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BROKERS PROFILE AND ACTIVITY OF CURRENCY FUTURE TRADING IN INDIA

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Abstract
The emergence of derivatives market is a creative achievement of financial engineering that provides an effective and less costly solution to the problem of risk embedded in the price unpredictability of the underlying asset. The objective of the study was to overview the growth of currency future trading in India. A questionnaire was developed for the study. The active members of the various exchanges i.e. brokers were taken as respondents. Percentage method was used to analyze the data. Results indicated that the ratio of turnover in currency futures market in the total derivatives market is growing but at a low speed. There is a need to create awareness about the market to increase the volume in currency futures market.

Key words: Currency Futures, Brokers, Trading Activity.

INTRODUCTION

Risk is a characteristic feature of commodity and capital markets. Variations in the prices of agricultural and non-agricultural commodities are induced, over time, by demand-supply dynamics. The last two decades have witnessed many-fold increase in the volume of international trade and business due to the wave of globalization and liberalization sweeping across the world. This has led to rapid and unpredictable variations in financial assets prices, interest rates and exchange rates, and subsequently, to exposing the corporate world to an unwieldy financial risk. In the present extremely uncertain business scenario, the importance of risk management is much greater than ever before.

With the economic reforms ushered in the New Economic policy of July 1991, India made an earnest entry into the process of world economic integration and globalization. Various policy reforms were designed to integrate the Indian economy with the global economy. As a result of liberalization & globalization of the Indian economy, a well-functioning stock market became a necessity. Steps were taken to reform the Indian stock market which is crucial part of the financial system. Numerous innovations & structural changes took place. Various kinds of financial innovations, and new risk management strategies evolved. One development that has particularly gained attention has been the extraordinary increase in the use of diverse financial innovations, especially numerous kinds of new derivatives instruments. In India, the emergence and growth of derivatives market is relatively a recent phenomenon. Since its inception in June 2000 in stock derivatives, market has exhibited exponential growth both in terms of volume and number of traded contracts.

With electronic trading and capable risk management systems, exchange traded currency derivatives were introduced from August 2008 onward. Firstly currency futures on USD:INR were launched by National Stock Exchange(NSE) on August 29, 2008, then by Bombay Stock Exchange(BSE), and Multi Commodity Exchange (MCX-SX) on October 1, 2008 and on October 7, 2008 respectively. Futures on 3 additional currency pairs, namely, EURO: INR, GBP: INR and JPY: INR were introduced at NSE and MCX-SX on February 1, 2010. Trading on all currency futures pair was started at United Stock Exchange (USE) on September 20, 2010. Further, options on USD:INR, were introduced at NSE and USE on October 29, 2010, that was firstly launched by Philadelphia Stock Exchange (PHLX) on Pound Sterling/USD In December 1982. The currency derivatives segment in India has witnessed an increasing growth over time.

REVIEW OF LITERATURE

Ellis (n.d) published a conceptual study on the problem of changing concept of convertibility and the futures of currencies. Convertibility is a pearl of great price in furthering the efficacy of market forces and the economic

strength of the free world. While its attainment was not an intractable or insoluble problem, as some economists maintained, it was a matter of great complexity because such a large variety of adversities can interfere. Only by a great degree of self-discipline in domestic affairs and by effective and Continuous co-operation by the chief trading nations of the world could secure and maintain convertible currencies.

Remolona (1993) studied the growth pattern of future and option contracts over the Chicago Board of Trade (CBOT) and The London International Financial Futures and Options Exchange (LIFFE) and the factors driving the growth of derivatives trading. The study includes data of the official website of Bank of International Studies (BIS). The study identified four developments giving rise to such demands: sustained shifts and temporary shifts in market volatility, the emergence of important but relatively illiquid cash markets for government bonds, new inducements for financial institutions and non-financial firms to deal with interest rate risks and the international diversification of institutional equity portfolios.

