Worst is over for Indian Commodity Exchanges

- Metalworld Research Team

India's commodity exchanges have started gradually getting their confidence back after merger of the erstwhile regulator the Forward Markets Commission (FMC) with the markets watchdog the Securities and Exchange Board of India (Sebi) and resolution of problems faced after the payment crisis at the National Spot Exchange Ltd (NSEL). Sebi being the more powerful and independent regulator, can take actions against wrongdoers in the entire commodity eco-system. Therefore, market participants are now assured of smooth and pro-active decisions for the growth of commodity derivative markets.

At the time of FMC merger with Sebi in September 2015, India's finance minister Arun Jaitley had said, We had only two options one to empower FMC which was objected to by various political parties in the Parliament and two to merge FMC with Sebi for smooth transition of commodity futures market. We opted for the second in the best interest of entire commodity futures market participants.

Long Wait for a Strong Regulator

Commodity futures were discontinued in India in 1960s due perhaps to excessive speculation and inadequate power given to the then regulator FMC. After over four decades of discontinuation, futures trading in commodities both agri and non-agri were allowed in 2002 which saw emergence of three national level commodities exchanges i.e. Multi Commodity Exchange of India (MCX), National Commodity and derivatives Exchange of India (NCDEX) and National Multi Commodity Exchange (NMCE). Through continuous innovation and introduction of specialized contracts, the three commodity exchanges strengthened their presence in non-agri (like gold, silver, crude, base metals etc), agri (guar, spices, wheat and sugar) and plantations (coffee, isabgul etc) products. Apart from that there existed a number of regional commodity exchanges that shut their operations within a few years of the existence of the national level platforms. Despite strong domain knowledge, deep rooted expertise and hard core membership base of commodity specific traders, these regional exchanges started losing their members along with their business. Lack of financial muscle for technology up-gradation and appointment of intellectuals to run day to day operations put regional exchanges on the back foot.

National exchanges, meanwhile, started flourishing leaps and bounds. Strong manpower and clear vision to set new benchmark in commodity futures space provided edge over some of centurion regional exchanges. Commodity exchanges in India, thus, proved an important tool for day traders and corporate manufacturers to hedge their risk on local exchanges with domestic flavor of trade practices. National exchanges, however, continued to face challenges to attract




participation from large corporate. With FMC merger with Sebi, effective regulations look to encourage corporate participation with some riders in terms of position limit, narrow price range, limitation on stock holding especially in narrow commodities.

While the two exchanges MCX and NCDEX have maintained their market shares with continue innovations in their contracts, Ahmedabad-based NMCE is struggling to cope with the frequent change in regulatory guidelines. Allegations over its promoter fund transfer for other than the exchange purposes, led Kailash Gupta ouster in early years of exchange set up. Since then, NMCE has been facing challenges for its survival. Its present management led by the managing director Anil Mishra is yet to achieve any remarkable growth in the exchanges performance.

Exchanges Set Up and Shut Down

Looking at the success of two exchanges i.e. MCX and NCDEX, many aspirants applied for licences. In fact, two other exchanges i.e. Indiabulls and MMTC promoted Indian Commodity Exchange (ICEX) and Universal Commodity Exchange (UCX) were set up. But, within a couple of years of their existence, they shut down their shops citing unfavourable trading climate, lack of innovations and deficiency of trading enthusiasm in the commodity eco-system. While Indiabulls sold its majority stake to Anil Ambani group company Reliance Capital to attract participation from large corporate. But, even Reliance Capital could not prevent closure of ICEX which in fact issued a rights issue to bring in more capital from existing stakeholders to meet the regulatory requirement. The exchange claims to see its re-launch in June. Technocrat Ketan Sheth promoted UCX failed to attract participation adequate enough for survival and therefore, the exchange was shut down with no plans for its re-launch.

