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Development of a Safe and Efficient OTC Commodity Derivatives Market in India

EXECUTIVE SUMMARY

The development of a robust and liquid over-the-counter (OTC) commodity derivatives market in India could support the continued growth of India's economy given its significant reliance on commodities. A well-functioning OTC market in India would offer several advantages. First, it would provide a flexible and efficient means for market participants to navigate evolving economic and commodity market conditions. Second, it would improve the ability of the economy to withstand commodity price swings by enabling firms that do not participate in the offshore OTC derivatives market to use these instruments to manage their commodity risks. Third, an onshore OTC commodity derivatives market would give regulators a clearer picture of economic and market dynamics within the country and their impact on companies and the economy.

Establishing OTC commodity derivatives in India would help domestic Indian companies and the Indian economy by providing a flexible system for managing commodity risks

The hedging of bullion, energy, agriculture and base metals currently occurs offshore, although gold and silver can be hedged via Gujarat International Finance Tec-City (GIFT City), an international financial services center (IFSC) in India. Offshore markets can be useful but mainly benefit the largest companies and remain outside the supervision of Indian regulators – they cannot replace onshore OTC derivatives markets.

A 2024 ISDA whitepaper described the opportunities and challenges in opening India's OTC derivatives market[1]. Building on that framework, ISDA believes the time is right for regulators to allow OTC commodity derivatives to be traded onshore – starting with metals and energy in the first phase and followed by other commodities.

An onshore OTC commodity derivatives market in India would complement the existing exchange-traded derivatives (ETD) market. As shown in other jurisdictions, there is a healthy interplay between OTC and ETD markets that help participants achieve their risk management goals in the most efficient manner. Both are needed for derivatives end users to manage their risks effectively and thrive in a complex global market.

Establishing OTC commodity derivatives in India would help domestic Indian companies and the Indian economy by providing a flexible system for managing commodity risks. Such an initiative would build on the valuable efforts made within GIFT City, where OTC derivatives on gold and silver are permitted, by enabling a broader liberalization of the onshore OTC commodity derivatives market. Regulators in India can be guided by supervisory practices that have been successful in other jurisdictions and across all types of market conditions to foster the healthy growth of OTC derivatives within an orderly and effective framework.

[1] ISDA, *Charting the Next Phase of India's OTC Derivatives Market*, March 2024, www.isda.org/a/CVsgE/Charting-the-Next-Phase-of-Indias-OTC-Derivatives-Market.pdf

USES AND BENEFITS OF OTC COMMODITY DERIVATIVES

The Challenge of Managing Risk in Commodities Markets

Commodity markets span a wide range of materials and products. Indeed, the word 'commodity' can be difficult to define precisely. This paper uses the definition by the Securities and Exchange Board of India (SEBI) in its frequently asked questions on commodity derivatives, which was updated in December 2023[2].

"A commodity is generally considered to be any kind of tangible good, a product or material that can be bought and sold. According to the Securities Contracts (Regulation) Act, 1956 (SCRA) 'goods' mean every kind of movable property other than actionable claims, money and securities. Commodities are mostly used as inputs in the production of other goods or services. Grains, Gold, Crude Oil, Copper, Natural Gas are some examples of commodities."

Commodities are usually grouped into three main categories:

- **Energy:** Commodities traded in both the unprocessed form in which they are extracted or in various refined forms or by-products of refining/processing, such as oil, natural gas and electricity.

- **Metals:** Natural resources that are mined, extracted or processed, including precious metals (platinum, gold[3], silver and palladium) and non-precious metals (ferrous and non-ferrous metals).

- **Soft commodities:** Including agriculture commodities, such as cereals (wheat, rice), pulses (chana, tur), spices (jeera, pepper) and oilseeds (soybean, castor).

Commodities markets facilitate the transportation, transformation and storage of key raw materials on their journey from producers to consumers. They are real economy goods with a finite supply and often inelastic demand in the short term, so any disruption or constraints on supply can have a direct impact on prices. Commodity price risk represents the potential for financial losses that governments, corporations and other market participants can face because of fluctuations in commodity prices.

Commodity prices are expected to increase from current levels due to a forecast rise in the world's population from 6 billion people in 2010 to more than 9 billion in 2050[4].

Within this context of a steady upward trajectory, commodity prices can still be volatile. Sharp spikes in prices can occur for many reasons, including fundamental economic factors, such as imbalances between supply and demand, uncertainty about producers' ability to meet future demand, and inflation and currency fluctuations. Other factors include local climate shocks, such as droughts and floods, insufficient transportation and storage infrastructure in key regions, geopolitical instability and seasonality, as harvesting conditions for soft commodities vary throughout the year.

[2] Securities and Exchange Board of India (SEBI), FAQs on Commodity Derivatives, www.sebi.gov.in/sebi_data/faqfiles/feb-2024/1706788568782.pdf

[3] Gold must be treated as a commodity and not as foreign exchange (FX), even if central banks are investing in gold and use gold derivatives as a proxy for FX exposures

[4] United Nations, Department of Economic and Social Affairs, www.un.org/en/desa/world-population-projected-reach-98-billion-2050-and-112-billion-2100#:~:text=The%20current%20world%20population%20of%207.6%20billion,new%20United%20Nations%20report%20being%20launched%20today

The Role of Derivatives in Managing Risk in Commodities Markets

Derivatives have long been used to manage commodity risks. Some of the earliest evidence for derivatives can be found in Mesopotamia and ancient Greece, where contracts were used to manage the risk of grain prices[5]. The same rationale applies today, as producers and users of commodities utilize derivatives to manage risk across the supply chain.

