## INTRODUCTION TO COMMODITY MARKET

India, a commodity based economy where two-third of the one billion population depends on agricultural commodities, surprisingly has an under developed commodity market. Unlike the physical market, futures markets trades in commodity are largely used as risk management (hedging) mechanism on either physical commodity itself or open positions in commodity stock.

India is one of the top producers of a large number of commodities, and also has a long history of trading in commodities and related derivatives. The commodities derivatives market has seen ups and downs, but seems to have finally arrived now. The market has made enormous progress in terms of technology, transparency and the trading activity. Interestingly, this has happened only after the Government protection was removed from a number of commodities, and market forces Were allowed to play their role. This should act as a major lesson for the policy makers in developing countries, that pricing and price risk management should be left to the market forces rather.

## HISTORY

Commodities future trading was evolved from need of assured continuous supply of seasonal agricultural crops. The concept of organized trading in commodities evolved in Chicago, in 1848. But one can trace its roots in Japan. In 19th century Chicago in United States had merged as a major commercial hub. So that wheat producers from Mid-west attracted here to sell their produce to dealers and distributors. Due to lack of organized storage facilities, absence of uniform weighing and grading mechanisms producers often confined to the mercy of dealers discretion. These situations lead to need of establishing a common meeting place for farmers and dealers to transact in spot grain to deliver wheat and receive cash in return. Gradually sellers and buyers started making commitments to exchange the produce for cash in future and thus contract for "futures trading" evolved; Whereby the producer would agree to sell his produce to the buyer at a future delivery date at an agreed upon price. Trading of wheat in futures became very profitable which encouraged the entry of other commodities in futures market. This created a platform for establishment of a body to regulate and supervise these

contracts. That's why Chicago Board of Trade (CBOT) was established in 1848. In 1870 and 18805 the New York Coffee, Cotton and Produce Exchanges were born. Agricultural commodities were mostly traded but as long as there are buyers and sellers, any commodity can be traded. In 1872, a group of Manhattan dairy merchants got together to bring chaotic condition in New York market to a system in terms 0f storage, pricing, and transfer of agricultural products. The largest commonly exchange in USA is Chicago Board of Trade, The Chicago Mercantile Exchange, the New York Mercantile Exchange, the New York Commodity Exchange and New York Coffee, sugar and cocoa Exchange. Worldwide there are major futures trading exchanges in over twenty countries including Canada, England, India, France, Singapore, Japan, Australia and New Zealand.

**HISTORY OF INDIAN COMMODITY MARKET**

Commodity futures markets largely remain underdeveloped in India. This is in spite of the country's long history of commodity derivatives trade as compared to the US and UK. A major contributor to this fact is the extensive government intervention in the agricultural sector in the post-independence era. In reality, the production and distribution of several agricultural commodities is still governed by the state and forwards as well as futures trading have only been selectively introduced with stringent regulatory controls. Free trade in many commodity items remains restricted under the Essential Commodities Act (ECA), 1955, and forwards as well as future contracts are limited to specific commodity items listed under the Forward Contracts (Regulation) Act (FCRA), 1952.

The evolution of the organized futures market in India commenced in 1875 with the setting up of the Bombay Cotton Trade Association Ltd. Following widespread discontent among leading cotton mill owners and merchants over the functioning of the Bombay Cotton Trade Association, a separate association, Bombay Cotton Exchange Ltd., was constituted in 1983. Futures trading in oilseeds originated with the setting up of the Gujarati Vyapari Mandali in 1900, which carried out futures trading in ground nuts, castor seeds and cotton. The Calcutta Hessian Exchange Ltd. and the East India Jute Association Ltd. were set up in 1919 and 1927 respectively for futures trade in raw jute. In 1921, futures in cotton were organized in Mumbai under the auspices of East India Cotton Association (EICA). Before the Second World War broke

out in 1939, several futures markets in oilseeds were functioning in the states of Gujarat and Punjab. Futures markets in Bullion began in Mumbai in 1920, and later, similar markets were established in Rajkot, Jaipur, Jamnagar, Kanpur, Delhi and Calcutta. In due course, several other exchanges were established in the country, facilitating trade in diverse commodities such as pepper, turmeric, potato, Sugar and jaggery.

