Banking & Finance DIGEST

Issue No. 10 January 2012

3 years of Currency Derivatives Segment

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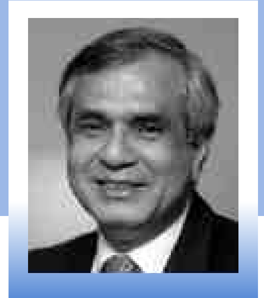
PREFACE



As we embark on a new calendar year 2012, it gives me immense pleasure to release the tenth issue of our widely acclaimed Banking & Finance Digest. Through the Digest, FICCI endeavors to facilitate a comprehensive forum for dialogue amongst the Indian Inc. and the Government thereby providing necessary directions to policy makers and business processes. The issues discussed herein are invaluable inputs for FICCI's extensive network of industry members and stakeholders. This issue of our digest aims to bring to the forefront perspectives of experts from India Inc. and financial sector intermediaries on "3 years of Currency Derivatives Segment"

Currency futures has come a long way in these three years. Currency futures markets now have sufficient volumes to meet corporate hedging requirements. Since currency derivatives can be used for hedging forex risks, promotion of currency futures and the derivatives market may also work as a risk mitigation tool for the Indian banking system. Perhaps RBI's vision of "currency Futures is the way ahead" will become a reality in the near future. As we have seen in the recent past, the world is shifting from the OTC products to exchange traded products and the future holds bright for currency derivatives in India. It is evident that this segment is here to stay along with the OTC market.

Through the voice of some of India's leading names in the financial sector, this issue deliberates on the possible way forward for the Currency Derivatives segment.

We thank our partner MCX Stock Exchange for extending their support to help achieve our endeavor.

We do look forward to views and suggestion from the readers to help us improvise the content of the digest and make it more relevant and informative.

Dr. Rajiv Kumar

Three Years of Currency Futures

Mr Manoj Choudhary
Head Business Development
Alpari Financial Services

PREVIEW

On August 15, 1971, the United States unilaterally terminated convertiblity of the dollar to gold. As a result, the Bretton Woods system officially ended and the dollar became fully fiat currency, that marked the birth of a currency trading exchange' CME' for Currency futures. The launch of currency future market has been a major landmark in the history of financial markets globally. The Chicago Mercantile Exchange (CME) became the first currency future exchange.

But for India 2008 was the year which shall hold equal importance as National Stock Exchange was the first privileged exchange to flag off launch of Currency Derivatives segment on August 29, 2008,followed by Bombay Stock Exchange on October 1, 2008and Multi Commodity Exchange's arm MCX-SX on October 7, 2008 finally ?United Stock Exchange on September 20, 2010.

The move of RBI was probably instigated by some existent bodies offering domestic currency i.e DGCX (Dubai Gold and Commodity Exchange) and NDF Markets(Non Deliverable Forwards)While DGCX was the the only exchange outside India where the Indian currency was traded, there is also an unregulated non-deliverable forward (NDF) market for it in Singapore, where a large number of funds took positions. Though the recent circular by RBI will keep a better control over participants who had overseas arms and were actively doing arbitrage.

GLOBAL VISION

As we all know that globally FX(Foreign Exchange) is the largest liquid market known in the world in terms of the cash value traded which exceeds 4 trillion/day.and FX Markets in true sense are 24 hrs Markets is also said that FX markets follow the sun moments around the earth, while its morning in NY ,London is in noon time, Post noon sessions in NY are usually dull, and opening of NY session marks release of economic datas, dollar being the base currency so the US datas have equilateral effect on entire markets ecosystem. Globally the Foreign exchange markets, better known as FX markets are the biggest on the basis of the traded turnovers and transparency so are preferred by traders globally.

But that's the global picture, back in India Currency futures had a modest beginning but eventually went on gaining the grounds of credibility and acceptability.

INDIAN JOURNEY

Now journey of INR Futures had begun, Since it was a historic step there were expectations of a mix bag of feelings amongst the various segments

Exporters/Importers: Why do we need this platform we already have been hedging with our respective banks? Investors Class: What kind of investment/trading tool can INR be, we are comfortable with present set of investment options! Corporates: I get red carpet from my banks and moreover my ticket size is huge ,so I guess it might take a couple of years for the markets to qualify to take orders of my book. Arbitraguers: OK, another segment, but how do I derive the historical data/lead:Lag ratio since the product itself is a new!

DIFFERENT PHASES OF CHALLENGES: ACHIEVEMENTS

So the challenge for the Regulators faced was to ensure immaculate functioning of the Futures Exchange since historically launch of futures Exchanges had different types of reactions as in countries like Mexico, the volatility of foreign exchange rates declined after introduction of currency futures trading while in some countries like Brazil and Hungary, currency futures trading did not have significant impact on existing structures, Exchanges had their roles to familiarize common man to this new segment ,get the liquidity and target actual end users.

First phase was most defining since it needed to clear the myths/beliefs of traders/ hedgers, Exchanges did a marvelous job by reaching the different parts of the country conducting series of seminars/road shows and explaining them that why futures of INR was the need of the times. The results were imminent wherein the Leading exchanges came out with impressive average trading volumes from initial phase of launch and in less than a years time the rise was almost 1500% from $60million in sep08 to $1 Billion each, officially this kind of growth rate was the highest as compared to any other derivative product/market.

Unambiguously the message was clearly passed on to the business class of the country that exchanges had definitely got them Transparency since any SME/Individual in any corner of the country could see the live single price irrespective of the ticket/business,relationship with OTC Dealers, No longer they needed access to Reuters/Bloomberg screens to know the live markets, awareness about impact cost was also understood.

Next challenge faced now was of liquidity, Exchanges continued to grow in terms of Volumes and OI, the biggest advantage for exchanges

was a new segment entering the markets' arbitrageurs' who got in with their technological feed/formulae to track the price variations in OTC/Futures,Intra Month spreads(Calendar spreads) and Intra exchange arbitrage this gave enormous liquidity to the exchanges and by now Currency Segment was compared to Commodity markets turnovers.

Liquidity was enough by then but now the exchanges were out to serve the big business houses so now few more mind blocks were there as it was a single pair and with that Now the regulator permitted additional currency pairs ?Euro-Indian Rupee (EUR-INR),? Pound Sterling-Indian Rupee (GBP-INR),? Japanese Yen-Indian Rupee (JPY-INR), and the markets took this with a welcome gesture, though USD-INR, pair was the leader in terms of Volumes, but these currencies added variety in the portfolio. Meanwhile on 15 July 2010 INR got a symbol, a big day indeed for the segment as officially Indian Rupee was amongst the most favourable trading pairs amongst elite currencies.

This phase was the most positive one as by now Head Hunters were after candidates with Currency as a speciality and Brokling Firms were on Hiring spree by adding parallel verticals for this segment which initially was taken care by their existing Commodity and Equity teams. Regulator permitted some of the exchanges to offer 'Options' which was another feather in Currency's Cap!

Memberships of the Banks increased ,OTC markets used to look at ETF (Exchange traded futures), Exchanges were at their fieriest best to have majority share in Currency segment. The composition of actual users was increasing MoM, The impressive growth of currency futures market

within three years of its inception in August 2008 (average daily trading volume beyond Rs

50,000 crore in Mid 2011)then the two exchanges which introduced transaction charges, fell significantly since August 22, while trading volume at USE actually grew marginally. Compared to the period 1st January, 2011- 18th August, 2011, it can be seen from the figure, average daily trading volumes fell by 20% NSE and by 17% at MCX-SX since 22nd August, while it grew by 7% at USE. It must be mentioned here that trading volume in currency options at NSE actually grew by 8% after introduction of transaction charges. Probably the arbitrageurs found options more lucrative than futures post the charges.

Nevertheless Currencies were still best performers amongst all the classes, presently In India, National Stock Exchange, United Stock

Exchange and MCX Stock Exchange together put up an average daily turnover of over Rs 20,000-25,000 crore in currency trading. Lately, Equity was gloomy, Commodity was dull while entire show was stolen by Currency!

TRANSITIONS

Exporters Importers-Embraced the segment which helped them hedge without counter party risk and with complete transparency, Corporates -Shifted part of their respective portfolios to ETF's (Exchange traded futures) to have dual advantage of OTC and ETF's, Investors-discovered a all new product with complete transparency, least margin and highest levels of Risk Management enabling themselves to diversify their portfolios, Scalpers/ Arbitrageurs always wanted a novice tool so were happy to see

the successful innings, Commodity Traders could operate at ease, Since they are/were directly affected by currency fluctuations so an accessible portal was their biggest utility.(especially bullion dealers)

CONCERNS WITNESSED

Any product at early stages comes with some wishful points, some of anecdotal incidents/evidences-

Many participants felt that FIIs and NRIs must be allowed in Currency Future Trading, There should be eased norms on eligibility for Banks to become a Clearing and/or a trading member. Brokers should get some kind of ease in membership registration process if they have permissions from any regulator of the country, Trading hours must be extended, since bullion traders are hit the most post market closure as Gold's volatility is historical and hysterical.

ROAD AHEAD-INR as Instrument

Recent Currency moves during the last 12 months, the Indian Rupee exchange rate depreciated 14.89 percent against the US Dollar. Historically, from 1973 until 2012 the USDINR exchange averaged 30.38 reaching an historical high of 53.72 in December of 2011 and a record low of 7.19 in March of 1973.The perpetual weakness in INR can be backed by many factors combined, the phenomenon which started from U.S collapse also one of the reason behind the structural increase in volatility is the growth of India's Current Account, including exports and imports of both goods and services, and India's Capital Account, which is on a high degree of volatility in portfolio investment flows, to some it is now increasingly difficult for the RBI to contain the volatility on a daily basis. As the economy continues to grow and open up, it is unlikely that forex volatility is going to decrease. Moreover the ongoing Euro-zone debt crisis seems to be intensifying and rescue packages have been of limited assistance in truly resolving the crisis. While the risk of sovereign default by individual Euro states is a concern, the risk of an impending contagion is also significant. It is estimated that the IMF has about $400 billion available to provide funding to the Euro-zone, but Italy alone has to refinance $350 billion worth of debt in the next six months. Domestic macro-economic prospects as well are weighed by high inflation and sagging industrial production, which have led to downward revision of growth estimates to just 7.6% for FY12,so INR can be on weaker side.

ROAD AHEAD-Currency Derivative Segment

As seen currency derivative can be used for hedging forex risks, speculation or arbitrage. Companies and financial institutions can enter the forex market primarily for minimizing the risks due to exposure to foreign currencies. An investor can take a position to participate in the market for trading or sell immediately to benefit from the variation in the forex rates on different exchanges. Currently, only resident Indians (including individuals, companies and financial institutions) can trade in the four currency pairs available in the local market-dollar/rupee, pound/rupee, euro/rupee and yen/rupee.

Not to miss that the volatility in INR is on up move, which will be directly proportional to the Business revenue/risks.So going ahead managing forex risk will/should be handled with same caution as other business activities. As such, the sooner Corporate India realizes that forex volatility is a fact of life and learns how to deal with it, the better.

The belief in INR futures outperforming again in 2012 is as strong as disbelief about some Doomsday in 2012!!

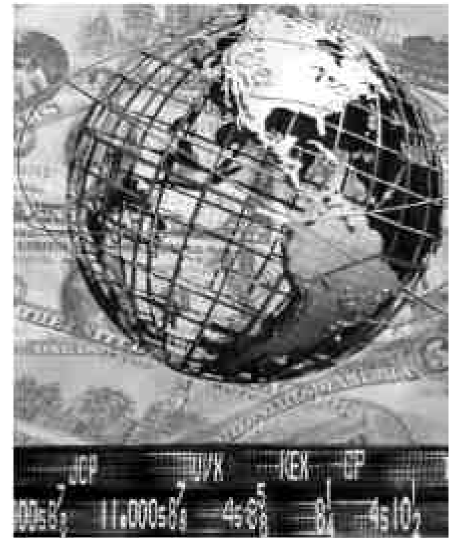
Changing dynamics of forex trade in India – OTC to currency derivatives

Mr Naveen Mathur
Associate Director-Commodities and Currencies
Angel Broking, Mumbai

Globally, currency trading accounts for more than 60 percent of global trading and marks as one of the world's largest financial markets in the world followed by commodities and equities. The global foreign exchange market stands at a whopping $4 trillion in turnover per day, slightly less than the size of the Japanese economy at $5.4 trillion. Activity in the global foreign exchange market has witnessed sharp growth since 2007, with turnover between 2007 - 2010 rising more than 20 percent. Increased volumes in global forex trade are on the back of rise in trading activity of other financial institutions like non-reporting banks, pension funds, hedge funds, insurance companies and central bankers.

India is in its phase of nurturing and developing this market to the fullest. In this era of financial globalization, India too has made a mark with the launch and development of derivative products. The $1.7 trillion economy has seen a remarkable difference in the financial market space. What started as a shift in the currency regime in India in the 1990s, has now led to increased risk-bearing capacity amongst banks coupled with rise in foreign exchange trading volumes. Increase in foreign currency turnover in India can be attributed to rising foreign investment inflows and as large Indian companies use the external commercial borrowings route to raise capital.

A break-up of the Indian currency market indicates that the interbank forex market has an average daily turnover of $40 billion, out of which spot forex trading volume which is $20 billion, contributing to 50 percent of the forex market volume.



The rest of the 50 percent comes from derivatives such as swaps and forwards. The recently introduced Exchange Traded Currency Derivatives (ETCD) at the national level exchanges in the year 2008 have seen phenomenal growth and this segment has an average daily turnover of $15 billion, thus bringing the average daily turnover of India to approximately $55 billion. On a global level, turnover in

the currency futures market stands at $207 billion, out of the total turnover of $4 trillion. In India, three exchanges offer currency derivatives trading - National Stock Exchange (NSE), Multi Commodity Exchange - Stock Exchange (MCX-SX) and the United Stock Exchange (USE).

With the emergence of currency derivatives, a participant with a foreign exchange exposure can find easy access to information over rates and future market expectations for the currencies traded. Benefits of trading in the currency futures segment are immense - from accessibility to price transparency and standardization, which in the case of over-the-counter trade is entirely different. As far as accessibility is concerned, currency derivatives offer an online electronic trading platform as opposed to the interbank forex market. In terms of price transparency, an online trading platform makes sure of uniform and real-time price access to all market participants, while in the OTC market one has to rely upon the rates offered by the bank.

In case of forward contracts and the OTC market there is a high bid-ask spread on the back of high transaction costs and bank charges. Standardization in any financial derivative is a must and currency derivatives offer standard futures contract lot size as against customized forwards contracts, in the case where banks prefer a contract value of at least $1 million. Another major positive in case of currency derivatives is that there is no question of counterparty default risk as exchange clearing house guarantees trade settlement. Efficient risk management system helps all market participants to witness stress-free trade. Apart from that, other advantages of currency trading include - low commissions, high liquidity, real-time transactions, low margin and with no scope of manipulation in rates.

In India, currency derivatives have emerged as a popular tool to hedge currency risks. But it is surprising to see that only 10 percent of volumes actually come from the hedgers. The reason why hedgers are currently weighing the currency market is that in India, the traditional tendency is to extract rates from the OTC markets and the quotes by the banks are considered as final. But a major drawback in case of over-the-counter trade is that different rates are offered to the bank clients depending upon on their relationship with the bank and the volume of business that a client offers to the bank. The system of the OTC market is opaque and makes it difficult for small and medium enterprises along with retail investors to make an entry and have a successful trade. It is now a lot easier for a small and medium enterprise to venture in the foreign exchange market with clarity and transparency.

Largely, a shift has been seen in currency trade from the OTC market to futures. Taking equities as an example, in India itself we have seen a major shift from the open outcry system on the NSE and the

BSE, the major Indian equity exchanges. Globally, too the trade is witnessing a change in trend as investors whether corporate, institutional or retail, prefers the online and transparent trading system.

