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# Trading in India

The Status Quo

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# Roadmap

- Brief look at equity, bond and derivative markets
  - Level of electronic trading
    - DMA and Algorithmic trading
  - Industry evolution
  - Regulatory practices
-



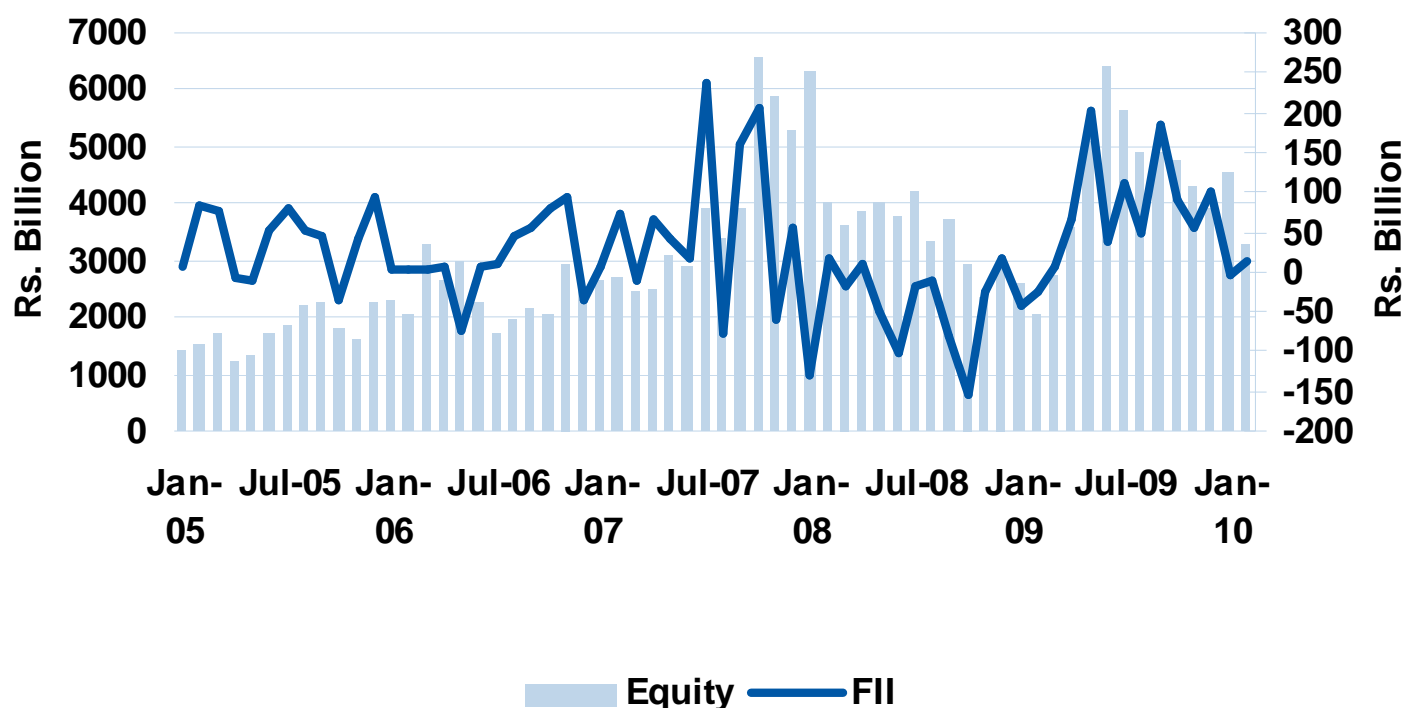
# Market Overview

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# Cash Equity

## Cash Equity Turnover and FII

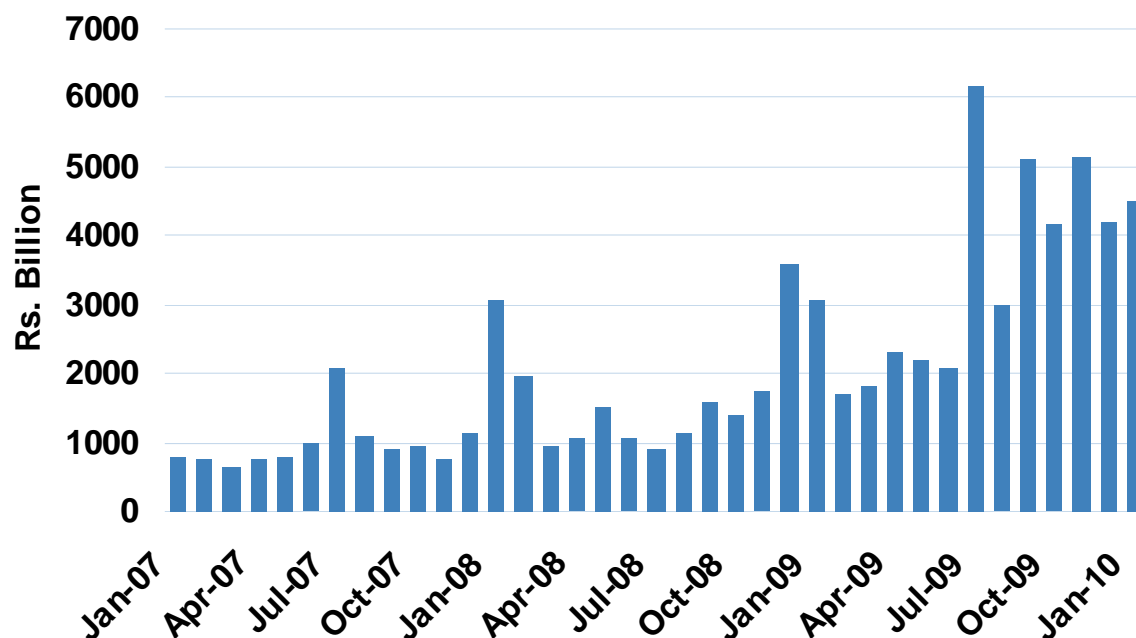


