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Financial Markets International, Inc.  
*A USAID Contractor*

**QUARTERLY REPORT**  
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Submitted by  
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USAID Contractor

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## Executive Summary

There are 24 commodity exchanges in India trading in futures contracts of over 140 commodities that span agricultural commodities, precious metals, base metals, and energy products. The aggregate turnover in all the commodity bourses has reached a staggering USD 650 billion (April 06 to Jan 15, 07) from a meager USD 29 billion in 2003-04.

While commodity futures trading is booming, the regulatory regime needs improvement to properly monitor and undertake surveillance of trading to regulate a technologically advanced commodity market. The current regulatory structure is headed by the Forwards Markets Commission (FMC) which in turn has a regulatory role secondary to the Department of Consumer Affairs (DCA) in the Ministry of Consumer Affairs, Food & Public Distribution. The Government of India (GoI) derives its authority to regulate the commodity futures markets from the Forward Contracts (Regulation) Act, 1952 (FCRA). In order for the FMC to meaningfully undertake its rightful responsibility as an autonomous regulator, the GoI has introduced an amendment to the FCRA in the Indian Parliament which is expected to be taken up for voting in the February 2007 Budget session. If passed without major changes, the amended Act will enhance FMC's powers and provide it the necessary authority and autonomy to regulate the commodity futures markets without having to play a secondary role to DCA.

Anticipating the above changes to the legal/regulatory framework, the GoI requested United States Agency for International Development (USAID) to assist the development of commodity futures markets in India by strengthening the regulatory, operational, and facilitating framework for commodity futures markets in India.

Financial Markets International, Inc. (FMI) was awarded a USAID contract with the FMC as a principal project counterpart, with the overarching project goal being strengthening of regulatory capacity. The Project will also assist FMC, DCA, the leading Indian commodity futures exchanges, and the agricultural sector farmers and end-users in developing the legal, policy, regulatory and operational environment for promoting a vibrant and safe commodity futures market in India. Under the Commodity Futures Market Project, FMI provides technical assistance (TA) and associated training to:

1. Strengthen the institutional capacity of the FMC in the areas of rule-making, surveillance, inspection and enforcement;
2. Help develop institutional infrastructure and systems that are critical to transparent efficient functioning of the market; and
3. Institutionalize commodity futures market related state-of-the-art knowledge and skills.

The project's core program in the first quarter was focused on the FMC, but includes optional activities to expand assistance to other market players. USAID/India coordinates with the FMC, DCA, and Department of Economic Affairs ("DEA") in the Ministry of Finance.

## **Tasks and Work Plan**

Under the Project FMI will implement the following tasks:

1. Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement in the Commodity Futures Market

The overall objective of activities under this task are to develop a legal, policy and regulatory environment that promote a vibrant and safe commodity futures market. Under the task, FMI will work closely with the FMC to modernize its systems and processes and upgrade the capacity of its staff in commodity futures regulation and supervision. FMI will provide global 'best practices' technical expertise and innovative training in the following broad areas: (a) development of a comprehensive regulatory framework for commodity futures exchanges, clearinghouses, and other intermediaries; and (b) building FMC's capacity in inspection of intermediaries, market surveillance and investigation and enforcement of market manipulation and fraud cases.

2. Development of Institutional Infrastructure for an efficient Commodity Futures Market

Commodity futures market requires a wide network of regulated warehouses, a system of grades and standards based on international 'best practices', an extensive network of licensed testing facilities, a system for collection and disseminating of spot market price information to the farmers and hedgers, and an enabling policy and regulatory environment for banks to lend against commodities (assets) stored in warehouses. The activities under this task will assist in developing a functioning institutional infrastructure that is necessary for efficient operation of the Indian commodity futures market.

## **Counterparty Requirements and Priorities**

FMI's principal counterparty for the first quarter of the project has been the FMC. Following a series of meetings in early October, 2006, with the FMC Chairman and other senior FMC officials, it became clear that the Commission faced an immediate and acute human resources constraint. FMC needs more qualified personnel to fulfill its various regulatory functions and is in the midst of implementing a plan to recruit and train competent staff in these key areas. It also emerged that passage of the FCRA amendment bill, with its grant of operational autonomy, would allow the FMC to enhance its personnel capacities. Hence, CFMP and the FMC agreed that the majority of direct training for the regulator's staff by CFMP should be scheduled and tailored to include the intake of personnel anticipated for mid-2007.

The following activities were identified by FMC as priority areas where FMI could provide immediate assistance and incorporated into the Project's training plans for future consideration:

- Drafting of new Regulations
- Surveillance Technology
- Enforcement Manual
- Programs for increasing awareness of commodity futures usage

## Initial Implementation of USAID CFMP, India

- Regulations and Electronic Market Surveillance System

FMI Commodity Law Experts Charles Seeger, Grant Collins, and Kate Hathaway commenced drafting new regulations during this Quarter. Draft regulations were prepared using an interactive process of discussion and drafting which incorporated senior officials of the FMC, as well as leading legal experts from MCX, NCDEX, and NMCE (India's three leading commodity futures exchanges representing 98% of commodity futures trading in India). In addition, FMI Commodity Markets Specialist Kate Hathaway focused on preparing the necessary analysis, strategic plan and resource requirements for developing an electronic market surveillance system for FMC. As a result of this activity, by early January, six drafts were submitted to FMC:

