CIRCULAR

CIR/MRD/DP/ 26 /2012 September 26, 2012

To

All Stock Exchanges

Dear Sir / Madam,

Sub: Review of Margining with respect to Exchange Traded Funds (ETFs)

1. This is further to the Risk Management framework for Cash Market specified by SEBI vide circular no. MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 and modification thereto. The following additional provisions are hereby incorporated in the said framework:

A. Use of VaR Methodology with respect to Exchange Traded Funds

I. Index ETFs are based on a basket of securities. However, for computing margins on ETFs they are treated at par with stocks and margins that are applicable on stocks are being applied for ETFs.

II. In order to bring efficiency in margining of index ETFs, it has been decided that VaR margin computation for ETFs that track an index shall be computed as higher of 5% or three times sigma of the ETF.

III. The revised margin framework is applicable to ETFs that tracks broad based market indices and does not include ETFs which track sectoral indices.

B. Introduction of Cross-Margining facility in respect of offsetting positions in ETFs based on equity indices and constituent stocks.

I. SEBI vide its circular SEBI/DNPD/Cir-44/2008 dated December 02, 2008 allowed cross margining across cash segment and exchange traded derivatives segments.

II. In order to facilitate efficient use of margin capital by market participants, it has been decided to extend cross margining facility to ETFs based on equity index and its constituent stocks for following off-setting positions in cash market segment, as follows:

- ETFs and constituent stocks (in the proportion specified for the ETF) to the extent they offset each other,
- ETFs and constituent stocks futures (in the proportion specified for the ETF) to the extent they offset each other and

- ETFs and relevant Index Futures to the extent they offset each other.

III. In the event of a suspension on creation / redemption of the ETF units, the cross-margining benefit shall be withdrawn.

2. Stock Exchanges are advised to:
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   a. take necessary steps and put in place necessary systems for implementation of the above.
   b. make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision.
   c. bring the provisions of this circular to the notice of the member brokers of the stock exchange and also to disseminate the same on the website.

3. This circular is being issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Yours faithfully,

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