- Equity indices reached two year highs in end-March'10
- Cumulative Equity FII in 2009 was higher than in 2007 (Rs. 834 billion vs. Rs. 715 billion)



# Government Bonds

Government Bonds Secondary Market Turnover

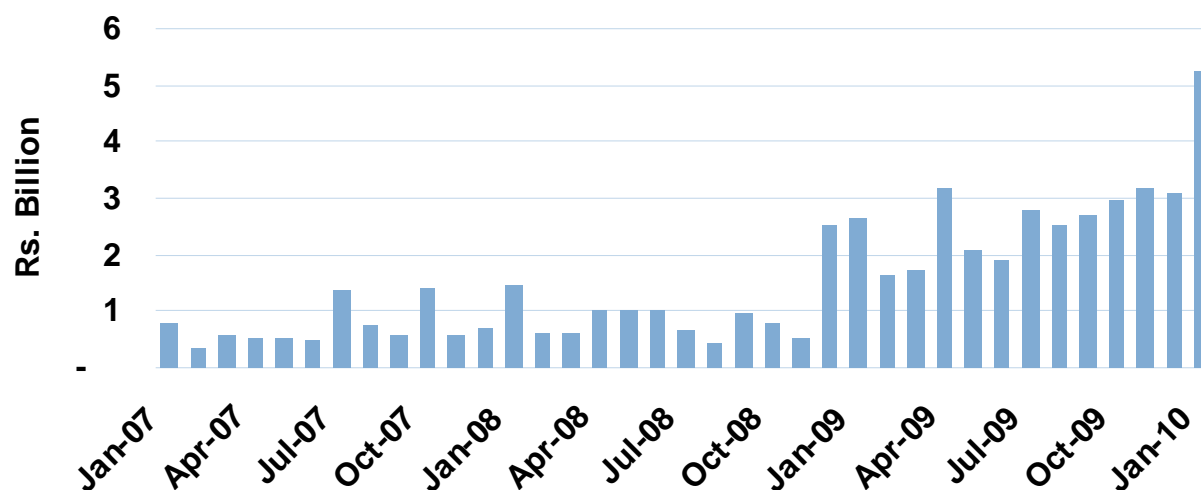


- Proportion of G-Secs in trading book of leading FIs is low
- Turnover lower when yields rise, indicating long only investors are dominant
- Main reason: Much of the investment by banks in government securities is part of the mandated SLR requirement and is held to maturity to avoid the mark-to-market risk