1. Intermediary Registration Rules
2. Intermediary Registration Regulations
3. Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer Rules
4. Procedure for Holding Inquiry by Inquiry Officer and Imposing Penalties Regulations
5. Outline of Manual on Investigation and Disciplinary Action along with A review of Investigation And Disciplinary Action Infrastructure of FMC
6. A paper on Developing an electronic Market Surveillance System, along with a Review Regulatory Activities of FMC and Exchanges in relation to IOSCO best practices in Market Surveillance

In addition, after receiving an urgent request to review the issue of foreign ownership in the futures industry as part of an ongoing GOI review, Charles Seeger and Jayaprakash prepared and submitted to FMC a detailed paper entitled "Foreign Ownership in Indian Commodity Exchanges." The ability to respond to this sort of demand driven is a hallmark of the Project and critical in a rapidly changing economic environment such as India.

- Public Awareness and Profile

Simultaneous to Project launch in October 2007, the annual FIA/Asia Derivatives Conference was held in Mumbai, attracting representatives from across India and around the world to this prestigious three day program. In order to both raise the profile of commodity futures markets issues in India and the new USAID/CFMP program, FMI Chairman Charles Seeger facilitated a high level presence for senior members of the FMC and participated in several seminars, workshops and networking sessions. This effort was highlighted when FIA President John Damgard requested that Mr. Seeger step-in for him at the last minute and moderate a high level wrap up session which included virtually every participant to the Conference. Mr. Seeger led the group in a dynamic Q&A session which reviewed the history of derivatives markets, the current state of play in India and around the world, and the keys to future development.

- Training

Given the prominence of training in the original CFMP scope of work, this Quarter included an ongoing series of discussions and negotiations with FMC on potential training programs

(domestic and international) slated to take place between March and September 2007. This included:

1. A review of proposed weeklong training to be delivered by a high level group of U.S. Commodity Futures Trading Commission (CFTC) staff in India on market surveillance and supervision for the FMC and exchanges;
2. Invitations for the Chairman and one senior official of FMC to attend the Boca Raton Conference of Futures Industry Association (FIA) in March 2007;
3. A specialized seminar by former CFTC regulator and international expert Mike Gorham of Illinois Institute of Technology on contract design, settlement related issues with a case study approach;
4. Attendance by FMC staff at the CFTC International Regulators Training Seminar during fall 2007; and,
5. Potential joint FMI/Futures Industry Association Institute for Futures Markets Training in India in January 2008.

Subsequent discussions with FMC have more clearly focused the field of potential joint training activities, several of which will be underway in the second Quarter of the Project.

### **Current Developments and Future Plan of Action**

In January 2007, the FMI senior commodity futures experts met with both FMC and DCA leaders who expressed their optimism that the critical pending amendments to the FCRA would be passed by June 2007. However, during these discussions it became clear that even if the Bill passed in June, administrative delays could impact the speed of implementation related to FMC's increased autonomy, its restructuring, and the recruitment of professionals. In the absence of adequate human resources, FMC stated it was not in a position to respond to the drafts of regulations that had been submitted to them, limiting the ability of the Project to engage the regulator in a dialogue and interactive effort to promulgate these important items. As a result, the Regulations that were submitted are unlikely to be finalized promptly, but will be placed on reserve by the FMC for implementation as soon as institutional issues are resolved. However since FMC indicated during discussions that it desired a draft Enforcement Manual, such a Manual will be submitted in the first week of February 2007.

Considering the importance of establishing a vibrant, sustainable, well regulated commodity futures market in India despite the relative lack of readiness in the regulator, a decision was made to focus increased attention on work with other key players in the private and NGO sector. In particular, the Project will expand its work with exchanges, develop innovative programs for increasing awareness of commodity futures usage by farmers, co-operatives, millers, exporters, etc., and begin working more closely with entities such as the State Agricultural Marketing Federations (like HARFED in Haryana), Farmers co-operative organizations like IFFCO, Agricultural Institutes, etc. FMC will remain a key partner and collaborator for this work, subject to availability.

Based on the above, Work Plan of October 30 is being recast and a new version will be submitted to USAID in February 2007.

## **I. Project Launch, Staffing and Organization**

Immediately after the signing of the Task Order, the Project was launched in New Delhi on October 12, 2006 at a function attended by the DCA Secretary, FMC Chairman, commodity futures industry leaders, and senior officials of USAID/India including the Deputy Mission Director Beth Hogan who opened the event (an agenda and list of attendees is included in Appendix A). Invitees included a broad cross-section of leaders from the private, public and NGO sector engaged in commodity futures, agriculture and related activities. Simultaneously, FMI Vice President Peter Levine directed the administrative start-up of the Project from Mumbai, recruiting and training necessary staff, identifying and negotiating a lease on appropriate office space, and vetting local vendors for necessary office supplies and equipment. The project staff consisting of the Chief of Party/Resident Advisor Jayaprakash, an Office Manager, and a part-time Training Coordinator were in place at the time of official launch of the Project and final interior work on the leased space completed within the month.

