



CIRCULAR

SEBI/HO/CDMRD/DMP/CIR/P/2020/05

January 16, 2020

To,

**The Managing Directors / Chief Executive Officers  
All Recognised Stock Exchanges and Clearing Corporations having  
commodity derivatives segment except those in International Financial  
Services Centre**

Dear Sir / Madam,

**Sub: Options in Goods - Product Design and Risk Management Framework**

1. The Central Government, in exercise of the powers conferred by sub-clause (D) of clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 and in consultation with the SEBI, have vide Notification No. [S.O. 3743\(E\) dated October 18, 2019](#) declared a contract for the purchase or sale of a right to buy or sell or a right to buy and sell in future, such underlying goods, as notified vide number S.O. 3068(E), dated the 27th September, 2016, as a derivative for the purposes of the said Act. For ease of nomenclature, the instrument notified vide the said Notification may be called as 'Option in Goods'.
2. Stock Exchanges are now permitted to launch 'Option in Goods' in their commodity derivatives segment. This is in addition to 'Options on commodity futures', guidelines which were issued vide SEBI circular [SEBI/HO/CDMRD/DMP/CIR/P/2017/55](#) dated June 13, 2017.
3. The product design and risk management framework would be in conformity with the guidelines prescribed in **Annexure** enclosed with this circular.
4. Exchanges willing to start trading in options contracts with goods as underlying shall take prior approval of SEBI for launching such contracts.
5. Exchanges shall make necessary disclosures such as open interest of top 10 largest participants/group of participants in "option in goods" (both long and short) and the details of their combined open interest in underlying constituents etc., in line with SEBI circular [SEBI/HO/CDMRD/DNPMP/CIR/P/2019/08](#) dated January 04, 2019 regarding "Disclosures by Stock Exchanges for commodity derivatives" to the public.



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Securities and Exchange Board of India

6. The Exchanges shall augment their monitoring and surveillance capacity.
7. The circular shall be effective from the date of this circular.
8. The Exchanges are advised to:
  - i. take steps to make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the same,
  - ii. bring the provisions of this circular to the notice of the members of the Exchange and also to disseminate the same on their website,
  - iii. 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 circular is available on SEBI website [www.sebi.gov.in](http://www.sebi.gov.in) under the category “Circulars” and “Info for Commodity Derivatives”.

Yours faithfully,

**Vikas Sukhwal**  
**General Manager**  
**Division of Market Policy and New Products**  
**Commodity Derivatives Market Regulation Department**  
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**Annexure 1: Product Design and Risk Management Framework for Option in Goods**

1. **Underlying:** Goods as notified vide number S.O. 3068(E), dated the 27th September, 2016 under clause (bc) of section 2 of the Securities Contracts (Regulation) Act, 1956.
2. **Eligibility Criteria for Underlying:** Only those goods shall be eligible as underlying for these options, on which exchange either is already trading the futures contracts or is proposing to launch the futures contracts on or before the day of launching option in those goods. These Option contracts shall have same quality specifications, delivery centres, Final Settlement Price methodology etc. as in the case of corresponding futures contracts.
3. **Settlement Method:** On exercise, option contract shall be settled through delivery of goods.
4. **Exercise Style:** All exercise style are permitted.
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. **Exercise Mechanism:**

On expiry, following mechanism shall be adopted by Exchanges for exercise of the options contracts:

- 6.1. Option series having strike price closest to the price of the underlying shall be termed as At the Money (ATM) option series.

This ATM option series and three option series having strike prices immediately above this ATM strike and three option series having strike prices immediately below this ATM strike shall be referred as 'Close to the money' (CTM) option series.



In case the price of the underlying is exactly midway between two strike prices, then immediate three option series having strike prices just above the price of the underlying and immediate three option series having strike prices just below the price of the underlying shall be referred as 'Close to the money' (CTM) option series.

- 6.2. All option contracts belonging to 'CTM' option series shall be exercised only on 'explicit instruction' for exercise by the long position holders of such contracts.
- 6.3. All In the money (ITM) option contracts, except those belonging to 'CTM' option series, shall be exercised automatically, unless 'contrary instruction' has been given by long position holders of such contracts for not doing so.
- 6.4. All Out of the money (OTM) option contracts, except those belonging to 'CTM' option series, shall expire worthless.
- 6.5. All exercised contracts within an option series shall be assigned to short positions in that series in a fair and non-preferential manner.
7. **Trading Hours:** Trading hours shall be same as those of corresponding futures contract.
8. **Expiry Day:** Exchanges shall have flexibility to decide upon Expiry day of options contracts.
9. **Minimum Tenor:** Minimum tenor of such option contracts shall be same as those of corresponding futures contracts.
10. **Position Limits:**
  - 10.1. SEBI vide Circulars dated September 27, 2016 and [July 25, 2017](#) prescribed norms for position limits for commodity futures. Position limits for options shall follow the same norms as provided in the said circulars for futures.
  - 10.2. 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. Numerical value for client level/member level limits shall be twice of the corresponding numbers applicable for futures contracts.

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

**11.1. Margining model and quantum of initial margins:** CC 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

- a) use a conservative estimate of the time horizons for close out of the positions (including in stressed market conditions),
- b) have an appropriate method for measuring credit exposure that accounts for relevant risk factors and portfolio effects, and
- c) 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 equal to three days or MPOR of corresponding futures contracts, whichever is higher. In case of portfolio based margining, this requirement applies to each portfolio's distribution of future 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, delivery period margin etc. for option contracts.

**11.2. Margining at client level:** CCs shall impose initial margins at the level of portfolio of individual client comprising of his positions in futures and options contracts on each commodity.



11.3. **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.

11.4. **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.

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