

SECURITIES BROKING INDUSTRY

**F&O volumes to face friction as
policymakers put speed-breakers**

JULY 2024





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Union budget for FY2025 presented in July 2024 increases STT on futures and options, raising transaction costs

SEBI directs market infrastructure institutions to levy "True to Label" charges, impacting discount brokers significantly



In the Union Budget for FY2025, the securities transaction tax (STT) on futures and options has been increased to 0.02% and 0.1%, from 0.0125% and 0.0625%, respectively. This sizeable increase in the transaction tax incidence, applicable from October 01, 2024, will raise the transaction cost for derivatives trading. The Government has, however, budgeted only 16% growth in STT collections compared to the 60% increase in incidence rate for futures and options. The budgeted number, in ICRA's view, is achievable even with 30% lower trading volumes hereon (across segments) compared to the run rate seen Q1 FY2025.



In another action by a policymaker, the Securities and Exchange Board of India (SEBI) has directed that Market Infrastructure Institution (MII) charges collected from end-clients by brokers must match the amounts received by MIIs. This 'True to Label' charge structure aims to ensure fairness and transparency. Effective October 1, 2024, this directive will eliminate volume-based discounts. The impact will be more pronounced in the options segment, where potential fee disparity is greater compared to the cash segment. As a result, discount brokers, particularly those with significant trading volumes in the options segment, are expected to see an impact of 15%-25% on profit before tax (PBT).



Retail investor participation in India's capital markets has surged since March 2020, particularly in the derivatives market. Derivative trading volumes have grown dramatically, with options trading dominating this increase. Weekly options and zero-day expiry contracts, particularly, have gained popularity due to their low premiums and high leverage. The combined effect of increase in STT and revised MII charge structure will increase the friction for speculative F&O trading volumes. To maintain profitability, increase in brokerage charges by 10%-20%, led by discount brokers, cannot be ruled out. This adjustment could counterbalance the loss of exchange discounts, but it requires balancing higher fees with competitive dynamics. This may also lead to changes in the business models, such as reassessing brokerage-free offerings.

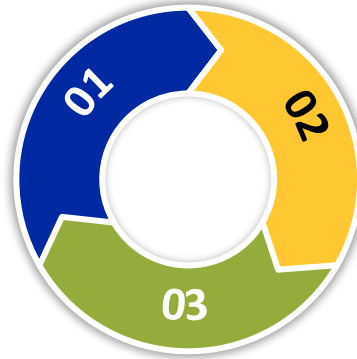


Recent Developments & Analysis

Policymakers commence F&O clampdown with action on STT and exchange transaction charges; further steps not ruled out

STT on futures and options hiked by 60%

In the Union Budget for FY2025 presented in July 2024, the securities transaction tax (STT) on futures and options has been increased to 0.02% and 0.1%*, from 0.0125% and 0.0625%*, respectively. This is a 60% increase in the transaction tax, and hence will result in a meaningful increase in overall transaction cost associated with derivatives trading. The revised rates will be applicable from October 01, 2024.



Market infrastructure institutions (MII) directed to levy 'True to Label' charges

SEBI has directed the market participants that MII charges (such as exchange transaction charges), which are recovered from the end client, should be True to Label i.e. if a certain MII charge is levied on the end client by brokers, the same amount is to be received by the MIIs. The charge structure of the MII should be uniform and equal instead of slab-wise viz. dependent on volume of brokers. This will impact the income of broking houses, especially discount brokers, who have been receiving sizeable discounts from MIIs. Thus, an upward pressure on broking yields cannot be ruled out, which in turn would mean higher transaction cost for trading in the derivatives segment.

Further actions not ruled out; consultation paper on stock derivatives, study on intraday traders already published

The apex regulator has taken note of the rising euphoria in the F&O/ intraday trading and expressed concern that household savings are unlikely to help in capital formation. In this regard, further actions cannot be ruled out. A consultation paper on review of eligibility criteria of stock derivatives was published on June 08, 2024, while a study on individual intraday traders was released on July 24, 2024. Any further steps like increase in lot size, lesser expiries etc. will induce further friction for trading volumes.

Amplifying transaction cost a step in right direction to discourage speculative activities; transaction charges involve multiple elements

Charges vary across transactions i.e buy vs sell, as well as across segments i.e cash-delivery, cash-intraday, futures, and options.

While some charges like STT, stamp duty, SBI turnover charge are statutory and uniform across brokerages, other charges may vary across broking houses and may also tend to be client specific/ broking plan specific.

Recent actions by policymakers involve STT and Exchange Transaction Charges.

