

Govt brings commodity option trading, settlement at par with equities

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Commodity options can now be settled directly instead of the current practice of options devolving into futures first and then being settled

The government has brought commodity options trading and settlement on a par with equities, paving the way for new norms for farmers and small and medium enterprises to step up hedging.

Commodity options can now be settled directly. The current practice is options devolve into futures first and then futures are settled.

This was not attracting enough hedging because of the complexities involved.

Now, brokers are hoping than once the Securities and Exchange Board of India (SEBI) implements the new norms, even hedging by farmers and small and medium units will increase.

Through a gazette notification making changes in Securities and Contract Regulations Act, the government has declared "a contract for purchase and sale of right to buy and sell or a right to buy and sell in future in notified underlying goods as derivative".

So far options or purchase and sale of rights were not defined and hence when options were introduced by SEBI in commodities settlement, things were found to be complicated.

"Today, we have options on futures and not options on Goods. That is why options in commodity derivatives devolve on futures rather than the spot (price) of the underlying. With options on goods, options players can actually give or take delivery of the underlying without getting into the futures contract at the time of expiry. Secondly, in case of cash settled contracts, options can be settled on the spot of the underlying.

Thirdly, according to Sanjit Prasad, MD & CEO of ICEX (Indian Commodity Exchange), "today options are allowed based on liquidity of the futures contract, now options can be allowed without futures contract also provided the physical market is liquid. Now we have to wait for SEBI's circulars for the implementation. Legally, options on goods have been allowed."

Concept of options on futures prevailing now instead of options on goods is limiting hedges participation and government has now addressed this.

Prasad also said, "This notification paves the way for options on goods rather than options on futures. Now, we can witness robust growth in commodity options market, with hedgers using options effectively."

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As this legal clarity has come now, SEBI will have to change existing regulations governing commodities options and allow options in goods. This also means that commodity options will now be settled in line with equities options and settlement price will be spot market price. On expiry of relevant contracts, options will not have to be converted in futures.

However, SEBI and exchanges will have to change rules.