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# REGULATION OF FORWARD TRADING: A CRITICAL ANALYSIS

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## REGULATION OF FORWARD TRADING: A CRITICAL ANALYSIS

## INTRODUCTION

In general the contracts and agreements are done to perform instantaneously. But quite often they are also done to perform in future. As far as the forward trading is concerned this is also a type of agreement or contract which is generally done at instantaneous time to perform the promises in future. There is some time-limit within which the promise made is required to be performed by the contracting parties.

In very simple words we can say that forward trading is a non-standardised contract between two parties to buy or to sell an asset at specified future time at a price agreed up on today. Now question arises that in how this trading takes place? What is the subject matter of this type of trade practice? Further the very relevant question need to be answered is about the existing position of forward trading.

In our definition part of this project we first define each and every term which is relevant in the context of forward trading. Renowned economists have mentioned that trade and exchange allow us to benefit from specialization and obtain welfare gains. Trade and exchange require the existence of markets. India, a commodity based economy where two-third of the one billion population depends on agricultural commodities, surprisingly has an under developed commodity market. Unlike the physical market, future markets trades in commodity are largely used as risk management (hedging) mechanism on either physical commodity itself or open positions in commodity stock. It means that habit for using the future commodity market is not for the purpose of business in true sense but it is merely used for avoiding the risk of market.[1]

Instead of having large nation-wide commodity market, India is generally characterised to have isolated regional commodity markets. In parallel with the underlying cash markets, Indian commodity futures markets too are dispersed and fragmented, with separate trading communities in different regions and with little contact with one another. While the exchanges have varying degrees of success, the industry is generally viewed as unsuccessful. The exchanges – with a few exceptions – have acknowledged that they need to embrace new technologies, and, above all, modern – and transparent – methods of doing business. But management often find it difficult to chart out a route into the future, and have had difficulties in convincing their membership. For the future trading we needed a strong chain of commodity market.[2]

## CONCEPTS, TERMINOLOGIES AND DEFINITIONS

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[1] Nishant Burte, Sagar Bijwe, Ajit Ratnaparkhi, Sanket Patle ,Prasad Joshi, *Study Of Forward Market Commission of India*, INDIAN INSTITUTE OF TECHNOLOGY BOMBAY

[2] *Id*

**COMMODITY:**

A commodity may be defined as an article, a product or material that is bought and sold. It can be classified as every kind of movable property, except Actionable Claims, Money & Securities. Commodities actually offer immense potential to become a separate asset class for market-savvy investors, arbitrageurs and speculators. Retail investors, who claim to understand the equity markets, may find commodities an unfathomable market. But commodities are easy to understand as far as fundamentals of demand and supply are concerned. Retail investors should understand the risks and advantages of trading in commodities futures before taking a leap. Historically, pricing in commodities futures has been less volatile compared with equity and bonds, thus providing an efficient portfolio diversification option.[3]

**COMMODITY MARKET:**

Commodity market is an important constituent of the financial markets of any country. It is the market where a wide range of products, viz., precious metals, base metals, crude oil, energy and soft commodities like palm oil, coffee etc. are traded. It is important to develop a vibrant, active and liquid commodity market. This would help investors hedge their commodity risk, take speculative positions in commodities and exploit arbitrage opportunities in the market.[4]

**THE COMMODITIES SUITABLE FOR FUTURES TRADING:**

All the commodities are not suitable for futures trading and for conducting futures trading. For being suitable for futures trading the market for commodity should be competitive, i.e., there should be large demand for and supply of the commodity – no individual or group of persons acting in concert should be in a position to influence the demand or supply, and consequently the price substantially. There should be fluctuations in price. The market for the commodity should be free from substantial government control. The commodity should have long shelf-life and be capable of standardisation and gradation. Such commodities are; oil and oilseeds, spices, metals, fibre, pulses, cereals, energy and others.[5]

