

TRADING, CLEARING AND SETTLEMENT IN DERIVATIVES MARKET

Module 6



Trading, Clearing, and Settlement in Derivatives Market

Trading:

The process of buying and selling financial instruments, such as derivatives, in the market.

Concept of Trading:

Participants execute trades to take positions in derivatives, speculating on price movements or hedging against risk. Trading can occur on various platforms, including electronic exchanges or over-the-counter (OTC) markets.

Clearing:

The process of reconciling and confirming trades, ensuring both parties meet their contractual obligations.

Concept of Clearing:

A clearinghouse acts as an intermediary, guaranteeing the performance of the trade. All trades are submitted to the clearinghouse, which becomes the counterparty to both the buyer and the seller. Clearing involves the calculation of margin requirements and the establishment of a net position for each participant.

Settlement:

The completion of a trade, involving the actual transfer of the financial instruments and the exchange of money.

Concept of Settlement:

Settlement can be physical or cash-based, depending on the type of derivative. Physical settlement involves the actual delivery of the underlying asset. Cash settlement involves the exchange of cash based on the value of the derivative at the time of settlement.

SEBI Guidelines (Securities and Exchange Board of India)

Regulatory Authority: SEBI is the regulatory authority overseeing securities markets in India.

Objective: Ensure investor protection, market integrity, and the development of fair and transparent markets.

Functions: Formulates policies and regulations for securities markets.

Supervises and regulates market intermediaries.

Conducts inspections and audits of exchanges and market participants.



Listing Requirements: Prescribes guidelines for companies seeking to list on stock exchanges.

Continuous Disclosure: Emphasizes timely and accurate disclosure of information by listed entities.

Market Surveillance: Monitors market activities to detect and prevent market manipulations and fraud.

Corporate Governance: Encourages good corporate governance practices among listed companies.



Trading Mechanism – Types of Orders

Market Order: A market order is a straightforward instruction to buy or sell a security immediately at the prevailing market price. The primary objective is swift execution, making it suitable when speed takes precedence over the exact price of the trade.

Limit Order: Limit orders provide traders with control over the price at which they buy or sell a security. Placed at a specified or better price, they ensure execution at the designated level or a more favorable one, offering precision in trade execution.

Stop Order (Stop-Loss or Stop-Buy): A stop order becomes a market order once a specified price level is reached. It is commonly used for risk management, triggering the sale of a security at a predetermined level to limit losses (stop-loss) or activating a buy order at a favorable level (stop-buy).

Clearing Mechanism - NSCCL (National Securities Clearing Corporation Limited)

NSCCL, a subsidiary of the National Stock Exchange of India (NSE), serves as the clearing and settlement arm. Its primary objectives are to ensure the integrity and efficiency of the clearing and settlement process in the securities market. NSCCL aims to minimize counterparty risk, enhance market safety, and facilitate smooth transactions.

NSCCL is a key player in the securities market, ensuring robust risk management through tailored margin requirements. Acting as a central counterparty, it facilitates timely and accurate trade settlement, reducing default risks. Managing collateral cushions, providing trade guarantees, and executing well-defined default management processes contribute to financial stability. Continuous real-time monitoring identifies irregularities, allowing prompt interventions. The Settlement Guarantee Fund covers potential losses from defaults, bolstering overall clearing and settlement system stability. NSCCL's rule formulation and technology integration uphold market integrity, fostering a secure trading environment.





Settlement Mechanism – Types of Settlement

Physical Settlement: Actual delivery of the underlying asset, common in commodity markets.

Cash Settlement: Settlement in cash based on the net value, prevalent in financial derivatives.

Regular Settlement: Periodic settlement to account for market changes and reduce risks.

Spot Settlement: Immediate settlement for swift asset and fund transfer, common in spot markets.

Forward Settlement: Settlement at a future date specified in the contract for flexibility.

T+1, T+2, T+3 Settlement: Standardized settlement timelines after the trade date.

Partial Settlement: Partial settlement of the total trade amount, offering flexibility.

Bilateral Netting: Offsetting obligations between two parties for a net settlement amount.

Multilateral Netting: Offsetting obligations among multiple parties for streamlined settlement.

Delivery Versus Payment (DVP): Simultaneous exchange of securities and funds, minimizing counterparty risk.

