भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

CIR/MRD/DRMNP/35/2013   December 05, 2013

To

Recognized Stock Exchanges
Recognized Clearing Corporations

Dear Sir/Madam,

Sub: Exchange Traded Cash Settled Interest Rate Futures (IRF) on 10-Year Government of India Security

1. SEBI vide circular No. SEBI/DNPD/Cir- 46 /2009 dated August 28, 2009 permitted Stock Exchanges to launch physically settled futures on 10-Year Government of India (GoI) Security.

2. In consultation with RBI, after taking into account feedback from market participants and Stock Exchanges, it has been decided to permit stock exchanges to introduce cash settled Interest Rate Futures on 10-Year Government of India Security.

3. The product specifications, position limits and risk management framework for cash settled futures on 10-year GoI security is given in Annexure-1. Two different designs (Option-A: Coupon bearing Government of India security as underlying and Option-B: Coupon bearing notional 10-year Government of India security with settlement price based on basket of Securities as underlying) are permitted for cash settled futures on 10-year GoI Secuirty. Exchanges are permitted to launch contracts on either one or both of these options.

4. The cash settled 10-year IRF is being introduced on a pilot basis and the product features would be reviewed based on the experience gained.

5. Before the launch of the product, the Stock Exchange/Clearing Corporation shall submit the proposal to SEBI for approval giving the details of contract specifications, risk management framework, the safeguards and the risk protection mechanisms, the surveillance systems etc.

6. This circular is issued in exercise of the powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act 1992, read with Section 10 of the Securities Contracts (Regulation) Act, 1956 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

7. This circular is available on SEBI website at www.sebi.gov.in., under the category "Circulars".

Yours faithfully,

Shashi Kumar
General Manager
Division of Risk Management and New Products
Market Regulation Department
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Encl: as above

Annexure-1: Cash Settled interest rate futures on 10-year GoI security

1. **Underlying**

   Option-A: GoI security of face value Rs 100 with semi-annual coupon and residual maturity between 9 and 10 years on the day of expiry of IRF contract, as decided by stock exchanges in consultation with FIMMDA.

   Option-B: Notional coupon bearing 10-year GoI security with a notional coupon paid semi-annually and face value of Rs 100. For each contract, there shall be basket of Government of India Securities, with residual maturity between 9 and 11 years on the day of expiry of IRF contract, with appropriate weight assigned to each security in the basket. Exchanges shall determine criteria for including securities in the basket and determining their weights such as trading volumes in cash market, minimum outstanding etc.

   Exchanges shall disclose the criteria for selection of the underlying bond/s in both options of cash settled Interest Rate Futures on 10 –Year Government of India security.

2. **Coupon**

   Option-A: Coupon shall be same as that of the underlying bond.

   Option-B: To be decided by the exchange to reflect the interest rate environment during the launch of the contract.

3. **Trading Hours**

   9 a.m. to 5.00 p.m. on all working days from Monday to Friday. Exchanges shall align the trading hours of IRF with that of underlying market in case of change of trading hours of underlying NDS-OM platform.

4. **Size of the Contract**

   Each futures contract shall represent 2000 underlying bonds of total face value of INR 2,00,000/-.

5. **Quotation**

   The Quotation shall be similar to the quoted price of the Government of India security.

6. **Tenure of the Contracts**

   To begin with, serial monthly contracts with maximum maturity of 3 months shall be available.

7. **Contract Value**

   The contract value shall be: = Quoted price * 2000

8. **Daily Contract Settlement Value**

   The Daily Contract Settlement Value shall be: = P_w*2000

   (Here P_w is volume weighted average futures price of last half an hour).

   In the absence of last half an hour trading, theoretical futures price shall be considered for computation of Daily Contract Settlement Value. For computing theoretical futures price, following shall be considered:-

   a) Weighted average price of underlying bond in last two hours of trading on NDS-OM

   b) If no trades are executed in the underlying bond then, a theoretical price with reference to FIMMDA rates shall be used.

   Exchanges shall be required to disclose the model/methodology used for arriving at the theoretical price.