**DERIVATIVES AND DERIVATIVE CONTRACT:**

Derivatives are financial instruments whose value is derived from the value of something else. The main types of derivative instruments are futures, forwards, options, and swaps. A derivative contract is an enforceable agreement whose value is derived from the value of an underlying asset; the underlying asset can be a commodity, precious metal, currency, bond, stock, or, indices of commodities, stocks etc. In simple words we can say that the value in future time for a contract is decided by the present assets such as metals, bullions etc.[6]

**FORWARD CONTRACT:**

A forward contract is an agreement between two parties to buy or sell an asset

[3] *Supra* note 1
[4] *Id*
[5] *A Beginners' Guide to Commodity Market (Spot and Futures)*, Karvy Commodities Broking
[6] *Id*

(which can be of any kind) at a pre-agreed future point in time. Therefore, the trade date and delivery date are separated. It is used to control and hedge risk, for example currency exposure risk (e.g., forward contracts on USD or EUR) or commodity prices (e.g., forward contracts on oil).

One party agrees (obligated) to sell, the other to buy, for a forward price agreed in advance. In a forward transaction, no actual cash changes hands. If the transaction is collateralized, exchange of margin will take place according to a pre-agreed rule or schedule. Otherwise no asset of any kind actually changes hands, until the maturity of the contract. The forward price of such a contract is commonly contrasted with the spot price, which is the price at which the asset changes hands (on the spot date, usually two business days). The difference between the spot and the forward price is the forward premium or forward discount. Under Forward Contracts (Regulation) Act, 1952, all the contracts for delivery of goods, which are settled by payment of money difference or where delivery and payment is made after period of 11 days, are forward contracts.[7]

**FUTURE CONTRACT:**

Futures contracts are standardized. In other words, the parties to the contracts do not decide the terms of futures contracts; but they merely accept terms of contracts standardized by the Exchange.

**DIFFERENCE BETWEEN FORWARD CONTRACT AND FUTURE CONTRACT:**

Futures contracts are standardized. In other words, the parties to the contracts do not decide the terms of futures contracts; but they merely accept terms of contracts standardized by the exchange. On the other hand, forward contracts (other than futures) are customized. In other words, the terms of forward contracts are individually agreed between two counter-parties. Forwards transact only when purchased and on the settlement date. Futures, on the other hand, are rebalanced, or "marked to market," every day to the daily spot price of a forward with the same agreed upon delivery price and underlying asset. Futures are always traded on an exchange, whereas forwards always trade over-the-counter, or can simply be a signed contract between two parties.[8]

**WHAT ARE COMMODITY FUTURES?**

Commodity Futures are contracts to buy/sell specific quantity of a particular commodity at a future date. It is similar to the Index futures and Stock futures but the underlying happens to be commodities instead of Stocks and indices.

Commodity futures market has been in existence in India for centuries. The Government of India banned futures trading in certain commodities in 70s. However, trading in commodity futures has been permitted again by the government in order to help the Commodity producers, traders and investors. World-wide, the commodity exchanges originated before other financial exchanges. In fact most of the derivatives instruments had their birth in commodity exchanges.[9]

[7] *Supra* note 1

[8] *Supra* note 6

[9] *Supra* note 6

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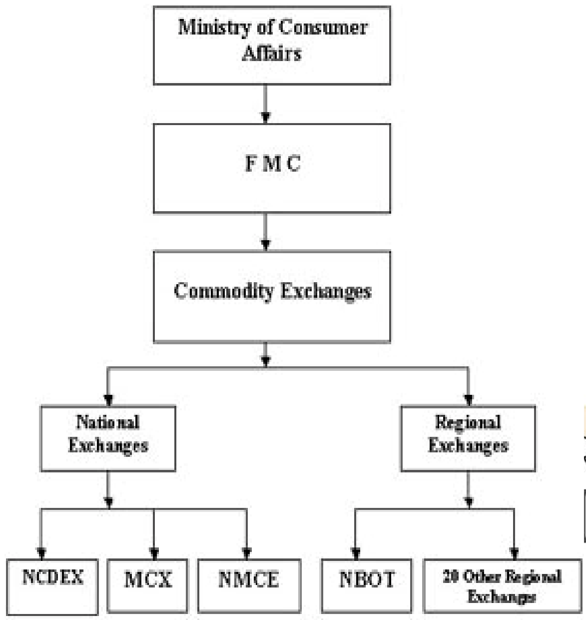
**Commodity Exchanges:**




