



CIRCULAR

SEBI/HO/CDMRD/DNPMP/CIR/P/2019/71

June 18, 2019

To,

**The Managing Directors / Chief Executive Officers
All Recognized Stock Exchanges having Commodity Derivatives Segment**

Dear Sir / Madam,

Sub: Design of Commodity Indices and Product Design for Futures on Commodity Indices

1. In the Union Budget Speech for the year 2016-17, the Hon'ble Finance Minister had announced that "new derivatives products will be developed by SEBI in the Commodity Derivatives Market". Introduction of new commodity derivatives products has been a subject of deliberation as it is considered to be conducive for the overall development of the commodity derivatives market, attracting broad based participation, enhancing liquidity, facilitating hedging and bringing in more depth to the commodity derivatives market.
2. In this regard, the Commodity Derivatives Advisory Committee (CDAC) of SEBI had inter-alia recommended introduction of options, derivatives on commodity indices and at later stage products such as weather and freight derivatives. SEBI has already permitted commodity options in Indian commodity derivatives markets. Based on the above recommendation of CDAC and comments received on SEBI [consultation paper dated January 16, 2019](#) on design of commodity indices and product design for futures on commodity indices, it has now been decided to permit recognised stock exchanges with commodity derivative segment to introduce futures on commodity indices. Construction of commodity indices shall conform to the guidelines prescribed in **Annexure I** and futures on commodity indices shall conform to the product design given in **Annexure II**.
3. The recognised stock exchanges with commodity derivative segment willing to start trading in futures on commodity indices shall take prior approval of SEBI for launching such contracts. Exchanges will have to submit at-least past 3 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, exchanges shall also publish the above data on their website before launch of the products.



भारतीय प्रतिभूति और विनियम बोर्ड
Securities and Exchange Board of India

4. Exchanges shall make necessary disclosures such as open interest of top 10 largest participants/group of participants in index futures (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.
5. The Exchanges shall augment their monitoring and surveillance capacity.
6. The provisions of this circular shall be effective from the date of this circular.
7. 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.
8. Exchanges are advised to:
 - i. make necessary amendments to the relevant bye-laws, rules and regulations.
 - ii. bring the provisions of this circular to the notice of the stock brokers 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 available on SEBI website www.sebi.gov.in under the category “Circulars” and “Info for Commodity Derivatives”.

Yours faithfully,

Vikas Sukhwal
General Manager
Division of New Products and Market Policy
Commodity Derivatives Market Regulation Department
Email: vikass@sebi.gov.in



Annexure I

Design of Commodity Indices

1. Types of Indices:

Composite (i.e., comprising of commodities from more than one sector) as well as sectoral indices, meeting the eligibility criteria prescribed herein are permitted. For being eligible to launch derivatives upon, Exchanges shall ensure that indices are compliant with IOSCO Principles for Financial Benchmarks and make necessary disclosures in this regard on their websites. Further, exchanges shall also ensure that an index is not susceptible to manipulation and shall make mandatory disclosure with respect to the Index design parameters on their website.

2. Name:

The name of index should include the name of the exchange on which the constituents of index are traded.

3. Eligibility criteria:

Constituents of the commodity index shall meet the criteria given below –

- a. Constituent futures contracts should be in existence on the respective exchange for at least previous twelve months. (All constituents shall meet this criterion)
- b. The contracts have traded for at least 90% of the trading days during the previous twelve months. (All constituents shall meet this criterion)
- c. The average daily turnover of the constituent futures contracts during the previous twelve months is at least :
 - i. INR 75 Crore for agricultural and agri-processed commodities
 - ii. INR 500 Crore for all other commodities.

(Constituents having at least 80% combined weightage in the index shall meet this criterion and no single constituent not meeting this criterion shall have a weightage of more than 15% in the index)



However, the above turnover requirements shall not be applicable for sectoral indices subject to exchanges ensuring that constituent futures have adequate liquidity.

4. Re-balancing:

- a. The index constituents and their weightages shall be at least annually selected and rebalanced. Exchanges shall decide and announce/disclose the constituents and weightages of the index at least three months before the actual re-balancing of the index. Exchanges shall ensure that constituents meet the eligibility criteria as given in para 3 while deciding the constituents and weightages for rebalancing.
- b. However, in case of an extraordinary event such as ban / suspension of trading of an index constituent, following action shall be taken by exchange-
 - i. Reselection of commodities (excluding banned/suspended commodities)
 - ii. Recalculation of weightageExchanges shall ensure that constituents meet the eligibility criteria as given in para 3.
- c. The index changes shall be implemented only after market hours.