In India, the introduction of new products within currency futures is another step forward that will help boost volumes further. In October'2010, the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) had allowed the exchanges to introduce currency options trading in USD/INR pair. The RBI permitted commercial banks to be trading and clearing members of exchange-traded currency options subject to fulfilling conditions related to net worth, capital adequacy ratio, net profit and other requirements. Other scheduled commercial banks are permitted to participate in the exchange-traded currency options market only as clients. With the introduction of options in the currency markets, we expect phenomenal growth in volume in Currencies derivatives space too. This is because options will help to reduce risks as spread rates in an exchange will be better and will also help to reduce counter-party risk. The developed markets across the globe already allow trading of these products and going by this experience, we feel that the Indian exchanges would be benefited hugely with the launch of options in all the other currency pairs as well.

Having un-hedged currency positions in the current market scenario can be risky and currency futures offer an excellent platform to mitigate these un-warranted losses. The Rupee depreciated sharply in last few months of 2011 and continues to trade above the 52-mark, indicating that risks to the Indian economy are high. At the point when the Rupee touched an all-time low of 54.30 on December 15th 2011, importers who would not have hedged their positions would have suffered dire consequences.

Moving on to the current market scenario, we feel that the recent move by the RBI to curb speculative positions in the foreign exchange market will be helpful to the futures market. This indicates that the central bank has taken a stance apart from direct intervention and has also reduced further volatility in the Rupee. The recent circular dated December 15th 2011 includes withdrawal of the facility to cancel and re-book forward contracts by resident and foreign institutional investors. The RBI also reduced the net overnight open position limit of banks that are authorized to deal in foreign exchange. The impact of this move by the central bank is expected to be advantageous for the currency futures market of India as reduced limits of importers to 25 percent from 75 percent in case where the importers utilized the past performance facility to hedge currency risks will help draw interest among the participants on the futures platform.

The global increase in trade and foreign investments has led to many national economies becoming interconnected with one another. This interconnection, and the resulting fluctuations in exchange rates, has created a huge international market i.e. foreign exchange. India, being no exception and an important economy in the globalized world today shall therefore witness a tremendous opportunity which is yet untapped. Currency markets hence will get a boost and support from the same, thus creating exciting opportunities and new profit potential for market participants.

We are confident that years ahead would present a much more structured and developed foreign exchange markets in India. As we have seen in the recent past, the world is shifting from the opaque OTC products to exchange traded products and the future holds bright for currency derivatives in India.

Mr Naveen Mathur
Associate Director
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Angel Broking, Mumbai

Presently, Associate Director of Commodities & Currencies businesses at Angel Broking Limited, Mumbai, India. With rich industry experience of about 16 years in financial markets, he is associated with Commodities Trading right from 2003, the year when two online commodities exchanges started traded activities.

Prior joining Angel group, he has worked as Country Head of Commodities with Religare Commodities Limited (a Ranbaxy Promoted group company) for two years. He was instrumental in establishment and growth of Commodities business at Religare.

Mr. Mathur has also been associated with Karvy Consultants Limited and also worked with BLB Limited as Director on the board of the company. He has been involved in various management activities including opening of a subsidiary company in Mauritius, Treasury Operations, Corporate and Strategic planning, Research activities in Futures and Options markets etc.

Mr. Mathur is a regular speaker on electronic media channels (CNBC TV18, CNBC Awaaz, Zee Business, ET Now and NDTV Profit) and has been regularly featured in print media also. He has been a guest speaker at various conferences and seminars and is a speaker on financial services at leading Educational Institutions.

With Bachelors in Commerce, he completed his CFA in 1997 and has done Post Graduation in Financial Management from Institute of Management Technology. He also holds Post Graduation in Business Finance from ICFAI. Throughout his academic and extracurricular career, he has always been a meritorious student.

His interests are listening to music, reading journals and books apart from traveling to hill stations.

Aiming for Quantum Growth in the FX Derivatives Market in India

Dr Sayee Srinivasan, *Head of Product Strategy*
Bombay Stock Exchange

Introduction

The near-explosive growth of the FX futures market in the Indian market in the past three years has been very impressive. This unprecedented growth can be attributed to the strong latent interest in trading FX - for both speculative and hedging - and, aided by market structure factors like lower transactions cost and intense competition by trading venues offering the same product. Looking to the future, this note looks at other factors which can potentially drive quantum growth in this market by extending the range of products and services, and expanding the range of participants.

Introduction of FX derivatives on exchanges was preceded by a long consultation process, driven initially by the Reserve Bank of India (RBI). Later rule making was, and continues to be through a collaborative process between RBI and the Securities Exchange Board of India (SEBI). Regulators typically do not make good product developers, both due to lack of knowledge of the product and market, and lack of accountability for product failures. While their role has to be commended, the resounding success was clearly due to latent demand from a wide spectrum of market participants, including those trading commodity derivatives - who normally do not come under the jurisdiction of either RBI or SEBI.

Product-Settlement Process

The largest exchange traded currency futures and options

market continues to be operated by the CME group - the erstwhile Chicago Mercantile Exchange. FX futures were first launched there in the 1970s. The contracts were settled through physical delivery, and continue to be settled in that manner, except in cases where such settlement is not feasible due to convertibility issues. In such instances, contracts are settled in cash against either a reference price published by the central bank of the respective country, or a price arrived at by polling or surveying the market.

Given the fact that Indian residents are not typically allowed (by FEMA) to hold foreign currency in bank accounts, RBI chose cash settlement. The choice of cash or physical settlement depends on the liquidity in the spot market, and on the ability of investors to arbitrage between the spot and derivatives markets.

One of the reasons stated by RBI for introducing INR FX futures in India was to reduce the cost of hedging risk by Indian companies. Typically firms will cover the FX risk by entering into forward purchase (for importers) or forward sale (for exporters) transactions with bankers. RBI was of the view that some competition in the form of exchange traded futures will reduce the spreads or commissions charged by bankers to companies.

While there has been no formal study on whether spreads in the forward markets have come down, there is ample evidence that the FX futures market tracks the spot market closely. This will typically be the case when the futures product is being used to express views on the movement of the respective currency pairs.

Unfortunately, the cash settlement feature does not buy much protection for companies against any price gouging behaviour by Indian banks. The reason for this is as follows. Let's take the case of a company that wants to protect the value of its US dollar (to be received at a later date against some good being exported). So as to avoid paying the high commissions (typically added to the exchange rate), the exporter could choose to sell an equivalent amount of futures on one of the exchange. This helps protect the earnings in INR terms to some extent. But it still leaves the exporter to residual risk from two sources.

First, when the exporter receives the foreign currency remittance, he still has to go to the bank to convert it into INR. This will be at the spot rate plus the usual commission assessed by a bank for such trades. Second, assuming that the remittance is received on the same day as the expiry day of the futures contracts, it is possible that the conversion of the remittance happens at a price different from the settlement price of the futures contract - it would be positive or negative and hence a source of risk.

If the futures contract was instead settled through physical delivery, the exporter could simply deliver the foreign currency remittance to the clearing house of the exchange to fullfill his obligation against the

short futures position at expiry. This will ensure that the proceeds from the sale of the FX remittance are the same as that agreed upon while entering into the futures contract.

Participation

Given that the product still leaves the corporate at the mercy of the banker, it is hard to expect any respectable share of the true hedging activity coming to the exchange-traded product. Without active participation, activity will be driven primarily by speculators and arbitrageurs. As only banks can participate in both spot and futures markets, and thus arbitrage away any pricing discrepancy, and thus ensure that the derivatives markets prices are in line with those of the OTC market, it might limit the overall growth of the exchange traded market. At the minimum, it deprives the market of another source of growth. Worse, by leaving it at the mercy of speculative interests only, we run the risk of higher market volatility, and drying up of liquidity. This in turn can further discourage participation by end-users.

Moving away from OTC

There are typically two markets (or platforms) for any given underlying. A public market, where products or instruments with standardized descriptions and contractual obligations are traded - In this instance, on a platform operated by an exchange, with a clearing house taking on the role of being the counter-party to every trade. So as to protect itself against any risk of default by market participants, the clearing house will collect some margins, and largely have some risk management rules, systems, and process to indentify, monitor, and manage the risks.

A second type of market is the private, or over-the-counter (or OTC) market. All trades are bilateral, with terms negotiated and products designed to suit the needs of specific needs of the respective firms. The agreements could provide for collateral collection, but is less rule-driven than a public market.

The risks of the OTC market, and the relatively more secure nature of the exchange-traded and centrally cleared public markets have been highlighted by the aftermath of the sub-prime crises, and well-illustrated by the continuing challenges to settle obligations by Lehman and its counterparties for OTC trades.

The trend now is to move as much of the OTC trading activity as possible to the exchange traded and centrally cleared markets.

This trend should be encouraged in India too, especially in the currency derivatives markets. Indian companies have risk exposures that will need customized solutions. Unfortunately, markets have a tendency at times, to build excesses that result in losses and default. The latest instance in India has been the large number of FX options traded between banks and corporate in the OTC market.

Given the lack of transparency in this market, nobody was aware of the size of exposures being built up by banks and corporate. The collaterals collected were not sufficient to cover potential losses from market and credit risk. The problem of insufficient collateral was acerbated severely, as there was no daily mark to market of gains/losses.

As a result, to quote a popular phrase in the context of such transactions, these trades are being settled through "law-suits".

Assuming that there are genuine economic risks, not just in FX, but also in the context of interest rate and other risks, there is a strong case to avoid reactionary behaviour - which basically involves banning all such trades. Instead, the regulators should mandate that all such customized trades be reported, risk managed, and cleared through central platforms.

Most complex products are constructed using other liquid and actively traded instruments. Hence, it should be feasible for a clearing house to assess risks and compute margins for a wide range of such customized products. Even in instances wherein a clearing house might not be willing to underwrite the risk for a specific product, in other words, where it is not willing or able to step in to novate and become the single counterparty for all trades, it can still compute margins, collect collateral, and do daily mark to market.

Having such services provided by an independent institution can go a long way in reducing systemic risks. In addition, it can directly reduce the credit risk concerns of market participants. Such reduction in risks can help attract participation in the market.

Most important, from the perspective of this note, growth of an institutional negotiated trading and clearing platform for customized FX derivatives will bring new flow to the exchange traded FX derivatives market. Banks and others will use the more plain-vanilla futures and options contracts to lay-off their risks from customized FX derivatives, thus potentially driving quantum growth to the exchange traded FX derivatives markets in the country.

Summary

In summary, while growth in the Indian FX futures market has been impressive, it is not really surprising given the wide-spread interest in FX as such. Our fascination with gold has clearly been a huge driver, given the synchronous behaviour of gold prices and the US dollar in the local and international markets. This market has also grown from cost-arbitrage by speculators moving away from equity derivatives which are subject to securities transaction tax, and hence are more expensive and thus reduce the return on investment from over INR of risk capital invested in a product. The cash settlement process has discouraged true hedging interest from participating in the market. Collectively, it has exposed the market to the vagaries of speculative trading, with low economic benefits to end-users.

Two solutions have been proposed. First, moving to delivery based could attract end-user hedging interest, and bring core liquidity to the market. Second, corporate India needs customized hedging solutions, and allowing such instruments to be processed through central trading platforms and clearing houses can reduce systemic risk, attract participation, and help achieve quantum growth in the more plain vanilla exchange traded FX futures and options markets.

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Dr. Sayee Srinivasan is the head of Product Strategy at the Bombay Stock Exchange. He has over 10 years of experience in developing products across multiple asset classes including equities, interest rates, corporate bonds and foreign exchange. He has worked with the CME Group, as Director of Asian Product and Market Development, based out of Mumbai. In addition to his experience at the CME, he also worked at the NSE, on derivatives market development, and at OptiMark Technologies in the US, developing electronic trading systems.

He graduated with a B.Com in accounting followed by MMS in Finance from Mumbai University. He went on to obtain a doctorate in Economics from the University of Texas at Austin.

Currency Futures and Derivative Exchanges in India

Mr Rajat Prasad, *Head Treasury and Forex*
Gitanjali Group

Currency Futures and Derivatives market has completed three years of successful stint in India. There is a link between a well functioning currency derivatives market and the ability of the economy to absorb exchange rate fluctuations.

It took 36 years from the date of the innovation (currency futures at CME) to get started with trading in India but in a short span of 3 years, the CD segment has witnessed a rapid development with the onset of new generation exchanges, soon overtaking the equities cash segment.

Amidst the recent volatility in financial markets across the globe, while the interest and confidence of equity market participants is on the wane, the exchange traded currency segment in India is witnessing a steady growth, fuelled by increasing interests from more and more hedgers and other market participants.

The currency futures and derivatives have grown both in volumes and open interest. Combined volumes of USD/INR contract on NSE and MCX has reached an average of Rs. 26,000 crores while the open interest in USD/INR future contract is on an average $ 3 billion. The volumes of USD/INR option contracts on NSE platform has reached to an average of Rs 6000 crores with an average open interest of USD 3 billion. This shows the depth of currency futures and derivative markets on new generation exchanges.

OTC Market - A market for hedgers

OTC market is ideal for corporates who want to hedge their actual exposure on deliverable basis. They can book the actual amount up to the last cent. Forward contract can be booked for any date not necessarily for the month end and also for a period of time if the receivable / payables are maturing within that time period and exact due dates are not certain. This makes OTC market ideal for booking contracts against actual receivables / payables.

Reserve Bank has put lot of restrictions on Customers using the OTC market so that the OTC market is primarily used for Hedging the Forex Exposure and not for trading. Corporates wanting to book forward contracts on OTC market have to show their underline exposure. They can also book Forward contract on past performance basis but under this facility it is mandatory to deliver 25% of bookings for exporter and 75% for importers.

There are lot of restrictions on OTC market for cancelation and rebooking of contracts. Any contract booked under actual underline if cancelled once cannot be rebooked. Also if a contract booked under past performance facility is cancelled the profit is not passed but the losses are recovered. These restrictions make OTC market unattractive for traders who want to make money taking advantage of volatility in Forex markets.

OTC derivatives market is very shallow and only a few banks are permitted to run their own books. Other banks cover back to back with these banks. Plain selling of derivatives and receiving of net premium is not permitted in OTC derivatives Market. Corporates can use these products to hedge their exposure with limited loss (premium paid) and unlimited gains (Currency movement in direction of the option purchased).

During the financial crisis of 2008, a number of instances came to light where adverse positions of clients were allowed to run and later the Forex losses were converted to medium term loans. OTC cost reduction derivative structures were sold by banks without explaining the risks involved in such structures. This had put counterparty risk and financial stress on the Banking sector as a whole.

Currency Futures - An alternative to OTC

Currency futures market has become an alternate platform for people using the OTC market .Actual hedgers face many practical difficulties in OTC market .Corporates having smaller forex exposure do not get limits to book Forward contracts or the brokerage charged by banks is very high. These corporates use currency futures market to hedge their exposures as they can book even $1000 in this market and brokerage charged is same irrespective of the amount.

There are a number of transactions where the actual date/month of payment is not known. In OTC market maximum permissible period of booking is 1 month option period. Such hedgers book their exposure for the first month in currency futures market, roll it over near the month end and cancel the contract on actual delivery to their bank.

Corporates who want to use derivatives to hedge their exposure have also started using the exchange traded currency derivative markets. This platform has helped them in price discovery and hedging through options can be done for smaller quantity also. Corporates can also use cost reduction structures on this platform as there is no restriction on plain selling of options in exchange traded derivative segment.

Currency Futures and derivative segment on exchanges have another advantage of less documentation after execution of trades. Instances of hiding the trades from top management and blowing out of proportion of hedge books is also prevented due to daily Mark to Market mechanism.

