Exchange Traded Forwards: Streamlined Settlement

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'Commodities trading' offers unique and multifarious opportunities, while also throwing up a number of challenges. This is more so in the case of forwards. Trading on an exchange alleviates several of the challenges, including the most critical one of settlement. Fulfillment of the various stages in the settlement cycle, as well as adherence to the timelines, are the important benefits offered by regulated trades on the exchange.

Physical settlements and delivery pose a motley of risks, irritants and costs, including that of storage space, consistency of quality, and ensuring timely movement and payments. Any delay or default in the payment process increases the risk and cost for the other party.

NCDEX, the leading exchange for agricultural commodities, provides an online trading platform that helps ensure efficient settlement of forward trades. Its forward contracts have a settlement period that last for 12 days from the contract expiry date (Figure 1: P+12 days). This settlement mechanism has standard timelines set for different activities forming part of the settlement process, such as assaying, delivery of goods, as well as payment, etc., which help streamline the settlement procedure by keeping track of all the transactions, in addition to guaranteeing the compliance of all trade commitments undertaken by the parties to each transaction.

Traders can choose between 'Non-Transferable Specific Delivery' (NTSD), which is settled at the end of a minimum 12 day period, and 'Transferable Specific Delivery' (TSD). TSD allows the trader to net off his buy / sell trade positions for identical trading parameters during a particular trading day, with the open positions at the end of the day being deliverable. On day 1 of TSD, the client has the flexibility of transferring the trade position, unlike the prevailing mechanism of forward trades.

Figure 1: Settlement Process for Exchange Traded Forwards

T	T+1 to P	P+1	P+2	P+3 to P+12	P+13
Seller & Buyer mutually agree on Delivery Mode, Pricing Date (P), Quality and Location	Seller provides WH & VAT Registration Details Buyer may appoint Assayer (FOT or FOR) Buyer gives Rake Loading Point & Consignee Details Assyer submits Sampling Schedule latest by P	Seller updates Tax & Mandi Fee Rates	Pay-in by Buyer	Assayer carries out Assaying Lifting by Buyer Pay-out to Seller Assayer has to submit Report before P+B Invoicing & Tax Settlement	Final Pay-out to Seller

P: Pricing date or contract expiry date, T: Trading date. i.e., the day trading is initiated

Time-bound settlement procedure assures buyers and sellers of the receipt of goods and payment, thereby helping them in rational allocation of resources and planning business activities.

Since these forwards are executed under the regulatory framework of NCDEX and the Forward Markets Commission, they have a strong legal underpinning. Exchange traded forwards guarantee compensation in case of default to the extent of margin collected, thereby reducing counterparty risks.