The Government of India permitted establishment of National-level Multi-Commodity exchanges in the year 2002 -03 and accordingly following exchanges have come into picture. In India currently total 24 commodity exchanges are working of which 3 are national level exchanges and remaining 21 are working on regional level. At international level there are major commodity exchanges in USA, Japan and UK. Commodity Exchanges function from 10.00 AM to 11.30 PM/11.55 PM every-day. However, only metals, bullions and energy products are available for trading after 5.00 PM. On Saturdays, the exchanges are open from 10.00 AM to 2.00 PM.[10]

**DETERMINATION OF FUTURE PRICE AND PREDICTION OF PRICE BY PROFESSIONALS IN FURTURE:**

Futures prices evolve from the interaction of bids and offers emanating from all over the country – which converge in the trading floor or the trading engine. The bid and offer prices are based on the expectations of prices on the maturity date. Two methods generally used for predicting futures prices are fundamental analysis and technical analysis. The fundamental analysis is concerned with basic supply and demand information, such as, weather patterns, carryover supplies, relevant policies of the Government and agricultural reports. Technical analysis includes analysis of movement of prices in the past. Many participants use fundamental analysis to determine the direction of the market, and technical analysis to time their entry and exist.[11]

One doesn't need to have the physical commodity or own a contract for the commodity to enter into a sale contract in futures market. It is simply agreeing to sell the physical commodity at a later date or selling short. It is possible to repurchase the contract before the maturity, thereby dispensing with delivery of goods.

**SETTLEMENT PRICE:**

The settlement price is the price at which all the outstanding trades are settled, i.e, profits or losses, if any, are paid. The method of fixing Settlement price is prescribed in the Byelaws of the exchanges; normally it is a weighted average of prices of transactions both in spot and futures market during specified period.

[10] *Id*

[11] *Supra* note 6

**MARGINS ON THE COMMODITY FUTURE CONTRACTS:**

Generally commodity futures require an initial margin between 5-10% of the contract value. The exchanges levy higher additional margin in case of excess volatility. The margin amount varies between exchanges and commodities. Therefore they provide great benefits of leverage in comparison to the stock and index futures trade on the stock exchanges. The exchange also requires the daily profits and losses to be paid in/out on open positions (Mark to Market or MTM) so that the buyers and sellers do not carry a risk of not more than one day.[12]

**CONSTITUENTS OF MARKET:**

**Participants** in forward/futures markets are hedgers, speculators, day-traders/scalpers, market makers, and, arbitrageurs.

**What is Hedger?**

Hedger is a user of the market, who enters into futures contract to manage the risk of adverse price fluctuation in respect of his existing or future asset.

**What is arbitrage?**

Arbitrage refers to the simultaneous purchase and sale in two markets so that the selling price is higher than the buying price by more than the transaction cost, so that the arbitrageur makes risk-less profit**.**

**Who are day-traders?**

Day traders are speculators who take positions in futures or options contracts and liquidate them prior to the close of the same trading day.

**Who is floor-trader?**

A floor trader is an Exchange member or employee, who executes trade by being personally present in the trading ring or pit floor trader has no place in electronic trading systems.

**Who is speculator?**

A trader, who trades or takes position without having exposure in the physical market, with the sole intention of earning profit is a speculator.