Post independence, the Indian constitution listed the subject of Stock Exchanges and Future Markets under the union list. As a result, the regulation and development of the commodities futures markets were defined solely as: responsibility of the central government. A bill on forward contracts was referred to an expert committee headed by Prof. A.D. Shroff and selected committees of the successive parliaments and finally, in December 1952, the Forward Contrami (Regulation) Act was enacted. The Forward Contracts (Regulation) rules were notifies by the central government in 1954. The futures trade in spices was first organized by the India Pepper and Spices Trade Association (IPSTA) in Cochin in 1957. However in order to monitor the price movements of several agricultural and essential commodities, futures trade was completely banned by the government in 1966. Subsequent to the ban of futures trade, many traders resorted to unofficial and informal trade in futures. However, in India‘s liberalization epoch as per the JunQ 1980 Khusro committee‘s recommendations, the government reintroduced futures on selected commodities, including cotton, jute, potatoes, etc.

Following the introduction of economic reforms in 1991, the Government of India appointed an expert committee on forward markets under the chairmanship of Prof. KN. Kabra in June 1993. The committee submitted its report in September 1994, championing the reintroduction of futures, which were banned in 1966, and expanding its coverage to agricultural commodities, along with silver. In order to boost the agricultural sector, the National Agricultural Policy 2000 envisaged external and domestic market reforms and dismantling of all controls and regulations in the agricultural commodity markets. It also proposed an expansion of the coverage of futures markets to minimize the wide fluctuations in commodity prices and for hedging the risk arising from extreme price volatilities.

## GOVERNING BODY/REGULATING BODY

The commodity futures traded in commodity exchanges are regulated by the Government under the Forward Contracts Regulations Act, 1952 and the Rules framed there under. The Forward Markets Commission (FMC) is the chief regulator of forwards and futures markets in India. As of March 2009, it regulated Rs. 52 trillion worth of commodity trades in India. It is headquartered in Mumbai and this financial regulatory agency is overseen by the Ministry of Finance. Mr. Ramesh Abhishek replaced Mr. B.C. Khatua as the interim chairman of the commission in 2011. Mr. ltamesh Abhishek is the Chairman of commodities regulator FMC. He is an IAS Officer of 1982 Batch (Bihar Cadre) and was appointed on 24 September 2012 as the Chairman of Forward Market Commission.

Forward Markets. Commission (FMC) is a statutory institution set up iI' 1953 under Forward Contracts (Regulation) Act, 1952. Commission consists 0f minimum two and maximum four members appointed by Central Govt. Out of these members there is one nominated chairman. All the exchanges have been set up under overall control of Forward Market Commission (FMC) of Government of India,

## FUNCTIONS/RESPONSIBILITIES OF FMC

The functions 0f the Forward Markets Commission are as follows:

1. To advise the Central Government in respect of the recognition or the withdrawal of recognition from any association or in respect of any other matter arising out of the administration of the Forward Contracts (Regulation) Act, 1952
2. To keep forward markets under observation and to take such action in relation to them, as it may consider necessary, in exercise of the powers assigned to it by or under the Act.
3. To collect and whenever the Commission thinks it necessary, to publish information regarding the trading conditions in respect of goods to which any of the provisions of the Act is made applicable, including information regarding supply, demand and prices, and to submit to the Central Government, periodical reports on the working of forward markets relating to such goods;



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4. To make recommendations generally with a view to improving the organization and working of forward markets;
5. To undertake the inspection of the accounts and other documents of any recognized association or registered association or any member of such association whenever it considers it necessary.

**Membership**

How to become a Member of Commodity Exchange?

To become member of Commodity Exchange the person should comply with the following Eligibility Criteria:

1. He should be Citizen of India.
2. He should have completed 21 years of his age.
3. He should be Graduate or having equivalent qualification. He should not be bankrupt.
4. He has not been debarred from trading in Commodities by statutory/regulatory authority.

**There are following three types of Memberships. of Commodity Exchanges:**

Trading-cum-Clearing Member (TCM)

A TCM is entitled to trade On his own account as well as on account of his clients, and clear and settle trades himself. A sole proprietor, Partnership firm, a Joint Hindu Undivided Family (HUF), a corporate entity, a cooperative society, a Public sector organization or any other Government or non-Government entity can become a TCM.

There are two types of TCM viz.,

TCM~1 and 'I'CM-2

TCM-l refers to transferable non-deposit based membership and TCM-2 refers to nontransferable deposit based membership. A person desired to register as TCM is required to submit an application as per the format prescribed under the business; rules,

along with all enclosures, fee and other documents specified therein. He is required to go through interview by Membership Admission Committee and committee is also empowered to frame rules or criteria relating to selection or rejection of a member.