OTC market is executed primarily over the phone. In the recent volatility it was observed that execution of deals in OTC market was not very smooth due to congestion of phone lines or non availability of price in the market. Currency Futures and Derivatives segment ion exchanges is online system driven hence better execution of trades is possible.

Exchanges carry out the clearing and settlement of the trades executed in the futures and derivatives segment through a well-defined settlement cycle and there are no deviations or deferments from this cycle. It aggregates trades over a trading period, nets the positions to determine the liabilities of members and ensures movement of funds and securities to meet respective liabilities thus Currency futures market takes away the counterparty risk from the forex market.

Exchanges have put in place a comprehensive risk management system, which is constantly upgraded to pre-empt market failures. The Clearing Corporation ensures that trading member obligations are commensurate with their net worth. Mark to market margin on daily basis ensures that the client position does not blow out of proportion.

Currency Exchanges - An opportunity for traders.

Exchange has automated screen based trading, modern, fully computerised trading system designed to offer investors across the length and breadth of the country a safe and easy way to invest. The NSE trading system called 'National Exchange for Automated Trading' (NEAT) and ODIN from MCX are fully automated screen based trading systems, which adopt the principle of an order driven market.

Traders have started using the currency exchange platform for proprietary trading. Extreme volatility in currency markets provides more opportunities for traders to make money in this market. Even individuals can trade in this market as there are no preconditions to have an exposure to use this platform.

Traders have an incentive to do more on currency instead of Nifty because of zero STT, zero transactions charge and less brokerage. A number of participants of equity derivative segments have shifted to currency derivative segment due to high volatility and thus returns are more.

Currency Exchanges - the limitations faced.

Currency exchanges have only four currency pairs viz. USD/INR, EUR/INR, GBP/INR and JPY/INR so corporates having exposure in other currencies have no alternatives to the OTC Market.

Currency Exchanges have only month end contracts. People having exposure maturing in odd dates have to use workaround methods in exchanges like booking for month end and unwinding on exact date if they want to hedge such exposures on currency exchange market.

Exchange traded futures are cash settled and not deliverable while such contracts are available on commodity exchanges. In commodity market delivery options are available for Gold / Silver and other commodities. Deliverable contracts will put more pressure on OTC market for better performance and competitive brokerages.

Currency exchanges are tilted in favour of small and medium corporates due to limited open position limit for all currency pairs at client level. Another limitation is thin liquidity in contracts having expiry of more than one month. In cross currency futures this liquidity is very thin even in current month expiry.

Roadmap ahead

Currency futures market can introduce more currency pairs like AUD/INR, CHF/INR etc for other market participants. Currency option market should also introduce option in other cross currencies like

EUR/INR,GBP/INR etc. Introduction of weekly contracts will provide better opportunities for hedgers to manage their risks.

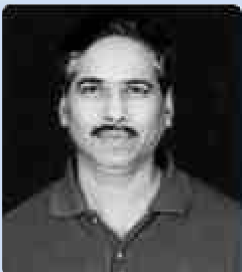
Currency Futures market can also introduce delivery based contracts where the client will give settlement instructions. In such contracts the exchange can mitigate risk by asking clients to pay the full value in advance and then charge MTM on a daily basis.

Currency futures markets after three years of stability and depth has come to a stage where the net open position limit at client level can be increased. This will attract even bigger corporates to this market which in turn will also solve the problem of limited liquidity to some extent.

Currency futures can also offer variety of contracts for same currency like mini ($1000 lot), midi ($10,0000) and mega ($100,000). This will also help bring bigger players and more liquidity in exchanges.

Conclusion

Three years of successful growth of currency exchanges have ensured that this segment is here to stay along with the OTC market. Introduction of variety of currencies and contracts will increase the depth and liquidity in this market. Promotion of currency futures and derivatives market will also work as risk mitigation tool for Indian Banking System.



Mr Rajat Prasad
Head - Terasury and Forex
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Head – Treasury and Forex at Gitanjali Group of companies. A certified treasury Manager from I C F A I with a total 21 years of experience in Banking and Corporate world. Having 9 years of exposure in treasury operation including 7 years in Bank of India Treasury and 2 years in Gitanjali Group. Involved in currency futures and derivatives extensively for hedging the forex exposure.

Three Years of Currency Futures

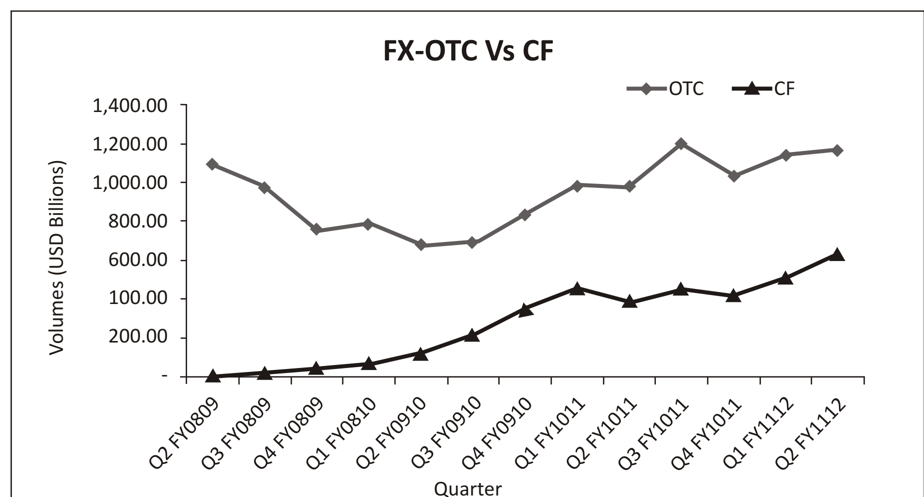
Mr Shrikant Subbarayan, Director
Greenback Financial & FX Services Pvt Ltd.

Currency Futures - Objectives

In a landmark move on 6th Aug. '08, RBI had allowed trading of currency futures in recognized stock exchanges. In RBI's words the main objective of allowing currency futures was to provide wider hedging opportunities that would enhance the flexibility for the residents to manage their currency risk in a more dynamic way. Moreover, it was also observed from International experiences that the exchange traded currency futures contracts facilitate efficient price discovery, enable better counterparty credit risk management, wider participation, trading of standardized products, reduce transaction costs, etc. Initially trading was limited only to USDINR pair and after three years now we have three more currency pairs viz. EURINR, GBPINR and JPYINR being traded.

Evolution of Currency Futures

- **USDINR pair trading was launched**
- **Calendar Spread allowed**
- **EURINR, GBPINR, JPYINR pairs allowed in Currency Futures**
- **Exchange traded Options allowed in USDINR pair**



Currency Futures - Performance Score Card

None of the mentioned objectives of efficient price discovery, better counterparty credit risk management, wider participation, trading of standardized product, reduced transaction costs can be evaluated if volumes are insufficient. Hence, volume is a key indicator to analyze the effectiveness of Currency futures.

Volumes: The Currency Futures market in India has grown consistently and the combined volumes of the major three exchanges clocked more than USD 630 Billion in the quarter ended September 2011, rising from around the modest volumes of USD 20 Billion seen in the final four months of 2008 after its initial launch. The traditional OTC markets saw a volume of above USD 1163 Billion in the same period as per the data available from CCIL (The clearing Corporation of India Limited). The gap between the OTC & the Currency Futures markets are reducing considerably. Neither the commodities markets nor the equities market have seen such a huge growth in volumes in the initial three years of their existence. While the growth has been commendable & spectacular it is also to be noted that 95% of the total volumes are still confined to the USDINR pair.

On the other parameters too, the currency futures markets has evolved better than expected. The near month contracts liquidity is high with bid- ask spread as low as 0.25 paise. Highly transparent price quotes coupled with rising volumes are helping in efficient price discovery of the markets. SMEs &

MSMEs have benefited a lot with transparent & fixed transaction costs which are much lower when compared to the OTC markets. With the exchanges being the counterparty to participants along with stringent margins & Marked to Market (MTMs) practices counter party credit default risk is completely eliminated.

Objective	Performance	Scope for Improvement
Volumes	Huge Liquidity seen in Near month contracts	Longer Tenor Contracts still Illiquid
Efficient Price Discovery	Bid - Ask spread as low as 0.25 paise	
Counter Party Credit Risk Management	Stringent Margins & MTM systems allow exchanges to eliminate Counter Party Risk	
Wider Participation	Most volumes still limited to speculative trades	Lots to Improve
Transaction cost	Much lower than OTC markets	
Price Transparency	Highly transparent vis a vis the OTC markets.	

Scope for Improvements

Corporate Participation: The exchanges so far haven't seen much participation from corporate due to two major reasons -

i) The Currency Futures markets were in their nascent stage & the market volumes were not deep enough to absorb the corporate volumes.

ii) The corporate also shied away from the currency futures markets due to the upfront margin requirements and daily MTMs.

To take positions in the exchange, corporate needed to pay upfront margins and they also need to shell out Marked to market (MTM) losses, if any, on a daily basis which affects their working capital. While many corporate think of this as a disadvantage they fail to realize that it is an inbuilt risk management system whereby the decision making process on loss making positions are quickly made & allows them to retune their strategy with the market. Hence, the margins & MTMS work in favour of the end user if observed keenly.

Even though, the margin based limits & daily MTMs are standard practices that avoids risk of default, it was comfortable for corporate to work with the OTC markets where the limits were based on limits and MTMs were not stringent. Now with the recent guidelines from RBI on hedging through Forward Markets, corporate should look into having an alternate hedging platform apart from the traditional Forward contracts.

RBI, a proactive regulator:

The Reserve Bank of India has time and again proved itself that its moves are in the best interests of the Indian corporate. While the RBI was seen very conservative, it proved to be right when the Indian banking system was one among the least affected by the sub-prime crisis, thanks to the stringent risk management regulations by the RBI. The RBI's recent directive to banks on derivatives is seen as a right step forward to avoid the repetition of the derivative mess that took a toll on the financial health of major corporate houses in the recent past.

Study of financial crisis from the developed economies including the US & Euro zone would show that all major financial crisis originated from the OTC markets. Whether, it may be the sub-prime crisis of the US which shook the global financial markets or the current European debt crisis which threatens the survival of the Eurozone are results of the inability of the OTC markets in efficient price discovery and recognizing resultant MTM losses. This causes financial bubbles which eventually causes financial destruction.

RBI through its recent move to arrest one sided speculative bets against the Rupee in the onshore & offshore markets came up with measures to curb speculation in the OTC markets. RBI made a master stroke by literally banning

speculation in the onshore OTC markets. While not allowing cancellation & rebooking of forward contracts, RBI also reduced the past performance limits of importers, through which probable payments were hedged. It also reduced the Net Overnight Open Positions of Primary dealers. With this move, RBI leads the way in arresting overleveraged speculative bets in the OTC markets & indirectly directing speculators to move towards the efficient & disciplined exchange traded products. RBI has shown the way to the western regulators that the initial step in preventing financial catastrophes is the shifting of products from OTC markets towards regulated exchanges and it has showcased & managed the effective transition of the same.

Increased Volatility

- **Intraday moves averaging 40 paise in Q4 of 2011 against 12 paise in Q4 of 2007**
- **Gaps between close & next day open has shot up to 17 paise from 5 paise in the respective periods**

Way Ahead:

Exchange Timings: RBI's twin objective in the effective management of the exchange rate is to reduce volatility & to maintain the Real Effective Exchange Rate (REER) of the rupee. With increased globalization and the evolving debt problems arising from the developed worlds, the overnight volatility of the exchange rates have considerably increased. The average gap between a day's closing price & the next day's opening price in the USDINR has increased by 240% from around 5 paise in the quarter ended Dec. '07 to around 17 paise for the same period in 2011. Also, the intraday price moves has shot up by 230% from 12 paise to 40 paise in the respective periods. With this increased volatility, corporate in the SME & MSME segments are more often caught on the wrong foot. Hence, it would be prudent to increase the currency exchange timings to 11:30 pm when the London & New York markets close. With Indian commodity markets already operating in the same timings along with clearing & trading infrastructure already in place, the transition could be effected very easily. As the markets would be able to react to global changes almost instantaneously, the management of risk arising out of such moves can be dealt within the trading hours rather than reacting to the same in a panic mode in the next morning. This will also reduce the frequency of intervention from the regulators to curb volatility and thus meet an important objective.

Wider Participation:

The regulators, exchanges, brokers & the industry associations need to work together towards spreading awareness regarding the benefits of the Currency Futures & help in the increased participation. This knowledge up gradation process would particularly help the SME &

MSME segments who bear the brunt of wild swings in currencies.

Regulatory Oversight:

The regulator must ensure the highest level of governance among the exchanges. Rationalization of transaction costs is a must and uniform transaction costs should be adopted by all the exchanges.

Delivery:

In due course, delivery on the exchanges can be facilitated. While this may seem strange, international models are already in place where both cash settlements as well as settlement through delivery co-exist. Such a market will ensure complete migration from the OTC markets to the Exchange Traded Currency Futures markets.

Currency futures markets now have sufficient volumes to accept the corporate hedging requirements. Corporate would be well advised to accept the inherent advantages of risk management by way of margining & mark to markets which only the currency futures market offers. This will augur for a healthy corporate India and hence a disciplined & a healthy financial system.

To summarize, Currency futures has come a long way in these three years and we believe that the RBI's vision of "Currency Futures is the way ahead" will become a reality in the near future.

Mr Shrikant Subbrayan
Director
Greenback financial & FX Services Pvt. Ltd

Shrikant Subbarayan is widely regarded as one of the key figures instrumental in developing financial markets in India. He has been closely associated with the setup and launch of both the currency and commodity futures markets. A unique 360 degree understanding of the Exchange perspective, Industry perspective and a Trading perspective has helped him create a niche in the marketplace. This coupled with practical insight has helped him earn respect in industry circles.

He is currently Director, Greenback Financial & FX Services Pvt Ltd.

Greenback Financial & FX Services Pvt. Ltd (GBFFS) is a trading member of the currency futures exchanges (NSE, MCX-SX & USE) in India since 2008. GBFFS has been promoted by Greenback Forex Services Pvt. Ltd. - one of India's most renowned consultants in the area of Currency & Interest Rate Risk Management since 1995 and currently serving more than 1500 corporate clients across India.

GBFFS provides hedging/trading solutions for corporate houses through the Currency futures platform. Solid Research, Sound Understanding & Comprehensive Knowledge of the Global & Indian FX markets gives us an edge over other players in the market.

Currency Derivatives in India: From Infancy to Maturity

Dr Alok Pandey
Director - Advanced Studies
ICWAI

Warren Buffet in the Berkshire Hathway Annual report 2002 calledDerivatives "financial weapons of mass destruction, carrying dangers , that while now latent are potentially lethal". He however had praised derivatives later in his annual letter to shareholders of Berkshire Hathaway published in March 2008. The dichotomy of derivatives use is however not restricted to Warren Buffet only. There are strong views worldwide for and against them with reactions ranging from prudence to caution and at times downright imposition on restrictions on their usage.