**Who is market maker?**

A market maker is a trader, who simultaneously quotes both bid and offer price for a same commodity throughout the trading session.[13]

**SPECULATION AND GAMBLING:**

Participants in futures market include market intermediaries in the physical market, like, producers, processors, manufacturers, exporters, importers, bulk consumers etc., besides speculators. There is difference between speculation and gambling. Therefore futures markets are not "satta markets". Participants in physical markets use futures market for price discovery and price risk management. In fact, in the absence of futures market, they would be compelled to speculate on prices. Futures market helps them to avoid speculation by entering into hedge contracts. It is however extremely unlikely for every hedger to find a hedger counterparty with matching requirements. The hedgers intend to shift price risk, which they can only if there are participants willing to accept the risk. Speculators are such participants who are willing to take risk of hedgers in the expectation of making profit. Speculators

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[12] *Id*

[13] *Supra* note 6

provide liquidity to the market therefore; it is difficult to imagine a futures market functioning without speculators. Speculators are not gamblers, since they do not create risk, but merely accept the risk, which already exists in the market. The speculators are the persons who try to assimilate all the possible price-sensitive information, on the basis of which they can expect to make profit. The speculators therefore contribute in improving the efficiency of price discovery function of the futures market.[14]

**OVER-SPECULATION:**

Informed and speculation is good for the market. However over-speculation needs to be kerbed. There is no unanimity about what constitutes over-speculation. In order to curb over-speculation, leading to distortion of price signals, limits are imposed on the open position held by speculators. The positions held by speculators are also subject to certain margins; many Exchanges exempt hedgers from this margins.[15]

**RISK IN FUTURE MARKET:**

Commodity prices are generally less volatile than the stocks and this has been statistically proven. Therefore it's relatively safer to trade in commodities. Also the regulatory authorities ensure through continuous vigil that the commodity prices are market-driven and free from manipulations. However, all investments are subject to market risk and depend on the individual decision. There is risk of loss while trading in commodity futures like any other financial instruments.[16]

**WHAT ARE THE BENEFITS FROM COMMODITY FORWARD/FUTURES TRADING?**

Forward/Futures trading performs two important functions, namely, price discovery and price risk management with reference to the given commodity. It is useful to all segments of the economy. It enables the 'Consumer' in getting an idea of the price at which the commodity would be available at a future point of time. He can do proper costing and also cover his purchases by making forward contracts. It is very useful to the 'exporter' as it provides an advance indication of the price likely to prevail and thereby helps him in quoting a realistic price and secure export contract in a competitive market It ensures balance in supply and demand position throughout the year and leads to integrated price structure throughout the country. It also helps in removing risk of price uncertainty, encourages competition and acts as a price barometer to farmers and other functionaries in the economy. Commodity futures are beneficial to a large section of the society, be it farmer, businessmen, industrialist, importer, exporter, consumer.[17]

**WHAT IS HEDGING?**

Hedging is a mechanism by which the participants in the physical/cash markets can cover their price risk. Theoretically, the relationship between the futures and cash prices is determined by cost of carry. The two prices therefore move in tandem. This

[14] *Supra* note 6
[15] *Id*
[16] *Id*
[17] *Supra* note 6

enables the participants in the physical/cash markets to cover their price risk by taking opposite position in the futures market. In other words the practice of offsetting the price risk inherent in any cash market position by taking an opposite position in the futures market. A long hedge involves buying futures contracts to protect against possible increasing prices of commodities. A short hedge involves selling futures contracts to protect against possible declining prices of commodities.[18]

**HOW DOES FUTURES MARKET BENEFIT FARMERS?**

Over the world, farmers do not directly participate in the futures market. They take advantage of the price signals emanating from a futures market. Price-signals given by long-duration new-season futures contract can help farmers to take decision about cropping pattern and the investment intensity of cultivation. Direct participation of farmers in futures market to manage price risk –either as members of an Exchange or as non-member clients of some member - can be cumbersome as it involves meeting various membership criteria and payment of daily margins etc. Options in goods would be relatively more farmer-friendly, as and when they are legally permitted.[19]

