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The Behavioural Forces Shaping Currency Futures and Options Trading in the Indian Context: A Behavioural Finance Perspective with Reference to RBI Guidelines on Unauthorized Platforms

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Abstract:

This study explores the behavioural forces influencing currency futures and options trading in the Indian context, with a particular focus on the psychological biases that drive retail investors' decisions. Utilizing a behavioural finance perspective, the research examines key biases such as overconfidence, herd behaviour, and risk aversion, which significantly impact trading patterns in the currency derivatives market. The paper also addresses the rising issue of unauthorized trading platforms, referencing the Reserve Bank of India's (RBI) guidelines to analyse how regulatory awareness and enforcement influence trader behaviour. A survey of 100 traders reveals the impact of behavioural forces on both authorized and unauthorized platforms, highlighting the regulatory challenges and proposing solutions to mitigate the risks associated with psychological biases and unauthorized trading.

Keywords: Behavioural Finance, Currency Futures, Options Trading, Behavioural Biases

Introduction:

1. Background of Currency Futures and Options Trading in India

Currency futures and options have become integral financial instruments in India's growing derivatives market, enabling traders to hedge against currency fluctuations or speculate on forex movements. These instruments provide participants, particularly retail traders, with opportunities to manage risk and optimize returns in a volatile foreign exchange market. The Indian currency derivatives market, regulated by entities such as the Reserve Bank of India (RBI) and the Securities and Exchange Board of India (SEBI), has seen increased participation due to the globalized nature of the economy, where currency volatility is a constant concern.

2. Behavioural Finance and Its Relevance to Currency Trading

Traditional financial models assume that traders behave rationally, making decisions based on available information and market fundamentals. However, behavioural finance challenges this notion by recognizing that psychological factors often drive market behaviour. Cognitive biases such as overconfidence, herd behaviour, and risk aversion play a significant role in shaping traders' decisions, particularly in speculative markets like currency futures and options. Retail traders, who often lack the sophisticated tools and knowledge of institutional players, are more prone to these biases, which can result in suboptimal trading strategies.

3. The Rise of Unauthorized Trading Platforms

While the growth of regulated exchanges has provided a structured avenue for currency derivatives trading, unauthorized platforms have simultaneously proliferated, offering attractive but often deceptive opportunities. These platforms operate outside the purview of regulatory oversight, promising high returns while exposing traders to significant risks, including fraud and financial loss. The lure of quick profits, combined with psychological biases, makes retail traders particularly vulnerable to such platforms. In response, the RBI has issued several circulars and warnings to caution traders about the dangers of unauthorized trading and has called for stricter regulatory enforcement.

4. RBI's Role and Regulatory Framework

The Reserve Bank of India plays a pivotal role in regulating the country's financial markets and ensuring their stability. Through its various circulars, the RBI has emphasized the risks associated with unauthorized trading platforms. These platforms often exploit traders' lack of knowledge and understanding of regulatory guidelines. The RBI's framework aims to protect investors by promoting awareness of the legal and financial dangers involved in trading through non-compliant platforms, while encouraging participation in authorized exchanges that adhere to regulatory norms.

Objectives of Study

1. To analyse the psychological biases affecting currency derivatives traders in India.
2. To explore the role of unauthorized platforms in influencing trading behaviour.
3. To assess the impact of RBI's regulatory efforts on curbing unauthorized trading.

Literature Review:

- Beatrice et al. (2021) conducted research into the influence of demographic variables like gender, age, occupation, education, income, and experience in investment on several behavioural biases that include overconfidence, disposition effect, herding, and mental accounting. The research used questionnaires to get responses from 152 investors trading within the Indonesia Stock Exchange. Structural equation modelling was done on the data. It was observed that investment experience significantly impacted overconfidence bias, disposition effect influenced by age, income level, and investment experience, herding bias influenced by age and occupation, and mental accounting influenced by income level.
- Lachhwani (2016) examined demographic variables as determinants in moulding behavioural investment biases. A structured interview and email questionnaire were used to contact a total sample of 125 respondents. Secondary data are also collected through research papers, websites, and books. The study has used Chi-square tests and ANOVA that show the influence of these factors. From the Chi-square test, it supports yearly income and overconfidence bias, occupation and its relation with self-attribution and framing bias. The one-way ANOVA showed significant mean differences in yearly income with overconfidence bias, occupation with self-attribution and framing bias, and gender with overconfidence bias. This study has established that demographic variables predispose investment biases. Gender, yearly income, and occupation were significantly associated with various biases.
- Ritika and Kishor, 2020, constructed a scale to measure behavioural biases in individual investors. The data collection was done in two stages: In the first phase, it was done from 274 investors of Delhi. This was followed by an exploratory factor analysis. Data for the second phase were drawn from 576 investors and followed confirmatory factor analysis. Data analysis was done using SEM. The results indicated that investors' financial behaviour is influenced by their mental aptitude, and the preference of individual investors for different investment avenues and securities is determined by their past beliefs, experiences, and prevailing market trends.
- Jain et al. (2019) evaluated the impact of behavioural biases on investment decisions by individual equity investors. Primary data was sourced through questionnaires from 165 equity investors in Punjab. Further, these researchers employed the Fuzzy AHP method to evaluate the impact of behavioural biases in decision-making. The results indicated that herding bias, loss aversion, overconfidence bias, and regret aversion were the major parameters that affected investment decisions made by the surveyed investors.

