भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

CIRCULAR

SEBI/HO/CDMRD/DMP/CIR/P/2018/134 **October 09, 2018**

To,

The Managing Directors / Chief Executive Officers
All Recognised Stock Exchanges and recognised Clearing Corporations with Commodity Derivatives Segment

Dear Sir / Madam,

Sub: Participation of Eligible Foreign Entities (EFEs) in the commodity derivatives market

1. Currently, foreign entities are not permitted to directly participate in the Indian commodity derivatives market, even if they import/export various commodities from/to India. Such entities by virtue of their actual exposure to the various commodities in Indian market, are valuable stakeholders in the value chain of such commodities, and are also exposed to price uncertainty of Indian commodity markets. Therefore these foreign entities should be enabled to hedge their price risk in the Indian commodity derivatives market.

2. Taking cognizance of the fact that participation by such foreign participants would be conducive for the overall development of the commodity derivatives market in India, SEBI issued consultation paper on May 18, 2018 to discuss the suitable framework for allowing foreign participants to hedge their commodity exposure. Pursuant to feedback received from the market participants during the consultative process, **it has been decided to permit foreign entities having actual exposure to Indian commodity markets, to participate in the commodity derivative segment of recognized stock exchanges for hedging their exposure**. Such foreign entities shall be known as "Eligible Foreign Entities" (EFEs). The detailed regulatory framework for participation by the EFEs have been outlined at **Annexure** to the circular.

3. The provisions of this circular shall come into effect from the date of the circular.

4. This circular is issued in exercise of the 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.

5. The Exchanges are advised to:
   i. To 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.

6. This circular is available on SEBI website at www.sebi.gov.in under the category "Circulars" and "Info for Commodity Derivatives".

Yours faithfully,

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Annexure: Regulatory framework for Eligible Foreign Entities (EFEs) in Commodity Derivatives Segment

I. Eligible Commodities:

All commodity derivatives traded on Indian Exchanges except for those contracts having underlying commodity defined as 'Sensitive Commodity' in terms of SEBI circular SEBI/HO/CDMRD/DMP/CIR/P/2017/84 dated July 25, 2017 or by any other stipulation by SEBI which are disclosed on Exchange websites.

II. Definitions:

1. "Eligible Foreign Entities" (EFEs) are the 'Person resident outside India' as defined in Foreign Exchange Management Act, 1999, and are having actual exposure to Indian physical commodity markets.

2. "Exchanges" under these guidelines would mean recognized stock exchanges having commodity derivatives segment.

3. "Clearing Corporations (CC)" under these guidelines would mean recognized clearing corporation undertaking the activity of clearing and settlement of trades in commodity derivative segment of a recognized stock exchange.

4. "Auditor" under these guidelines would mean statutory auditor or such other authority carrying equivalent function of auditing and assurance in the respective jurisdiction as may be applicable

III. Eligibility and Jurisdiction

1. Such EFEs shall have actual exposure to Indian physical commodity markets.

2. Such EFE is resident in a country/jurisdiction whose securities market regulator and/or commodity derivatives market regulator is a signatory to IOSCO's MMoU (Appendix A Signatories) or a signatory of a bilateral MoU with SEBI.

   Provided that such EFE is not resident in a country identified in the public statement of Financial Action Task Force as:

i. a jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

ii. a jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

3. If such EFEs are also registered with SEBI as Foreign Portfolio Investors (FPIs) or Foreign Venture Capital Investors (FVCIs) then they are permitted to participate in commodity derivatives markets as EFE **provided that they have actual exposure to Indian physical commodity markets and subject to conditions that there is clear segregation of funds / securities / commodities under the respective registrations.**

4. The minimum net-worth requirement for such EFE shall be **US$ 500,000**.

IV. Registration of EFEs

1. The EFEs desirous of taking hedge positions in Indian commodity derivatives market shall approach Authorized Stock Brokers (ASBs), from amongst the Brokers which are registered under SEBI(Stock brokers and sub-brokers) Regulations, 1992 having minimum net-worth of **INR 25 Crores** and are authorized by the Exchanges for opening of such accounts.