9. **Expiry/Last trading day**

   The expiry / last trading day for the contract shall be the last Thursday of the expiry month. If any expiry day is a trading holiday, then the expiry/ last trading day shall be the previous trading day.

10. **Settlement Day**

    Settlement day shall be the next working day of the Expiry day.

11. **Settlement Mechanism**

    Settlement shall happen in cash in INR.

12. **Final Contract Settlement Value**

    The Final Contract Settlement Value shall be = 2000 * P_f

    where P_f is the final settlement price of the Underlying/Notional bond, which shall be determined as given below.

Option-A:

P_f will be arrived at by calculating the weighted average price of the underlying bond based on the prices during the last two hours of the trading on NDS-OM. If less than 5 trades are executed in the underlying bond during the last two hours of trading, then FIMMDA price shall be used for final settlement.

Option-B:

The final settlement price shall be based on average settlement yield (Ys) which shall be the weighted average of the yields of bonds in the underlying basket, where weights will be the assigned weight of the bonds in the underlying basket. Ys will be rounded off to 4 decimal digits. For each bond in the basket, yield shall be calculated by determining weighted average yield of the bond based on last two hours of the trading in NDS-OM. If less than 5 trades are executed in the bond during the last two hours of trading, then FIMMDA price shall be used for determining the yields of individual bonds in the basket.

P_f =

$$\left[\frac{100}{\left(1 + \frac{Ys}{2}\right)^{20}} \right] + \left[\sum_{k=1}^{20} \frac{100 * \frac{C}{2}}{\left(1 + \frac{Ys}{2}\right)^{k}} \right]$$

where,

Ys: Settlement yield
C: The notional coupon of underlying bond

13. **Position Limits**

Following position limits shall be applicable for IRF contracts:

a) **Client Level**

The gross open positions of the client across all contracts shall not exceed 3% of the total open interest or INR 200 crores, whichever is higher.

b) **Trading Member Level**

The gross open positions of the trading member across all contracts shall not exceed 10% of the total open interest or INR 600 crores, whichever is higher.

c) **Clearing Member Level**

No separate position limit is prescribed at the level of clearing member. However, the clearing member shall ensure that his own trading position and the positions of each trading member clearing through him is within the limits specified above.

d) **FIIs**

The gross open positions of the FII across all contracts shall not exceed 10% of the total open interest or INR 600 crores, whichever is higher.

Additional restriction: The total gross short (sold) position of each FII in IRF shall not exceed its long position in the government securities and in Interest Rate Futures, at any point in time. The total gross long (bought) position in cash and IRF markets taken together for all FIIs shall not exceed the aggregate permissible limit for investment in government securities for FIIs.

FIIs shall ensure compliance with the above limits. Stringent action shall be taken against FII in case of violation of the limits.

e) **Exchange Level Overall Position Limit:**

Following limits shall be applicable on overall open interest on derivatives contracts on each underlying per exchange:

Option-A: INR 25,000 crore or 25% of the outstanding of underlying bond whichever is higher.

Option-B: INR 30,000 crore or 20% of the outstanding of all underlying bonds whichever is higher.

14. **Price Bands**

For every IRF contract, Stock Exchanges shall set an initial price band at 3% of the previous closing price thus preventing acceptance of orders for execution that are placed beyond the set band. Whenever a trade in any contract is executed at the highest/lowest price of the band, stock

exchanges may expand the price band for that contract by 0.5% in that direction after 30 minutes after taking into account market trend. However, no more than 2 expansions in the price band shall be allowed within a day.

Further, SEBI in consultation with RBI may halt the trading in case of extreme volatility in the IRF market.

15. **Risk Management Framework**

Clearing Corporations shall determine appropriate risk management framework for the product and submit the same to SEBI for approval.

The Initial Margin requirement shall be based on a worst case loss of a portfolio of an individual client across various scenarios of price changes. The various scenarios of price changes would be so computed so as to cover a 99% VaR over a one day horizon. Further Extreme Loss margins and calendar spread margins shall also be prescribed by clearing corporations. Margins shall be deducted from the liquid assets of the clearing member on an on line, real time basis.