

“A STUDY ON HISTORY OF DERIVATIVE MARKET AND ITS CURRENT SENERIO IN INDIA”

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1.INTRODUCTION

The financial derivatives market have been in existence in India is some form or the other for long term. The financial derivative gained prominence after 1970 in recent years the market for financial derivatives has grown in terms of the variety of instruments available, as well as their complexity and turnover. Financial derivatives have changed the world of finance through the creation of innovative way to comprehend measure and manage risk. the problem of risk caused by uncertainty and volatility in the underlying assets can be effectively solved by derivatives as it is the risk management tools that help an organisation to effectively transfer risk. Derivative are instrument which have no independent value. Their value depends upon the underlying asset. That may be financial or non financial Equity derivative market in India has registered an explosive growth and is expected to continue the same in the years to come. Introduced in 2000, financial derivatives market in India has shown a remarkable growth both in terms of volumes and numbers of traded contracts. NSE alone accounts for 99 percent of the derivatives trading in Indian markets. The introduction of derivatives has been well received by stock market players. Trading in derivatives gained popularity soon after its introduction. In due course, the turnover of the NSE derivatives market exceeded the turnover of the NSE cash market. For example, in 2008, the value of the NSE derivatives markets was Rs. 130, 90,477.75 Cr. whereas the value of the NSE cash markets was only Rs. 3,551,038 Cr. If we compare the trading figures of NSE and BSE, performance of BSE is not encouraging both in terms of volumes and numbers of contracts traded in all product categories .

Definition of Financial Derivatives

Section 2(ac) of Securities Contract Regulation Act (SCRA) 1956 defines Derivative as: a) “a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security; b) “a contract which derives its value from the prices, or index of prices, of underlying securities.

2. OBJECTIVE OF THE STUDY

- 1] To analyse the risk and return towards the future trends of equity derivative.
- 2] To review the background of derivative market in India
- 3] To have an over view on the derivative market from its introduction to current position in India.

3. REVIEW OF LITERATURE

1. Sushmita Bose (2006) title- “ The Indian derivative market revisited”.
2. Ashitosh vashishta and satish kumar (2010) title- development of financial derivative market in India- a case study”
3. Caroline priyanka koorse and Dr. S.Kavitha (2015) title- “ A analysis of financial derivatives and its growth rate in India”
4. S.Satya ,title “ a comparative study on equity commodity, currency derivatives in india –evidence from future market with special reference to BSE ltd.”

4. MAJOR PLAYERS IN THE FINANCIAL DERIVATIVES TRADING :-

There are three major players in the financial derivatives trading:

1. **Hedgers:** Hedgers are traders who use derivatives to reduce the risk that they face from potential movements in a market variable and they want to avoid exposure to adverse movements in the price of an asset. Majority of the participants in derivatives market belongs to this category.
2. **Speculators:** Speculators are traders who buy/sell the assets only to sell/buy them back profitably at a later point in time. They want to assume risk. They use derivatives to bet on the future direction of the price of an asset and take a position in order to make a quick profit. They can increase both the potential gains and potential losses by usage of derivatives in a speculative venture.
3. **Arbitrageurs:** Arbitrageurs are traders who simultaneously buy and sell the same (or different, but related) assets in an effort to profit from unrealistic price differentials. They attempt to make profits by locking in a riskless trading by simultaneously entering into transaction in two or more markets.

5. USES OF FINANCIAL DERIVATIVES

Derivatives are supposed to provide some services and these services are used by investors. Some of the uses and applications of financial derivatives can be enumerated as following:

2. **Management of risk:** One of the most important services provided by the derivatives is to control, avoid, shift and manage efficiently different types of risk through various strategies like hedging, arbitrage, spreading etc. Derivative assist the holders to shift or modify suitable the risk characteristics of the portfolios.
3. **Price discovery:** Derivative markets provide a mechanism by which diverse and scattered opinions of future are collected into one readily discernible number which provides a consensus of knowledgeable thinking.
4. **Liquidity and reduce transaction cost :** They help in disseminating different information regarding the future markets trading of various commodities and securities to the society which enable to discover or form suitable or correct or true equilibrium price in the markets. As a result, the assets will be in an appropriate and superior allocation of resources in the society.

5. Price stabilization function: Derivative market helps to keep a stabilizing influence on spot prices by reducing the short term fluctuations. In other words, derivatives reduce both peak and depths and lends to price stabilization effect in the cash market for underlying asset.