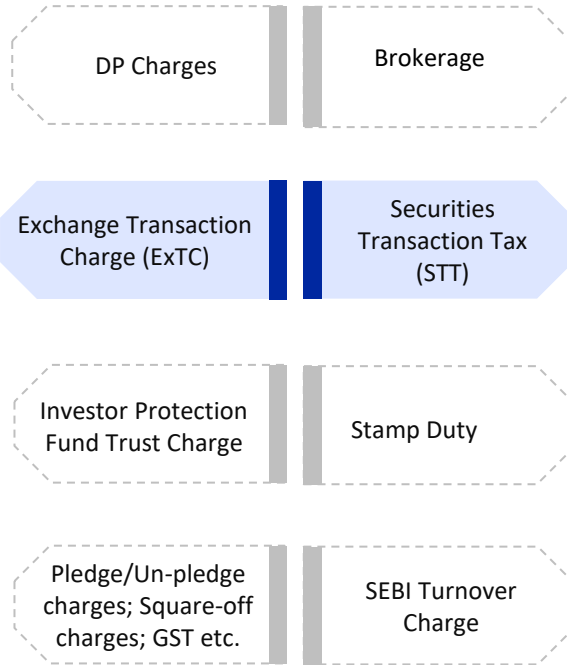


Exhibit 1: Illustration – at-the-money option sell transaction (notional value of ~Rs. 6 lakh; brokerage @ Rs. 20 per lot)

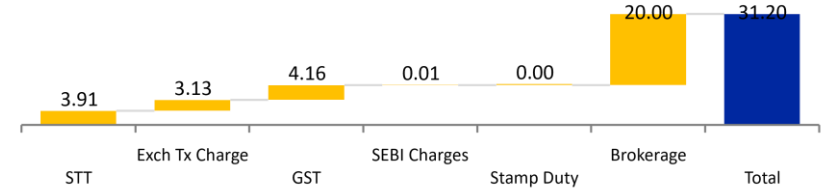


Exhibit 2: Illustration - intraday equity sell transaction of Rs. 1 lakh; brokerage @ Rs. 20 per order

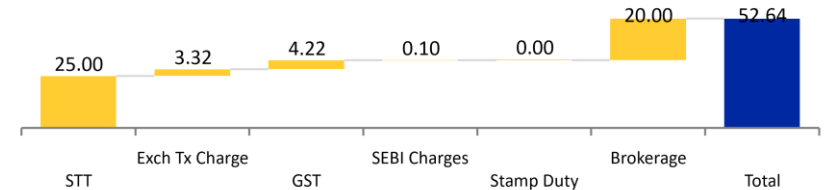
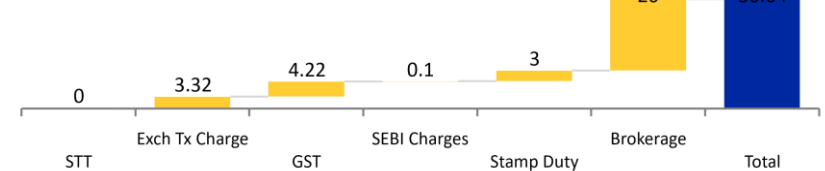


Exhibit 3: Illustration - intraday equity sell transaction of Rs. 1 lakh; brokerage @ Rs. 20 per order



Higher STT on F&O trades to raise transaction cost and friction for trading volumes

STT on futures and options has been increased in the Union Budget for FY2025. This is a 60% increase in the transaction tax, and hence will result in a meaningful increase in overall transaction cost associated with derivatives trading.

It is estimated that the Government collected STT totaling Rs. 32,000 crore in FY2024, which is budgeted to increase to Rs. 37,000 crore in FY2025.

ICRA projects that the F&O segment accounts for almost half of the STT collections by the exchequer. Within the F&O segment, options is likely to have accounted for about 70% share.