In addition to the kick-off event in India and related launch activities, a series of initial meetings took place with FMC in Mumbai and DCA in New Delhi. These focused on critical priorities for the Project and benefited from the presence of a broad cross section of industry experts in Mumbai for the FIA/Asia Derivatives Conference which was taking place at the same time. FMI was able to secure a high profile for the Project and key Indian counterparts at this prestigious meeting, including a last minute request from FIA President John Damgard that firm Chairman Charles Seeger moderate the high level wrap up session.

At the request of USAID, additional briefings were prepared for senior staff at the U.S. Embassy, New Delhi and for the U.S. Consul General in Mumbai. Furthermore, to insure a strong private sector voice in the initial strategic planning, meetings were held with secondary counterparties like the three national online multi-commodity exchanges namely, Multi Commodity Exchange of India Limited (MCX) and National Commodity & Derivatives Exchange Limited (NCDEX), both in Mumbai, and National Multi Commodity Exchange of India Limited, Ahmedabad.

## **II. Tasks and Work Plan**

In order to facilitate the resolution of immediate issues in the Indian market, but reserve secondary areas for action contingent on funding and GoI support, USAID organized CFMP into primary activities and options. The primary activities funded under Year 1 of the contract are as follows:

### **1. Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement in the Commodity Futures Market**

The overall objective of activities under this task will be to help develop a legal, policy and regulatory environment that promote a vibrant and safe commodity futures market. In order to achieve this, FMI will work closely with the FMC to modernize its systems and processes, while also upgrading the knowledge and skills of its staff in commodity futures regulation and supervision. The Project will also deliver technical assistance and innovative training based on international best practices in: (a) development of a comprehensive regulatory framework for

commodity futures exchanges, clearinghouses, and other intermediaries; and (b) building FMC's capacity in inspection of intermediaries, market surveillance and investigation, and enforcement of market manipulation and fraud cases.

## **2. Institutional Infrastructure for an efficient Commodity Futures Market**

Commodity futures markets require a wide network of regulated warehouses, a system of grades and standards based on international 'best practices', an extensive network of licensed testing facilities, and a system for collection and disseminating of spot market price information to the farmers and hedgers. In addition, it is critical that an enabling policy and regulatory environment be in place for banks to lend against commodities (assets) stored in warehouses. The activities under this task will assist in developing the functioning institutional infrastructure necessary for efficient and sustainable operation of the Indian commodity futures market.

### **Options Tasks**

In addition to the above main tasks, the Task Order has several Options built into the CFMP Scope of Work. These include:

#### **Option 1: Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement in the Commodity Futures Market**

The major Option Tasks in this area, *inter alia*, may include:

- Review of existing regulations on capital adequacy and risk management aspects of brokers and intermediaries licensing.
- Assist FMC in the review of risk management and surveillance systems in the market.
- A comparative analysis of the laws that govern the Indian commodity futures market against other developed markets.

#### **Option 2: Development of Institutional Infrastructure for an efficient Commodity Futures Market**

- Assist selected State Marketing Boards and spot markets (called *mandis*) in development of an efficient price collection and dissemination system.
- Assist development of a uniform approach to commodity grades and standards.
- Fostering alliances between selected exchanges and agriculture universities to develop a network of facilities for testing grades and standards.

#### **Option 3: Knowledge Development and Deepening of the Commodity Futures Market Outreach**

Development of a robust and developed market requires innovative outreach programs to make sure that a significant percentage of India's farming community uses the market to hedge price risk of their agricultural produce. If this option is exercised, the Project will work with leading public, private and non-governmental organizations to:

- Design and implement innovative outreach programs with selected partners (e.g. banks and financial institutions, trade associations, agricultural universities).
- Assess the knowledge and skill gaps in the Indian commodity futures industry, develop an action plan to address key issues, and work with local champions to launch an effort to resolve these.

On the basis of the identified Tasks, FMI and USAID jointly decided to address the two core tasks (Tasks 1 and 2) in the Project's first year October 1, 2006 to September 30, 2007. A Work Plan along with a chart outlining an Implementation Schedule was submitted to and approved by USAID on October 30, 2006 (a copy is included in Appendix C). A detailed outline of the Principal and Options Tasks, FMI activities thereunder and planned Outputs can be found in Appendix B.

### **III. Counterpart Requirements and Priorities**

FMI's principal counterpart under Q1 activities is the FMC and following initial meetings in October with Chairman Sundaresharan and other senior FMC officials, it became clear that it was an organization facing an immediate and acute human resources constraint. FMC needs additional qualified personnel to fulfill its various regulatory functions and is planning to recruit the necessary employees during the second half of 2007. Passage of the FCRA amendment bill, with its grant of operational autonomy will allow the FMC to enhance its personnel capacities and therefore any training under the CFMP will be scheduled and tailored accordingly. In order to lay the foundation for such training, the following activities were identified via an interactive discussion with FMC as priorities the Project could provide assistance:

#### **A. Drafting of new regulations**

The FMC initially identified 20 areas (Appendix D) where new regulations will be required in anticipation of the FCRA amendment legislation. Subsequently, FMC narrowed these areas down to twelve key regulations (Appendix E) and requested assistance from FMI to both prioritize those issues which required new regulations and in the drafting thereof. Even in the eventuality of a delay in the passage of the FCRA Amendment bill, the FMC would still need to issue such regulations, although they would take the form of "Directives" under the existing regulatory structure.