Types of Risk

Risk in financial markets comes in various forms, and one crucial measure is Value at Risk (VaR). VaR quantifies the potential loss in the value of a portfolio or investment over a specified time horizon with a given level of confidence. It considers the statistical distribution of returns and provides a snapshot of the downside risk, aiding investors and institutions in making informed risk management decisions.





Methods of Calculating VaR:

Several methods exist to calculate VaR, with the most common being historical simulation, parametric (variance-covariance), and Monte Carlo simulation. Historical simulation uses past returns to estimate future risk, parametric relies on statistical measures of asset returns and correlations, while Monte Carlo simulation generates multiple future scenarios to assess potential losses. Each method has its strengths and limitations, and the choice often depends on the nature of the portfolio and the available data.



Historical Simulation:

Formula:

$VaR = \text{Percentile of historical returns} \times \text{Portfolio value}$

$R = \text{Percentile of historical returns} \times \text{Portfolio value}$



Parametric (Variance-Covariance)

Formula for a Single Asset: $VaR = \mu + Z \times \sigma$

Formula for a Portfolio of Assets:

$VaR = w^T \Sigma w \times Z$

Risk Management Measures:

Effective risk management is paramount in financial markets. Measures include diversification, hedging, and the use of derivatives. Diversification involves spreading investments across different assets to reduce overall risk, while hedging involves taking offsetting positions to mitigate specific risks. Derivatives like options and futures can be employed to manage risk exposure. Additionally, ongoing monitoring, stress testing, and scenario analysis contribute to a comprehensive risk management framework.



Types of Margin

Margins play a crucial role in risk management, and different types are employed in financial markets

These margins ensure that traders have sufficient funds to cover potential losses and contribute to overall market stability.



Initial margin is the amount required to open a position, serving as a security deposit. Maintenance margin is the minimum balance needed to keep a position open.



Variation margin is the amount added or deducted from an account based on the daily price movements of the underlying asset.



Span Theory

SPAN (Standard Portfolio Analysis of Risk) Margin is a comprehensive margining system used in the derivatives market. Developed by the Chicago Mercantile Exchange (CME), SPAN considers the overall risk of a portfolio by analyzing the potential future risk rather than historical volatility. It calculates margins based on the potential worst-case scenario, incorporating factors such as volatility, price changes, and interrelationships between different instruments. SPAN Margin is widely recognized for its accuracy in reflecting portfolio risk and is employed by various exchanges globally to ensure robust risk management.

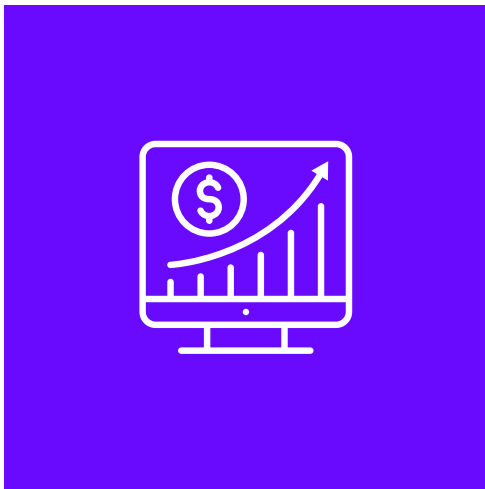
A person wearing a blue sweater is holding a tablet. The tablet screen shows a financial chart with a blue background, a grid, and various data points and lines. A large purple banner is overlaid on the screen, containing the text "Thanks for watching!".

Thanks for watching!

Our Services

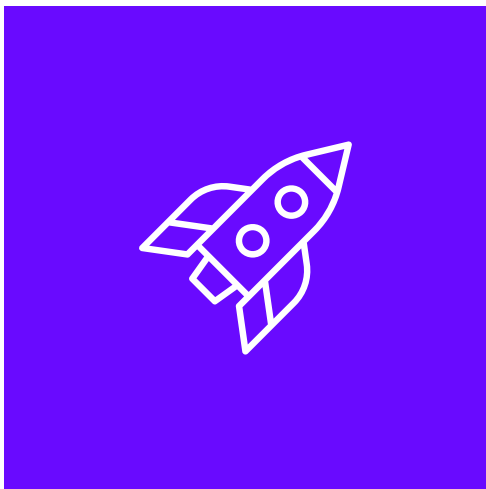
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Our Competitors



Competitor 01

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Competitor 02

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Competitor 03

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Them vs us

Items	Us	Competitor 01	Competitor 02	Competitor 03
Simple	✓	✓	✓	
Powerful	✓	✓		✓
Clean	✓	✓	✓	✓
Creative	✓			
Useful	✓		✓	✓
Flexible	✓		✓	



LOGO

A picture is
worth a
thousand
words.