Exhibit 4: Segment wise STT applicable

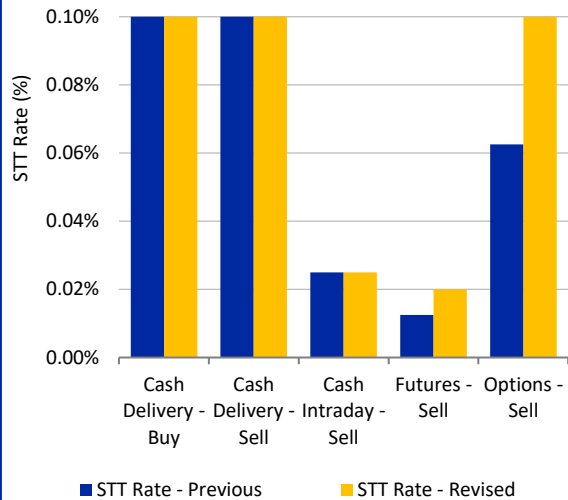


Exhibit 5: Trend in STT collections

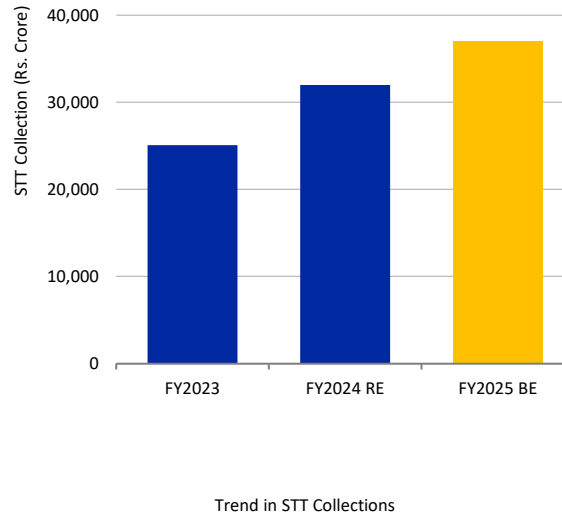
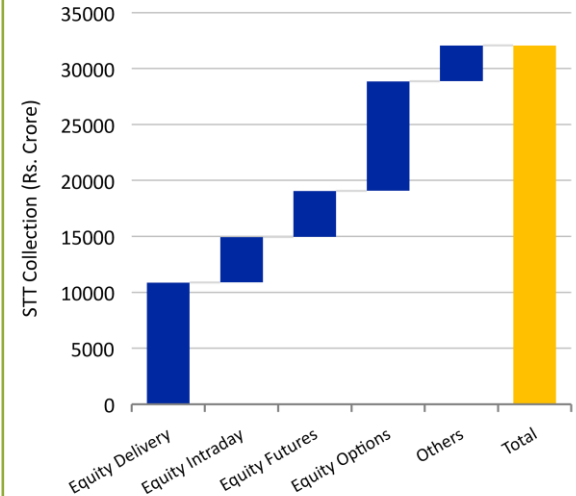


Exhibit 6: Segment wise share in STT collections



Increase in transaction costs may curtail futures and options; budgeted STT collections, however, may be met even with 30% lower trading volumes hereon

The increase in STT is sizeable and hence will result in a meaningful increase in overall transaction cost associated with derivatives trading. This, coupled with SEBI's second order impact related to 'true to label' charges to be levied by market infrastructure institutions, is likely to induce material friction for F&O trading volumes. Nonetheless, the Government has budgeted only 16% growth in STT collections compared to 60% increase in incidence rate for futures and options. Thus, the budgeted number is achievable even with 30% lower trading volumes (across segments) hereon (compared to Q1 FY2025 run rate). If the cash segment volumes are assumed to sustain (as STT rates have been revised only for F&O), the budgeted collection will be achievable even in case of much higher dip in derivative trading volumes. It is, however, noted that trading volumes in recent months have been higher than the average trajectory witnessed in FY2024.

	STT Rate (Previous)	STT Rate (Revised)	Applicable on	Turnover (NSE + BSE) (Rs. Lakh crore)		STT Collections (Rs. 000 crore)		STT Collections (Scenario Analysis; Rs. 000 crore)		
				FY2024	2M FY2025	FY2024 Estimates	2M FY2025 Estimates	FY2025 Gov Budget Estimate	FY2025 Scenario 1: If Ongoing Volumes Sustain	FY2025 Scenario 2: 30% Dip* in volumes hereon
Equity Segments of NSE and BSE										
Cash Delivery - Buy	0.1000%	0.100%	Turnover	54	12	5.4	1.2		7.3	5.8
Cash Delivery - Sell	0.1000%	0.100%	Turnover	54	12	5.4	1.2		7.3	5.8
Cash Intraday - Buy	0.0000%	0.000%	Turnover	163	37	-	-		-	-
Cash Intraday - Sell	0.0250%	0.025%	Turnover	163	37	4.0	1.0		5.5	4.3
Futures - Buy	0.0000%	0.000%	Turnover	330	81	-	-		-	-
Futures - Sell	0.0125%	0.020%	Turnover	330	81	4.1	1.0		9.1	6.6
Options - Buy	0.0000%	0.000%	Premium Turnover	157	30	-	-		-	-
Options - Sell	0.0625%	0.100%	Premium Turnover	157	30	9.8	1.9		16.8	12.1
Others						3.2	0.6		3.2	3.2
Total						32.0	7.0	37.0	50.0	38.0

Source: sebi.gov.in, ICRA Research; *For simplicity, dip across the segments has been assumed, though STT has been revised only for futures and options.

Slab-wise rate cards to be discontinued by exchanges; uniform charges to ensure level playing field among all brokers

