Insights Unwrapped

Regulatory Discipline: The Key to India's Market Stability

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SPROUT Research

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Tight Regulations in India Since September 2024

Why Are Regulators Acting as Party Poopers?

A SEBI study revealed that F&O traders lost INR 1.8 lakh crore over the past three fiscal years, with over 93% of retail traders incurring losses. This led to stricter norms, including:-

- Increase in Contract Value: Minimum lot size of derivative contracts to Rs 20 lakh-Rs 30 lakh from the current Rs 5 lakh (which was last set in 2015)
- Restricting weekly options to one expiry per stock exchange per week
- Increased Capital Requirements- Higher margins
- Increased Margin Requirements- Brokers will likely require higher margin deposits from traders to cover the increased risk associated with larger contract sizes. This could further limit the ability of some traders to participate

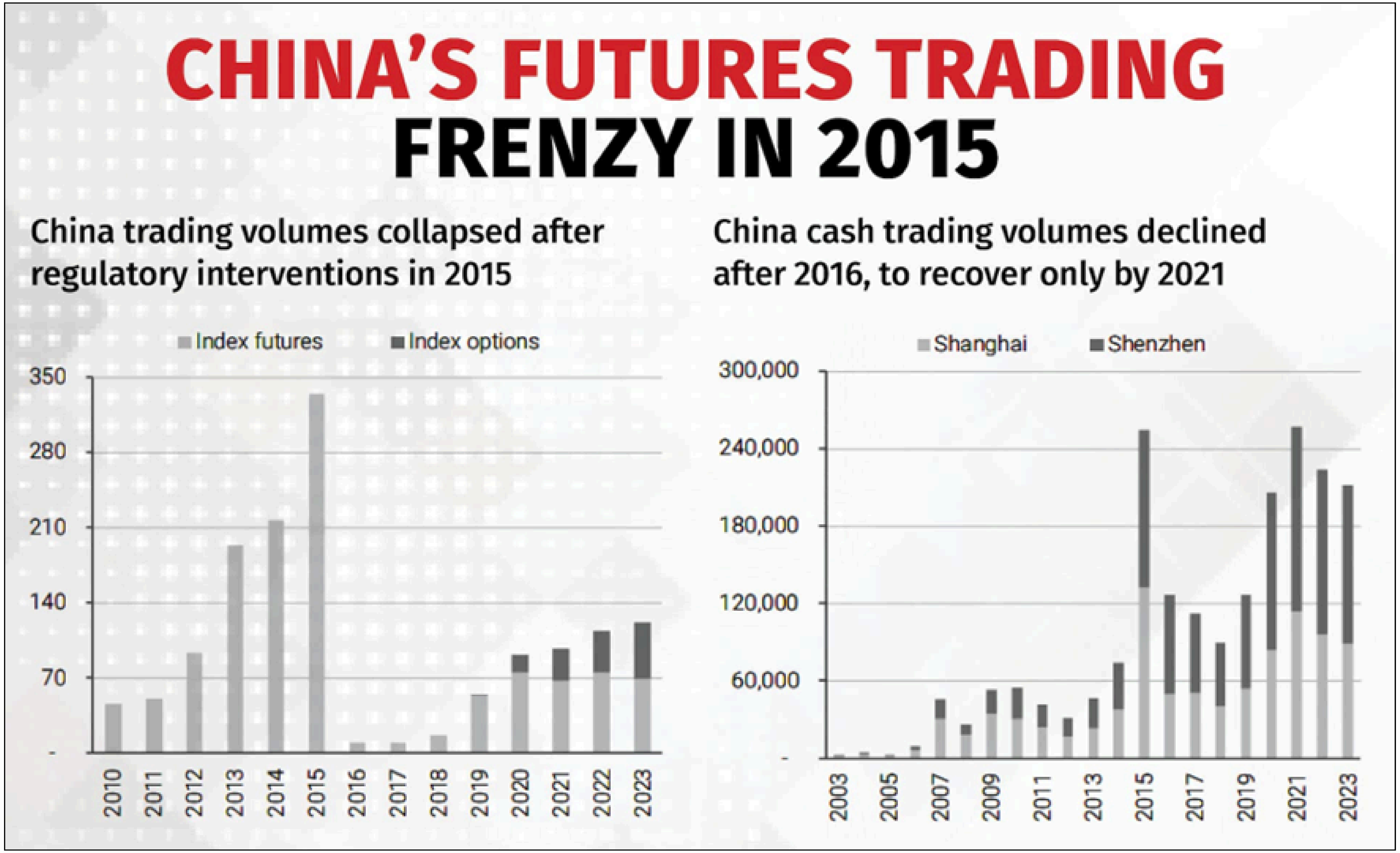
These measures have drawn comparisons to South Korea (2010-11) and China (2015), where similar regulatory tightening led to a sharp decline in market volumes for several years. Market participants fear that India's derivatives market could face a similar slowdown.