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Our Portfolios

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02.

Market Analysis

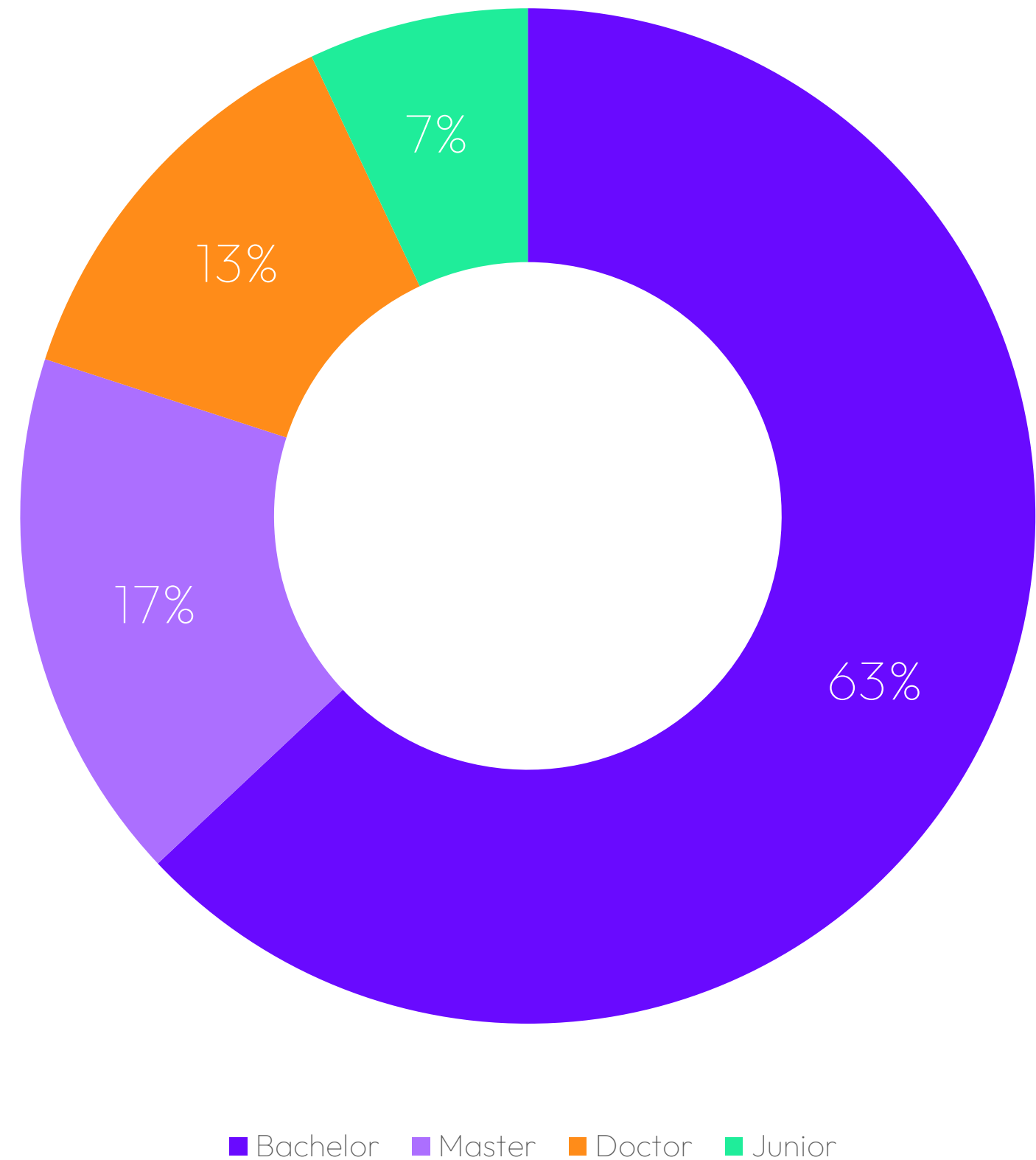
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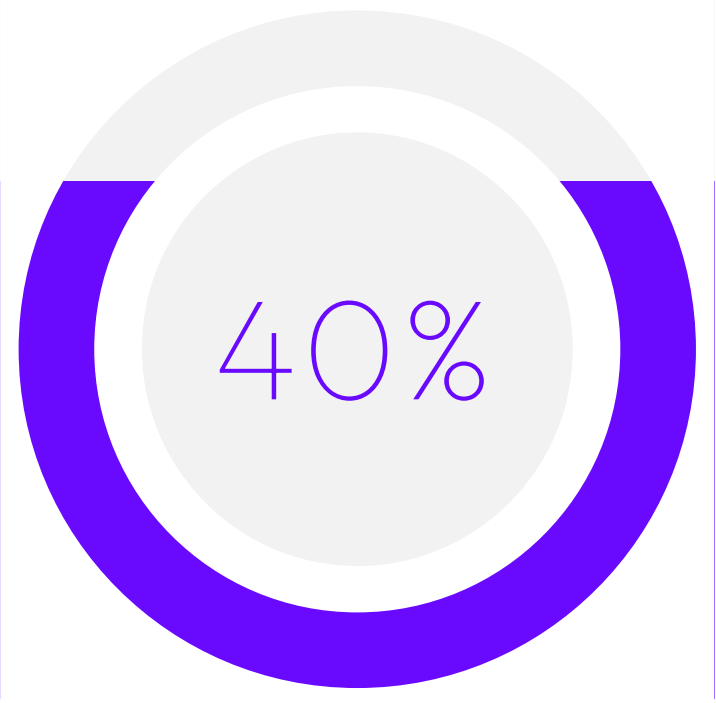
Marketing Analysis

