



Addendum to “Discussion paper on Growth and Development of Equity Derivative Market in India”

Physical Settlement in Stock Future and Stock Option contracts

1. Equity derivatives turnover is largely dominated by Index options, followed by Stock Futures, Stock Options and Index Futures. The high trading volume in derivatives on individual stocks especially stock futures is unique to only few markets including India. The other markets where stock futures are traded actively are Korea Exchange, Moscow Exchange, Eurex, etc.
2. SEBI, in the past, through various committees has examined the issue of physical settlement in stock derivatives. The following issues have been highlighted by various committees with regard to physical settlement of stock derivatives:
 - ❖ Hedgers and arbitragers are in a better position to manage basis risk, if physical settlement is made mandatory for stock derivative contracts.
 - ❖ Globally, cash settlement is more cost effective than physical settlement.
 - ❖ There may be a possibility of a short squeeze, in the absence of a vibrant mechanism for securities lending and borrowing. A pre-requisite for successful introduction of physical settlement of derivatives is efficient and transparent lending and borrowing mechanism in cash segment.
 - ❖ Physical settlement in stock derivative contracts may be introduced in a phased manner, first with single stock option contracts and then extended to cover single stock futures.
 - ❖ Another perspective could be that the threat of physical delivery in stock derivative leads to better alignment, coupling and convergence between cash and derivative market.



Matters for discussion

3. In light of above views regarding physical settlement for stock derivatives, market participants are requested to provide their comments on following issues:
- ❖ Whether there is a need to have compulsory physical settlement in stock derivatives contracts?
 - ❖ Whether physical settlement should be done in a phased manner starting with stock options followed by stock futures?
4. Comments/ suggestions may be provided in the format given below:-

Name of entity / person / intermediary/ Organization			
Sr. No.	Issues	Suggestions	Rationale

5. Accordingly the timeline for furnishing comments on the Discussion paper on Growth and Development of Equity Derivative Market in India has been extended till September 25, 2017. Comments in this regard may please be emailed to vishalp@sebi.gov.in or sent by post to:-

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