South Korea's Volumes Declined After Tight Regulations

Source : Kotak Institutional Securities

- Once the world's top derivatives trader (until 2011), South Korea dropped out of the top 10 due to stricter regulations. Retail investor participation dropped due to stricter regulations
- <u>Trading volume fell nearly 70%</u>
- Regulations include:
  - <u>Higher collateral requirements</u> for margin trading
  - <u>Increased minimum trading units</u> for index-linked options. (Source: FT)

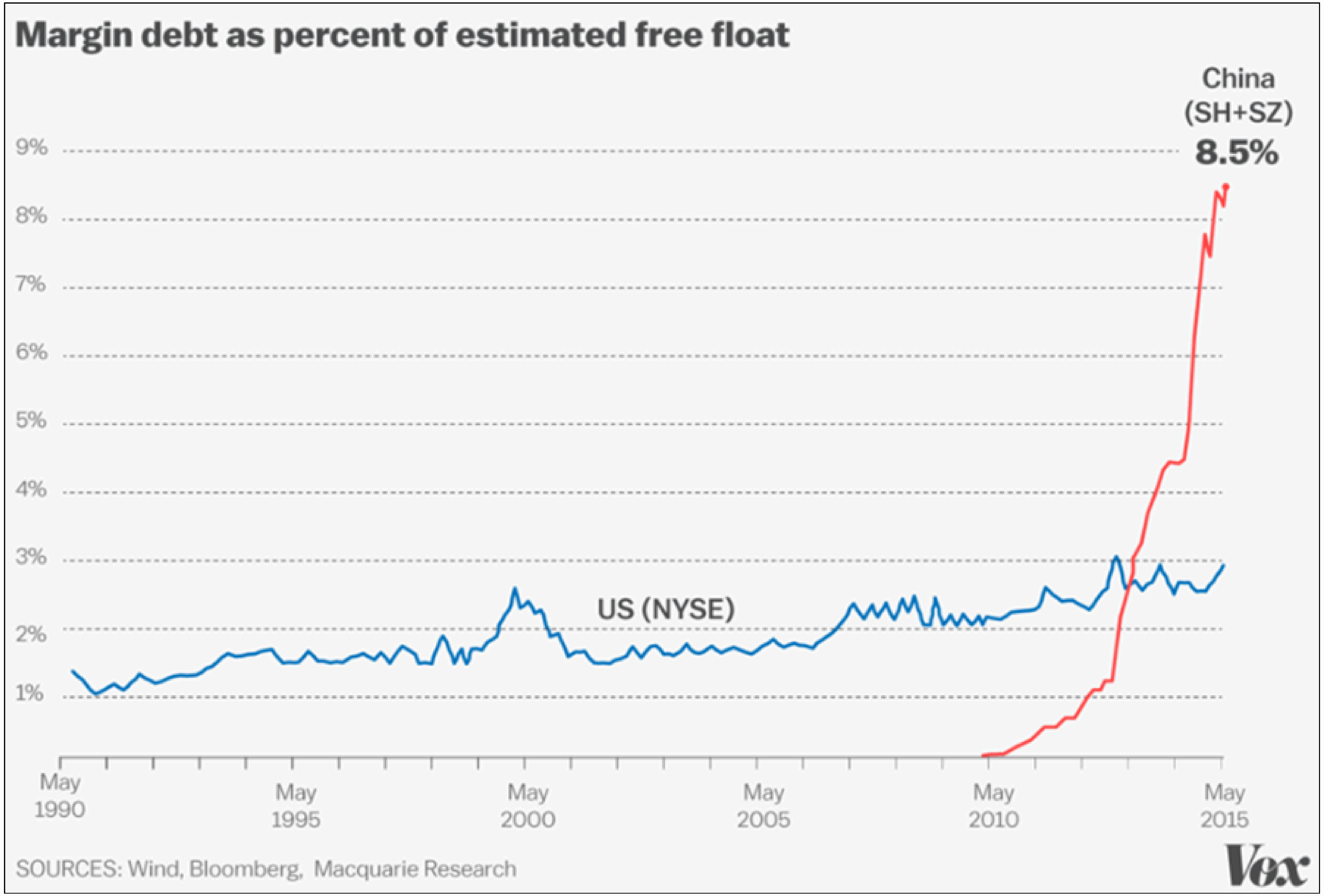
China's Market Collapsed After Tight Regulations



Source : Kotak Institutional Securities

- From 2014 to 2015, China's government encouraged citizens to invest in the stock market in order to strengthen the economy, which effectively doubled the capitalization of the Shanghai Stock Exchange
- Over **38 million new accounts** were opened in just 2 months before the crash
- In 2015, regulators raised **margin requirements from 10% to 40%,** triggering a market collapse that erased $5 trillion in wealth within three months, with trading volumes plummeting