Key highlights

Equal, unrestricted, transparent and fair access to all market participants

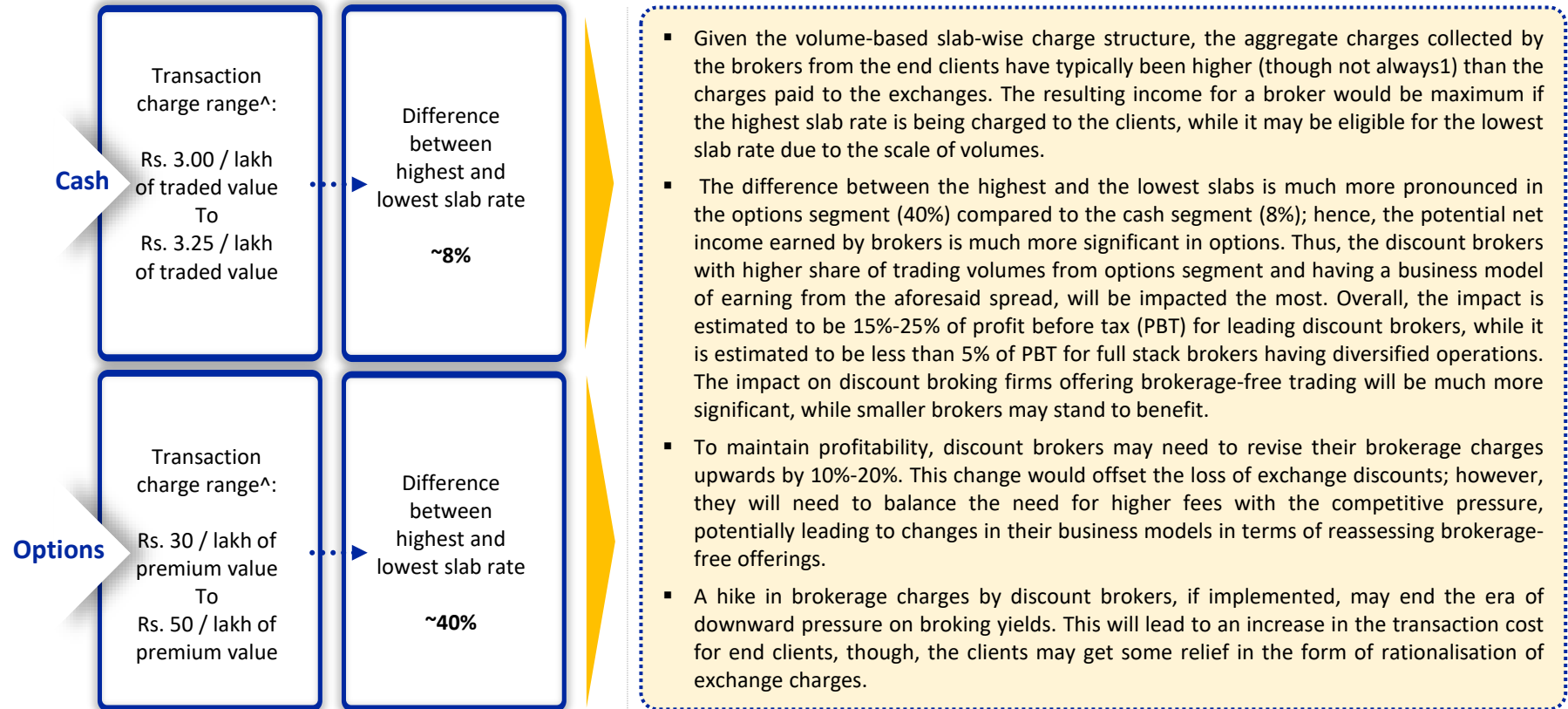
Slab-wise charge structure of MIIs creates a hindrance in ensuring equal access to all

MIIs to comply with additional principles

Observations and recommendations

- The Securities and Exchange Board of India (SEBI) released a circular on July 01, 2024, regarding the charges levied by MIIs such as exchanges.
- SEBI emphasised that MIIs, being public utility institutions, act as first level regulator and are entrusted with the responsibility of providing equal, unrestricted, transparent and fair access to all market participants.
- Some MIIs follow volume-based slab-wise charge structure, wherein the charges are recovered from the end clients by members such as brokers, depository participants, clearing members. While members recover such charges from the end clients on a daily basis, MIIs receive aggregate monthly charges from the members. The aggregate charges collected by the brokers from the end clients may be higher than the end-of-month charges paid to the MII, due to the slab benefit. This results in a misleading disclosure to the end client, besides creating a hindrance to equal access to all by impacting the level playing field between brokers of different sizes.
- MII charges recovered from the end client should be True to Label i.e. if certain MII charges are levied on the end client by members, it should be ensured by MIIs that the same amount is received by them.
- Charge structure of the MIIs should be uniform and equal for all its members instead of being dependent on the activity of the members.
- The new charge structure, to be applicable from October 01, 2024, should consider the existing per unit charges realised by MIIs so that the end clients are benefitted with the reduction of charges.

End of exchange discounts to impact discount brokers most; hike in brokerage fees likely



