The costs of not sharing data

Fixing the policy issues that have eroded Indian financial markets' competitive edge will be postponed if the three exchanges unilaterally terminate their data-sharing and licence arrangements with offshore platforms

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The joint press release by three Indian exchanges to unilaterally terminate their data-sharing and license arrangements with offshore platforms, which trade derivatives with Indian underlyings, is problematic. It seeks to equate the exchanges' market share in trading of Indian derivatives with the best interests of the Indian markets. The press release, on the contrary, raises several concerns for the Indian capital markets. First, this measure will increase the cost of raising capital by Indian issuers abroad. Second, the commercial wisdom underlying this measure is not entirely clear and warrants some explanation for the exchanges' shareholders. Third, this joint proclamation underscores the urgent need for structural policy reforms that can restore Indian financial markets' competitive edge.

This measure does not augur well for the Indian economy, as it increases the costs for Indian entities raising capital abroad, in tangible and intangible ways. How does an Indian issuer of securities benefit from a foreign investor taking exposure to derivatives on its securities abroad since the money does not go to the Indian issuer? There are four proximate benefits to the Indian issuer. First, the availability of Indian underlyings abroad helps foreign investors overcome home bias, a phenomenon that prevents investors from making a rational choice of globally diversifying their portfolios. Any Indian issuer seeking offshore capital must overcome investors' home bias to get them to invest in India. Second, it facilitates global price discovery of the Indian underlyings, which in turn, gives confidence to foreign investors to take India exposure. Third, it allows a foreign investor who has invested in the capital of an Indian issuer to conveniently and cheaply hedge its risk through the offshore derivative with the Indian underlying. Fourth, since the offshore contracts are dollar denominated, the foreign investor faces only price risk and no currency risk. In the absence of onshore liquid hedging markets, this tangibly reduces the costs of taking exposure to Indian underlyings.

Take the classic case of a foreign fund that wishes to take exposure to Indian assets abroad. Here, the fund has two options. Option 1 is to route the order to an Indian exchange, trade during the five hours that Indian exchanges are open for trading, pay securities transaction tax (STT) and capital gains to the Indian exchequer and settle in INR. Option 2 is to take a position on a derivative with an Indian underlying on SGX, trade during a timezone of their convenience, settle in their own local currency and since it is Singapore, not pay STT or capital gains tax. The reduced costs and increased convenience of taking exposure to Indian underlyings abroad make it easier for foreign investors to include Indian assets in their global portfolio.

ILLUSTRATION BY BINAY SINHA

Since the 1990s, Indian manufacturers compete with global manufacturers, and consumers benefit from this competition. Since 2000, Indian companies wanting to raise capital and Indian investors wanting to diversify their portfolios across different economies, have similarly benefited from the gradual but steady integration of the Indian financial market with the global financial markets. Policymakers have also steadily moved towards this integration.

The exchanges' proclamation that they will no longer share their data-feed with foreign platforms offering trading in Indian underlyings is akin to Indian manufacturers refusing to outsource their manufacturing activity to countries where goods can be manufactured at cheaper rates, continuing to manufacture at higher costs in India and compelling consumers to buy at this higher price. Equating the refusal to compete with global exchanges offering similar products at cheaper rates, to the best interests of Indian markets, would therefore be inaccurate.

Now the intangible costs. The timing of the joint proclamation of the Indian exchanges is unfortunate, as India is already reeling from the damage caused by contract enforcement disputes between foreign investors and Indians. An earlier editorial in this newspaper narrated how the non-disclosure by the Singh brothers of severe FDA violations by Ranbaxy, when they sold Ranbaxy to Daiichi Sankyo, causes severe reputation damage to Indian businesses. The non-disclosure led to Daiichi Sankyo successfully winning hefty damages in an arbitration against the brothers. Earlier, we had argued in this paper how the complex regulatory quagmire of capital controls is often used by Indian investors to deny contractual pay outs to their foreign counterparties. The joint proclamation by Indian exchanges to terminate their long standing data-sharing arrangements, similarly undermines the commitment of Indian financial markets institutions to their counterparties in cross-border contracts. While intangibly so, this too will increase the costs of doing business in India.

Second, it is not entirely clear that the termination of data-feed to foreign platforms will bring the liquidity onshore. It is possible that this may happen. It is equally plausible that foreign investors seeking exposure to Indian assets may move their trades off the exchange. India has already experienced this in the trading of derivatives on the INR, large volumes of which happen in the offshore OTC markets. Imagine an offshore fund running a book that nets-off positions of investors, and comes onshore only to off-set the outstanding position. A third possibility is that the inability to take positions on Indian assets abroad and the costs associated with trading in India, may disincentivise foreign investors from taking exposure to Indian assets in their portfolio altogether. A combination of these three possibilities seems most likely.

It is unclear whether other revenue maximising alternatives, such as linking the royalty to trading volumes on offshore platforms, were considered. The question assumes greater importance in the case of BSE, a listed company, which promised to 'expand its cross-border reach' in its prospectus. The exchanges will have to justify the commercial wisdom of this measure to their shareholders.

Finally, as has already been argued in this paper, the measure indefinitely postpones fixing the policy issues that have resulted in Indian financial markets losing their competitive edge.

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