

Chapter-II

Historical review of the Indian Commodity Derivative Market

2.1 Pre Independence era

The history of organized commodity derivatives in India goes back to the nineteenth century when the Cotton Trade Association started futures trading in 1875. In 1893, following widespread dissatisfaction amongst leading cotton mill owners and merchants over the functioning of the Bombay Cotton Trade Association, a separate association by the name "Bombay Cotton Exchange Limited" was constituted.

Soon after the commencement of cotton futures, futures trading in oil seeds were started with the formation of Gujarat Vyapari Mandali, which was established in the year 1900 in Mumbai. This institution has evolved into the present day Bombay Commodity Exchange Limited (BCE).

Futures trading in wheat were existent at several places in Punjab and Uttar Pradesh. But the most notable derivative exchange for wheat was chamber of commerce at Hapur set up in 1913. Other markets were located at Amritsar, Moga, Ludhiana, Jalandhar, Bhatinda, in Punjab and at Meerut, Hathras, Saharanpur and Barreily in Uttar Pradesh. Futures trading in wheat have been taking place since long back at various international commodity exchanges of world like Chicago Board of Trade (CBOT) in Chicago; USA, Winnipeg Commodity Exchange in Canada, Kansas City Board of Trade in Kansas, USA, Minneapolis Grains in Missouri, USA and many other exchanges located in Japan, Australia, and East European Countries.

Futures trading in bullion began in Mumbai in 1920. Calcutta Hessian Exchange Limited was established in 1919 for futures trading in raw jute and jute goods. But organized derivative trading in raw jute began only in 1927 with the establishment of East Indian Jute Association Limited. These two associations amalgamated in 1945 to form the East India Jute & Hessian Limited to conduct organized trading in both raw jute and jute goods.

However many feared that derivatives fuelled unnecessary speculation in essential commodities, and were 'detrimental to the healthy functioning of the markets for the underlying to the farmer'. Acting on that, in 1919, the Government of Bombay passed the Bombay Contract Control (War Provision) Act and set up the Cotton Contracts Board. With a view to restricting speculative activity in cotton market, the Government of Bombay issued an Ordinance in September 1939 prohibiting cotton trading.

In 1943, the Defense of India Act was widely used to prohibit futures trading in some commodities and regulating such trading in others commodities. In the same year oilseeds future contracts prohibition order was issued and forward contracts in oilseeds were banned. Similarly orders were issued banning forward trading in food grains, spices, vegetable oils, sugar and cloth. These orders were retained with necessary modifications in the Essential Supplies Temporary Powers Act 1946, after the Defence of India Act had lapsed. With a view to evolving the unified systems of Bombay enacted the Bombay Forward Contract Control Act 1947 (Government of Bombay, 1947) to provide for the regulation and control of forward contracts, for prohibition of options and for certain other purposes in the Province of Bombay.

2.2 Post Independence era

After Independence, the Constitution of India adopted by Parliament on 26th January, 1950 placed the subject of "Stock Exchanges and Futures Market" in the Union list and therefore the responsibility for regulation of forward contracts devolved on Government of India. The Parliament passed the Forward Contracts (Regulation) Act, 1952 which presently regulated future contracts in commodities all over India.

The Act provided for a three-tier system:

Pradesh. Though Government relaxed future trading rules for some of the commodities, but market could not recover the lost ground due to decades of ban.

The extended period of the ban on derivatives trading resulted in driving a part of the trade underground, whereas a large number of participants shifted to other professions, including securities market. Commodity futures trading in India remained in a state of hibernation for nearly four decades, from 1950 to 1990. The ban on future trading in some commodities attracted severe criticism from commodity market participants on the ground that fundamental inadequacies in the system cannot be covered by banning futures which seeks to protect the consumer at the expense of the farmer.