For example, a wheat farmer who is worried that prices might fall by harvest can sell futures contracts to lock in a price. When the crop is harvested, a flour mill can buy futures to ensure a predictable input price. The mill grinds the wheat into flour and sells it to a bakery, which can also use derivatives, such as swaps, to stabilize flour costs and plan production without fear of sudden price spikes. By the time the bread reaches grocery store shelves, these hedging strategies will have resulted in a steadier supply chain, shielding households from sharp swings in commodity markets that could otherwise raise the price of bread.

There is a wide range of market participants in this ecosystem, including financial institutions like pension funds, investment houses and asset managers, which ensure the market for commodity derivatives is liquid, deep and efficient

There is a wide range of market participants in this ecosystem, including financial institutions like pension funds, investment houses and asset managers, which ensure the market for commodity derivatives is liquid, deep and efficient. Their ability to supply capital and quickly adapt to market changes and price fluctuations ensure the market operates smoothly for all participants, even in times of stress[6].

In recent years, the role of financial investors in commodity markets has led to concern among some policymakers that the 'financialization' of commodities could be a source of instability and cause prices to rise[7]. This was fueled by the post-pandemic recovery and inflation surges that resulted in higher trading volumes and rapid price swings. Today, growing participation from algorithmic traders and environmental, social and governance funds contribute to pricing dynamics, along with physical market uncertainties like export bans and droughts, which drive increased use of financial hedging in commodities.

The financial system has been instrumental to the growth of international commodities markets, and financialization has occurred in parallel with the growth of international trade[8]. While financialization and speculative trading are frequently targets of criticism during volatile markets, there is little evidence in academic literature that they destabilize markets or exacerbate price volatility. In fact, research has shown that financialization plays an important role by enhancing liquidity and maintaining efficient markets. The main drivers of commodity price volatility are economic fundamentals, such as changes in supply and demand arising from geopolitical shocks or other events, rather than financial speculation. The concern that commodity index trading leads to price distortions has little support in the data[9].

[5] ISDA, *The Value of OTC Derivatives: Empowering Organizations to Manage Risks, Enhance Returns and Optimize Liquidity,* March 2025, www.isda.org/2025/03/17/the-value-of-otc-derivatives-empowering-organizations-to-manage-risks-enhance-returns-and-optimize-liquidity/

[6] The interaction between financial and physical markets is a complex and politically contentious issue. See European Commission, *Tackling the Challenges in Commodity Markets and on Raw Materials,* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52011DC0025

[7] Financialization can be defined as the use of commodity derivatives primarily for portfolio diversification or speculative profit rather than for producing, processing or consuming the underlying goods

[8] Centre for European Policy Studies (CEPS), Price Formation in Commodities Markets, July 2013, www.ceps.eu/ceps-publications/price-formation-commodities-markets-financialisation-and-beyond/. This report from CEPS and the European Capital Markets Institute was based on an analysis of commodity market turmoil during the 2007-2009 global financial crisis

[9] Journal of Commodity Markets, *An Update on Speculation and Financialization in Commodity Markets,* June 2018, www.sciencedirect.com/science/article/abs/pii/S2405851317300405

Likewise, a review of academic research demonstrates that financial speculation is not the cause of higher food prices[10]. Instead, it shows the capacity of financial markets to adjust to major structural changes and provide valuable price discovery and risk-transfer services. As a result, the positive role of financial investors in commodity derivatives markets is becoming more widely recognized.

If financial market participants are barred from commodity markets, non-regulated entities would fill the gap and respond to the risk management demands of corporations and other end users. Consequently, there would be a market for contracts that may have financial characteristics but are not labeled as financial instruments. If executed between two non-financial firms, these transactions would not be supervised or monitored by financial regulators and would slip under supervisors' radar. A similar situation occurred in the EU in the past, with EU-based banks exiting commodity markets due to regulatory constraints and non-regulated dealers filling the gap by offering commodity derivatives to EU end users.

The Role and Size of OTC Commodity Derivatives

Commodity derivatives meet the needs of various market participants to hedge commodity price risk, as described in a recent ISDA paper[11].

- Commodity markets are essential in moving raw materials from producers to consumers. With limited supplies and often inelastic short-term demand, disruptions (like geopolitical tensions, weather events or production issues) can lead to sudden price spikes. Governments and corporations hedge against these risks to protect against unplanned costs.

- For governments, especially those in commodity-dependent countries, hedging stabilizes revenue from exports like oil or agriculture. This can help to steady broader economic conditions and avoid adverse effects on public spending and investment, ensuring more stable growth.

- Commodities producers and consumers hedge against changes in physical commodity prices (eg, a producer would hedge against a price decline with short commodity futures positions) and fluctuations in various bases and spreads (eg, calendar spreads, product spreads and location spreads).

In essence, OTC commodity derivatives help governments, corporations and producers manage commodity price volatility, ensuring operational stability and financial resilience against market fluctuations. The OTC derivatives market plays a vital role for industries like energy, agriculture and metals, allowing companies to manage risks associated with commodity price fluctuations and lock in purchase or sale prices. These derivatives are essential because they provide stability and predictability in revenues and costs, helping businesses navigate volatile markets.