# Corporate Bonds

Corporate bond market: Turnover



- Impact of the financial crisis
- Sharp increase in the spreads on corporate bonds
- Decline in the turnover after August 2008
- Risk spread on corporate bonds declined significantly by the end of Q4 of 2008-09
- Improvement in volumes
- Introduction of CDS

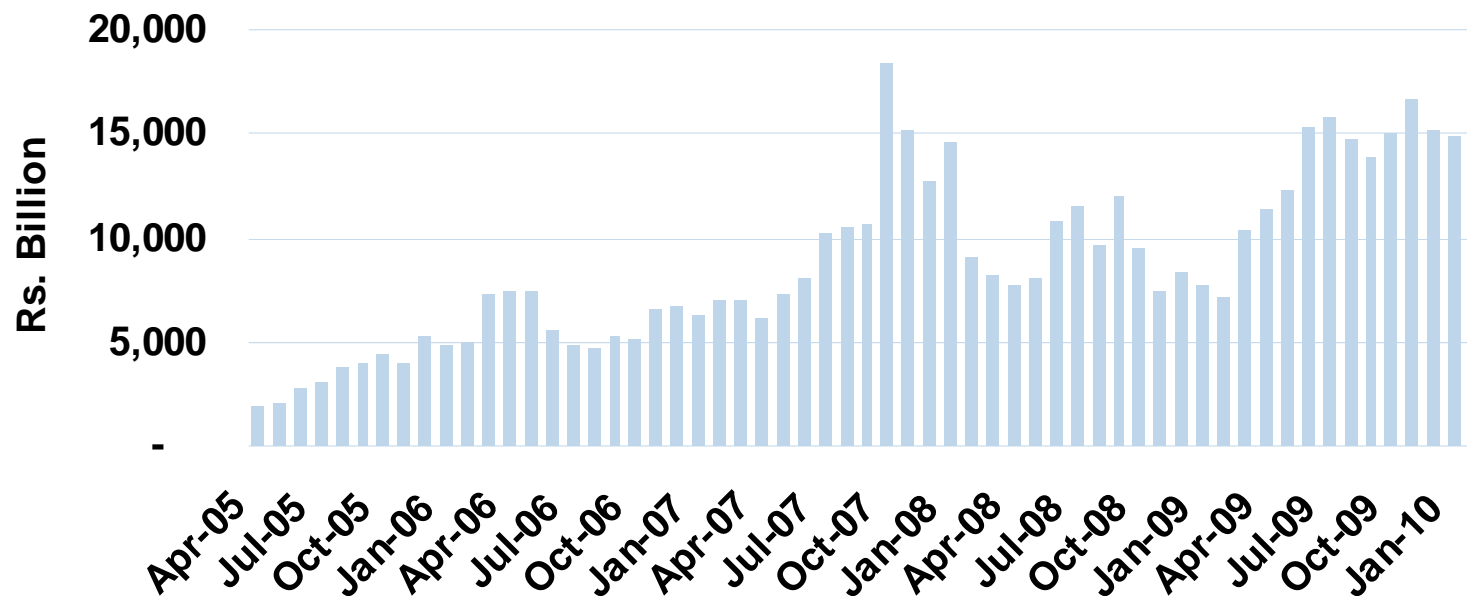
## Regulatory and institutional barriers:

- Stamp duty varies depending on state and type of investor
- Product standardization required
- Centralized database needed
- Bankruptcy norms