The currency derivative markets are an essential component of currency risk management in the modern international system and despite all the drawbacks and criticism of other exotic financial derivative contracts have been responsible for liquidity in the international currency markets by bringing, hedgers, arbitrageurs and speculators together.Milton Fried man when commissioned to study the introduction of currency derivatives markets in 1970's had said:

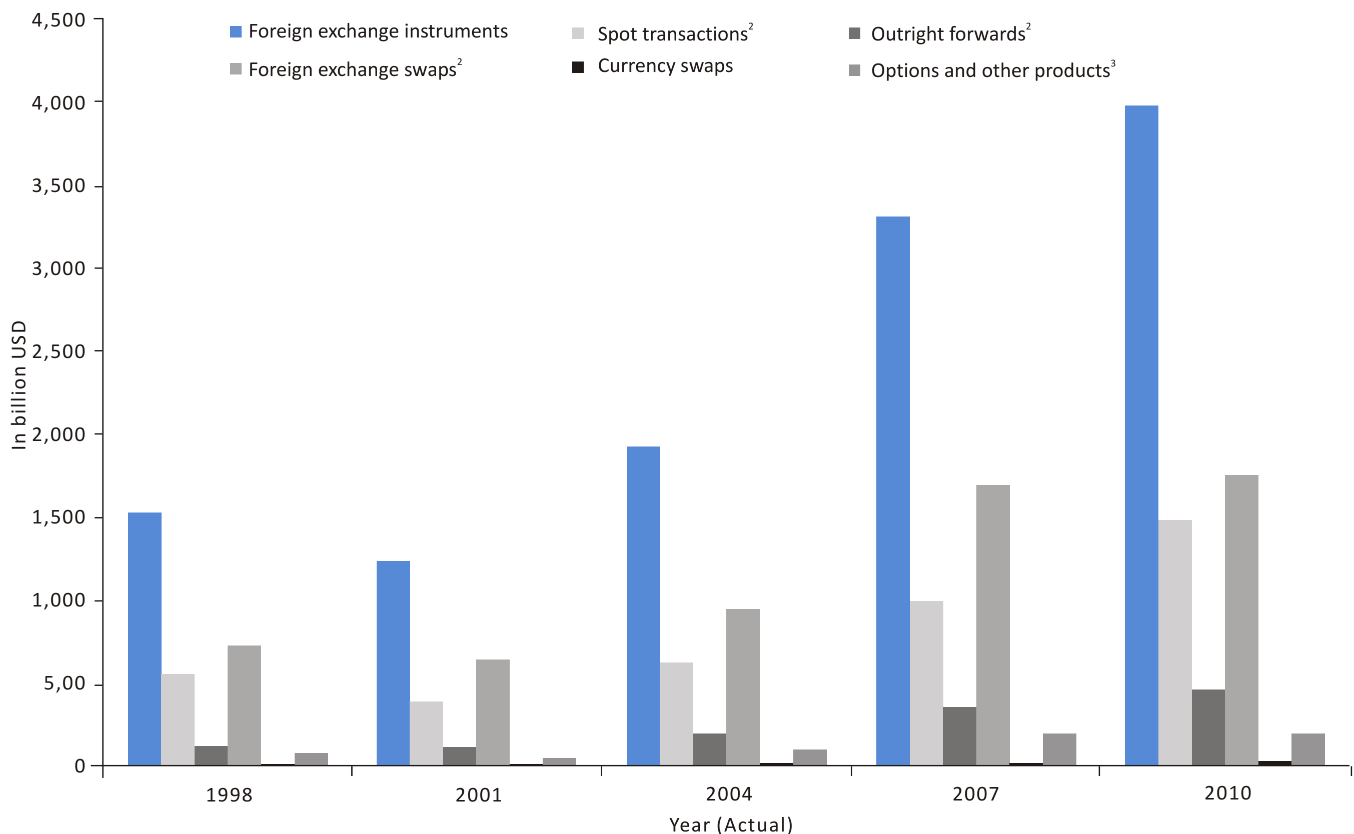
"Changes in the international financial structure will create agreat expansion in the demand for foreign cover. It is highly desirable that this demand be met by as broad, as deep, as resilient a futures market in foreign currencies as possible in order to facilitate foreign trade and investment. Such a wider market is almost certain to develop in response to the demand. The major open question is where. The U.S. is a natural place and it is very much in the interests of the U.S. that it should develop here."

The Reserve Bank of India in its report on introduction of currency futures published in April 2008, however used cautious optimism and said,

"While prima facie dollarisation does not appear to be a significant probability, it is reasonably clear that costs of dollarisation could far outweigh the benefits for an economy like India's, as the country has neither faced nor is facing high/hyper inflation or a loss of confidence in its currency.The initial trends are encouraging with volumes considerably higher than expected by policy makers and regulators. The volumes are expected to be higher as the volatile climate for major currencies continues."

It is to be noted that currency over the counter currency options were introduced in India in 2004 and did not lead to any major problem either for the Indian currency or the financial system as a whole. The OTC markets worldwide are much bigger worldwide than their exchange traded versions. However, since the introduction of currency futures in a country like India we have seen strong upswing in the volume of traded currency derivatives which is much higher than the activity in the OTC segment.

Currency derivatives on the whole make up the smallest segment of the global derivatives marketand the daily average turnover grew at a blistering pace worldwide from a level of $ 1,490 bn in 1998 to $3,981 bn USD by April 2010 as per the BIS triennial survey, a CAGR of close to 9% over a decade. Despite financial crisis the growth was up stellar 142 per cent in 2010 largely due to Indian market that accounts for 71 per cent of the turnover. MCX-SX registered 294 per cent year-on-year growth in the number of contracts traded, while NSE grew 221 per cent. Currency futures accounted for most of the currency derivatives volume in India since currency options have been introduced only recently.

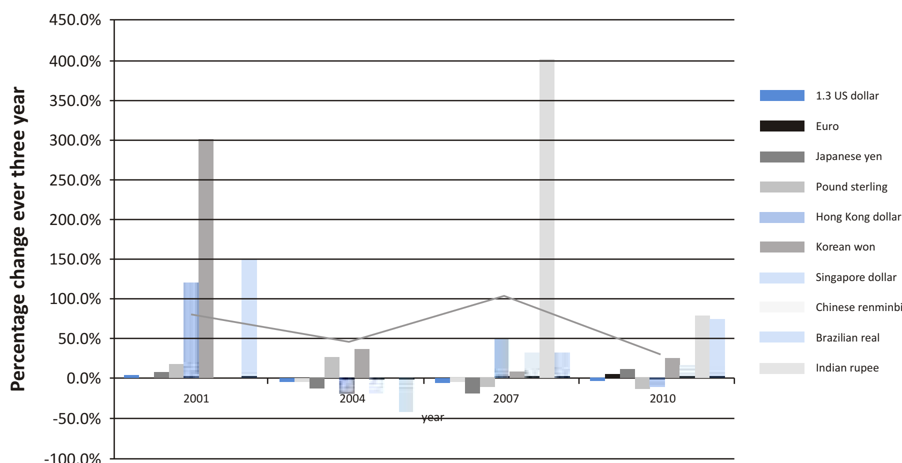


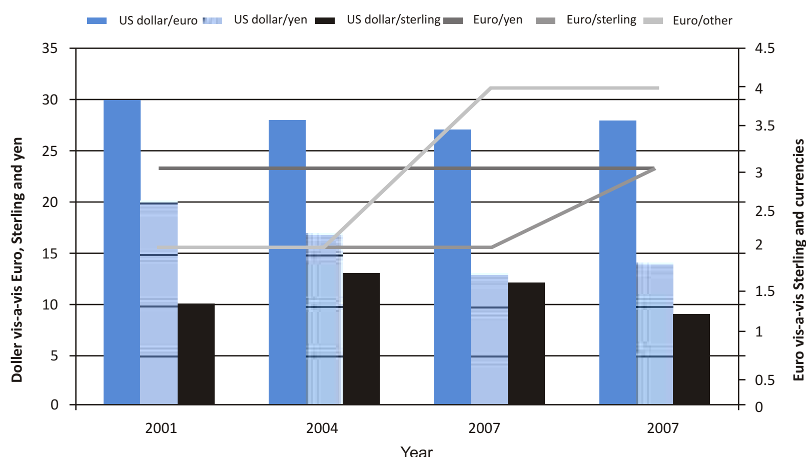
The trading is allowed in four currency pairs of dollar-rupee, euro-rupee, pound-rupee and yen-rupee pairs, it is the dollar-rupee pair that is most widely traded and accounted for almost 90 per cent of the turnover in 2010. Among the three exchanges namely NSE, USE and MCX -SX the performance has been mixed. The USE started aggressively in the currency derivatives market only to lose out to MCX-SX later. The two Indian exchanges MCX-SX along

with NSE look like emerging global leaders in terms of the number of contracts traded in currency futures in 2010 with 885 million contracts and 726 million contracts respectively.

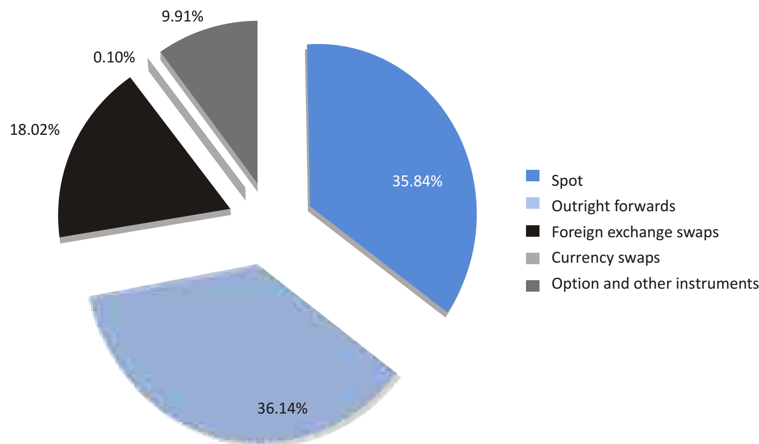
In terms of the notional value of the contract traded, however, Indian exchanges are not the leaders. That spot is occupied by Chicago Mercantile Exchange group that traded contracts worth $29,979 billion as against $908 billion traded on MCX-SX. The same is the story of Indian Rupee along with the Indian economy despite its robust growth figures remains a fringe player in terms of global trade, investments and financial linkages with rest of the world.

Currency derivatives markets are still in their infancy in Indiadespite the claims by regulators such as SEEBI and RBI that the markets have matured. The OTC market has been there in the form of forwards swaps and options for some time. The traded derivative markets in currencies started three years ago with NSE, MCX-SX and USE trading currency futures and later on currency options.





Currency and instrument distribution of Indian Foreign exchange market daily turnover (April 2010)



The markets lack product innovation with plain vanilla being the current flavor in currency option and only two out of these these three exchanges being allowed to offer them. Too much caution can kill the innovation and creation of capacity of risk management in these systems in infancy.Curiousity may kill the proverbial goose but caging the goose may make it unhealthy. It may never become strong enough to fly and probably too ill to be consumed.

The Securities and Exchange Board of India (SEBI) in 2010 had given approval to the National Stock Exchange (NSE) and United Stock Exchange (USE) to commence trading in currency options contracts. However, MCX Stock Exchange (MCX-SX) continued to remain barred from launching new products including currency options. The regulator must understand that the appetite of Indian businesses and bank with respect to currency trading and risk management is rapidly growing. The evidence lies in the fact that the USEwithin one year of commencement of operations in currency futures trading clocked an average turnover of Rs 23,100 crores(September 20,2010) leaving the other two older exchanges far behind.

Inter exchange competition needs to be given a boost by the regulators to ensure that these exchanges keep investing in new trading technology, better risk management processes and follow international practices in corporate governance. Promoting monopoly during the stages of infancy of currencyderivative markets would be disastrous for end users of these intermediaries and newest market infrastructural institutions. The Indian investor in the equity market greatly benefitted from increased competition among the exchanges during the nineties largely due to open transparent and clear objectives set by the regulators to increase the depth of the market through higher participation of common investor. Technology allowed benefits such as dematerialization and online

trading. The investors, corporates, banks and regulators all are therefore expecting similar approach from regulators so that they may also gain from technology driven, low cost foreign currency transactions from Indian currency derivative markets.

It is highly desirable that all players be accorded same status and be given the freedom to offer a wider set of product portfolios. This will help the exchanges to attract human resources and talent to build up financial engineering expertise for better risk management in the volatile currencyenvironment in a crisis prone world economy. With bigger product set would come process innovation. Internationally over the past three decades several innovative practices for clearing and settlement have been adopted. Such practices need adoption and adaptation in accordance with the Indian financial environment. The demand of foreign currency in India has been rising especially in the High Net worth Individual segment of the population and the medium size entities on account of personal, credit and other trade related usage. These segments are the ones who may become the real users over next decade. The currency derivative trading also allows and supports Currency overlay services such as advice on forex aspects of security portfolio of clients holding international portfolioswhich is a reality for NRIs and FIIs today and with rapidly changing international outlook of Indian establishment may become a reality for Indian investor looking forward to hold international portfolios.

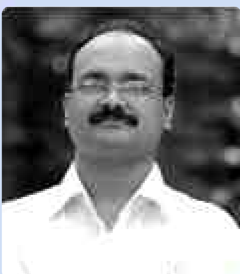
Practices such as prime brokerage and white labeling may find more prominent use for such segments by the market makers and large foreign exchange dealers. The enhancement of liquidity in fixed income markets, introduction of options on trade weighted indices and development of Credit Derivatives in India along with continued growth of Non Deliverable Forward (NDF) markets are some parallel innovations which will support the growth of currency derivative markets and in return shall help themselves get benefitted by innovations in processes in currency derivative markets in India. The development of non-deliverable forward markets has been an important step which actually supported the liquidity in currency futures and option markets. The traded options shall allow better price discovery in long run for the OTC markets as well and make treasury operations more viable for Indian banks, multinationals exporters and importers. One big advantage of traded currency products is better understanding

and forecasting of actual and implied volatility numbers. Thisalso improves the validity of VaR numbers and makes easier for dealers to advise the hedgers trying to manage the downside of the payoff. The traded options shall also allow better price discovery in long run and make treasury operations viable for Indian banks, multinationals exporters and importers.

Accounting and reporting of currency derivativesin India largely dependent on western formats and standards. With IFRS becoming order of the day in many countries the accounting standards are being modified and adapted at a much faster pace worldwide. Very little research is being done in this direction in India by academic institutions and other statutory bodies to develop the same in

Indian context. It is expected that studies be undertaken by the regulators, industry associations, statutory bodies and independent researchers to understand the use of currency derivatives for not just transaction exposure management but also operating and translation exposurefaced by corporates, banks and the foreign exchange dealers. An annual currency derivative survey needs to be conducted in India to ensure that we do not make currency derivatives weapons of economic mass destruction but tools of wealth maximization.

Development of currency markets are a must for this poor but growing economy duringturbulent times when even international financial market structure is under tremendous strain. Improving market microstructure of the fledgling foreign currency markets in India, of whose currency derivative trading is an integral part is a necessity today. Only a vibrant and strong currency market can improve trade and investment climate for a country whose contribution to international trade, investment and capital formation is one of the lowest in the world.



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Exchange Traded Currency Derivatives in India-Road Ahead

Mr K G Mantri, *Sr. VP - Corporate Affairs*
MAN Industries (India) Ltd

Domestic currency is a medium of exchange but foreign currency is a class of asset or commodity, just like gold silver, shares and securities, land etc. In an inflationary economy like India the value of domestic currency keeps falling. Presently INR value is less than one percent of what it was at the time of independence. In a deflationary economy like Japan it's the other way round. In last 40 years the Japanese currency has appreciated more than 400%.

Derivative markets are devised for various classes of assets with an idea of providing a platform for seamless trading and finest price discovery. Derivatives are therefore "shadow Markets" of Real Objects (Assets). The purpose is very much achieved. The size of global economy expanded manifold but over a period of time the size of these "shadows" became larger than life (read real assets/objects). It resulted in interesting situation in which now shadows are moving the objects instead of objects moving shadows. In the current scenario outstanding derivative contracts globally are several times more than the real underlying assets of different classes. For example, the daily turnover of crude futures traded on various exchanges globally is more than the actual annual output and consumption. We have seen in the recent past the price movement of crude is no more a function of actual production and consumption but more a function of speculative positions. Disproportionately large size of derivatives market has thrown big challenges and threatened the very existence of several economies in the world.

