



# BANGLADESH SECURITIES AND EXCHANGE COMMISSION

JIBON BIMA TOWER (14, 15, 16 & 20 FLOOR), 10 DILKUSHA C/A, DHAKA-1000, BANGLADESH

## DIRECTIVE

20 June 2016

No. BSEC/CMRRCD/2009-193/187: The Bangladesh Securities and Exchange Commission (BSEC), in exercise of the power conferred by section 20A of the Securities and Exchange Ordinance, 1969 (Ordinance No. XVII of 1969) hereby directs every person concerned to comply with the following Guidelines in respect of issue and operations of financial derivatives:

### 1. Derivative

Derivative includes—

- (a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;
- (b) a contract which derives its value from the prices, or index of prices, of underlying securities.

### 2. Types of derivative products

Derivative contracts may be of different types. The most common variants are forwards, futures, options and swaps which are briefly described below:

- (a) **Forwards:** Forward contract is customized contract between two entities, where settlement takes place on a specific date in the future at today's price;
- (b) **Futures:** A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that these are standardized exchange-traded contracts;
- (c) **Options:** Options are of two types – calls and puts. Calls give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date. Puts give the buyer the





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right, but not the obligation to sell a given quantity of the underlying asset at a given price on or before a given date;

- (d) **Swaps:** Swaps are private agreements between two parties to exchange cash flows in the future according to a prearranged formula. They can be regarded as portfolios of forward contracts. The two commonly used swaps are Interest rate swaps and Currency swaps.

### 3. Product design

To design a derivatives product, the following factors should be taken into consideration:

- (a) Underlying assets;
- (b) Eligibility criteria of base;
- (c) Trading hours;
- (d) Size of the contract;
- (e) Quotation;
- (f) Tenor of the contract;
- (g) Available contracts;
- (h) Settlement mechanism;
- (i) Settlement price;
- (j) Final settlement day; and
- (k) Any other issue as mentioned in the relevant rules.

### 4. Contract specification

All derivatives contracts should contain standard contract specifications as specified by the exchange. Among others, the following information should be included in the contract specifications:

- (a) Exchange of trading;
- (b) Security descriptor;
- (c) Contract size;
- (d) Price steps;
- (e) Price bands;





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- (f) Trading cycle;
- (g) Expiry day;
- (h) Settlement basis;
- (i) Settlement price.

## 5. Trading platform

For trading of derivative products, the concerned exchange should provide a fully automated screen-based trading on a nationwide basis and an online monitoring and surveillance mechanism. It should support an anonymous order driven market which provides complete transparency of trading operations and operates on strict price-time priority. It should provide tremendous flexibility to users in terms of kinds of orders that can be placed on the system. Various conditions like Immediate or Cancel, Limit/Market price, Stop loss, etc. can be built into an order. If the exchange has other trading platforms, those should be completely separated from the derivatives trading platform in all aspects.

## 6. Basic of trading

The trading system should support an order driven market, wherein orders match automatically. Order matching is essentially on the basis of security, its price, time and quantity. All quantity fields shall be in units and price in the same currency. The lot size shall be uniform for a certain type of derivatives. The exchange shall notify the regular lot size and tick size for each of the contracts traded on this segment from time to time. When any order enters the trading system, it is an active order. It tries to find a match on the other side of the book. If it finds a match, a trade is generated. If it does not find a match, the order becomes passive and goes and sits in the respective outstanding order book in the system.

## 7. Entities in the trading system

The derivatives exchange shall admit participants on its derivatives segment in accordance with regulations of the exchange and rules of the Commission. Participation may be structured in different categories to enable wider participation. Participants should fulfill the eligibility criteria and get separate





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registration to participate in the derivatives segment. Among other the eligibility criteria shall cover capital and margin adequacy, risk management capacity, manpower competence, logistics requirements, integrity, past performance etc. Participants may be categorized in the following types:

- (a) **Self Clearing Participant:** A SCP clears and settles trades executed by it only either on its own account or on account of its clients;
- (b) **Trading Participant Clearing Participant:** TP-CP is CP who is also TP. TP-CP may clear and settle its own proprietary trades and client's trade as well as clear and settle for other TPs;
- (c) **Professional Clearing Participant:** PCP is a CP who is not a TP. Typically, banks or custodians could become a PCP and clear and settle for TPs;
- (d) **Institutional Participants:** An IP is a client of trading participants like financial institutions. These clients may trade through multiple trading participants but settle through a single clearing participant.