Schulmeister (2005) examined the mutually reinforcing interactions between exchange rate dynamics and technical trading strategies. The analysis was based on the performance of 1024 moving average and momentum models in the single most active foreign exchange market, the DM/$ market between 1973 and 1999. An out-of-sample test of the performance of all 1024 models between 2000 and 2004 (euro/US dollar) was also the part of the study. The main results showed that technical trading systems were quite profitable during the floating rate period. It was also found that technical models exert an excess demand pressure on currency markets. When these models produced trading signals, almost all signals were on the same side of the market, either buying or selling. When technical models maintain open positions they were either long or short. Initial exchange rate movements triggered by news or by stop-loss orders were strengthened by technical trading and often transformed into a trend. This "Multiplier effect" was reflected by the close relationship between technical trading signals and Order flows. Author concluded that order flows were not only driven by (fundamental) news but also by Technical trading, which reinforces exchange rate trends to which it responds.

Bose (2006) studied about the major developments in the Indian commodity, exchange rate and financial derivatives markets and outlines the regulatory provisions that were introduced to minimize the misuse of derivatives. It was revealed that there were a number of pointers to the efficient functioning of the derivatives markets. Study found that in the early years of the equity derivatives market there was a degree of concentration in the market and consequent lack of width and depth across segments. Further there were violations of put-call parity, and consequential arbitrage opportunities. Author emphasized that there was a need to see how these attributes were changed over time along with increased participation in the market and whether the growing volumes were in corroboration with a move towards more efficient markets.

SivaKumar & Sarkar (n.d) evaluated the various alternatives available to the Indian corporates for hedging financial risks. Author concluded that forward and options were preferred as short term hedging instruments while swaps were preferred as long term hedging instruments. The high use of forward contracts by Indian firms also highlighted the absence of a rupee futures exchange in India. It was found that there was a requirement for managing foreign currency risks. Author also emphasized that Reserve Bank India had responsibility to realize the need for rupee futures and the convertibility of the rupee in India.

Lingareddy (n.d) studied the state of currency derivatives in India with a comparison to futures and forwards. Sample period was from September 2008 to March 2009. Research tools i.e. Correlation, T test, Standard deviation and Coefficient of Variation were used as volatility measure. Data on forward rates for various term structures was collected from traded as well as polled data. Source for traded data was from the official website of Clearing Corporation of India Ltd. (CCIL) while the polled rates were collected from the official website of Reserve Bank of India (RBI). The extent of match/mismatch between the polled and traded forward rates were studied for pooled as well as individual categories of major trading members such as foreign banks, nationalized banks and private

banks. Results indicated that the foreign exchange market become more efficient due to the introduction of currency futures but introduction of currency futures had no impact on the volatility of spot market.

Mihaljek & Packer (2010) reviewed derivatives markets in emerging market economies (EMEs) on a comprehensive basis. The study was based on the objectives to study about the structure and dynamics of EME's ,the difference between the growth of EME's and mature markets, to study the factors that explain differences in the growth of derivatives markets across countries and time. The study combined data from the Triennial Central Bank Survey of OTC derivatives market activity with those on derivatives traded on emerging market exchanges and data on exchange-traded derivatives, compiled by commercial providers and published on a regular basis in the BIS Quarterly Review, provide detailed information on standardized derivative contracts listed and traded on emerging market exchanges. Data was analysed through regression and coefficient of correlation. It was found that First, daily turnover in derivatives markets in EMEs was expanded four times over the past decade, to over 6% of emerging market GDP. Second, derivatives in emerging markets were traded in almost equal proportions over the counter and on exchanges. Third, unlike in advanced economies, FX derivatives were still the most traded derivatives in EMEs (50% of total turnover), while interest rate derivatives remain underdeveloped. Fourth, the FX derivatives turnover in emerging markets was becoming increasingly global, with a growing share of transactions being done cross-border, and transactions in emerging market currencies increasingly taking place offshore. Fifth, the largest derivatives markets in EMEs were located in Korea, Brazil and the two Asian financial centers of Hong Kong SAR and Singapore. And sixth, trade, financial activity and per capita GDP were positively related to the growth of derivatives markets in EMEs.