Despite the above perception on derivatives that they are posing a significant challenge to the global economists, introduction of currency derivatives in Indian securities markets was a right decision at the right time.

The exchange traded currency futures market is an extension of the already available OTC market, with added benefits of greater accessibility to potential participants; higher price transparency; high liquidity; standardized contracts; counterparty risk management through clearing corporation and no requirement of underlying exposure in the currency.

The Indian Economy started opening since 1991, but US Dollar remained an alluring asset for the resident Indians till introduction of currency futures in 2008. In last 20 years, we are moving towards Capital Account Convertibility in a calibrated manner. Exchange Traded Currency Derivatives is a judicious move in this direction. All those who are interested in taking long or short position on Dollar, can do so by trading on these electronic trading platforms. For investors, it is another assets class.

For those who are engaged in import, export or any other foreign currency related transaction; this is a highly liquid platform for hedging against the fluctuations in the foreign exchange markets. Currently more than 90% of turnover in currency derivatives is derived from metros but as we move on, the small town exporters and importers are going to be the real beneficiaries in long run as local banks can never provide them so much liquid and efficient platform for their import export activities. Imagine a village keralite resident Indian is hedging his monthly receivable from his relative working in Middle East and taking advantage of currency fluctuations as well as hedging against the risk. Imagine an SME exporter is able to discover right conversion price through these exchanges and not burdened by the inefficient banking system in remote areas. In the globalised business environment where it is becoming increasingly difficult to protect shrinking margins coupled with volatile currency, the exchange traded currency derivatives provide a seamless and efficient hedging platform.

The third category of people are the arbitrageurs who get the opportunity of trading in currency futures by simultaneous purchase and sale in different markets taking advantage of differential between different markets because at any time one or the other market is open somewhere in the world, effectively making it 24 hour market.

The forth category of people are most hated but an integral part of any derivative markets. They are speculators alias punters. They may or may not make money but undoubtedly provide depth to the market. The significant burden of loss or profit from currency volatility gets shifted to the shoulders of these unwanted participants but they provide stability and easy entry-exit to the genuine hedgers. I believe that this category of people is more active in our Currency Derivatives Market at present. Large genuine players are using OTC and NDF markets. However, the recently announced restrictions by RBI to curb speculation by corporates in OTC market are likely to divert significant volumes to Exchanges Traded Currency Derivatives.

The growth witnessed in the currency derivatives market so far is phenomenal but its only tip of the iceberg. In terms of products, participation and geographic penetration a lot more is going to happen in the years to come. FIIs and NRIs are significant participants in foreign exchange flows in the country still they depend more on NDF market for their hedging/arbitration requirements. Their participation in due course will further deepen the markets. Soon nationwide launch of 4G services

will unfold next level of revolution in mobile and wireless internet technology enabling deeper penetration of Exchange Traded Currency Derivative Market in India.

The very reason of phenomenal growth of currency derivatives is that the participants in this market have high degree of faith because there is no possibility of manipulation as compared to other commodities derivatives. This is largely because of the fact that the currency markets world over are near perfect and well regulated and a handful of operators can't rig the markets. At the same time, a robust underlying USD 1.7 trillion economy with more than USD 1 trillion of foreign exchange movement annually in and out of the country in the form of imports, exports, services, remittances, investments etc is a strong backbone of the currency derivatives.

Indian Currency derivative markets too have many challenges. Significant volume of these markets is eaten away by NDF markets because of restrictions on the participation of NRIs and FIIs. Sooner or later RBI and Government will decide to open these markets for the two vital categories of participants. This in fact, tantamount to Capital Account Convertibility for all intents and purposes hence the move will come very slowly. However, this is possible with in built checks and balances in the form of margin, client/market wide open limit restrictions and improved monitoring systems. This single move has the capacity to transform the shape of currency trading in the country but at the same time fraught with risk of destabilizing the Economy. The kind of wild moves seen in stock markets due to FII participation are not uncommon in India and other emerging economies; hence every step in this direction has to be treaded carefully.

The NDF market accounted for about 50% of dollar-rupee market, according to a triennial central bank survey on foreign exchange and derivatives market activity by the Bank for International Settlements (BIS) released in 2011. An NDF is a cash-settled, short-term forward contract on a foreign currency. The offshore Non Deliverable Forward (NDF) market in the Indian Rupee has been witnessing increasing volumes. The average daily trading volume of approximately USD 1000 million during 2010-11 in the NDF markets for Indian rupee. Most major foreign banks offer NDFs, but Indian banks are barred from doing so.

These markets have evolved for the Indian Rupee, as for other emerging market currencies, following foreign exchange convertibility restrictions. It is serving as an avenue for non-domestic players, private companies and investors in India to hedge

foreign currency exposure. This market also derives liquidity from nonresidents wishing to speculate in the Indian rupee without exposure to the currency and from arbitrageurs who try to exploit the differentials in the prices in the onshore and offshore markets. Though foreign investors can now transact in the onshore Indian forward markets with greater flexibility, allowing them access to the exchange traded currency futures platform would further help in getting the volumes in the NDF market onshore and enhance the liquidity on the domestic exchanges.

The positions limits for clients trading in this segment are restricted which is major roadblock in the development of an efficient and in depth market with huge participation from all the segments. There is thus a felt need to enhance

these limits in terms of percentage of open interest. For larger exporters and importers these limits may be restrictive and chances are that they might continue to deal in the OTC market, where there is no limit on the hedges.

Another challenge is to provide liquidity in the long dated contracts. There is hardly any liquidity in long dated futures currency derivative contracts traded on MCX-SX, NSE and USE. Long dated options market is virtually non existent even for USD. Exchanges should promote market making in these long dated contracts to make it an attractive place for hedging.

Despite the fact that Exchanges have introduced EUR/INR, JPY/INR, GBP/INR pairs, they continue to derive maximum turnover from only USD/INR contracts, here also market making is needed. There is an urgent need that crosses are also introduced in these markets. EUR/USD and DX will provide further impetus to the currency derivatives market in India.

Ever increasing Cost of transaction is another cause of concern; revenue hungry government and profit hungry exchanges are always ready to kill the goose which lays golden eggs. The temptation to make more money in short term by these monsters has to be kept in check. They too will get their share as the market expands.

Many corporates using currency derivatives for hedging their foreign currency exposure find the requirement of margin and settlement of daily mark to market differences burdensome, especially since there is no such requirement for OTC trades.

Last but not least, the regulator should not adopt partisan approach. While NSE has been allowed launch of both futures and Options segment, MCX-SX has been denied launching Currency Options. This is unfair, if MCX-SX is wrong, it should be banned from futures trading too. As rightly said, a woman can't be partially pregnant; you can't allow an exchange to operate partially. Either it should have full platform or it should be shut till it puts its house in order.

To sum up, currency derivative markets in India are at nascent stage. So long as the shadow is supporting the object (Real Economy) and not moving it, there should be untiring efforts to develop these markets.

The only worry in India is political hooliganism which is capable of making any wise move redundant and blunt in the name of killing speculation and supporting the dormant socialist ideology. But thankfully this has occasionally happened in the financial markets in India so far and hopefully will not happen to currency derivatives. The hope is not unfounded, because recent sharp depreciation in INR has so far not prompted any enlightened politician to demand ban on the exchange traded derivatives.

Mr K G Mantri
Sr. VP-Corporate Affairs
MAN Industries (India) Ltd.

K G Mantri brings on board 25 years of rich experience with corporates, having worked in major Indian metros and in UK & Dubai. Prior to Man Group, he has worked with various organizations of high repute.

K G Mantri has a CAIIB from Indian Institute of Bankers, Mumbai and AICWA from Institute of Cost and Works Accounts of India, Calcutta to his credit. Also, M.Com and LLB from Vikram University.

K G Mantri has a rich experience in Accounts, Finance, Commercial and Corporate Affairs.

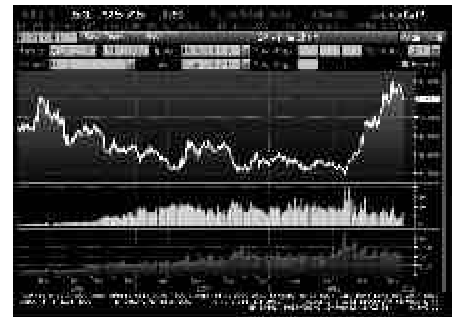
Exchange Traded Currency Derivatives Market-Performance Account

Dr V Shunmugam, *Chief Economist*
MCX Stock Exchange

With the Indian economy driving itself in globalization and liberalization, there was a strong need for policy making to strengthen the support institutions including that of markets. One among them being currency markets, the regulators pushed forward with reforms of the currency markets leading to the formation of the exchange traded currency derivatives segment during 2008. Participants in exchange traded derivative markets were provided with an opportunity to participate in the price discovery mechanism of the exchange market. With more than three years since the inception of the exchange traded derivatives segment, below is an effort to account for the growth of the exchange traded currency derivatives segment and its benefits to the ecosystem and its stakeholders.

Exchange Traded Currency Derivatives – A Historical Account:

With a compounded average annual growth rate of 119 percent over a period of CY 2009 to CY 2011, the daily turnover in the exchange traded currency derivatives increased to the highest level of INR 1,091 billion on 27 July 2011. Despite being a late starter, MCX-SX volumes continued to scale newer heights with a CAGR of 94 percent during CY 2009 – CY 2011 more or less towing in line with that of the CAGR of 119 percent for the markets as a whole. The currency derivatives segment which started with only the USD-INR futures contracts to trade with, saw the entry of futures contracts in three other major currency pairs namely EURO-INR, GBP-INR, and JPY-INR, on Feb 01, 2010, thanks to the



calibrated reforms of our joint Regulators RBI and SEBI, in line with the concentration in our external currency transactions of the stakeholders and hence the risks associated with it. Towing in line with the physical markets, USD-INR volumes continued to evolve as the major currency pair in terms of traded volumes. Among the currency pairs, USD-INR futures accounted for 96.1 percent compared with 2.0, 1.2, and 0.7 percent respectively of the EUR-INR, GBP-INR, and JPY-INR currency futures of the total volume during December 2011. With the successful

launch of the currency futures on the exchange traded platforms, the regulators allowed trading in options in USD-INR and the same was launched to the market participants on Oct 29, 2010. Comparatively, since their inception till date the exchange traded currency options markets witnessed an average daily turnover of Rs 5000 Crores compared with that of Rs 37,678 Crores of turnover in the exchange traded currency futures markets.

Alternative Markets – OTC/Forward/NDF:

The other markets in currency that have already been in existence and serving the purpose of spot and forward transactions of the stakeholders prior to the launch of exchange traded currency derivatives include the onshore OTC

Spot/OTC Forward market and to a limited extent offshore Non-Deliverable Forward markets While the onshore markets are largely populated by the banks and financial institutions, the offshore market participants, it is reported, consist of various domestic and foreign stakeholders with access to NDF markets predominantly originating from New York, London and Singapore. However, most of the domestic stakeholders are limited to participation in OTC spot markets for their immediate forex needs and to the OTC forward markets for their future and risk management needs. The key differentiator between the onshore and offshore markets is that the offshore NDF markets are purely dollar settled and the onshore exchange traded markets are only rupee settled except in cases where the trades end up in delivery of USD. Whereas the onshore markets are regulated by the central bank, the offshore markets are largely unregulated and clearing of trades in offshore markets is now moving towards the formal clearing houses though this has not been achieved till date. While the NDF markets enabled risk sharing among eligible domestic and the foreign participants, the domestic markets, due to physical exposure restrictions for participation in the OTC forward markets, OTC stakeholders who had one more avenue in the form of exchange traded markets, shifted the risks amongst themselves with each one having cash market exposure on either of the sides of the market. According to the recent BIS Trienniel Survey, during April 2010, turnover in the Spot, Outright Forwards, Foreign Exchange Swaps, other Swaps, Options and other instruments accounted for 35.8, 36.1, 18.0, 0.1, 9.8 percent respectively of the total average daily turnover.

Economic Significance of Markets:

Market for currency enables participants to exchange one for another at a rate agreed upon between them and/or share risks in future exchange rate movement with other participants in the market. To sum it up, a currency market either enables exchange of currency or enables the stakeholders to manage/transfer risks in the same. While it does so,

the relevance of the market lies in how widely participated the market is and how efficiently (or cost effectively) it enables the participants to manage their currency related risks. Hence the market and its economic significance can be measured in terms of the efficiency with which it enables the exchange of currencies between the stakeholders. However, an exchange traded derivatives market which settles in cash enables risk management for its participants. While doing so, the efficiency of an exchange traded currency derivatives segment lies in how much cost effectively they can manage their risks. Cost of risk management is the sum of cost of participating on an exchange traded platform in addition to the cost incurred while at the market i.e the price fluctuation and the ability to manage the same cost effectively in a plain vanilla futures market. To put it simply, the cost efficiency of participating in a market is a function of the spread in the bid and ask prices in a plain vanilla derivatives market. Technically called as 'Bid-Ask Spread' (BAS) is a measure by which the efficiency of the futures markets can be compared. BAS could practically range from anything to one tick (allowed price increment) level. In markets trading on similar contracts, ultimate efficiency is said to have been achieved if the price differential on an average at any time during the trading hours existed at near to one tick level i.e. as low as 0.0025 paise

The economic efficiency of the markets has improved since inception. The BAS of the MCX-SX currency derivatives market has been declining since the inception of trading. Though the BAS in the other markets have also improved over a period in time, not only that the decline in the spread has been rapid in the USD-INR futures market but also that the spread is at the lowest possible level. However, taking efficiency to the next level one would have to look into the depth of market. Depth refers to the availability of the lot size at varied price points so that the entry and exit of a participant happens with a minimal disruption to the market's price discovery process. The minimal or nil the disruption the most efficient the market would be and vice versa. . Despite being a standardized lot referring to a lot size of USD1000, with increasing depth of the markets and the lowest possible BAS, medium sized hedgers could cost effectively hedge risk exposure on a real time basis. As the market gathers mass in terms of average order size or the depth, it could help stakeholders with larger exposure requirement of more than USD 1 million with and yet not moving the market equilibrium in a significant way. There have been several instances where the order sizes have far exceeded the USD 1 million during the past two years.

Exchange Traded Currency Derivatives - Reaching out to wider stakeholders:

Developments in Information and Communication Technology had enabled the participants to connect to the exchange traded currency market places depending on the need for speed and reliability of the connectivity. Thanks to the spread of telecom network, exchange traded services are available through a large number of members of the MCX-SX located in over 673 centers connecting a wide variety of retail participants with a choice for varied modes of connectivity depending on their needs. As on December 31, 2011, there are 751 members of the exchange located across various centers of the country through which the stakeholders can have access to market to fulfill their risk management requirements. Depending on cost expectations, a currency hedger ranging from a small time exporter to a large manufacturing firm can access the exchange traded currency derivatives market through a variety of ways to manage their currency exposure risks. Though the market intermediation in the currency derivatives segment rode on the back of the other established financial market intermediaries, the lot size and the efforts of MCX-SX in taking the product to the stakeholders through various outreach programs made it a widely accepted product among the market stakeholders. Additionally, existence of well developed financial markets in stock and commodities also helped the stakeholders to manage their currency related risks in an efficient manner.

