



launch of the

Certification Examination for Financial Advisors'

Thursday, July 8, 2010.

Bandra Kurla Complex, Mumbai

Mr. Haribhakti was the key note speaker at the launch of the 'Certification Examination for Financial Advisors' at Bandra Kurla Complex on last Thursday. Mr. Bhavé, Chairman SEBI was the chief guest at the event. This event was organised by Financial Planning Standards Board (FBSB India).

Below are snippets from the press conference that took place.

Norms for physical delivery in F&O soon



(left) Mr C.B. Bhavé, Chairman, SEBI, Mr Ranjeet S. Mudholkar, Managing Director, Financial Planning Corporation (India) Pvt Ltd and Mr Shailesh Haribhakti, Chairman, Advisory Board, at a press conference of the launch of "Certification Examination for Financial Advisors" in Mumbai on Thursday. —


Mumbai, July 8

F&O market participants now have one more alternative to the existing three modes of transacting, after the Securities and Exchange Board of India (SEBI) Chairman, Mr C. B. Bhavé, announced on Thursday that guidelines for physical delivery in the F&O segment would be out by July-end.

Participants may now physically deliver the underlying asset, i.e. buy or sell equity shares whenever they have bought or sold a futures contract or whenever an in-the-money call or put option is assigned to them. This is in addition to the already existing options of roll-over of an existing position, close-out of an existing position by an equal and opposite contract and settling the difference in cash by letting it expire.

"Volatility will increase in the last week prior to expiry. The market will see more roll-over and more close-out of existing positions because of two reasons." says Mr Siddarth Bhamre, Head of Derivatives desk at Angel Broking. "One, the retail investor's mindset would take some more time to accept physical delivery of the underlying as a fact of life. And two, very few people have the financial wherewithal to take delivery." he adds.

Liquidity of midcap stocks in the F&O segment, which are otherwise rather illiquid in the cash segment, will go up when players start accumulating positions in futures with a view to taking delivery. When these positions are delivered, the counter-party would have to deliver and impact cost would be the least, a thing which is impossible for a bulk deal for midcaps in the cash segment, say market experts.



For options, there is a chance of liquidity drying up and increase in the premium post physical delivery, especially because stock options may be exercised at any time during the lifetime of the option contract, feel experts.

Physical delivery of the underlying would largely finish off the value weighted average price (VWAP) for arbitrage settlements, says Mr T.S. Harihar, Co-Head Derivatives, ICICI Securities. Market volatility that normally increases around the settlement date nowadays would get tempered once physical delivery ushers in. For short positions, whether it is selling a futures, writing a call or buying a put, a robust securities lending and borrowing mechanism (SLBM) is required," he adds.

According to Mr Harihar, this move will sharply impact option prices. The volatility pricing portion of an option price would come down. We also need to ascertain whether physical delivery is optional or compulsory under the new guidelines and whether subsequent modification is allowed or not between physical delivery to cash settlement and vice versa. We expect the modification to be at the discretion of the broker as he has to crystallise the margin, (that every client who indulges in such subsequent modification needs to bring in) and the margin cannot be flexible.

Implementation

Mr Yogesh Radke, Head of Quantitative Research at Edelweiss Securities, says "It would take a year or two to implement the guidelines that are expected by this month end. The prerequisite for successful implementation of physical delivery is the presence of a robust securities lending and borrowing mechanism (SLBM) simply because it would enable entities with short positions to deliver the underlying, in case they do not possess them. As on date, the ease of transacting in the futures segment is far higher than using the SLBM mechanism in India as it takes a higher turnaround time to transact using SLBM. To add up to it, when SLBM is allowed only for stocks in the F&O segment as it is today, the participants have less incentive to use the SLBM window.

The main reason for lack of liquidity in the options segment is the American style of exercise. If this is changed to European, liquidity will surely look up. In the American style of exercise, the option holder has the right to exercise at any time while the holder of a European option may exercise only on the due date. This could result in an undesirable increase in volatility in stocks. As a result, very few option writers in India are willing to write and hence liquidity is restricted only to a few stocks."

For institutions, this does not have much significance as they can only hedge their existing open positions in the cash segment using the F&O segment. But for participants, especially highnet worth individuals, and retail, it all boils down to cost of rollover versus cost of delivery, sum up experts.

Hope you find the above information interesting.

Thanks,