



13 March 2025

To: SEBI

Dear Sirs/Madams

### **SEBI - Consultation Paper on Enhancing Trading Convenience and Strengthening Risk Monitoring in Equity Derivatives**

FIA<sup>1</sup> appreciates the opportunity to provide comments to SEBI's "Consultation Paper on Enhancing Trading Convenience and Strengthening Risk Monitoring in Equity Derivatives".

FIA is dedicated to fostering open, transparent, and competitive markets globally. We strongly support SEBI's commitment to enhancing market stability, strengthening risk management, and improving trading convenience. These are essential steps toward maintaining a resilient and efficient financial ecosystem.

We endorse the overall intent of the proposals and believe that certain refinements could further enhance their effectiveness. To that end, we respectfully offer several recommendations for SEBI's consideration, aimed at ensuring that the measures achieve their regulatory objectives while maintaining market stability and efficiency.

#### **OBSERVATIONS ON KEY PROPOSALS**

We would like to highlight two key proposals that warrant further evaluation to ensure they do not inadvertently disrupt market stability:

- **Section 3.1 – Formulation of OI**
- **Section 3.6 – Position Limits for Index Futures and Index Options**

As currently structured, these measures could dampen market liquidity, increase trading costs, and introduce operational complexities. They may lead to wider bid-ask spreads, heightened market volatility, and reduced participation from institutional investors, ultimately impacting market depth and efficiency. Additionally, while intended to enhance risk management, these restrictions could create inefficiencies that could inadvertently increase the likelihood of price manipulation.

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<sup>1</sup> FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers. FIA's mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA's clearing firm members play a critical role in the reduction of systemic risk in global financial markets. Further information is available at [www.fia.org](http://www.fia.org).



## SECTION 3.1 – FORMULATION OF OI

We recognize that delta-based limits provide a dynamic framework that adapts to market conditions. However, they remain uncommon in global derivatives markets due to the significant complexities they introduce.

Implementing delta-adjusted thresholds require multiple layers of calculation, monitoring and dissemination across the trading ecosystem, adding operational burdens and increasing the risk of errors. Additionally, the fluctuating nature of delta further introduces instability as limits constantly shift with market movements. This added technical complexity makes delta calculations more prone to errors, which could inadvertently disrupt market function rather than enhance risk management.

## SECTION 3.6 – POSITION LIMITS FOR INDEX FUTURES AND INDEX OPTIONS

### Section 3.6.4.1 – Revised Index Options Limits - Gross FutEq Limit (End-of-Day and Intraday)

#### 1. Effectiveness of a Gross Delta Limit

While the Gross Delta limit aims to enhance risk management, it may not fully achieve its intended objective. An entity could still take large positions in short-term out-of-the-money (OTM) options with low Net and Gross Delta but high Gamma, causing rapid fluctuations in FutEq Delta as the market moves. This could introduce risks that a Gross Delta limit alone may not effectively address.

Additionally, imposing a Gross Delta limit could create unforeseen challenges for commonly used strategies. For example, long straddles or strangles—where participants are long gamma and long vega with full premium paid upfront—would consume gross delta limits despite presenting no additional risk beyond the premium paid. Similarly, dispersion strategies, such as trading Bankex against its index components, carry significantly lower risk than gross delta calculations would indicate. Restrictive limits on these strategies could reduce liquidity, heighten volatility and lead to greater market dislocations, particularly in news-driven risk-off scenarios.

We understand that the intent behind introducing a Gross Delta limit is to simplify risk management by avoiding the complexities of limiting higher-order Greeks. However, market participants are already well-equipped to manage these exposures, operating under strict controls on higher-order Greeks such as Gamma, Vega, Vanna, and Volga to keep their net delta exposure stable even amid market fluctuations.

A more effective approach would be to allow participants to continue managing these exposures within a structured Net FutEq Limit and the CCP margin framework. Global markets such as Hong Kong and the U.S. (CME) follow a similar model, allowing participants to operate under higher position limits while maintaining responsibility for risk management within well-established controls. Adopting this globally recognized framework would help sustain market liquidity and efficiency while ensuring robust risk oversight.

