Sebi allows options in one commodity per exchange

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The Securities and Exchange Board of India (Sebi) has issued a circular allowing commodity exchanges to launch options trading in commodities. Initially, an exchange can launch options in only one commodity and the position limits for options will be double that of the respective futures contract.

The settlement of commodity options will be complex as they become futures contracts on settlement. This mechanism has been introduced to allow option-holders to give or take delivery, which is not possible in the current legal framework.

Sebi has also specified criteria for commodities to be allowed for options trading. The commodity must be among the top five by traded volume on an exchange and the daily average volume over the previous 12 months must be ₹200 crore for agri and agri-processed commodities and ₹1,000 crore for non-agri commodities. Exchanges are still deliberating on their choice of commodities because, as an industry source said, "the product being permitted for the first time, it is sensible to ensure it succeeds".

The NCDEX is prioritising soybean and the MCX gold.

Mrugank Paranjape, managing director and chief executive officer, MCX, said, "The options features relating to the product design, such as the choice of underlying, will ensure the commodity options would operate on a strong foundation. After consultation with stakeholders, we will decide on which commodity we would launch our first option product, as also its contract specification features."

"The combination of futures and options will provide market participants the benefit of price discovery of futures and simpler risk management of options," NCDEX said in a statement.

Settlement of commodity options is complex because when an option is exercised, the options position devolves into the underlying futures. All such devolved futures positions will be opened at the strike price of the exercised options.

Sebi has permitted European-style options, with a fixed settlement period. Sources said Sebi's advisory committee was deliberating whether to allow weekly options to suit farmers. The NCDEX has proposed such options. Each option expiry will have a minimum of three strikes: in the money, at the money and out of money. The expiry date of options contracts will be decided by exchanges based upon the liquidity of the underlying futures contracts.

Position limits for options will be separate from, and double the value of, position limits for futures contracts. If after devolution of options into corresponding futures positions, clients and members exceed their position limits for future contracts, they will have two trading days to reduce their futures positions to within limits. At the client level, initial margins will comprise positions in futures and options contracts on each commodity. This will be monitored in real time and margins will change accordingly. Mark-to-market gains will not be settled in cash for option positions.

COMMODITY BUSINESS

Turnover* (₹ crore)

MCX	
Crude Oil	5,053
Gold	3,549
Silver	2,329
Zinc	1,977
Natural gas	1,450

NCDEX	
Refined soy oil-Indore	410
Guar seed 10	362
Rape mustard seed	274
Soybean-Indore	257

*Traling 12 months average turnover; compiled by BS Research Bureau Source: Exchange