#### **B. Surveillance Technology**

FMC requested assistance in evaluating existing market surveillance capacity and requirements (e.g., IT needs, etc.) for a real-time surveillance system. An upgrade is planned and the Project will likely assist in formulating an RFP for use in a tender.

#### **C. Enforcement Manual**

Assistance in drafting a detailed manual that can be used as orientation material for new recruits and as stand-alone reference guide on enforcement issues was requested by the

Division of Counseling and Enforcement. The manual will explain how to initiate, investigate and conduct an enforcement action, including references to the statutory/regulatory basis of these powers and examples.

D. Programs for increasing awareness of commodity futures usage

Although the FMC is quite active in outreach, working particularly closely with the exchange sector, the Project was approached about expanding and enhancing these activities in order to increase the impact and reach a wider audience. The need for such activities was also strongly endorsed by the three approved National Commodity Exchanges and the Project will work closely on joint public-private activities which leverage its own resources, as well as those in the market.

**IV. Selected Accomplishments and Deliverables**

- Draft regulations in key areas identified by the Project in conjunction with FMC and the leading exchanges were prepared and delivered. They include the following:
  - A. Intermediary Registration Rules
  - B. Intermediary Registration Regulations
  - C. Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer Rules
  - D. Procedure for Holding Inquiry by Inquiry Officer and Imposing Penalties Regulations
  - E. Outline of Manual on Investigation and Disciplinary Action along with A review of Investigation And Disciplinary Action Infrastructure of FMC
- An analysis and evaluation of critical issues for the development of a modern and efficient system for market surveillance was completed. Two papers were prepared in order to facilitate progress on this issue and discussed with FMC and the leading exchanges to explore next steps. These were: “Developing an Electronic Market Surveillance System for India,” and “A Review of Regulatory Activities of the FMC and Exchanges In Relation to IOSCO Best Practices in Market Surveillance.”
- A paper on “Foreign Ownership in Indian Commodity Exchanges” was prepared and delivered to FMC in response to a development in the market which required immediate attention.
- A detailed series of proposed training initiatives for FMC were developed and discussed, including both domestic and international programs. Expertise will be delivered by Project experts, current and former U.S. CFTC staff, and industry specialists associated with leading international futures associations such as FIA. The specific activities implemented will be contingent on funding, commitment of attendees and resources from counterparts, and scheduling. A comprehensive list of proposed training programs initially approved by both FMC and USAID/FMI is attached in Appendix F.

## V. Current Developments and Future Plan of Action

Although the drafting of key regulations was linked to the anticipated passage of the Amendment Bill to FCRA by the Indian Parliament during its Winter Session in December 2006, the legislation was not taken up for discussion during this period. Based on ongoing discussions with key policymakers, it is anticipated that the Bill may be considered during the Budget Session of the Parliament which takes place in February-March 2007, but the Project is prepared to work with FMC on issuance of the regulations as directives if necessary.

In addition in the later stages of this Quarter, the FMC delisted from the commodity futures market two agricultural commodities viz., Tur and Urad which are protein nutrients of daily consumption in Indian households. This action came as a result of a public outcry against the rising prices of essential commodities and the politicizing of these issues by selected political parties. Although there is a certain amount of disinformation involved and this indicates the ongoing need to further educate the general public on commodity futures markets, it may also have a positive unintended consequence by accelerating pressure to pass the Amendment Bill.

During meetings with USAID/FMI, the FMC and DCA both expressed their optimism that the FCRA Amendment Bill would be tabled in February/March 2007 and passed by June. However, even if the Bill is passed on this schedule, it became apparent that administrative delays could impact the speed with which FMC would receive its expanded autonomy to FMC, launch institutional restructuring efforts, and recruit/hire needed additional professional staff. In the absence of adequate human resources, FMC is not in a position to respond to the drafts of regulations were submitted to them and at the moment these documents are being held in reserve for future action. Following more extensive discussions with FMC, DCA and USAID/New Delhi, it was agreed that further work on Regulations be postponed until the legislative situation is clarified. However, given FMC's commitment to advance work on enforcement issues and desire to receive the draft Enforcement Manual, this project will be completed and submitted by the first week of February 2007.

Under the circumstances, a decision was made to increase work with the private and non-governmental sector in order to address a number of crucial issues in the market. In particular, a greater emphasis will be placed on programs which raise awareness of commodity futures usage by farmers, co-operatives, millers, exporters, etc. Potential partners for such initiatives which will take place in different locations across India include the State Agricultural Marketing Federations (like HARFED in Haryana), Farmers co-operative organizations such as like IFFCO, Agricultural Institutes.

As regards the training programs, the number of training programs has been cut down to two or three as indicated in the Current Status in Appendix E. In view of the reduction in training programs, it was felt that there was no need of continuing with the services of the part-time Training Coordinator in India. The incumbent's service has since been terminated. A new position of Outreach Program Coordinator is being contemplated and recruitment will be completed soon.