The way forward:

Being the support institution, the ultimate aim of the policy makers behind the launch of exchange traded currency derivative markets has been to strengthen the market and to make it widely participated so that the economy as a whole, and particularly those having currency expsoures can effectively use a market determined exchange rate for the hedging requirements (this is a negative statement and hence I am removing this) The growth in terms of volumes and participants in the Exchange Traded Currency Derivative Segment would improve the process of assimilation various global and domestic economic information into the markets while it discovers its exchange rates. While doing so, information is best incorporated if done on a real time basis. If not 24

hours in a day, extension of market timings in a day would help incorporate key economic information from the developed markets of EU and US thereby enabling the exporters to negotiate trade deals with their counterparties of the west and secure their realization on a real-time basis. Extension of trading hours would also help participation in the exchange traded currency derivatives markets to mature in terms of reflecting information into markets and thereby become efficient in their price discovery process, besides remaining as the cost effective market for participants with risk management needs. With all regulatory tools in place added with effective monitoring undertaken by the currency exchanges would pose no additional risks while adding value to the participants in terms of providing them with an opportunity to manage currency risks on a real time basis rather than the current practice of carry over besides improving the efficiency of the process of price discovery in the currency futures segment. Theaugmented outreach efforts of the exchanges and regulators would not only broad base the Exchange Traded Currency market but also would take th markets to further heights in future .

Dr V Shunmugam
Chief Economist
MCX Stock Exchange

Dr. V Shunmugam is the Chief Economist at MCX Stock Exchange Pvt Ltd. (MCX-SX), Mumbai. Having obtained extensive experience in economic research, commodity and currency markets and policy analysis, his key responsibility as the Head of Research at MCX-SX is to analyse market data and trends and informing market participants, regulators and policymakers about how the markets are trending and, therefore, the course that ought to be taken in line with the changing global and domestic socio-economic and political needs.

As an expert on forex and commodity markets, Dr. Shunmugam also propagates the need and benefits of hedging risks in foreign currency on the exchange platform via his articles, white paper, case studies, lectures and speeches etc, for various market participants like corporates, SMEs, importers and exporters, among others.

Earlier, Dr. Shunmugam was the Chief Economist at the Multi Commodity Exchange of India Ltd. (MCX), and as the Head - Economic Analysis and Publications Division, he analysed commodity market trends, regulations and policy issues and kept the stakeholders updated about the same.

Dr. Shunmugam regularly contributes research papers, analyses, articles, etc. on subjects ranging from commodities to capital markets to issues related to trade policy, financial markets and the recent global financial crisis in national and international publications of repute, including journals, books, financial dailies and trade publications.

Prior to joining MCX, he was an Agricultural Specialist at US Department of Agriculture (USDA), where he spent more than 8 years.

Dr. Shunmugam has a Ph. D. in Agricultural Economics from Indian Agricultural Research Institute, New Delhi.

Indian Currency Markets - At Cross Roads

Mr Jagannadham Thunuguntla
Strategist & Head of Research
SMC Global Securities

India's financial market has been increasingly getting integrated with the rest of the world through increased trade and finance activity. This has led to a demand for the introduction of exchange traded hedging instruments like currency futures and options to manage foreign currency exchange risk in addition to existing OTC products. With electronic trading and efficient risk management systems, exchange traded currency derivatives were introduced at different points of time through four exchanges, namely NSE, BSE, MCX-SX and USE starting from August 2008 onward.

Trading in USD:INR currency futures contracts started on August 29, 2008 at NSE, on October 1, 2008 at BSE and on October 7, 2008 at MCX-SX. BSE has stopped all its operations in the currency derivatives segment from April 7, 2010. Futures on 3 additional currency pairs, namely, EURO:INR, GBP:INR and JPY:INR were introduced at NSE and MCX-SX on February 1, 2010. Trading on all currency futures pair started at USE on September 20, 2010. Further, options on USD:INR, were introduced at NSE and USE on October 29, 2010.

The currency derivatives segment on NSE and MCX-SX has witnessed an increasing growth over time. At the end of 2010-11, total turnover at NSE stood at Rs 34,49,788 crore as compared to Rs 17,82,608 crore in 2009-10, indicating an increase of 93.5 percent over the year. MCX-SX witnessed an increase of 115.7 percent in trading volume during 2010-11 and turnover at MCX-SX was Rs 41,94,017 crore in 2010-11 as against Rs 19,44,654 crore in 2009-10. USE launched its trading platform on September 20, 2010. The turnover at USE stood at Rs 7,62,501 crore at the end of 2010-11.

	MCX-SX			NSE			USE		
Year	No. of Contracts Traded	Turnover (in Rs Crs)	Open Interest at the end of month (in Rs Crs)	No. of Contracts Traded	Turnover (in Rs Crs)	Open Interest at the end of month (in Rs Crs)	No. of Contracts Traded	Turnover (in Rs Crs)	Open Interest at the end of month (in Rs Crs)
2008-09	29,847,569	148,826	990	32,738,566	162,563	1,313	NA	NA	NA
2009-10	408,166,278	1,944,654	1,951	378,606,983	1,782,608	1,964		NA	NANA
2010-11	903,185,639	4,194,017	3,706	749,602,075	3,449,788	13,690	167,772,367	762,501	109

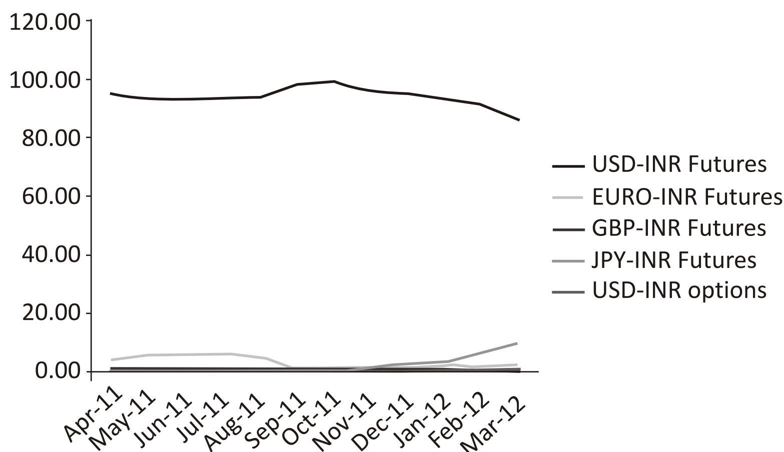
USD-INR futures dominate the market share in terms of number of contracts in currency derivatives segment followed by USD-INR Options, which has consistently increased its market share.

Market Shares of various products

The percentage market shares of various products are as follows:

Month	USD-INR Futures	EURO-INR Futures	GBP-INR Futures	JPY-INR Futures	USD-INR options
Apr-11	94.90	3.80	0.80	0.50	0.00
May-11	92.90	5.70	0.80	0.60	0.00
Jun-11	93.10	5.80	0.60	0.50	0.00
Jul-11	93.10	5.70	0.70	0.50	0.00
Aug-11	93.90	4.60	0.50	1.00	0.00
Sep-11	98.00	1.30	0.30	0.40	0.00
Oct-11	98.90	0.70	0.20	0.20	0.00
Nov-11	96.10	1.30	0.40	0.30	1.90
Dec-11	95.00	1.60	0.40	0.40	2.60
Jan-12	93.30	2.40	0.60	0.30	3.40
Feb-12	91.10	1.80	0.50	0.40	6.20
Mar-12	86.40	2.10	0.60	1.00	9.90

The graphical representation of the market shares is as follows:



Number of Registrations of Trading Members and Clearing Members in Currency Segments of NSE, BSE, MCX-SX and USE

Number of Registrations at the end of March, 2011	NSE	BSE	MCX-SX	USE
Trading Member	760	161	742	339
Clearing Member	172	32	114	49

Rupee Weakness during 2011 and debate on possible RBI intervention

1. The steep rupee depreciation has been occupying lots of thought process in the minds of the market participants and Indian corporate circles.

2. This rupee depreciation has opened up debate regarding the possible RBI's intervention to support rupee.

3. However, close observation of some of the macro ratios can give some perspective regarding whether RBI can intervene or not.

4. There is a ratio of "Forex Reserves to Total External Debt". This ratio indicates the total forex reserves as % of total external debt.

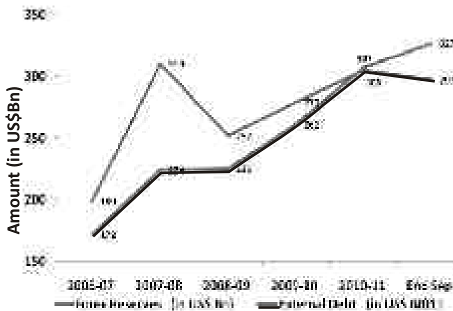
5. Currently (as per the latest data available as of 30th September 2011), this ratio of "Forex Reserves to Total External Debt" is about 90.8. This indicates that the total forex reserves of India are about 90.8% of the total external debt. To put in other words, the total forex reserves are lower than that of total external debt.

6. Where as in the year 2007-08, this ratio was at 138. Meaning thereby, the total forex reserves of India were 138% of total external debt. To put in simple words, India had buffer of excess forex reserves over and above total external debt to handle the global economic shock of 2008 crisis. Such excess forex reserves has also helped RBI to effectively manage the impact on the Rupee during the 2008 crisis. Hence, in the worst depth of 2008 crisis, the rupee has weaken to just Rs 52.17 / $.

7. However, considering the current ratio of 90.8, this time the ammunition of RBI is restricted in handling the crisis. This time India has lesser forex buffer to handle the shocks of 2011/12 crisis. Until now, the European crisis has not completely unfolded. The European crisis is still in early stages, and Indian rupee has already went below 2008 depths. If the European crisis completely unfolds from here, RBI may find it difficult to withstand the shocks on Indian currency.

Year	Forex Reserves (in US$ Bn)	External Debt (in US$ Bn)	Ratio of Forex Reserves to Total External Debt
2006-07	199	172	115.6
2007-08	310	224	138.0
2008-09	252	225	112.2
2009-10	279	261	106.9
2010-11	305	307	99.5
End Sep 2011	297	327	90.8

The pictorial representation is as follows:



Rupee Weakness and ECBs Timebomb

1. During the calendar year 2011, Indian corporates have raised about US$ 30 Bn of ECB (External Commercial Borrowing). That is, about Rs 1,50,000 Crores.

2. Between 1st January 2011 and 31st December 2011, the rupee has moved from Rs 44.67/$ level to Rs 53.27/$ level. Hence, the rupee has depreciated by 19.25%.

3. This naturally translates into an increased burden on the Indian companies in repaying the ECBs. Such additional burden works out to US$ 5.8 Bn. That is, an additional burden of about Rs 31,200 Crores.

4. As per the ICAI guidelines, mark-to-market losses on forex needs to be provided as a provision on each quarterly basis in the financial statements.

5. Hence, this additional burden of Rs 31,200 Crores on ECB forex coversion, can result into "Difficult" corporate results.

6. ECB used to be available at about 5-7% interest rates, where as Rupee denominated loans from Indian banks were available at 12-14% interest rates. Hence, several Indian corportates have chosen ECB route for borrowing instead of Indian rupee loans, in the anticipation saving about 5-7% of interest cost.

7. However, such Indian corporates are realizing now the side effects of non-rupee borrowing. In the case of non-rupee borrowing, the forex fluctuation can be very punishing, as it is happening now.

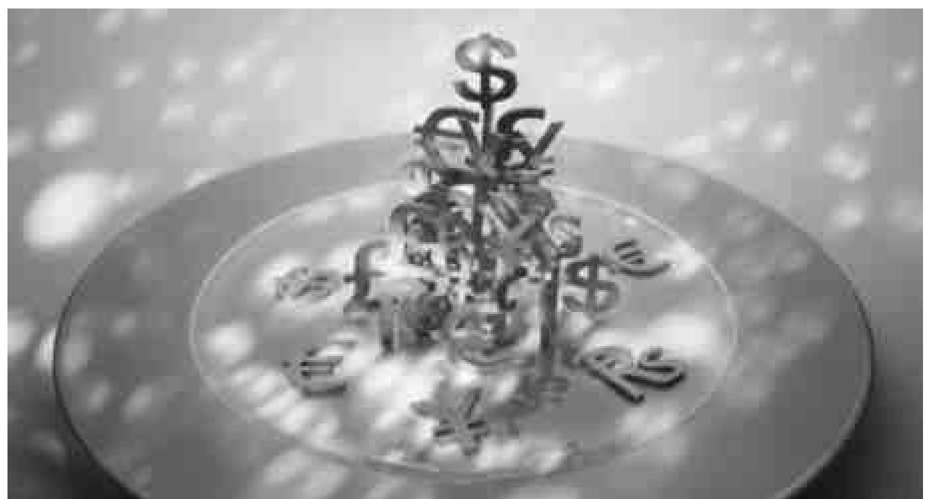
8. Several companies must have learnt now, that they would have been better-off had they borrowed in Indian rupees instead of ECBs.

9. The companies who would have hedged such dollar exposure can weather through this sharp rupee depreciation. However, the companies who would have unhedged their exposure, are literally sitting on "ECB Time bomb".

Euro Crisis and Impact on Indian Rupee

The problem in various Euro region countries is quite severe. For example, the total sovereign debt of Greece is about US$ 500 Bn, that of Spain is about US$ 1.2 Tn, and that of Italy is about US$ 2 Tn.

The largest sovereign default in the history of financial world till date was by Argentina in 2001, to the extent of US$ 88 Bn. So, in the cases of Greece / Spain / Italy, if there is a default, world has never seen



sovereign default of this magnitude. Hence, this is unprecedented to that extent.

The total sovereign debt of Greece is about US$ 500 Bn. The total surplus funds with IMF is about US$ 420 Bn. If IMF bails out Greece, then somebody else has to bail out IMF.

All this naturally raises a valid question: "Can Euro Survive?"

The current day uncertainty makes one feel that it is difficult for Euro to survive in the current format. It may not fully die, but it may survive in a handicapped format. People may like Euro or hate Euro, but no one can afford the severe implications that it can have if Euro collapses.

If Euro as a currency collapses, the effect can be quite dangerous. This is because about 28% of the world's reserve currencies with all the global central banks put together is Euro denominated. Euro collapse can lead to havoc in these central banks.

In the highly interrelated global economy, other regions of the world will also have to bear the burden, as there is high degree of business and trade happens between the regions.

To summarize, the sovereign bonds in the past used to give "Risk-free Returns", whereas these days they are giving "Return-free Risks". Greece, with a population base of 1 Crore, has literally held hostage of world with 700 Crore population.

As world has become highly integrated, interrelated and interdependent, even India may not escape the spill-over effects of European sovereign debt crisis.

While India has enjoyed the benefits of globalization during the past 2 decades, probably this is the time we have to see the side effects of that globalization.

Awareness about Currency Trading and Hedging shall increase in India

In that backdrop of precarious global economic situation, the volatility in the global currencies can become more severe. As India has several corporate with significant business interests through imports and exports, they shall be careful in positioning themselves to handle the volatility Indian rupees.

Indian corporate shall come out of mind set that the range for Indian rupee is Rs 44-47 per dollar. They shall groom their internal talent as well as exposure in terms of trading and hedging caliber to face the volatile currencies. They shall appreciate the relevance of the professional advisors to handle the trading and hedging aspects of currency.

Regulatory Roadmap

The role of regulator is highly appreciated in creating a vibrant currency market over the past 4-5 years. The volumes of currency trading have went up, ensuring the enough liquidity for the market participants for hedging purposes. All these things have helped in adding more number of market participants in the currency segment.

However, one shall remember that while we have made good beginning in the currency market, we have long long way to go to become globally influential currency market.

For the size of Indian economy, the currency market size is still far too small. The number of products available also restricted to just 4 currencies USD, EUR, GBP, JPY. As Indian companies are trading with several parts of the world, efforts shall be made to ensure more and more currencies are also added to the product basket of Indian currency market. Especially, the role and significance of the Swiss Franc has substantially increased in the global scheme of things. Hence, the Swiss Franc based trades shall be considered for inclusion at the earliest possible.