## 2. Market Imbalance and Liquidity Challenges

### a. Constraints on Market Makers

The proposal would place significant constraints on market makers, limiting their ability to provide liquidity efficiently.

Analysis based on NSE Daily Trading Reports provides an indication of the Gross FutEq exposure required for liquidity providers to support retail and institutional interest in Nifty throughout January:

**Table A - Gross FutEq Exposure to Support Nifty Liquidity**

Expiry Date	Gross Limits			Net Limits		
	Peak Gross Cash Delta (Cr)	Number of LP at caps (intraday)	Number of LP at caps (EOD)	Peak Net CashDelta (cr)	Number of LP at caps (intraday)	Number of LP at caps (EOD)
9/01/2025	1,32,441	53	132	52,611	21	53
16/01/2025	1,56,673	63	157	1,15,298	46	115
23/01/2025	1,71,808	69	172	39,677	16	40
30/01/2025	65,338	26	65	9,980	4	10

Under a conservative assumption that all liquidity providers operate at full risk capacity to the proposed cap, up to 69 liquidity providers would be needed to meet peak intraday end-user demand, and up to 172 liquidity providers to accommodate peak end-of-day demand. Given the structure of the Indian market, it is unlikely that such a large number of liquidity providers exist, nor would they all have identical risk appetites.

This issue is further compounded by the fact that gross delta limits would be highly restrictive for volatility traders, who serve as crucial market makers by contributing significantly to liquidity. As they often hold large gross positions due to offsetting exposures across various strikes and expiries, imposing such limits would effectively force them out of the market. Given the critical role volatility traders play in maintaining a smooth and efficient implied volatility surface—preventing excessive distortions in option pricing caused by supply-demand imbalances at specific strikes—their removal would lead to a sharp reduction in liquidity and have far-reaching consequences for overall market equilibrium.

### b. Persistent Retail Demand

While the proposed delta limits place significant restrictions on index options market makers, they do not directly limit liquidity demand from small investors (as noted in the consultation).

To illustrate, at end-of-day on 25 February 2025, open interest and delta in near-the-money NIFTY index options expiring on 27 February 2025 were as follows:

**Table B - Open Interest and Delta in Near-the-Money NIFTY Options (25 Feb 2025)**

Strike	Call OI (contracts)	Delta	Call FutEq Delta (₹ Crore)
22450	4768	0.76	611
22500	56783	0.67	6432
22550	37889	0.55	3533
22600	125230	0.40	8467
22650	71956	0.25	3089
22700	196260	0.16	5245
Strike	Put OI (contracts)	Delta	Put FutEq Delta (₹ Crore)
22450	27781	-0.24	-1137
22500	137339	-0.33	-7665
22550	54205	-0.45	-4110
22600	145033	-0.60	-14716
22650	50598	-0.75	-6383
22700	34993	-0.84	-4981

The total gross FutEq Delta of just these near-the-money options stood at ₹61,388 crore, which is over 40 times the proposed limit of ₹1,500 crore. While open interest is not a perfect measure of aggregate market demand since it does not fully capture the ultimate position held by market makers, this data strongly suggests that market demand would far exceed the capacity of liquidity providers under the proposed limits.

This persistent demand, coupled with severely constrained liquidity supply, would create a fundamental imbalance in the market. Such an environment poses serious risks to market function and stability, as a shortage of liquidity could weaken price discovery and increase trading costs. Retail investors, who rely on tight spreads and efficient execution, would be particularly affected.

### 3. Increased Volatility

Markets typically experience higher volatility when liquidity is constrained, particularly when liquidity providers are restricted in the volume they can supply. To assess this effect, the price impact of trades in Nifty during the first 15 minutes of trading was analysed —when market activity is generally highest— compared to the rest of the trading day<sup>2</sup>.