Friedman (2011) studied on the need of futures market in currencies in United States. Changes in international financial Structure will create a great expansion in the demand for foreign cover. It was highly desirable that this demand be met by as broad, as deep, as resilient a futures market in foreign currencies as possible in order to facilitate foreign trade and investment. Such a wider market was almost certain to develop in response to the demand. The U.S. was a natural place and it was very much in the interests of the U.S. that it should develop here. Because the dollar was almost certain to continue to be the major intervention currency for central banks and the major vehicle currency for international transactions. Exchange rates will almost surely continue to be stated in terms of the dollar. Its development here will encourage the growth of other financial activities in this country, providing both additional income from the export of services, and easing the problem of executing monetary policy.

Pandey (2011) assessed the speed of growth and volatility of currency futures in India and also aimed at analysing the volatility of the currency futures. Author employed correlation and Kolmogorov- Smirnov test for a 10 months sample period from February to December 2010. Kolmogorov- Smirnov Test is a non-parametric test and it was used to determine whether the distribution was homogeneous. Study included all the four currencies traded under currency futures (EURO, Dollar, YEN and Pound) in India. The number of contracts traded and open interest at NSE and MCX were inclusively compared to study the growth of the currency futures. Findings showed a positive growth pattern in currency futures but highest in the case of USD-INR currency futures and least in the EURO-INR as the value of rupee for Euro was more volatile that creates negative return.

Bhagwat et al. (2012) analysed the Indian financial derivative market and its position in global financial market. Study was based on the secondary data collected from the official website of National Stock Exchange (NSE). The analysis was made through tables using percentage method of total turnover of cash segment, the derivate segment of stocks, currency futures and options. It was found that financial derivatives earned a well-deserved and extremely significant place among all the financial instruments (products), due to innovation and revolutionized the landscape. The growth of derivatives in the recent years had surpassed the growth of its counterpart globally. The Notional value of option on the NSE increased from 1195.691178 lakhs USD in 2003 to 354648.1941 lakhs USD in 2012 and notional value of NSE futures increased from 14329.35627 lakhs USD in 2003 to 39228.38563

lakhs USD in 2012. India is one of the most successful developing country in terms of a vibrate market for exchange-traded derivatives. The equity derivatives market was playing a major role in shaping price discovery. Volatility in financial asset price, integration of financial market internationally, sophisticated risk management tools, innovations in financial engineering and choices at risk management strategies were driving the growth of financial derivatives worldwide, also in India.

Rajkumar & Rani (2012) analysed the trend and growth pattern of currency futures market in India. Secondary data was compiled from the SEBI annual reports and analysis was made using percentage method. It was revealed that the turnover of exchange traded currency derivatives increased day by day since its introduction and in 2010-2011, it was more than OTC currency derivatives market turnover. USDINR futures contracts were found to be the most actively traded contract among all the exchange traded currency derivatives instruments.

Saha (2012) focused on the growth of Indian economy and its financial sector using the different economic and financial indicators. The study used secondary data collected from different sources such as reports of Indian National Sample Survey Organization (NSSO), annual Economic surveys published by the Ministry of Finance, Government of India, reports of the World Bank etc. Data presentation was made with help of bar graphs and line graphs. It was observed that while the country was liberalized its international trade and investment regime, the economy was still insulated from international competition. Author suggested that the Central and State policymakers should exercise innovative measures to address to the challenges to lead India to become one of the leading economic powerhouses in near future.

Choudhary (2012) stated that foreign exchange markets are the biggest on the basis of traded turnovers and thus had a significant volatility. The journey of Indian futures has to face some challenges of myths of traders about the market and of liquidity. USD-INR pair is the mostly traded currency futures pair in India. While facing these challenges currencies were still best performers amongst all the classes, presently in India as there is no counter party risk in currency futures trading. It was also suggested that FIIs and NRIs must be allowed in currency future trading and also the trading hours must be extended.

Pandey (2012) studied that currency futures are the immense requirement for the developing economies to grow international space and efficient currency risk management system for the economy. Currency derivative provides better understanding and forecasting of actual and implied volatility numbers. It also helps in the price discovery in long run and make treasury operations viable for Indian banks, multinationals exporters and importers. Majority of the trade in currency futures is contributed by high net worth individuals and medium size entities. A further research in currency futures could be conducted by academicians related to accounting & reporting of currency derivatives in Indian context.