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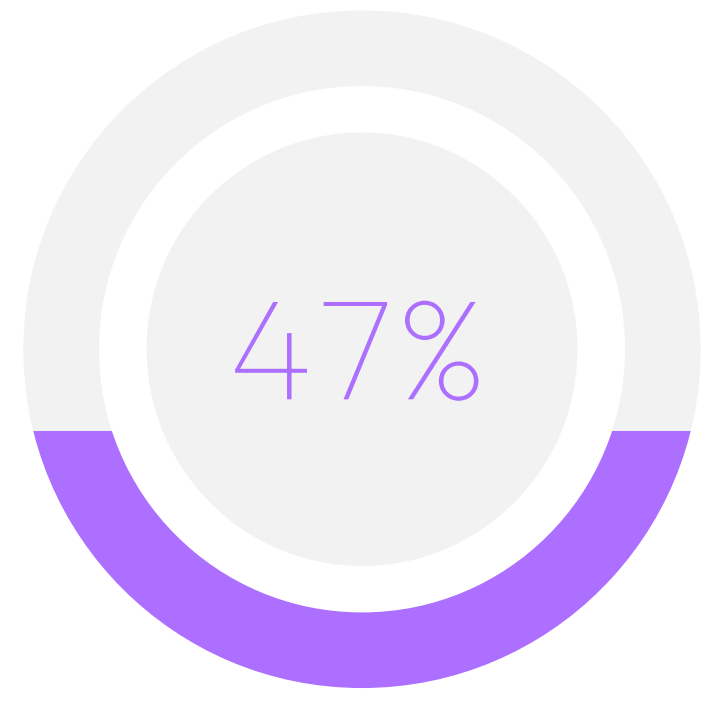


