Easier rules likely for MFs in derivatives trading

PAVAN BURUGULA
Mumbai, 22 May

The Securities and Exchange Board of India (Sebi) is planning to ease norms for mutual funds (MF) to participate in the derivatives markets. According to sources, the regulator plans to increase the investment cap and allow domestic funds to sell options.

Until now Sebi has adopted a cautious approach towards allowing MFs to invest in derivatives since the asset class is considered highly risky. At present, there are several restrictions on MF investments in equity derivatives. For instance, current rules permit MFs to invest in derivatives only for hedging purposes. The extent of exposure that an MF takes for hedging purposes cannot exceed the equity exposure that is being hedged. MFs are not allowed to sell options and the total equities, debt and derivatives exposure of an MF cannot exceed the value of their assets under management (AUM). But, with the improved liquidity and stable settlement systems, the market regulator is of the view that more leeway could be provided for MFs in derivatives markets.

"The issue was discussed in the last board meeting and Sebi is currently reaching out to various stakeholders for views on the matter. The idea is to open up the derivatives markets for MFs in a gradual manner. The idea is to encourage more MF participation in the derivatives markets without making them excessively risky products," said a source.

Sebi has been making several efforts to deepen the Indian derivatives markets. Sources say Sebi has reached out to other regulators, including the Reserve Bank of India (RBI) and the Insurance Regulatory and Development Authority of India (Irdai), asking them to consider relaxing the derivatives investment rules for institutions under their jurisdictions. While all the insurance companies are regulated by Irdai, non-banking financial institutions (NBFCs) and banks are regulated by the RBI.

"Various measures would be required in order to create a more balanced participation in derivatives. Therefore, there is need to relook at the regulatory restrictions placed on domestic institutions especially in light of the fact that Indian markets already have a robust risk management framework in place," said Sebi's recent board memorandum.

In developed markets, institutions such as MFs, NBFCs and insurance companies are big players in the derivatives markets. But, the Indian market is dominated by brokers and retail investors. While proprietary trades account for over 40 per cent of the total derivatives volumes, retail investors account for 24 per cent and MFs 0.4 per cent of the total volumes.

"Indian derivatives markets have evolved significantly in the past few years. We have better transparency and risk management practices now. Hence, it would be a good time for the regulator to open up derivatives markets for domestic institutions. Even if MFs start using derivatives for hedging purposes, it would contribute significantly for deepening our derivatives markets," said B Gopkumar, chief executive officer, Reliance Securities.

PROVIDING A BREATHER

- Sebi to ease norms for MFs investing in derivatives
- The regulator is mulling to increase the cap on F&O investments by MFs and may allow them to write options
- The move is part of Sebi's efforts to deepen the Indian derivative markets
- Currently, MFs contribute to only 0.4 per cent of the overall derivatives volume
- Sebi has also reached out to other regulators, including the IRDAI and the RBI, seeking their help in easing the regulatory framework for domestic institutions investing in derivatives