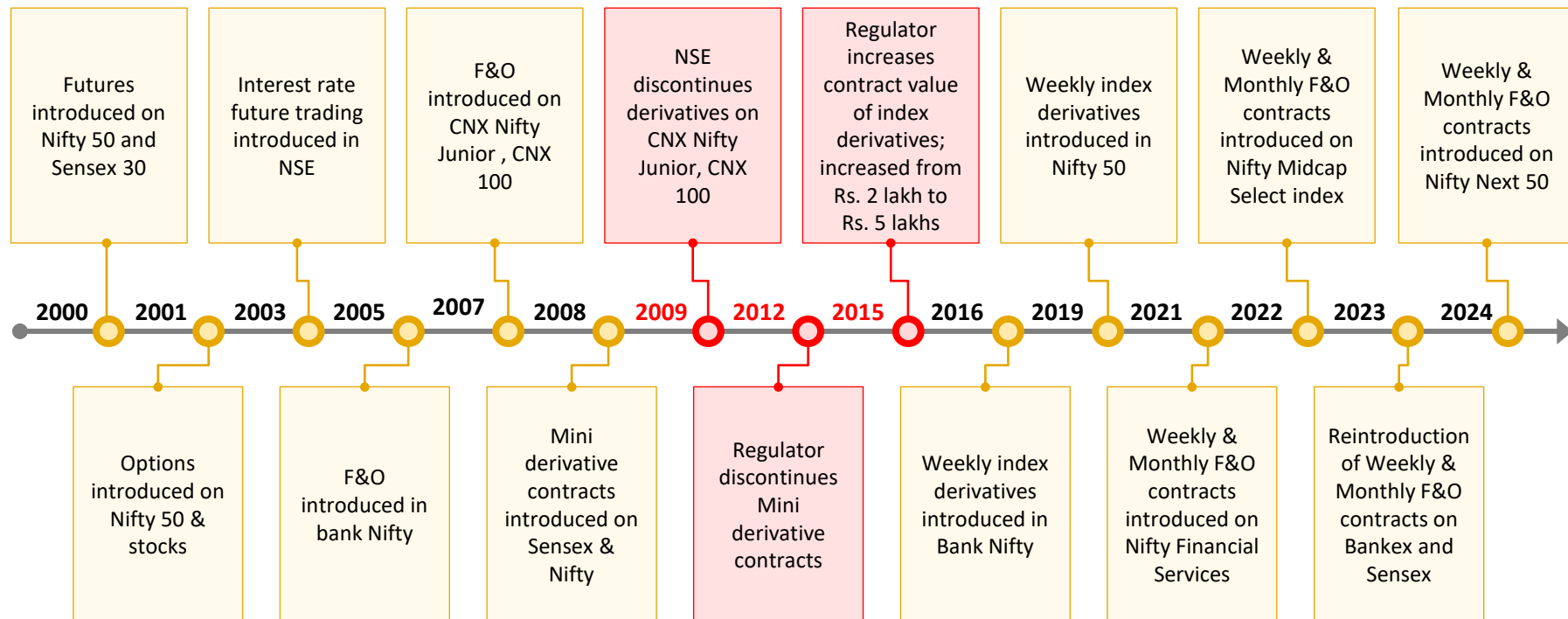
Source: sebi.gov.in, NSE, BSE, ICRA Research; 1: In some instances, smaller brokers charge lower rate to key clients, while the amount paid to exchanges is as per higher slab;