2.3 Post Liberalization and Globalization era

After the Indian economy embarked upon the process of liberalization and globalization in 1990, the Ministry of Civil Supplies, Consumer Affairs and Public Distribution, Government of India set up a committee under the chairmanship of Prof. K.N.Kabra, vide Order No. 2 (9)/IT/93 dated 15th of June, 1993 (Ministry of Consumer Affairs, Food & Public Distribution, 1993) to review the operations of future markets and to assess the role of the Forward Markets Commission to effectively regulate the functioning of futures trading with the following terms of reference (as amended in July, 1993):-

i) To assess-

(a) the working of the Commodity Exchanges and their trading practices in India and to make suitable recommendations with a view to making them well-matched with those of other countries, and

(b) the role of the Forward Markets Commission and to make suitable recommendations with a view to making it compatible with similar regulatory agencies in other countries so as to see how effectively these agencies can cope up with the reality of the fast changing economic scenario;

ii) To review the role that future trading has played in the Indian commodity markets during the last 10 years;

iii) To examine the extent to which future trading has special role to play in promoting exports;

iv) To suggest amendments to the Forward Contracts (Regulation) Act, in the light of the recommendations, particularly with a view to effective enforcement of the Act to check illegal forward trading when such trading is prohibited under the Act;

v) To suggest measures to ensure that future trading in the commodities in which it is allowed to be operative remains constructive and helps in maintaining prices within reasonable limits; and

vi) To assess the role that future trading can play in marketing/distribution system in the commodities in which future trading is possible, particularly in commodities in which resumption of future trading is generally demanded.

In order to effectively curb illegal forward trading in commodities, committee recommend that the penalties under Chapter V of the Forward Contracts (Regulation) Act, 1952, may be raised from the existing level of not less than Rupees one thousand to Rupees ten thousand, while maintaining the duration of the imprisonment. The

committee further recommends that the power to grant recognition to commodity exchanges, the power to withdraw their recognition and the power to supersede the governing bodies of recognized commodity exchanges be also given to Federation of Indian Commodity Exchange (FICE).

After careful consideration of the various relevant factors, the majority view of the Committee is that futures trading be allowed in-

- 1) Basmati Rice
- 2) Cotton and Kapas
- 3) Raw Jute and Jute Goods
- 4) Groundnut, rapeseed/mustard seed, cottonseed, sesame seed, sunflower seed, safflower seed, copra and soybean, and oils and oilcakes of all of them.
- 5) Rice bran oil
- 6) Castor oil and its oilcake
- 7) Linseed
- 8) Silver and
- 9) Onions.

The committee recommended that some of the existing commodity exchanges particularly the ones in pepper and castor seed may be upgraded to the level of international futures markets.

It also recommended strengthening of Forward Market Commission and amendments to Forward Contract (Regulation) Act, 1952 particularly allowing options trading in goods and registration of brokers with forward Market Commission.

The Government accepted most of these recommendations and futures trading were permitted in all recommended commodities.

The year 2002-2003 marked the real turning point in the policy framework for commodity derivative market when the government issued notifications for withdrawing all prohibitions and opening up demutualization national level multi commodity exchange, i.e. National Multi Commodity Exchange of India Limited (NMCE), National Commodity Derivative Exchange (NCDX), Multi Commodity Exchange (MCX) and Indian Commodity Exchange (ICEX). Following their establishment, there has been a revival of commodity derivatives markets in India, both in terms of commodities allowed for futures trading and volumes of the trade. While in 2001-02 futures trading was allowed only in eight commodities, the count jumped to 105 in 2008-09. The value of trading in rupee-denominated terms saw a quantum jump from about Rs.350 billion in 2001-02 to Rs. 33,162.07 billion in 2008-09. The growth charted by the Indian commodity exchanges can be summarized in Table-4.

Table-4: Turnover of the Indian National Commodity Derivative Exchanges

Year	Turnover (In Rs. Billion)
2002-03	665.30
2003-04	1293.64
2004-05	5717.59
2005-06	21551.22
2006-07	36769.27
2007-08	40659.89
2008-09 (Nov-2008)	33162.07

Source: MCX, NMCE, NCDX & ICEX web site

This period also witnessed other reforms such as amendments to the Essential Commodities Act, Securities (Contract) Rules, which have reduced bottlenecks in the

development and growth of commodity markets, daily mark to market system of margins, creation of trade guarantee fund, back-office computerization for the existing single commodity exchanges, online trading for the new exchanges, and one-third representation of independent Directors on the Boards of existing exchanges etc.

At present national commodity derivative trading is concentrated in the following exchanges which are regulated by Forward Market Commission in respect of futures trading in commodities. Besides these exchanges are subjected to various laws of the land like the Companies Act, Stamp Act, Contracts Act, Forward Commission (Regulation) Act and various other legislations, which impinge on its working.