2. For ASBs, in addition to the minimum Net-worth criteria prescribed above the Exchanges shall frame further guidelines regarding the other eligibility criteria for the ASBs which shall be approved by their Risk Management Committees. While framing guidelines for ASBs, the Exchanges shall look into various aspects, some of which are illustrated as under:

   a. Appropriate arrangements with clearing bank and clearing member of the respective exchange and clearing corporation;

   b. Appropriate arrangements for receipt and remittance of money with a designated Authorized Dealer (AD) Category - I bank.

c. Appropriate systems and procedures to comply with the FATF (Financial Action Task Force) Standards, PMLA (Prevention of Money Laundering Act, 2002) and SEBI circulars issued from time to time.

d. Appropriate systems and procedures to handle the physical deliveries of the underlying commodities on behalf of EFEs.

3. An EFE can open trading account with only one of the ASBs and participate in the commodity derivatives trading through the said ASB. EFE shall place orders for trading only through their ASBs on the Exchange platform.

4. The EFEs shall be responsible for complying with all the relevant laws.

5. EFEs shall ensure that they submit the required documents as specified by the ASBs/Exchanges/SEBI or any other law enforcing agencies.

6. The ASBs shall be responsible for carrying out due-diligence and complete necessary formalities/documentations as specified by the Exchanges in this regard.

7. The ASBs shall capture the details of the overseas bank account designated by the EFE. EFE shall open a single non-interest bearing Rupee account with an AD Category-I bank in India for routing the receipt and payment for transactions.

8. The ASBs shall obtain appropriate declarations and undertakings from EFEs including the one that they are in compliance with laws, rules and regulations of the jurisdictions where the EFEs are located.

9. The ASB shall, at all times, ensure that the participation of EFE is in compliance with the applicable norms prescribed by SEBI, RBI or any other statutory authority in India. For this purpose the ASB shall obtain appropriate declarations and undertaking from EFEs, from time to time, as may be prescribed by Exchanges and regulators.

V. Know Your Client (KYC) requirements

1. The EFE shall be required to meet the extant KYC requirements as per extant Indian Anti-Money Laundering Laws in line with extant KYC

approach adopted for the equivalent category of Foreign Portfolio Investors (FPIs).

2. Such EFE shall also provide its valid Legal Entity Identifier (LEI) issued by organizations accredited by the Global Legal Entity Identifier Foundation (GLEIF), wherever available.

VI. Position Limit, documentation and other conditions

1. The position limits shall be governed by the hedge policy of the Exchanges and no separate client trading limits shall be allowed for EFEs. Exchanges shall issue a separate hedge code for easy identification of EFEs.

2. Appropriate restrictions shall be placed by Exchanges to maintain market integrity.

3. The tenor of the hedge shall not be greater than the tenor of underlying exposure. At any point of time during the hedge period, hedging positions taken in derivatives contracts by EFE, across multiple Exchanges/Contracts, shall not exceed his/its actual exposure in the physical market.

4. Hedge limits for an EFE will be determined on a case to case basis, depending on applicant's actual exposure to the commodity, hedging requirement and other factors which the Exchanges deems appropriate in the interest of market. The EFE shall approach the ASB of the relevant Exchanges for hedge limits in the format prescribed by Exchanges encompassing the following information –

   a. Details of import / export to India during past three years, financial statements / annual report of last three years, certified by auditor.

   b. Supporting proof of Import and/or Export in the form of invoice or shipping/cargo bills. In case of Export/import commitments, documents like proof of export / import commitments and any other relevant documents, duly certified by auditor.

   c. A certificate of import/export turnover of the EFE during the past three years duly certified by their auditor. Hedging limit shall be permitted up to the average of previous three financial years' actual purchases / sales or the previous year's actual purchases / sales turnover from/to India, whichever is higher, in respect of the desired commodities. In case an EFE has been in existence for less than 3 years, then the applicable time period for exposure calculation shall be for the actual period as may be certified by their auditor.

d. EFE shall submit a Board resolution certifying Board approved policies which define the overall framework within which it proposes to conduct its hedging activities.

e. A declaration of details of hedging positions in other Indian exchanges (if applicable), certified by auditor.

f. Any other additional information sought by the registering Exchanges.

5. Exchanges may prescribe additional documents/materials for short hedging and long hedging separately based on the nature and use of the commodity.