Market Analysis



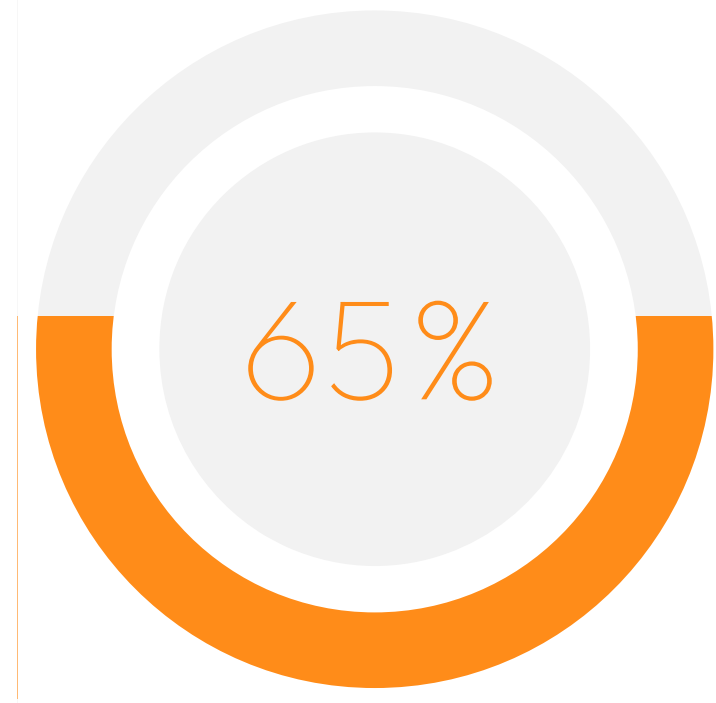
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Powerful

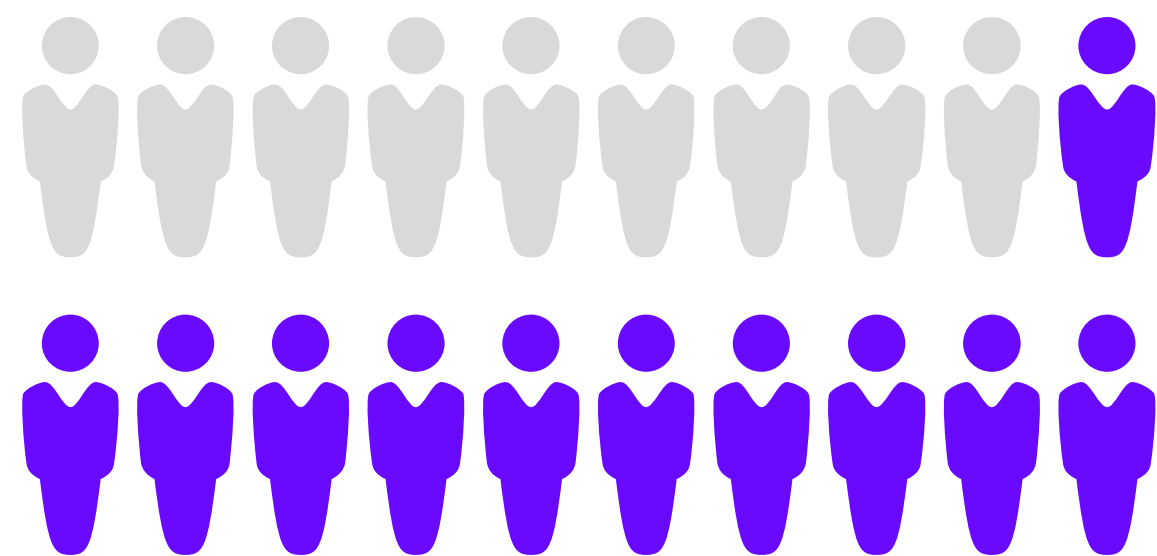
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Creative