**DELIVERY AND SETTLEMENT:**

**How would contracts settle?** All open contracts not intended for delivery and non-deliverable positions at client level would be settled in cash. **Are the trades/ settlement guaranteed by the exchanges?** Yes, the commodity exchanges have got some of the most high profile corporate as their promoters. Such a high profile share-holding provides these exchanges valuable experience, knowledge and also high standards of operations. Also the exchange guarantees the settlement of trades and so eliminates the counter-party risk in the transactions. The exchange for this purpose maintains a Settlement Guarantee fund akin to the stock exchanges. **Are there physical deliveries in commodity futures exchanges?** Yes, the exchanges, in order to maintain the futures prices in line with the spot market, have made available provisions of settlement of contracts by physical delivery. They also make sure that the price of futures and spot prices coincide during the settlement so that the arbitrage opportunities do not exist. **Is delivery mandatory in futures contract trading?** The provision for delivery is made in the Byelaws of the Associations so as to ensure that the futures prices in commodities are in conformity with the underlying. Delivery is generally at the option of the sellers. However, provisions vary from Exchange to Exchange. Byelaws of some Associations give both the buyer and seller the right to demand/give delivery. **How the deliveries are made possible?** The exchange has enlisted certain cities for specific commodities as the delivery centres. The seller of commodity futures, upon expiry of the contract may choose to deliver physical stock instead of settling the positions by cash, in which case he would be required to deliver the stocks to the specified warehouses. The buyer of the commodity futures, if he is interested in physical delivery would be matched with a seller and

[18] *Id*
[19] *Id*

would be required to take delivery of the specified quantity of stock from the designated warehouse. World-wide commodity futures are generally used for hedging and speculation and hence physical deliveries are negligible. However, the possibility of physical delivery has made these markets more attractive in India. Both NCDEX and MCX have successfully completed physical delivery in bullions and various agro-commodities. The delivery and settlement procedure differs for each exchange and commodity.[20]

**REGULATIONS OF FORWARD MARKET:**

Having understood the concept of future contracts it is necessary to understand the need to regulate and sometimes put a ban on them. Former Finance Minister Palaniappan Chidambaram, once pointed out that, "If rightly or wrongly, people perceive that commodity futures trading is contributing to speculation-driven rise in prices, then in a democracy you will have to heed that voice".[21] Thus many times future contracts lead to the rise in price of the commodity due to speculation regarding that commodity. This explains the reason for regulation of the same. Forward contracts are regulated by Forward Contracts (Regulation) Act, 1952 and draft rules of 2014.

The major tools that are being employed in India in regards to this regulation are:

- **Maintaining Market Integrity;** it is necessary that the integrity in the market is maintained so that the trust of the customer remains strong. This can be done when there is proper and *effective surveillance and monitoring* done of the ways the market is functioning. Also when the exchanges are given the responsibility of facilitating the business done through these contracts thus time to time *audit of their accounts* is also called for**.**
- **Ensuring alignment of Future and Spot prices:** As forward contracts are made before the date on which actual delivery of goods is expected thus it becomes imperative to maintain a balance between the future and spot prices. Also there is always a *threat of delivery* that haunts such contracts. The exchanges are made to ensure that none of the parties are at loss and the final settlement that is reached at is based on correct spot prices.
- **Investor Protection:** The investor who is investing by way of such contracts also needs to be protected. The regulations also need to cater to the need that the investor is *fairly and evenly handed at the hands of the exchange.* The exchange must have an unbiased attitude towards all. None should suffer at the cost of the other.
- **Fairness and Transparency in Trading, Clearing and Settlement Process:** The exchanges that are made as the regulators or rather facilitators need to be kept within

[20] *Supra* note 6

[21] Sandhya Srinivasan, *Futures Trading in Agricultural Commodities. Is The Government Ban On Commodities Trading Logical?*, Centre for Civil Society, 5

their domain as well. They have power to regulate but such power should not be misused. Also such methods should be adopted that the trading via exchanges becomes more user friendly. Thus methods like *electronic trading* should be made famous among the people.