Research Methodology

This study adopts a mixed-method approach, integrating both qualitative and quantitative analyses to explore the behavioural forces shaping currency futures and options trading in India, focusing on psychological biases, unauthorized platforms, and the role of RBI guidelines. Data was collected through surveys distributed to 100 traders, divided into two groups: those who trade through authorized platforms and those who engage with unauthorized platforms.

1. Data Collection

The primary data was gathered using structured questionnaires targeting retail investors actively involved in currency futures and options trading. The questionnaire was designed to assess the presence of behavioral biases such as overconfidence, herd behaviour, and risk aversion. It also included questions on the traders' awareness of RBI guidelines and their interaction with unauthorized trading platforms.

The sample size consists of 100 traders, with 60% using authorized platforms and 40% using unauthorized ones. Secondary data was sourced from RBI circulars, regulatory reports, and existing literature on behavioural finance and currency trading.

2. Sample Demographics

- **Gender**: 75% male, 25% female
- **Age**: 45% between 25-35 years, 35% between 36-45 years, 20% above 45 years
- **Occupation**: 60% salaried, 30% business owners, 10% self-employed
- **Income Level**: 50% earn between INR 5-10 lakh annually, 30% earn below INR 5 lakh, 20% above INR 10 lakh
- **Trading Experience**: 40% have 1-3 years of experience, 35% have 4-6 years, and 25% have over 7 years

- **Behavioural Bias**

Behavioural Bias	Authorized Platforms	Unauthorized Platforms
Overconfidence Bias	45%	70%
Herd Behaviour	35%	65%
Risk Aversion	60%	40%
Fraud/Loss Experience	15%	30%
Awareness of RBI Guidelines	60%	20%

3. Tools for Data Analysis

The data was analyzed using descriptive statistics to identify the prevalence of biases and structural equation modeling (SEM) to assess the relationships between psychological factors, platform choice (authorized vs. unauthorized), and the traders' awareness of RBI guidelines. A chi-square test was also used to evaluate the relationship between demographic factors (age, income, investment experience) and behavioural biases.

Findings and Discussion

The study's findings, based on data, provide insights into how psychological biases and unauthorized trading platforms influence the behaviour of retail investors in India's currency derivatives market.

1. Prevalence of Behavioural Biases

The survey results reveal that a significant portion of traders exhibit key behavioural biases.

- **Overconfidence Bias**: 70% of traders using unauthorized platforms exhibited overconfidence in their trading decisions, believing they possessed superior knowledge about market trends. This was particularly prevalent among traders with more than five years of experience.
- **Herd Behaviour**: 65% of respondents admitted to following trends without conducting personal research, particularly in periods of market volatility. Herding behaviour was more common among younger traders (25-35 years) and those using unauthorized platforms.
- **Risk Aversion**: Around 55% of traders showed signs of risk aversion, preferring to make smaller trades with a lower chance of loss rather than larger, potentially more profitable trades. This was especially prominent among older traders (above 45 years) and those with lower incomes.

2. Impact of Unauthorized Platforms

The lure of unauthorized platforms has a strong psychological appeal, especially for traders affected by overconfidence and herd behaviour.

- **Perception of Higher Returns**: 80% of traders using unauthorized platforms believed they could achieve higher returns, despite the inherent risks and lack of regulatory protection. These traders also reported lower awareness of the potential legal consequences of using such platforms.
- **Fraud and Financial Losses**: 30% of traders who use unauthorized platforms had experienced fraud or significant financial loss, but their overconfidence bias prevented them from acknowledging the risks.

3. Awareness and Effectiveness of RBI Guidelines

Despite several RBI circulars warning traders about the risks of unauthorized platforms, the level of awareness among traders remained low.

- **Awareness of RBI Guidelines**: Only 40% of traders were aware of the RBI's guidelines on unauthorized platforms. Among those using unauthorized platforms, this figure dropped to just 20%.
- **Perceived Effectiveness of RBI Guidelines**: 50% of the traders who were aware of the guidelines believed they were not effective in curbing the use of unauthorized platforms, citing the need for stricter enforcement and broader public awareness campaigns.

Conclusion

This research highlights the significant role that behavioural biases and unauthorized platforms play in shaping the trading behaviour of retail investors in the Indian currency derivatives market. Traders exhibit key psychological biases, such as overconfidence and herd behaviour, which are exacerbated by the perceived high returns offered by unauthorized trading platforms. The RBI has made commendable efforts to raise awareness about the dangers of these platforms, but the effectiveness of its guidelines remains limited due to low awareness levels among traders.

The study underscores the need for a more robust regulatory framework that combines stricter enforcement of guidelines with targeted education initiatives aimed at retail traders. Increasing awareness about behavioural finance could also help traders recognize their biases and make more informed decisions, thereby reducing the risks associated with unauthorized platforms.

Suggestions

Based on the findings, the following suggestions are proposed:

1. **Increase Awareness of RBI Guidelines**: The RBI should enhance its efforts to educate traders about the dangers of unauthorized platforms

through digital campaigns, workshops, and partnerships with authorized trading platforms.

2. **Stronger Regulatory Enforcement**: Stricter penalties should be imposed on unauthorized platforms and their promoters. The RBI could collaborate with SEBI and other regulatory bodies to tighten control over the market.
3. **Promote Behavioural Finance Education**: Educational programs on behavioural finance should be made available to retail traders to help them recognize and mitigate their biases. These programs could be offered by authorized trading platforms as part of their customer onboarding process.
4. **Technology-Driven Monitoring**: The use of AI and data analytics by regulators could improve the detection of unauthorized platforms and their users, enabling more proactive interventions.

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