PAN number of the customer. This would simultaneously serve to establish the identity of the customer, and limit the extent to which the parallel economy is able to trade on the public securities markets.

4.59 This effort must be linked with a greater effort on regulation of listed firms. A prime issue here is that of disclosure. Improvements in accounting disclosure, handling of news, and continuous disclosure of material events, are all areas where much new work is required. There is a need for greater regulatory and Market-based Mechanisms to give firms incentives for better disclosure.

4.60 In the area of the debt market, two elements are currently in place: corporate bond settlement is taking place in dematerialised form, and government bonds are now traded on exchanges using anonymous order matching. However, in both cases, the bulk of the secondary market continues to be an opaque market, characterised by bilateral negotiations. Many synchronised policy efforts are required in order to bring both these markets up to the standards of the equity market, where all trading takes place by anonymous order matching, and price-time priority holds across the country.

4.61 The equity derivatives market has made enormous progress on obtaining liquidity. However, there is much to be desired in terms of pricing efficiency. Recent studies have revealed that prices of equity derivatives often diverge from those consistent with the lack of arbitrage opportunities. There is a need for policy efforts at the level of exchanges, SEBI and RBI in resolving the impediments to arbitrage.

4.62 Internationally, exchanges which trade derivatives offer a full range of products, spanning equities, currencies, interest rates and commodities. Currently, derivatives trading in India is fragmented across some exchanges which offer commodity derivatives only, and other exchanges which offer equity derivatives only. Currency and interest rate derivatives are currently not traded on exchanges. Government has announced that trading in interest rate futures would commence, which will mark one step towards addressing this fragmentation.

4.63 A major issue which will influence India's securities markets in the future is the challenge of globalisation. RBI has increasingly moved in the direction of giving access to international diversification to institutional investors and individual investors in India. Financial intermediaries and exchanges in India will also experience global competition. There is a need for greater thought and policy initiatives, in fully integrating a global perspective into the plans of firms, exchanges, regulators and policy makers.