Derivatives Market in India

Origin of the Derivatives Market in India

The Indian derivatives market is very old. It was the year 1875 when The Bombay Cotton Trading Association started future trading. As per history, records by the year 1900 India became one of the world's largest futures trading industry. Though after independence, in 1952, Indian Government officially imposed a ban on cash settlement and options trading. This ban on commodities future trading was removed in the year 2000 and the National Electronics Commodity Exchange was established.

Derivatives trading commenced in India in June 2000. Securities and Exchange Board of India (SEBI) permitted the derivative segments in two main Indian stock exchanges, NSE and BSE. Since then India has become a big and lively market for derivatives. Equity derivatives play a significant role in price discovery. They help to increase liquidity and lessen transaction cost. Derivatives in share market acquired importance as risk hesitant investors wanted to protect themselves against uncertainties due to ups and downs in prices of assets. As the asset prices are fixed, derivative products lower the impact of ups and downs in asset prices and act as tools of risk management. Derivatives transfer risk from risk cautious investors to risk takers. Derivative securities or instruments are forward, futures options and swaps. Players in derivatives securities not only transact in these simple derivative securities but also trade hybrid derivative instrument.

Current Scenario (Data Source NSE Website)

Any investor can participate derivatives trading in India through National Stocks Exchange (NSE), Bombay Stocks Exchange (BSE) in stocks. For Commodity trading there are MCX and NCDEX markets are there. MCX stands for the Multi Commodity Exchange and NCDEX stands for the National Commodity and Derivatives Exchange. For currency trading, we can use NSE-SX, MCX-SX markets. For bond, trading NSE platform is used.

Equity Derivatives: As for as equity derivatives are concerned the liking of Indian investors to equity derivatives segment has been highly positive. In FY 2018, total turnover of derivatives in NSE went to Rs 1,649trn maintaining a continuous incremental trend. Important to note that it increased by 75% in FY 2018 than previous financial year due to some factors, like lower transaction cost in derivatives market than cash market and shift in investors' choice towards derivatives from cash market. After that growth in derivatives segment slowed down in Apr-Dec'18 might be due to increase in market risks both domestically and globally.

Currency Derivatives:

Total turnover in currency derivatives part at NSE increased by 4% to Rs50.3tn in FY2018 than Rs48.6tn in FY 2017. The fast growth in FY 2019 due to a policy change that included important relaxation on limits of domestic investors and FPIs in currency derivatives. Total transaction value during Apr-Dec'18 was Rs62.7trn which is nearly 92% higher than total turnover during the same period previous year.

Interest Rate Futures:

Total turnover of Exchange traded interest rate futures (IRF) at NSE increased by 4% to Rs3.2tn in FY18 from Rs3.1tn in FY17. In BSE, total turnover increased highly by 75% from Rs1,280bn in 2016-17 to Rs2,239bn in 2017-18. Total transaction volume has declined highly in both NSE and BSE in Apr-Dec'18 than the same period previous year

Commodity Derivatives:

On October 1, 2018, SEBI permitted any single exchange to run in various asset classes, such as equity, equity derivatives, commodity derivatives, debt, interest rate futures, and currency derivatives. In reply, both NSE and BSE applied for and received SEBI's consent to participate into commodity derivatives segment. BSE opened its commodity segment with gold and silver futures contracts, while NSE launched with the same commodities from October 12, 2018. BSE and NSE fulfilled 4 and 2 contracts respectively in commodity segment till December 2018, while other commodity exchanges like NCDEX, MCX and ICEX fulfilled 24, 22 and 13 contracts respectively.

Currently in India there are five clearing corporations working in India–

1. India International Clearing Corporation (IFSC) Ltd
2. Indian Clearing Corporation Ltd
3. Metropolitan Clearing Corporation of India Ltd
4. National Securities Clearing Corporation Ltd
5. NSE IFSC Clearing Corporation Ltd

Derivatives Trading & Points to Remember while Investing

- A Derivatives product needs a large amount of funds. So it is not for an investor who has limited resources. Limited resources mean less fund and low-risk appetite.
- Trading derivatives need experienced and knowledge. A top trading expertise and experience is essential with high-risk tolerance.
- As a derivatives trader, an investor must consider its suitability depending upon his financial position.
- An investor must refer to Model Risk Disclosure Document before beginning the derivative trade and before signing it one should read and understand its repercussions. This disclosure clearly mentions all risk associated with derivatives trading.
- One must read the sample SEBI Model Risk Document and also the same document for NSE derivatives trading for getting essential knowledge regarding risk.

==============Chapter Ends with Part Three =============