

## Development of and Strategies for Stock Index Futures in China

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### Abstract

Since 2010 the stock index futures in China has been launched for three years, we have make a big progress in the development of stock index futures market which play an important role in the progress of finance market. But some of the problems still exist for the influence of many factors; we need to find the corresponding solutions and strategies urgently. First, we show the conception of stock index futures and then we analyze the problems existing in the stock index futures market and state the factors in China such as the shortcomings of China's stock index futures contract in the development process. Finally, we put forward some of the strategies and countermeasures which are suitable to the development of stock index futures in China such as effective risk control, improve the varieties, positive the cultivation and development of market based on the analysis of the problems.

**Key words:** Stock index futures; China; Stock market

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## 1. INTRODUCTION OF STOCK INDEX FUTURES

### 1.1 Conception of Stock Index Futures and Its Characteristics

Stock index futures is the stock index transaction in

accordance with the agreed advance transaction price contracts which are signed by the futures transaction parties at a future date. Stock index futures can reduce the investors in the capital market to avoid the risk of the stock index of the special financial products investment possible tool. Stock index futures trading in a particular futures place is a process of risk transfer, investors rely on its own to future stock index to judge the trend of stock index futures will be different, so the risk of the stock index futures market to the stock index futures market, which makes the risk of the stock market lower.

As a kind of futures contracts in the futures market, the general characteristic of the stock index futures is the same with futures obviously. The characteristics of stock index are high leverage effect, strong liquidity and convenient short selling transactions. At the same time, the stock index futures are closely related with the stock, which is determined by the price to stock index point, and delivery of cash. So the stock index futures as the common effect of futures and stock market products, including both futures and stock.

### 1.2 Main Function of Stock Index Futures

#### 1.2.1 Function of Price Discovery

It is generally regarded that due to the stock index futures transactions with low cost, high leverage, investors tend to buy and sell within one transaction day, so stock index futures prices are often ahead of the spot, to indicate the effect on spot prices. It is so called the function of price discovery. It is conducive to the formation of more can reflect the real value of the stock price through efficient futures market investors bidding.

#### 1.2.2 Function of Hedging

With the function of the stock index futures hedging, arbitrage and speculation market, large amount of new information based on different market speculation can make the stock index futures trading more active, and

therefore enlarge the gap between spot price and futures price, surplus change, so the arbitrage activities occur frequently in the market, in such circumstances, spot and futures prices tend to be the same. In addition, the hedging activities in the market restrain excessive speculation in the stock market.

### 1.2.3 Function of Short Selling in Bull Market

Stock index futures is a double-trade transaction, you can sell and buy. In accordance with the provisions of the United States of America's securities and Exchange Commission rules of SEC3B-3, the so-called short selling refers to the investors sell securities which he does not possess, or investors on their own account with the borrowed securities to complete the delivery of any sale behavior. It is mainly used by professional arbitrageurs, when judging a stock price is excessively high, take the stock to sell, also will sell securities to get money for undervalued securities purchase benefit from. When arbitrageurs try to pursue individual profit maximization and the high prices of the assets with the action of "throwing the high absorption of low", it also guide the relative pricing of financial assets return to rational direction. So when the stock market is in weak, short selling in bull market can short the stock index futures, hedging and portfolio management can make some speculative revenue.

## 2. PROBLEMS IN STOCK INDEX FUTURES IN CHINA

### 2.1 The Speculative in the Stock Index Futures in China Became More and More Serious

As early as three months after the issuance of the stock index futures in China, the speculative problems had begun. Concrete manifestation of this problem lies in the use of stock index futures, hedging which accounted for only 10%, if the stock index futures contract, daily turnover of 500000 hand, then only 50000 contracts are investors used to position to reduce their portfolio risk, while 450000 contracts traded the rest is all in the hands of investors short stay, to arbitrage or speculation, to obtain the proceeds, which is the development of the futures market is obviously unfavorable. Generally speaking, in those foreign mature stock index futures market, such as the S & P 500 index trading market, hedging should account for about 60% of all trading of stock index futures and even more than 70% to ensure the healthy operation of the stock index futures market, that is to say, only 30% to 40% of turnover can be used for arbitrage or speculation, the quotas of the stock index futures trading is investors should normally used, rather than the opposite approach. But due to the stock index futures laws and regulations on the fuzzy management of speculation, speculation and not just because the risk is too great to be give investors,

but investors are more likely to be attracted to the higher income, relative to the use of hedging to reduce portfolio risk, investors tend to use higher yields to compensate for the risk speculation. A variety of reasons, eventually led to the speculation of Chinese stock index futures market serious results.