5. Weights of constituents:

- a. Index constituents will be assigned weightages based on their production value and liquidity value with appropriate weightages pre-decided by exchange for production value and liquidity value (provided that weightage of either shall not be less than 25%). The liquidity value will be total traded value of the index constituent on the exchange platform in the preceding twelve months prior to the construction / announcement of re-balancing of the index. The production value will be average of the value of deliverable supply of underlying commodity for past five financial years prior to the construction / announcement of re-balancing of the index.
- b. In order to ensure that no single commodity dominates a composite index, maximum weightage for any index constituent in a composite index shall be capped at 30% and minimum weightage shall be at least 1%. However, these weightage caps shall not be applicable for sectoral indices subject to exchanges ensuring that any single constituent does not get heavily weighted in an index.



- c. In case of an index having multiple commodity groups, exchanges may put in place maximum and minimum weightages for a commodity group.

6. Computation and roll over:

- a. The index value shall ordinarily be computed using the nearest expiry futures prices of the index constituents so that prices of liquid contracts are used for index construction.
- b. Exchange shall put in place a transparent methodology (including the dates of roll over, the various constituents which will be rolled over from nearest to next expiry, weights of nearest and next expiry contracts during each of the roll over day for such constituents etc.) for gradual roll over of the index constituents to next expiry taking into account the liquidity in the underlying nearest /next expiry contracts.

7. Real time dissemination:

The index value shall be updated on real time continuous basis and shall be displayed on the Exchange website.

8. Dissemination of methodology:

Exchange shall ensure a transparent methodology of index construction, calculation, dates and details of roll over, dates and other details of periodic rebalancing, report on compliance with IOSCO principles etc., and disseminate the same on its website.



Annexure II

Product Design for Futures on Commodity Indices

1. 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 futures contract shall expire at 5:00 pm.

2. Size of the Contract:

At least INR 5 lakh at the time of introduction in the market.

3. Tenor of the Contract:

To begin with, maximum tenor of contracts shall be 12 months.

4. Available Contracts:

Stock Exchanges shall decide the number of contracts, duration of contracts and launch calendar based on market requirements.

5. Position Limits:

a. Client level- Higher of:

5% of the total open interest in the market in commodity index futures

Or

1000 lots

b. Trading Member level- Higher of:

15% of the total open interest in the market in commodity index futures

Or

10000 lots

6. Daily Price Limit:

Stock Exchanges shall decide appropriate daily price limits for commodity index futures based on historical price movement of the indices.



7. Settlement Mechanism:

Final Settlement for futures on commodity index shall be done in cash.

8. 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 futures contract. {In absence of trading in any constituent during last one hour, 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}.

9. Expiry date:

The stock exchanges shall have the flexibility to set the expiry date for contracts. However, the expiry date may not coincide with the roll-over period of the constituents of the underlying index.

10. Application:

Before launching any futures contract on an index, a Recognised Stock Exchange with commodity derivative segment shall submit its proposal with contract specifications and risk management framework to SEBI, for approval.

11. Risk Management Framework:

Exchanges shall adopt risk management framework compliant with the CPMI-IOSCO Principles for Financial Market Infrastructures, including the following:

- a. Margining model and quantum of initial margins:** Exchanges 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:
 - i. use a conservative estimate of the time horizons for close out of the positions (including in stressed market conditions),
 - ii. have an appropriate method for measuring credit exposure that accounts for relevant risk factors and portfolio effects, and



- iii. to the extent practicable and prudent, limit the need for destabilising, pro-cyclical changes.

Initial margin requirement shall be adequate to cover at least 99% VaR (Value at Risk) and Margin Period of Risk (MPOR) shall be at least two days. In case of portfolio based margining, this requirement applies to each portfolio's distribution of future exposure.

Accordingly, exchanges shall fix prudent price scan range, and/or plausible changes in any other parameters impacting futures price.

- b. Margining at client level:** Exchanges shall impose initial margins at the level of portfolio of individual client.
- c. 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.