# Equity Derivatives

NSE Equity Derivatives: Turnover

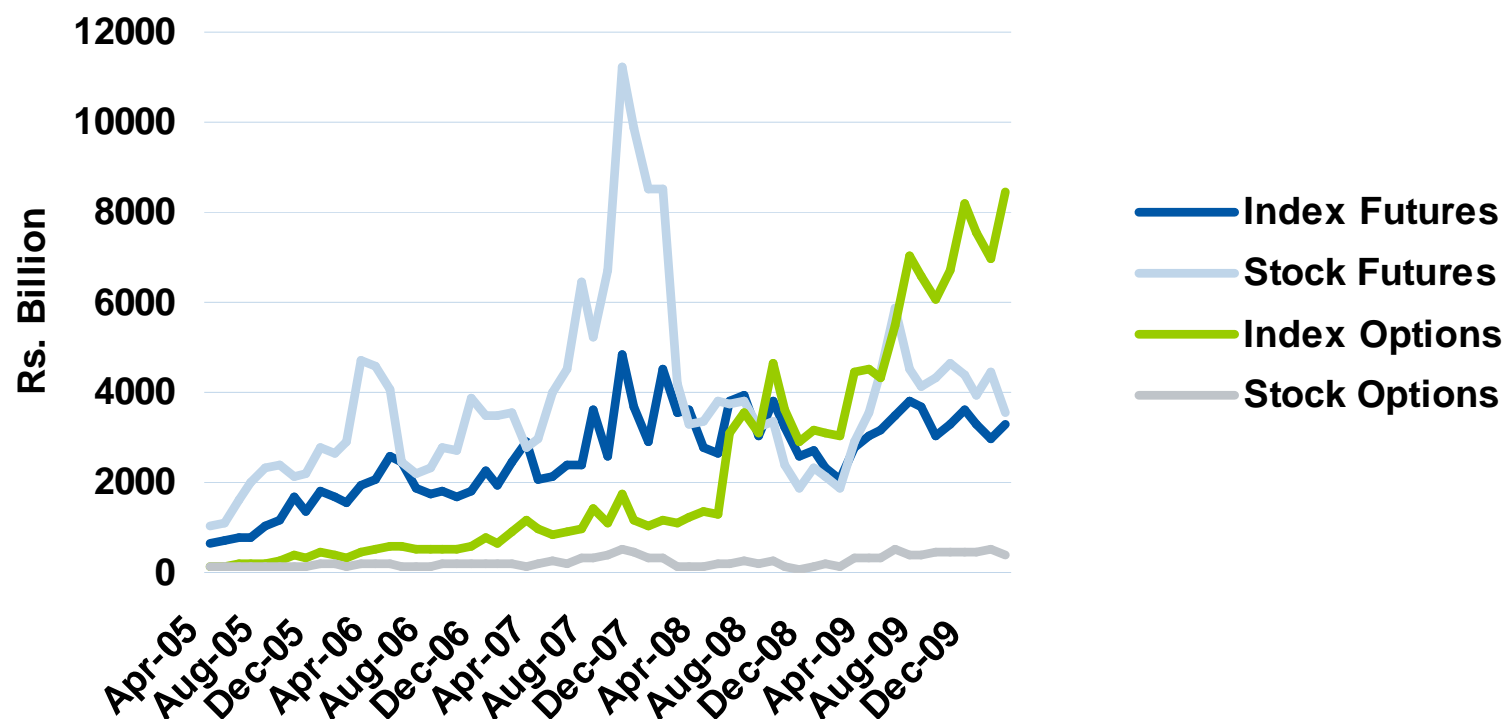


Nifty Index Options and Index Futures are among top 10 index derivatives worldwide