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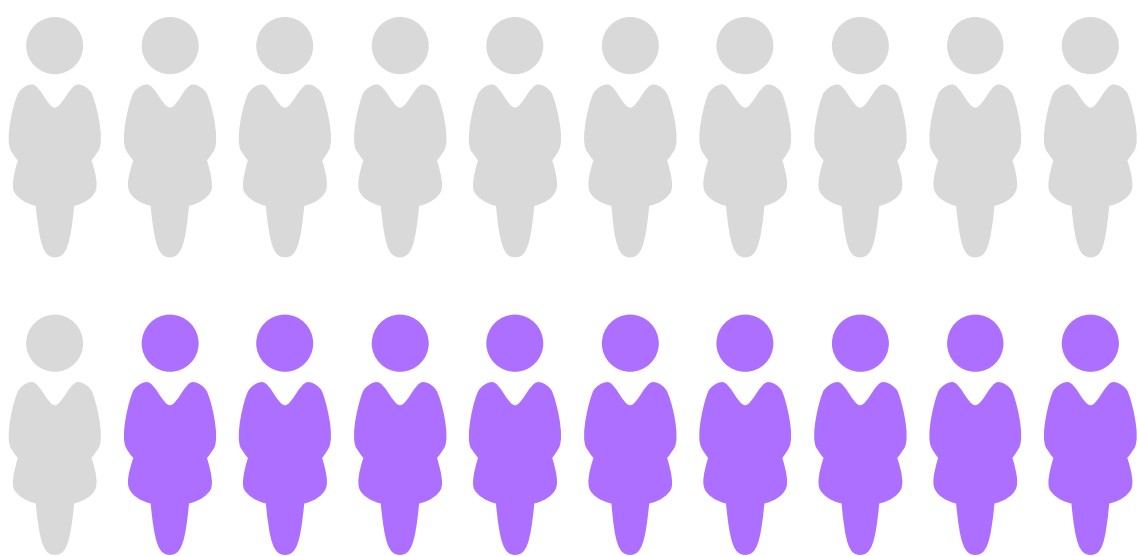
User Analysis