#### <sup>2</sup> Methodology for Measuring Trade Price Impact in the First 15 Minutes of Trading vs. the Rest of the Trading Day

To assess the price impact of trades during the first 15 minutes of trading compared to the rest of the day, all trades exceeding 50% of the maximum order size, where the maximum order size for NIFTY is 1,800, were analysed. Price impact is measured by calculating how many fee-corrected spread widths the trade moves the price within a 5-second window. To determine the fee-corrected spread width, it is assumed that pricing is based on the mid-spot price. The spread between the mid-spot and the trade side is then calculated, and associated fees are subtracted to obtain the fee-corrected spread. The 5-second price movement is then divided by this fee-corrected spread to quantify the price impact. This analysis is based on data collected throughout February and March. Additionally, when examining single-stock option data, a clear pattern emerges. Less actively traded stocks tend to have wider spreads, and larger trades exert a significantly greater price impact compared to more liquid stocks.



**Table C - Price Impact Analysis: First 15 Minutes vs. Rest of Trading Day**

Trading Period	First 15 Minutes Price Impact	Rest Of Day Price Impact
Expiry Day	0.71	1.32
Day Before Expiry	0.64	1.23

The analysis shows that market activity during the first 15 minutes is approximately 50% higher than the average activity in other 15-minute periods throughout the day. Furthermore, price impact nearly doubles later in the session when trading volumes decline. This trend remains consistent on both expiry day and the day before expiry—two of the most active trading days.

As trading volumes decline due to the reduced capacity of liquidity providers to participate, spreads are likely to widen and price volatility may increase, ultimately affecting end investors. Retail traders could face greater losses when crossing spreads, while market integrity may weaken as misalignments between instruments—such as options within a series or futures versus the underlying asset—become more frequent. Lower volumes and fewer large investors with the ability to stabilize the market through effective risk management may also heighten the risk of price manipulation, further exacerbating market instability.

#### 4. Overnight Market Movements

The impact of the Gross FutEq limit in the context of market news events and overnight price fluctuations warrants careful consideration. A market participant may remain well within limits at market close, yet overnight price shifts can significantly alter option deltas, unintentionally pushing them beyond the prescribed threshold.

For instance, a participant holding two call spread positions (a butterfly) would see changes in limit usage when comparing end-of-day to start-of-day after a 2% price increase—a moderate move given the intraday swings observed in 2024. This comparison helps evaluate the impact of such fluctuations.

**Table D - Impact of Market Fluctuations on Limit Usage**

Index = 23,000

Index 2% Up = 23,460

Product	Delta	Position	EOD Gross Delta	2% Up Move Delta	SOD Gross Delta
22,750 C	80	-1	80	95	95
23,000 C	50	2	100	75	150
23,250 C	20	-1	20	60	60
<b>Total</b>			<b>200</b>		<b>305</b>

Table D shows that limit usage rises by ~50%, despite the participant neither trading nor taking on additional risk. Since call spreads and butterflies have a fixed downside loss potential, such a price



move does not materially change their risk. Conversely, put spreads experience a sharp increase in limit usage when prices decline.

Liquidity is most critical during large market moves, making these restrictions particularly problematic as they increase the likelihood that participants will be forced to reduce positions precisely when the market needs liquidity the most. With intraday limits set so low relative to market demand, the risk of price volatility rises, especially near market close or expiry, when participants must further reduce already constrained positions to comply with EOD limits. These conditions can create self-reinforcing volatility spikes rather than stabilizing the market and may also increase the risk of market manipulation.

While we recognize SEBI's intent to monitor delta-neutral risks, this limit applies equally to lower-risk strategies, such as spreads and butterflies as it does to riskier positions. More effective methods such as SPAN and ELM, which already provide a robust risk framework and have been recently strengthened on expiry days—could better address delta-neutral exposures without restricting efficient market functioning.

### **Section 3.6.4.1 – Revised Index Options Limits – Net FutEq Limit (End-of-Day and Intraday)**

#### **1. Market Instability**

The imposition of the proposed FutEq net limit could cause large price movements when there is aggregate demand from small investors to buy volatility.

When retail investors are net buyers of options, market makers will be short volatility and short gamma. To remain delta-hedged on moves in the underlying index, market makers must buy delta during upward price movements and sell delta during downward price movements. This is because a short gamma position leads to a short delta position when prices rise and a long delta position when prices fall.