**Institutional Trading-cum-clearing Member (ITCM)**

Only an Institution! Corporate can be admitted by the Exchange as a member, conferring upon them the right to trade and' clear through the clearing house of exchange as an Institutional Trading-cum-clearing Member (ITCM). The member may be allowed to make deals for himself as well as on behalf of his clients and clear and settle such deals. ITCMs can also appoint sub-brokers, authorized persons and Trading Members who would be registered as trading members.

**Professional Clearing Member (PCM)**

A PCM entitled to clear and settle trades executed by other members of the exchange. A corporate entity and an institution only can apply for PCM. The member would be allowed to clear and settle trades of such members of the Exchange who choose to clear and settle their trades through such PCM.

**Meaning of Commodity**

In general a commodity may be defined as an article, a product or material that is bought. and sold. It can be classified as every kind of movable property, except Actionable Claims, Money and Securities.

A commodity is a product that has commercial value, which can be produced, bought, sold, and consumed. Commodities are basically the products of the primary sector of an economy. The primary sector of an economy is concerned with agriculture and extraction of raw materials such as metals, energy (crude oil, natural gas), etc., which serve as basic inputs for the secondary sector of the economy

Commodity means a raw material or primary agricultural product that can be bought and sold, such as copper or coffee. In economics, a commodity is a marketable item produced to satisfy wants or needs.

In economic a commodity is the generic term for any marketable item produced to satisfy wants or needs. Economic commodities comprise goods and services

Commodities are split into two types: hard and soft commodities. Hard commodities are typically natural resources that must be mined or extracted (gold, rubber, oil, etc.), whereas soft commodities are agricultural products or livestock (corn, wheat, coffee, sugar, soybeans, pork, etc.)

**Definition of Commodity**

A commodity is any good or service produced by human labour and offered as a product for general sale on the market- Karl Max

**COMMODITY MARKETS OF WORLD**

Some of the exchanges of the world are:

New York Mercantile Exchange (NYMIEX)

London Metal Exchange (LME)

Chicago Board of Trade (CBOT)

New York Board of Trade (NYBOT)

Kansas Board of Trade

Winnipeg Commodity Exchange, Manitoba

Dalian Commodity Exchange, China

Bursa Malaysia Derivatives exchange

Singapore Commodity Exchange (SICOM)

Chicago Mercantile Exchange (CME), US

London Metal Exchange

Tokyo Commodity Exchange

Shanghai Futures Exchange

Sydney Futures Exchange

## DIFFERENT TYPES OF COMMODITIES THAT ARE TRADED

Market exists for almost all the commodities known to us. These commodities can be broadly classified Into the following

(i) Precious Metals: Gold, Silver, Platinum, etc.
(ii) Other Metals: Nickel, Aluminum, Copper, etc.
(iii) Agro-Based Commodities: Wheat, Cotton, Oils, Oil seeds, etc.
(iv) Soft Commodities: Coffee, Cocoa, Sugar, etc.
(v) Live-Stock: Live Cattle, Pork Bellies, etc. (vi) Energy: Crude Oil, Natural Gas

## SIGNIFICANCE OF COMMODITY MARKET

(i) 50% of GDP is Commodity related
(ii) 18% of GDP is from Agriculture
(iii) India is 5th largest producer of Steel
(iV) Over 65% of 1 trillion population depend on agriculture directly
(v) Over 7500 physical market yards History of more than 150 years of derivatives trading.

## OBJECTIVES OF COMMODITY MARKETS

(i) Hedging with the objective of transferring risk related to the possession of physical assets through any adverse moments in price.

(ii) Liquidity and Price discovery to ensure base minimum volume in trading of a commodity through market information and demand supply factors that facilitates a regular and authentic price discovery mechanism.

(iii) Maintaining buffer stock and better allocation of resources as it augments reduction in inventory requirement and thus the exposure to risks related with price fluctuation declines. Resources can thus be diversified for investments.

(iv) Price stabilization along with balancing demand and supply position. Futures trading leads to predictability in assessing the domestic prices, which maintains stability, thus safeguarding

against any short term adverse price movements. Liquidity in Contracts of the commodities traded. also ensures in maintaining the equilibrium between demand and supply.

