Expansion of commodity derivatives trading

Why in news?

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BSE and NSE have received permission from the Securities and Exchange Board of India (Sebi) for commodity derivatives trading recently.

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What is a derivative?

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- Derivatives are the contract whose value is derived from the underlying asset or the contract where delivery of security or commodity held on specific future date.
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- The main purpose of commodity derivative is to reduce the risk of future price uncertainty and provide the industry knowledge as well investment opportunity to a general investor.
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- Derivatives could be stocks, indices, commodities, currencies, exchange rates or the rate of interest.
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- Till date, commodity derivatives contracts are available only on MCX and NCDEX, the two specialised commodity derivatives exchanges in the country.
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- The Bombay Stock Exchange(BSE) became the first stock exchange in the country to launch commodity derivatives contract in gold and silver.
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- Both BSE and NSE has plans to launch derivatives trading in non-agriculture commodities in the initial phase, followed by agriculture commodities.
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What are the other such initiatives in this regard?

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- SEBI has recently redrafted the rules for trading, membership, products and risk management.
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- Market surveillance has also improved with tighter supervision and scrutiny.
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- Domestic companies with direct exposure to commodity price risk in gold, gems and precious stones have been barred by RBI from hedging in international markets.
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- This is likely to result in these companies using the domestic exchanges to take cover, thus helping domestic commodity derivative volumes.
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- Also, all listed companies are required to disclose their commodity risk, hedged exposure as well as their risk-management policy.
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- This is to make companies take greater cover for their commodity exposures due to the fear of investor displeasure, which could also help improve volumes on exchanges.
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What should be done?

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- **Agri-contracts** - Both exchanges are beginning their foray in this segment with bullion and energy-based contracts.
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- SEBI needs to ensure that both BSE and NSE soon launch agri-contracts that serve farmers and companies in hedging price risks.
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- **Pricing** - Exchanges often tend to use predatory pricing or other underhand methods to garner market share and it should be dissuaded.
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- Also, SEBI needs to examine ways to bring down the high cost of trading in domestic exchanges.
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- **Participation & Monitoring** - Increasing market participation by allowing other investor segments such as mutual funds into commodity markets should be looked out.
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- A tight vigil needs to be maintained to ensure that there is no unhealthy competition among exchanges.
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Source: Business Line

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