



Edited Transcript of Panel Discussion on

**Developing the Securities Lending and Borrowing
Market in India**

Mumbai, September 3, 2012

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Moderator: S. Ramann	
Panellists: Rajiv Hingoo	
Vikas Khemani	
Debopama Sen	
R. Sundararaman	

Preface

As part of our efforts to continually facilitate the development of a stable and efficient securities market in India, we at NSE organize knowledge forums of different kinds such as panel discussions, seminars and round tables from time to time to discuss on developments in and issues related to different components of the securities market. These debates provide a platform to the stakeholders to share their experience of the market under consideration, particularly to the operational and regulatory issues they face and to suggest possible remedies for the regulators to consider.

In this context, NSE organized a panel discussion on 'Developing the Securities Lending and Borrowing Market (SLB) in India' in September 2012. The SLB market is a critical component of the capital market in both developed and developing economies, and serve a variety of needs of the market such as infusing liquidity, promoting price discovery, and helping to maintain equilibrium between the cash and the futures market. In short, it can and does play a major role in widening and deepening the securities market.

In India, however, the SLB market--introduced in April 2008-- is far from realizing its full potential, despite a number of initiatives taken by the regulator and the stock exchanges. This raises several questions. How do the market structures and practices in India differ from those in countries where SLB markets have flourished? Does the experience of these countries have any lessons for India? Can the scope of the market be expanded? What regulatory initiatives are necessary to motivate different types of players? What operational issues are facing the market participants? These are some of the questions that were covered in the panel discussion, and the subsequent Q & A session with the market participants.

These deliberations have been captured in this edited transcript and we believe that the transcript would be useful for industry participants, academics and policy makers.

Nirmal Mohanty
Vice President
Department of Economic Policy and Research
National Stock Exchange of India Ltd.

Executive Summary

Recognizing that the Indian Securities Lending and Borrowing Market (SLBM) has significant potential in creating liquidity in the Indian markets, the Economic Policy and Research Department of NSE had commissioned a paper to identify the reasons for the grossly underdeveloped SLB market in India and to compare and analyze the SLBM models followed by countries such as US, Brazil, and South Korea to see if any lessons could be drawn. After the paper was completed, a panel discussion on 'Developing the Securities Lending and Borrowing Market in India' was held at NSE, which was preceded by a presentation on the paper. This was done by bringing to the table the experience of different stakeholders in the SLB market. Mr. S. Ramann, Executive Director, SEBI, moderated the session. The other panel members were Mr. Rajiv Hingoo, COO, CLSA, India; Mr. Vikas Khemani, Head - Wholesale Capital Market, Edelweiss Financial Services; Ms. Debopama Sen, MD, Securities Funds and Services, Citibank India; and Mr. Sundararaman, SVP, NSE.

The highlights of the discussion have been outlined below in two parts a) general observations and b) specific issues and suggestions.

A. General Observations

- It was observed that in India the SLB market is highly underdeveloped and has weak linkages with other markets such as cash, future and options market. This is in sharp contrast to markets in other countries such as the US and South Korea.
- At present, the primary motivation for borrowing in Indian SLB market is cash-futures arbitrage.
- The current market is supply constrained; there is a relative shortage of lenders.
- From both the borrower's and the lender's perspective, market volumes are mainly driven by individual investors and proprietary groups. It was felt that for a robust market to develop, there is a need for greater diversification among the participants, especially on the lending side.
- It was observed that the SLB market and single stock futures market, which serve the same need, can potentially thrive simultaneously.
- Relative value trading (which is in its nascent stages in India) particularly between corporate bonds and stocks, could give a significant boost to the market.
- The participants believed that to make the SLB market work, many critical pieces needed to be put in place, which are listed under 'Specific Issues and Suggestions'.

B. Specific Issues and Suggestions

I. Coexistence with single stock futures

- Given that the same set of stocks are permitted for trading in both single stock futures and the SLB market and that the former is far more liquid than the latter, it is not surprising that most market players fulfil their need for shorting by accessing the single stock futures market rather than the SLB market.
- The single stock futures market, by definition, offers a standardised product. Therefore, one of the ways of offsetting part of the handicap of the SLB market is to provide it with some amount of customisation to help address the varied needs of the participants.
- Participants found single stock futures transaction comparatively simpler vis-à-vis SLB market transactions, underlining the need to address this weakness of the SLB market.

II. Scope of SLB market

- Expanding the basket of securities eligible for the SLB market beyond the ones allowed for single stock futures trading could raise volumes in this market.
- SLB could be permitted in asset classes other than equities, such as government bonds, corporate bonds, exchange-traded funds (ETFs), etc.

III. Shortage of lenders

- To address the relative shortage of lenders in the market, institutional investors need to be encouraged to participate, particularly on the lending side.
- One way to create incentive for potential lenders, so that more lenders come into the market, is to allow them to use the collateral provided by the borrowers for the purpose of risk management (in the form of margin).
- Current regulations do not clearly specify whether promoters are allowed to lend in the SLB market. Should they be (explicitly) permitted, three issues could potentially arise: (a) promoters may fear that they could be trapped in insider trading rules; (b) there may be implications for reporting on shareholding pattern to the stock exchanges; and (c) what would be the disclosure requirements for the promoters?

IV. Collateral and transaction costs for borrowers

- Currently, only cash and cash equivalents are allowed to be offered as collateral, but for FIIs only cash is allowed. This gives rise to three issues. First, lack of flexibility in permissible collateral raises costs for borrowers. Second, potential FII borrowers are

at a *relative* disadvantage vis-a-vis domestic institutions, since they are not allowed to offer cash equivalents as collateral. Third, FIIs are allowed to offer government securities in other markets such as cash and F&O, but not in SLB. This appears to be an anomaly.

- It was felt that other avenues of collateral such as equities and government securities could be allowed, although it was recognized that in such an event, the required haircut would have to be much higher than in other markets.
- For a broker operating in different markets, collateral is currently not being optimally utilized because of segment-specific margins. It may be explored as to whether it is possible to make margins fungible across segments, with the CCP playing a central role in this.
- The borrower may need the securities for a shorter period than the standardized tenure available in the market. In such a case, the borrower has no option but to pay fees for the entire standardized tenure. His collateral will also be blocked for the entire period. This entails avoidable expenses for borrowers.

V. Risk of early recall

- Institutional investors may face the need to recall their position (a) to take advantage of a favorable change in the market prices or (b) to respond to client's demand for change in their portfolio. Since early recall requests are taken care of by the CCPs only on a *best-effort basis*, institutional participants are not comfortable and hence suggest an introduction of daily rollover.
- To minimize legal hassles in recall, enough clauses should be built into the contract to ensure that benefits due to a lender should flow to him without any legal obstruction.
- In case of corporate events, other than dividend payouts and stock splits, the borrower is mandated to return the securities before the expiry period of the SLB contract and the lender has no option but to foreclose. This mandatory foreclosure provision for lenders discourages some market players. So, lenders need to be given the *option* to foreclose (partially or entirely) or continue.

VI. Rollover

- It was suggested that introducing a system of daily rollover would allow lenders and borrowers to suit their needs and thereby, address (a) the uncertainty (associated with recall) for the lenders and (b) the high cost of borrowing for the borrowers. To make daily rollover viable, it is necessary to ensure that it does not have a cost disadvantage (in terms of depository and regulatory charges) vis-à-vis monthly rollover.

- If the borrowers and the lenders so desire, they may be allowed to roll over their position rather than unwinding and entering into a new contract.

