Meet the CEO

A new era begins for commodity exchanges

As SEBI and FMC merge and equity exchanges launch commodity trading, competition will increase, says PK Singhal, Joint MD of MCX

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The Indian commodity market is yet to recover from the blow delivered by the imposition of commodities transaction tax (CTT). This tax resulted in plunging volumes as higher trading cost made traders move away from commodities — ushering in an era of 'dabba' trading. But all this is set to change as SEBI and FMC, the securities and commodities market regulators, merge in September.

PK Singhal, Joint Managing Director of MCX, India's largest commodity bourse, outlines the opportunities and challenges that open up with this event, in an interview with *BusinessLine*. The new watchdog's sharp scrutiny is set to change the commodity derivatives landscape. But he thinks that as the market opens up and new competitors from the securities market debut with a commodity platform, existing players in the commodity exchange business need to gear up.





Are you all set to welcome the new regulator? What do you see as the outcome of the SEBI-FMC merger?

MCX has complied with all requirements, including the net worth stipulations, to become a deemed stock exchange. With respect to trading norms and other things, we have to wait. Only broad guidelines on operations have been given now.

But as far as the markets are concerned, there will be better governance and more transparency as commodity brokers will come under the direct supervision of the regulator. SEBI's coming will also check the mushrooming 'dabba' trading.

Post-CTT, the off-market trades in commodities has grown by about 8-10 times, from three times earlier. Now, because SEBI will have powers to conduct search, investigate and arrest wrong-doers, illicit trading will be checked. The introduction of new products, such as options or commodity indices, will take time as all brokers need to first register with SEBI, understand the regulations and move. The transition process will take at least six months.

Have commodity markets adjusted to the new normal, post-CTT? Or are volumes still under stress?

All market participants want CTT to be removed. But I do not know if the Finance Ministry is considering it. Volumes in the market are down by about 60 per cent since introduction of the commodities transaction tax.

Though volumes have recovered from the pit seen after the spot market debacle, they haven't gone back to the pre-CTT levels. Daily turnover (single side) in the exchange prior to CTT was about ₹55,000 crore, now it is about ₹28,000-30,000 crore. When the crisis in the spot market broke, daily volumes hit a low of about ₹16,000 crore. Now, despite commodity prices falling by about 30 per cent, a turnover of about ₹30,000 crore (single side) is not bad. CTT has increased the cost of trading. We don't know how the loss in market volumes brought about by CTT can be made good. If commodity options come, then volumes may go up as CTT will be applicable on the premium and the costs won't be significantly high for traders.

Do you see competition going up in the commodity exchanges business as SEBI takes over and equity exchanges establish their commodity platforms?

We feel both the BSE and the NSE will debut with their commodity platforms and it is going to be a challenging task for existing commodity exchanges. Because of fungibility of margins, cost of transaction on commodities will be lower in these exchanges.

But, it will take time. SEBI may not give a green flag to security exchanges to launch commodity platforms or commodity exchanges to launch securities segment until the existing commodity exchanges and brokers fully understand new products, such as commodity options, and indices, and commodity exchanges are at par with securities exchanges. Capital markets are way ahead of commodity markets, they provide co-location facility to members, they have options trading on their platforms, but commodity brokers are not exposed to all these.

Will foreign institutions be allowed in commodities as SEBI steps in and how will it help commodity markets?

Yes, FPIs may find their way into the Indian commodity markets. But I don't know how far it will work. In commodities, wherever there is CTT I don't think it makes any sense for foreign institutions to come to India because it is a relatively expensive affair. In agri commodities, they may show interest, as there is no CTT , but again, am not sure how comfortable the government will be to allow foreign institutions to trade (in this segment), as futures is a leverage product and there may be higher volatility. When the standing committee of the Ministry of Consumer Affairs was commenting on the FCRA Bill, it had clearly stated that FPIs and hedge funds should not be allowed to trade commodities.

Although they had recommended passing of FCRA Bill, introduction of options, and allowing Indian institutions to trade commodity futures, they had a strict 'no' to foreign institutions.

Where does India stand in global commodity trading? What is MCX's position?

We are nowhere in the global picture, which is dominated by players such as CME. The futures-to-spot ratio in the global markets is multiple times that in India. But, in gold futures, we are a significant player. In fact, before CTT, impact cost in domestic gold futures contract was way lower than the impact cost on gold contract in Comex. But, post-CTT, we have lost volumes and a good share of liquidity in our gold futures. Import restrictions, higher tax and increased smuggling over the last two years have also been dampeners. Earlier, all jewellers hedged on gold on the exchange platform, but now since a lot of transactions are happening in cash and there is a lot of difference because of duty, these people go to 'dabba' traders who have smuggled gold, to hedge their risk.

MCX is setting up an international exchange in the GIFT city. So, what can we look forward to?

We are awaiting clarity on taxation and other issues. We will first study the viability of setting up an exchange and then come up with strategies. It looks like all contracts will be dollar denominated to woo foreign investors. Now Indian investors are not allowed to trade in many international exchanges, and there will be an opportunity for them too.



Profile

PK Singhal has over 39 years of experience in financial services and securities and commodities markets. He has worked as Division Chief (Secondary Market) with the Securities and Exchange Board of India, Executive Director & CEO of Delhi Stock Exchange and Director of Forward Markets Commission.