Under normal circumstances, market makers have the flexibility to manage the pace of hedging deltas they have acquired through gamma. This allows them to gradually adjust their positions and avoid trading a large amount of delta in a short period of time, which could disrupt the market. However, a strict net limit would eliminate this discretion, forcing market makers to instantly sell delta during sharp negative price movements to stay within the limit. This forced selling could amplify market declines, heighten volatility and introduce systemic instability into the derivatives market, with ripple effects extending to the underlying equity markets.

#### **2. Impact on Liquidity**

These proposed limits place a disproportionate burden on liquidity providers and institutional participants, while also negatively impacting retail traders by reducing overall market liquidity. Although the number of liquidity providers required to meet this limit is generally lower than for the Gross Delta, there are still critical periods—such as the 16 January expiry—where significantly higher limits would be necessary to accommodate end-user demand (see [Table A](#) above for further details).



### 3. **Delta Computation and Operational Complexity**

While this limit offers a more structured approach compared to the Gross Delta and current sentiment limits, its implementation would benefit from further consultation. For instance, the proposal does not specify how SEBI or the exchanges plan to calculate delta across all options and market participants, leaving key operational details to be determined.

As noted above, Delta calculation is inherently complex, and reasonable differences in methodology may arise—particularly regarding key inputs such as the appropriate fair base volatility. Greater clarity on these calculations is essential to ensure consistency and transparency across the market.

## **RECOMMENDATIONS**

In light of the above observations, we propose the following recommendations.

### 1. **Extend the Consultation Process**

Extending the consultation period will allow for in-depth industry discussions and comprehensive market feedback, ensuring that all potential impacts of the proposals are carefully evaluated and effectively addressed.

### 2. **Maintain the Current EOD Gross Notional OI Limit**

We recommend retaining the existing end-of-day (EOD) Gross Notional Open Interest (OI) Limit, which is well understood by the industry, without introducing a delta adjustment.

The current delta-neutral risk management frameworks, including the widely adopted SPAN margining system used by NSE and BSE, already ensure that participants adequately cover their positions. Additionally, safeguards such as the Extreme Loss Margin further enhance risk mitigation. These measures have proven effective in maintaining market stability, even as India's derivatives market has grown into one of the largest in the world.

### 3. **Establish a ₹7,500 Crore EOD Net FutEq limit**

While delta-adjusted limits offer advantages over OI and absolute notional limits by being more dynamic and reflective of actual exposure, they also significantly increase operational complexity for participants, particularly for intraday limits. This challenge is further exacerbated by the extremely tight constraints currently imposed relative to the overall size of the derivatives market.

If SEBI decides to move forward with introducing a delta-adjusted limit, our primary recommendation is to set it in line with the current scale of India's derivatives market, at a level such as ₹7,500 crore. This will support market-making activities, enhance market stability, effectively manage concentration risk, and promote liquidity.

Alternatively, SEBI could consider unifying the net delta limit for index futures and options and setting it at a level such as ₹7,500 crore, rather than maintaining separate limits for each segment. This approach better reflects actual trading practices, as most volatility trading participants operate on a delta-hedged basis, using index futures to offset the net delta of their option



positions. Their true exposure lies in the aggregate net delta across both futures and options, rather than each segment individually. Notably, major global markets such as Hong Kong and the U.S. (CME) already combine futures and options when calculating position limits for index derivatives, reinforcing the case for a more streamlined approach.

Additionally, intraday monitoring should be reconsidered until exchanges can effectively manage the operational complexities of real-time delta calculations.

These recommendations align with position limit frameworks in major global markets, where gross limits are almost never used and net limits, where applied, are set at levels that appropriately reflect local market dynamics. The table below outlines position limit frameworks in key international markets, demonstrating the consistency of our proposals with established global practices.