# Comparison of Equity Derivatives

Comparison of Equity Derivatives Turnover

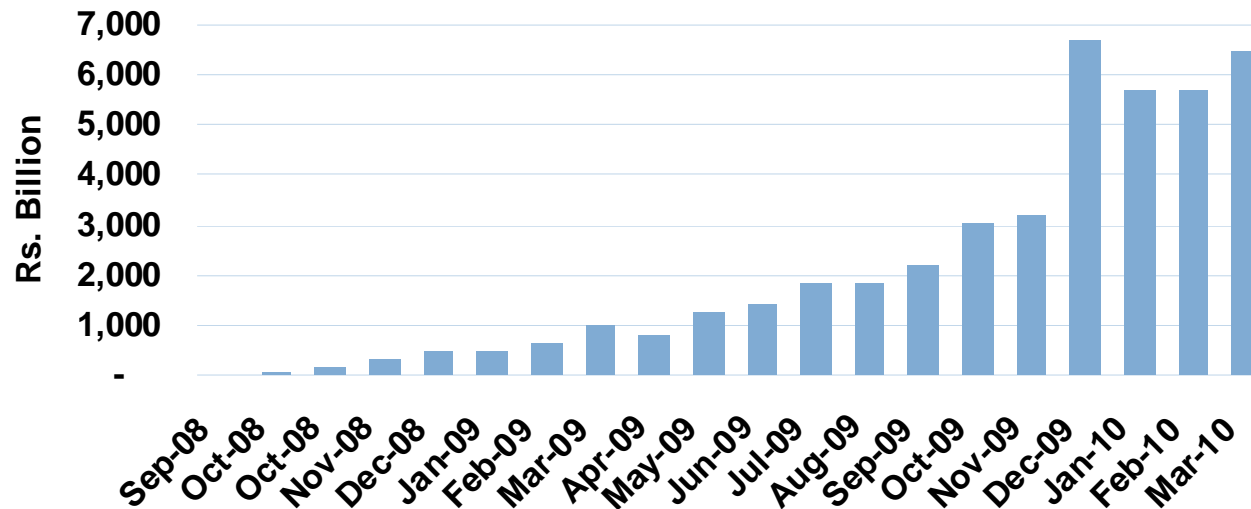






# Currency Futures

Currency Futures: Turnover

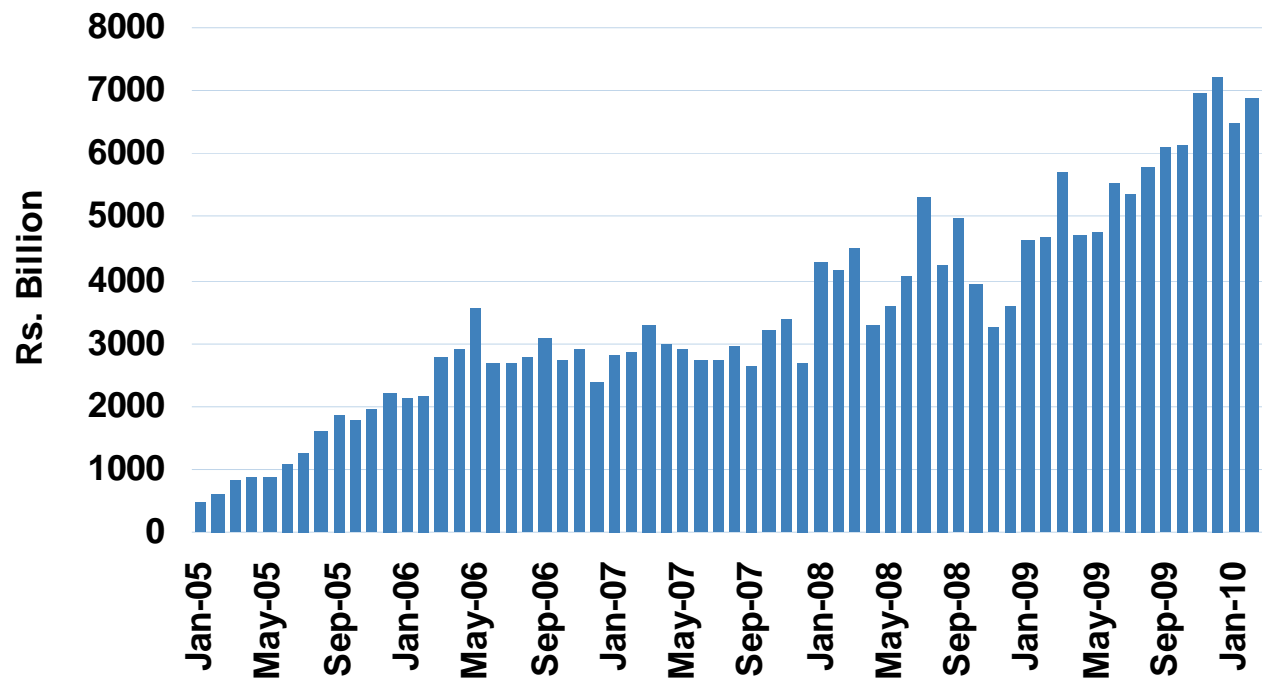


- Currency futures were introduced in NSE and MCX-SX in August and October 2008
- US\$-Rupee futures contracts at NSE and MCX-SX are the top 2 forex futures contracts globally
- Contracts are cash settled
- Do not require proof of any underlying that needs hedging
- Market is driven largely by intra-day activity



