Indian Rupee Options FAQs

What are Options?

Options are contracts that give the buyers the right (but not the obligation) to buy or sell a specified amount of INR futures at a specified strike price, in a specified period of time. On the other hand the seller is under obligation to perform the contract (buy or sell the underlying).

Important terminology connected with INR Options?

- Option Premium - It is the price paid by the buyer of the option to the seller of that option to acquire the right to buy or sell INR/US$ futures.
- Strike Price or Exercise Price - The strike or exercise price of an option is the specified / predetermined price of the INR/US$ futures at which the same can be bought or sold if the option buyer exercises his right to buy / sell on or before the expiration date.
- Expiration date - The date on which the INR option expires is known as Expiration Date. On Expiration date, the INR option may either be exercised or it expires worthless.
- Exercise Date - The date on which the INR option is actually exercised is called as Exercise Date. In the INR optin case (European) the exercise date is the same as the expiration date
- Open Interest - The total number of options contracts outstanding (open positions) in the market at any given point of time.
- Option Buyer / Holder - is one who buys an INR option. It can be a Call, or a Put option. The holder / buyer of an INR option enjoys the right to buy or sell the INR/US$ futures at a specified price on or before specified time.His profit potential is unlimited while the loss is limited to the premium paid by him to the option writer.
- Option Seller / Writer - is the one who sells or writes an option in consideration of premium. He is obligated to buy (in case of Put option) or to sell (in case of Call option), the INR/US$ futures in case the buyer of the option decides to exercise his option. His profit potential is limited to the premium received from the buyer whereas the loss can be unlimited.
- Option Class - Options of the same type relating to the same underlying instrument are options of the same class.
- Option Series - An option series consists of all the options of a given class with the same expiration date and strike price.
- Option Assignment - When holder of an option exercises his right to buy / sell, a randomly selected option seller is assigned the obligation to honor the underlying contract, and this process is termed as Assignment.

What is European Style of Options?

European Option: One which can be exercised by the buyer only on the expiration day and not any time before that.

What is a Call Option?

A Call option gives the holder (buyer / one who is long Call) the right to buy a specified quantity of INR futures at the strike price onthe expiry date. The seller (one who is short Call) however, has the obligation to sell the INR/US$ futures if the buyer of the Call option decides to exercise his option to buy.

What is a Put Option?

A Put option gives the holder (buyer / one who is long Put), the right to sell specified quantity of the INR/US$ futures at the strike price on the expiry date. The seller of the Put option (one who is short Put) however, has the obligation to buy the underlying asset at the strike price if the buyer decides to exercise his option to sell.

Explain 'In the Money', 'At the Money' & 'Out of the money' Options?

An option is said to be at-the-money, when the option's strike price is equal to the INR/US$ futures price. This is true for both Puts and Calls. A Call option is said to be in the money when the price of the INR/US$ futures exceed the strike price of the option. A Put option is in-the-money when the price of the INR/US$ futures falls below the strike price of the option. A Call option is out-of-the-money when the price of the INR/US$ futures is below the strike price of the option. A Put option is out-of-the money when the price of the INR/US$ futures is above the strike price of the option.

What are the factors that determine the premium (price of the option)?

- The strike price of the option
- Underlying commodity price
- The time to expiration
- Volatility of the underlying stock and contract/product
- The risk free interest rate
- Dividends (in case of stocks)

Who decides on the premium on options & how is it calculated? Is it determined by the exchange?

The price of an option (premium) is determined by the interaction of demand and supply forces in the market. The Exchange does not have any role to play in determination of the price of options. It is the buying and selling action of the market participants that leads to price discovery. The fair value / theoretical price of an option can be known with the help of mathematical pricing models & then depending on market conditions the price is determined by competitive bids & offers in the trading environment. An option's premium / price is the sum of its intrinsic value & time value. If the price of the underlying asset is held constant, the intrinsic value portion of an option premium will also remain unchanged. Any change in the price of the option will be entirely due to a change in the option's time value. The time value component of the option premium can change in response to a change in the volatility of the INR/US$ futures, the time to expiry, interest rate fluctuations and dividend payments. Besides, a sudden shift in the supply & demand equation for the INR/US$ futures or its option can also impact the option price.