VII. Low position limits

- It has also been observed that potential market participants feel discouraged to participate in the SLB market as they perceive the position limits to be too low. Compared to stock futures, the limits available in SLBM are very low, which makes it imperative to review the limits.

VIII. Operational issues

- SEBI's initiative for simplifying KYC norms does not extend to the SLB market.
- There is no facility to change a client code in the event of any human error, although such facility is available in other markets such as F&O, albeit with penalty.
- It was suggested that Unique Client Code (UCC)--used in the capital market and the F&O market--be allowed in the SLBM.

IX. Inadequate awareness

Improved education and awareness programs are necessary for the following reasons.

- FII participants mistakenly tend to perceive all new products launched in India as restrictive, costly and associated with complex procedures as compared to the international markets.
- Many FIIs are not aware about the advantages of the central counterparty guaranteed set up (prevalent in India) over the OTC framework, which they are familiar with and attuned to.
- High networth individuals (HNIs) particularly feel that if they lend and the securities go out of their demat account; there is a chance that the securities may never come back to their account.

A. Welcome Remarks

- Nirmal Mohanty, Vice President, NSE

Good Evening. On behalf of NSE, I welcome you. We are all here to participate in a panel discussion on 'Developing the Securities Lending and Borrowing Market (SLBM) in India'. As you may be aware, we at NSE hold such panel discussions from time to time on topics related to the securities markets, by involving a wide cross-section of stakeholders.

Before we begin today's discussion, let me briefly describe what promise the SLB market holds for its various participants—borrowers, lenders, exchanges, brokers, etc. From a borrower's perspective, it is a scheme that facilitates the settlement of securities sold short. From a lenders' perspective, some of the idle securities that they're holding can earn them a fee. The exchange, of course, earns a fee when the trade takes place, and so on.

The more important question is how does the market benefit the system: There are two principal ways in which the SLBM benefits the system: one, it can improve price discovery of securities by providing those participants who do not have the securities an avenue to hold securities and to take a view on it; two, it acts as a useful linkage to better align different components of the securities market.

In India, the SLB scheme was introduced by the SEBI as an exchange-traded mechanism in April, 2008. Since then, it has been modified a number of times with the intention of enhancing liquidity in the market. For example, the tenure of the contracts has been extended to a maximum of 12 months, and early recall as well as early repayment options have been made available. Following these measures, the liquidity in the market has risen from about Rs. 11 crore a day in 2011–2012, to about Rs. 22 crore a day so far in the current financial year (2012-13).

However, the size of the SLB market is far smaller in India than in other countries where the market has matured. Our trading volumes are about half a billion dollars a year compared to United States' USD 1.2 trillion, South Korea's USD 70 billion and Hong Kong's USD 500 billion (approximately), which are rather astounding figures. Thus, while the liquidity in the Indian market is rising, we are grossly underdeveloped by international standards.

In view of the underdeveloped state of the SLB market, which can generate multiple benefits for the stakeholders and the market, we had commissioned a paper by Mr. Gopi Suvanam and Mr. Manish Jalan, to analyse the current Indian market structure and compare it with the markets in South Korea, the U.S., and Brazil. The paper makes many interesting points, which I'm sure Mr. Suvanam would highlight during the course of his presentation. Following Mr. Suvanam's presentation, we will have a panel discussion, which is the main event of the day. With almost all the stakeholders in the market being represented in today's panel, I am sure this is going to be a very interesting and enjoyable session. Mr. Ramann, Executive Director, SEBI, will chair the session, and guide the discussion.

Once again, on behalf of NSE, I welcome all of you and wish you a very productive session.

B. Presentation

- Gopi Suvanam, Director, FinStream Financial Advisors Pvt. Ltd.

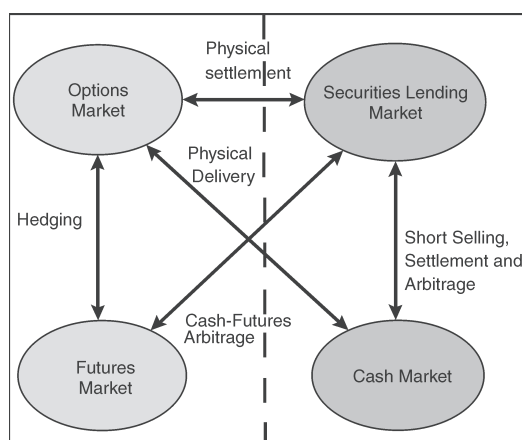
Thanks for the warm introduction, and welcome all. It is really heartening to see a group that has shown interest in this particular topic.

Today, my presentation will focus on three main areas. I shall begin with 'utilities and significance' of the SLB market. Then, I will spend considerable time comparing the current features and status of the Indian market, with those of some select countries. And towards the end, I shall suggest a few measures that could potentially boost the market.

The SLBM's utility can be seen from two perspectives--one is how it adds value to the overall health of the securities market and the other is how it creates value for individual participants.

As regards the first perspective, it would be useful to compare the Indian market with some matured international markets. Let us consider the example of the U.S. market, where the options market is physically settled. As physical delivery would involve transfer of securities, the options market has an interface with the SLBM, which in turn is interlinked with the cash market through short selling and settlement support. At the same time, there is an interface between the futures market and the options market via hedging (called delta hedging¹) and between the futures and SLB markets through arbitrage. Thus, the cash market, derivative market and SLBM are all interlinked and if there is a change in terms of either liquidity or pricing in one market, it is reflected in every other market (see Chart 1).

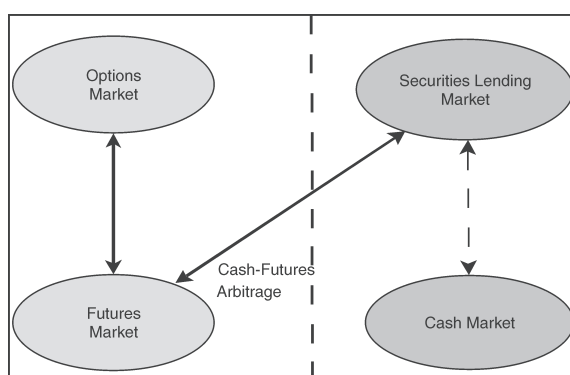
Chart 1: Market Inter-linkage in U.S market



¹ An options strategy that aims at reducing the risk associated with price movements in the underlying asset by offsetting long and short positions.

Currently, the complete market inter-linkage as evident in the international markets is missing in India (see Chart 2). No doubt, there are vibrant futures and options markets and a strong inter-linkage exists between these two markets through the process of delta hedging. However, the inter-linkage of the cash market with these two markets is very weak. As a result, any large change in liquidity conditions in the futures market or in the options market is not reflected in the cash market. Although a weak relationship in terms of arbitrage is developing between cash and futures through the SLBM, the arbitrage has yet to reach high enough volumes to strengthen the linkage. This dichotomy is evidenced by (a) disconnects in trading volumes between cash and derivatives segments and (b) a highly fluctuating cash-futures basis.

Chart 2: Market Inter-linkage in Indian Markets



I shall now discuss the SLBM from a market participant’s perspective. There are some factors that have to be weighed in making a decision of shorting some stock in the cash market by borrowing in the SLBM or shorting it in the futures market. One of the elements is the futures cash basis. If the basis is highly positive—which means that the futures price is very high compared to the cash price—then of course it would make more sense to sell in futures. However, if the basis is flat or negative (which may happen in several cases), it is more advantageous to short in the cash market rather than sell futures, because when you are shorting in the cash market, you get cash in hand which can be invested in collateral for positive returns.