### 2.2 Single Type of Transaction Product and No Financial Derivatives

After three years of development, another prominent problem of stock index futures market exposed is our stock index futures contracts trading varieties of a single. So far, our stock index futures contract has one and only one, is the Shanghai and Shenzhen 300 index contracts, regardless of the Shanghai and Shenzhen 300 index of its defects, only from the quantitative point of view, the Shanghai and Shenzhen 300 index contracts obviously can not meet the increasing requirement of the main market transactions. This is because as a risk management of financial instruments, stock index futures investors need to meet different requirements for risk management, but the risk management requirements and different types, so China's only the Shanghai and Shenzhen 300 index contract is unable to support the development of futures market.

In fact, in developed countries, those in the more mature futures market, futures contracts are often more than one, in the case of the United States, the stock index futures has three kinds, respectively is the value line index futures contract, standard & Poor's 500 stock index futures contracts as well as the main market index futures contracts, this three futures contracts from different levels, different purpose to meet the needs of various types of investors. In the development of stock index futures in the experience of the developed countries, we can easily see, only our current stock index futures contracts—the Shanghai and Shenzhen 300 index contracts, and not specifically for stock index futures special contract Shenzhen and Shanghai stock markets, but the combination of the two markets and the introduction of the overall situation of futures, the investors and institutions, the inevitable will hardship and trouble risk aversion in real trading. To sum up, continuous introduction of new stock index futures contracts, to speed up the design structure and variety of products, further perfect our market is the main direction of China's stock index futures market forward. Only in this way, the stock index futures market in China can continue to progress, thus become the effective market real mature.

### 2.3 Lack of Effective Regulation and Finance Supervise System

Laws and regulations in the stock index futures regulatory aspects of our country has not set up this system, and the developed country mature futures market in sharp contrast. Despite such efforts of China Securities

Regulatory Commission, but obviously the “China Financial Futures Exchange member customers futures trading management implementation details”, “China financial futures exchange futures transactions real-time monitoring guidelines” and “on the implementation of position limit quota system related issues notice” the lack of legal measures for the stock index futures market supervision is not enough. Especially in our criminal law is not specified for futures fraud. For example, a controller unauthorized trading, misappropriation of funds, promote customer fast continuous trading, commitment to customers ensure profitability, false bid, the publication of false information, without authorization by customers and authorization for customer transactions, without permission and authorization of customer as customers buy or sell positions as buying selling, making false transaction report or file etc.. For instance, the stock index futures, the relevant regulations and not to fund the company and its employees can be engaged in the trading of stock index futures was expressly, but because the fund especially in public funds often enormous amount, once the money invested in stock index futures market, so the stock market trend will be seriously affected, this also that is to say, if the relevant aspects can be engaged in the trading of stock index futures, stock index futures market will have some illegal behavior. These actions may damage than general fraud caused by large, but it will seriously disrupt the stock index futures market transaction order, buy the hidden trouble to the healthy development of the market, so the relevant departments should carry on the development of effective law expressly prohibited.

#### **2.4 Lack of Investors With Multi-Level and Diversified**

Some powerful funds of individual investors in China stock index futures market investors, and relative lack of institutions and the remaining funds of individual investors is obviously insufficient participation. Generally speaking, the stock index futures market in developed countries mature, trading in groups is the main underwriter, the market maker, various funds and stock distribution firm capital adequacy of institutional investors, but not like our country as individual investors are, for example, so far, the product market is derived the whole financial English only for institutional investors. This is because the individual investors dominated in the structure of investors will increase the degree of risk and speculation of stock index futures market. Mainly in the following aspects: first, the stock index futures by margin trading, more capital investment, the corresponding margin to pay more, so individual investors relative institutional investors, which guarantee the quantity of demand guarantee will be much lower. Second, individual investors in general are difficult to support the purchase of matching with the contract size portfolios of stocks, thus, individual investors who buy

investment stock index futures contracts are often not to hedge, hedging risk to realize the spot, only speculation, leverage effect of margin trading on the basis of further increase of the individual obviously investors in the stock index futures market. Once again, individual investors investment failure, not enough funds to supplement the margin, then the mark to market system in the stock index futures can not be unlimited positions under the provisions of, the individual investors will be forced open, eventually led to huge losses. To sum up, only individual investors are unable to ensure the effective operation of stock index futures market.