6. An EFE shall apply for the hedge limits corresponding to its own physical exposure to the commodity and cannot apply for a hedge limit in respect of any stock it holds on behalf of another entity including stock positions it holds on behalf of a group-entity. The limits sanctioned to EFE shall be utilized only by it and not by anyone else including any subsidiary/associate company.

7. The EFE shall not undertake any arbitrage/speculative transactions and the initiation and unwinding of hedge positions shall correspond to the underlying position in the physical markets. The quota for hedging shall be used to only hedge/ unwind the hedge. The contracts, once cancelled, cannot be rebooked. The contracts may, however, be rolled over on or before, maturity subject to maturity of the underlying exposure.

8. The approved hedge limit is valid from the date of sanction for a period specified in the sanction letter. Unless renewed, the hedge limit shall stand terminated automatically upon expiry of such period without any notice. The EFE shall apply for any renewal of limits in advance and before the expiry of earlier approval, along with relevant documents as prescribed by the Exchanges from time to time.

9. The hedge limit shall not be available for the near month contracts of the said underlying commodity from the date of applicability of near month or spot month, however once the near month starts the limit shall

be equivalent to the limit available to regular clients or the hedge limit allocated, whichever is lower.

10. For the ease of business, the Exchanges shall develop an online system to deal with the EFEs through ASBs in this regard.

VII. Risk Management

1. Exchanges/CC shall put in place appropriate risk management systems for allowing EFE to take positions in eligible commodities.

2. The margins for any commodity prescribed by the Exchanges/CC for the other market participants shall also be applicable to EFE. As the hedge positions are expected to be larger than the normal client level limits, the Exchanges/CC shall, based on their assessment of the risks, levy additional margins including concentration margin wherever necessary, as may be prudent. Accordingly the ASB concerned shall ensure that appropriate margins are collected upfront from the EFE as risk mitigation.

3. Where, in the assessment of the ASB, the risk profile of EFE warrants margins in addition to the margin stipulated by the Exchanges/CC, the ASB shall collect such additional margins. The margins collected by the ASB at no time shall be less than those stipulated by the Exchanges/CC.

VIII. Monitoring of limits and physical exposure

1. The Exchanges shall put in place a mechanism to monitor the limits as well as physical exposure of an EFE, which may include seeking periodical reports from EFEs and ASBs covering the following aspects:

   a. Periodical statement of imports / exports undertaken and outstanding contracts, as certified by auditor.

   b. Audited summary of import or export details/documents in the form of invoice or shipping/cargo bills, containing information like Date of Dispatch, Tentative date of arrival, Quantity on that invoice/bill etc.

   c. Details of hedging positions in other Indian exchanges(if applicable), as certified by auditor,

   d. Where hedge limit is sanctioned based on prior import / export commitments/contracts, a report showing subsequent performance of such contracts and the corresponding hedging proposed to be undertaken, as certified by an auditor.

e. EFE / ASB shall be required to submit a consolidated statement on an annual basis.

f. Any other additional information as may be sought by the SEBI/ Exchanges from time to time.

2. The EFEs shall also be required to submit to the respective ASB a half-yearly certificate from their auditors as on March 31 and September 30, within sixty days from the said dates, to the effect that during the preceding six months, whether the derivative contracts entered into by the EFE exceeded or not exceeded the actual underlying exposure. In this regard, Exchanges shall develop an online system for such submission.

3. The Exchanges/ clearing corporations shall provide EFE wise information on day end open position as well as intra-day highest position to the respective ASBs. If the EFE exceeds the allocated hedge limit on any day, the concerned EFE shall be liable to such penal action as may be laid down by the SEBI/Exchanges. The ASB will be required to monitor this and bring transgressions, if any, to the notice of SEBI/Exchanges.

4. The positions shall be separately monitored by the respective Exchanges and such Exchanges shall augment their monitoring and surveillance capacity.

5. The ASBs shall also put in place necessary system to monitor hedge limits for such EFEs.

IX. Disclosure by the Exchanges:

The Exchanges on daily basis shall disclose on their website the hedge limit allocated to such EFEs, indicating the period for which approval is valid, in the particular commodity in an anonymous manner. This shall be on the similar lines of disclosures made by the exchanges for the domestic hedgers.