

SECURITY AND EXCHANGE BOARD OF INDIA: ECONOMY

NEWS: Sebi announces measures to strengthen risk monitoring in equity derivatives

WHAT'S IN THE NEWS?

SEBI has introduced key reforms in the equity derivatives market, including a new exposure metric (FutEq OI), revised position limits, and stricter intraday surveillance to address expiry-day volatility and rising retail participation.

These reforms aim to improve risk management, transparency, and market integrity in line with evolving trading dynamics.

Context

- The **Securities and Exchange Board of India (SEBI)** has issued a circular introducing major reforms in the equity derivatives market.
- The reforms aim to address **increased volatility on expiry days**, and **rising retail investor participation**, and to ensure more **effective risk management and surveillance**.

1. About SEBI (Securities and Exchange Board of India)

- **Legal Status:** Statutory body established under the **SEBI Act, 1992**.
- **Primary Functions:**
 - Regulates the **securities market** in India.
 - Protects the **interests of investors**.
 - Promotes orderly **market development** and fair practices.

2. Understanding Derivatives

- **Definition:**
 - Derivatives are financial contracts whose value is **derived from an underlying asset**, such as stocks, indices, commodities, or currencies.
- **Purpose:**
 - Used for **hedging, speculation, and arbitrage**.
- **Types:**
 - Mainly **Futures** and **Options** in the equity segment.

3. Key Reforms Introduced by SEBI in 2024

A. Risk Measurement – Future Equivalent Open Interest (FutEq OI)

- A new metric **FutEq OI** is introduced to measure **actual exposure** in the options market.

- **Delta** (sensitivity of option value to the underlying asset price) is used to convert option positions into **futures-equivalent exposure**.
- This helps in **more accurate risk estimation and margin calculation**.

B. Market Wide Position Limit (MWPL) – New Formula

- The method of calculating MWPL has been revised.
- Now based on:
 - **Free-float market capitalization** of the stock.
 - **Average daily delivery value** of the stock.
- Objective:
 - Reduce frequent **F&O bans**, especially in illiquid or speculative stocks.

C. Changes to F&O Ban Rules

- Traders are now required to **reduce their positions daily** during an F&O ban period.
- No **new positions** are allowed once a ban is in effect.
- Purpose:
 - Prevent **manipulation and excessive speculation** in stocks with low liquidity.

D. Index Options Exposure Limits

- SEBI has set exposure caps for trading in index options:
 - **Net exposure**: ₹1,500 crore.
 - **Gross exposure (long + short)**: ₹10,000 crore.
- Conditions:
 - Exposure must be **backed by collateral** in the form of **cash or approved securities**.
- Rationale:
 - To **mitigate systemic risk** from large unhedged option positions.

E. Intraday Surveillance Enhancements

- Exchanges must now conduct **multiple intraday monitoring sessions**, not just once at end-of-day.
- Allows identification of **abnormal position build-ups or speculative activity** early in the trading session.

- Helps in **real-time risk detection and mitigation**.

F. Pre-Open Session in Derivatives Segment

- A **pre-open session** is being introduced in derivatives trading, similar to the cash equity market.
- Objective:
 - Improve **price discovery** and **market stability** at the time of opening.
 - Reduce **sharp volatility spikes** at market open.

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