Yield on collateral can be typically expected to be equal to fixed deposit rates (6-8 percent currently). If optimal utilization of collateral is done, higher yields can also be achieved. For example, if a trader borrows some stock and shorts it, he would receive the price of the stock upfront. Instead of putting 100 percent of this amount as a deposit for collateral, he can put in 50 percent with the bank and get a bank guarantee; he can then utilize the remaining 50 percent for his/her own purposes. If we assume a trading member’s cost of funding is about 18 percent, on an average, the trader would get yield on collateral up to 12 percent (which is 50 percent at 6 percent and 50 percent at approximately 18 percent)

under current market scenarios. Thus, it makes sense to use the SLBM even if the stock prices are lower than the futures prices. Only when the futures prices are higher than the stock prices—by about 12 percent on an annualized basis—would it make sense to short in futures rather than shorting the security in the cash market. This same logic would also help in calculation of cash-futures arbitrage.

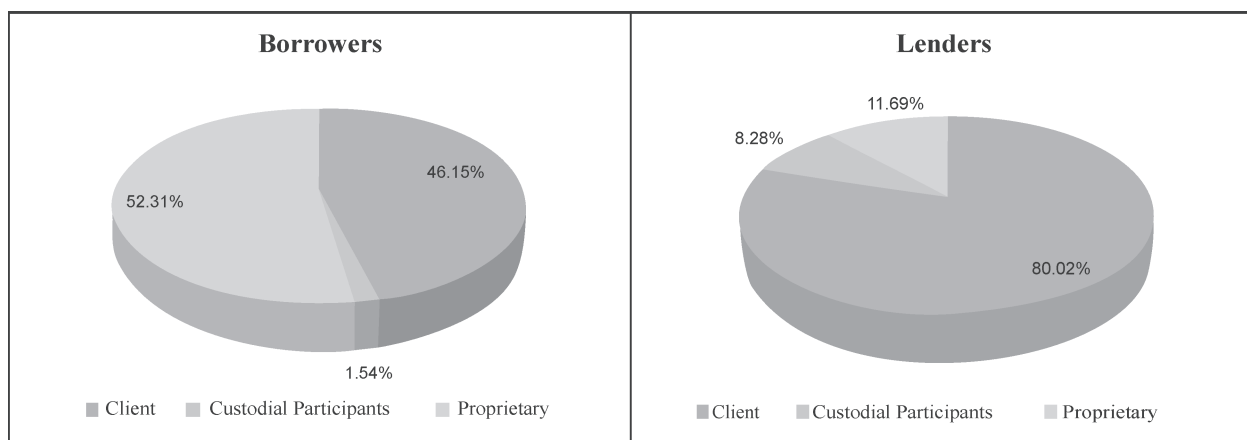
One important aspect to be taken into consideration—aside from yield on collateral—is that the profits are taxed at different rates, depending on whether the transactions are in cash market or in futures. For an individual investor especially, a cash market transaction would be taxed as short-term capital gains, whereas, if he/she were trading on futures, it would be taxed as business income, and the former is lower than the latter. Thus, two of the key advantages of shorting in the SLBM vis-à-vis selling futures are yield on collateral and lower tax liability on profits.

Having made a case for developing the SLBM makes a lot of sense from a market participant's perspective and from the perspective of overall market; I will now present some statistics relating to the current status of the SLB market. First, there has been a steady increase in volumes. Starting with very low volumes, we are now trading approximately Rs.10–20 crore a day. While this is not significant enough to move the underlying cash market or to help improve the liquidity of the cash market, it is nevertheless a positive development.

Secondly, the average yield that the securities lender gets is currently very high. For example, in case of certain securities, the average yield a lender gets by just lending is as high as 21 percent. In case of other securities, the yield is not that high, but is generally much higher than what prevails internationally. As more participants come in on the lending side, the fee is expected to decline.

Thirdly, both individual investors and proprietary groups participate in SLBM trades. On the borrower side, it is almost equally split between proprietary groups and individual clients (see Chart 3). From the way the trades are happening in the market, the primary motivation for borrowing appears to be cash-futures arbitrage. On the lender side, the majority of trades comes from retail investors and HNI, with the balance from proprietary groups (about 12 percent), and from institutional investors (about 8 percent) (see Chart 3). This lack of diversification of the market participants, especially on the lending side, is not conducive for a healthy market, as the potential value that the institutional investors (for example, insurance companies who typically hold securities for a long period) could create for their clients by lending securities that otherwise lie idle, is not materializing.

Chart 3: Borrowers and Lenders Contribution in SLB Market ²



International Comparison

How does the Indian SLB market compare with other markets? (see Box 1 for summary). For comparison purpose, I have chosen three countries—the U.S., Brazil, and South Korea. The U.S. was chosen because it is a huge market. ³ Brazil and South Korea were chosen, because their securities markets are similar to India: both were late entrants in a lot of areas, and their market growth in terms of equity capitalisation is also very high, just like in India. There are, however, some differences. While they don't have as vibrant a futures market as we do, they have much more active SLB market than India, which is why we can draw some lessons from them. In Brazil, the SLBM started around 2000, but it took about 10 years to fully develop, following which the trading volumes grew by almost 100 percent on a year-on-year basis. The South Korean market started in 1996, and there has been a tremendous pickup in this market as well.

Trading Volumes: On a daily basis, Brazil has a trading volume of USD 2–3 billion, which is almost 70–80 percent of the cash market. In South Korea, it is USD 280 million a day, which is much smaller, than the Brazilian market, but is still large in absolute terms. The U.S., of course, is the biggest market, with about USD 5–6 billion dollars per day.

Market Participants: In terms of participation, in India, it is mostly proprietary groups or clients, as stated earlier. On the other hand, it is mostly institutions in the U.S., mostly a mix of funds and individual

² As of September 2012.

³ The U.S. has had more than a hundred years of experience in the SLBM itself, which was developed initially for the primary purpose of easing settlement failures. There has been a tremendous growth in the U.S. market post 2000, mainly due to third-party agent lending. This means that there are dedicated third parties such as brokers and PMS service providers, who have the power to lend securities on behalf of their clients, who can leave standing instructions for lending their stocks. This is not a complete outsourcing but might be exploited by some smart clients.

investors in Brazil and primarily FIIs in South Korea. So, there is a different kind of structure in each one of these markets. Also, in the U.S., the primary motivation for borrowing is settlement and short support. In South Korea and in Brazil, it is primarily short selling, both for outright shorting of/for shorting against another security (relative value trading).

OTC vs. Exchange: In India, the SLB market is entirely on the exchange; there cannot be any SLB transaction over the counter. The exchange, as the Central Counterparty (CCP) provides settlement guarantee for both the first leg and reverse leg. In the U.S., on the other hand, it is purely OTC. In Brazil and South Korea, SLB transactions can be either on exchange or OTC. In Brazil, one can do a trade outside the market (an OTC transaction), but one has to report it on the exchange, and clear it through a CCP. South Korea also has a CCP. One of the advantages of an OTC is that it allows a lot of flexibility in terms of both tenure as well as collateral. The other major advantage is that when two counterparties enter into an SLBM transaction, the lender gets collateral, which he/she can use for other transactions. This does not happen in the current setup in India, because once the security goes to a CCP, it sits idle there.

