Publication: ET_Mumbai; Date:2007 Nov 15; Section:Front Page; Page Number 1

Sebi to roll out new derivatives

Our Bureaus MUMBAI/CHENNAI

MELEVEETIL Damodaran has set in motion something that could electrify the Indian financial markets. The Sebi chairman on Wednesday announced a slew of financial products that can deepen the market, empower investors to more aggressively hedge their stock bets, enable corporates to trade dollar or euro futures in local exchanges and attract global investors from many offshore markets.

The Sebi board has given an 'in principle' clearance to new financial products, some of which are advanced derivatives traded in many developed markets, based on the recommendations made by the Sebi Committee on Derivatives headed by M Rammohan Rao.

However, the final launch of these products will be preceded by a wider consultative process.

Rammohan Rao panel to propose OTC products

"WHAT we are trying to do is to see India's market becomes largely onshore and that parts of the market do not continue to be indefinitely offshore. One of the steps is to add more products in the Indian market," Mr Damodaran told reporters in Chennai after the board meeting. Today, overseas banks, hedge funds and other global investors bet on interest rate, stock futures and even rupee. EThad reported on the development in its edition dated November 14.

The proposed new products are:

Mini contracts on equity indices: Such contracts in the stock derivatives segment will enable efficient hedging of smaller portfolios. Currently, derivatives contracts have a value of around Rs 2 lakh. Mini contracts will allow small valued positions in the derivatives markets and step up retail participation in this segment. Just as dematerialisation in stocks has enabled investors to trade in even a few shares, mini contracts will bring in a similar change in the derivatives market.

Options with longer life/tenure: Currently, contracts have a maximum life of three months. However, in offshore markets, there are contracts of up to three-year maturities being traded with Indian stocks or indices as underlying. The intent is to create this market locally. Sections of the market feel this calls for a special negotiated deal window. Longer contracts will also help investors with their capital gains tax planning.

Volatility Index: Such an index, popular abroad, helps a market player assess the expected volatility in the near future (say, a month). If such an index is traded like the Nifty futures, then investors can bet on how volatile the market would be. If they are expecting the market to turn more volatile, they would buy the index futures and vice-versa. Options on futures: Currently, options are traded on the basis of stock prices in the spot market or movements of an index like Nifty. What is being proposed is that options will be available based on stock or index futures as an underlying. While this will allow more dynamic hedging, one has to see whether this would really take off; more so, since liquidity continues to be an issue even in plain vanilla options.

Currency futures & options:

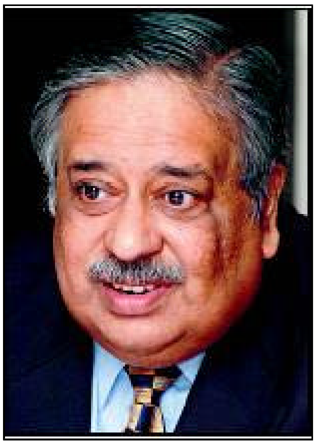
This will allow exporters/importers and even players like banks to trade foreign currency derivatives in local bourses. For instance, just like stocks, an investor can pay a margin to buy dollar or yen futures. It will also draw investors from the non-deliverable forward markets where the rupee is traded overseas. Such a market has flourished for years since the rupee is non-convertible and thus cannot be delivered in London or Singapore — some of the biggest Non-Deliverable Forward markets. Recently, Dubai has also kicked off trading in rupee futures.

This proposal, however, will call for greater liberalisation in the foreign exchange regime. With the rupee expected to go up in the long run, such a tool may lower the cost of hedging by software firms and other exporters.

Bond indices and F&O contracts: The Indian bond market is highly regulated and even today, lacks adequate hedging tools to guard against adverse interest rate movements (bond prices fall when rates rise). A bond index could be a new trading tool for banks and bond houses which can take short positions in such index futures if they fear RBI will increase rates.

Besides these, the Rammohan Rao Committee will also suggest some OTC products where two players can strike derivatives contracts like currency and interest rate swaps that banks now offer to corporates. According to former Sebi member JR Varma, the simultaneous existence of exchange traded and OTC contracts will help lower costs and encourage product innovation.

“What we are saying is, let us have these products, let people come to our products. More products will bring in more investor interest. It will lead to growth and development of the market and more investor protection,“ said Mr Damodaran. ”Last year, we came out with a new product, Qualified Institutional Placements which could be issued by companies as quickly as possible like GDRs and also at a lower cost. It became popular. The idea behind derivative products is the same,” he added.



CHANGE AGENT: M Damodaran