**Appendix A**

**Selected Materials from Project Launch Event**

**“Commodity Futures Markets Project Launch”**

**October 13, 2006**

**Hotel Taj Mansingh, New Delhi**

Mr. Charles Seeger Financial Markets International, Inc.	Mr. Grant Collins Financial Markets International, Inc.
Mr. L. Mansingh Department of Consumer Affairs	Mr. S. Sundareshan Forward Markets Commission
ATTENDEES	
Mr. Alok Kumar Agarwal Alankit Imaginations Ltd.	Mr. R.V. Anuradha Amarchand Mangaldas – Solicitors & Advocates
Mr. Yatin Arya Bharti Airtel Ltd.	Mr. Gokul Patnaik Cebeco India Pvt. Ltd.
Mr. N.K. Choubey Central Warehousing Corporation	Mr. Anurag Bhatnagar Ch. Charan Singh National Institute of Agricultural Marketing
Mr. S. Prabhakar CMIE	Mr. Dibyajyoti Bora Confederation of Indian Industry
Mr. Sarju Singh D1 Oils Ltd.	Mr. Ganesh Singh Dabur Ayurved Ltd.
Mr. Suranjan Upadhyay Dabur Ayurved Ltd.	Mr. D.C. Devgune Department of Consumer Affairs
Mr. G. S. Negi Department of Consumer Affairs	Mr. Sudhir Shyam Department of Consumer Affairs
Mr. Paul Joseph Department of Consumer Affairs	Mr. Alok Chandra Department of Economic Affairs
Mr. Girish Agnani ICICI Bank Ltd.	Mr. Joseph Massey Multi-Commodity Exchange of India Ltd.
Mr. Madan Sabnavis National Commodity & Derivative Exchange	Mr. Ravindra Sachdeva National Commodity & Derivative Exchange
Dr. Anil Sharma National Council of Applied Economic Research	Mr. S. George National Multi-Commodity Exchange

Ms. Baljeet Kaur National Multi-Commodity Exchange	Mr. Surendra Mehta National Multi-Commodity Exchange
Mr. Kailash Gupta National Multi-Commodity Exchange	Dr. C. Prabhu Rabo India Finance Pvt. Ltd.
Ms. Elizabeth Hogan USAID	Mr. Ashok Jha USAID
Mr. Aleen Mukherjee USAID	Mr. Lawrence Paulson USAID
Mr. Venkat R. Chary Advocate – High Court	Mr. C.K.G. Nair Former Director – Department of Consumer Affairs
Ms. Poonam Barua Public Affairs Management	Ms. Aarti Malhotra Public Affairs Management

## **FMC, US agency launches futures market programme**

[http://WWW.financialexpress.com/fe\\_full\\_story.php?content\\_id=143401](http://WWW.financialexpress.com/fe_full_story.php?content_id=143401)

ASHOK B SHARMA ECONOMY BUREAU Posted online: Saturday, October 14, 2006

NEW DELHI, OCT 13: The US has decided to help India in streamlining the commodity futures market and making its operations more transparent. This programme would be under the US-India Knowledge Initiative in Agricultural Research and Education.

The US Agency for International Development (USAID) and regulator of futures market in India, the Forward Markets Commission (FMC), launched a Rs 4.5-crore (\$1 million) commodity futures market programme on Friday in the capital.

Speaking on the occasion, US Agency for International Development's India mission deputy director Beth Hogan said, "Drawing on our experience, the US wants to help India improve futures markets support and the country's 120 million farming households. An effective commodity futures market here can help farmers to guide planting decisions and manage the risks of market fluctuations."

The secretary in the department of consumer affairs, Labadenyu Mansingh and Forward Markets Commission chairman, S Sundareshan also attended the launch.

- The Rs 4.5-cr commodity futures market programme is part of US-India Knowledge Initiative in Agricultural Research and Education
- FMC to lead work on regulatory issues for the market place
- US Agency for International Development support to be used for technical assistance from Financial Markets International Inc and the US Commodity Futures Trading Commission

According to Hogan, the programme will promote vibrant and safe commodity futures markets by making the farm products market more transparent and available to the country's farmers.

The programme represents a practical benefit from co-operation between the US and India under the joint agricultural knowledge initiative launched by US President Bush and Indian Prime Minister Manmohan Singh in July 2005 and subsequently signed in March 2006 during Bush's visit to India.

Forward Markets Commission will lead the work on regulatory issues for the market place. US Agency for International Development support will be used for technical assistance from Financial Markets International Inc and the US Commodity Futures Trading Commission.

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## **USAID to invest \$3mln in commodity future market program**

New Delhi, Oct 13 (UNI) In an effort to develop institutional infrastructure for an efficient commodity futures market in India, the United States Agency for International Development (USAID) and the market regulator Forward Markets Commission (FMC) today launched a Rs 4.5 crore Commodity Futures Market programme.

The programme will be carried on for three years on a year-on-year basis with a total investment of 3 million dollars.

The project will assist the FMC, Department of Consumer Affairs and leading Indian exchanges in developing the legal, policy, regulatory and operational environment necessary for promoting a vibrant and safe commodity futures market in India.

"Drawing on our experience, the US wants to help India improve futures markets support India's 120 million farming households," USAID India Mission India Director Beth Hogan told reporters here.