- i) **National Multi Commodity Exchange of India Limited (NMCE)** is the first demutualised electronic commodity exchange of India which became operational in 26th November, 2002. This exchange is promoted by the Central Warehousing Corporation (CWC), National Agricultural Cooperative Marketing Federation of India (NAFED), Gujarat Agro- Industries Corporation Limited (GAICL), Gujarat State Agricultural Marketing Board (GSAMB), National Institute of Agricultural Marketing (NIAM) and Neptune Overseas Ltd. (NOL). The principal equity holders of this exchange is Punjab National Bank (PNB). The Head Office of NMCE is located in Ahmadabad.

There are various commodity trades on NMCE Platform including Agricultural and non-agricultural commodities. NMCE offers futures trading in the following commodities-

Precious Metals	: Gold and Silver
Base Metals	: Aluminum, Copper, Nickel, Zinc and Lead
Oil and Oil Seeds	: Castor Seed, Soy Bean Oil, Copra and Rape/Mustard Seed

Spices	: Pepper, Cardamom and Turmeric
Pulses	: Channa
Others	: Coffee, Rubber, Raw Jute, Menthol, Isabgul Seed, Kalyan Kapas, Sacking, Guar Seed, Guar Gum and Wheat

ii) **National Commodity & Derivatives Exchange Limited (NCDEX)** is the second professionally managed online multi commodity exchange incorporated on April 23, 2003 under the Companies Act, 1956 and promoted by Industrial Credit Investment and Corporation of India (ICICI) Bank Limited, Life Insurance Corporation of India (LICI), National Bank for Agriculture and Rural Development (NABARD) and National Stock Exchange of India Limited (NSE), Punjab National Bank (PNB), CRISIL Limited (formerly the Credit Rating Information Services of India Limited), Indian Farmers Fertilizer Cooperative Limited (IFFCO). Canara Bank by subscribing to the equity shares has joined the initial promoters as shareholders of the Exchange.

NCDEX is located in Mumbai and offers facilities to its members in more than 390 centers throughout India. The exchange proposes to extend its reach to more centres in the country. NCDEX currently facilitates trading of the following commodities-

Bullions	: Gold, Silver and Platinum
Metals	: Aluminum, Copper, Lead, Nickel, Tin and Zinc
Energy	: Crude oil, Brent Crude Oil, Gasoline, Heating oil, Thermal Coal and Natural Gas
Oil and Oil Seeds	: Castor Seed, Cotton Seed Oilcake, Soy Complex, Mustard Complex, Palm Complex
Pulses	: Chana and Yellow Peas

Cereals	: Barley, Wheat, Maize (Yellow/Red)
Plantation Products	: Rubber
Fiber	: Kapas and Cotton
Spices	: Pepper, Turmeric, Jeera, Chilli and Coriander
Others	: Gaur Seed, Gaur Gum, Gur, Potato, Sugar, Almond, Mentha Oil and Carbon Credit.

iii) **Multi-Commodity Exchange of India Limited (MCX)** is the third independent and de-mutualised multi-commodity exchange incorporated in November 2003 for facilitating online trading, clearing and settlement operations for commodity futures markets across the country. Promoted by Financial Technologies India Limited (FTIL), MCX broad-based strategic equity partners include New York Stock Exchange (NYSE), State Bank of India and its associates (SBI), National Bank for Agriculture and Rural Development (NABARD), National Stock Exchange of India Limited (NSE), SBI Life Insurance Company Limited, Bank of India (BOI) , Bank of Baroda (BOB), Union Bank of India (UBI), Corporation Bank, Canara Bank, Housing Development Finance Corporation (HDFC) Bank, Fid Fund (Mauritius) Limited an affiliate of Fidelity International, ICICI Ventures, Infrastructure Leasing & Financial (IL&FS), Kotak Group, Citi Group and Merrill Lynch.