(V) Flexibility, certainty and transparency in purchasing commodities facilitate bank financing. Predictability in prices of commodity would lead to stability, which in turn would eliminate the risks associated with running the business of trading commodities. This would make funding easier and less stringent for banks to Commodity market players.

**FUNCTIONS 0F COMMODITY MARKETS**

The primary objectives of any futures exchange are authentic price discovery and an efficient price risk management. The beneficiaries include those who trade in the commodities being offered in the exchange as well as those who have nothing to do with futures trading. It is because of price discovery and risk management through the existence of futures exchanges that a lot of businesses and services are able to function smoothly. Following are the functions of commodity markets:

1. Price Discovery

Based on inputs regarding specific market information, the demand and supply equilibrium, weather forecasts, expert views and comments, inflation rates, Government policies, market dynamics, hopes and fears, buyers and sellers conduct trading at futures exchanges. This transforms in to continuous price discovery mechanism. The execution of trade between buyers and sellers leads to assessment of fair value of a particular commodity that is immediately disseminated on the trading terminal.

2, Price Risk Management

Hedging is the most common method of price risk management. It is strategy of offering price risk that is inherent in spot market by taking an equal but opposite position in the futures market. Futures markets are used as a mode by hedgers to protect their business from adverse price change. This could dent the profitability of their business. Hedging benefits who are involved in trading of commodities like farmers, processors, merchandisers, manufacturers, exporters, importers etc.

3. Import Export competitiveness

The exporters can hedge their price risk and improve their competitiveness by making use of futures market. A majority of traders which are involved in physical trade internationally intend to buy forwards. The purchases made from the physical market might expose them to the risk of price risk resulting to losses. The existence of futures market would allow the exporters to hedge their proposed purchase by temporarily substituting for actual purchase till the time is ripe to buy in physical market. In the absence of futures market it will be meticulous, time consuming and costly physical transactions.

4. Predictable Pricing

The demand for certain commodities is highly price elastic. The manufacturers have to ensure that the prices should be stable in order to protect their market share with the free entry of imports. Futures contracts will enable predictability in domestic prices. The manufacturers can, as a result smooth out the influence of changes in their input prices very easily. With no futures market, the manufacturer can be caught between severe short-term price movements of oils and necessity to maintain price stability, which could only be possible through sufficient financial reserves that could otherwise be utilized for making other profitable investments.

5. Benefits for farmers/Agriculturalists

Price instability has a direct bearing on farmers in the absence of futures market. There would be no need to have large reserves to cover against unfavorable Price fluctuations. This would reduce the risk premiums associated with the marketing or processing margins enabling more returns on produce. Storing more and being more active in the markets. The price information accessible to the farmers determines the extent to which traders/processors increase price to them. Since one of the objectives or futures exchange is to make available these prices as far as possible it is very likely to benefit the farmers. Also, due to the time lag between planning and production, the market-determined price information disseminated by future exchanges would be crucial for their production decisions.

6. Credit Accessibility

The absence of proper risk management tools would attract the marketing and processing of commodities to high-risk exposure making it risky business activity to fund. Even a small movement in prices can eat up a huge proportion of capital owned by traders, at times making it virtually impossible to payback the loan. There is a high degree of reluctance among banks to fund commodity traders, especially those who do not manage price risks. If in case they do, the interest rate is likely to be high and terms and conditions very stringent. This possesses a huge obstacle in the smooth functioning and competition of commodities market. Hedging, which is possible through futures markets, would cut down the discount rate in commodity lending.

7. Commodities as an asset class for diversification of portfolio risk

Commodities have historically an inverse correlation of daily returns as compared to equities. The skewness of daily returns favors commodities, thereby indicating that in a given time period commodities have a greater probability of providing positive returns as compared to equities. Another aspect to be noted is that the "Sharpe ratio" of a portfolio consisting of different asset classes is higher in the case of a portfolio consisting of commodities as well as equities. Thus, an Investor can effectively minimize the portfolio risk arising due to price fluctuations in other asset classes by including commodities in the portfolio.

**COMMODITY EXCHANGE**

A commodity exchange is an association or a company or any other body corporate organizing futures trading in commodities for which license has been granted by regulating authority. Commodity exchanges are transaction hubs and depots for physical goods.

Commodities exchanges usually trade futures contracts on commodities, such as trading contracts to receive something, say corn, in a certain month. A farmer raising corn can sell a future contract on his corn, which will not be harvested for several months, and guarantee the price he will be paid when he delivers; a breakfast cereal producer buys the contract now and

guarantees the price will not go up when it is delivered. This protects the farmer from price drops and the buyer from price rises.