6. TYPES AND CLASSIFICATION OF DERIVATIVES:-

There are many ways in which the derivatives can be categorized based on the markets where they trade, based on the underlying asset and based on the product feature etc. some ways of classification are follows:-

(1) On the basis of linear and non-linear: On the basis of this classification the financial derivatives can be classified into two big class namely linear and non-linear derivatives:

(a) Linear derivatives: Those derivatives whose Over-the-counter (OTC) traded derivative: These values depend linearly on the underlying's value are called linear derivatives. They are following: (i) Forwards (ii) Futures (iii) Swaps

(b) Non-linear derivatives: Those derivatives whose value is a non-linear function of the underlying are called non-linear derivatives. They are following: (i) Options (ii) Convertibles (iii) Equity linked bonds (iv) Reinsurance

(2) On the basis of financial and non-financial: On the basis of this classification the derivatives can be classified into two category namely financial derivatives and non-financial derivatives.

(a) Financial derivatives: Those derivatives which are of financial nature are called financial derivatives. They are following: i) Forwards (ii) Futures (iii) Options (iv) Swaps

The above financial derivatives may be credit derivatives, forex, currency fixed-income, interest, insider trading and exchange traded.

(b) Non-financial derivatives: Those derivatives which are not of financial nature are called non-financial derivatives. They are following:

(i) Commodities (ii) Metals (iii) Weather (iv) Others

(3) On the basis of market where they trade: On the basis of this classification, the derivatives can be classified into three categories namely; OTC traded derivatives, exchange-traded derivative and common derivative. Derivative contracts are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary.

The OTC derivative market is the largest market for derivatives and largely unregulated with respect to disclosure of information between parties. They are following:

(i) Swaps (ii) Forward rate agreements (iii) Exotic options (iv) Other exotic derivative

(b) Exchange traded derivative: Those derivative instruments that are traded via specialized derivatives exchange of other exchange. A derivatives exchange is a market where individual trade standardized contracts that have been defined by the exchange. Derivative exchange act as an intermediary to all related transactions and takes initial margin from both sides of the trade to act as a guarantee. They may be following:-

i) Futures (ii) Options (iii) Interest rate (iv) Index product (v) Convertible (vi) Warrants
(vii) Others

(c) Common derivative: These derivatives are common in nature/trading and classification. They are following:

(i) Forwards (ii) Futures (iii) Options (iv) Binary options (v) Warrant (vi) Swaps

7.HISTORY OF DERIVATIVE MARKET IN INDIA:-

Derivative Market in India have been in existence in one form or the other for a long time. In 1875, the Bombay cotton trade association started future trading way back then. The government of India banned cash settlement and options trading .thus derivative trading shifted to informal forward market.

In 1995, the introduction of financial derivative trading in India was promulgation on options in securities laws (amendment) ordinance. It provides for withdrawal of prohibition on options in securities.

Derivative trading commenced in India in June 2000 after SEBI granted the final approval to this effect in may 2001 on the recommendation of L.C.Gupta committee. SEBI permitted the derivative segments of 2 stock exchange NSE and BSE and their clearing house/ corporation to commence trading and settlement in approval derivative contracts.

8.GROWTH OF INDIAN DERIVATIVES MARKET:-

If we compare the business growth of NSE and BSE in terms of number of contracts traded and volumes in all product categories with the help of table no.4, table no.5 and table no.12 which shows the NSE traded 636132957 total contracts whose total turnover is presents a description of the types of derivative product

1. Date Progress 14 December 1995 NSE asked SEBI for permission to trade index futures.
- 2.18 November 1996 SEBI setup L. C. Gupta Committee to draft a policy framework for index futures.
3. 11 May 1998 L. C. Gupta Committee submitted report
4. 7 July 1999 RBI gave permission for OTC forward rate agreements (FRAs) and interest rate swaps
5. 24 May 2000 SIMEX chose Nifty for trading futures and options on an Indian index.
- 6.25 May 2000 SEBI gave permission to NSE and BSE to do index futures trading.
7. 9 June 2000 Trading of BSE Sensex futures commenced at BSE.
8. 12 June 2000 Trading of Nifty futures commenced at NSE.
- 9.31 August 2000 Trading of futures and options on Nifty to commence at SIMEX.
10. June 2001 Trading of Equity Index Options at NSE July 2001 Trading of Stock Options at NSE
11. November 9, 2002 Trading of Single Stock futures at BSE June 2003 Trading of Interest Rate Futures at NSE

12. September 13, 2004 Weekly Options at BSE

13. January 1, 2008 Trading of Chhota(Mini) Sensex at BSE

14. January 1, 2008 Trading of Mini Index Futures & Options at NSE

15. August 29, 2008 Trading of Currency Futures at NSE October 2, 2008 Trading of Currency Futures at BSE Source: Compiled from BSE & NSE.

