

## Mutual Funds and Portfolio Managers in Commodity Exchanges - SEBI's Moves

### What is the issue?

- Securities and Exchange Board of India (SEBI) has decided to permit mutual funds and portfolio managers to transact in commodity exchanges.
- It gains significance with another recent ban order of SEBI on intermediaries involved in the NSEL scam.

### What are Commodity Derivatives?

- **Derivatives** - Derivative is a contract between two or more parties.
- Its value is determined by the underlying asset.
- The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes.
- **Commodity Derivatives** - It is a derivative contract with a commodity as the underlying asset.
- Producers who want to manage the risk of future price uncertainty for their commodities enter into commodity derivatives.
- In India, as a stock market NSE provides a platform to trade in different shares, the Multi Commodity Exchange (MCX) and National commodity derivative Exchange (NCDEX) facilitate for the commodities trade.
- MCX is known for the trading of Bullions metals (Gold, Silver, etc), Base Metals (Zinc, Aluminium, etc) and Energy (Crude Oil and Natural Gas).
- The NCDEX is known for trading in Derivative contract of agricultural produces.

### What are Mutual Funds and Portfolio Managers?

- **Mutual Fund** (MF) is an investment vehicle made up of a pool of moneys collected from public investors.
- The pooled money is used to buy other securities by professional money managers.
- They give small or individual investors access to professionally managed portfolios of equities, bonds and other securities.
- **Portfolio Manager** (PM) is a professional person or a group of people, usually experienced investors responsible for making investment decisions on behalf of individuals or institutions.

- The main difference between MFs and PMs is that in Mutual Funds, the investors' money is pooled and collectively invested, which is not the case with PMs.

### **What is SEBI's recent decision?**

- Since taking regulatory responsibility of the commodity derivatives market in 2015, it has been SEBI's main focus area.
- As of now, only gold is a permissible commodity for institutional investors, and is allowed through exchange-traded funds (ETFs).
- SEBI had earlier attempted to increase the institutional participation in the commodity segment.
- E.g. it recently allowed category -III Alternative Investment Funds (AIFs) to participate in the commodity derivatives market
- In line with this, allowing mutual funds and portfolio managers in the commodity derivatives segment aims at broad-basing the commodity derivatives market.
- The decision is also part of SEBI's larger task to cleanse this segment of the negative fallout from the National Spot Exchange Ltd (NSEL) scam.

### **What was the NSEL scam about?**

- It occurred more than 5 years ago, and involved questionable acts by brokers.
- They had allegedly, among many other violations, -
  - i. made false representations of assured and risk-free returns to clients
  - ii. modified client codes
  - iii. engaged in trades without the permission of clients
  - iv. failed to report suspicious transactions to the Financial Intelligence Unit
- Recently, SEBI ordered against 4 commodity brokers who operated on the NSEL, acknowledging the wrongdoings of these intermediaries.
- They are Motilal Oswal Commodities Broker, Indian Infoline Commodities, Geofin Comtrade and Anand Rathi Commodities.
- It was held by SEBI that the reputation, fairness, honesty, integrity and character of the brokers had been seriously eroded.
- SEBI concluded that they were not fit to be allowed to operate as commodity derivatives brokers, either directly or indirectly.

### **How effective are SEBI's moves?**

- The latest move with MFs and PMs is yet another attempt to improve participation in this segment.

- But SEBI's actions against commodity brokers have had little impact.
- Barring the commodity broking services of the 4 intermediaries has not caused much disruption in the commodity derivatives market.
- This is because the commodity broking operations of the brokers charged in the order are being carried out through other entities.
- SEBI's ban order thus needs to be effectively enforced.
- The regulator needs to evaluate the operations of the entire group of companies to ascertain whether the order is being followed in spirit.

**Source: Business Line, Business Standard**

## **Quick Facts**

### **Alternative Investment Funds**

- An alternative investment is an asset that is not one of the conventional investment types, such as stocks, bonds and cash.
- Alternative investments instead include private equity, hedge funds, managed futures, real estate, commodities and derivatives contracts.
- Most alternative investment assets are held by institutional investors or accredited, high-net-worth individuals because of the complex natures and limited regulations of the investments.