RESEARCH METHODOLOGY

Based on the review of literature the following objective was formulated for the study:
To study the brokers profile and activity of currency futures trading in India.
A questionnaire method was used for the study. Sample for this objective was authorized dealers i.e. members of exchanges dealing in currency futures. Sample size is 56 brokers. Percentage method was used for analyzing the data.

DATA ANALYSIS AND INTERPRETATION

The results of survey were related to the broker's activities which include information about trading exchange, turnover and category of broker, classification of trading volume and investor's profile.

- **Trading Exchanges**

Authorized dealers i.e. brokers can be registered with more than one exchange at the same time. The survey result shows that 52 respondents were trading at NSE and only four members are trading only on MCX-SX. It revealed

that most of trading volume was coming from the NSE. Among the 52 respondents, 18 were trading from both BSE &NSE, 9 were from both MCX-SX & NSE. There is no broker from USE as its operation have been closed in December, 2014 and data collection was made during the first quarter of 2015 i.e. from January-March, 2015.

- **Category of Member**

Table 1 Category of member operating in different exchanges

Category of Member	No. of respondents	% of respondent
Trading Member	24	42%
Trading Member-Clearing Member	31	55%
Professional Clearing Member	1	3%
Self-Clearing Member	0	0%
Total	56	100%

Like stock market currency futures are traded through the members of the exchange spread all across the country. There are four categories of members in the trading system, namely a) trading member b) trading member-clearing c) professional clearing member and d) self-clearing member. Among all 55% brokers were trading cum clearing member as shown in **Table 1.** Trading member represented 42 % of all the responses and there was only one professional clearing member in the currency futures market. There was no self-clearing member as majority of the trading is being done by trading cum clearing member.

- **Trading Turnover of Currency Futures**

Table 2 Average daily turnover in currency future segment

% of Turnover(in crores)	No. of respondents	% of respondent
Less than 5	15	26%
5-25	22	39%
25-50	9	16%
50-75	0	0%
75-100	10	19%
Total	56	100%

The brokers were asked for details of their average daily turnover in the terms of the notional value of contracts in the F&O segment as shown in **Table 2**. Majority of brokers (39%) were having their daily turnover between 5-25 crores in currency futures segment while 26% of brokers traded less than 5 crores. On the higher side only 10 (19 percent) brokers had daily turnover more than 75 crores.

- **Weightage of Individual Derivatives Securities**

Table 3 The weightage of individual derivatives securities trading in Total Turnover

Derivative securities	Less than 25%	Between 25-50%	Between 50-75%	More than 75 %	Total
Currency Future	32	16	6	2	56
Currency Option	34	20	2	0	56
Stock Derivative	0	16	22	18	56
Total	66	52	30	20	168

With regard to the weightage of derivatives securities, higher trading was made in the stock derivatives as depicted in **Table 3.** These stock derivatives trade contributed to more than 50 percent of their turnover in the case of 40 (22+18) respondent (71 percent).Brokers were getting more volume in the stock market as investors are more aware of this market and getting more returns. Stock derivatives had gone through a rapid growth in last few years. Currency futures accounted for less than 25 percent of the total turnover in derivative segment in the case of 32 (57 percent) brokers, while 8 (6+2) brokers reported 25-50 percent and 34 (60 percent) brokers reported that currency options were accounted for less than 25 percent of the total turnover. This could be due to that barely seven years have passed when the currency futures were introduced in India. Currency option were introduced four year back only i.e. 2010 and a large group of investors are not aware of the market mechanism.

CONCLUSION

The survey was conducted to know the profile and trading activity of brokers who are active member of the currency future segment in Indian exchanges i.e. NSE, BSE and MCX-SX. Findings reported that Majority of brokers were trading cum clearing member and registered with NSE. It was found that out of the total turnover of derivative segment currency future represent only less than 25 percent due to the less exposure of currency futures market among investors. It was concluded that trading volumes in currency futures market is growing gradually. Some policy initiatives are required for creating awareness among the investors about the usage of the currency futures.

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