

CIRCULAR

SEBI/HO/MRD/TPD-1/P/CIR/2024/132

October 01, 2024

To

All Stock Exchanges

All Clearing Corporations

(Except Commodity Derivatives Exchanges and Clearing Corporations)

Sir/Madam,

Measures to Strengthen Equity Index Derivatives Framework for Increased Investor Protection and Market Stability

1. Derivatives market assist in better price discovery, help improve market liquidity and allow investors to manage their risks better. Stock Exchanges and Clearing Corporations together provide the platform and products for trading in derivatives market, while ensuring online real time risk management, adequate surveillance, as well as smooth settlement of trades.
2. The role of product offering, risk management, and surveillance by Stock Exchanges and Clearing Corporations is crucial in ensuring integrity of securities market ecosystem. This is particularly heightened in view of the changing market dynamics in derivatives segment in recent years, with increased retail participation, offering of short tenure index options contracts, and heightened speculative trading volumes in index derivatives on expiry day. Regulation 28 (2) read with Part–C of Schedule II of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (SECC Regulations, 2018), considers Risk Management, Surveillance, and Product development functions of Stock Exchanges and Clearing Corporations as core functions. In addition, Clearing and Settlement is considered as a core function of Clearing Corporations.

3. The Securities and Exchange Board of India Act, 1992 ("SEBI Act"), *inter alia*, mandates SEBI to protect the interest of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit. One of the measures to achieve the aforesaid mandate as provided in the SEBI Act is to regulate the market through measures that may enable regulating the business of Stock Exchanges.
4. In order to review the existing regulatory measures for investor protection while ensuring the orderly development and strengthening of equity derivatives market, as well as to identify measures to assist stock exchanges in carrying out their aforementioned core functions, SEBI formed an Expert Working Group (EWG) on derivatives, to suggest measures for investor protection and market stability.
5. On the basis of the measures recommended by the EWG and subsequent deliberations in the Secondary Market Advisory Committee (SMAC) of SEBI, a [consultation paper](#) was issued by SEBI on July 30, 2024, in the matter. The comments received were examined by SEBI, and the matter was further discussed with Stock Exchanges and Clearing Corporations, subsequent to which it has been decided to put in place the following measures to strengthen the equity index derivatives framework.

5.1. Upfront collection of Option Premium from options buyers

- 5.1.1. Options prices move in a non-linear way and carry very high implicit leverage. These are timed contracts with the possibility of fast-paced price appreciation or depreciation. In order to avoid any undue intraday leverage to the end-client, and to discourage any practice of allowing any positions beyond the collateral at the end-client level, it has been decided to mandate collection of options premium upfront from option buyers by the Trading Member (TM)/ Clearing Member (CM).
- 5.1.2. Clause 14.3 of Chapter 5 of SEBI Master Circular for Stock Exchanges and Clearing Corporations dated October 16, 2023, stipulates TMs to collect Initial Margin (IM) and Extreme Loss Margin (ELM) upfront from

their clients. In view of the above, it has been decided that the upfront margin collection requirement shall also include net options premium payable at the client level. The same may be included in the intraday snapshots conducted by Clearing Corporations for verification of upfront collection of margins, and for imposition of penalty in the event of non-compliance.

5.1.3. In order to provide sufficient time to implement the aforesaid measure, this requirement would be applicable for equity derivatives segment from February 01, 2025.

5.2. Removal of calendar spread treatment on the Expiry Day

5.2.1. Expiry day can see significant basis risk, where the value of a contract expiring on the day can move very differently from the value of similar contracts expiring in future. Given the relatively very large volumes witnessed on the expiry day vis-à-vis future expiry days, and the enhanced basis risk that it represents, it has been decided that the benefit of offsetting positions across different expiries ('calendar spread') shall not be available on the day of expiry for contracts expiring on that day. This would also align calendar spread treatment with cross-margin framework on correlated indices having different expiries, wherein such cross-margin benefit is fully revoked at the start of the first of the expiring correlated indices.

5.2.2. On the day of expiry, the worst scenario loss as specified at Clause 14.3 of Chapter 5 of SEBI Master Circular for Stock Exchanges and Clearing Corporations dated October 16, 2023 shall be calculated separately for contracts expiring on the given day and for the rest of the contracts. Given that the worst scenario loss is calculated separately, and hence calendar spread benefit is not available for contracts on the day of expiry, an additional calendar spread margin will not be applicable for contracts expiring on a given day (as illustrated at clause 1.2.5.10 of Chapter 5 of the aforesaid SEBI Master Circular). Further, the ELM for calendar spread

positions on futures, if one of the legs is expiring on the same day, shall be computed without considering such futures positions as an offsetting calendar spread position.

5.2.3. It is clarified that the existing margin calculations for calendar spread positions (i.e. worst scenario loss, calendar spread margin and ELM) shall remain unchanged for calendar spread positions involving all expiries other than the contracts expiring on a given day. As an illustration, if monthly expiries are on 29th (current month), 30th (next month) and 31st (far month) respectively, then calendar spread positions involving positions expiring on 29th (current month) and 30th (next month), or 29th (current month) and 31st (far month), shall not be provided calendar spread treatment on 29th (current month expiry). However, calendar spread positions involving positions expiring on 30th (next month) and 31st (far month) shall continue to receive calendar spread treatment on 29th (current month expiry).