### 8. Custody

The derivative contracts should be issued in fungible format and maintained with a depository. Trading, clearing and settlement should be made in automated electronic system.

### 9. Clearing and settlement

To mitigate counterparty risks, clearing and settlement of derivative trades should be undertaken by a Central Counterparty (CCP) clearing and settlement company who shall establish required mechanisms for clearing and settlement of derivative contracts.

### 10. Risk Management

Following risk management measures can be used as a risk management tool in financial derivative segment;





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- (a) Client level margining for derivative;
- (b) Risk management framework
  - Margins
  - Liquid Network
  - Position Limits;
- (c) Mark to Market Settlement-adjusted against the available Liquid Network and balance collected in cash before start of trading on T+1 day;
- (d) Portfolio based Approach using SPAN-a software which takes integrated view of the risk in the portfolio of each individual client comprising positions in all derivative contracts for each underlying;
- (e) The Liquid Network will be prescribed by the Commission time to time;
- (f) Position limits-to monitor concentration of positions and market manipulation
  - Market Wide, Trading Member Level, Client level.

### 11. Client broker relationship in derivative segment

A broker should have sufficient knowledge and intimate relationship with its clients in the derivative segment so that it can assess the financial capability, knowledge and risk taking ability of the clients. Trading participant must ensure compliance particularly with relation to the following while dealing with clients:

- (a) Collecting 'Know Your Client' (KYC) form in details;
- (b) Executing Client Broker agreement;
- (c) Bringing risk factors to the knowledge of client by getting acknowledgement of client on risk disclosure document;
- (d) Executing orders timely as per the instruction of clients in respective client codes;
- (e) Collecting adequate margins from the client;
- (f) Maintaining separate client bank account for the segregation of client money;





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- (g) Issuing contract notes timely as per the prescribed format to the client;
- (h) Ensuring timely pay-in and pay-out of funds to and from the clients;
- (i) Resolving complaint of clients at the earliest, if any;
- (j) Avoiding receipt and payment of cash and deal only through banking channel;
- (k) Sending the periodical statement of accounts to clients;
- (l) Not charging excess brokerage;
- (m) Maintaining unique client code as per the regulations; etc.

### 12. Professional/investor education

Continuous education program for all the market participants and investors should be undertaken in order to run the derivative market smoothly. The professional who will be associated with this product must have special training and certificates as may be required from time to time. An investor shall not be eligible to invest in the derivatives market without having necessary knowledge and training on derivatives. Both for the professionals and the investors, sufficient training has to be started before launching derivative products.

### 13. Approval and issue

- (a) The Commission shall notify all concerned which derivate product may be launched;
- (b) The exchange concerned shall apply to the Commission for issuance of derivative product along with full particulars like type of contract, underlying asset, tenure and maturity, frequency of issue, contract size, other contract specifications and any other relevant legal requirements;
- (c) After verifying the proposal, the Commission, if thinks appropriate, shall approve the issuance of derivative contracts along with total size of issue;
- (d) Upon approval of the Commission, the exchange shall issue the derivative contracts comply all legal requirements.





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### 14. Preconditions

Before launching the derivative market, the following preconditions should be fulfilled:

- (a) Relevant Rules has been enacted by the Commission;
- (b) Concerned exchange(s) have got permission to introduce derivative segment comply all legal requirements and all provisions of the Exchanges (Demutualization) Act, 2013 (XV of 2013);
- (c) The exchange has established all infrastructures required for launching derivative platform and formulated relevant regulations;
- (d) A CCP is in operation and capable for clearing and settlement of derivative trades;
- (e) Settlement guarantee fund is in operation;
- (f) Investor protection fund is in operation;
- (g) Brokers and participants have got required registration comply all legal requirements;
- (h) Investors and market participants have got required training regarding derivatives.

By order of the Bangladesh Securities and Exchange Commission

Dr. M. Khairul Hossain  
Chairman