



**Discussion Paper on Applicability of Individual Scrip wise Price Bands/
Circuit Filters on F&O scrips**

A. Background

1. SEBI vide circular SMDRPD/Policy/Cir-37/2001 dated June 28, 2001 had specified individual scrip wise price bands/ circuit filters of 20% either way, for all scrips in the compulsory rolling settlement except for the scrips on which derivatives products are available or scrips included in indices on which derivatives products are available.
2. Derivatives markets reflect expectation of spot prices in the future, and as such price bands/ circuit filters are generally not applied on them. Further, imposition of price bands/ circuit filters on the scrips, in the cash segment, on which derivatives are available may lead to possible mis-alignment between the price of underlying in cash segment and price of the derivatives.
3. Notwithstanding the above, in order to prevent executing orders at non-genuine prices, on account of fat-finger error or otherwise, SEBI vide circular CIR/MRD/DP/34/2012 dated December 13, 2012 read with circular CIR/MRD/DP/25/2013 dated September 03, 2013 mandated dynamic price bands at 10% of the previous day's closing price for the following securities:
 - (a) Stocks on which derivatives products are available,
 - (b) Stocks included in indices on which derivatives products are available,
 - (c) Index futures,
 - (d) Stock futures.

The dynamic price bands are to be relaxed by the stock exchanges in increments of 5%, in the event of a market trend in either direction. Stock exchanges were also directed to frame suitable rules with mutual consultation for such relaxation of dynamic price bands. The initial threshold set by the stock exchanges for flexing were "10 trades executed with multiple UCC on both sides of the trade at or above 7% or more of the base price and in further multiples of 5% of the price movement".

4. In May 2014, the stock exchanges revised the criteria for flexing of dynamic price bands as "10 trades executed with multiple UCC on both sides of the trade at or above 9.90% or more of the base price and in further multiples of 5% of the price movement". These measures were taken by the stock exchanges to mitigate disruption caused by erroneous orders and at the same time not interfere in the price discovery process. In exigencies situation, exchanges



consult and relax the dynamic price band with a 15 minutes notice to the market.

5. Further, as a measure to protect against excessive price movements with respect to those scrips on which no derivatives products are available but which are part of index derivatives, subsequent to the recommendation of Secondary Market Advisory Committee (SMAC) of SEBI, SEBI vide circular CIR/MRD/DP/04/2014 dated February 06, 2014 mandated implementation of appropriate individual scrip wise price bands/ circuit filters upto 20% on such scrips. However, in terms of stock selection criteria for frontline indices (Nifty and Sensex), index providers have stipulated inclusion of only those stocks in the said indices which are individually available for trading in derivatives segment.

B. International Practices

6. The World Federation of Exchanges (WFE) has done a study on the implementation of circuit filter types across the world in 2016. It is observed from the aforesaid report that for orderliness in the marketplace on account of wild swings in the prices of certain stocks, various jurisdictions deploy measures ranging from call auctions to temporary trading halts in the security to no change in price bands.
7. Jurisdictions like the US, UK, Spain, Germany, Switzerland etc., have call auctions on breach of the price band.
8. The WFE report is placed as [Annexure I](#).

C. Data Analysis

9. The examination of price movement of scrips, on which derivatives are available, during the last six months, reveals the following (source: NSE):
 - 9.1. Forty scrips have witnessed intra-day movement of more than 20%
 - 9.2. Out of this, twenty nine scrips have witnessed intra-day movement between 20%- 30%.
 - 9.3. Five scrips have witnessed intra-day movement between 30%- 40%
 - 9.4. Six scrips have witnessed intra-day movement of more than 40%
10. Concerns have been raised that investors' wealth is getting wiped out in a single day by recent falls in stocks on which derivative products are available, as no price bands/ circuit filters are applicable on them. In view of recent abnormal intra-day price movements, suggestions are being made to review the rules to prevent such extraordinary price movements.



D. Recent measures to strengthen fair price discovery

11. With a view to strengthen fair price discovery and promote orderliness in the market, following measures have been taken recently:

11.1. Revision in criteria for flexing dynamic price bands:

In consultation with SMAC, the existing criteria for flexing the dynamic price bands has been revised such that in case price of an F&O scrip touches 9.9%, it may be flexed by incremental 5% provided there are minimum 25 trades & 5 UCCs on both sides. It is expected that this measure shall help ensure that the flexing is carried out only on account of genuine market trend and not arising out of few erroneous orders.