Early Recall: In India, the lenders are not allowed to force an early recall (before the maturity) of the securities they have lent. They can only put in an early recall 'request' through the exchange. The request would materialize only if there is enough liquidity, and some other participant is willing to lend the same security. Otherwise, the lender cannot force the borrower to return the securities before the maturity. This is problematic for the institutions who need to have control over their securities holdings to respond quickly to market moves and redemption pressures. Different countries deal with this issue differently. The U.S. has an OTC-like platform, where the mutual agreement between the parties can include a clause of recall with penalty, and so on. Brazil has an interesting feature that allows people to lend or borrow overnight, and it can be rolled over on a day-to-day basis; it is quite like the call money market. South Korea has explicitly put an obligation on the borrower to return the security if the security is recalled.

Eligible Securities: Another big difference relates to the eligible securities. In India, only the F&O stocks are eligible for the SLB market, whereas in the U.S. and South Korea, it is across the board—equities, bonds, exchange traded funds (ETFs), everything. In Brazil, only corporate bonds and equities are the eligible securities.

Collateral: The last difference is on the front of collateral. In India, collateral is primarily cash and cash equivalents, while internationally, it can be any security. In fact, South Korea accepts even external debt (U.S. debt) as security, which may not be possible under the current FEMA Regulations in India.

Box 1: International Comparison of SLB Market		
Feature	India	International (Brazil, South Korea, U.S.)
Trading Volumes & Yields	Low volumes, High yields	<i>Brazil:</i> USD 2-3 billion <i>Korea:</i> USD 280 million <i>U.S.:</i> USD 5-6 billion Very low yields in all three countries
Market Participants	Mostly proprietary groups and retail	<i>U.S.:</i> Mostly institutions <i>Brazil:</i> Mix of funds and individual investors <i>South Korea:</i> Primarily FIIs
OTC vs. Exchange Traded & CCP	Exchange traded, Two CCPs	Mix of exchange and OTC. <i>U.S.:</i> OTC, No CCP <i>Brazil and South Korea:</i> One CCP each <i>Brazil:</i> OTC trade but reporting on exchange.
Early Recall	Borrower is not obliged	<i>U.S.:</i> Depends on mutual agreement <i>Brazil:</i> Overnight lending market <i>South Korea:</i> Borrower has obligation of returning if recalled
Eligible Securities	Equities in F&O segment	<i>U.S. and South Korea:</i> Equities, Bonds and ETFs. <i>Brazil:</i> Corporate Bonds and Equities
Collateral	Cash and cash equivalents	Wide range of collateral

Way Forward

Now, I shall suggest some measures, which I think can potentially boost the market. (see Box 2 for summary)

Immediate Measures

Introduction of contracts with shorter duration: One immediate step that could enhance the SLBM is the introduction of contracts with shorter durations. If allowed to lend an overnight basis, mutual funds may show interest in participating in the market, because this would allow them to release their securities from the SLB market at a relatively short notice and sell them in the cash market. From a borrower's perspective, short duration contracts may not be suitable for somebody trying to do an arbitrage, but it would be ideal for someone who's looking for just settlement support (i.e. for supporting settlement of open short positions), or for shorting the security.

Allowing SLB in more securities and asset classes: Securities, such as non-F&O stocks, could be made eligible based on some market capitalisation criterion, for instance. Introducing ETFs as eligible security can potentially have stronger impact. If ETFs can be traded in the SLBM, they would add liquidity to not only the ETFs themselves, but also to the underlying stocks.

Increased range of collateral: The range of acceptable collaterals has been constrained particularly for the FIIs and retail participants due to FEMA and banking regulations. For example, retail participants

have no access to bank guarantees (bank regulations) and FIIs have no access to bank deposits or bank guarantees (FEMA regulation), which put them at a disadvantage vis-à-vis others. A liberalization of these regulations would allow the retail and FII participants to have access to bank guarantees and bank deposits, which they can use as collateral.

Clarity on guidelines by regulators: Regulatory guidelines pertaining to SLBM are not adequately clear. This is especially true for institutional investors. For example, greater clarity is required in terms of whether insurance companies and banks can lend or not.

Increased awareness: My last suggestion for immediate implementation is to generate greater awareness about the market for the market participants, especially those on the retail side.

Long-term Measures

As regards the long-term measures, one option that can be explored is the creation of a parallel OTC market, alongside an exchange-traded market. This need not necessarily hurt the volumes on exchange, since any volumes in an SLBM on an OTC market would ultimately reflect in the cash volumes in the exchange market. Another interesting measure would be to create incentives for FIIs to trade. Such incentives could take the form of lower tax liability or greater options in terms of collateral, etc.

I will wind up by saying that provided the structure of the market is flexible enough to allow people to choose a cost-efficient way to trade, I think SLB could be potentially a big and important market, in terms of not only profitability for individual market participants but also impact on the liquidity of cash markets.

I would like to conclude by thanking the NSE for giving me this opportunity.

Box 2: Summary of Recommendations for Development of SLB Market			
Immediate Measures	Implementing Authority	Long Term Measures	Implementing Authority
Introduction of contracts with shorter duration	Exchanges	Parallel OTC Market	SEBI
More eligible securities (non-F&O stocks, ETFs, bonds)	SEBI	Allowing outsourcing of lending and borrowing activities to third party agents	SEBI, Brokers and Custodians
Accepting wide range of collaterals	SEBI and Exchanges	Incentivize FIIs to trade	MoF, RBI, SEBI
Clarity on guidelines given to insurance companies, banks, FIIs, AIFs	IRDA and RBI		
Build awareness on lending side and non-proprietary borrowing side	Exchange, Trading Members		

C. Panel Discussion

Moderator: S. Ramann, Executive Director, SEBI

Panellists: Rajiv Hingoo, Chief Operating Officer, CLSA India

Vikas Khemani, Head-Wholesale Capital Market, Edelweiss Financial Services

Debopama Sen, MD, Securities Funds and Services, Citibank

R. Sundararaman, Senior Vice President, National Stock Exchange of India

Moderator:

I have always wondered: with an efficient F&O market prevailing in India, what could bring players to the SLB segment, and why? In this respect, Mr. Suvanam's presentation provided some useful insights. For a market to have balanced development, I think it's very important that we have the different products that customers want in a market. And from my understanding, the SLB market, a key component in any securities market, may still take some more time to pick up in India, given the experience of other countries. But we need to kick-start it by putting the SLBM pieces in place.

I would like to start off by throwing some questions in, more to get a sense from my fellow panellists about what they feel about the several options that are available to boost this market. Let us try and list out the things that are frightfully important, but can be done without too much hard work. If such things exist, then let's go straight for them. We could look at this from either the borrower's side or the lender's side. To whatever extent SEBI needs to step in or the NSE needs to rework its model, to boost this market, they will. I do not know how large the F&O market is in Brazil, but I think Korea certainly does have a large market. In spite of that, if they have a thriving SLBM segment, then maybe there are things that we could do immediately. Mr. Khemani, would you like to start off?

Vikas Khemani:

Mr. Suvanam covered a lot of factors in his presentation. We've been trying to promote the SLB market for some time.

Why is it that despite several attempts over the last four to five years, SLBM has not picked up in India? I think one of the reasons is the co-existence of single stock futures with the SLB market. Based on our interactions with institutional participants and other participants, I know that the trading volumes of single stock futures in India are very large compared to those in other markets, such as the U.S. and Brazil, where the SLB market is large

(relative to their single stock future market). In other words, the space occupied by the single stock futures in India, the corresponding space in the US and Brazil is occupied by the SLB market.