# Commodity Futures

Commodities Futures Turnover

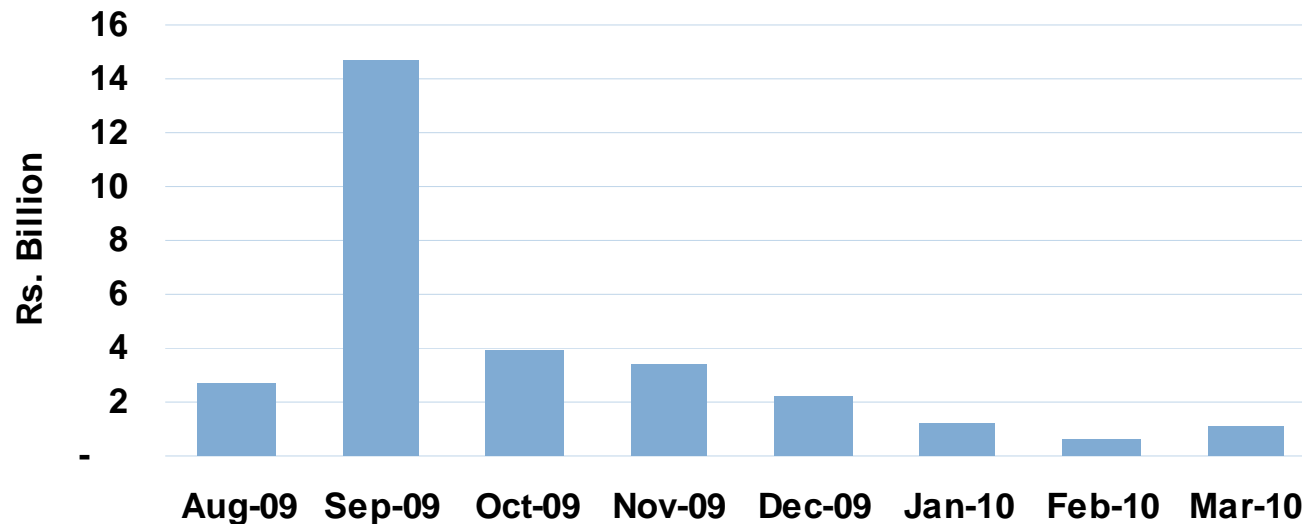


- MCX has 6 contracts in top 20 metals futures and options contracts globally
- 2 contracts in top 20 energy futures and options contracts



# Interest Rate Futures

Interest Rate Futures: Turnover



- Interest rate swaps and forward rate agreements introduced in 1999
- IRS attracted significant liquidity
- Turnover in interest rate futures at very low levels
- RBI in discussions with market participants to try and revive the market



