

08-Aug-08

FUTURES are simply Fixed Date Forwards

Forward and Futures Contracts are essentially the same, the differences being largely in conventions regarding the quotation of prices. Since we are familiar with Forward Contracts, the similarities/ differences of the Futures contracts are set off against the features of Forward Contracts, as below:

Forwards	Futures
Traded in the OTC (over the counter) or Interbank market, with buyer/ seller bearing mutual counterparty risk.	Traded on Exchanges, with the Exchange bearing counterparty risk with respect to the buyer/ seller.
Can have any maturity date, customized to the requirement of the Buyer.	Has Fixed maturity dates. In the case of Dollar-Rupee Futures, the maturity dates will be the last working day of a calendar month, going out to 12 months.
Can be for any amount, customized to the requirement of the Buyer.	Lot Size is fixed. Transactions can be in multiples of the fixed Lot Size, not in broken/ odd amounts.
The Forward Rate = Spot Rate + Forward Difference, where Forward Difference \neq 0.	The Futures Rate = Spot Rate + Forward Difference, where Forward Difference \neq 0
In case of USD-INR, the Forward Rate is quoted as X INR per 1 USD. For example, the current Forward Rate for 31-Aug-08 is 42.3350 INR per USD 1.	Some clarity is needed on this, but our understanding, so far, is that for Dollar-Rupee futures, the Futures Rate will also be quoted in the same manner as the Forward Rate.
No margin requirement	Margin required
Avowedly non-speculative for Corporates in the Indian context, because trades (hedges) can be done only against and to the extent of actual exposures.	Fully speculative, because the contracts will be cash-settled on expiry. No delivery of Dollars can either be taken or given.
Account for, by far, the lion's share of the market volume. Estimates range from 80-95%.	Accounts for a small part of the total market volume, with estimates ranging from 5-20%.
Client (corporate) trades/ hedges with a bank.	Client will trade/ hedge with a broker who is a member of the exchange.

In the proposed Futures market, any resident Indian can buy/ sell Dollar-Rupee Futures (lot size USD 1000) upto a maximum of USD 5 million with a broker, at rates similar to the currently quoted Forward Rates. The Contract may be squared off at or before maturity, the difference in rates being settled in cash.