Moreover, the SLB market probably does not address the specific needs of participants as SLB is available only on stocks on which single stock futures trading is permitted. This problem could be addressed by permitting SLB in more securities outside the list of stocks where futures and options are allowed.

The measure that could give SLB a relative advantage to grow is to allow it to be customized. Single stock futures market can offer only a standardised product (in terms of underlying securities, tenor, collateral etc.). Therefore, it would be helpful if SLB market can provide some amount of customisation according to the specific needs of the borrower, since every borrower tends to have different requirements.

There are other issues as well with SLB. For instance, currently, if a corporate event happens, other than the dividend and the splits, the securities have to be recalled, and the borrowers are supposed to return them before expiry. Borrowers generally do not like this kind of discontinuity in the market and hence, many potential participants are currently discouraged from participating in the market.

These points would need to be addressed; further, there needs to be greater clarity regarding certain taxation matters, which would encourage more participants to come into this market. I'm not an expert on tax, but one issue I have come across is as follows. When I borrow, and then short the stock and buy it back, would that be considered capital gains or business income? While some say that it is clear from a policy perspective; some clients feel otherwise.

Debopama Sen:

I think these are all very valid points; I will add on to them. The points you made about permitting SLB in more securities, including more asset classes, introducing a little more flexibility around the mandatory foreclosure when there is a corporate action—these are certainly things that we hear from clients. To a large extent, I speak for the institutional client base. In the current market, we would all recognise that demand exceeds supply and there is shortage of lenders. If we are to bring in more supply into the market, it is important for institutional lenders to participate. The obvious need is for the respective regulators to permit these entities to participate in SLB, e.g.

IRDA for insurance, RBI for banking etc. The other key concern that we hear is related to the ability to recall the position in the face of a change in the market price, or market conditions or the client's own portfolio. Today, early recall is on a best-efforts basis. There are many ways of working around this. One suggestion mentioned earlier is the introduction of a daily roll, but this will need to be evaluated for overall impact on demand as well. Another possibility would be to bring in a lender of last resort.

Moving on to institutional borrowers, Mr. Suvanam spoke about how we would like to see more institutional borrowers in the market. One of the reasons that they, particularly the FIIs stay away—although we see a lot of interest in them in participating in this market—is that it tends to be more expensive for them to borrow in the on-shore SLB market than it is for the local borrowers, which is largely due to the lack of flexibility around the collaterals that the latter can place. This is less of an exchange imposed constraint, and more of a regulatory constraint given the foreign exchange rules; but perhaps, there are workarounds over here as well. For instance, equities or other forms of non-cash collateral (which are permitted for FIIs in other segments) could be opened up. These are some of the things that I think may not be too difficult to address.

Rajiv Hingoo:

The technical and the product aspects were covered by Ms. Sen and Mr. Khemani, so I'll look at the matter from the issue of perception in India. When I speak to my sales and trading desks in different parts of Asia and the world, the first perception they have of any new product that is launched is that it is too restrictive, too difficult, not profitable, too costly, and so on. I think there is a degree of investment that needs to be done to give a boost to the education and awareness process, and also to bring about visibility on platforms such as Bloomberg. I think India is at a nascent stage when it comes to free access to the market products; clearly, we have a long way to go. I think the education aspect will make it more effective, and take care of the issue of perception.

My second point is from the perspective of FIIs, which Ms. Sen mentioned. If an FII has already invested a large amount in stocks in India and it does the borrowing, it still needs to go through the whole process of putting up cash as collateral, rather than utilizing its existing portfolio. This is a clear deterrent for them.

Moderator:

I will lead Mr. Sundararaman to the next question: if we agree that the F&O market is, in a sense, mimicking the SLB market, then what is the cause for

unhappiness? This is relevant, since we have a thriving F&O market; and as Mr. Khemani mentioned, the volumes are very good on the single stock futures.

R. Sundararaman:

As was discussed by Mr. Suvanam, there are multiple ways in which the SLBM helps in bringing about fairness in equity pricing. One is by taking care of any shorting needs. One could argue that this is being taken care of by stock futures, but Mr. Suvanam's numbers show that there are many instances where the SLBM could be a better option compared to stock futures for expressing a shorting view.

There are other critical pieces that the SLB market tries to address. If somebody wants to do a reverse cash and carry arbitrage so that the bases between the cash and the futures remain in equilibrium levels, the SLBM would be very useful. Further, if somebody has had a wrong selling in the market as a result of which they have a settlement shortage, the SLBM comes to the rescue in a big way. Moreover, the SLBM serves a very important purpose in relative value trading, which is in nascent stages in India. Such trading could involve a convertible corporate bond and equity of the same company or it could be pair trading between two securities. In the case of pair trading between two equities, the futures probably could have helped; however, in a scenario involving corporate bonds, only the SLBM could be helpful. So clearly, there is a specific purpose to be served by the SLBM that cannot be served by the futures.

Now you could ask: If there is so much of purpose to be served, why are the volumes not growing in a big way? One of the reasons could be lack of education; the other could be the associated cost—in terms of recall and repay. I certainly feel that a vibrant securities futures market does not necessarily mean that there will be no SLB market.

Moderator:

I think there are some legal problems in the recall, in addition to what Ms. Sen had mentioned about the recall problem. Further, what was mentioned about other corporate actions causing the foreclosure of the contract is something that we should try to get sorted out. We should be able to build in enough tenets into the contract and make it quite clear that if a benefit is due to the lender, then it should flow to the lender.

Vikas Khemani:

Both single stock futures market and SLB market products serve two needs—shorting and relative value trading. In the stock future market, these are currently easier, more convenient, and cheaper, which the SLBM has not offered yet. I think there is another objective of the SLBM that is

there in other countries--the use of the borrowing mechanism to express voting rights, which can lead to some amount of shareholder activism. This is currently not possible in our system, but it is a very interesting objective to achieve from an overall market perspective.

Moderator: Do we wish to do that? I mean, where would the balance lie? Should the rights remain with the lender, or the borrower?

Vikas Khemani: Currently, in our system, the lender retains the rights, which entails that the securities must be recalled before any corporate action.

Moderator: That's right. That's the whole point.

Vikas Khemani: In other markets, it is a big practice to borrow securities to exercise voting rights. This can lead to some amount of shareholder activism.

Moderator: While I understand your point, I would be surprised if an insurance company in India ever allowed voting rights to be taken by the borrower. I mean, I don't see that happening. One of the important things for them is to keep their voting rights with them. So, would that really work?

Debopama Sen: A lot of our conversations in the past have been with the mutual funds, insurance companies and FIIs. One of the things that we've heard from a lot of these institutional lenders is that they are not necessarily looking for a mandatory foreclosure. Rather, they would like the ability to make a choice. I don't want to get into a situation where I'm automatically foreclosed and I have to pay back a proportionate return, whereas I was anticipating a larger return.

Is that the primary reason why such lenders don't participate in a big way? Certainly not. Is that one of the things that comes up negative in their analysis? Potentially, yes. This is where I would like to add to Mr. Hingoo's point on education, as the mindset of a lot of institutional lenders (especially international ones) is tuned to operating in an OTC framework. This is a highly debatable subject; over the years, we've seen regulators moving away from an OTC framework. While one could argue that the OTC framework also serves a certain value, I think there is a lot to be gained from continuous dialogue and conversation with lenders to convince them to come and look at the set-up in India—it is a central counterparty guaranteed set up, with the CCP rated AAA by an international rating agency. Moreover, there is a certain degree of safety that is provided by this framework, which perhaps is not available elsewhere. I think all of us as market participants need to focus on this aspect as well.