[^]For a leading exchange as of July 01, 2024

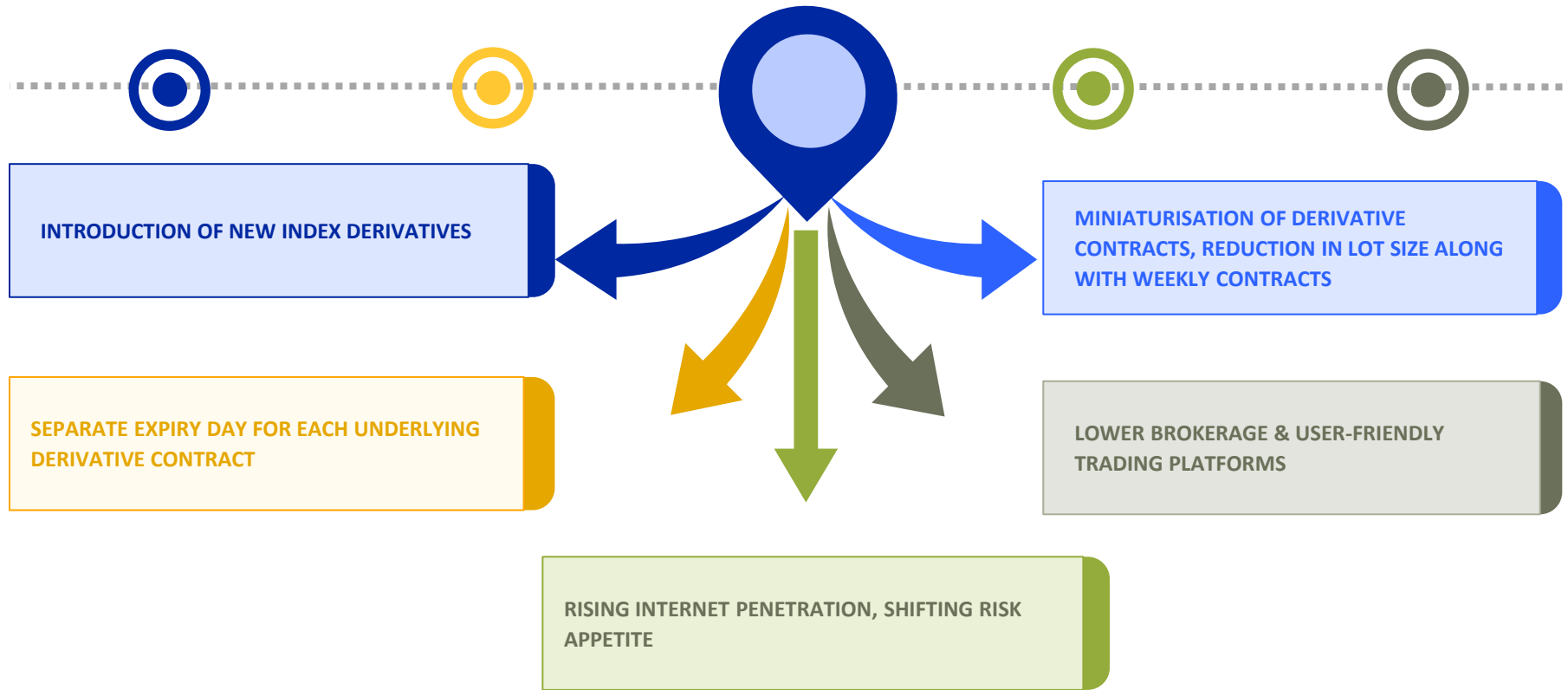


Euphoria in F&O Trading

Evolution of derivative markets in India has been noteworthy with accelerated transformation post the pandemic

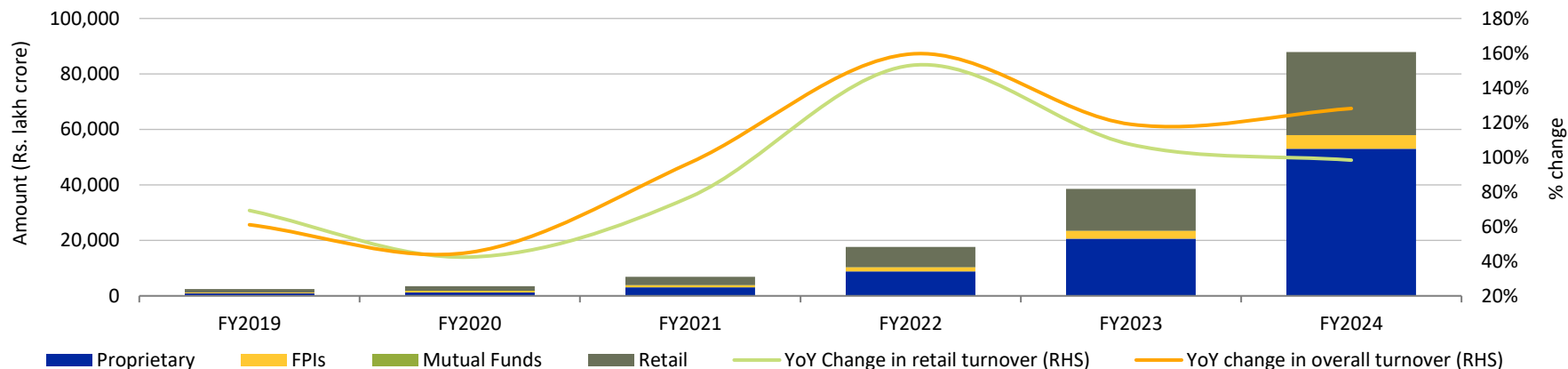


Trading volumes have been energised by user-friendly trading applications, miniaturisation of contracts and introduction of new products



With the rise in retail participation in the derivative segment, its trading volumes have increased relentlessly

Exhibit 7: Investor category-wise trend in notional F&O volumes

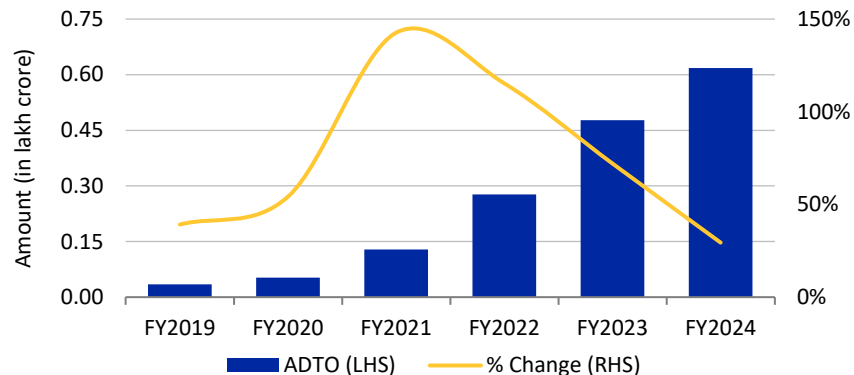


Source: SEBI, ICRA Research

- Indian capital markets have witnessed a significant rise in the participation of retail investors since March 2020. In the past four years, the active NSE client base increased by ~3.8 times to 408 lakh as of March 31, 2024. The increase in participation in derivatives was even sharper with 10 times increase in active clients during the same period.
- With the rise in retail participation in the futures & options (F&O) segment, its trading volumes have increased relentlessly since the Covid-19 pandemic. The notional trading volumes in derivatives increased at a staggering CAGR of 106% during FY2019–FY2024 to ~Rs. 87,964 lakh crore.

