Headline: Plan to end derivatives trading abroad is fraught with common sense	
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Plan to End Derivatives Trading Abroad is Fraught with Common Sense

Expert Take

SANDEEP PAREKH

The past few days saw some interesting Chinese whispers where media reported some sort of fatwa by market regulator Sebi to the exchanges to stop the trade of Indian indices in foreign exchanges. Based on these 'facts', opinions flew easy. Terms like de-globalisation, regressive, protectionist were offered. One commentator even argues that it would tempt MSCI index, a much followed international emerging market index, to cut its India weightage. Another syndicated piece quotes someone as saying that this will in fact impact the onshore market. In fact, the move is sensible. The comments are alarmist and simply wrong. If there is some high principle of killing your own business, perhaps that high principle has been compromised. There is no reason, India and Indian exchanges should not act in their self interest if current reality demands such a change.

Imagine if a corporate entity were to email a list of its vendors and customers on a daily basis to its nearest competitor. Really, this is what was happening. While BSE/NSE have shared data and branding for a fee when foreign exchanges were not competitors, now the very same entities are direct competitors. Now, the loss to business is greater than the fee received from the foreign exchanges for data feeds and thus requires rethinking from a competitive landscape perspective. This is Adam Smith's self interest and common sense, not some nationalist conspiracy theory of protectionism.

As the regulator has clarified, there has been no direction to the exchanges to stop any trading in foreign exchanges. Mainly because that is not how it happens, as Sebi has no power to ban trading in overseas exchanges and attempting that would plainly be silly. At most the regulator could have convened a meeting and nudged the exchanges to act, which really is in their own interest.

The only handle Indian exchanges have over overseas exchanges trading of Indian products is the data based on which trades take place. So, for instance, the Singapore exchange's trading the Nifty futures would depend on the data of the index and also the data of the individual stocks comprising of the index to trade the contracts. If this data were stopped, there is a likelihood that the trading would become out of whack and inaccurate. A similar outcome is likely in single stock futures of Indian companies which have recently been announced by SGX and were probably the root cause of the action.

ANIRBAN BORA

NO SERIOUS IMPACT

The move by Sebi is unlikely to tempt MSCI Index to cut its India weightage

In other words, the life blood of several products, in particular the SGX Nifty contract, is the data feed of the prices of the underlying and to a limited extent the branding of Nifty itself. The Singapore exchange is clearly more competitive in terms of costs and taxes with no STT, stamp duty, capital gains tax etc. But it is wrong to compete with Singapore or Dubai in terms of lower taxation, though there is merit in some rationalisation of investment taxes as the RBI governor recently pointed out. India cannot and should not compete with tax havens or the likes for a race to the bottom of taxation. We simply can't afford that.

The key issue is commercial in nature. Though the numbers are not published, one can assume that the revenue from brand lending of Nifty and the data feeds is less than the lost revenue from bringing the trades onshore. Thus, the decision to restrict trades would have been taken by NSE in its self-interest. Similarly, nothing would be achieved unless other exchanges cooperated, as the same component stock's price could be obtained from BSE.

Having said that, the task would be far more difficult if not impossible if the restriction were sought to be extended to currency derivatives. Any products which are not dependent on onshore data would not be impacted and there is no way to regulate or prohibit the same. However, such products are primarily highly competitive with little or no profits.

Finally, the end game for the exchanges is unclear, but there does appear to be some regulatory nudge towards the GIFT city SEZ. That is no bad thing, as that jurisdiction has exchanges which are owned by BSE and NSE, they offer a far lower tax impact and there is a policy reason to incentivise those rather than foreign owned trade venues. The very fact that the Singapore exchange lost nearly a tenth of its value on Monday's early morning trade (and BSE gained) shows the impact on its profitability by its losing the index derivatives business. If SEBI does something to develop the Indian markets as it is mandated to do under its preamble, it is no bad thing. If the exchanges did anything else, it would breach their fiduciary duty to their own shareholders.

(The author is managing partner of Finsec Law Advisors)