Secretary, Department of Consumer Affairs, L Mansingh said that an effective commodity futures market can help farmers to guide planting decisions and manage the risks of market fluctuations.

The programme will promote vibrant and safe commodity futures markets by making the farm products market more transparent and available to Indian farmers.

The Forward Markets Commission will lead the work on regulatory issues for the market place.

USAID support will be used for technical assistance from Financial Markets International (FMI) and the US Commodity Futures Trading Commission.

UNI DKS PV HS1817

**Appendix B**

**Principal Task and Option Tasks**

FMI will implement the following tasks:

### **1: Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement in the Commodity Futures Market**

The overall objective of activities under this task will be to help develop a legal, policy and regulatory environment that promote a vibrant and safe commodity futures market. Under the task, the contractor will work closely with the FMC to modernize its systems and processes and upgrade knowledge and skill of its staff in the commodity futures regulation and supervision. The contractor will provide global 'best practices' technical expertise and innovative training in the following broad areas: (a) development of a comprehensive regulatory framework for commodity futures exchanges, clearinghouses, and other intermediaries; and (b) building FMC's capacity in inspection of intermediaries, market surveillance and investigation and enforcement of market manipulation and fraud cases.

FMI's assistance may include but not be limited to:

- Review of FMC's existing monitoring and market surveillance system, including rules, regulations and procedures and high-level design of an IT-enabled real time surveillance system
- Review of the existing enforcement infrastructure, including investigatory and enforcement procedures, quality and timeliness of investigations
- Development of manuals for inspection and investigations;
- Institutional strengthening of FMC's legal department, including the system of adjudication, no-action letter process
- Review of exchanges' current practices with regard to (a) dealing with market volatility, (b) default handling, (c) investigation and enforcement of market manipulation and frauds, (d) full documentation and audit trail, (e) imposition of sanctions for non-compliance, (f) oversight of member firms' activities, (g) anti-money laundering provisions, and (h) self-regulation

#### **Associated Training**

The training support under Task 1 may include, but not be limited to:

- FMC and Exchange staff: Risk management, inspection (examination of market intermediaries), surveillance, investigation and enforcement
- FMC and Exchange staff: Self Regulatory Organizations (SRO) and rule-making

#### **Planned Outputs**

- (1) Comments on exchange risk management systems, including the inspection, compliance and surveillance, and necessary assistance in the implementation of the recommendations
- (2) Comment on the existing enforcement infrastructure, including investigatory and enforcement procedures, quality and timeliness of investigations

- (3) Manuals for inspection of market intermediaries;
- (4) Recommendations on enforcement policy and manuals for investigation and enforcement
- (5) Review and comments on current practices on (a) dealing with changes in market volatility, (b) default handling, (c) oversight of member firms' activities across different markets (cash, futures and options markets),(d) full documentation and audit trail, and (e) imposition of sanctions for non-compliance, and necessary assistance in the implementation of the recommendations
- (6) The Associated training under Task 1 described above delivered.

**Wherever outputs require making recommendations and the institution to which these are addressed need TA to implement them, the contractor shall propose necessary TA for the prior approval of USAID/India which will be subject to funding availability.**

## **2: Development of Institutional Infrastructure for an efficient Commodity Futures Market**

Commodity futures market requires a wide network of regulated warehouses, a system of grades and standards based on international 'best practices', an extensive network of licensed testing facilities, a system for collection and disseminating of spot market price information to the farmers and hedgers, and an enabling policy and regulatory environment for banks to lend against commodities (assets) stored in warehouses.

The activities under this task will assist in developing a functioning institutional infrastructure that is necessary for efficient operation of the Indian commodity futures market. FMI activities may include, but not be limited to:

### **Associated Training**

- Training programs for bankers on warehouse receipt financing

### **Planned outputs**

- (1) Training programs for bankers, state marketing boards, and agriculture graduates on grades and standards

**Wherever outputs require making recommendations and the institution to which these are addressed need TA to implement them, the contractor shall propose necessary TA for the prior approval of USAID/India which will be subject to funding availability.**

## **OPTIONS TASKS**

The activities to be taken as options under each task are marked with an asterisk (\*).

### **Option 1: Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement in the Commodity Futures Market**

FMI activities may include, but not be limited to:

- Review of existing regulations on capital adequacy and risk management aspects of brokers and intermediaries licensing and assistance in alignment of the regulations to international standards\*
- Development of a framework for testing, certification and licensing of market intermediaries\*
- Assist FMC in the review of risk management and surveillance systems of commodity futures exchanges and clearing houses\*
- A comparative analysis of the laws that govern the commodity futures market with the legal framework that exists in the developed markets with a view to identifying the gaps and areas for improvement\*
- Assist in building FMC's economic and market research capabilities\*

Analysis of regulatory gaps and overlaps in financial market regulatory jurisdictions to improve regulatory harmonization and coordination\*

#### **Associated Training**

- FMC staff: Commodity futures markets data collection and analysis\*

#### **Planned Potential Outputs**

- (1) Comments on existing regulations on capital adequacy and risk management aspects of brokers and intermediaries licensing\*
- (2) Recommendations on developing a framework for testing, licensing and certification of market intermediaries\*
- (3) A comparative study of Indian commodity futures laws with those in the developed markets completed and recommendations made\*