Riders

The commodity derivatives market in India faced many challenges in a short span of 14 years which curbed its growth. The Lehman Brothers crisis in 2008 shook the entire global financial system, Indian commodity exchanges were no exceptions. When the world financial markets were recovering from Lehman crisis, the Rs 5600-crore scam erupted at Financial Technologies promoted National Spot Exchange (NSEL). Since Financial Technologies had promoted Multi Commodity Exchange also, the entire eco-system entrusted confidence in NSEL which resulted into huge trading in its spot commodity trade. Many brokers and individual traders invested immensely in NSEL contracts. In July 2013, therefore, the NSEL payment crisis took place which cautioned commodity traders and created uncertainty in the market. The threat of Sebi stern action is so high that there has been no news of dabba trading (settlement of agri commodity trade in physical markets with price reference from online future exchanges) as used to be the case earlier.

Interestingly, the markets regulator Sebi suspended trading in forward segment of commodities that were launched on NCDEX in a number of commodities. Forward trading was considered to be the link between spot and futures which till now was missing from the exchange platform. Encouraged by this forward concept, Ahmedabad-based prepared to launch this segment on its own platform. But, the exchange could not succeed in its launch. Faced with excessive speculation in a number of sensitive commodities, Sebi suspended trading in castor seed, an oilseed. Also, the government introduced commodity transaction tax (CTT) on processed agri and all segment of non-agri commodities. Because of this tax, day traders and short term hedgers found trading on commodity exchanges unviable. All these actions created uncertainty in base metals trading on MCX.

Absence of Corporate Participants

Primary metals producers in India including Hindalco Industries, Vedanta, Hindustan Copper, National Aluminium Co. etc. remained so far absent from participating in domestic commodity exchanges due perhaps to the lack of depth. Understandably, a number of them continued to hedge their price volatility risk on the benchmark London Metal Exchange (LME). While there has been no major risk of stubborn price volatility in domestic exchanges being price on local platforms closing (upto 99.9 per cent) linked with LME, Indian producers failed to take advantage of local exchanges. Exchanges, meanwhile, have been trying their tooth and nail to convince them for local presence, Indian metal producers continued to stay away from trading. In fact, convincing them to hedge their risk on local platform proves to be a herculean task for Indian commodity exchanges. Consequently, Indian commodity exchanges continued to witness trading either from traders or users resulting into trade becoming one sided. Had producers also participated, the depth and confidence on domestic commodity exchanges could have been at the seventh heaven.

Turnover Bouncing Back

Still commodity exchanges succeeded on bouncing back from deep crisis. Sustained innovation resulted into a positive growth in their accumulative turnover with sharp gain in base metals segment. Total turnover of commodity trading on registered exchanges fell to around Rs 65 lakh crore in the financial year 2013 - 14, almost half of Rs 123 lakh crore clocked in 2012-13 with the worst seems to be over".

In 2014, the regulations were tightened for promoter and shareholders of the exchanges, warehouse facilities were strengthened. Going ahead, the focus would be on increasing depth of the market and quality trade volumes, and is in talks with RBI to allow more market participants like foreign institutional investor (FIIs) and banks in the commodity market. Increasing depth in commodity exchanges might allow participation of base metals producers with simultaneous participation from banks and financial institutions. With Sebi in charge of the commodity market, investors are getting their confidence back as the turnover of commodity exchanges grew 9 per cent to Rs 67 lakh crore in 2015-16. This is being seen as one of the best years for the segment in recent times. Commodity futures turnover on the two major bourses – MCX and NCDEX stood at nearly Rs 60.9 lakh crore in 2014-15, latest data showed. In volume terms, the number of such contracts traded rose 56.5 per cent to 27.5 crore in 2015-16, from about 17.6 crore in the year-ago period. Experts believe that the growth in commodity trading is attributed to pick-up in investor confidence, with the Securities and Exchange Board of India (Sebi) entrusted with the job of commodity market. Individually, MCX saw a trading value of Rs 56.3 lakh crore in 2015-16 as against Rs 51.8 lakh crore in 2014-15. There was trading in 23.4 crore contracts for the period under review, up nearly 58 per cent. NCDEX reported a 13 percent jump in turnover at Rs 10.2 lakh crore while volumes rose 50 percent to 4.1 crore during the last fiscal.