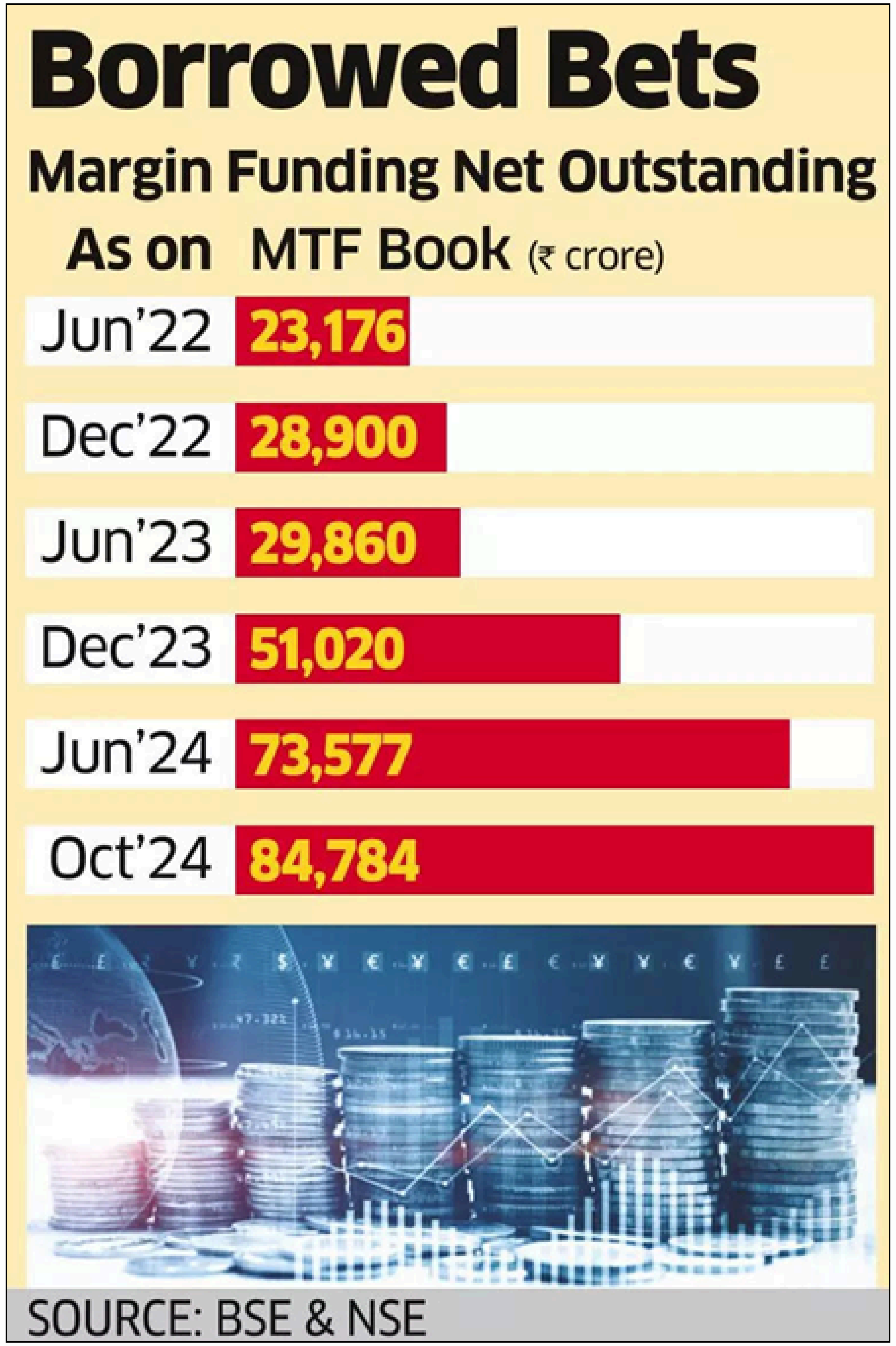
Thankfully, Our Conservative Regulators Prevented a China-Like Crisis in India



Margin Finance in China and the 2010-15 Bull Market

- Margin trading, introduced in 2010, played a key role in China's market reforms
- During the 2014-15 bull run, the Shanghai Composite Index surged 150%, fueled by 2.2 trillion yuan ($350 billion) in margin-financed stock purchases
- However, in 2015, China imposed strict restrictions:
  - Margin requirements increased from 10% to 40%
  - Position limits were tightened, leading to a stock market crash

Margin Trading Funding (MTF) in India – Not a Concern!



- India's MTF book peaked at INR 85,000 crore in September 2024 **but declined 20% to ₹67,700 crore by February 2025**

- Unlike **China's 2015 margin debt surge from nearly 0% to 8% of free float, India's current ratio remains a modest 1.8%**
  (Free float: ~$2,196B; MTF incl. F&O: ~$40B)

Source: ET

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