CIRCULAR

CIR/MRD/DRMNP/11/2015 June 12, 2015

Recognized Stock Exchanges
Recognized Clearing Corporations

Dear Sir/Madam

Exchange Traded Cash Settled Interest Rate Futures (IRF) on 6 year, 10 year and 13 year Government of India (GoI) Security

1. SEBI vide circular CIR/MRD/DRMNP/35/2013 dated December 05, 2013 permitted Stock Exchanges to launch cash settled Interest Rate 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 6-Year and 13 year GoI Security.

3. The product specifications, position limits and risk management framework for both IRF products are given in Annexure 1.

4. Before the launch of the product/s, the Stock Exchange/Clearing Corporation shall submit 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.

5. **10-Year Cash Settled IRF:** SEBI vide circular CIR/MRD/DRMNP/35/2013 dated December 05, 2013 while stipulating norms for cash settled 10-year IRF, inter alia, prescribed underlying bonds' maturity criteria, position limits and maximum tenure for cash settled 10-year IRF.

   The residual maturity of the underlying bonds as prescribed in the said circular stands modified (i.e. Para 1 of the Annexure 1) to 'between 8 years and 11 years' for both option A and B.

   The position limits as prescribed in the said circular also stand modified as mentioned in Para '13(a - e)' of the Annexure 1 of this circular (i.e. Para '13(a - e)' of Annexure 1 of SEBI circular dated December 05, 2013 is replaced by Para '13(a - e)' of Annexure 1 of this circular).

In the said circular, for cash settled 10-year IRF, maximum three serial monthly contracts were permitted. In this regard, Stock Exchanges are now permitted to introduce three quarterly contracts of March/ June/ September/ December cycle in addition to three serial monthly contracts.

6. SEBI vide circular CIR/MRD/DRMNP/2/2014 dated January 20, 2014 prescribed monitoring mechanism for IRF positions of Foreign Portfolio Investors (FPIs). The mechanism specified in the said circular shall also be applicable on cash settled Interest Rate Futures on 6-Year and 13 year GoI Security.

7. 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.

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

Yours faithfully

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Encl: as above

Annexure 1: Cash Settled interest rate futures on 6 year and 13 year GoI security

1. Underlying

a) 6 years: Exchanges are permitted to launch contracts on either one or both of the following options

Option A: GoI security of face value INR 100 with semi-annual coupon and residual maturity between 4 years and 8 years on the day of expiry of IRF contract, as decided by stock exchanges in consultation with FIMMDA.

Option B: Notional coupon bearing 6-year GoI security with a notional coupon paid semi-annually and face value of INR 100. For each contract, there shall be basket of Government of India Securities, with residual maturity between 4 years and 8 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 6 –Year Government of India security.

b) 13 years: Exchanges are permitted to launch contracts on either one or both of the following options

Option A: GoI security of face value INR 100 with semi-annual coupon and residual maturity between 11 years and 15 years on the day of expiry of IRF contract, as decided by stock exchanges in consultation with FIMMDA.

Option B: Notional coupon bearing 13-year GoI security with a notional coupon paid semi-annually and face value of INR 100. For each contract, there shall be basket of Government of India Securities, with residual maturity between 11 years and 15 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 13 –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 2,000 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

Three serial monthly contracts followed by maximum three additional quarterly contracts of March/June/September/December cycle may be made available by Stock Exchanges.

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) Volume 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 volume 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 system. 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.

$P_f =$

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

where,

Ys: Average Settlement yield

C: The notional coupon of underlying bond

n = 6 (for 6 year IRF); 13 (for 13 year IRF)

13. Position Limits

Following position limits shall be applicable for IRF contracts:

a) **Client/ Category III FPI/ Scheme of Mutual Fund Level**
The gross open positions across all contracts within the respective maturity bucket shall not exceed 3% of the total open interest in the respective maturity bucket or INR 200 crore, whichever is higher.

b) **Trading Member/ Category I & II FPI/ Mutual Fund/ Insurance Companies /Housing Finance Companies/ Pension Funds Level**
The gross open positions across all contracts within the respective maturity bucket shall not exceed 10% of the total open interest in the respective maturity bucket or INR 600 crore, whichever is higher.

c) **Additional restriction for FPIs:** The total gross short (sold) position of each FPI 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 FPIs shall not exceed the aggregate permissible limit for investment in government securities for FPIs.

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

d) 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.

e) Exchange Level Overall Position Limit

At any Exchange overall open interest on IRF contracts on each underlying shall not exceed 25% of the outstanding of underlying bond.

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, not 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.