Rajiv Hingoo: To counter one of your points, from a lender's point of view, if we look at FII's or mutual funds or other domestic institutions, they are long-only position keepers. From a market stand point, restrictions in the securities that can be short sold may not lead to ideal price discovery. This in itself would be a motivation for introducing securities lending and borrowing on wider range of securities.

R. Sundararaman: From the returns perspective for a long-only individual, if he/she is holding shares, he/she is not going to lose the title of the shares by lending; he/she is going to get it back in any case. The returns that we were talking about are decent. Without losing title, if somebody is getting these returns, rationality demands that they should lend the security. However, very often, we find people hitting the limits and hence, not being able to lend further. Compared to stock futures, the limits available here are very low but the returns are better. So I'm not sure whether it is the concern about returns that is preventing investors from participating. There is certainly the issue of the restricted limits that may be discouraging people from participating.

Moderator: This is something that we could take up; reviewing the limits is definitely a takeaway for us. I also completely back the point made about the changes that we've seen in the financial markets and essentially, the whole debate about exchange-traded vs. OTC transactions. We are all aware about how, across the world, the OTC markets are being forced by regulators to report transactions on the exchanges and eventually to move to a CCP kind of platform. So what we have started in India looks costly, because of higher costs involved in the exchange-traded system than the OTC might. However, in the long run, exchange traded system may be safer.

Having said that, is there a way the collateral being placed on the table by the borrower can come into play? Currently, it is being kept by the CCP and is not available for the lender. This would have been possible in an OTC set up. If we could, however, make the collateral available to the lender, there would be a huge incentive for the lender to come in. We could also look at a situation where the lender could use that for his/her margin purpose.

R. Sundararaman: This is certainly an insightful thought that is worth exploring. There could be a way to devise a system in which the settlement guarantee continues and the lender is able to use the collaterals held by the clearing corporation with appropriate haircuts, without any additional risk coming in.

Vikas Khemani: I would like to take up one of the issues mentioned earlier: why does the Brazilian market have a higher volume than the Korean market? To my mind the main difference is the daily rollover present in Brazil, but not in Korea. I think the uncertainty of recall in Brazil is addressed through provision of the daily roll-over. Daily rollover serves the additional purpose of offering customisation.

Moderator: Your point is that daily roll-over would reduce uncertainties: that is, if I want to get out of my lending obligations, I can provided I have the option. In that case, would another lender take my place?

Vikas Khemani: Together with duration customisation, yes. If I need to borrow for only seven days or ten days, I can set the duration accordingly, instead of going for a standardised contract time period. This would probably boost the liquidity in the market as wider range of participants would be attracted to the market especially on the lending side like short durational lenders. This would be one of the ways to take this market forward.

Moderator: That is a good point.

Rajiv Hingoo: Another thing—which probably Ms. Sen can confirm—is that for every borrow transaction, there has to be a corresponding selling transaction within a short span of time; the borrower cannot sit on the borrowed stock for a long period of time.

Debopama Sen: The initial RBI regulation was that every borrow transaction has to be followed by a short sale; so you first borrow and then immediately need to have a short sale transaction, as a back-to-back. However, the traditional reason why a lot of institutions borrow securities overseas is to keep an inventory that they can sell as and when opportunities arise. RBI has now clarified the short sale can be done within a “reasonable period of time” which makes sense.

One key impediment that prevents a lot of FIIs from taking advantage of borrow opportunities is the requirement that an FII borrower needs to put up cash as collateral, which makes the costs very high, relative to the domestic investors. Since there is a lot of potential from this segment, one could argue that a tweak in some of these aspects would lead to stronger pickup.

Moderator: Would borrowing have any implication for the sectoral holding limits of FIIs?

- Debopama Sen:** The sectoral limit aspect has been clarified satisfactorily. Earlier, there was a lack of clarity on the implications of borrowing for sectoral limits. Suppose, an FII borrowed a stock and did a short sell, and in that intervening period, it goes into the sectoral restricted list; in such a situation, earlier, even buying the stock back would have been subject to restriction from a sectoral limits perspective. These matters have now been clarified by the Central Bank, putting to rest the sectoral cap issues. However, the issues related to the cost of collaterals have still not been satisfactorily resolved.
- Moderator:** So it's a fair point to say that within a reasonable time, an FII should sell the borrowed security; or alternatively, it could just be returned.
- R. Sundararaman:** Another issue that we hear from many FIIs is as follows. I have a security, but for some reason I cannot sell it. In such a situation, if I borrow the same security, would it be treated as a violation?
- Debopama Sen:** As long as the borrow is linked to a short sale and there is evidence for the same, we have not heard of any case where the regulator has had an issue with such a transaction.
- Moderator:** I think that's a fair point. So far, we have discussed possible improvements to the legal framework. We have also discussed the impact of daily rollover on liquidity.
- R. Sundararaman:** The lender getting the benefit of the collateral, and whether FIIs could post securities as collateral are two other issues that we discussed.
- Moderator:** FIIs posting collateral is something that we could take forward and get a dialogue moving. These cover the issues from the lender's perspective. Is there anything from the borrower's perspective that needs to be addressed?
- Vikas Khemani:** I think on the borrower's side, customisation is a major requirement; currently, only a standardised contract is allowed.
- Moderator:** Isn't that already available, where I can do a five-day contract, without having to do a monthly contract?
- R. Sundararaman:** As of today, I have to borrow for a longer period, because that is the only tenure available. Say after five days my need is over, I can return the securities and my margins will be released; but I have already paid the borrowing fee for the entire period, which is lost money, unless there is another willing borrower. For this, however, there is no guarantee.
- Vikas Khemani:** From a borrower's perspective, in single stock futures, I have to pay on the day zero only the margin; whereas in the SLB market, I have to pay

100 percent of the securities' price in addition to the margin, which means I require more capital. This is a disadvantage from a borrower's perspective, when compared to single stock futures.

R. Sundararaman: Actually, that may not be correct, as Mr. Suvanam was trying to explain in his presentation. Let us assume that the borrower puts collateral plus margin of 120 percent of the securities' price and gets the securities, which he/she sells; the next day he/she gets the 100 percent back in cash. The 120 percent might have been given as a bank guarantee, whereas the 100 percent that he/she got back for delivery in the cash market is in the form of cash. So this would work out to be beneficial.

Moderator: This brings us back to the point that was raised about the need for greater education.

Vikas Khemani: Actually, SLB and single stock futures are not exactly at par as regards margin because in SLB market there is a need for additional funding for a day which the broker typically finances. If this funding requirement for one day is purely for operational reasons, without any impact on risk management—there must be some way to handle this at CCP level.

Moderator: Does this mean that just a margin on a borrowing transaction is sufficient?

R. Sundararaman: On a borrow transaction; I don't think we are charging 100 percent margin on the T+1 day. It is charged only when the security is given away. On the day of the borrow transaction, the cost is just the lending fee, which is what is charged as margin. So I don't know whether that significantly increases the cost, because once you have parted with the security, naturally a collateral is required in order to safeguard the interests of the CCP.

Vikas Khemani: SLB market entails a clear disadvantage for the borrower as compared to a trader in single stock futures. As long as that disadvantage remains, people will prefer single stock futures over the SLBM. This is one of the reasons why we have not seen the SLBM picking up in a big way, in addition to the inconvenience, costs, and all the other factors that were discussed.