Thus to meet the above requirements the main legislation available is the Forward Contacts (Regulation) Act, 1952.

**FORWARD CONTRACTS (REGULATION) ACT, 1952**

The preamble of the Act itself states the main purpose for which it was enacted. It reads as, an act to provide for the regulation of certain matters relating to forward contracts, the prohibition of options in goods and for matters connected therewith.[22]

The Act applies to goods that are defined as movable property under the Act under section 2(d) excluding actionable claims, money and securities. It also provides where forward trading has been prohibited. The Act has strictly provided that only certain associations that are registered under the Act are allowed to felicitate and organize forward contracts and none other. Under section 15 the Act provides for a list of goods that are 'regulated commodities' and section 17 provides the list of goods that are 'prohibited commodities'. All the other goods are allowed for forward trading by this Act.

The Act envisages three-tier regulation:

(i) The Exchange which organizes forward trading in commodities can regulate trading on a day-to-day basis;

(ii) The Forward Markets Commission provides regulatory oversight under the powers delegated to it by the central Government, and

(iii) The Central Government - Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution - is the ultimate regulatory authority.[23]

Thus this clarifies that a lot of efforts have been put to regulate the forward contracts which such vast layers of regulatory authorities at every level. From the very basic level to the highest level none of the tier is ready to compromise with the regulation of these contracts. In India there are at present 24 commodity exchanges working at the moment, 3 at national level and 21 at regional level. Forward trading has grown to be done in over 100 goods in India now and thus the level of business growth has increased the need for regulation in the area.

- **Central Government:** The government has power to grant as well as withdraw recognition of the exchanges. Also the government has power to notify commodities under section 15, 17 and 18(3). It is the highest governing body in this area. It supersedes
the governing body of a recognized Association / Exchange.
- **Forward market commission:** This constitutes as the second tier of the regulating framework. It approves the rules and the bye laws of the exchange that they make for the proper functioning of their setup.

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22 Preamble, Forward Contracts (Regulation) Act, 1952

23 *Supra* note 1

Also the commission grants permission and supervises the trading methods of the exchanges. Such permission is subject to appropriate regulatory measures. It further is responsible for the monitoring and surveillance of the markets. Thus it is the domain of the commission to keep a check on the exchanges that are working in this field. To ensure this the commission keeps a close eye check on the exchanges by inspecting their members and accounts. It may even appoint the independent directors in the exchange to have transparency and unbiased working in the internal management of the exchanges. The commission even has power to register a police complaint in case of fraudulent practices in the working of the exchanges.

- **Exchanges:** The last and the most basic tier in this setup. They conduct the trading in forward contracts on the basis of the Articles, by-laws and other rules that have already been approved by the commission. They have been given the power to deal with and take action against the intermediaries.

**Forward market commission:**

Having studied the three tiers of the framework, it is important to study the commission in detail because even though central government has been given the superior most power yet the main supervisory work is carried on by this commission. The commission consists of not less than two but not more than four members appointed by the central government. The chairman too shall be appointed by the central government. Such members shall hold office for three years and shall be eligible for re-election.

The commission performs many important ***functions*** in its sphere:

- It assists the central government in granting and withdrawing recognition of the exchanges or associations.
- It keeps a close check on the forward market and takes all the necessary steps to regulate it under the powers given to it by the Act.
- It also collects information regarding the trading condition in respect of the goods such as the demand and supply as well as the prices. It publishes such vital information whenever it deems necessary.
- It also submits periodical reports to the central government keeping it well informed about the market condition and the working of the Act.
- It makes recommendations for changes wherever there is requirement of any improvement in the forward market.
- As already talked about, one of the most important functions of the commission is to regulate the exchanges. For the purpose it has been given power to inspect the accounts of the exchanges. It may even appoint the Independent directors in the exchanges so as to bring about a transparency in the working.
- To perform any other duties that it may under the Act.

