Hedge funds allowed in commodity derivatives

FC BUREAU

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REGULATOR Sebi on Wednesday allowed hedge funds to invest in commodity derivatives, in a move to deepen the market and boost liquidity.

However, this is subject to certain conditions, including that Category-III alternative investment funds (AIFs) or hedge funds should not invest more than 10 per cent of the investible funds in one underlying commodity.

Besides, they should make disclosure in private placement memorandum issued to investors about investment in commodity derivatives and should take consent of the existing investors if such AIFs intend to invest in such derivatives.

These AIFs can participate in all commodity derivatives products being traded in exchanges as 'clients'. They should have position limits as applicable to clients. At present, institutional participants are not allowed to participate in the commodity derivatives market in India.

Consequently, the commodity derivatives markets lack the desired liquidity and depth for efficient price discovery and price risk management, Sebi said in a circular.

"Taking cognisance of the fact that participation by institutional investors would be conducive for the overall development of the commodity derivatives market... It is now decided to allow the Category-III AIF to participate in the commodity derivatives market," the regulator said.

Category-III AIFs are those that employ diverse or complex trading strategies and may employ leverage, including through investment in listed or unlisted derivatives.

In the past, various committees including those constituted by the government have recommended participation of institutional investors in the commodity derivatives markets for improving the quality of price discovery, thereby leading to better price risk management.

Welcoming Sebi's decision, MCX managing director and chief executive Mrugank Paranjape said a significant beginning has been made to not just provide access to a fast-growing asset class to the investor community, but also unlock the potential this segment holds.

"The presence of AIFs, we are sure, will spur the infusion of research based information, capital, innovation and new trading strategies in India's commodity markets, improving the quality of price discovery, lending it a degree of depth and vibrancy which matches the global standards we have long been aspiring for.

"We are also confident that such depth and vibrancy of the market will, in turn, incentivise hedging interest in India's commodity derivatives market to a great extent," he added.

Earlier in April, Sebi had floated a discussion paper in this regard and had sought comments from the public till May 20. The final norms have been put in place after taking into consideration views of all the stakeholders.