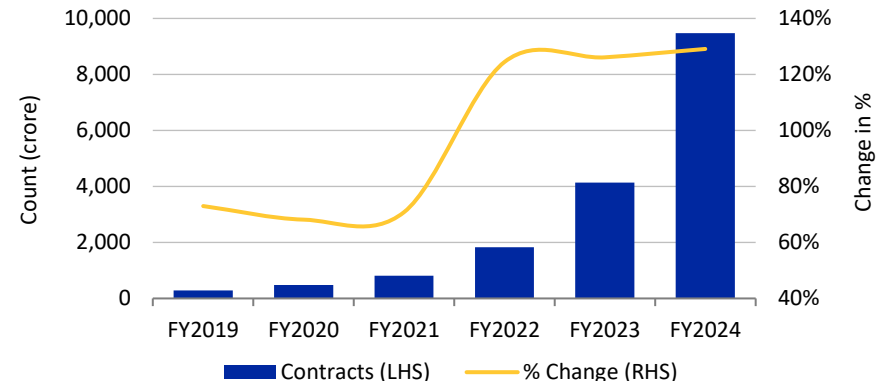
Indian markets topped contracts traded for fifth consecutive year; options have emerged as a popular trading tool among investors

Exhibit 8: Trend in option premium ADTO in NSE



Source: SEBI, ICRA Research

Exhibit 9: Trend in option contracts traded in NSE

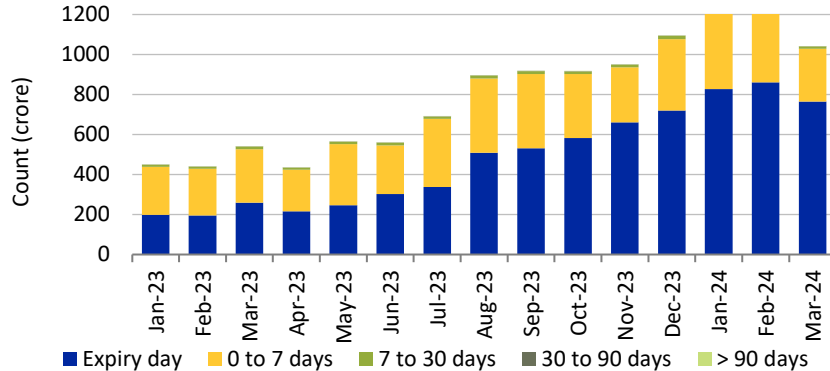


Source: SEBI, ICRA Research

- The stellar increase in derivative volumes has been led by options, which account over 99% of overall F&O volumes.
- With rising popularity of options, its premium turnover traded on the NSE increased at a staggering CAGR of 78% during FY2019 – FY2024 to ~Rs. 152 lakh crore.
- In addition to the premium turnover, the number of option contracts traded on the NSE increased considerably in recent times. During FY2019 – FY2024, the count of option contracts traded at the leading exchange increased by over 33 times.

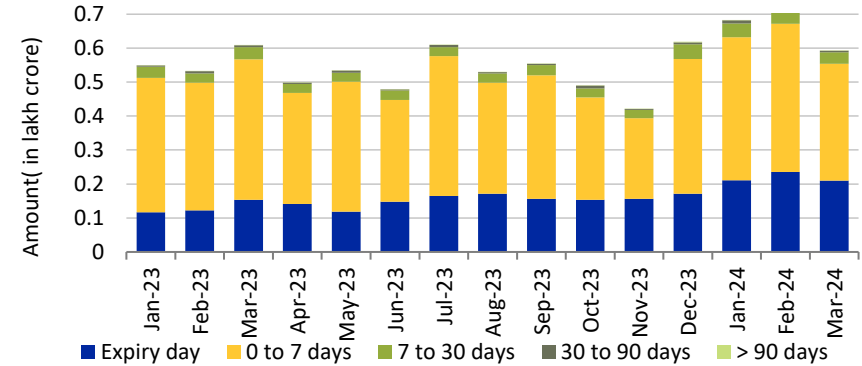
Speculative trading patterns have, however, drawn attention; zero-day expiry trades account for large share of contracts traded

Exhibit 10: Trend in tenure-wise index option contracts traded



Source: SEBI, ICRA Research

Exhibit 11: Trend in tenure-wise premium ADTO of index options traded - NSE



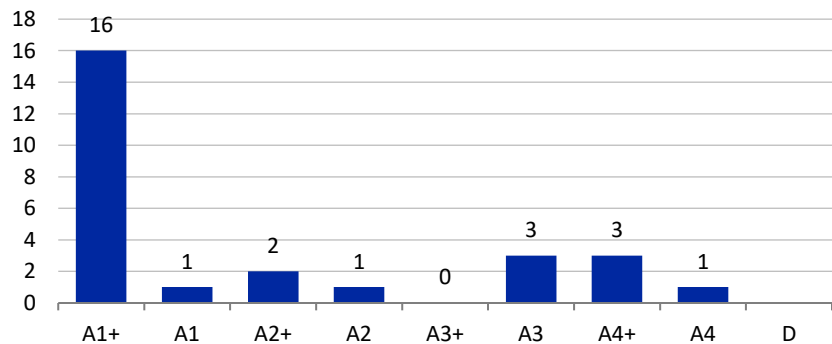
Source: SEBI, ICRA Research

- Weekly options have gained popularity among investors due to their low premiums, thereby contributing about 81% of the option contracts traded.
- With higher leverage, while zero-day expiry trades accounted for only about 30% of the overall premium turnover, they drove about 62% of the overall options contracts traded in FY2024. The higher leverage on zero-day expiry contracts on account of low time value can be witnessed from the fact that on May 23, 2024, the premium for the nearest at the money call option expiring on the same day was trading at 0.4 times of the premium of the option with seven days to expiry.
- Overall, the average daily premium turnover in the options segment has become comparable to the turnover in the cash segment. In fact, the money exchanging hands for taking positions in derivatives is now comparable to fund flow towards equity cash segment.