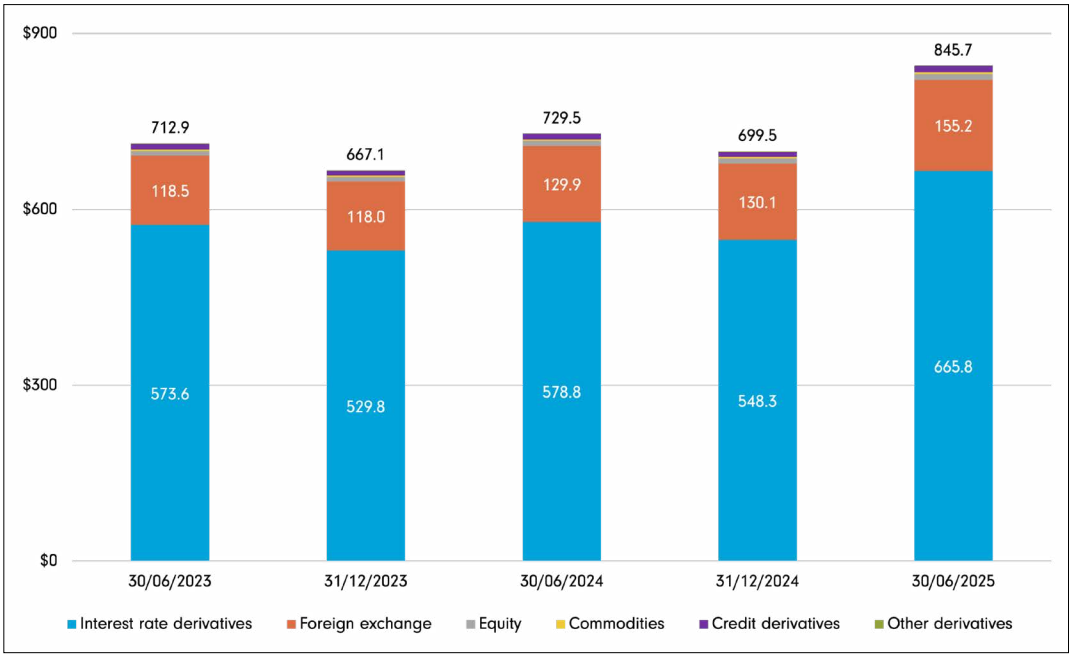
According to the statistics from the Bank for International Settlements (BIS), commodity derivatives notional outstanding rose to $2.6 trillion at the end of June 2025, an increase of 7% from the year before (see Chart 1)[12].

[10] Scott Irwin, *Speculation by Commodity Index Funds: The Impact on Food and Energy Prices*, https://search.library.yale.edu/catalog/99167871263408651

[11] ISDA, *The Value of OTC Derivatives: Empowering Organizations to Manage Risks, Enhance Returns and Optimize Liquidity*, March 2025, www.isda.org/2025/03/17/the-value-of-otc-derivatives-empowering-organizations-to-manage-risks-enhance-returns-and-optimize-liquidity/

[12] Bank for International Settlements (BIS), OTC Derivatives Statistics, https://data.bis.org/topics/OTC_DER/tables-and-dashboards

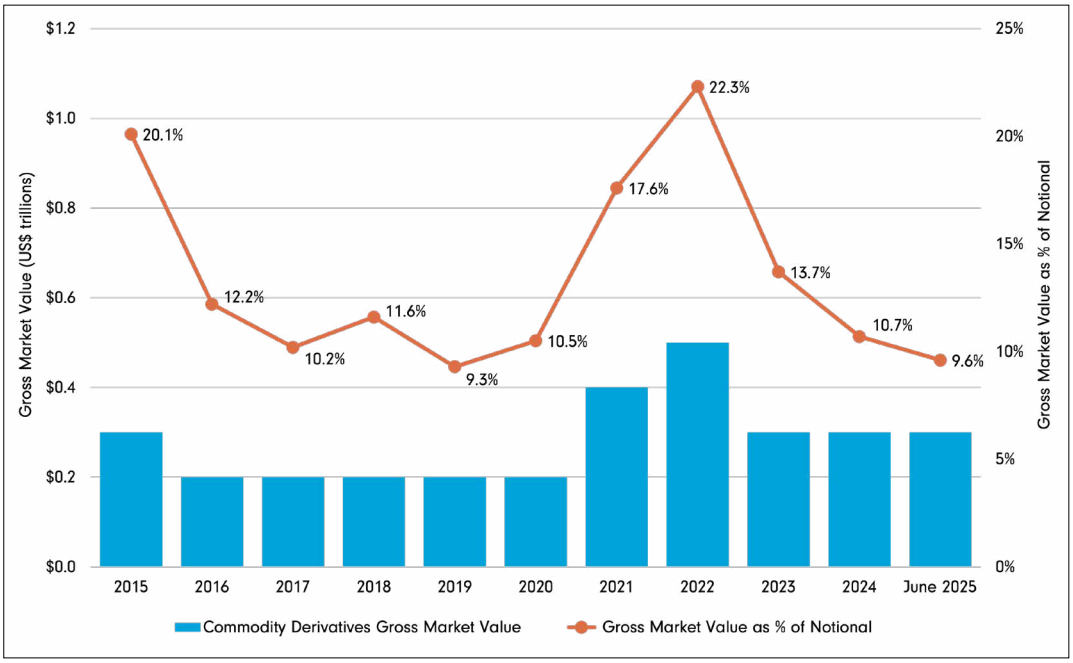
Chart 1: Global OTC Derivatives Notional Outstanding (US$ trillions)



Source: BIS OTC Derivatives Statistics

The gross market value of commodity derivatives – which is a better reflection of risk than notional outstanding as it represents the cost of replacing all open contracts at current prices – stood at $0.3 trillion at the end of June 2025. This represented 9.6% of notional outstanding (see Chart 2).