To be able to perform these functions the commission has been given certain ***powers***. They are:

- For the performance of its functions, the commission has been given all the powers that are available to a civil court under the Civil Procedure Code, 1908 (5of 1908). It can, while trying a suit,
  - (i) Summon parties enforcing attendance of any person examining him on oath.
  - (ii) Requiring the discovery and production of any document.[24]
  - (iii) Receiving evidence on affidavits.[25]
  - (iv) Requisitioning any public record or copy thereof from any office.[26]
  - (v) Any other matters which may be prescribed.[27]
- The Commission has power compel any person to produce the documents or such information before the commission which it deems as necessary. Such person shall be legally bound to produce such information.
- The commission shall be deemed to be a civil court and whenever any offence under sections 175, 178, 179, 180 or Sec. 228 of the Indian Penal Code, 1860 (45 of 1860), is committed in the view or presence of the Commission, the Commission may, after recording the facts constituting the offence and the statement of the accused as provided for in the Code of Criminal Procedure,1898 (5 of 1898)11[11] forward the case to a Magistrate having jurisdiction to try the same and the Magistrate to whom any such case is forwarded shall proceed to hear the complaint against the accused as if the case had been forwarded to him under Section 482 of the said Code12[12].[28]
- The proceedings before the commission shall be deemed to judicial proceeding within the meaning of sections 193 and 228 of IPC, 1860.

Thus the powers given to the commission are vast as it has been given power under the civil code as well as the criminal code. The reason seems to be that the commission has to regulate a huge market and if it is not given any power as stipulated above it would become difficult to function. Also already the courts are overburdened and if these matters are also sent to them then a speedy disposal would become very difficult. These act as specialized agency of the forward market which is able to deal with problems more efficiently. Now having gotten an overview of the powers of the Commission, it becomes easier to comprehend what regulatory measures are resorted to by it.

As per the Act, illegal contracts are those which are made either between the unauthorized associations or through any such members or which are made in regards to nay of the prohibited commodities under

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[24] *Supra* Note 1
[25] *Id*
[26] *Id*
[27] *Id*
[28] *Id*

section 17 of the Act. Thus the work of the commission mainly revolves around the control of such contracts. The commission mainly resorts to two measures:

(i) First it communicates the fact that any such offence has happened to the police and assists them in the investigation by guiding them in search and seizure of relevant documents.
(ii) As the offence under the said Act are technical in nature thus the commission has taken up the job of conducting periodical seminars and training programmes for the investigating officers, magistrates, public prosecutors etc. so that the crimes under this can be effectively dealt with.

The liability under this Act has been made vast, covering a lot of people under its domain.

(i) The person who had a knowledge that the contract made is illegal and still made his place to carry on with the contract
(ii) A person who does have the permission of the Central Government and still organizes the contract
(iii) A person who misrepresents that he is a member of any recognized association, but he is not
(iv) A person being a member of a recognized association effects to make any contract in contravention to the provisions of the Act

All such persons shall be held liable under the act and will be liable to be prosecuted under the provisions of the Act. Thus the scope of the Act has been kept vast in order to strictly combat to the aim for which the Act was enacted. The Commission strictly exercises an effective control over the forward market.