One other factor which has helped in the significant growth in the currency market over the past 4-5 years is that of the healthy competition between the exchanges in popularizing the product. Such competition is good for everyone to make the products more and more vibrant. Similar approach can be considered even in the cases of the other products, to bring in the vibrancy and dynamism in those products.

Further, as the currency market is a round-the-clock business, the efforts can be made to increase the duration of the market in lines of the commodity market, to capture the movements in the currencies after the European and United States markets open, by the evening / night time in India.

Conclusion

The world's economy is in historic times. India as a country, as an economy shall prepare to handle the side effects such unprecedented times. The key instrument which is going to witness immediate impact is Currency. Everybody associated with the value chain of currency market ranging from the regulators, market participants, traders shall strive hard in ensuring the effective currency market in India.

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JT's views are highly sought after across varied media channels. He is well respected for his views and insight of the market. He has often represented industry bodies in consulting process of the government and the RBI for subjects ranging from Monetary Policy to Infrastructure Institutions.

In his earlier assignments he has worked with Morgan Stanley India.

INDIAN ECONOMY – AN UPDATE

Box1. Key Facts

- The projected GDP growth in FY 2011-12 has been revised downward to 7.0 per cent from 7.6 per cent by the RBI.
- Since November 2011, inflation has shown moderation with WPI inflation declining to two year low of 7.5 per cent in December 2011.
- The moderation in industrial growth has become evident with a slow down in manufacturing sector growth to 4.1 per cent for April - November 2011 as against 9.0 per cent in the corresponding period last year.
- The World Bank has projected the global economic growth to be 2.5 per cent and 3.1 per cent in 2012 and 2013 against its earlier projections (June 2011) of 3.6 per cent for both years.
- FICCI projects the GDP growth rate for this fiscal to be marginally below 7 per cent.

Economic Scenario

Concerns of a significant downturn in economic activity are becoming stronger. Indian economy grew at 6.9 per cent in Q2 FY 2011-12, its weakest pace in more than two years. FICCI analysis shows that growth in Q2 of 2011-12 would have been lower at 6.4 per cent without a downward revision in GDP data of the corresponding quarter of previous year. This reveals the heavy toll that persistent high inflation, rising interest rates and fragile global economic scenario have on our growth prospects.

RBI in its third quarter review of the monetary policy revised downward its projections for GDP growth this fiscal from 7.6 per cent to 7.0 per cent. Earlier, both IMF and ADB have projected a moderation in the growth prospects for the Indian economy on account of base effects and policy tightening.

FICCI projects the GDP growth rate for this fiscal to be marginally below 7 per cent. For the next fiscal too the growth outlook is not expected to improve unless the global economic scenario changes significantly.

FICCI's Projection on Growth rates

Projection on Growth rates	2011-12	2012-13
Agriculture	3.3	3.3
Industry	3.5 - 4.0	4.0 - 4.5
Services	8.2	8.1
Overall	6.6 - 6.8 with downside risks	6.7 - 6.8

Source: FICCI Research

As for the global economic growth prospects, the World Bank in its bi-annual report sharply lowered its global economic growth forecast for 2012, citing European financial turmoil and weak growth prospects in emerging nations, including India. The global economy is now expected to expand 2.5 per cent and 3.1 per cent in 2012 and 2013 against earlier projections (June 2011) of 3.6 per cent for both years.

Inflation

Persistently high headline inflation has shown some signs of abatement in December 2011 which decelerated to a two-year low of 7.5 per cent. However, the quarterly average WPI based inflation rate during Q3 FY 2011-12 stands high at 8.8 per cent as against 9.7 per cent in the previous quarter. Inflation in non-food manufactured products remains persistently high, reflecting input cost pressures, as the impact of imported inflation resulting from the rupee depreciation more than offset the sobering impact of weakening domestic demand and softer global commodity prices.

According to RBI, there are upside risks to the projected inflation rate of 7 per cent for March 2012 from the insufficient supply responses, exchange rate pass-through and suppressed inflation in the energy segment.

FICCI estimates shows that the WPI based inflation rate is projected to be around 7 - 7.5 per cent by end March 2012.

Fiscal Performance & Balance of Payment

As a proportion of budget estimate, fiscal deficit during April-November 2011 was 85.6 per cent and revenue deficit was 91.3 per cent.

As per the latest FICCI Economic Outlook Survey, the slippage in fiscal in current may be more than 100 basis points vis-à-vis the budgeted fiscal deficit, going by the estimates. However, more importantly, the consensus fiscal deficit estimate in the next fiscal is 5.1 per cent, indicating that the process of fiscal consolidation will be long and arduous and it may be difficult to plough it back to the levels witnessed prior to the crisis.

There is now an increasing consensus that the recent decline in rupee value (the good news is that the rupee has ploughed back recently on the back of currency supportive measures by RBI and portfolio inflows in the first fortnight of 2012) is because of the huge Current Account Deficit (CAD). In this context, it may be noted that India is only country with a CAD among Asian peers.

Performance of IIP

In November 2011, overall growth in the Index of Industrial Production (IIP) rebounded sharply on a month on month basis. The industrial production grew by 5.9 per cent against a decline of 5.1 per cent witnessed in October 2011. During April - November 2011, industrial growth as reflected by the IIP was significantly lower at 3.8 per cent against 8.4 per cent during 2010-11.

What concerns the most is the declining trend in manufacturing sector growth. Average growth in the manufacturing sector for April - November 2011 slowed down to 4.1 per cent as against 9.0 per cent in the corresponding period last year.

The slowdown in industrial growth is all pervasive, with both investment demand (capital goods growth at -1.0 per cent during April-November 2011 vis-à-vis 18.2 per cent in the like period previous year) and consumer demand (consumer durables goods growth at 5.3 per cent during April - November 2011 vis-à-vis 14.6 per cent in the like period previous year) being hit. This indicates weakening of both investment and private consumption which would impact the aggregate demand in the domestic economy.

Liquidity Position & Financial Markets

The domestic liquidity deficit has remained significantly above the Reserve Bank's comfort zone of 1 per cent of NDTL since November 2011. Money market liquidity tightened significantly partly due to dollar sales by RBI. Credit growth slowed below RBI's indicative projection due to demand as well as supply side factors, reflecting the combined effect of a slowing economy and increasing risk aversion by banks.

The Reserve Bank's timely policy actions of providing liquidity without compromising on the anti-inflationary policy objective or funding speculative positions in the foreign exchange market has helped in limiting pressures on short-term rates.

The impact of stress in global financial markets witnessed during Q3 of 2011-12 has been evident in Indian financial markets as well. The impact of the global financial instability on India can be witnessed in the performance of domestic equity and currency markets. Capital flow moderation coupled with higher trade deficit led to a sharp fall in the exchange rate of the Indian rupee during August - December 2011. As a result, the corporate sector abstained from mobilising resources by way of public issues during Q3 FY 2011-12.

Banking Sector

RBI Q3 Monetary policy review January 244th, 2012: Highlights

Key points

RBI cuts CRR by 50 bps to 5.5 per cent

CRR cut effective beginning 28th Jan 2012

CRR cut will infuse Rs 32,000 crore liquidity in system

Repo Rate retained at 8.5 per cent

Reverse Repo rate remains unchanged at 7.5 per cent

Marginal Standing Facility stands at 9.5 per cent

Bank Rate retained at 6 per cent

Growth Outlook

FY12 GDP growth revised downward from 7.6 per cent to 7 per cent

Downside risks have increased since October even as inflation remains elevated

There is increased global uncertainty, weak industrial growth, slowdown in investment

Agricultural prospects look buoyant

Slower industrial growth will impact services sector growth

Economy will exhibit modest recovery in 2012-13

Guidance

Growth - Inflation balance of monetary policy stance shifted to growth

Cut in CRR to address structural pressures on liquidity

Based on current inflation, premature to begin reducing policy rates

RBI will be constrained from lowering policy rate in absence of fiscal consolidation

Reduction will be conditioned by signs of sustainable moderation in inflation

CRR reduction reinforces guidance that future rate actions will be towards lowering them

Timing and magnitude of future actions contingent on various factors

Policy actions to induce investment & address supply bottlenecks critical

Fiscal slippage poses significant threat to inflation management

Union budget must begin process of fiscal consolidation

Prudent to fully deregulate diesel prices to contain aggregate demand & trade deficit

Inflation

Food inflation has moderated more than anticipated

Benefit offset by lower moderation in manufactured goods inflation

Baseline projection for WPI inflation retained at 7 per cent

Rupee depreciation, suppressed inflation in preventing downward revision of inflation

Inflation will remain vulnerable to variety of upside risks

Fiscal Worries

Gross fiscal deficit for FY12 will overshoot budget estimate substantially

Fiscal deficit could potentially crowd out credit to the private sector

Fiscal slippages adding to inflationary pressures & continue to pose a risk

Liquidity

Liquidity conditions have remained beyond comfort zone

Structural deficit in the system has increased significantly

Structural deficit could hurt credit flow to productive sectors

Structural deficit presents a strong case for injecting permanent liquidity

Global Risks

Sovereign debt concerns in Eurozone pose a major downside risk to growth

Uncertainty will adversely affect Indian growth through trade

Slowing capital flows raises concerns about current account deficit

Credit & Deposit Growth

Credit offtake has been below projected trajectory

Nonfood credit growth scaled down to 16 per cent versus 18 per cent

Money supply growth projection for FY12 retained at 15.5 per cent

RBI's mid quarter monetary policy review December 16, 2011

On the backdrop, of challenging global & domestic economic environment RBI in its mid quarter review halted its monetary policy tightening measure. RBI decided to

- Keep the cash reserve ratio (CRR) unchanged at 6%
- Keep the policy repo rate under the liquidity adjustment facility (LAF) unchanged at 8.5%
- Consequently, the reverse repo rate under the LAF will remain unchanged at 7.5% and the marginal standing facility (MSF) rate at 9.5%.

The RBI's view on rates was based on

- Growth momentum is weakening in the advanced economies amidst heightened concerns that recovery may take longer than expected earlier.
- This, combined with the slowing down of domestic demand, to which the monetary policy stance is also contributing, suggests that risks to the growth projection for 2011-12 made in the January Review are on the downside.
- Meanwhile, RBI maintained its inflation projection for March 2012 at 7% due to moderation in food inflation in November 2011 and expected moderation in aggregate demand leading to decline in non-food manufactured products inflation.

Capital Market

Government allows foreign individuals to invest in stock markets

The Central Government has decided to allow qualified foreign investors to directly invest in the Indian equity market from January 15 in order to widen the class of investors, attract more foreign funds, and reduce market volatility. Previously, foreign nationals were limited to investing in India's equity market through indirect routes such as mutual funds, or through institutional vehicles. QFIs includes individuals, groups or associations of a foreign country compliant with the Financial Action Task Force, a global body to boost national and international policies to counter terror funding and money laundering. These countries will also have to be signatories of the International Organisation of Securities Commissions, a federation of bodies which regulate the world's securities and futures market.

Foreign fund inflows, a major driver of Indian stocks, dried up with net outflows of about USD 380 million, a far cry from record inflows of more than USD 29 billion in 2010 that had powered a 17% rise in the benchmark index, following an 81% surge in 2009.

Collective investment plans may soon come under 'principal regulator'

Owing to new and innovative methods of raising funds from investors, there has been a regulatory gap or overlap regarding types of instruments. Policy makers have proposed a 'principal regulator' to oversee collective investment schemes. The proposal intends to regulate those entities, which use grey areas in the regulatory system to raise funds.

Depository participants knock SEBI door for enlarged role

Depository participants have made a representation to SEBI to reconsider some of the responsibilities entrusted to depositories and depository participants (DP).

The existing regulation on depositories and DPs mandates them to deal only with securities pay-in and pay-out. However, with the introduction of the new Qualified Foreign Investor (QFI) guidelines, the roles and responsibilities of the depository and DP have been extended beyond the original brief. DPs are expected to do the know your customer (KYC) due diligence of a QFI; receive and remit foreign exchange; place buy and sell orders of securities on their behalf; ensure pay-in/pay-out of funds/securities on the designated day and also address all taxation related procedures. In addition, they are also expected to ensure that the QFI uses only one demat account and one forex bank account; the shares held are free from all encumbrances and that the QFI does not issue P Notes to others and the like. For monitoring and administering all this, DPs and depositories cannot charge anything.

SEBI weighing speed limits on high-frequency trading of listed Indian securities

Indian regulators may consult market participants to discuss whether speed limits be imposed on high-frequency trading of listed Indian securities. SEBI is concerned that while the use of algorithms in high-frequency trading enables a more diverse range of investors to participate in the market, higher speeds are being pursued without a clear understanding of whether the resulting increased trading velocity could be problematic.

FDI in aviation

The Civil Aviation Minister will move a cabinet note on 49% FDI by foreign carriers. However, until SEBI gives a carve out for the aviation sector, this 49% proposal will be against the current Takeover Code because of the trigger point.

The Substantial Acquisition of Shares and Takeover Regulations, 2011, specify that any entity acquiring 25 per cent or more in a company would have to mandatorily make an open offer of 26 per cent. That means, if a foreign firm were to pick 25 per cent or above in a domestic carrier, it would have to make an open offer of another 26 per cent. If the issue is fully subscribed, the foreign company may end up holding as much as 51 per cent or more - or a clear majority stake - in a domestic carrier. On the other hand, the government has capped the foreign direct investment (limit) to 49 per cent. Similarly, if a foreign company were to pick 49 per cent, the open offer regulation would still get triggered, according to the existing takeover guidelines. So, on the one hand the government is capping the FDI in aviation at 49 per cent, while, on the other, the takeover code forces the acquirer to make an open offer if they exceed 25 per cent.

Companies may have to make provision for FCCB payouts

The government may ask companies issuing foreign currency convertible bonds (FCCBs) to set aside funds to redeem the borrowings. The proposal was discussed at a recent meeting of the Financial Stability and Development Council (FSDC) - a forum set up to ensure co-ordination of policies between regulators such as the RBI, SEBI and the Finance Ministry. A final decision is yet to be taken, but the intent is to avoid defaults by Indian companies,

SEBI cuts share buyback time to 34-44 days

SEBI has reduced the timeline for completion of buy back of shares by companies to 34-44 days. Earlier, the buyback process could take anywhere between 63 and 114 days. These changes form a part of amendments made by the regulator in the SEBI (Buy back of Securities) Regulations, 1998. They have come into effect from January 3,2012.

Pension fund should have tax incentives, lock-in till retirement

SEBI Chairman has called upon mutual funds to actively get into the pension funds business. Such products would fill a serious gap that is there in the range of retail financial products that are available.

SEBI to make it easier to tap MF, FI funds

SEBI plans to allow mutual funds and insurance firms to subscribe to preferential issues of companies even if they have traded the shares of the issuing corporates in the past six months, to boost liquidity in the markets and make it easier for firms to raise funds. Such transactions are currently banned, blocking a key source of funds for companies. But this restriction will continue to be in place for promoters.

SEBI constitutes an Advisory Committee for Investor Protection and Education Fund

SEBI constituted an Advisory Committee for SEBI Investor Protection and Education Fund. The Committee which consists of eight-members will be headed by ICICI Bank Chairman Mr. K.V. Kamath. The committee will recommend investor education and protection activities that may be undertaken directly by the board, or through any other agency, for utilisation of the SEBI Investor Protection and Education Fund for the purposes stated in the SEBI regulations, 2009.

FMC plans minimum deposit for trading

For the first time, the Forward Markets Commission, regulator for the commodity futures market, is considering levy of an exposure-free minimum deposit criterion for members. The capital market exchanges have such a requirement. This is one of several measures the FMC has planned to strengthen the risk management system, to attract wider participation on the exchange platform.

Life insurers' public issues will need IRDA approval

Life insurance companies planning to tap the equity market through IPOs would have to secure a "written" approval from IRDA, before applying to SEBI.