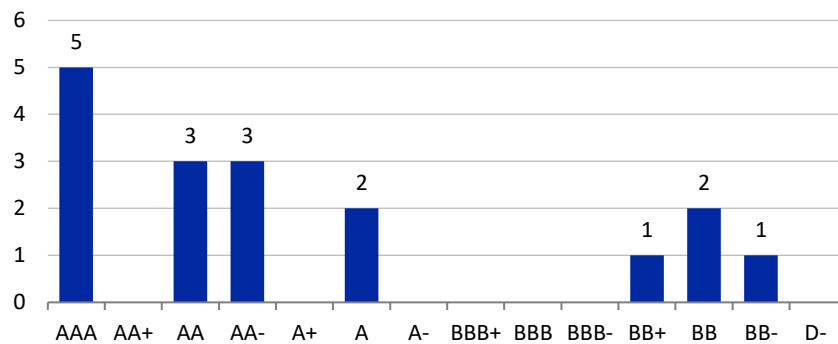
Annexure

Exhibit 12: Distribution of ICRA's short-term ratings for brokerage companies



Source: ICRA Research; Note[^]: as on June 30, 2024

Exhibit 13: Distribution of ICRA's long-term ratings for brokerage companies



Source: ICRA Research; Note[^]: as on June 30, 2024

- ICRA has ratings outstanding on 30 brokerage companies.
- Of these, ICRA has long-term ratings outstanding for 17 companies while 27 have been rated on the short-term scale. The median long-term rating for brokerage companies is in the AA category, reflecting the strong franchise and/or parentage of the ICRA-rated universe of brokerage companies.
- During FY2024, the long-term rating of one securities broker was upgraded due to the steady scale-up of its operations and the consistency of its profitability, while the rating of one company has been downgraded on account of its weakened performance.

ICRA-rated securities broking entities - I

Exhibit 14: List of ICRA-rated securities broking entities[^] - I

Company Name	Long Term (LT) Rating	Outlook on LT Rating	Short Term (ST) Rating
Axis Securities Limited	[ICRA]AAA	Stable	[ICRA]A1+
Barclays Securities (India) Private Limited			[ICRA]A1+
Centrum Broking Limited			[ICRA]A3
Cholamandalam Securities Limited			[ICRA]A1+
Emkay Global Financial Services Limited			[ICRA]A2+
GEPL Capital Private Limited	[ICRA]BB-	Stable	[ICRA]A4
Globe Capital Market Limited	[ICRA]AA-	Stable	
Groww Invest Tech Private Limited	[ICRA]AA-	Stable	[ICRA]A1+
HDFC Securities Limited	[ICRA]AAA	Stable	[ICRA]A1+
ICICI Securities Limited	[ICRA]AAA	Stable	[ICRA]A1+
IIFL Securities Limited			[ICRA]A1+
JM Financial Institutional Securities Limited	[ICRA]AA	Stable	[ICRA]A1+
JM Financial Services Limited	[ICRA]AA	Stable	[ICRA]A1+
Kotak Securities Limited	[ICRA]AAA	Stable	[ICRA]A1+
Manubhai Mangaldas Securities Pvt Ltd	[ICRA]BB	Stable	[ICRA]A4+

Source: ICRA Research; Note[^]: as on March 31, 2024

ICRA-rated securities broking entities - II

Exhibit 15: List of ICRA-rated securities broking entities ^ - II

Company Name	Long Term (LT) Rating	Outlook on LT Rating	Short Term (ST) Rating
Master Capital Services Ltd.			[ICRA]A2+
Motilal Oswal Financial Services Limited	[ICRA]AA	Positive	[ICRA]A1+
Nuvama Wealth Management Limited	[ICRA]AA-	Stable	
Pace Stock Broking Services Pvt. Ltd.	[ICRA]A	Stable	
PhillipCapital (India) Private Limited			[ICRA]A1
Prabhudas Lilladher Private Limited			[ICRA]A2
Pragya Securities Private Limited			[ICRA]A3
Rakhecha Securities Limited	[ICRA]BB	Stable	[ICRA]A4+
SBICAP Securities Limited			[ICRA]A1+
Sharekhan Limited			[ICRA]A1+
SMC Global Securities Limited	[ICRA]A	Stable	[ICRA]A1+
Standard Chartered Securities (India) Limited	[ICRA]AAA	Stable	[ICRA]A1+
Sushil Financial Services Private Limited			[ICRA]A3
Systematix Shares and Stocks (India) Ltd	[ICRA]BB+	Stable	[ICRA]A4+
360 One Distribution Services Limited			[ICRA]A1+

Source: ICRA Research; Note^: as on March 31, 2024



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