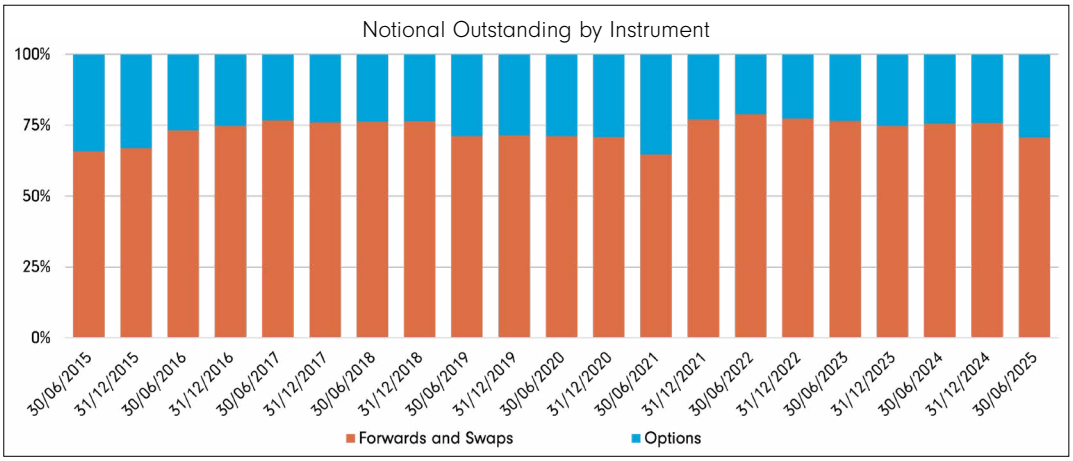
Chart 2: Commodity Derivatives Gross Market Value ($ trillions) and as % of Notional Outstanding

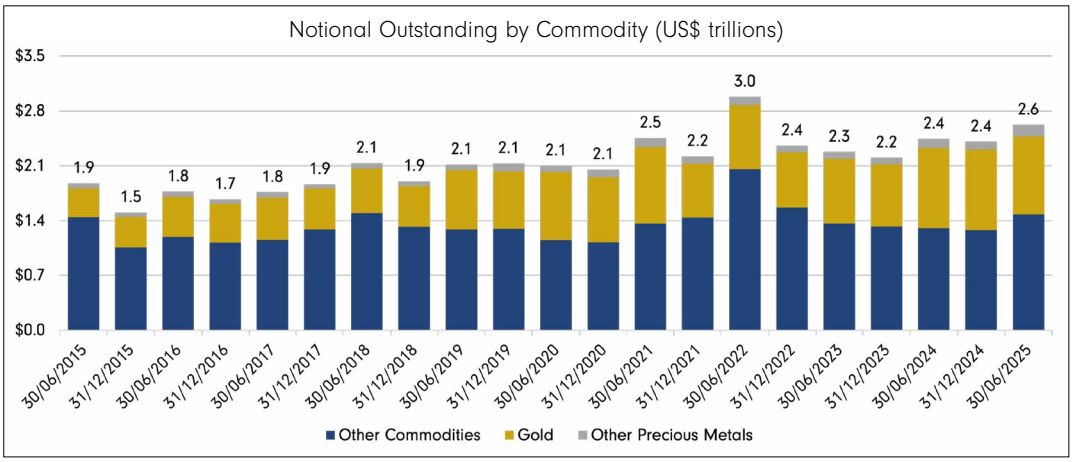


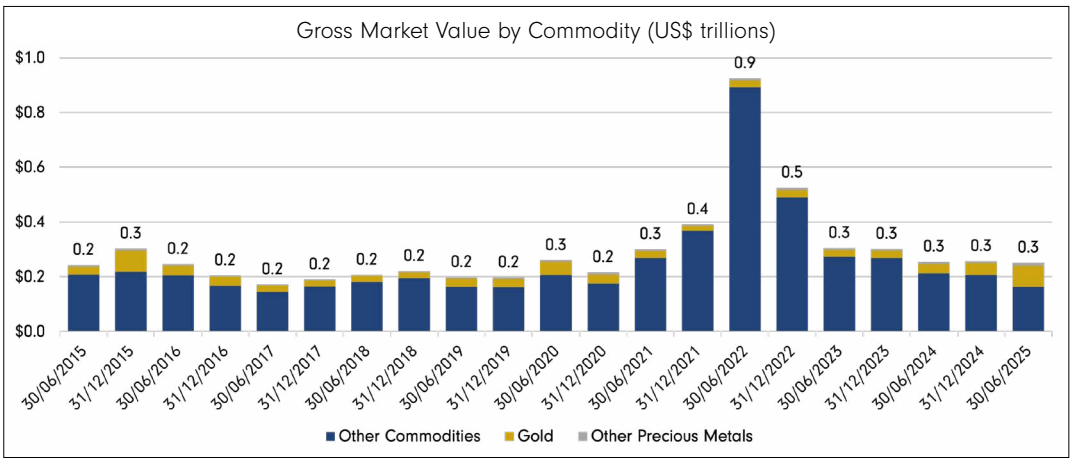
Source: BIS OTC Derivatives Statistics

OTC commodity derivatives are mainly held in the form of forwards and swaps, which have comprised approximately 70%-75% of notional outstanding in recent years, with options making up the balance. Chart 3 shows the breakdown by instrument and by commodity at mid-year 2025 for gold, other precious metals and other commodities. The latter category includes oil, the largest commodity market in the world both in volume and value terms, representing around 35% of global commodity trade in value.

