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FINANCIAL DERIVATIVES : PERSPECTIVES AND PROSPECTS

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Introduction of index based futures is a landmark in the history of Indian bourses. As a result, Indian stock market has taken another step forward. The objective of this paper is to give a brief overview of the need for financial derivatives, their types with special reference to stock index futures and the developments leading to introduction of stock index futures in India stock market.

INTRODUCTION

The international financial markets have witnessed revolutionary changes during the past three decades or so. The beginning of seventies saw the dismantling of fixed exchange rate regimes and the end of the hegemony of the dollar, deregulation of interest rates and liberalisation of capital account in various countries. The direct result of these developments was the emergence of euromarkets and the globalisation of financial markets.

With the integration of financial markets and free mobility of capital, risk also multiplied and risk diversification came to occupy the centrestage. Adoption of floating exchange rates brought exchange related risk while deregulation of interest rates caused interest rate risk. This logically led to the evolution of risk hedging mechanisms, first in the forex markets, later in other segments of financial services industry. These hedging tools and techniques have come to be known generically as derivatives.

Broadly, this paper has been divided into parts. Section I gives the concept and need for financial derivatives and their types with special reference to stock index futures. Section II deals with the Indian scenario including the recommendations of the SEBI Committee on derivatives and subsequently the launch of Sensex Futures and Nifty Futures in June, 2000 at Bombay Stock Exchange and National Stock Exchange respectively.

SECTION I

DERIVATIVE - THE CONCEPT

A Derivative is one which derives its value from a primary source or underlying asset. It has no independent value of its own. Its value is derived entirely from the value of an underlying variable which may be a cash asset (asset bought and sold in the market on normal deliverable terms) like a commodity; a financial security like shares, debentures or bonds; a share price index; exchange rate; interest rate or the like. The SEBI committee on derivatives opines:

> *"A derivative means forward, future or option contract of predetermined fixed duration linked for the purpose of*

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