

SAROJ SECURITIES

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Policy for Physical Settlement of Stock Derivatives

F&O positions held till expiry used to be settled in cash on the basis of price of the underlying stock. However, since October 2019 the settlement takes place by giving or taking delivery of the actual shares. You can check the framework followed for physical settlement in this [SEBI circular](#).

Since most people trading F&O usually have just a small portion of the overall contract value blocked as margins (Futures and Short Options) or premium (Long calls & puts), the actual obligation of taking or giving delivery can be exponentially higher. This increases the risk for brokerage firms significantly and results in higher margin requirements.

The margins applicable depend on the delivery value of your contract. You can compute the deliverable quantity as under:

Futures

- Long futures shall result in a buy (security receivable) position
- Short futures shall result in a sell (security deliverable) position

In-the-money call options

- Long call exercised shall result in a buy (security receivable) position
- Short call assigned shall result in a sell (security deliverable) position

In-the-money put options

- Long put exercised shall result in a sell (security deliverable) position
- Short put assigned shall result in a buy (security receivable) position

Quantity to be delivered/received = Market lot * Number of contracts that result in delivery settlement

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Below is our new policy on physically settled derivative contracts which is part of our broader RMS (Risk Management) policy.

Futures and Short Option (Calls & Puts) positions

- The margin requirement for all stock Futures and options contracts will be increased 2 days prior to expiry (Wednesday and Thursday of the expiry week) to twice of the exchange mandated SPAN + Exposure margin required.
- These margins will be debited on your trading ledger. The increase in exposure margin is to cover for the additional obligation that will arise if these contracts are held until expiry and result in physical settlement.
- For example, if the margin required for Allahabad Bank futures is normally 25% as SPAN+Exposure of the contract value, it will be 50% of the contract value on Wednesday and Thursday of the expiry week.

Long/Buy option (Calls & Puts) positions

- The Exchange charges physical delivery margins as a percentage of applicable margins (VaR + ELM + Adhoc) of the underlying stock which is levied from expiry minus 4 days for long ITM options in the following manner:

Day (BOD-Beginning of the day)	Margins applicable
E-4 Day (Friday BOD)	10% of VaR + ELM + Adhoc margins
E-3 Day (Monday BOD)	25% of VaR + ELM + Adhoc margins
E-2 Day (Tuesday BOD)	45% of VaR + ELM + Adhoc margins
E-1 Day (Wednesday BOD)	70% VaR + ELM + Adhoc margins

- However, at Saroj Securities, on Wednesday and Thursday of the expiry week, we charge 50% of the contract value (This will cover the exchange stipulated margins explained above as well)

Exchanges have defined Close to money (CTM) contracts which are a subset of 'in the money (ITM)' or contracts that expire with some intrinsic value.

For Call Options – 3 ITM options strikes immediately below the final settlement price shall be considered as 'CTM'. For example, if Wipro contract settles at 243 on expiry day, call options with strike 230, 235, and 240 will be marked as CTM contracts

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- For Put Options – 3 ITM options strikes immediately above the final settlement price shall be considered as 'CTM'. For example, if Wipro contract settles at 243 on expiry day, put options with strike 245, 250, and 255 will be marked as CTM contracts

For long ITM Put options, you will be allowed to carry your position until expiry if you maintain sufficient margins as explained above. An exercised Put option would result in you having to deliver shares to the Exchange. As such,

If you hold the shares in your demat account, such shares will be debited towards meeting the Exchange settlement obligation.

If you don't hold the shares in your demat account, you wouldn't be able to deliver the shares towards the physical delivery obligation, resulting in short delivery. Appropriate auction penalties from the Exchange shall be charged on your account for such short deliveries.

OTM (Out of the money) options are those strikes that are above the final settlement price for calls and below the final settlement price for puts. There won't be any delivery obligation if your call option expires out of the money(OTM).

Policy regarding Close to Money contracts (CTM)

Exchanges have provided an option to not exercise long CTM contracts. We will be using this option on expiry day in case the cash balance and the intrinsic value of the option contract is less than twice the SPAN+Exposure margin (Exchange mandated) required to take a position in the futures contract of the same stock for the current expiry.

