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## INTRODUCTION

**About ICEX:** Indian Commodity Exchange Limited (ICEX) is a Securities & Exchange Board of India (SEBI) regulated commodity derivatives exchange, headquartered in Mumbai. Some of the prominent shareholders of ICEX are Central Warehousing Corporation (CWC), Punjab National Bank (PNB), IDFC Bank, Krishak Bharati Cooperative Limited (KRIBHCO), Indian Potash, Metals & Minerals Trading Corporation of India (MMTC), Gujarat Agro Industries Corp. Limited, Gujarat State Agricultural Marketing Board, Reliance Exchangenext Ltd, Bajaj Holding and Indiabulls Housing Financial Services.

**Background:** On 27<sup>th</sup> September 2016, the Government of India, vide its Gazette notification number S.O. 3068 (E) notified Basmati Paddy as the commodity to be traded on commodity futures exchanges like ICEX.

**Tax advantage:** The Central Board of Direct Taxes (CBDT) vide its order no: 3528 (E) dated 30<sup>th</sup> October, 2017 under section 43 (5) of Income Tax Act 1961 allowed actual users or hedgers to get a tax advantage by treating profit or loss while trading in ICEX as business income or loss. Accordingly, the value chain participants in the Basmati rice industry could set off the loss/profit resulting in the ICEX Basmati Paddy contract hedging against their business operations profit/loss for the purposes of computation of income tax payment, provided the hedging is done in the same business entity.

### Why Futures Contract in Paddy Basmati 1121?

- **Price risk management:** Basmati Paddy 1121 witnesses extreme price volatility of around 98% annualized. Due to this volatility, stockists, exporters, millers, growers and traders face challenges to their business operations. Presently, there is no way or means in which people exposed to this price uncertainty can 'insure' or insulate their business from the price risk arising out of price volatility. As compared to this, today, Paddy exporters can hedge their currency risk in banks. But the same exporters don't have the option of hedging in Paddy. Therefore, ICEX now offers futures contracts, allowing people exposed to price risk to hedge/'insure' against price risk or future price uncertainty, as currency hedging is offered by banks.

- **To increase competitiveness of Indian exporters:** ICEX Basmati Paddy futures contracts will enhance the competitiveness of Indian exporters in the world market by enabling them to create inventory and hedge the same on the futures market, so as to eliminate adverse price movement.

- **Benefits for stockists:** Availability of ICEX Basmati Paddy futures contracts will help stockists to seek insurance against falling Basmati Paddy/rice prices, salvaging the value of their inventory.

- **Transparent price discovery mechanism:** An ICEX Basmati Paddy futures contract is expected to be a transparent price discovery mechanism for Basmati prices, reflecting the demand and supply scenario of the entire market. It will establish a benchmark price of Paddy, which will soon be referred to by the entire domestic as well as global Basmati market.

### What should value chain participants do to hedge their price risk?

- When the rice mill/exporter has obtained a firm order on Day 1, from any domestic buyer or international firm to sell Basmati Rice for forward delivery:
  - The rice mill/exporter has not stocked/bought corresponding quantity of Paddy for the purpose of milling into rice and is hence subject to the risk of prices of Paddy going up, hence affecting his conversions/profit margins.
  - Accordingly, on the date of receipt of the order from the buyer, i.e. Day 1, the rice mill/exporter buys an equivalent quantity of ICEX Basmati Paddy futures contracts for the future month through his ICEX member broker. He has thus locked into his Paddy buying rate and hence fixed his profit/conversion margins. Besides, since his buying in ICEX is very confidential, it does not affect the price in the physical market. On Day 25, when the rice mill/exporter purchases Paddy from the spot (physical) market, he sells the corresponding quantity of ICEX Basmati Paddy futures contracts and thus squares off (closes out) his ICEX hedge position or can take delivery from ICEX at the rate at which he had bought on Day 1 irrespective of the price movement thereafter.

## CONTRACT SPECIFICATION

- When the stockist/rice mill has stocks of Paddy/milled Basmati rice and no pending sale orders for ready/forward delivery to customers
  - The stockist/rice mill has stored stocks of Paddy/milled rice in his warehouse/factory.
  - He has no pending orders for sale of Paddy or milled rice to potential customers.
  - He therefore is exposed to price risk on his stocks due to highly volatile Paddy and Basmati rice prices.
  - Accordingly, to mitigate his price risk and seek 'insurance' from the downward price movement, he sells the corresponding quantity of ICEX Basmati Paddy futures contracts for the forward month through his ICEX member broker. He has thus locked into his Paddy selling rate and hence is protected from falling Paddy/Basmati rice prices. The stockist/ rice miller can deliver the Paddy at the ICEX warehouse.
  - Whenever on a later date, he gets an order from his customer, the stockist/rice miller buys the corresponding quantity of ICEX Basmati Paddy futures contracts and thus squares off (closes out) his ICEX hedge position.
  - Thus, irrespective of whether the Paddy/Basmati rice prices go up or down when the stockist/rice mill sells Paddy/Basmati rice to customers in the spot markets, the conversion margin fixed when he sold the ICEX Basmati Paddy futures contracts, is maintained and thus he is able to seek an insurance against volatile Paddy/Basmati rice prices.

### Contract Specifications of Paddy Basmati 1121 (Ex- Karnal)

<b>Trading Period</b>	Mondays through Fridays
<b>Trading Session</b>	Mondays through Fridays: 9:00 a.m. to 5:00 p.m.
<b>Trading Unit</b>	10 MT
<b>Quotation/Base Value</b>	Rs. Per Quintal
<b>Price Quote</b>	Ex - Karnal (Warehouse excluding GST)
<b>Tick Size (Minimum Price)</b>	Re. 1 per Quintal
<b>Daily Price Limit</b>	DPL shall have two slabs- Initial and Enhanced Slab. Once the initial slab limit of 3% is reached in any contract, then after a period of 15 minutes this limit shall be increased further by enhanced slab of 1%, only in that contract. The trading shall be permitted during the 15 minutes period within the initial slab limit. After the DPL is enhanced, trades shall be permitted throughout the day within the enhanced total DPL of 4%.
<b>Delivery Unit</b>	10 MT with tolerance limit of 5%
<b>Quality Specifications</b>	Paddy shall: <ol style="list-style-type: none"> <li>Be the dried mature grains (with husk) of Oryza sativa L. variety 1121.*</li> <li>have uniform size, shape and color;*</li> <li>Not have moisture exceeding 14%;</li> <li>Purity: Min 95%</li> <li>Admixture: max 4% ( Other varieties of Basmati Paddy)</li> <li>Foreign matter: Max 1%</li> </ol>
<b>Delivery Logic</b>	Compulsory delivery (Ex- ICEX warehouse, Karnal)

### As defined (\*):

Yield – 72% min	Crackness/Broken – 25% max	Average brown rice grain length – 8.7 mm
Chalky – 10% max	Green Grains – 10% max	Damage and discoloured grains – 2% max
Immature grains – 5% max		