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Male users

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45%

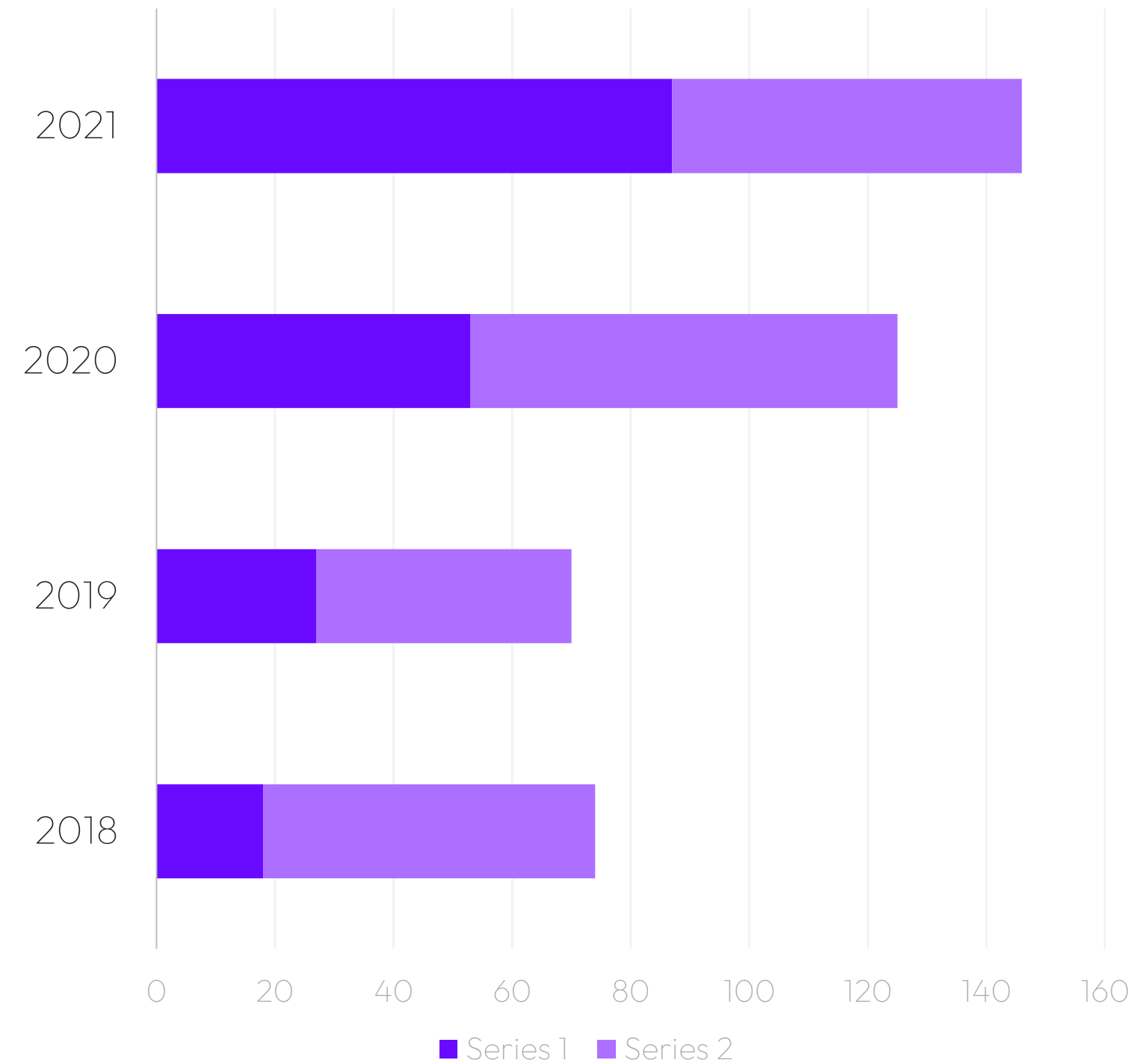
Female users

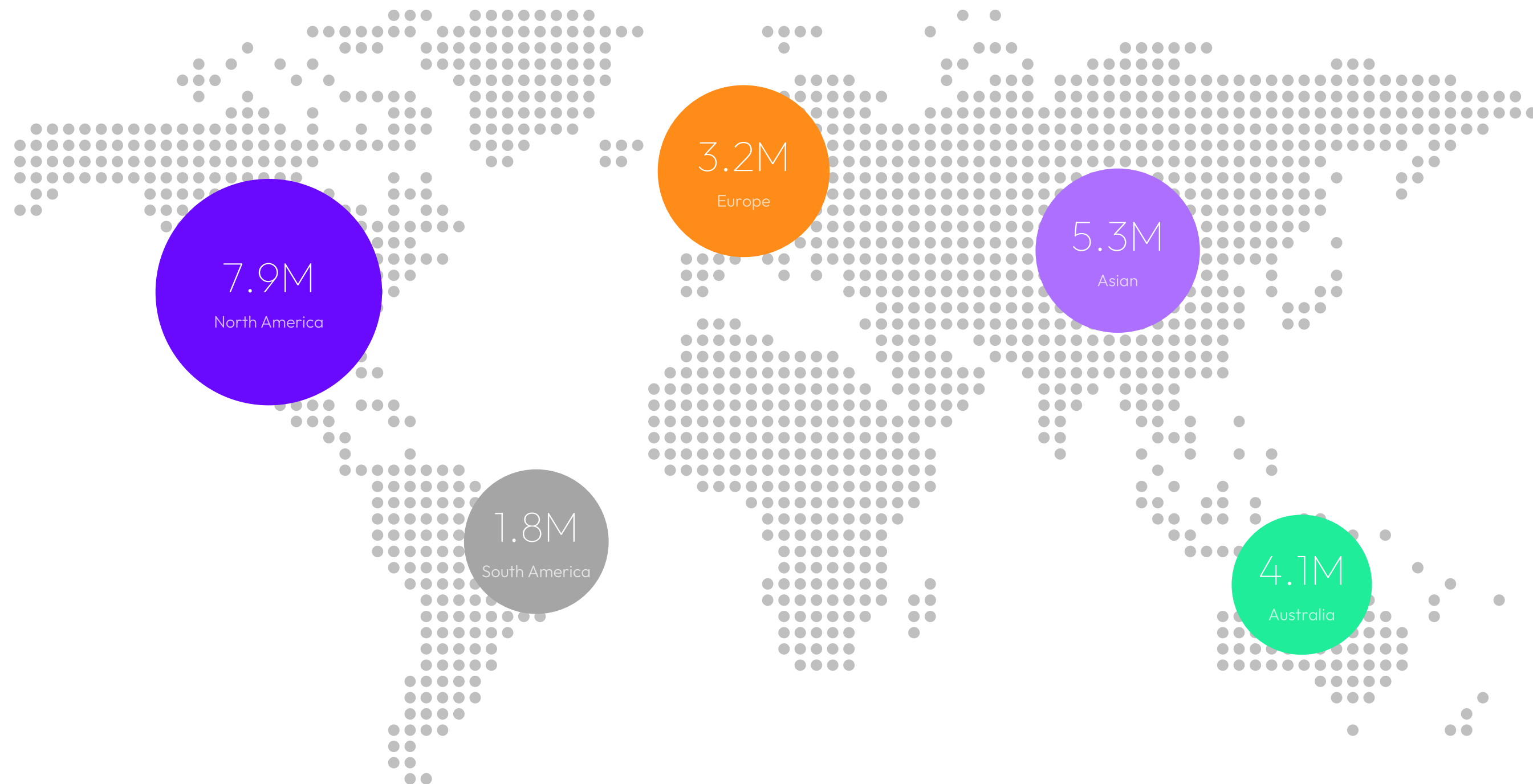
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Marketing Analysis

