Business Standard

Sebi allows exchanges to launch options in goods under commodity derivatives

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Markets regulator Sebi has allowed stock exchanges to launch 'options in goods' in commodity derivatives segment, a move that will play a major role in stimulating agricultural marketing and enable farmer-friendly options products.

Securities and Exchange Board of India (Sebi) has also put in place a product design and risk management framework in this regard.

"Stock exchanges are now permitted to launch 'option in goods' in their commodity derivatives segment. This is in addition to options on commodity futures," Sebi said in a circular.

Prior approval from Sebi will be required for the stock exchanges to start trading in options contracts with underlying goods.

Sebi's decision has been welcomed by industry experts, saying the decision will strengthen the commodity derivatives markets and option will reduce the risk for the hedgers.

"It is a very right step taken by the regulator to further strengthen the commodity derivatives market. The provision shall pave the way for launching options contract in commodities based on underlying spot market price and settlement through compulsory delivery.

"For the first time, Indian commodity derivatives market will witness both European as well as American options, whereas in Securities market options are restricted to European style only. Option will reduce the risk for the hedgers. Options in agriculture commodities can prove to be an important tool to replace minimum support price intervention scheme of the government," ICEX MD and CEO Sanjit Prasad said.

CPAI President Narinder Wadhwa said this is a progressive step towards integration of spot market with derivatives market. "It will play a major role in stimulating agricultural marketing and enable farmer-friendly options products".

Under the eligibility criteria, Sebi said only those goods on which the exchange is either trading futures contracts or is proposing to launch futures contracts will be permitted.

In case of proposed futures contracts, the same should be launched on or before the day of starting option in the goods concerned.

The option contracts would have same quality specifications, delivery centres, final settlement price methodology, trading hours and minimum tenor as the corresponding futures contracts, Sebi said.

Exchanges can decide on the expiry day of options contracts.

Norms for position limits for options would be same as that of futures contracts.

However, "the computation of position limits for 'option in goods' shall be clubbed with position limits of 'options on commodity futures' on the same underlying goods but shall remain separate from position limits of futures contracts on the same underlying", the regulator said.

According to the watchdog, Clearing Corporations (CCs) should adopt initial margin models and parameters that are based on potential risks.

There should be margin requirements sufficient to cover potential future exposure to clients in the interval between the last margin collection and the close out of positions following a client's default.

Initial margin requirement should be adequate to cover at least 99 per cent value at risk. The margin period of risk should either be at least equal to three days or of corresponding futures contracts, whichever is higher.

For margining at client level, Sebi has asked the CCs to impose initial margins at the level of portfolio of individual client comprising his positions in futures and options contracts on each commodity.

Regarding real time computation, the regulator said CCs should mark to market the options positions by adding the current market value of options. It should be positive for long options and negative for short options.

"Thus, mark to market gains and losses would not be settled in cash for options positions," it added.

Derivatives in financial markets typically refers to a forward, future, option or any other hybrid contract of pre-determined fixed duration.

A futures contract is a legally binding agreement to buy or sell the underlying security on a future date, while options contract gives the right but not the obligation to buy or sell the underlying asset at a pre-determined price.