Chart 3: OTC Commodity Derivatives Breakdown







Source: BIS OTC Derivatives Statistics

Table 1 provides a breakdown of notional outstanding and gross market value. Notional outstanding for gold, other precious metals and other commodities totaled $1.0 trillion, $0.2 trillion and $1.5 trillion, respectively, at the end of June 2025. The gross market value of these commodities was $76.9 billion, $11.3 billion and $162.9 billion, respectively.

The other commodities segment, which includes oil derivatives, showed strong growth in the first half of 2025, with notional outstanding rising by 15.5% as geopolitical tensions in the Gulf region drove increased hedging of oil.

Table 1: OTC Commodity Derivatives Notional Outstanding and Gross Market Value ($ billions)

	31/12/2023	30/06/2024	31/12/2024	30/06/2025	31/12/2023	30/06/2024	31/12/2024	30/06/2025
US$ billions	Notional amounts outstanding				Gross market value			
Commodity Contracts	**2,202.9**	**2,445.5**	**2,407.6**	**2,623.1**	**301.2**	**254.2**	**256.7**	**251.2**
By Commodity								
Gold	791.3	1,025.1	1,024.8	992.5	26.4	34.8	42.8	76.9
Other precious metals	86.8	117.8	102.8	152.4	6.3	8.0	7.9	11.3
Other commodities	1,324.8	1,302.6	1,280.0	1,478.2	268.5	211.5	206.1	162.9
By Instrument&Commodity								
Forwards and swaps	1,647.3	1,848.7	1,824.5	1,856.0				
Gold	629.1	810.5	804.3	706.6				
Other precious metals	61.8	86.9	79.2	104.8				
Other commodities	956.4	951.3	941.1	1,044.6				
Total options	555.6	596.8	583.1	767.1				
Gold	162.2	214.7	220.5	285.9				
Other precious metals	25.0	30.9	23.6	47.6				
Other commodities	368.4	351.2	339.0	433.6				
Options sold (gross basis)	367.3	384.4	382.1	525.5				
Gold	95.9	127.3	132.6	175.6				
Other precious metals	14.0	15.4	10.7	28.0				
Other commodities	257.4	241.6	238.9	321.9				
Options bought (gross basis)	310.9	344.2	329.8	412.8				
Gold	102.6	135.3	137.2	174.1				
Other precious metals	16.5	22.4	18.2	30.2				
Other commodities	191.9	186.6	174.3	208.6				

Source: BIS OTC Derivatives Statistics

THE CASE FOR BROADENED USE OF OTC COMMODITY DERIVATIVES IN INDIA

Impediments to the Development of OTC Commodity Derivatives in India

The derivatives market in India has existed for almost as long as in the US and the UK, and the first organized derivatives markets in India started in 1875 with the trading of commodity futures. However, use of OTC commodity derivatives today faces regulatory barriers.

An ETD market in India exists for equities, foreign exchange (FX), interest rate products and commodities. Commodity derivatives contracts are currently available on four exchanges: Multi Commodity Exchange of India Limited (MCX), National Commodity & Derivatives Exchange Limited (NCDEX), National Stock Exchange of India Ltd and BSE Ltd.

Commodity ETDs experienced a steady increase in market participation from 2019 to 2022, following a change in rules to allow foreign portfolio investors to participate in the onshore ETD market for cash-settled non-agriculture contracts, the introduction of cash-settled contracts for commodities like crude oil, and the ability of exchanges to launch multiple contracts on the same commodity. Consequently, India has an established and growing commodity ETD market onshore and in India's GIFT City, comprising futures and options across four major market segments: energy (crude oil and natural gas); bullion (gold and silver); metals (copper, aluminum, zinc, lead, and nickel); and agriculture (edible oils, cotton and others).

Several regulatory reforms have helped to broaden market participation and increase trading volume in India's derivatives markets.

- In 2000, the Reserve Bank of India (RBI) allowed resident Indians to hedge their price risk in overseas commodity derivatives markets (OTC or exchange-traded), subject to approvals and alignment with regulatory guidelines[15].
- In 2010, the RBI issued comprehensive guidelines on OTC FX derivatives and overseas hedging of commodity price and freight risks[16].
- In 2018, the RBI liberalized certain elements of the commodity hedging guidelines issued in 2010, especially on permission for entities to undertake more hedging via the automatic route (ie, approval from banks) than the approval route (ie, specific approval from the RBI)[17].
- In 2019, SEBI permitted mutual funds to participate in certain exchange-traded commodity derivatives except sensitive commodities[18].

[15] Reserve Bank of India (RBI), Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, https://rbi.org.in/Scripts/NotificationUser.aspx?Id=179&Mode=0

[16] RBI, Comprehensive Guidelines on Over the Counter (OTC) Foreign Exchange Derivatives and Overseas Hedging of Commodity Price and Freight Risks, www.rbi.org.in/Scripts/NotificationUser.aspx?Id=6175

[17] RBI, Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions, www.rbi.org.in/scripts/NotificationUser.aspx?Id=11226

[18] SEBI, Participation of Mutual Funds in Commodity Derivatives Market in India, www.sebi.gov.in/legal/circulars/may-2019/participation-of-mutual-funds-in-commodity-derivatives-market-in-india_43046.html

- In 2022, the RBI permitted eligible entities to hedge their gold price risk (with settlement in non-rupee currency) on exchanges in GIFT City[19]. In 2024, the RBI extended this to permit eligible entities to hedge their gold price risk in the OTC derivatives market in GIFT City. Banks were also allowed to participate as professional clearing members and brokers (through a subsidiary) for exchange-traded commodity derivatives in India to further deepen market participation[20].