**Commodity market:**

Commodity market has gained importance in the near future however has gained much importance as the business runs in the high numbers of 11 trillion per annum. The commodities that are allowed for future trading area mainly food grains, fibres, spices, metals etc. the business in these are regulated by the commodity exchanges. Some of them are:

- National Commodity and Derivatives Exchange of India, Mumbai (NCDEX). [29]
- National Multi Commodity Exchange, Ahmadabad (NMCE). [30]
- Indian Commodity Exchange (ICEX) [31]
- ACE Derivatives & Commodity Exchange Ltd [32]

The commodity exchanges work for long hours because the business is so huge. They are functional between 10 A.M. and 11:30 P.M. they are the regulators and the facilitators in this market. The trade and the settlement in this market are guaranteed by them. The exchanges have high profile promoters who have an experience of the market and who are well able to contemplate as to how the market is to work. Thus they guarantee the settlement in such market thus eliminating the possibility of counter-party

[29] *Supra* note 6
[30] *Id*
[31] *Id*
[32] *Id*

transactions. Thus they have to even maintain a Guarantee fund akin to the stock exchanges.

**Delivery in commodities:**

One of the methods of regulation is asking for the delivery in the commodities at the exchange. This makes it easier for the exchange to make the spot price and the future price coincide with each other. Such delivery is not mandatory though because the provision for the same is made in the by-laws of the exchanges. Generally it is at the option of the seller to deliver the commodity. However it depends from exchange to exchange to make delivery mandatory.

The delivery is made possible by making certain cities as destinations for such deliveries. On expiry of the contract if the seller chooses to deliver, he is required to physically deliver at these warehouses and the buyer can collect from there. This acts as a regulation because the fear of delivery would scare away people who wish to artificially rigging up or depressing the futures prices.[33] For instance a participant may wrongfully rig up the price and another participant may give his intention to deliver the commodity on being tempted to a high price.

A participant can avoid delivery as the exchanges have given an option to avoid delivery by the option of liquidation. The participant can liquidate his contract before the delivery period commences.

The by-laws of the exchange have been made strict to make most of the commodities to be compulsorily delivered. Thus the buyer as well as the seller is under the obligation to opt for delivery. While in the case of Seller's option, i.e., if the seller gives his intention to give delivery, buyers have no choice, but to accept delivery or face selling on account and/or penalty.[34] Both the parties are supposed to settle at the due date rate, i.e. weighted average of both the spot price and the future price of the specified number of days.

Another concern regarding the quality and description of commodities is also looked into by these exchanges. The contract as regulated by the exchange is to specify the description, the particular grade and variety of the commodity that is being offered for trade. The description shall deal with every detail of the commodity specifying varieties and ranges of quality that would be accepted in delivery shall also be mentioned in the contract under the supervision of the exchange. If the commodities differ from the quality stipulated then the exchange shall specify the premium or rebate payable. The rate at which such rebate shall be payable will be prior mentioned on the website of the exchange. The authorities who will ascertain whether the commodity is different from the benchmark specifications setup are: SGS India Pvt. Limited, Geo-Chem Laboratories, Dr. Amin Superintendents & Surveyors Pvt Ltd., Calib Brett and Stewart etc. Only certificates given by specified assayers by NCDEX will be accepted. All the certificates issued will have time validity.[35]

If any disputes arise in regards to the above issue, they shall be resolved by the Arbitration Committee which has been set up for the purpose.

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[33] *Id*

[34] *Id*

[35] *Id*

## CONCLUSION:

Here we end up with our Research paper with the conclusion related to concept of forward market commission and regulation mechanism of forward market. We have discussed about the commodity and the commodity market. Commodity underlying the transaction is the subject matter of contract whereas Commodity market is the venue where the agreement is made. The important thing is the suitability of the commodity being a transaction of contract. Further, we have made distinction between the forward contract and future contract. The distinction lies in the fact that in the forward contract the parties are free to determine the term of agreement but in future contract parties are not allowed to determine the term of agreement but they just accept the standardised form of contract for future. Another main thing is the management of risk in the commodity market. Investment is always accompanied with the risk to lose the said investment, so it is necessary to manage the risk of investment. This management is done through securing the interest of investment by the forward contract. As far as the regulation is concerned the main concern is regarding the autonomy of regulating authority in connection with the ultimate regulator.

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