19BAE710-FINANCIAL DERIVATIVES

SPECIFICATIONS OF A FUTURES CONTRACT

Following are the specifications required of a futures contract:

1. Expiration

Expiration (also known as maturity or expiry date) refers to the last trading day of the futures contract. After the expiry of a futures contract, final settlement and delivery is made according to the rules laid down by the exchange in the contract specifications document.

2. Contract Size

Contract size, or lot size, is the minimum tradable size of a contract. It is often one unit of the defined contract. For example, current contract size of PMEX sugar contract is 10 Tons. This implies that trading one contract creates a position of 10 tons of sugar. PMEX rice contract has a contract size of 25 tons.

3. Initial Margin

Initial margin is the minimum collateral required by the exchange before a trader is allowed to take a position. Initial margins can be paid in various forms as laid down by the exchange and varies from commodity to commodity as well as from time to time. The level of initial margin is dependent on the price volatility of the contract. More volatile commodities generally have higher margin requirements.

4. Price Quotation

Price Quotation is the units in which the traded price of a contract is displayed. It can be different from the trading size of a contract and is often based on industry practices and conventions. While the contract size of PMEX sugar contract is 10 tons, its price is quoted in Rupees per 100 kgs. PMEX Palm Oil contract has a size of 25 tons but its price quotation follows local trade practices and is displayed as Rupees per maund.

5. Tick Size

Tick Size is the minimum movement allowed by the exchange in Price Quotation. For example, the tick size of PMEX 100gms gold futures contract is Re. 1, whereas it is $0.01 or 1cent for the PMEX 10oz gold futures contract.

6. Tick Value

Tick Value refers to the minimum profit or loss that can arise from holding a position of one contract. Tick value depends on the size of the contract and its tick size. While it is often explicitly mentioned in contract specifications, it can be calculated by the formula:

Tick Value = Contract Size x Tick Size

7. Mark to Market

Mark to market refers to the process by which the exchange calculates and values all open positions according to pre-defined rules and regulations. Mark-to-market is an essential feature of exchange-traded futures contracts whereby the exchange ensures that all profit and losses are recognized by pricing them according to accurate market conditions. It is also an important feature for the risk management of positions of participants.

8. Delivery Date

Delivery date or delivery period refers to the time specified by the exchange during or by which the seller has to make delivery according to contract specifications and regulations. Delivery date is often later than expiry date of a contract, especially in case of physically delivered commodities.

9. Daily Settlement

Daily settlement refers to the process whereby the exchange debits and credits all accounts with daily profits and losses as calculated by the mark-to-market process. Daily settlement is necessary in order to recover losses and pay profits to respective accounts.