

CHAPTER 3

FUNDAMENTALS OF FUTURES CONTRACTS

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3.1 INTRODUCTION

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FUTURES CONTRACTS ARE AGREEMENTS THAT CREATE THE OBLIGATION TO BUY OR SELL AN ASSET AT AN AGREED-UPON PRICE FOR A SPECIFIC QUANTITY ON A FUTURE DATE SPECIFIED TODAY.



FUTURE DATE



SPECIFIC PRICE



SPECIFIC QUANTITY

☒ STANDARDISED

☒ CUSTOMISED

☒ EXCHANGE TRADED

☒ OVER THE COUNTER

☒ REGULATED BY SEBI

These are typically exchange-traded contracts, regulated by SEBI – Securities and Exchange Board of India. We buy or sell these via the Exchange, i.e., BSE or NSE and SEBI keeps a close watch on proper execution, fair practice and regulations.



FUTURES CONTRACTS ARE STANDARDISED BY BSE OR NSE, WHEREVER YOU BUY OR SELL THEM.

THE REGULATED OVER THE EXCHANGE NATURE OF FUTURES GIVE IT AN UPPER HAND OVER FORWARDS BY REMOVING COUNTER-PARTY RISKS.

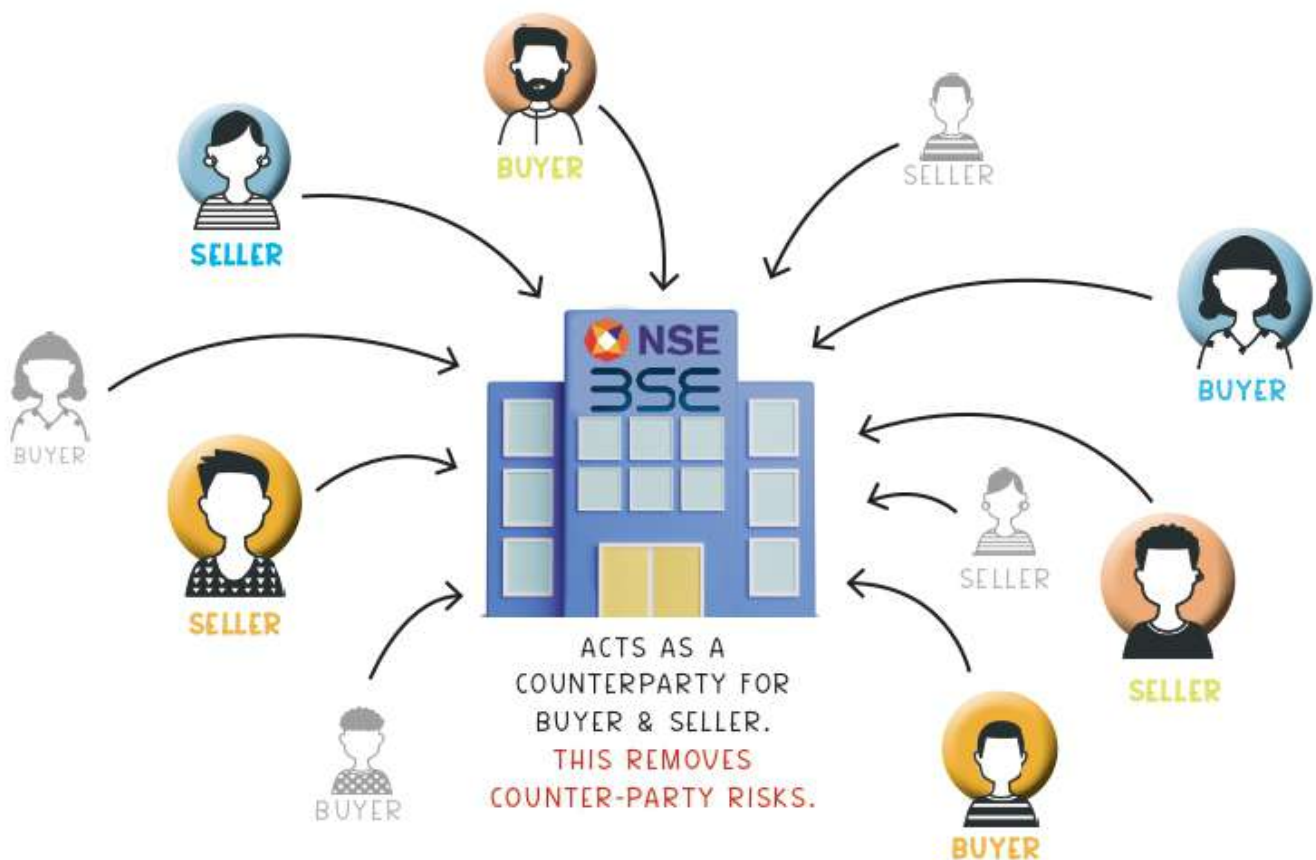


TYPICALLY, FUTURES CONTRACT IN INDIA EXPIRES ON THE LAST THURSDAY OF EVERY MONTH.

ENTERING OR EXITING THE CONTRACT IS QUICK AND EASY AS YOU DO NOT HAVE TO FIND THE COUNTER-PARTY YOURSELVES.



The seller and buyer do not have a contract with each other but with the exchange. They do not even know of each other's existence. The exchange, in a futures contract, acts as a counterparty to every buyer and seller.



So, even if you want to exit the contract at any point, you can do so with the exchange.

For instance, if you entered the contract as a buyer, to square it off you may simply sell the contract and exit from this obligation. You can do this by simply selling them using your trading account with the broker. You do not have to go and find another counterparty.



Future contracts are completely financial in nature. They do not involve any physical assets. They are settled by paying the difference itself. There is no involvement of actual delivery of assets.