

Review of Framework for Stocks in Derivatives Segment

Following the decisions taken by the Securities and Exchange Board of India (SEBI) in its board meeting held on March 28, 2018, in the context of rationalising and strengthening the framework of Equity Derivatives Market, SEBI has released a Circular on April 11, 2018, on 'Review of Framework for Stocks in Derivatives Segment'. The key takeaways from the SEBI circular are:

1. **Physical settlement of stock derivatives:**

In line with the recommendations made by the L.C Gupta committee and discussion in Secondary Market Advisory Committee (SMAC) regarding the functioning of the Securities Lending and Borrowing mechanism (SLBM), it has been decided that physical settlement of stock derivatives shall be made mandatory in a phased/calibrated manner.

2. **Enhanced eligibility criteria for introduction of stocks in Derivatives Segment ('Enhanced criteria'):**

- A stock, on which option and future contracts are proposed to be introduced, shall conform to the following broad eligibility criteria: -
 - i. The stock shall be chosen from amongst the top 500 stocks in terms of average daily market capitalisation and average daily traded value in the previous six months on a rolling basis;
 - ii. The stock's median quarter-sigma order size over the last six months, on a rolling basis, shall not be less than INR 2.5 million;
 - iii. The market wide position limit in the stock shall not be less than INR 5 billion on a rolling basis and;
 - iv. Average daily delivery value in the cash market shall not be less than INR 100 million in the previous six months on a rolling basis.

Above criteria are to be met for a continuous period of six months.

- Derivatives on stocks (new/existing) which meet the enhanced eligibility criteria shall be cash settled until further notification. However, such stocks, if they fail to satisfy any of the enhanced eligibility criteria for a continuous period of three months, shall be moved from cash settlement to physical settlement.

After moving if such stocks do not meet any of the eligibility criteria specified in SEBI circular dated July 23, 2012 (refer note 1 below) for a continuous period of three months, then they shall exit from derivatives segment.

- Derivative stocks meeting eligibility criteria mentioned in SEBI circular dated July 23, 2012, but not meeting the enhanced criteria shall be settled physically. In case, such stocks fail to meet any of the eligibility criteria mentioned in SEBI circular dated July 23, 2012, for a continuous period of three months or fail to meet any of the enhanced eligibility criteria after a period of one year from the date of this circular, they shall exit from derivatives segment.
- After a period of one year from the date of the Circular, only those stocks that meet the enhanced eligibility criteria shall remain in derivatives segment.

Stock which meet the enhanced eligibility criteria, shall also move to physical settlement albeit in a phased/calibrated manner.

- The risk management framework, settlement mechanism and other procedures of the cash segment shall be applicable when a stock derivatives devolves into physical settlement.
- The other provisions regarding single stock derivatives shall remain as specified in SEBI Circulars CIR/DPND/3/2012 dated July 23, 2012, and CIR/DPND/4/2010 dated July 15, 2010.
- Further, stock exchanges have been directed to put in place proper systems and procedures for implementation of the Circular i.e. physical settlement.

- No new contract shall be issued on stocks that may exit the derivatives segment. However, the existing unexpired contracts may be permitted to trade until expiry and new strikes may be introduced in the existing contract months.

Note 1:

Revised eligibility criteria for stocks in derivatives segment:

- The minimum Median Quarter Sigma Order Size (MQSOS) requirement for a stock to be eligible for introduction in derivatives segment is INR 1 million.
- The minimum Market Wide Position Limit requirement for a stock to be eligible for introduction in derivatives segment is INR 3 billion.

Click [here](#) to access the copy of the SEBI Circular for your ready reference.

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