**Table E: Position Limit Frameworks Across Global Markets<sup>3</sup>**

No.	Markets	Exchange	Option / Futures	Benchmark Index	Gross Limit	Net Exposure Limit
i.	US	NYSE	Futures/Options	Nasdaq100	None	None
ii.	US	CME	Futures/Options	S&P500 / Nasdaq100	None	\$85-100 B (Net Notional)
iii.	US	Nasdaq	Options	S&P500 / Nasdaq100	None	None
	US	Nasdaq	Futures	S&P500 / Nasdaq100	None	None
iv.	HK	HKEX	Futures/ Options	HSI / HSCEI / HSTECH	None	\$700M - \$1.5B (Net Delta)
v.	Korea	KRX	Futures/Options	KOSPI200	None	\$1.2B (Net Delta)
vi.	Taiwan	TAIFEX	Futures	TAIEX	None	\$3B (Notional)
	Taiwan	TAIFEX	Options	TAIEX	\$11.6B (Gross Notional)	None

<sup>3</sup> Sources:

- i. NYSE
  - Rule 904C - <https://nyseamericanguide.srorules.com/rules/09013e2c853aa77e>
  - Rule 905C - <https://nyseamericanguide.srorules.com/rules/09013e2c853aa77f>
- ii. CME - Position Limits  
<https://view.officeapps.live.com/op/view.aspx?src=https%3A%2F%2Fwww.cmegroup.com%2Frulebook%2Ffiles%2Fposition-limits-cme.xlsx&wdOrigin=BROWSELINK>
- iii. Nasdaq – Section 6. Position Limits  
[https://listingcenter.nasdaq.com/rulebook/phlx/rules/Phlx%20Options%204A#:~:text=current%20index%20value.-,Aadopted%20Feb.,2020%20\(20-03\).&text=\(a\)%20The%20position%20limit%20for,\(e\)%20below](https://listingcenter.nasdaq.com/rulebook/phlx/rules/Phlx%20Options%204A#:~:text=current%20index%20value.-,Aadopted%20Feb.,2020%20(20-03).&text=(a)%20The%20position%20limit%20for,(e)%20below)
- iv. HKEX – Large Open Positions and Position Limits  
[https://www.hkex.com.hk/Services/Trading/Derivatives/Overview/Trading-Mechanism/Large-Open-Positions-and-Position-Limits?sc\\_lang=en#largeopenpositions](https://www.hkex.com.hk/Services/Trading/Derivatives/Overview/Trading-Mechanism/Large-Open-Positions-and-Position-Limits?sc_lang=en#largeopenpositions)
- v. KRX – KOSPI 200 - <https://global.krx.co.kr/contents/GLB/02/0201/0201040201/GLB0201040201.jsp>
- vi. TAIFEX - Position Limit for Individual Trader - <https://www.taifex.com.tw/enl/eng4/traderPLNonEquity>



## OTHER COMMENTS

Additionally, we would like to present some specific comments on the proposals for SEBI's consideration. Capitalized terms used in this letter will carry the same meanings as defined in the consultation paper, unless otherwise specified.

Ref#	Proposal	Level of Agreement	Comment	Rationale
3.1.2	<p><u>Formulation of OI</u> Move from notional terms to a "Future Equivalent" (Delta-based) approach for computing OI.</p> <p>This aims to reduce instances of stocks entering the ban period without significant risk buildup and mitigate circumvention of position limits.</p>	Strongly Disagree	Please see our comments above	Please see our comments above
3.3.2.2	<p><u>Broker System Check</u> A mechanism would be built into brokers' trading software to ensure compliance with these rules, i.e., to confirm that any new trade during the ban period decreases the participant's net Delta exposure in that scrip.</p>	Disagree	The mechanism should be built into the clients' futures clearing member / Professional Clearing Member systems.	Custodian-settled CP Code clients can trade through multiple stockbrokers, meaning an executing broker will not have full visibility into the client's net FutEq OI positions.
4.1.2	<u>Pre Open and Post Closing Sessions for</u>	Partially Agree	This measure will help align the cash	Extending trading hours for derivatives is expected to