- In 2024, the International Financial Services Centres Authority allowed IFSC banking units (within GIFT City) to undertake OTC derivatives on gold and silver and offer such derivatives to their clients[21].

Despite these important changes, OTC commodity derivatives are currently not allowed onshore. The primary regulatory barrier arises from the provisions of the Securities Contracts (Regulation) Act, 1956 (SCRA), which prohibit forward contracts in commodities unless they are classified as non-transferable specific delivery contracts[22]. As a result, most OTC forward contracts, which typically involve financial settlement rather than physical delivery, fall outside the permissible scope of the SCRA, limiting the development and regulation of a broader commodity derivatives market. The only existing permission in India is limited to gold and silver within GIFT City and GIFT City is not considered onshore.

This contrasts with the regulatory frameworks in other major world markets, which allow both onshore OTC and exchange-traded commodity derivatives markets.

Rules in the US[23], EU[24], UK[25], Singapore[26] and Hong Kong[27] permit the use of onshore OTC commodity derivatives, subject to limitations (eg, position limits with aggregation, hedging exemptions and baseline limits rules, as well as position management rules for the exchanges) and strict reporting requirements. These jurisdictions typically allow hedge funds, institutional investors and banks to engage in bespoke OTC contracts, including forwards, swaps and options, subject to regulatory oversight (eg, the Commodity Futures Trading Commission in the US, the European Securities and Markets Authority in the EU, the Financial Conduct Authority in the UK, the Monetary Authority of Singapore and the Hong Kong Monetary Authority).

[19] RBI, Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12427

[20] RBI, Master Direction – Reserve Bank of India (Financial Services Provided by Banks) Directions, 2016, www.rbi.org.in/scripts/BS_ViewMasDirections.aspx?id=10425

[21] International Financial Services Centres Authority, Permission to Offer OTC Derivatives on Gold and Silver, https://ifsca.gov.in/Viewer?Path=Document%2FLegal%2Fotde-module27062024022351.pdf&Title=Permission%20to%20offer%20OTC%20derivatives%20on%20Gold%20and%20Silver%3A%20Amendment%20to%20OTDE%20Module%20%28Module%20no.%2013%29%20of%20IFSCA%20Banking%20Handbook%20COB%20Directions%20v6.0&Date=27%2F06%2F2024

[22] Section 30A of the Securities Contracts (Regulation) Act, 1956

[23] Code of Federal Regulations (CFR), Title 17 Chapter I, Commodity Futures Trading Commission, www.ecfr.gov/current/title-17/chapter-I; CFR, Title 17 Chapter 1 Part 150, Limits on Positions, www.ecfr.gov/current/title-17/chapter-I/part-150

[24] Directive 2014/65/EU, Markets in Financial Instruments Directive, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014L0065-20250117; Regulation (EU) 600/2014 – Markets in Financial Instruments Regulation, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02014R0600-20250117; European Commission Delegated Regulation (EU) 2022/1302 – Regulatory Technical Standard for the Application of Position Limits to Commodity Derivatives and Procedures for Applying for Exemption from Position Limits, https://eur-lex.europa.eu/eli/reg_del/2022/1302/oj/eng#:~:text=Commission%20Delegated%20Regulation%20%28EU%29%202022%2F1302%20of%2020%20April,exemption%20from%20position%20limits%20%28Text%20with%20EEA%20relevance%29; Regulation (EU) 648/2012, OTC Derivatives, Central Counterparties and Trade Repositories, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02012R0648-20250117; Regulation (EU) 1227/2011, Wholesale Energy Market Integrity and Transparency, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02011R1227-20250205

[25] Financial Conduct Authority (FCA) Handbook, MAR 10, www.handbook.fca.org.uk/handbook/MAR/10/?view=chapter; FCA Handbook, MAR 10.2 Position Limit Requirements, www.handbook.fca.org.uk/handbook/MAR/10/2.html?date=2023-04-25

[26] Securities and Futures (Trading of Derivatives Contracts) Regulations 2019; ISDA, The Asian OTC Derivatives Markets, page 4, www.isda.org/a/9QiDE/celent-isda-asian-otc-derivatives-markets-fmal.pdf

[27] ISDA, *The Asian OTC Derivatives Markets*, page 4, www.isda.org/a/9QiDE/celent-isda-asian-otc-derivatives-markets-fmal.pdf

Onshore OTC Commodity Derivatives: A Useful Complement to the ETD Market

While the standardized terms of ETD contracts enable market participants to hedge exposures against general market movements, OTC derivatives offer the flexibility to tailor contracts to each firm's specific business needs. This flexibility to customize OTC derivatives allows users to address unique risk exposures that may not be covered by standardized ETD instruments. This is fundamentally important to enable precise, tailor-made risk management. Global companies have long valued the flexibility OTC derivatives provide as they seek to manage complex business risks.

While the standardized terms of ETD contracts enable market participants to hedge exposures against general market movements, OTC derivatives offer the flexibility to tailor contracts to each firm's specific business needs

There is a healthy interplay between OTC and ETD markets that helps participants achieve their risk management goals in the most efficient manner. For example, OTC derivatives dealers frequently rely on a liquid ETD market to dynamically hedge their market risk. Conversely, organized futures and derivatives markets face competitive pressure from OTC markets, which can offer similar contracts. To a certain extent, competition between OTC and exchange-traded derivatives is determined by the size, duration and other elements of the contracts and what type of risk the end users want to hedge[28].