11.2. Review of criteria for moving of cash settled stock derivatives to physical settlement:

SEBI vide circular SEBI/HO/MRD/DOPI/CIR/P/2018/161 dated December 31, 2018 had specified phased movement of cash settled stock derivatives to physical settlement (for April 2019 expiry, July 2019 expiry and October 2019 expiry) on the basis of average daily market capitalisation of the stocks.

In addition to this schedule, SEBI vide circular SEBI/HO/MRD/DOP1/CIR/P/2019/28 dated February 08, 2019 has further directed for shifting of stock derivatives to physical settlement from new expiry cycle on the basis of intra-day movement or volatility in such stock. Shifting of such stock to physical settlement is expected to help reduce speculation and hence excessive intra-day movement / volatility in such stock.

E. Available Options

12. With a view to address the concerns arising out of significant price movements in scrips having presence in derivatives segment, followings options are being put forward for consultation:

12.1. Option 1- Price Bands/ Circuit Filters (Hard limits)

Whether individual scrip wise price bands/ circuit filters of 20% either way be adopted for all scrips, including scrips on which derivatives are available, in the compulsory rolling settlement?

The perceived benefits and concerns/ challenges arising out of this proposal are as follows.



Benefits:

- Imposing price bands/ circuit filters on scrips on which derivatives products are available may arrest abnormal movement of the price of the scrip beyond a certain limit.
- It may also afford some opportunity to listed companies and its promoters to assess the movement of the stock price and enable them to make market announcement, if any, to address market sentiments, which may restore the price to its normalcy.

Concerns/ challenges:

- Presently, only those stocks which satisfy the enhanced eligibility criteria (which includes criterion for liquidity) are being permitted in derivatives segment. Imposition of price bands/ circuit filters on such stocks may hamper fair price discovery and liquidity.
- It may lead to mis-alignment between the price of underlying in cash segment and price of the derivative products. While the price movement of the underlying scrip in cash segment would be bound with the price band/ circuit filter, the price movement of the derivative products may go much beyond.

12.2. Option 2- Combination of Dynamic and Fixed price band/ circuit filter or call auction mechanism

The current framework for dynamic price band may be allowed to continue with the initial threshold set by the stock exchanges for flexing. This framework would be available upto a threshold (say 30% intraday movement in either direction).

Upon reaching such threshold, following options may be considered:

- either a fixed price band/ circuit filter on the stock may be imposed.*
- or*
- a call auction shall be conducted for a fixed duration as per criteria to be prescribed relating to minimum trades, volume, etc. The price discovered in such call auction may be considered for continuous market.*

The perceived benefits and concerns/ challenges arising out of this proposal are as follows.

Benefits:

- Imposing fixed price bands/ circuit filters on scrips upon reaching certain threshold may arrest drastic movement of the price of the scrip beyond a certain limit.



- Introducing call auction may ensure wider participation of investors thereby leading to better price discovery as compared to the current system of flexing of dynamic price bands which is based on limited number of trades and UCC.

Concerns/ challenges:

- Imposing fixed price bands/ circuit filters may have same concerns/ challenges as enumerated at Para 12.1 above.
- For a scrip which is also a constituent of an index, computation of the index may become a challenge during the period of the call auction on account of lack of availability of current market price of the scrip during the period.

12.3.Option 3- No change in existing framework

The present framework, including the recent measures to strengthen fair price discovery as enumerated at Para 11 above, may continue if considered as adequate to address the concerns arising out of significant price movements in scrips having presence in derivatives segment. In that case, no further measures may be required at this stage as the same may hamper free market and fair price discovery.

F. Public comments

Comments from public are invited on the proposed options given at Para 12 above in the following format:

Name of entity/ person			
Sl. No.	Reference Para of the discussion paper	Suggestions/ comments	Rationale

In view of the extraordinary price movements witnessed in recent times, there is a need to take a timely view in the matter. Accordingly, it is requested that comments should reach SEBI latest by February 20, 2019 by e-mail to manishkj@sebi.gov.in.