For example: If you are long 1 lot of WIPRO Oct 19 240 CE and let it expire and WIPRO(Stock) settles at Rs. 243, this contract will be a CTM contract. The intrinsic value of this contract will be $3 [243-240] \times 3200(\text{lot size}) = \text{Rs } 9600$.

Post-market closing we will check if the client's free balance (Cash balance + Rs 9,600) > Rs 2,76,518 (Twice the SPAN +Exposure margin for WIPRO Oct future contract). If client balance is lesser than Rs 2,76,518, this position will be marked as "Do not exercise" and the option contract will expire worthless. If the balance

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is more than the SPAN+Exposure, we will let the option be exercised, resulting in physical delivery. All costs arising out of such delivery obligations will be applied to the client's account.

In the money contracts (ITM)

All ITM contracts which aren't CTM will be mandatorily exercised by the exchange. This means that anyone holding an ITM option contract will receive/give delivery of stocks depending on whether one is holding call/put options. All the costs arising out of this delivery obligation will be applied to the client's account.

Out of the money contracts (OTM)

All OTM options will expire worthless. There will be no delivery obligations arising out of this.

Spread and covered contracts

Spread contracts that result in both – take and give delivery obligation will be netted off for the client. For example, you have a bull call spread of Reliance of the same expiry, a lot of long call options of strike 1300 and a lot of short call options of strike 1320 and the spot expires at 1330, this will result in a net-off and there won't be any delivery obligation.

Margins will be charged separately on all legs of spread contracts(credit and debit spreads, iron condors, etc) and for covered call positions given the risk on the broker(Saroj Securities) that you can exit one of the legs of the spread before expiry leading to a physical delivery obligation. You will still continue to receive SPAN margin benefit for the contracts(if any).

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Random Assignment of short CTM Position

In case you've written an option that expires 'in the money' and have left such position to expire, the assignment of such CTM option is done randomly by the Exchange. In the event that your option contract does not get assigned, you are entitled to retain the premium. However, if an option gets assigned to you, you will have to give/receive delivery of stocks depending on whether you have written a call/put option.

Buy/Sell price of the physically settled stocks

The expiry day will be the buy/sell date of the shares that have undergone physical delivery. The buy/sell price for the various cases is as below-

- Long/short Futures- The settlement price on the expiry date will be the buy/sell (average) price of the stocks.
- Call/Put options – ITM options get exercised but expire at 0 value. The strike price of the contract will be the buy/sell (average) price of the stocks.

Additional Notes

- All give delivery positions will require you to have the shares equal to the lot size in your demat account during the expiry week.
- Stocks received by means of physical settlement can only be sold after receiving delivery of stock in the demat account (2 working days after expiry). In case of a short delivery, the credit of shares will take up to 4 working days after expiry.
- Additional margins are also leviable on Short OTM option contracts since the margin charged is on the basis of SPAN+Exposure which increases closer to expiry.
- If you have 2 open positions on expiry that result in a net-off(Long futures and short call options, short put, and short future, etc) you are not required to give or take delivery for the position. However, there will be STT charged on the long position(s) as this is treated as notional delivery.
- Fresh long option positions will not be allowed on Wednesday and Thursday of the expiry week. Fresh positions will be allowed for futures and options writing contracts throughout the month. The allowed product types are NRML and MIS.

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- You need to have a demat account linked to your trading to trade in compulsory delivery contracts. This is to ensure that the stocks are credited in your demat account in the event of physical delivery.
- The increased margin requirement mentioned above is applicable on Wednesday(Expiry -1 day) and Thursday(Expiry day). If the contract expiry is changed to a different day, the same will be applicable from one day before the expiry day.
- In the event that you do not fulfill these margin obligations on time, your positions are liable to be squared off. Any loss arising out of such square off would be the sole responsibility of the client. For any reason which our RMS team is not able to square-off a margin shortfall position(s) and leads to compulsory physical delivery, the costs and risks of physical delivery will be applicable to the client.
- Contracts settled through physical settlement are illiquid closer to expiry. Any losses arising out of liquidation of position(s) with margin shortfall by our RMS team have to be borne by the client. It is advisable for a client to square-off such positions on their own or add funds to carry the position(s) to expiry.
- This policy may be changed at the discretion of the RMS team.