As experience in other countries has shown, OTC and ETD markets can coexist, exploiting their comparative advantages to offer risk management benefits to corporations, investors and other users. It means users have broader hedging choice using the instruments that make most sense for each specific exposure.

Recognizing and understanding the distinct strengths of OTC and ETD instruments would enable Indian market participants to effectively navigate these markets, allowing them to choose the most appropriate option for risk management and investment. Flourishing ETD and onshore OTC derivatives markets will facilitate a more comprehensive and efficient ecosystem to serve the growing needs of India's economy and help realize its full potential.

Benefits of an Onshore OTC Commodity Derivatives Market for Indian Companies

Commodity derivatives – in the form of both ETD and OTC contracts – are widely used in diverse industries worldwide to meet the risk management and investment needs of market participants.

In the airline industry, for example, the use of commodity derivatives allows for effective fuel-price hedging, which helps ensure financial stability for the airline and affordable ticket prices for consumers. In fact, fuel hedging is widely used among non-US airlines, according to a 2023 study[29]. Air France hedged 72% of fuel needs in early 2022, later reducing coverage to 63%. Cathay Pacific hedged 100% of fuel consumption in the first quarter of 2022, dropping to 50% in the following three-month period, demonstrating varying approaches to managing fuel costs. Similarly, airlines like Ryanair (85%), Lufthansa (74%) and Finnair (50%) used derivatives to hedge 2024 fuel needs against price volatility[30].

[28] Jens Nystedt, IMF Working Paper 04/61, *Derivative Market Competition: OTC Markets Versus Organized Derivative Exchanges*, www.imf.org/external/pubs/ft/wp/2004/wp0461.pdf. Although dating from 2004, this paper still presents very valid examples of synergies

[29] Reuters, December 2023, How European Airlines have Hedged Against Fuel Price Increases, www.reuters.com/business/aerospace-defense/how-european-airlines-have-hedged-against-fuel-price-increases-2023-11-02/

[30] ISDA, *The Value of OTC Derivatives: Empowering Organizations to Manage Risks, Enhance Returns and Optimize Liquidity*, March 2025, www.isda.org/2025/03/17/the-value-of-otc-derivatives-empowering-organizations-to-manage-risks-enhance-returns-and-optimize-liquidity/

Agricultural derivatives are used to manage price volatility and stabilize income for farmers. In 2020, 94% of futures trading and 87% of options trading by US farmers focused on corn and soybeans, according to a US Department of Agriculture study[31]. These derivatives support efficient risk transfer, benefiting farmers and consumers by promoting price stability in agricultural markets. Many food and consumer-products companies also use derivatives to hedge their commodity price risks.

Derivatives markets are essential for managing energy sector risks, particularly during extreme price volatility

Derivatives markets are essential for managing energy sector risks, particularly during extreme price volatility. They stabilize operations for traders, ensure critical service continuity and support price stability. In electricity markets, derivatives help align supply and demand, enabling distribution operators to plan and avoid short-term market risks. For natural gas, derivatives optimize storage, balancing electricity markets during supply-demand fluctuations. In Europe, participation in energy derivatives markets rose by 30% in 2022, with 25% of 1,700 participating firms originating from the oil, gas and energy sectors, and the remaining 75% primarily from energy-intensive industries like transport and manufacturing, according to a European Central Bank analysis[32,33].

Indian companies are equally exposed to price volatility on raw materials – primarily iron ore and coal, as well as various petroleum, petrochemical and other energy-related commodities (eg, crude oil, natural gas and polymers) – as part of their business operations. These companies use various derivatives in the offshore market, such as interest rate swaps, currency swaps, forwards and options, and commodity derivatives to mitigate the risk of changes in interest rates, exchange rates and commodity prices. This allows them to hedge a percentage of their exposure to commodities[34].

However, the ability of Indian companies to manage their commodity risks is limited by the lack of an onshore OTC derivatives market. Restricting OTC commodity derivatives to the offshore market (and to GIFT City for gold and silver) means Indian companies have limited use of OTC commodity derivatives. Even if all Indian corporates can theoretically access offshore OTC commodity derivatives markets, only global Indian companies are using OTC commodity derivatives through the offshore market in practice. Smaller companies generally lack the necessary infrastructure, operational processes and expertise required for trading in offshore markets.

The full array of efficient hedging tools therefore cannot be easily accessed by Indian companies, especially domestic firms that lack the size and reach to participate in the offshore market. These firms would benefit most from such access. For instance, airlines, which are highly sensitive to fluctuations in jet fuel prices, and agricultural companies, which need to hedge price risks, could immediately take advantage of the benefits of access to an onshore OTC commodity derivatives market.

[31] US Department of Agriculture, *Corn and Soybean Farmers Combine Futures, Options, and Marketing Contracts To Manage Financial Risks*, November 2020, www.ers.usda.gov/amber-waves/2020/november/corn-and-soybean-farmers-combine-futures-options-and-marketing-contracts-to-manage-financial-risks#:~:text=Researchers%20at%20USDA%2C%20Economic%20Research,to%20deliver%20corn%20in%20December).

[32] European Central Bank (ECB), Financial Stability Review, November 2022, www.ecb.europa.eu/press/financial-stability-publications/fsr/special/html/ecb.fsrart202211_01~173476301a.en.html#:~:text=The%20remaining%20firms%20belong%20to,it%20for%20the%20first%20time.