#### **Option 2: Development of Institutional Infrastructure for an efficient Commodity Futures Market**

- Assist selected State Marketing Boards and spot markets (called *mandis*) in the development of an efficient price collection and dissemination system
- Assistance in the development of a uniform approach to commodity grades and standards that is in harmony with other existing standards
- Fostering alliances between selected exchanges and agriculture universities to develop a network of facilities for testing grades and standards of agriculture commodities\*

#### **Associated Training**

- Training support to selected State Marketing Boards on how to improve the efficiency and price dissemination practices of *mandis*
- Institutionalization of 'Train-the-trainers' programs on grading and standardization\*

### **Planned Potential Outputs**

- (1) Assessment report on the development and implementation of a national grading and standardization system
- (2) Implementation of a pilot program for the development of an efficient spot market price dissemination system
- (3) A few alliances between selected exchanges and other agriculture institutions for testing grades and standards of agriculture commodities in place\*

### **Option 3: Knowledge Development and Deepening of the Commodity Futures Market Outreach**

In order to become a robust and developed market, the commodity futures industry will need a supply of quality professionals (regulators, traders, trainers, researchers and risk managers) in the near and medium-term. It will also need to develop and implement innovative outreach programs to make sure that a significant percentage of India's farming community uses the market to hedge price risk of their agricultural produce. Under the task, FMI may work with key institutions to build their capacity to design and deliver quality training and research programs. FMI activities may include, but not be limited to:

- An assessment of knowledge and skill gaps in the Indian commodity futures industry and the development of an action plan to address key issues identified in the assessment report\*
- Develop a plan for establishing Centers of Excellence for the commodity futures and agriculture risk management industries\*
- Development of innovative outreach programs in collaboration with selected partners (e.g. banks and financial institutions, trade associations, agricultural universities) and provide strategic assistance in the implementation of one or two programs\*
- Assist selected agricultural universities and business schools in the development and delivery of state-of-the-art curricula on relevant commodity futures themes\*

### **Associated Training**

- 'Train-the-trainers' for university, bankers training centers, co-operatives training and business schools
- Orientation programs for policy makers in NABARD, RBI and State Agricultural Departments

### **Planned Potential Outputs**

- (1) Assessment report on the existing knowledge and skill gaps in the futures industry with recommendations to fill these gaps
- (2) Vision Statement and Business plan for the proposed FMC sponsored "Institute of Excellence" with possible collaboration with and international institution(s)
- (3) A few outreach programs developed in collaboration with key institutions

- (4) Curricula on various commodity futures training themes developed and selectively implemented in collaboration with selected agricultural universities, business schools and bankers training centers

**Appendix C**

**Work Plan and Implementation Schedule**



**USAID/India Commodity Futures Market Project  
Work Plan Timetable 2006-2007**



Task/Activity Description	2006			2007									Staff/Partner	Deliverables	
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept			
<b>1. Legal and Institutional Strengthening of Regulation, Surveillance and Enforcement</b>															
Drafting and Promulgation of new Regulations/Directives for FMC														Collins, Hathaway, Jayaprakash, Seeger	Necessary Regulations Drafted and FMC Approved (estimated at 25 regs.)
Review of the FMC's existing enforcement infrastructure and associated comments/recommendations														Collins, Jayaprakash, Seeger	Report published on FMC Enforcement Infrastructure
Development of an FMC Enforcement Manual														Collins, Seeger	Training Manual on Enforcement Published
Institutional strengthening of FMC's Division of Counseling and Enforcement														Collins, Seeger	FMC Staff Trained in No-Action Letter Process
Review of FMC's existing monitoring and market surveillance system														Hathaway, Jayaprakash, Collins	Assessment Published on Recommendations for Monitoring / Surveillance
Review and comments on the GoI approved National Commodity exchanges' current practices on Task 1, Activity (vii) (a)-(h)														Collins, Hathaway, Jayaprakash, Seeger	Incorporated into FMC Regulation Drafting Process
Comments on the National Commodity exchanges' risk management systems														Hathaway, Jayaprakash, Collins	Assessment of Risk Management System
Development of FMC Manual for Inspection/Examination of Intermediaries														Hathaway, Collins, Seeger	Manual Published on Inspection

Task/Activity Description	2006			2007									Staff/Partner	Deliverables
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept		
Assistance in formulating design of Electronic Surveillance System for FMC													Hathaway, Jayaprakash, TBD Expert	Best Practice Concept Drafted Surveillance
Acceptance by FMC of Electronic Surveillance System concept													Hathaway, Jayaprakash	Concept Accepted by FMC
Training - Investigation and Enforcement (fraud and manipulation) FMC and exchanges													Collins, Rodrigues	FMC Staff Trained
Training – Risk Management, Market Surveillance, Inspection/Examination of Intermediaries FMC and exchanges													Hathaway, Rodrigues, CFTC	FMC Staff Trained
Training – Promulgation of Regulations and Rule making/ SROs for FMC													Collins, Seeger, Rodrigues, Levine	FMC Staff Trained
<b>2. Development of Institutional Infrastructure</b>														
Training – Bankers, on Warehouse Receipts and Hedge Lending; State Marketing Boards, and Agriculture Graduates on Grades and Standards/International Best Practices													Jayaprakash, Rodrigues, TBD expert	Professionals Trained in Train-the-Trainer programs