Having started operations in November 2003, now MCX holds a market share of over eighty percent of the Indian commodity derivative market and has more than 2000 registered members operating through over 100,000 trader work stations, across India. The Exchange has also emerged as the sixth largest and amongst the fastest growing commodity futures exchange in the world, in terms of the number of contracts traded in 2009. MCX offers more than forty commodities across various segments such as-

Bullions	: Gold, Silver, Platinum
Metals	: Aluminum, Copper, Lead, Steel, Nickel, Tin, Zinc
Energy	: Brent Crude oil, Crude oil, Electricity (monthly & weekly), Gasoline, Heating Oil, Imported Thermal coal, Natural Gas, ATF
Oil and Oil Seeds	: Crude Palam oil, Kapasia Khalli, Refined Soya oil, Soya Bean
Cereals	: Barley, Wheat, Maize feed/industrial grade
Plantations Pulses	: Rubber, Chana
Weather	: Carbon (CER), Carbon (CFI)
Fiber	: Kapas
Spices	: Cardamom, Coriander, Turmeric
Others	: Almond, Gaur Seed, Mentha oil, Melted Menthol Flakes, Potato (Agra), Potato (Tarkeshwar)

iv) **Indian Commodity Exchange Limited (ICEX)** is the latest commodity exchange of India which started functioning from 27 November, 2009. It is jointly promoted by Indiabulls Financial Services Limited and Minerals and Metals Trading Corporation of India (MMTCL) and has Indian Potash Limited, Krishak Bharati Cooperative Limited (KRIBHCO) and Infrastructure Development Finance Company Limited (IDFC) among others, as its partners having its head office at Gurgaon (Haryana). ICEX currently facilitates trading of the following commodities

Precious Metals	: Gold and Silver
Base Metals	: Copper, Aluminum, Lead, Nickel and Zinc
Energy	: Crude Oil and Natural Gas

Oil and Oil Seeds	: Mustard Seed, Soybean, Soya Oil and Palm Oil
Spices	: Black Pepper, Cumin (Jeera) and Turmeric
Pulses	: Chana
Others	: Guar Seed

Most of the Regional Commodity Exchanges are not demutualised. This results in substantial conflict of interests, non-transparent functioning and absence of state of the art technology leading to inefficiency and wastages. With the four national commodity exchanges NMCE, NCDX, MCX and ICEX coming up, the volumes of trading at these regional commodity exchanges have reduced substantially. There has been increasing call for integration of the regional commodities exchanges across the country to enable them to compete with the national commodity exchanges. To unify all the twenty regional commodities exchanges (Table-5) across the country and offer online trading across all exchange the three regional commodity exchanges in Gujarat (Ahmadabad Commodity Exchange, Surandranagar Commodity Exchange and Rajkot Commodity Exchange) along with the Mumbai Commodity Exchange, Indore Commodity Exchange and Cochin Commodity Exchange have organized themselves into the “Federation of Indian Commodity Exchange” in October, 2005.

At present, futures trading are permitted in 105 commodities (Table-6). During 2005-06, permission to trade in furnace oil, crude oil, mentha oil, PVC, polypropylene and natural gas was granted. Onion has also been notified for futures trading on 26.04.2006.

Table-5: List of regional exchanges and their respective traded commodities:

SL. No.	Name of the Exchange	Commodity Traded	SL. No.	Name of the Exchange	Commodity Traded
1	Bhatinda Om & Oil Exchange Limited, Batinda	Gur	11	The East India Cotton Association, Mumbai	Indian Cotton
2	The Bombay Commodity Exchange Limited, Mumbai	RBD Pamolem Groundnut Oil Sunflower Oil Cottonseed Safflower Groundnut Castor oil-Int'l Castor seed Cottonseed oil Sesamum oil Sesamum Oilcake Safflower Oilcake Rice Bran Rice Bran Oil Rice Bran Oilcake Safflower Oil Crude Palm Oil	12	The Central India Commercial Exchange Ltd., Gwalior	Gur Rapeseed / Mustard Seed
3	The Rajkot Seeds Oil & Bullion Merchants Association Ltd.	Groundnut Oil Castor seed	13	The East India Jute & Hessain Exchange Ltd.	Raw Jute & Jute goods.
4	The Meerut Agro Commodities Exchange Co. Ltd., Meerut	Gur	14	First Commodity Exchange of India Ltd, Kochi	Copra Coconut Oil Copra Cake
5	The Spices and Oilseeds Exchange Ltd.	Turmeric	15	Bikaner Commodity Exchange Ltd., Bikaner	Rape Seed / Mustard Seed Rape Seed / Mustard Seed Oil Rape Seed / Mustard Seed oil-Cake Guar Seed Gram Guar Gum
6	Ahmedabad Commodity Exchange Ltd.	Cotton Seed Castor Seed	16	Esugarindia Limited	Sugar Grade – M Sugar Grade – S
7	Vijay Beopar Chamber Ltd., Muzaffaragar	Gur Mustard Seed	17	Surendranagar Cotton Oil & Oilseeds Association Ltd.	Kapas Cotton Seed Cotton Bales
8	India Pepper & Spice Trade Association, Kochi	Pepper Domestic-MG1, Pepper Domestic-500g/l, Black Pepper Int'l-MLS ASTA, Black Pepper Int'l-VB ASTA, Black pepper Int'l FAQ, Pepper 550 G/L, Rubber RSS4	18	Haryana Commodities Ltd., Hissar	Rape Seed / Mustard Seed Rape Seed / Mustard Seed Oil
9	Rajdhani Oils and Oil Seeds Exchange Ltd., Delhi	Gur Rapeseed / Mustard Seed	19	E-Sugar India Ltd, Mumbai	Sugar
10	The Chamber of Commerce, Hapur	Gur Rapeseed / Mustard Seed	20	E-Commodities Ltd., New Delhi	Sugar (trading yet to commence)