[33] ISDA, *The Value of OTC Derivatives: Empowering Organizations to Manage Risks, Enhance Returns and Optimize Liquidity*, March 2025, www.isda.org/2025/03/17/the-value-of-otc-derivatives-empowering-organizations-to-manage-risks-enhance-returns-and-optimize-liquidity/

[34] For instance, the Indian company Reliance Industries Ltd (RIL) indicated in its Annual Report 2023-24 to have hedged 0.18% (out of 12.68%) of its exposure to crude oil and 2.49% (out of 19.99%) of its exposure to middle distillates in the offshore OTC derivatives market (www.ril.com/ar2023-24/pdf/RIL_IAR_2024.pdf). The Indian company Tata Steel Ltd stated in its Annual Report 2023-24 that 1.86% of its coal exposure was hedged in the offshore OTC derivatives market, with none hedged in the ETD market (www.tatasteel.com/investors/integrated-report-2023-24/pdf/tata-steel-limited-ir-2024.pdf)

INDIA HAS SET THE GROUNDWORK FOR AN ONSHORE OTC COMMODITY DERIVATIVES MARKET

The development of a robust and liquid OTC commodity derivatives market in India would support the continued growth of India's economy given its significant reliance on commodities. OTC commodity derivatives are key tools for managing financial risks arising from fluctuations in commodity prices, and the establishment of a well-functioning OTC market in India would give market participants a flexible and efficient means to navigate evolving economic and commodity market conditions.

OTC commodity derivatives are key tools for managing financial risks arising from fluctuations in commodity prices, and the establishment of a well-functioning OTC market in India would give market participants a flexible and efficient means to navigate evolving economic and commodity market conditions

It would also improve the ability of the economy to withstand commodity price swings by enabling more firms to closely manage their bespoke commodity risks – particularly those firms that cannot participate in the offshore OTC derivatives market today. The customizable features of OTC derivatives mean entities can effectively hedge exposures on a one-to-one or portfolio basis, aligning with accounting and regulatory requirements. In addition, an onshore OTC commodity derivatives market would give regulators a clearer picture of economic and market dynamics within the country and their impact on companies and institutions.

Hedging bullion, energy, agriculture and base metals currently takes place offshore (although gold and silver can be hedged with OTC derivatives in GIFT City). Corporates have been permitted to hedge commodity risk exposures in the overseas market[35], with commodity forwards and swaps most commonly used. While offshore markets are useful, they cannot replace onshore OTC derivatives markets and mainly benefit the largest companies.

India has taken important steps in establishing an onshore OTC derivatives market. It has successfully implemented many of the G-20 commitments[36] on OTC derivatives regulation[37] to enhance market stability, transparency and risk mitigation – for example, by strengthening oversight of OTC derivatives and incentivizing central clearing of standardized interest rate and foreign exchange derivatives.

Reporting requirements under the trade repository system were tightened to improve data visibility, while margin rules for non-centrally cleared derivatives were phased in to reduce systemic risk. The latter framework became fully applicable on April 1, 2025, with the adoption of initial margin requirements. Having implemented most of the risk mitigation G-20 commitments, India has the foundations in place for a safe and well-functioning onshore OTC commodity derivatives market.

The development of an onshore OTC commodity derivatives market should complement the existing ETD market to meet the growing risk management needs of market participants in India. The coexistence of both exchange-traded and OTC commodity derivatives markets is beneficial, as they cater to the distinct requirements of various market participants, giving them access to a broad set of risk management tools.

[35] RBI, Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets), www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12427

[36] ECB, Looking Back at OTC Derivative Reforms – Objectives, Progress and Gaps, www.ecb.europa.eu/pub/pdf/other/eb201608_article02.en.pdf

[37] Financial Stability Board, 2023 FSB Annual Report - Promoting Global Financial Stability, pages 23-24, www.fsb.org/uploads/P111023.pdf

Currently, Indian banks are barred from dealing commodities (other than gold) unless it's to recover dues from defaulted loans[38]. To enable wider participation, relevant laws will need to be amended, such as the Banking Regulation Act, 1949, and the Reserve Bank of India Act, 1934, to give the RBI regulatory authority over OTC commodity derivatives. The definition of 'derivatives' under Section 45U of the RBI Act also needs to be amended to include commodity derivatives and the RBI could amend its master directions to make the margin rules applicable to commodity derivatives. In addition, the RBI may have to notify commodity derivatives as qualified financial contracts (QFCs) under the Netting Act.

An onshore OTC commodity derivatives market requires a clear market regulatory regime. This includes clear definitions and enforcement powers for SEBI and the RBI. A well-structured regime will boost investor trust, align with global norms and support market growth.

For these reasons, ISDA recommends that regulators allow the development of an onshore OTC commodity derivatives market, starting with specific commodities, such as steel and crude oil, which both have readily available pricing benchmarks to facilitate OTC derivatives. The introduction of an onshore OTC derivatives market for steel can be linked to Management Engineering & Production Services International Ltd prices, which is commonly used by steel industry participants in India. Similarly, the introduction of OTC crude oil derivatives can be tied to the Brent and Dubai pricing benchmarks, which are currently used by refineries in foreign OTC derivatives markets to hedge against basis risk.

Establishing an OTC commodity derivatives market in India would greatly help domestic Indian companies and the Indian economy, providing an adaptable and flexible system for managing commodity risks. This initiative would build on the valuable efforts made in GIFT City by extending commodities derivatives trading beyond gold and silver. Regulators in India can be guided by supervisory practices that have been successful in other jurisdictions and across all types of market conditions to foster the healthy growth of OTC derivatives within an orderly and effective framework.

[38] Section 8 of the Banking Regulation Act, 1949

ABOUT ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn and YouTube.