### **3. STRATEGIES FOR PROMOTING THE DEVELOPMENT OF STOCK INDEX FUTURES IN CHINA**

#### **3.1 To Strengthen the Security Management in Stock Index Futures Market**

The Implementation of control the risk of futures market is the most important margin system. Stock index futures investors for the risk of the myriads of changes, but ultimately these risks may lead to results are capital loss, unable to complement an adequate margin positions. In this case, the market usually used methods corresponding measures to control transaction risk is to take a mark to market or investor day zero debt settlement system, that is to say investors at the end of the daily futures trading, should according to the day of the stock index futures settlement price margin, contract losses and the corresponding fees, tax disposable complete balance. The advantage of this method lies in its can be improved investors may encounter due to lack of funds caused by the risk of forced liquidation. At the same time, we can also deposit dynamic system of the developed countries in the mature market into account, because this is the first foreign margin dynamic system provided a guarantee a minimum, then on this premise, according to the degree of market risk is expected to differ and collect different amount of deposit, for example, the volatility of the expected stronger, the corresponding margin charged higher; instead the volatility of the expected more gentle, then collect the corresponding margin is low, this method not only reduces the market risk, but also does not influence the flow of the market, one a double. At the same time, with the stock market, we should also use price limit system to control the maximum and minimum degree daily risk, and comprehensive control of risk.

#### **3.2 To Build the Effective Regulation and Finance Supervise System**

Generally speaking, the development of China’s stock index futures market should be started from the development of forward-looking formulation, but

according to the current situation in China, we must first from the improvement of futures trading varieties in China, an important problem and then consider the development direction. In this paper the full understanding and Research on China's stock index futures market, that the stock index futures contract mini type urgent to launch is the Shanghai and Shenzhen 300 index contracts, that is appropriate to the Shanghai and Shenzhen 300 index futures contract is adjusted in order to meet the needs of more and more investors, this can not only establish the fair trade environment the general lack of funds of individual investors, also can make the transaction volume and transaction volume rises substantially, thereby preventing some large institutional investors or individual investors to manipulate the futures market, avoid the risk control more difficult. At the same time also can launch of stock index futures products, according to different market for example, according to the actual situation of the Shenzhen Stock Exchange issued a stock index futures contract, such as Shenzhen 120 index of the contract products, according to the actual situation of the Shanghai Stock Exchange issued another kind of stock index futures contracts, such as Shanghai 160 stock index futures contract. In this way, China's stock index futures market products will be perfect to meet the different needs of investors, risk control, but also create a more fair and stock index futures trading environment, which can ensure the healthy development of China's stock index futures market.

### 3.3 To Improve the Structure of Investors in the Stock Index Futures

A mature market is bound to be a fair and efficient market. Now China's securities market speculation atmosphere thick, the resource allocation function is low, is neither fair nor efficient, large medium and small investors suffer. Stock index futures market has just started, for the majority of investors and stock index futures or the emerging products, the trading of stock index futures is very different from the stock market investors, coupled with the lack of professional knowledge, lack of risk awareness, capacity is insufficient, so the stock index futures market for ordinary investors more risk. A stable

and mature market is established on the basis of rational investors have matured; they are constrained power market intrinsic. Therefore, we should strengthen the investor education, cultivate rational investment, strengthen risk awareness, and accelerate the construction of China's investor protection system; the investor education is a long-term, systematic work, so as to improve the market maturity. Basic knowledge of securities investors including card, explain the propaganda of securities and futures supervision of new policies and regulations, laws and regulations knowledge popularization s stock investors, popularization of financial knowledge.

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## CONCLUSION

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Emergence of stock index futures mapping out the Chinese stock market has entered a mature stage; the introductions of stock index futures products not only help us to reduce the investment risk, but also help us to realize the investors of multilateral investment. So combined with China's national conditions, we should make the improvement of laws and regulations in the stock index futures and speed up the diversification of investors, strengthen the security management in stock index futures market, build the effective regulation and finance supervise system for the further development of the stock index futures in China.

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