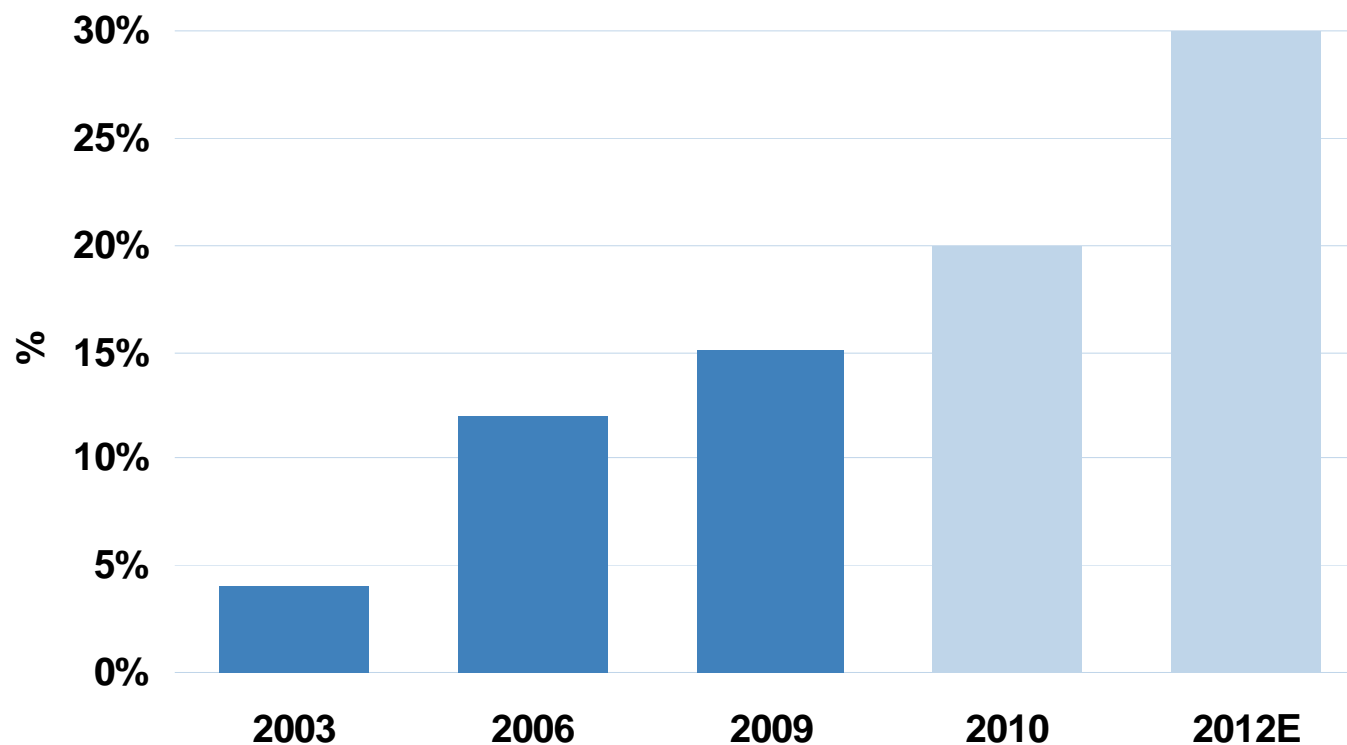
# Electronic Trading

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# Retail Cash Equity

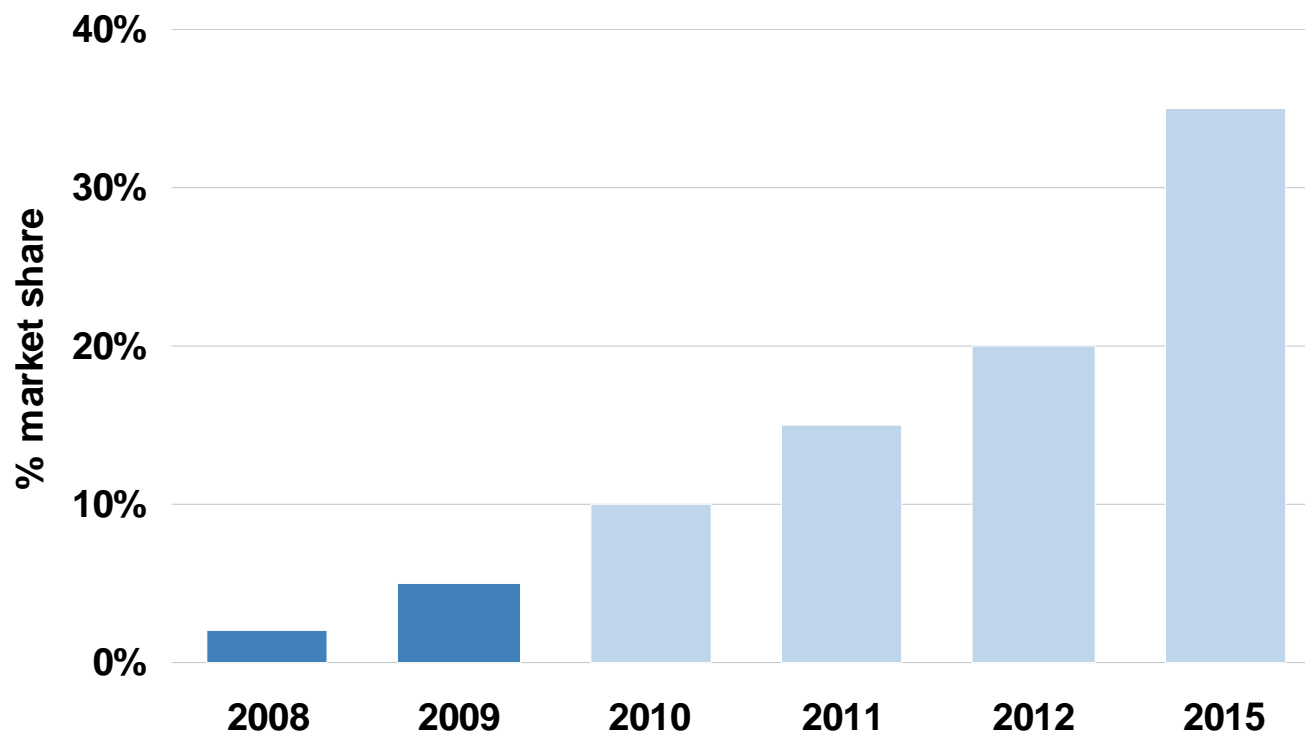
Share of Electronic Trading in Retail Equity market