What are Option Greeks?

The Options Greeks measure the sensitivity of the option price with respect to a change in the basic factors that affect the price of options. They are often used by professional traders for trading & managing the risk of large positions in options & stocks. These Option Greeks are:

- Delta: measures the amount of change in option premium / price in relation to a change in the price of the INR/US$ futures.
- Gamma: measures the estimated change in the Delta of an option due to a change in the price of the INR/US$ futures.
- Vega: measures the change in the option price that is caused by a change in the volatility of the INR/US$ futures.
- Theta: measures the change in the INR option price that is caused by a change in the time to option expiry.
- Rho: measures the estimated change in the INR option price that is due to a change in the risk free interest rates.

Who can participate in Options Market?

Options markets provide a lot of opportunities to a large variety of people with different financial objectives such as hedging, arbitrage and investment. Developmental Institutions, Mutual Funds, Domestic & Foreign Institutional Investors, Traders, Growers Manufactures, Brokers, Retail investors are some of the important participants in the Options Market. One can trade in options on a futures exchange only through a broker member of that exchange.

What are the main benefits of using options?

The following are some of the main benefits of using Options:

- They can be used as instruments for hedging
- Help in diversification of portfolio
- Allow a high degree of leverage to the user
- They can be used to generate additional streams of income from ideal assets
- Allow the user a great degree of flexibility – can be combined and structured to typically suit the user's requirements
- Can be used in all market conditions – up, down or sideways
- Buyers can precisely define and fix their risk levels

How can I use options?

One can use options according to one's investment / risk management needs. A wide variety of option strategies ranging from plain vanilla options to complex combinations are used by the option traders. The strategy to be used at a given point in time usually depend on factors like investment objective, perception of the future market moves, volatility expectation, time frame within which the perceived move is expected and the expected risk / reward ratio.

Some of the simple strategies that are used by market players are:

- Buy Call Option / Sell Put Option – in case the view is bullish
- Sell Call Option / Buy Put Option – where the view is bearish
- Buy Put Option - for hedging long futures position
- Buy Call Option - for hedging short futures position

How will the Option get settled?

Option is a contract which has a market value like any other tradable commodity. The following alternatives are available to the buyer of an option:

- Sell an option of the same series as bought & close out /square off position in that option at any time on or before its expiration date
- Exercise the option on the expiration day
- Positions that are 'out of the money' at the time of expiry, will not be exercised for the obvious reason that they are not profitable. Therefore, such options will automatically lapse or expire worthless

What are the risks for an Option buyer?

The risk / loss of an option buyer is limited to the premium that he has paid to buy the option.

What are the risks for an Option Writer?

The risk of an Options Writer is theoretically unlimited, whereas his gains are limited to the premiums earned. When an uncovered Call is exercised, the Call writer will have to purchase the underlying asset and his loss will be the excess of the purchase price over the exercise price of the Call as reduced by the premium received for writing the Call.

What is a clearing corporation? What role does it play in a futures exchange?

Clearing Corporations help in smooth and secure clearance and settlement of trades taking place in the exchange. They act as counterparty to each trade and thus provide a performance guarantee to the buyer / seller. In turn they also impose, monitor, and collect margins from brokers on regular basis to keep the market financially secure and orderly.

Further Information

For further information on DGCX, our products and how to access our markets, please contact us on the details below. Alternatively, please refer to the contract specifications for product related information. Delayed prices for all DGCX contracts are available on our website.

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As trading in derivatives involves leveraging, it can be fairly risky and could result into loss of capital in case the price of the commodity moves adversely to the position taken by an investor.