



CIRCULAR

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August 18, 2010

All Mutual Funds, Asset Management Companies (AMCs)

Sir/Madam,

Sub: Review of norms for investment and disclosure by Mutual Funds in derivatives

1. Please refer to the circular DNPD/CIR-29/2005 dated September 14 2005, circular MFD/CIR/9/120/2000 dated November 24 2000, and SEBI circular MFD/CIR/18337/2002 dated September 19, 2002 on investment in derivatives by mutual funds and disclosures thereof in half yearly portfolio statement.
2. In order to have prudential limits for derivative investments by mutual funds and to bring in transparency and clarity in the disclosure of the same to investors, it has been decided to bring in certain modification in the aforesaid circulars.

Exposure Limits

3. The cumulative gross exposure through equity, debt and derivative positions should not exceed 100% of the net assets of the scheme.
4. Mutual Funds shall not write options or purchase instruments with embedded written options.
5. The total exposure related to option premium paid must not exceed 20% of the net assets of the scheme.
6. Cash or cash equivalents with residual maturity of less than 91 days may be treated as not creating any exposure.
7. Exposure due to hedging positions may not be included in the above mentioned limits subject to the following
 - a. Hedging positions are the derivative positions that reduce possible losses on an existing position in securities and till the existing position remains.



- b. Hedging positions cannot be taken for existing derivative positions. Exposure due to such positions shall have to be added and treated under limits mentioned in Point 3.
 - c. Any derivative instrument used to hedge has the same underlying security as the existing position being hedged.
 - d. The quantity of underlying associated with the derivative position taken for hedging purposes does not exceed the quantity of the existing position against which hedge has been taken.
8. Mutual Funds may enter into plain vanilla interest rate swaps for hedging purposes. The counter party in such transactions has to be an entity recognized as a market maker by RBI. Further, the value of the notional principal in such cases must not exceed the value of respective existing assets being hedged by the scheme. Exposure to a single counterparty in such transactions should not exceed 10% of the net assets of the scheme.
9. Exposure due to derivative positions taken for hedging purposes in excess of the underlying position against which the hedging position has been taken, shall be treated under the limits mentioned in point 3.

Definition of Exposure in case of Derivative Positions

10. Each position taken in derivatives shall have an associated exposure as defined under. Exposure is the maximum possible loss that may occur on a position. However, certain derivative positions may theoretically have unlimited possible loss. Exposure in derivative positions shall be computed as follows:

Position	Exposure
Long Future	Futures Price * Lot Size * Number of Contracts
Short Future	Futures Price * Lot Size * Number of Contracts
Option bought	Option Premium Paid * Lot Size * Number of Contracts.

Disclosure of derivatives in Half Yearly Portfolios

11. The manner of disclosure of derivatives position in half yearly portfolio disclosure reports has not been specified in the SEBI (Mutual Funds) Regulations, 1996 and the disclosures being currently made are not uniform across the industry. Therefore, the following format for the purpose of uniform disclosure of investments in derivative instruments



by Mutual Funds in half yearly portfolio disclosure, annual report or in any other disclosures is prescribed.

12. Further, while listing net assets, the margin amounts paid should be reported separately under cash or bank balances.

13. The portfolio disclosure for derivative positions shall be made as follows:

Hedging Positions through Futures as on ...

Underlying	Long / Short	Futures Price when purchased	Current price of the contract	Margin maintained in Rs. Lakhs
Total %age of existing assets hedged through futures				
For the period ended ... specify the following for hedging transactions through futures which have been squared off/expired				
Total Number of contracts where futures were bought				
Total Number of contracts where futures were sold				
Gross Notional Value of contracts where futures were bought				
Gross Notional Value of contracts where futures were sold				
Net Profit/Loss value on all contracts combined				

Exposure created due to over hedging through futures (quantity of hedging position exceeding the quantity of existing position being hedged) shall be reported in the next table.

Other than Hedging Positions through Futures as on ...

Underlying	Long / Short	Futures Price when purchased	Current price of the contract	Margin maintained in Rs. Lakhs
Total exposure due to futures (non hedging positions) as a %age of net assets				
For the period ended ... specify the following for non-hedging transactions through futures which have been squared off/expired				
Total Number of contracts where futures were bought				
Total Number of contracts where futures were sold				
Gross Notional Value of contracts where futures were bought				
Gross Notional Value of contracts where futures were sold				
Net Profit/Loss Value on all contracts combined				



Hedging Positions through Put Options as on ...

Underlying	Number of Contracts	Option Price when purchased	Current Option Price
Total %age of existing assets hedged through put options			
For the period ended ... specify the following for hedging transactions through options which have already been exercised/expired			
Total Number of contracts entered into			
Gross Notional Value of contracts			
Net Profit/Loss on all contracts (treat premium paid as loss)			
Exposure created due to over hedging through options (quantity of hedging position exceeding the quantity of existing position being hedged) shall be reported in the next table.			

Other than Hedging Positions through Options as on ...

Underlying	Call / Put	Number of contracts	Option Price when purchased	Current Price
Total Exposure through options as a %age of net assets				
For the period ended ... with regard to non-hedging transactions through options which have already been exercised/expired specify:				
Total Number of contracts entered into				
Gross Notional Value of contracts				
Net Profit/Loss on all contracts (treat premium paid as loss)				

Hedging Positions through swaps as on ...

Swaps should be disclosed separately as two notional positions in the underlying security with relevant maturities. For example, an interest rate swap under which a mutual fund is receiving floating rate interest and paying fixed rate will be treated as a long position in a floating rate instrument of maturity equivalent to the period until the next interest fixing and a short position in a fixed rate instrument of maturity equivalent to the residual life of the swap.

14. The aforesaid circulars stand modified to the said extent.



15. The provisions shall be applicable for all new schemes launched post the issue of the circular. For all existing schemes, compliance with the circular shall be effective from October 01, 2010.

16. This circular is issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992, read with the provisions of Regulation 77 of SEBI (Mutual Funds) Regulations, 1996, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Yours faithfully,

S.Ravindran
Chief General Manager