Moderator: I would say that, from a CCP perspective, there is no substitute for collaterals for guaranteeing the return of securities to the lender.

Vikas Khemani: While I am not suggesting that risk management be compromised, I feel that until the two markets are at par, it will be very difficult for the SLBM to pick up in a big way. Both these markets have not co-existed in a very smooth way anywhere in the world. We have to keep this in mind.

There is another point I would like to make. It was mentioned earlier that even exchange-traded funds (ETFs) could be included and encouraged in the SLB market, because that is where a significant potential exists right now.

Moderator: I think including ETFs in SLBM is a very good idea; it might just help the ETFs as an asset class as well.

Vikas Khemani: Absolutely.

Moderator: We seem to have run out of time. We will now take questions from the audience.

Q&A Session:

Audience: Mr. Ramann, first of all, congratulations on a very good discussion related to the SLBM. I would like to make two points at a regulatory level. First of all, in the second leg, when the lender does not get back the share, he/she gets a close-out. As per the CBDT, this is not treated as a buy or a sell; this is only a transfer. In this case, because he's getting consideration for those shares at particular rate, should it not be treated as a sell or a buy? Secondly, the SEBI was kind enough to simplify the KYC norm in August last year; but in the case of the SLBM, this agreement still exists separately, as the client and broker or client and participant agreement. These are two important points.

Moderator: I thank you for the second point. I will take that back for further consideration, if it has not been addressed already. I will keep this in mind.

Audience: Another thing I would like to talk about is the suggestion about daily roll-over. Actually, the SEBI had started weekly settlement, which did not work; therefore, it has started monthly settlement. Now, in between, if somebody wants that share, there is a very nice system of repay. So I don't think daily settlement is required.

Audience: Currently, whatever contracts are done, you get settlement on the expiry date. So there is no system that allows the borrower or the lender to roll their position. If I'm a lender or a borrower, I may wish to continue with the position for the next month. Currently however, no roll-over is allowed in the system. If the contract gets closed out or expires, a fresh contract has to be made. As a result, the lender is losing two or three days because the equity would have come into the portfolio of a lender, and he/she would lend it back again. The same is true of a buyer. If this question could be addressed,

we would not find situations where the open interest drops down on expiry, and picks up again in the next cycle. It would be a smooth process, similar to what is currently available in the single stock futures. While the previous question was about a daily settlement, here I am suggesting a relatively minor change in regulation to allow rollover, so that the lender and borrower can continue with the position, if they so desire.

Moderator: I think, you can have a roll-over on a daily basis and also monthly roll-over.

Audience: Whatever the current situation is, on a monthly settlement, if you provide the position to be rolled at the end of the month with the consent of both the lender as well as the borrower, the position will still be in the system, rather than going out of the system and coming back again. This can be done immediately without any hassle, because both parties would be involved in this. Even the Exchange would be doing risk management in the right manner, and it would be quite a smooth process.

Moderator: My question is: if one party does not wish to roll-over, what happens then?

Audience: That can be settled off. So there could be an option provided to the borrower and lender to roll over their position rather than unwinding and doing a new trade. This option is available in stock futures currently. In the SLB market, a borrower who wants to roll-over, has to pay the prevailing market fee and for borrowers who do not want to roll-over, their positions will expire. As a lender, if I want my inventory back on the expiry, I'll not roll-over my position. Similarly, as a borrower, if I do not want to continue the position, I will not roll-over the position. But the people, who want to roll, should be given an opportunity. And I don't think there is a hassle on the exchange's, or even SEBI's side.

Audience: That is a good suggestion. I'd like to add another point at the regulatory level. There is no facility to change a client code in the event of any human error. In other markets, such as F&O and cash market, there is a facility to change the client code with a penalty. It would be good to have such a facility, maybe with some sort of penalty.

Moderator: I think that is a fair point. We've already given some inputs to the exchanges related to this point on the F&O side, so I'll be happy if they devise something for the SLB segment as well.

Audience: Currently, the SLBM system is mainly used by arbitrageurs. In case of daily settlement, will it not entail an additional cost in terms of depository and

regulatory charges? Will it not bring down the overall volumes? In arbitrage, every single penny saved is a penny earned. In the case of borrowers, they would end up paying higher costs; in the case of lenders, the returns would reduce, if they come regularly for daily settlement. I would like one of the panellists to address this issue.

Moderator: Is that necessary? I have not thought through the maths of this. If somebody makes a return on a monthly basis, would that not come down proportionally on a daily basis? I would certainly like to remove additional costs that might creep in; that is certainly something we can look at. But prima facie it should be possible to work out the daily roll-over. Anything you would like to add, Mr. Sundararaman?

R. Sundararaman: From what I've heard, if an option for a daily roll-over is given, somebody who wants a customised duration can benefit. If somebody doesn't want to customise and wants to do arbitrage, he can stick to the regular cycle. Even for arbitrageurs who want to square up their positions, a daily roll position would be helpful. Therefore, daily rollover should be an additional option. Is that right?

Vikas Khemani: Correct. Frankly speaking, I was just picking up from how it is working in the Brazilian market, because that is a market that has developed very well as compared to other markets. We could probably explore how it has worked more efficiently there and get some more information before deciding whether it should be optional or compulsory.

Audience: I have some feedback in terms of the interactions I've had with some retail and some large high net worth individuals (HNI) clients who are concerned about the process. While there is clarity on taxation, an HNI client is worried that shares will move out of his demat account. They are worried that the shares may not come back to them and hence, they don't want to lend; the risk of falling yield is all the more reason for them not to lend. On top of that, there are DP charges in case the shares move out. Can't there be a simpler solution, such as having a simple SLBM lock-in in the demat account of the customer? While the shares remain in the demat account of the customer, you give credit to the borrower through a mechanism that is managed by the exchanges or the settlement agency, so that the client is assured that the shares are with them, and they will get their corporate actions.

Moderator: I thought the CCP is supposed to allay such fears!

Audience: It does so, from the settlement point of view. For those of us who are educated and understand this process, it works. But, for a customer who hasn't experienced this product, it doesn't work. Typically, those who lend are long-only customers; many of them may be holding shares for five years or more. So when I tell my customer about returns of '6 percent per annum' or '12 percent per annum', she is generally not interested, because she feels that 'my shares are going out, why should I take that risk?' This is particularly true of HNI clients. We have already talked about the risks related to corporate action and dividend tracking. Particularly, when there is a large holding, and the dividend is say Rs 2 lakh or 3 lakh, the customers don't want to take that risk. These are people who have relied on dividend income for years; they don't understand some of these mechanisms and they don't want to get into them.

So, instead of giving the customer the experience of shares moving out of his/her DP, simple ways need to be devised to deal with this issue at the back end.

R. Sundararaman: No, the problem you are referring to very clearly underlines the need for a greater amount of education, because as you know the dividend is actually passed on and any corporate benefit that is manufactured is given to the lenders.

Moderator: I think one thing you should definitely tell your clients is that the audit trail in the whole system is so strong that even assuming the worst were to happen, we can always retrieve it, although I agree that you don't want to be correcting mistakes after they happen. I honestly feel that the role of the CCP here is very clear: if the shares were to not come back from the borrower, the CCP would go to the market to buy them and give them to the clients; and also, there would be a penalty for the borrower to pay.

