# Efficient Exchange Traded Forwards

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Adding sophistication to a product is a necessary and critical requirement for any business to evolve and grow. Exchanges seeking to provide a platform to offer equal opportunity to the transacting parties for fair price are no different.

Forward contract, in its basic form, reduces price risk for both the seller and the buyer. A maize farmer, for instance, enters into a pre-harvest forward contract with a buyer to sell his produce at a mutually agreed price. Thus ensuring that at the time of harvesting, he gets an assured sale and an assured post-harvest price.

Yet, even though forward contract has reduced the risk, are both parties getting the best deal? Probably not. An unexpected weather condition could drastically push up or down the price of maize, leaving both seller and the buyer stranded.

NCDEX, the exchange with the largest pool of liquidity for agricultural commodities, provides exchange traded forwards on its trading platform to mitigate the inefficiencies of fixed price traditional forward contracts. NCDEX provides a reference price contract to enable trading parties to link trade price to the futures contracts quoting a premium or a discount.

**The NCDEX Edge:**

- Reduction of Bilateral Agreement Risks
- Flexible Contracts
- Reduced Operating Costs
- Access to National Market Place

A feed miller willing to buy 500 MT of maize on March 5, 2015, can enter into a reference price contract that's anchored to the relevant NCDEX maize futures contract expiring on or after the forward trade pricing date. If he wants to purchase the maize of a more premium quality than the NCDEX benchmark quality, he can quote the premium he is ready to pay over and above NCDEX futures' price.

On March 5, 2015, if the DSP for March 2015 expiry maize contract is Rs. 1,250 per quintal, the exchange traded forward contract would be settled at Rs. 1,250 + Rs. 100 = Rs. 1,350 per quintal.

Futures prices discovered on the exchange, at any point of time during the contract tenure, capture the prevailing demand-supply dynamics, and provide a fair picture of the price trend likely to emerge. Hence, a reference price forward contract, settled at a price based on its futures market equivalent (counter-part), increases the possibility of receiving fair price by the trading parties.

The reference price forward contract settled on the expiry day of futures contract enhances the chances of getting an optimal price. That's because in any liquid futures contract, futures market prices converge to spot market prices on the expiry, as cost of carry turns zero, thus carting off arbitrage opportunities.

Example:

| | |
|---|---|
| Contract Date | Dec. 15, 2014 |
| Contract Price | NCDEX March 2015 Maize Futures + Rs 100 |
| Quantity | 500 MT |
| Pricing date | Mar. 5, 2015 |
| Settlement Price | DSP of the next expiring futures contract (March 20, 2015) on the pricing date (March 05, 2015) + the premium / discount agreed upfront (Rs. 100). |

DSP = Daily Settlement Price

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