Headline: The war of the exchanges	
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The war of the exchanges

Indian bourses are busy protecting their own market share from a constant haemorrhage

BY INVITATION
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Earlier this month, the three largest stock exchanges in the country — National Stock Exchange (NSE), Bombay Stock Exchange (BSE) and the new Metropolitan Stock Exchange (MSE) — agreed to stop sharing data with overseas stock exchanges that offer derivative contracts linked to popular Indian indices and stocks. As soon as the news hit the wires, the predictable responses came out like the proverbial ants out of the woodworks — it's anti-competitive, a policy self-goal, protectionist. MSCI, the popular global index-provider, even darkly hinted at a possible cut in India's weightage in its global benchmark indices.

The fact though is, from the perspective of the Indian stock exchanges, this was a perfectly sensible competitive move. It made so much sense that two intensely competitive companies — NSE and BSE fight a bruising battle for market share and market access — came together on this issue. This move is simply a way for Indian bourses to protect their own market share from a steady haemorrhage. The rationale is pretty simple.

NSE, BSE today share, with a range of offshore stock exchanges, price feeds and index brands for stocks and popular benchmark indices listed on their platforms. These offshore bourses — primarily in Singapore, Dubai and Hong Kong — in turn use the price feeds and brands to float their own India products — SGX Nifty for example. Over the last few years, a significant amount of incremental trading on Indian indices have moved to these offshore platforms. Reasons are manifold, lower taxes for one — Singapore/Hong Kong/Dubai do not have taxes on capital gains made out of derivative contracts, unlike India. Severe restrictions in India on Participatory Notes (P-Notes), a popular instrument used by a variety of foreign investors to take equity exposures are a second. Above all, there is also the ease of regulatory environment, where many of these offshore markets are considered better than India. The proverbial last straw in the camel's back was the launch of 50 Indian single stock futures by SGX earlier this month.

NSE and BSE came together to essentially use the nuclear option, ie, access to price feeds. Sans access to price feeds (as also brand rights to the popular indices, though that is a smaller issue), the ability of traders on the SGX (or any other offshore exchange) platform to efficiently price Indian underlying products is severely impaired.

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It also required both BSE and NSE to cooperate on the issue, as restriction by only one of the two would keep the window of price feeds open from the other, and defeat the purpose altogether. In other words, it's a question of pure self-interest in a competitive market, where offshore exchanges like SGX were actively competing with BSE/NSE for market share. Nothing "protectionist" about it at all. The fact that SGX's own share price fell 9 per cent on the day the announcement by BSE/NSE came partially reflects the competitive impact of this move.

How does this play out now for markets and its shape? In the short run, there's unlikely to be any great impact. India hasn't put physical controls over foreign access to Indian stock markets. India's attractiveness as an investment destination too doesn't change, one way or another, by the decision of local exchanges to either share or not share price feeds with their overseas counterparts. If investors and investment themes do not materially change, chances of index providers cutting India weightages are extremely remote too.

In the slightly longer run though, this would likely be a case of delaying the inevitable. The case of currency trading

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is illustrative in this respect. USDINR, the most popular currency pair traded on India, are traded both in India as well as offshore (in what is called the NDF — Non Deliverable Forward — market). Volumes in the NDF market are over twice the volumes traded onshore in India. This, despite the fact that the NDF market has structural limitations in the form of inability to "physically settle" trades, given that INR is not a convertible currency. Reasons are all familiar, and similar to the ones described for stocks above. Now, currency markets are largely OTC (Over The Counter — bilateral deals struck on the phone/computer network by two traders), and not exchange-traded, and hence do not require proprietary price feeds from an exchange, unlike equities. As a result, offshore traders cannot replicate the same model easily for equities.

There is also the additional factor of India's own IFSC (International Financial Services Centre), in GIFT City, Gujarat. There's been a huge amount of regulatory nudge to shift offshore trades there from overseas exchanges.

However, financial innovation typically tends to trump physical barriers. While its more difficult to price offshore-listed Indian derivatives sans data from NSE/BSE, its not impossible. There would be smart structures/traders/algorithm-writers at work to develop new models to obviate the issue. Given the experience worldwide, especially on USDINR case, it is a problem that doesn't seem immune to being cracked. On IFSC, while taxes are somewhat lower compared to onshore exchanges, the issues around acceptability, ecosystem and market depth are still open questions for foreign investors to move serious volumes, yet.

Net-net, while the popular narrative around protectionism is widely misplaced, and this buys some time for India's local exchanges, this is likely to look a bit more of Don Quixote than Napoleon in the longer run!

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