Ref#	Proposal	Level of Agreement	Comment	Rationale
	<p><u>the Derivatives Market Eligibility Criteria for Derivatives on Non Benchmark Indices</u></p> <p>Introduce pre-open and post-closing sessions for derivatives to improve price discovery and reduce volatility</p>		<p>and derivatives markets.</p> <p>To ensure a seamless transition, a minimum one-year preparation period should be provided, allowing market participants sufficient time to develop and adapt their systems.</p>	<p>enhance liquidity in actively traded contracts, improve price discovery, and ultimately lead to better pricing for market participants.</p> <p>However, introducing a pre-open session for derivatives may not be necessary, as their prices are derived from the underlying cash equity market, which already has a pre-open session to establish prices based on demand and supply.</p> <p>A post-closing session, on the other hand, could be beneficial as it would allow clients to trade at the last 30-minute VWAP, providing additional flexibility.</p> <p>We suggest implementing a block cross window either post-close or before the next day's pre-open, allowing participants to efficiently execute large trades. Additionally, we recommend keeping the expiry print methodology unchanged. On expiry days, post-close trading should be limited to the next month's expiry, while the expiry print remains based on the last 30-minute VWAP.</p> <p>To ensure a smooth transition, the extension should include at least the near and far month expiries, allowing for a seamless price transition between trading sessions. Additionally, adjustments to</p>

Ref#	Proposal	Level of Agreement	Comment	Rationale
				<p>give-up timings and end-of-day obligations, including institutional reporting requirements, must be carefully factored into the revised timelines.</p> <p>As derivatives have not had a pre-market open since their inception, this a significant structural change that will require adjustments to participant trading systems, including algorithm calibration and risk checks. To ensure a smooth transition, a phased implementation approach should be adopted.</p> <p>Major changes of this nature are typically introduced with at least 12 months' notice, allowing ample time for thorough testing and adaptation.</p> <p>We also recommend a post-implementation review to assess the impact on liquidity and market dynamics. Any necessary refinements should be made in consultation with market participants to optimize the framework for efficiency and effectiveness.</p>
4.2.2	<p><u>Eligibility Criteria for Derivatives on Non-Benchmark Indices</u></p> <p>Set criteria for introducing</p>	Disagree	This measure is likely to reduce cash and derivatives turnover for certain constituents of existing underlying	The primary criterion for determining whether a derivative should be introduced on an index is the trading volume of that index and its usefulness to market participants, particularly for

Ref#	Proposal	Level of Agreement	Comment	Rationale
	<p>derivatives on non-benchmark indices, including a minimum number of constituents and weight limits for top constituents</p>		<p>index derivatives, potentially diminishing overall market liquidity.</p>	<p>hedging purposes. The proposed measures could limit participants' ability to hedge exposures to non-benchmark indices, increasing risk within the market.</p> <p>One of the proposed criteria requires that "all other constituents' individual weights must be lower than those of the higher-weighted constituents (i.e., descending weight structure)." This restriction appears arbitrary, as it would exclude equally-weighted indices, which serve a distinct and valuable function for investors.</p> <p>For example, Bank Nifty derivatives would fail to qualify under the new norms. Bank Nifty is a high-volume index with heavier weightings for certain stocks. If strict weight limits were imposed, the index's value and trading volumes could decline. Bank Nifty plays a crucial role in risk management, as banks are a major component of the Nifty index. Furthermore, Bank Nifty hedges are widely used by market makers to provide liquidity to the ETF market, which is a key entry point for retail investors. Restricting its use could have broader implications for liquidity and market efficiency.</p>

Ref#	Proposal	Level of Agreement	Comment	Rationale
				As such, existing indices or strategies based on them should be exempt from these changes, as applying the proposed weight limits retroactively could disrupt established markets where these limits were not previously a factor.
3.6	<u>Position Limits for Index Derivatives</u>  Set end-of-day and intraday limits for net and gross Delta positions in index derivatives	Strongly Disagree	Please see our comments above.	Please see our comments above.

We welcome the opportunity to work with SEBI to address these comments. Please feel free to contact me at [bherder@fia.org](mailto:bherder@fia.org) or TzeMin Yeo, Head of Legal & Policy, Asia Pacific at [tmyeo@fia.org](mailto:tmyeo@fia.org) should you wish to further discuss.

Yours



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