Commodity exchange is defined as an association, or alternatively a company, as well as any corporate body that organizes trading in commodities. Earlier the commodity exchange was more like an open market place where traders would call their bids and purchase commodities. A commodities exchange is an exchange where various commodities and derivatives products are traded. Most commodity markets across the world trade in agricultural products and other raw materials.

Commodities exchanges usually trade futures contracts on commodities such as trading contracts to receive something, say corn, in a certain month. A farmer raising corn can sell a future contract on his corn which will not be harvested for several months and guarantee the price he will be paid when he delivers; a breakfast cereal Producer buys the contract now and guarantees the price will go up when it is delivered. This protects the farmer from falling price and the buyer from rising price.

**MAJOR REGIONAL COMMODITY EXCHANGES IN INDIA**

1. Batinda Commodity and Oil Exchange Ltd.
2. The Bombay Commodity Exchange
3. The Rajkot Seeds Oil And Bullion Merchant
4. The Kanpur Commodity Exchange And Oil seeds exchange
5. The Meerut Agra Commodity Exchange
6. Ahmadabad Commodity Exchange
7. Vijay Beopar Chamber Ltd. (Muzaffarnagar)
8. India Peppers And Spice Trade Association ( K00“i ) Rajdhani Oils And Seeds Exchange ( Delhi)
9. The Chamber Of Commerce (Hapur)
10. The East India Cotton Association (Mumbai)
11. The Central Commercial Exchange ( Gwalior )
12. The East India Jute and Hessian Exchange Of India (Kolkata)

13. First Commodity Exchange Of India ( Kochi )
14. Bikaner Commodity Exchange Ltd. ( Bikaner )
15. The Coffee Future Exchange Ltd. ( Bangalore )
16. E Sugar India Ltd. (Mumbai)

**TYPES OF TRANSACTIONS TO BE DEALT IN COMMODITY MARKET**

Classic commodity transactions are executed either in the spot market or in the futures market:

1. Spot Market 2. Future Market

**1. Spot Market/Cash Market/ Physical Market**

Spot Market is a commodities or securities market in which goods are sold for cash and delivered immediately. Contracts bought and sold on these markets are immediately effective.

The spot market is also called the "cash market" or "physical market", because prices are settled in cash on the spot at current market prices, as opposed to forward prices.

A market of commodities or securities in which goods are sold for ready cash and delivered immediately is known as Spot Market. Spot market is real time market for instant sale of commodities like grain, gold and other precious metals, Ram chips etc. It is a spot market because transactions take place on the spot. For example merchants and traders go to the fields and buy the standing crop or the freshly reaped crop at the spot. Since cash changes hands it is also called a Cash Market and since stock is physically delivered it is also called physical market.

The spot market or cash market is a public financial market, in which Financial instruments or commodities are traded for immediate delivery. It contrasts with a futures market in which delivery is due at a later date. In spot market settlement happens in 2 working days i.e. delivery of cash and commodity must be done after the two working day of the trade date. A spot market can be: An organized market or An exchange or Over-the-counter (OTC)

Spot markets can operate wherever the infrastructure exists to conduct the transaction. The spot market for most instruments exists primarily on the Internet.

A commodity is a basic good that is interchangeable with other like-kind goods. Some examples of commodities are grains, beef, oil, gold. silver, electricity, and natural gas. Technology has entered the market with commodities such as cell phone minutes and bandwidth. Commodities are standardized, and must meet specific standards to be sold.

The foreign currency trading (Forex) market is a huge spot market that allows for the simultaneous exchange of one nation's currency for another's. The way it Works is through an investor selecting a currency pair. Currency from Great Britain (GBP) and the United States (USD) is a common pair that is bought and sold on this market. If the GBP is gaining strength against the USD, the investor buys; if it is Weak, he sells. The benefit of foreign currency is that it is very liquid, so an investor can enter and exit the market as he chooses.

The futures market is different in that prices on the futures market are affected by the cost of storage and future price movements. In the spot market, prices can be affected by current supply and demand, which tends to make the prices more volatile.

