



**Consultation Paper on Amendment to SC(R)(SECC) Regulations, 2012 to enable Commodity Derivatives Exchanges to Deal in Instruments relating to Commodity Derivatives including Options**

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**1. Objective**

- 1.1. To solicit views from public on suggestion pertaining to amending the definition of "Commodity Derivatives Exchange" and "National Commodity Derivatives Exchange" and also provisions applicable to commodity derivatives exchanges in the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 (SECC Regulations) in order to enable trading instruments relating to commodity derivatives including options on commodity derivatives exchanges.

**2. Background**

- 2.1. Hon'ble Union Finance Minister, while presenting the budget for the FY 2016-2017, announced permitting new derivatives products in the commodity derivatives markets. In pursuance thereof, and also based on the recommendations made by the Commodities Derivatives Advisory Committee (CDAC), vide circular dated September 28, 2016, the commodity derivatives exchanges were permitted by SEBI to introduce trading in 'options'.
- 2.2. Thereafter, SEBI in consultation with commodity derivatives exchanges and market participants has been working on various aspects as product design, risk management norms and is in the process of finalizing the same for permitting options trading on the commodity derivatives exchanges.
- 2.3. Among other alternatives, one design that is being primarily being considered is options with commodity futures contracts as underlying and the option to settle by devolving into the commodity futures contracts on expiry. This is akin to derivative of derivative which has not been tried in Indian Equities markets so far. This being a complex product, there is a need to assess whether Indian Commodity derivatives markets are ready for such complex products and whether such products provide for regulatory and tax arbitrage. However, this design is most prevalent and most accepted in the commodity derivatives exchanges globally. This alternative also seems to be most suitable for agricultural commodities in India where cash settlement is not appropriate because of lack of ready availability of robust spot market prices of the underlying commodity of the specified grade/variety.



2.4. Globally, all leading commodity derivatives exchanges have options contracts with futures contracts as underlying e.g. Chicago Board of Trade (CBOT), Intercontinental Exchange (ICE), Euronext, Tokyo Commodity Exchange (TOCOM), New York Mercantile Exchange (NYMEX), London Metal Exchange (LME) etc., in developed economies as well as Johannesburg Stock Exchange, Bursa Malaysia Berhad, Bolsa de Valores, Mercadorias & Futuros de São Paulo (BM&FBOVESPA) in developing economies have options on futures in agricultural as well as non agricultural commodities.

### 3. Legal provisions:

In the aforesaid context, the relevant provisions in securities law are as follows:

3.1. The Securities Contracts (Regulation) Act, 1956 (SCRA) has the following relevant definitions in this regard:

*Section 2, (ac) “derivative”— includes*

- (A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;*
- (B) a contract which derives its value from the prices, or index of prices, of underlying securities;*
- (C) commodity derivatives; and*
- (D) such other instruments as may be declared by the Central Government to be derivatives;*

*Section 2, (bc) "commodity derivative" means a contract —*

- (i) for the delivery of such goods, as may be notified by the Central Government in the Official Gazette, and which is not a ready delivery contract; or*
- (ii) for differences, which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified by the Central Government, in consultation with the Board, but does not include securities as referred to in sub-clauses (A) and (B) of clause (ac);*

*Section 2, (d) “option in securities” means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call in securities;*

*Section 2, (h) “securities”— include*



(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

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3.2. The definition of “Commodity Derivatives Exchange” as per SECC Regulations is as under:

*2(1)(fa) “commodity derivatives exchange” means a recognized stock exchange which assists, regulates or controls the business of buying, selling or dealing only in commodity derivatives.*

3.3. The definition of “National Commodity Derivatives Exchange” as per SECC Regulations is as under:

*2(1)(ia) "national commodity derivatives exchange" means a commodity derivatives exchange that is demutualized, has an electronic trading platform and is permitted to assist, regulate or control the business of buying, selling or dealing in derivatives on all commodities as notified by the Central Government from time to time.*

3.4. The Provisions applicable to commodity derivatives exchanges as per SECC Regulations is as under:

*44(D)(1)(c) no commodity derivatives exchange shall engage in any activity other than that of assisting, regulating or controlling the business of buying, selling or dealing in commodity derivatives, except with the prior permission of the Board;*

#### **4. Need for Amendment:**

4.1. Thus, as per the definition in SCRA, a commodity derivatives contract can have only goods/activities/services/rights/interests/events as notified by central government as underlying.

4.2. An option contract with commodity futures as underlying and settled by devolving into (delivery of) the underlying commodity futures may not therefore strictly fit within the definition of 'commodity derivatives' as per SCRA unless such underlying commodity futures contracts are notified by the Central



Government from time to time. However, such an option contract does fit within the definition of “option in securities”[ Section 2(d) of SCRA] when the definition of “option in securities” is read together with the definitions of “securities”, “derivatives” and “commodity derivatives” in SCRA.

- 4.3. As per SECC Regulations, a commodity derivatives exchange cannot deal in any other product except for commodity derivatives, an option contract with commodity futures as underlying and settled by devolving into commodity futures may not be eligible for trading on commodity derivatives exchanges.

## 5. Proposal:

- 5.1. In order to overcome this legal hurdle so as to enable commodity derivatives exchanges to also organize trading in option contracts with commodity futures as underlying, it is being considered to suitably amend the definition of “Commodity Derivatives Exchange” and “National Commodity Derivatives Exchange” and also the “provisions applicable to commodity derivatives exchanges”. Thus, the proposed amendments in Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 is as follows:

Section	Old Provisions	Proposed Provisions
2(1)(fa)	“commodity derivatives exchange” means a recognized stock exchange which assists, regulates or controls the business of buying, selling or dealing only in commodity derivatives.	“commodity derivatives exchange” means a recognized stock exchange which assists, regulates or controls the business of buying, selling or dealing only in commodity derivatives <u>and such other instruments relating to commodity derivatives including options.</u>
2(1)(ia)	national commodity derivatives exchange means a commodity derivatives exchange that is demutualized, has an electronic trading platform and is permitted to assist, regulate or control the business of buying, selling or dealing in derivatives on all commodities as notified by the Central Government from time to time.	national commodity derivatives exchange means a commodity derivatives exchange that is demutualized, has an electronic trading platform and is permitted to assist, regulate or control the business of buying, selling or dealing in derivatives <u>and such other instruments relating to commodity derivatives including options</u> on all commodities as notified by the Central Government from time to time.



**भारतीय प्रतिभूति और विनियम बोर्ड**  
**Securities and Exchange Board of India**

Section	Old Provisions	Proposed Provisions
44(D)(1)(c)	no commodity derivatives exchange shall engage in any activity other than that of assisting, regulating or controlling the business of buying, selling or dealing in commodity derivatives, except with the prior permission of the Board;	no commodity derivatives exchange shall engage in any activity other than that of assisting, regulating or controlling the business of buying, selling or dealing in commodity derivatives <u>and such other instruments relating to commodity derivatives including options</u> , except with the prior permission of the Board;

5.2. Comments from public are invited on proposal /issues contained in this paper and should reach SEBI latest by **January 31, 2017**.

The comments may be sent by email to **cdmrd\_dmp@sebi.gov.in** or alternatively may be sent to following address:

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