Table-6: List of commodities notified under section 15 of the Forward Contract (Regulation) Act 1952.

Sl. No.	Commodity	Sl. No.	Commodity
	Fibers and Manufactures	52	Copper
1	Art Silk Yarn	53	Zinc
2	Cotton Cloth	54	Lead or Tin
3	Cotton Pods	55	Gold
4	Cotton Yarn	56	Silver
5	Indian Cotton (full pressed, half pressed or	57	Silver Coins
6	Jute goods (Hessian and sackings and cloths and	58	Oilseeds and Oils
7	Kapas	59	Celeryseed
8	Raw Jute (including Mesta)	60	Copra Oil / Coconut Oil
9	Staple Fibre Yarn	61	Copra Oilcake / Coconut Oilcake
	Food grains and Pulses	62	Copra / Coconut
10	Arhar Chuni	63	Cottonseed
11	Bajra		
12	Barley	64	Cottonseed Oilcake
13	Gram	65	CPO Refined
14	Gram Dal	66	Crude Palm Oil
15	Guar	67	Crude Palm Olive
16	Jowar	68	Groundnut
17	Kulthi	79	Groundnut Oil
18	Lakh (Khesari)	70	Groundnut Oilcake
19	Maize	71	Linseed
20	Masur	72	Linseed Oil
21	Moth	73	Linseed Oilcake
22	Mung	74	Rapeseed Oil / Mustard Oil
23	Mung Chuni	75	Rapeseed Oilcake / Mustardseed Oilcake
24	Mung Dal	76	Rapeseed / Mustardseed
25	Peas	77	RBD Palmolein
26	Ragi	78	Rice Bran
27	Rice or Paddy	89	Rice Bran Oil
28	Small Millets (Kodan Kulti, Kodra, Korra,	80	Rice Bran Oilcake
29	Tur Dal (Arhar Dal)	81	Safflower
30	Tur (Arhar)	82	Safflower Oil
31	Urad (Mash)	83	Safflower Oilcake
32	Urad Dal	84	Sesamum (Til or Jiljilli)
33	Wheat	85	Sesamum Oil
		86	Sesamum Oilcake
34	Soy Meal		Others
35	Soy Oil	87	Camphor
36	Soybean	88	Castor Seed
37	Sunflower Oil	89	Chara or Berseem (including Charaseed or
38	Sunflower Oilcake	90	Crude Oil
39	Sunflower Seed	91	Gram Husk (Gram Chilka)
	Spices	92	Gur
40	Aniseed	93	Khandsari Sugar
41	Betelnuts	94	Polymer
42	Cardamom	95	Potato
43	Chillies	96	Rubber
44	Cinnamon	97	Seedlac
45	Cloves	98	Shellac
46	Coriander Seed	99	Sugar
47	Ginger	100	Furnace Oil
48	Methi	101	Ethanol
49	Nutmegs	102	Coking Coal
50	Pepper	103	Electricity
51	Turmeric	104	Mentha Oil
	Metals	105	Natural Gas