Another factor that directs spot market prices is whether the commodity is perishable or non-perishable. A non-perishable commodity, such as gold or silver, will sell at a price that reflects future price movements. A perishable commodity, such as grain or fruit, will be affected by supply and demand. For example, tomatoes bought in July will reflect the current surplus of the commodity and will be less expensive than in January, when demand for a smaller crop drives costs up. An investor cannot purchase tomatoes for a January delivery at July's prices.

**2. Future Market**

Futures markets are places (exchanges) to buy and sell futures contracts. There are several futures exchanges. A futures contract is a financial contract giving the buyer an obligation to purchase an asset (and the seller an obligation to sell an asset) at a set price at a future point in time.

The assets often underlying futures contracts include commodities, stocks, and bonds. Grain, precious metals, electricity, oil, beef, orange juice, and natural gas are traditional examples of commodities, but foreign currencies, emissions credits, bandwidth and certain financial instruments are also part of today's commodity markets.

There are two kinds of participants in futures markets: hedgers and Speculators. Hedgers do not usually seek a profit by trading commodities futures but rather seek to stabilize the revenues or costs of their business operations. Speculators are usually not interested in taking possession of the underlying assets. They essentially place bets on the future prices of certain commodities. Speculators are often blamed for big price swings in the futures markets, but they also provide a lot of liquidity to the futures markets.

Futures exchanges do not set the prices of futures contracts or their underlying traded commodities. Rather, supply and demand determines the prices. But two things in particular ensure the stability and efficiency of futures markets: standardized contracts and the presence of clearing members. Standardized contracts mean that every futures contract specifies the underlying commodity's quality, quantity and delivery so that the prices mean the same thing to everyone in the market. A commodity from one producer is no different from another and the buyer knows exactly what he's getting. Clearing members manage the payments between buyer and seller. They are usually large banks and financial services companies. Clearing members guarantee each trade and thus require traders to make good-faith deposits (called margins) in order to ensure that the trader has sufficient funds to handle potential losses and will not default on the trade. The risk borne by clearing members lends further support to the stability of futures markets.

As opposed to spot markets, deals are stuck for future action in the future markets. A future contract can be defined as a type of financial contract wherein parties agree to exchange financial instruments like securities or physical commodities for future delivery at a particular price. Future contract is a standardized contract to buy at a future date at a certain price.

As far as the futures market in farm produce is concerned, the farmer has a guarantee for payment and quality risk is avoided. It promotes storage and Warehousing facilities and

logistics facilities. It also increases the bargaining power of the farmers and enables decision on crop sowing and time of sale.

**DIFFERENCES BETWEEN SPOT MARKET AND FUTURES MARKET**

| Spot Market | Futures Market |
|---|---|
| 1. Delivery of goods takes place immediately(2 to 3 days) | 1. Delivery 0f goods is due at a later date |
| 2. Settlement of cash takes place on the spot. | 2. Settlement of cash is postponed to a future date |
| 3. Spot markets are not speculative in nature | 3. Futures markets are speculative in nature |
| 4. Deals are stuck at spot prices. | 4. Deals are stuck at forward prices. |
| 5. There is no question of price risk. | 5. There is price risk due fluctuations in future prices. |
| 6. Availability of infrastructure is not a necessity. | 6. Availability of infrastructure is a necessity. |

**Commodity Options Exchange**

'Options', as the word suggests, refer to choices or alternatives. An option is a derivative contract which gives the buyer (the owner or holder of the option) the right, but not the obligation, to buy or sell an underlying. For owning this right, the option holder pays a price (called 'option premium') to the seller of this right. The seller (writer) of option, on the other hand, bears the obligation to honour the contract should the buyer choose to exercise the option.

The option buyer will exercise their option only when the price of the underlying is favorable to them, otherwise they will let the option expire worthless.

**Based on the right of the holder, options are of two types:**

**Call options**: It gives buyer the right to buy the underlying

**Put options**: It gives buyer the right to sell the underlying

**Based on exercise, options can primarily be of two types:**

**American**: The buyer can choose to exercise the option at any time before the expiry of the option contract.

**European**: The buyer can choose to exercise the option only on the date of expiration of the contract.

As per current regulatory norms, only European style commodity options are available in India at present.

**MCX offers** options on commodity futures contracts traded on the exchange. These commodity options, on exercise, devolve into the underlying futures contracts. All such devolved futures positions open at the strike price of exercised options.

Commodity options are useful risk management tools, particularly for the small stakeholders, as the option buyer does not generally have to maintain margins. They are akin to price insurance for the hedgers which can be bought by paying only a one-time option premium.



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