5.2.4. The aforesaid would be applicable for calendar spread positions in the equity index derivatives and shall be effective from February 01, 2025.

5.3. Intraday monitoring of position limits

5.3.1. The position limits for index derivatives contracts as specified by SEBI from time to time are being monitored by Stock Exchanges/ Clearing corporations at the end of day. Particularly amidst the large volumes of trading on expiry day, there is a possibility of undetected intraday positions beyond permissible limits during the course of the day. To address the aforesaid risk of position creation beyond permissible limits, it has been decided that existing position limits for equity index derivatives shall henceforth also be monitored intra-day by exchanges.

5.3.2. For this purpose, Stock Exchanges shall consider minimum 4 position snapshots during the day. The number of snapshots may be decided by the respective Stock Exchanges subject to a minimum of 4 snapshots in a

day. The snapshots would be randomly taken during pre-defined time windows.

5.3.3. To provide sufficient time for implementation, the measure shall be effective for equity index derivatives contracts from April 01, 2025. Further, the existing framework of penalty structure for breach of end of day position limit shall be extended by exchanges for intraday position limit breaches as well.

5.4. Contract size for index derivatives

5.4.1. Clause 1.1.4 and Clause 2.1.4 of Chapter 5 of SEBI Master Circular for Stock Exchanges and Clearing Corporations dated October 16, 2023, stipulates contract size for index futures and index options respectively. The current stipulation is for such contracts to have a value between Rs. 5 lakhs and Rs. 10 lakhs. This limit was last set in 2015. Since then, broad market values and prices have increased by around three times. Given this, it has been decided that a derivative contract shall have a value not less than Rs. 15 lakhs at the time of its introduction in the market. Further, the lot size shall be fixed in such a manner that the contract value of the derivative on the day of review is within Rs. 15 lakhs to Rs. 20 lakhs. All other stipulations for contract size of index derivatives as mentioned in the Master Circular referred above shall remain unchanged.

5.4.2. Given the inherent leverage and higher risk in derivatives, this recalibration in minimum contract size, in tune with the growth of the market, would ensure that an inbuilt suitability and appropriateness criteria for participants is maintained as intended.

5.4.3. The measure shall be effective for all new index derivatives contracts introduced after November 20, 2024.

5.5. Rationalization of Weekly Index derivatives products

5.5.1. Expiry day trading in index options, at a time when option premium are low, is largely speculative. Different stock exchanges offer short tenure options contracts on indices which expire on every day of the week. The SEBI [consultation paper](#) has noted that there is hyperactive trading in index options on expiry day, with average position holding periods in minutes, accompanied by increased volatility in the value of the index through the day and at expiry. All this has implications for investor protection and market stability, with no discernable benefit towards sustained capital formation.

5.5.2. Accordingly, in order to specifically address this issue of excessive trading in index derivatives on expiry day, it has been decided to rationalize index derivatives products offered by exchanges which expire on weekly basis. Henceforth, each exchange may provide derivatives contracts for only one of its benchmark index with weekly expiry.

5.5.3. This measure shall be effective from November 20, 2024., i.e. from this date weekly derivatives contracts would only be available on one benchmark index for each exchange.

5.6. Increase in tail risk coverage on the day of options expiry

5.6.1. ELM is levied with the view to cover tail risk outside the scanning risk. On the day of options contracts expiry, given the heightened speculative activity around options positions and the attendant risks, it has been decided to increase the tail risk coverage by levying an additional ELM of 2% for short options contracts.

5.6.2. This would be applicable for all open short options at the start of the day, as well on short options contracts initiated during the day that are due for expiry on that day. For instance, if weekly expiry on an index contract is on 7th of the month and other weekly/monthly expiries on the index are on

14th, 21st and 28th then, for all the options contracts expiring on 7th, there would be an additional ELM of 2% on 7th.

5.6.3. This measure shall be effective from November 20, 2024.

6. Out of the six measures proposed at para 5.1 to 5.6, four measures (i.e. para 5.2, 5.3, 5.5 and 5.6) are intended to address heightened activity in index options on expiry day, one measure (i.e. para 5.4) ensures continued suitability and appropriateness of index derivatives segment for investors, and the other measure (i.e. para 5.1) is to ensure basic risk hygiene.

7. Applicability:

The aforementioned measures shall come into effect from the following dates:

Sr. no.	Measure	Effective From
1.	Upfront collection of Option Premium from buyers	February 01, 2025
2.	Removal of Calendar spread treatment on the Expiry Day	February 01, 2025
3.	Intraday monitoring of position limits	April 01, 2025
4.	Contract size for index derivatives	November 20, 2024
5.	Rationalization of Weekly Index derivatives products	November 20, 2024
6.	Increase in tail risk coverage on the day of options expiry	November 20, 2024

8. Stock Exchanges and Clearing Corporations are directed to take necessary steps to put in place systems for implementation of this Circular, including necessary amendments to the relevant bye-laws, rules and regulations, if any.
9. This circular is being issued in exercise of powers conferred under Section 11(1) read with Section 11(2)(a) of the SEBI Act, 1992, read with Regulation 51 of SECC Regulations, 2018, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

10. This circular is available on SEBI website at www.sebi.gov.in under the category “Legal Circulars”.

Yours faithfully,

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