# DMA

Share of DMA in Institutional Equities





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# Main Issues

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## Points of Discussion

- DMA- more one touch than direct
  - Physical infrastructure for algorithmic trading
  - Co-location
  - Higher compliance costs driving consolidation
  - A volume game: automation and commissions
  - Benefit of longer trading hours
  - Standardization required
  - Technology integrating front and back-office
-





# DMA

- FIIs driving change
  - Greater acceptance among DIIs, especially top MFs
  - Still mainly low-touch
  - Restrictions on 'direct' DMA
  - Even low-touch has improved level of automation
    - Less manpower required
    - Costs of trading lowered
  - Foreign and Tier I domestic brokerages geared up
  - Tier II in process of adopting technology
-



# Algorithmic Trading

- Accepted as the future of institutional trading
  - Infrastructure a barrier in short term
    - Vital market data speed is improved
    - Latency reduced, matching engines faster
    - Low-touch DMA prevents algorithmic trading
    - Pre-order risk management also a factor - affects latency
  - Regulation slowing adoption - only 'white box' for now
    - Low incentive to foreign brokerages to bring developed algorithms to India
    - Need to refine algorithms for local markets
  - Local brokerages and vendors still developing capabilities
-



## Cost of Trading

- By global comparison, Indian markets are:
    - Costly in terms of exchange fees
    - Market data and clearing is much cheaper
  - Automation beneficial to buy-side
    - Post-trade processing has improved
  - Reducing revenues of sell-side: 'volume' game
-



## Higher Compliance Costs

- SEBI and exchanges' requirements tough on brokers
    - Smaller brokers struggling to cope
    - Consolidation inevitable
  - Need to take smaller brokers' resources into account
    - Provide IT support
    - Standardization of procedures across exchanges required
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## Co-location

- International standard
  - India late adopter
  - Overall latency needs to be reduced for co-location to be meaningful
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# Longer Trading Hours

- Benefits still not conclusive
    - Further extension expected
    - Greater pressure on post-trade processing
    - Smaller players will find it difficult to bear costs
    - Where does it end? Need for debate
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# Importance of Standardization

- Number of exchanges rising
    - Each with own certification → impacting costs
    - Standardization required going forward
    - More cooperation between exchanges - finding common ground
-



# Technology

- Front and back-office working together in real-time
    - Advantageous for IT vendors which cater to both front and back-office
  - Global and local systems also closer
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# Clearing Houses

- Clearing houses like 'silos'
    - Need to cover multiple assets across exchanges
    - Wider coverage will drive innovation and reduce costs
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## Block Deals

- High market impact
    - Operationally difficult to execute for institutional investors
    - Dark pools beneficial but not probable
    - Regulator needs to address issue
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## Relationships Still Matter

- Domestic institutional brokerages recruited from foreign counterparts to increase market-share
  - Reverse flow also seen
  - Expected to continue as a factor despite automation
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# Regulatory Overlaps

- Securities and Exchange Board of India is the main capital market regulator
  - Overlap of its domain with:
    - Insurance regulator, IRDA (e.g., unit linked insurance plans)
    - Central bank, RBI (e.g., FII limits, currency and interest rate futures, investment banks)
    - Provident fund regulator, PFRDA (e.g., NSDL)
    - FMC (commodity markets)
  - High Level Coordination Committee (HLCC) on capital markets not deemed successful
  - Financial Stability and Development Council (FSDC)
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# Thank You

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