Crisis Management group for financial markets on cards

With high volatility in the equity and currency markets, the Government aims to set up an empowered 'Crisis Management Group' for the financial markets. It is proposed to nominate a Deputy Governor of the Reserve Bank of India as the

Chairman, along with senior officials from SEBI, IRDA, PFRDA and the Ministry of Finance as members. The effort is to ensure that prompt decisions could be taken for effective crisis management. Though every segment of the financial sector has crisis prevention systems in place, an integrated system was needed to avoid sudden shocks which can quickly spread across market segments and institutions.

SEBI wants oversight mechanism quickly

SEBI has called for the creation of an independent regulator to oversee auditors, a move that is being opposed by the Institute of Chartered Accountants of India (ICAI), the industry body that self-regulates the auditing profession at present. SEBI feels that lack of a

strong regulatory framework for auditors compromises the efficient functioning of stock markets and there was a conflict of interest in the multiple roles being performed by ICAI.

SEBI may relax advertisement rules for Mutual Funds

SEBI may relax the recently introduced advertisement rules which require AMCs to display the performance data of all the other schemes managed by the fund manager of that particular scheme in advertisements. Fund houses have complained that it is difficult to advertise the performance of all schemes managed by one fund manager and it increases the space and cost.

Move to levy stamp duty only on seller

As part of a revamp of the proposed Indian Stamp (Amendment Bill) Act, the Ministry of Finance has proposed a uniform duty on securities transactions, to be collected by stock exchanges and passed on to the states where the seller is based. Rough estimates say the cost may come down by half in the proposed system. The existing practice is to levy the duty on both the buyer and the seller and most states agree to Ministry's suggestion to levy stamp duty only on the seller.

No service tax on late payment charges by stock investors

The Ministry of Finance has clarified to SEBI that stock market investors would not have to pay any service tax on any late payment charges paid by them to their brokers, provided such fines are shown separately in the account statement.

Compliance officers must pass test

SEBI will soon make it mandatory for compliance officers of all market participants to take a certification programme that will be conducted by the National Institute of Securities Markets (NISM).

SEBI body to set up securities training institute in Pakistan

SEBI-promoted National Institute of Securities Market (NISM) has agreed to offer its help to set up a securities training institute in Pakistan. This is part of the capacity building cooperation measures that the financial market regulators and intermediaries of India and Pakistan have finalized.

SEBI releases norms for outsourcing by brokers

SEBI released guidelines on outsourcing by intermediaries like brokers and depository participants that prohibit sub-contracting of core business activities. The guidelines also direct them to put in place a comprehensive policy on the outsourcing of activities.

SEBI sets up international advisory board

SEBI has set up an International Advisory Board (IAB) that would comprise of seven members, including SEBI Chairman Mr. U. K. Sinha. The IAB would have a three-year term and would help SEBI better understand the global market trends and emerging developments and challenges.

SEBI proposes to restrict slabs for anchor investors

SEBI proposes to restrict the slabs for anchor investors (AI) to two as per the provisions of current regulations. The regulator also plans to introduce a maximum number of AIs in each slab and also for an anchor tranche upto R10 crore. By this, there will be a maximum two AIs for an allotment tranche upto R10 crore and a minimum two and a maximum of 15 AIs for an allotment tranche above R10 crore and upto

R250 crore, subject to minimum allotment of R5 crore per AI. There will be a minimum of five and maximum of 25 AIs for allotment tranche of more than R250 crore subject to minimum allotment of R5 crore per AI.

SEBI mulls e-IPO for paperless bidding to fast track process

SEBI is considering a proposal to allow the companies to sell shares through an all-electronic Initial Public Offer (e-IPO), wherein investors would be able to bid for shares electronically and without the need for signing any papers physically. The proposed move would help in fast-tracking the IPO process and lower the costs, besides allowing the investors to apply for shares online, without the need for signature on bulky physical documents. SEBI is currently awaiting a formal clearance from the Ministry of Corporate Affairs (MCA) for the e-IPO process, although the Ministry has already given a go-ahead informally.

SEBI tweaks share allotment norms

SEBI made it easy for the government to quickly tap major institutional investors to sell up to 10% of its stake in listed public sector companies. SEBI introduced a concept of institutional placement programme (IPP) that will allow a promoter to either issue fresh equity or dilute its holding by up to 10% of the total equity.

Investors not to pay for maintaining KYC data

SEBI is working on simplifying the Know Your Client (KYC) process for easy investing. There will be no burden of charges on investors for maintaining their data with the KYC Registration Agency (KRA).

SEBI reviews exit policy for bourses, seeks ways to deal with their assets

SEBI is in the process of reviewing the exit policy of stock exchanges. There are 25 stock exchanges registered with SEBI, but the majority of them are not operational. In case of some stock exchanges, SEBI has refused recognition due to regulatory issues. These stock exchanges have valuable real estate assets, whose prices have appreciated like anything. These assets are owned by the brokers, but in the absence of an exit policy, the money cannot be distributed.

SEBI planning more centres to address investors' woes

SEBI is planning to set up more investor grievance and arbitration centres to address investors' woes.

SEBI turns focus on insider trading

SEBI stated that it needs more investigative powers to detect insider trading and that it was unable to access electronic surveillance and the quality of evidence was poor.

RBI booster for F&O settlement reform

In its financial stability report, RBI has identified fall in equity cash segment volumes and rise in derivative trades as stress points. RBI's concern over the falling cash volumes in equity markets has strengthened the demand for a change in the derivatives settlement system. Market players feel that the existing derivatives settlement on NSE, which has around 90 per cent market share, is based on the cash mechanism and should be changed to a delivery-based system.

SEBI releases norms for KYC registration agency

SEBI released guidelines to streamline know-your-customer (KYC) norms through a single-point

registration agency namely, KYC Registration Agency (KRA). This long awaited move is expected to bring in much needed transparency and ease with which individuals can participate in the financial markets. The new rules, effective January 1, 2012, apply to intermediaries such as stock brokers, depository participants, mutual funds, portfolio managers, venture capital funds and collective investment schemes. Henceforth, intermediaries will upload the KYC information on the system of KRA and send the KYC documents, of the clients to KRA within 10 working days from the date of execution of documents by the applicants.

Companies not holding AGMs to face SEBI probe

SEBI would investigate the details of those listed companies that do not conduct Annual General Meetings and send annual reports regularly to their shareholders.

CBSE to teach students stock market trade

Investment education will be a part of CBSE curriculum in the near future. The study material will primarily focus on educating children on stock markets and giving them an insight into investment of surplus money in the market.

SEBI changes norms for paying incentives

SEBI said that in public issue of debt securities, intermediaries should not pass on part of their brokerage or commission to the final investor(s) as incentive to subscribe to such public issue of debt.

SEBI launches toll-free helpline for investors

SEBI has launched a toll free helpline service number for investors across the country on December 30, 2011. The service will be in 14 languages and available on all working days during Monday to Friday from 9.30am to 5.30 pm. It would provide guidance to investors on the status of companies- whether unlisted, sick, delisted or liquidated, on how to lodge a complaint, and compliant status among others.

SEBI no to schemes with existing themes

SEBI is not encouraging mutual fund companies to float new schemes - unless it has a new theme. It has also asked companies to merge the existing schemes, if the themes are same.

SEBI proposes new norms for advisors

SEBI has proposed new rules for

investment advisors that will require them to be registered with a self-regulatory organisation (SRO) before undertaking such a role. The proposed framework intends to regulate investment advisory services in various forms including independent financial advisors, banks, distributors and fund managers.

SEBI is reviewing the entire IPO process

SEBI has set up an expert group to review the entire process for initial public offering of shares, including shortening the timeline for the entire process.

SEBI allows 2 and 5 year IRFS in G-secs

In order to help investors guard against interest rate fluctuations, SEBI introduced two-year and five-year exchange-traded IRFs (Interest Rate Futures) in government bonds.

Insurance Sector

IRDA introduces uniform asset-liability management regulations

The Insurance Regulatory and Development Authority (IRDA) has unveiled uniform asset-liability management regulations for market players with the aim to ensure their solvency. The regulator has also directed the companies to take up stress tests to find out their ability to fulfill financial obligations during crisis.

The asset-liability management guidelines are scheduled to become effective from April 1, 2012. It means that it is compulsory for the insurance firms to prepare an ALM policy and get it approved by the IRDA by the end of March. Moreover, IRDA has urged the insurance firms to check their ability to fulfill financial liabilities after taking into account factors such as 30% decline in equity values and one percentage point dip in yields on fixed investments.

IRDA has issued these norms to get uniformity in the ALM guildelines being followed by both life and non-life insurance companies.The ALM policy needs to ensure the insurers to understand the risks they are exposed to and also develop ALM policies for managing them effectively. The ALM can be used to determine the interest rate risk faced by the insurers.

IRDA Clarification on the Guidelines for Pension Products:

The IRDA had issued guidelines for pension products vide its circular dated November 8, 2011 and insurance companies were required to withdraw all insurance products which do not conform to the guidelines with effect from January 1, 2012.

In accordance with this circular, insurance companies had filed 22 revised products as on date out of which 21 products were filed only in the month of December 2011 and of which the largest number were filed in the last week of December 2011. During examination of the products, certain insurers have sought clarifications and in that context, the IRDA issues clarification on clause (17) of the Circular dated November 8, 2011 as follows:

1. Assured benefit referred to at clause (2) shall mean all of the following:

   (a) The insurer shall guarantee either a non-zero rate of return on premiums paid from the date of payment to the date of vesting or an absolute amount (which shall result in a non-zero return). In both cases, this shall be disclosed at the time of purchase of the policy.

   (b) Death benefit: In the event of the death of a policyholder during the term of the contract, the successors to the policyholder shall be entitled to receive a sum equal to the premiums paid at the guaranteed rate of return as specified in (a) above.

   (c) Surrender Value: If the insurance product is on a ULIP platform the surrender value shall be the higher of fund value and premium accumulation at a

guaranteed rate on the date of surrender less the discontinuance charges as per the Guidelines on IRDA (Treatment of Discontinued Linked Insurance Policies) Regulations, 2010. In all non-linked products, the surrender value shall be in conformity with the provisions of the Insurance Act.

2. It is further clarified that the provisions of the Circular dated November 8, 2011 do not apply to Group Gratuity and Group Leave Encashment products.

IRDA Issues guidelines pertaining to corporate agents

Non-life insurer directed to lay down minimum business requirement all corporate agents engaged with the non life insurance companies

The Insurance Regulatory Development of India (IRDA) has issued guidelines pertaining to corporate agents. Non life insurers have been directed to lay down minimum business requirement for all corporate agents engaged with the non life insurance companies for soliciting the insurance business.

The insurance authority had earlier issued guidelines for individual agents for persistency of life insurance policies and later on extended the stipulations to nonlife insurance companies as well. In the guidelines, non-life insurers were directed to lay down minimum business requirement for individual agents.

Now, the IRDA is extending the said provision minimum business requirement to all corporate agents and has directed the nonlife insurers to monitor the performance of corporate agents in this regard as often it is required. The authority also indicated that the above-mentioned guidelines will come into immediate effect.

Government health schemes

The government has decided to bring auto and taxi drivers under the Rashtriya Swasthya Bima Yojana (RSBY) scheme with the aim to bring everyone in the unorganized sector under the flagship of RSBY program. The health cover scheme was earlier extended to domestic, beedi workers and porters.

Portable health cover roll out soon

India could roll out cashless and portable Universal Health Coverage (UHC) in one district of each state during the first year of the 12th plan as a pilot project before introducing it nationwide by 2020.

IRDA: Only registered bodies can act as agents training institutes

Only those entities that are registered under the Companies Act and the Societies Registration Act and have more than three years of experience will be eligible for accreditation as institutes for training insurance agents.

No exit age for Health Insurance: IRDA

In its most recent initiative, Irda, while approving health insurance products, is advising all general insurers to ensure that there is no exit age in the policy, which ensures that no one is denied health insurance merely on grounds of age.

Insurance FDI

A parliamentary committee has rejected the government's proposal to raise the foreign investment cap in insurance to 49% from 26%. The move comes just a day after the government put on hold its decision to allow FDI in retail.

IRDA over Obligatory Commission

GIC, RE which had stopped paying commissions to general insurers on obligatory business on Ministry of Finance's instructions, has been asked by IRDA to continue doing so.

IRDA drafting norms to make health insurance more customer-friendly

IRDA is looking at standardizing policy wordings, the coverage and exclusions under a health insurance policy. These guidelines will also include claim settlement procedure.

IRDA warns General Insurance Companies on unhealthy marketing

Disapproving of huge discounts offered by GIC's in the face of increasing competition, IRDA said that such unhealthy marketing practices could lead to financial troubles

FICCI and the City of London will organise a roundtable on 'Role of insurance companies and pension funds as institutional investors'

in February 2012 in Mumbai

The roundtable follows the launch of the City of London special interest paper: Insurance companies and pension funds as institutional investors: global investment patterns (November 2011) in London. Pension funds and insurance companies have shaped financial systems in the developed world. In China and India, their involvement in capital markets so far has been limited. The City of London paper explores the role they could play in the deepening of equity and corporate bond markets by making comparisons with and drawing lessons from developed markets. In India, insurance companies have over the years increased their involvement in both equities and corporate bonds. They currently hold the equivalent of 11 per cent of free-float market capitalisation. Compared to the US and the UK, however, their participation is still limited. Pension funds barely invest in equities and not in corporate bonds at all.

The objective of the roundtable is to deliberate on the suggestions and recommendations made in the City of London paper - following the discussion we will publish a policy note, that will be circulated to all the regulators and Indian and UK stakeholders.

Some of the key questions to be discussed are:

- Is further liberalisation required for investment limits in equity and corporate bonds for insurance & pension funds?
- Why insurance companies are not allowed to invest in lower grade infrastructure debt instruments- if they are able to quantify the risks effectively?
- Should insurance &pensions funds be allowed to invest in derivatives to effectively hedge market risks?
- Should insurance companies also be allowed to invest in mutual funds?

The roundtable will be attended by the Policy Chairman of City of London, Mr. Stuart Fraser and senior representatives from IRDA, PFRDA, SEBI, RBI, Life Insurance Council, General Insurance Council, AMFI and the Indian insurance sector.

Indian Financial Services Congress on "Reinventing For Sustainability"

Tuesday, 7th February 2012, 9.30 AM onwards At Hotel Taj lands End, Mumbai

IDC is organizing Indian Financial Services Congress on "Reinventing For Sustainability" with FICCI as the knowledge partner on 7th February 2012 at Hotel Taj Lands End, Mumbai.

In the era of uncertainty where some well-capitalized incumbents are taking this opportunity to increase their footprint and progress into the league of super-regional institutions.

The IFSC 2012 will delve deep on challenges and issues for the players to innovate and reinvent themselves to ensure sustainable, profitable growth.

The conference will have senior business leaders sharing insights on the following:

- India's role in the global financial services.
- Disruptive Trends in Banking
- Technology: A Crucial Enabler of growth.

Key Topics to be discussed:

- Future of Indian Banking: How to stimulate growth in uncertainty?
- Globalization: Steep learning curve
- Influencing the mass influencers: Gen Y in Social Media
- Next Generation Technology: Insurance
- Capitalizing on the rising mass affluent
- Risk Implications from New Technologies

The Indian Financial Services Congress is meant for the CEOs/MDs/Country Heads/COOs/CFOs/CIOs and Head of Business. This forum offers a distinctive opportunity for genuine peer-to-peer debate along with eminent Industry exponents.

Date: Tuesday, 7th February 2012

Venue: Hotel Taj Lands End, Mumbai

Time: 9:30 A.M onwards, followed by networking lunch.

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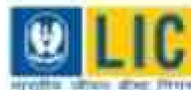

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