**Appendix D**

**FMC's First List of Regulations required for Commodity Derivatives Market**

1. Regulation of Commodity Pool Operators
2. Regulations for Depositories in Commodity Derivatives
3. Criteria for Fit and Proper Person Regulations
4. Regulations for Foreign Institutions Investors in Commodity Derivatives
5. Guidelines for Investors Protection Funds at Commodity Derivatives
6. Awareness and Investors Protection Rules
7. Regulations for Market Making
8. Regulation for Central Database of Market Participants
9. Rules for Commodity Derivatives Portfolio Managers
10. Guidelines for fair practice/code of conduct for public representatives and FMC Nominee Directors
11. Regulations for Self Regulatory Organizations
12. Regulations for Commodity Brokers and Sub-brokers
13. Regulation for Prohibition of Fraudulent and Unfair Trade Practice Relating to Commodity Derivatives
14. Regulations on Procedures for Commission Meetings
15. Capital Adequacy Regulations for Exchanges and Commissions Meetings
16. Regulations for Protection of Customers Interests and Funds
17. Certifications of Intermediaries Regulation
18. Regulations on Financial Record Keeping
19. Systems Audit Regulations
20. Margin Calculations Methodology Regulations

**Appendix E**

**FMC's revised List of regulations required on a priority basis**

1. Members/Brokers and Sub-brokers Regulations
2. Clearing members, professional clearing members, Assayer, Registrar and Depository regulations
3. Guidelines for Net worth requirements for all intermediaries in the commodities market, especially Assayer, Registrar and Depository Participant
4. Regulations to retain records of intermediaries for a specific period of time and access limits of such financial records pertaining to privacy policies
5. Regulations for SROs, including Commodity Exchanges/Associations, Depositories
6. Fit and Proper Person Regulations
7. Portfolio Management Services Regulations
8. Guidelines for appointment of CEO, Governing Commission and Statutory Committees
9. Insider trading prohibition regulations
10. Prohibition of Fraudulent and Unfair Trade Practices Relating to Commodities Derivatives Trading Regulations
11. Procedure for holding enquiry and imposing penalties by Adjudicating officers Regulations (*sic*)
12. Procedure for holding Enquiry by Enquiry Officer and Imposing penalty Regulations

**Appendix F**

**List of Training Programs initially planned and current status**

**1. Boca Raton Futures Industry Conference (March 14 - 17, 2007):**

The Chairman and a senior official of FMC have been invited for this prestigious international event. The Project will underwrite the participation of the two delegates.

**Current status:** FMC has declined this offer.

**2. FMI/Mike Gorham Contracts Training (March 25 or 26, 2007):**

One or one and a half day event will be held in Mumbai on a list of topics as discussed in our meeting with Mr. Gorham on Jan. 6, 2007. The topics will include, but not limited to, contract design, issues regarding physical delivery, relevant case studies, etc. as discussed at a meeting of Mr. Gorham, FMC Director and Resident Adviser, FMI on January 6, 2007 in Mumbai. Participants will be drawn from FMC and the exchanges.

**Current status:** The seminar is likely to take place in Mumbai on March 25, 2007.

**3. FMI Regulations and Investigations Workshop, Grant Collins (March 2007):**

Seminar/workshop on drafts of Regulation and/or Investigation & Disciplinary Action Manual and related issues in commodity markets with participation from FMC and exchanges.

**Current Status:** The focus has since been shifted to Enforcement Manual prepared by Mr. Grant Collins, at the request of FMC. Instead of workshop, individual meetings will be held by February 16 with FMC, MCX and NCDEX to discuss the draft.

**4. FMI/CFTC Regulatory Training (May 2007):**

This training of 1-2 weeks for senior FMC officials on commodity futures markets regulation to be implemented by a team of U.S. Commodity Futures Trading Commission (CFTC) experts with support and assistance from the Project. A list of tentative topics suggested by FMC is being shared with CFTC shortly in order to finalize the dates, duration and participants in this high level Mumbai based program. All cost including domestic and travel cost of CFTC personnel will be met by the Project and/or CFTC.

**Current Status:** The duration of the training has been reduced to one week as per request of FMC.

**5. CFTC International Regulators Training Seminar (Fall 2007)**

The Project will support an Indian delegation to this annual training program implemented by the CFTC in Chicago for regulators from around the world. Previous Indian participants have benefited extensively from participation. FMC indicated that the travel cost of FMC officials for this event will be met by FMC/GoI.

**Current Status:** FMC has since indicated its inability to fund the travel and attendant costs of its officials and has requested FMC to explore the possibility of financial support from USAID.

**6. FMI/Futures Industry Association Institute for Futures Markets Training (January 2008)**

Seminar/workshop with case studies on a series of topics to be defined in collaboration with the Project, likely working off the “Tentative List of Other Issues” suggested by FMC which includes SROs, defaults, clearing houses, HR, and regulatory coordination. FMI has some tentative agreement with FIA/IFM in place to implement this activity. The training is expected to be sponsored by Indian Exchanges, banks, industrials and commodity users.

**Current Status:** FMC has since expressed its lack of interest in the program.