9. CURRENT SENORIO OF DERIVATIVE MARKET IN INDIA:-

The over-the-counter derivatives market amounted to approximately \$800 trillion and the size of the market traded on exchanges totalled an additional \$83 trillion. For the fourth quarter 2017 the European securities market authority estimated the size of European derivatives market at a size of euro 700trillion with 74 million outstanding contracts. However these are national values and some economists say that this value greatly exaggerates the market value and the true credit risk faced by the parties involved, for instance in 2010 while the aggregate of OTC derivatives exceeded \$630 trillion, value of the market was estimated much lower at \$23 trillion the credit risk equivalent of the derivative contracts was estimated at \$22 trillion. The credit risk estimated at \$3.4 trillion.

Still, even these scaled down figures represent huge amount of money. For perspective, the budget for total expenditure of united states government during 2012 was \$3.5 trillion, and the total current value of the U.S. stock market is an estimated \$23 trillion the world annual gross domestic product is about \$65 trillion. And for any type of derivative at least, credit default swaps(CDS), for which the inherent, nominal value, remains relevant. It was this type of derivative that investment magnate warren buffet referred to in his famous 2002 speech in which he warned against “financial weapons of mass destruction” CDS notion value in early 2012 amounted to \$25.5 trillion, down from \$55 trillion in 2010.

10. MILE STONE OF NSE EQUITY DERIVATIVE MARKET IN INDIA:-

1993- Recognised as a stock exchange.

1994- Launched the equity and wholesale debt market segments & commenced electronic or screen- based trading.

1996- Created and administered a settlement fund, Launched NIFTY 50 Index & commenced trading and settlement in dematerialised securities.

1998- Established IISL, a subsidiary as a joint venture with CRISIL Limited to operate an indices business.

1999- Established NSEIT, a wholly-owned subsidiary and global technology firm that provides end- to-end technology solutions, including application services, infrastructure services, analytics as a service and IT enabled services.

2008- Became the first in India to offer trading in currency futures, introduced the securities lending and borrowing scheme(SLBS), Launched the NOW platform for web-based trading.

2009- Launched mutual fund services system(MFSS)

2010- Launched NOW platform for mobile devices, launched trading in currency options

2011 - Commenced trading in index futures and option on global indices, namely the S&P 500 and Dow Jones Industrial Average.

2012- Commenced trading in index future and options contract on the FTSE 100 index, launched SME-specific EMERGE platform for the listing and trading of securities of SMEs.

2013- Launched the NEW Debt Segment (NDS)

2014 - Launched NMF-11 platform for mutual funds, launched NBF-II segment for interest rate futures, Launched trading on India VIX Index futures, commenced trading on NIFTY 50(then known as CNX NIFTY) on the OSAKA Exchange.

2015- Entered into a memorandum of understanding to enhance the level of cooperation with the London stock exchange group, renamed CNX NIFTY TO NIFTY 50.

2016- Launched NIFTY 50 index futures trading on TAIFE, launched platform for sovereign gold bond issuances, launched electronic book-building platform for private placement of debt securities.

2017- Promoted NSE IFSC, the International stock Exchange in India's 1st IFSC SEZat GIFT City Gandhinagar

2018- Launched Tri-party Repo Market(TRM) Platform, in debt segment and "e-Gsec" platform for facilitating the non-competitive bidding in Government of India Dated securities (G-SEC) and treasury Bills..launched NIFTY SME EMERGE Index and 72 fixed income and 3 hybrid indices, entered into MOU to enhance cooperation with the Colombo stock exchange(CSE)

11.CONCLUSION:-

Financial derivatives have earned a well deserved extremely significant place among all the financial instruments (products), due to innovation and revolutionized the landscape. Derivatives are tool for managing risk. Derivatives provide an opportunity to transfer risk from one to another. Launch of equity derivatives in Indian market has been extremely encouraging and successful. The growth of derivatives in the recent years has surpassed the growth of its counterpart globally