Audience: I feel one of the primary reasons why the SLB market is not picking up currently is that it is pretty shallow on the lending side. We're trying to address the issue by getting more and more participants involved on the lending side. The limits on the SLBM are too small for the lenders to participate, especially for big FIIs and mutual funds. For example, the limit on an A-group stock is only Rs.50 crores. I think this does not add any great value to the portfolio. Apart from the tax aspect, this is one of the main reasons why institutions are unwilling to participate. Further, since the promoter holding in India is generally very high, I think promoters potentially form one of the most important sources on the lending side. The

current regulations do not specify clearly whether promoters are allowed to participate in the SLB market.

Moderator: I don't think they're debarred.

Audience: I think there is clarity in terms of banks and institutions participating in the SLB market, but nowhere do the regulations say that a promoter can also participate in an SLB market. Further, what would be the disclosure norms for a promoter participating in the SLB market? In the SLB market, the current limits are a function of the free float. Promoters tend to think that this market is not for them. By increasing the limit and getting promoters involved, it would be possible to bring more depth to the market, along with a more mature set of participants. This would develop the market much faster than going door-to-door or demat to demat, and explaining to retail clients how participation would be a great opportunity for them. I think Indian markets have picked up tremendously primarily because of institutions, who have been making use of the available opportunities much faster than the HNIs. HNIs are typically slow, but they'll catch up once they see that an opportunity is available in the market. The supply side bottleneck can be relaxed by raising the limit for big participants. Insurance, for example, is now going to be part of the lending side. The LIC and all the other insurance players hold such large holdings that a small limit would be really meaningless for them.

Moderator: I accept your point about the limits, which I think we did discuss. On the promoter front, I don't know what the rules say exactly, but I should think that they can come into the market as clients. The other point you made was a really good one. We could have disclosure requirements for the promoters, if they were to come into this segment. So, like we have a disclosure of pledgers, we could probably have something on similar lines.

Audience: I think it would be useful to have a circular giving greater clarity about disclosure norms and other rules.

Audience: To develop on the discussion pertaining to the promoter participation in the SLB market, the primary fear of the promoters is that they would be trapped by the insider trading rules if they lend. Furthermore, you have the system of quarterly reporting of shareholding patterns to the stock exchanges. How do you handle a situation where shares don't appear in the demat accounts? These are two important things that I think the SEBI needs to clarify. I must add here that the preamble says that 'all types of investors can participate';

so typically, it should include and not exclude promoters.

Moderator: I think they will get included...

Audience: There is also an issue relating to the SEBI Substantial Acquisition of Shares and Takeovers Regulations, 2011 (SAST), in the event the reverse leg didn't go through.

Moderator: These are very valid points. The concept of disclosure needs to be reviewed. What is it that needs to be disclosed? When do they need to disclose? In terms of insider trading, is there a requirement that they would have to come out with an immediate disclosure that they're doing this kind of lending? If these are not already in place, it is only because they don't really matter much so long as the limits are so low. As soon as you consider reviewing the limits, these issues will have to be solved simultaneously.

Audience: We have a few concerns from a broker's perspective. First, stock lending is allowed only in the F&O stocks, which after September 30, 2012 will be reduced to 150 stocks. If we can expand the universe of lending and borrowing stocks from F&O stocks to say NSE 200, or 500, it can potentially increase the participation from the retail side.

The second concern relates to the NSE. The stock lending/borrowing window is available in the NSE trading system (NEAT), but not in the Computer-to-Computer Link (CTCL). These are the two concerns that we're facing right now.

R. Sundararaman: With regards to your second question, in case you want to develop CTCL software, the APIs (Application Programming Interfaces) are available for SLB.

Audience: One more concern: when we enter the client code into the trading system, we have to enter the Permanent Account Number (PAN) of the client. It is a 10-digit number, which is alphanumeric. The dealer or the RM sometimes makes genuine mistakes in this process, and I don't know what the solution is. If the Unique Client Code (UCC) -- that is used in the capital market and the F&O market--were also allowed in the SLBM, it would perhaps be helpful in the execution and would bring in more transparency to the retail side.

R. Sundararaman: We have noted your point, and we will certainly look into it.

Audience: Currently, margins have to be given only in the cash or cash equivalents format. If we can increase the asset classes that can be used as collateral

to include equity or the A-class category, it would be really beneficial for the borrowers. The lender does not have any worry about it, so long as the borrower brings in 125 percent.

Moderator: I agree that will be the case because of the kind of collateral you're putting in. The only thing is that a CCP would fear whether the equity used as collateral is liquid enough and can be sold. We have securities for the cash market, so I suppose some subset of that could be looked at. I think the larger issue is whether the FIIs will be allowed to place that as collateral if they were to become borrowers.

Audience: Maybe you can bifurcate. You may not allow FIIs to use equity as collateral, but for other participants you may.

R. Sundararaman: Since the SEBI has always been kind enough to encourage stakeholder participation while framing regulations, some of us were involved in the process. One of the concerns that came up when securities were being considered as collateral was as follows. While the nominal value of cash remains constant and the nominal value of cash equivalent cannot fall, in the case of securities, the value can fall. In any other market, you can square up a position overnight, whereas in the case of the SLBM, the term is locked. During that time, the clearing corporation cannot square up. So even if it knows pretty well that the value of collateral lying with it has fallen, the clearing corporation will not be able to take any corrective steps. This was one of the reasons why securities were not allowed as collateral. This is the background. If securities were to be allowed to be part of collateral in the SLB market, the applicable haircut would probably have to be higher than what is prevalent in other markets.

Audience: We will be happy if the applicable haircut on the collateral is as high as 50 percent or even more. Further, as the market falls, you can add to it or top up your collateral in the form of equity.

Debopama Sen: To extend that a bit, there are other forms of collateral in other segments that FIIs are permitted to use. For example, in the cash equity segment, they can use Indian government securities. Creating some sort of parity between the other segments and the SLBM segments for the FIIs—which have been blessed by the foreign exchange regulator as well—would be good.

Moderator: How much of that is actually happening?

Debopama Sen: It is happening. We are seeing that from our clients.

- R. Sundararaman:** It is a valid point, it should be across segments.
- Debopama Sen:** This also requires an education process. But we find that some of our clients are quick to adapt the minute they know it is available, which certainly helps.
- Moderator:** So it would make sense to have collateral looked at centrally by the CCP, and then allocate across asset classes neutrally.
- Audience:** Is it time to go beyond segment-wise specific margins and look at margins that are fungible across segments? It could be cash, F&O, or currency as far as the exchange is concerned, depending on the brokers and their exposure.
- Moderator:** I don't think that should be too much of a problem, if you respect the margining of each product. The margin can be allowed to become fungible across whichever asset classes you may be operating in; but for that, you would need a central body to be able to understand your position across all asset classes.
- Vikas Khemani:** This is a very valid point. I think this will improve market cost efficiency a lot.
- Audience:** Otherwise, while you would have capital lying idle in one segment, you would need to go back to the bank to get an FD or a guarantee for the SLB segment.
- R. Sundararaman:** So what you're saying is that a broker needs to offer a single collateral across all segments, and the margining mechanism that is being handled in different segments could be allocated by the clearing corporation from that collateral.
- Audience:** Yes, that is right. Money is available, and so are bank guarantees, and you will keep charging against a single amount across segments. How does it matter whether I use it in the SLBM, or whether I use it in cash or F&O?
- Moderator:** We will certainly take that forward.

Thank You





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National Stock Exchange of India Limited

Exchange Plaza, Bandra Kurla Complex, Bandra (East), Mumbai 400051, India

Tel: +91 22 26598100 / 66418100 Fax: +91 22 26598120 E-mail: cc_nse@nse.co.in