



CIRCULAR

SEBI/HO/CDMRD/DNP/CIR/P/2022/34

March 24, 2022

To

The Managing Directors / Chief Executive Officers

All Recognized Stock Exchanges and Clearing Corporations having Commodity Derivatives Segment

Dear Sir/Madam,

Sub: Introduction of Options on Commodity Indices – Product Design and Risk Management Framework

1. In an endeavour to have more products in the Commodity Derivatives Market and based on the recommendation of Commodity Derivatives Advisory Committee (CDAC) and proposal from Stock Exchanges, it has now been decided to permit recognised Stock Exchanges having a Commodity Derivative segment, to introduce options on commodity indices.
2. The product design and risk management framework should be in conformity with the guidelines prescribed in the **Annexure** to this circular.
3. The recognised Stock Exchanges with a Commodity Derivative segment, willing to introduce trading in options on commodity indices shall take prior approval of SEBI for the same.
4. Stock Exchanges shall submit at-least past three-years data of the index constructed along with data on monthly volatility, roll over yield for the month and monthly return while seeking approval from SEBI. On approval, the Stock Exchange(s) shall also publish the above data on their website before launch of the contract.
5. Stock Exchanges shall make necessary disclosures, such as, open interest of top 10 largest participants/group of participants in “option in indices” (both long and short) and the details of their combined open interest in underlying constituents,



etc., in line with SEBI Circular No. [SEBI/HO/CDMRD/DNPMP/CIR/P/2019/08](#) dated January 04, 2019 regarding “Disclosures by Stock Exchanges for commodity derivatives”.

6. Stock exchanges shall put in place adequate monitoring and surveillance capacity for the options on indices contracts.
7. The provisions of this circular shall be effective from date of this circular.
8. The Stock Exchanges with Commodity Derivatives segment are directed to:
 - 8.1 take steps to make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the same,
 - 8.2 bring the provisions of this circular to the notice of the stock brokers/members of the stock exchange and also to disseminate the same on their website; and
 - 8.3 communicate to SEBI, the status of the implementation of the provisions of this circular
9. This Circular is issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
10. This Office Circular is issued with approval of the competent authority.
11. This circular is available on SEBI website www.sebi.gov.in under the category “Circulars” and “Info for Commodity Derivatives Market Regulation Department”.

Yours faithfully,

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Product Design and Risk Management Framework for Options on Commodity Indices

1. **Underlying:** The underlying shall be commodity indices, which shall conform to the guidelines as prescribed in the SEBI Circular No. [SEBI/HO/CDMRD/DNPMP/CIR/P/2019/71](#) dated June 18, 2019.
2. **Eligibility Criteria for Underlying:** Option contracts can be introduced on those indices on which futures contracts are available.
3. **Settlement Mechanism:** On exercise, options contract shall be settled in cash.
4. **Exercise Style:** European style options.
5. **Minimum Strikes:** Each option expiry shall have minimum three strikes available viz., one each for In the Money (ITM), Out of the Money (OTM) and At the Money (ATM).
6. **Size of the Contract:** At least INR 5 lakh at the time of introduction in the market.
7. **Exercise Mechanism:** On expiry, following mechanism shall be adopted by stock exchanges for exercise of the options contracts:
 - 7.1. All In the money (ITM) option contracts shall be exercised automatically, unless 'contrary instruction' has been given by long position holders of such contracts for not doing so.
 - 7.2. All Out of the money (OTM) option contracts shall expire worthless.
 - 7.3. All exercised contracts within an option series shall be assigned to short positions in that series in a fair and non-preferential manner.



8. **Trading Hours:** The trading hours will be in line with the trading hours for constituent futures of underlying index. In case trading hours vary for constituents, trading hours for index derivatives shall be kept such that it is available for trading whenever any of the constituent futures contract is available for trading. However, on the day of its expiry, Index options contract shall expire at 5:00 pm.
9. **Expiry Date:** The stock exchanges shall have the flexibility to set the expiry date for contracts. However, the expiry date shall not coincide with the roll-over period of the constituents of the underlying index.
10. **Tenor of the Contract:** To begin with, maximum tenor of contracts shall be 12 months.
11. **Final Settlement Price:** The Final Settlement Price shall be the underlying index price arrived at based on Volume Weightage Average Price of the constituents of the underlying index between 4:00 pm and 5:00 pm on the expiry day of the Index options contract. {In absence of trading in any constituent during last one hour, stock exchange shall determine appropriate methodology (in line with the methodology for determining daily closing price) to arrive at appropriate price of the constituent to be used for determining index price}.

12. Position Limits:

12.1. Client level- Higher of:

10% of the total open interest in the market in commodity index options
Or
2000 lots

12.2. Trading Member level- Higher of:

30% of the total open interest in the market in commodity index options
Or
20000 lots

The computation of position limits for 'options' shall remain separate from position limits of futures contracts on the same underlying.



13. Risk Management: Clearing Corporations (CCs) shall adopt risk management framework compliant with the CPMI-IOSCO Principles for Financial Market Infrastructures, including the following:

13.1. Margining model and quantum of initial margins: CCs shall adopt initial margin models and parameters that are risk-based and generate margin requirements sufficient to cover potential future exposure to participants/clients in the interval between the last margin collection and the close out of positions following a participant/client default. The model should

13.1.1. use a conservative estimate of the time horizons for close out of the positions (including in stressed market conditions),

13.1.2. have an appropriate method for measuring credit exposure that accounts for relevant risk factors and portfolio effects, and

13.1.3. to the extent practicable and prudent, limit the need for destabilizing, pro-cyclical changes.

Initial margin requirement shall be adequate to cover at least 99% VaR (Value at Risk). Margin Period of Risk (MPOR) shall be at least two days. In case of portfolio based margining, this requirement applies to each distribution of portfolio's exposure. Accordingly, CCs shall fix prudent price scan range, volatility scan range and/or plausible changes in any other parameters impacting options price. CCs shall impose appropriate short option minimum margin, calendar spread charge, extreme loss margin, concentration margins, additional margins, pre-expiry margin, etc. for option contracts.

13.2. Margining at client level: CCs shall impose initial margins at the level of portfolio of individual client.



13.3.Real time computation: Though the margining models may update various scenarios of parameter changes (underlying price, volatility etc.) at discrete time points each day (at least every two hours), the latest available scenarios shall be applied to client portfolios on a real time basis.

13.4.Mark to Market: CCs shall mark to market the options positions by adding the current market value of options (positive for long options and negative for short options) to the margin requirement. Thus, mark to market gains and losses would not be settled in cash for options positions.