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World Map



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Our Big Number

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1.3m

Competitor 01

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Competitor 02

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Competitor 03

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03.

More Infographics

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Text Layout

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Powerful

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Useful

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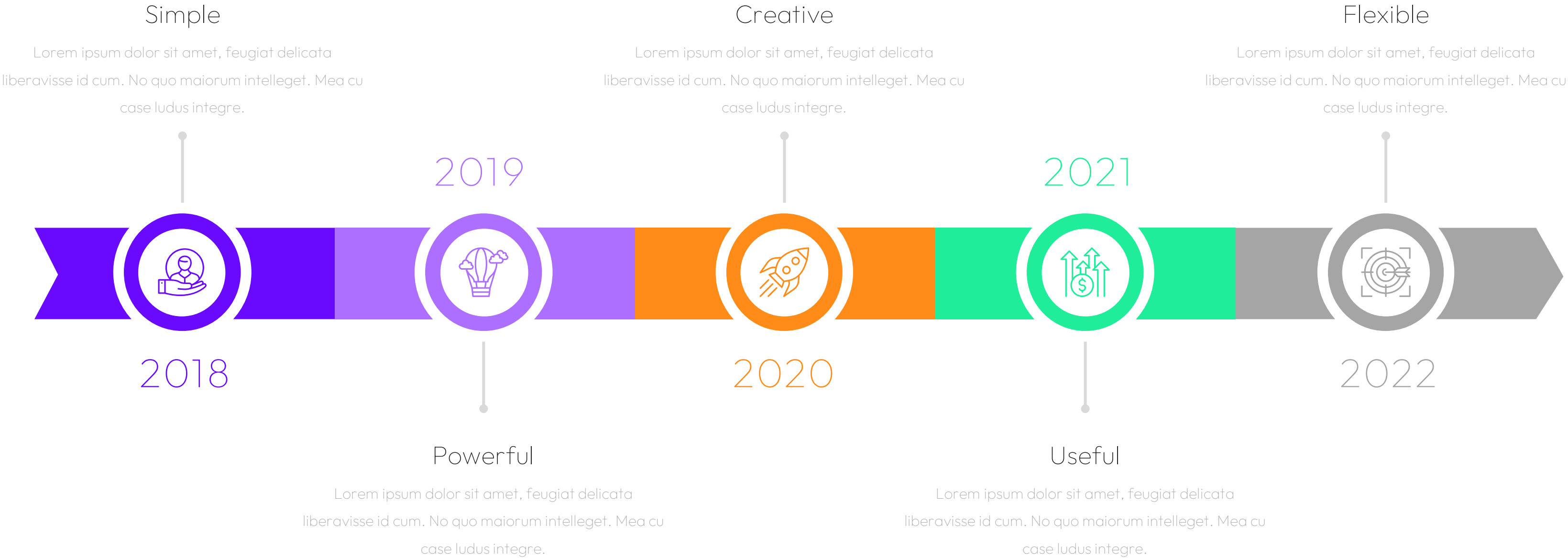
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Timeline Layout



Process Layout

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Creative

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Flexible

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Powerful

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Useful

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Price Table

PRICE TABLE	BASIC \$9.99 per month	STANDARD \$19.99 per month	PREMIUM \$29.99 per month
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No quo maiorum intellegit	✓	✓	✓
Mea cu case ludus integre	✗	✓	✓
vide viderer eleifend ex mea	✗	✗	✓
	SUBSCRIBE	SUBSCRIBE	SUBSCRIBE



Contact Us

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No.xxxx, xxxxxxxxxx Road, xxxxxxxxxx City, LSichuan Prov., P.R.China, xx0000



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Yourname@yourcompany.com