March 2018

SEBI Board Meeting - Key announcements for FPIs

The India capital markets' regulator, the Securities and Exchange Board of India (SEBI), in its recent Board meeting held on 28 March 2017, decided on various matters such as acceptance of several recommendations of the Kotak Committee on corporate governance, approved measures to strengthen algorithmic trading framework, approved proposals to rationalise and strengthen the framework of equity derivatives market, revise the framework for non-compliance of the Listing Regulations, etc. Some of the key aspects that may be relevant to Foreign Portfolio Investors ('FPI') is detailed below.

I. Rationalising and Strengthening the framework of Equity Derivatives Market

The Securities and Exchange Board of India (SEBI) had issued a discussion paper on 21 June 2017, to solicit comments from general public on the "Growth and Development of Equity Derivatives Market in India" in order to rationalise and strengthen the framework of the equity derivatives market. After taking into consideration the comments received and also recommendations of the Secondary Market Advisory Committee (SMAC), the SEBI in its Board meeting on 28 March 2018 has approved the following changes:

- To facilitate greater alignment of the cash and derivative market, physical settlement for all stock derivatives shall be carried out in a phased and calibrated manner.
- To update and strengthen the existing entry criteria for introduction of stocks into the derivative segment in line with the increase in market capitalisation, the existing criteria like market wide position limit and median quarter-sigma order size shall be revised upward from current level of INR 3000 mn and INR 1 mn respectively to INR 5000 mn and INR 2.5 mn respectively.
- An additional criterion of average daily 'deliverable' value in the cash market of INR 100 mn has also been prescribed. The enhanced criteria need to be met for a continuous period of six months.
- To begin with, stocks which are currently in derivatives but fail to meet any of the enhanced criteria, would be physically settled. Such stocks would exit the derivative segment if they fail to meet any of the enhanced criteria within one year from the specified date or fail to meet any of the current existing criteria for a continuous period of three months.
- Stocks which are currently in derivatives and meet the enhanced criteria shall be cash settled. Such stocks if they fail to meet any one of the enhanced criteria for continuous three months shall move from cash settlement to physical settlement. After moving to physical settlement if such stock does not meet any of the current existing criteria for a continuous period of three months, then it would exit out of derivatives.

  After a period of one year from the specified date, only those stocks which meet the enhanced criteria would remain in derivatives.
- To reflect global initiatives on product suitability, a framework has been approved. Individual investors may freely take exposure in the market (cash and derivatives) upto a computed exposure based on their disclosed income as per their Income Tax Return (ITR) over a period of time. For exposure beyond the computed exposure, the intermediary would be required to undertake rigorous due diligence and take appropriate documentation from the investor.

PwC comments - Tax implications on capital gains in situations where derivatives are physically settled needs to be analysed by investors.

II. Measures for strengthening algorithmic trading framework

In 2016, the SEBI had issued a public consultation paper on 'Strengthening of the regulatory framework for algorithmic trading and co-location'. The SEBI Board after receiving comments from the stakeholders and internal deliberations has approved the following proposals:

- Stock exchanges to introduce shared Colocation Services, in order to reduce the cost for trading members wishing to operate from the colocation facility.

- Stock exchanges to provide Tick-by-Tick data feed (TBT Feed) to all the trading members, free of charge, subject to trading members creating the necessary infrastructure for receiving and processing it. Stock exchanges to increase the depth of snapshot of 5 best bid and ask quotes, in consultation with trading members.
- Under the penalty framework for Order to Trade Ratio (OTR), penalty would be levied on algo orders placed beyond ±0.75% of last traded price (LTP) from the current level of ±1% of LTP. Further, the OTR framework would also be extended to orders placed in the equity cash segment and orders placed under the Liquidity Enhancement Scheme (LES).
- Stock exchanges to allot a unique identifier to each algorithm approved and each order generated by the algorithm to carry the unique identifier with it, in order to establish an audit trail and to ensure better surveillance of algo trading.
- In addition to the current disclosure of latencies, stock exchanges to publish minimum, maximum and mean latencies and latencies at 50th and 99th percentile, observed within the exchange trading infrastructure to ensure greater transparency. Further, exchanges to also publish a reference latency between a reference rack in the co-located facility and the core router of the exchange.
- Stock exchanges to provide a simulated market environment for testing of software including algorithms. Stock exchanges to provide such facility over and beyond the current framework of mock trading.

III. Distribution of cash benefits by listed companies through Depositories

The SEBI has decided to include the option of distribution of cash benefits like dividends through Depositories, in addition to the present system of distribution directly by the listed companies or through their Registrar to an issue and/or Share Transfer Agents. The above option will widen the choice for investors with its benefits such as shorter turnaround time for receiving benefits, ability to get consolidated statements of all such benefits and to receive alerts (SMS / E-mails), etc.

The above measures are largely to strengthen the capital markets for the benefit of market participants at large and to address, amongst others, concerns on market quality, market integrity and fairness.

Click here to access the copy of the SEBI Press release for your ready reference.

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