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CENTRE FOR ADVANCED FINANCIAL RESEARCH AND LEARNING
Promoted by Reserve Bank of India

CAFRAL's Workshop on Commodity Risk Management for Bankers was held on December 15, 2016, Mumbai

Takeaways from CAFRAL's Workshop on Commodity Risk Management for Bankers

Banks typically face a number of risks in their operations, including commodity price risk. However, this risk is less recognized and its potential impact less appreciated among bankers. To expose bankers to the various dimensions and issues connected to commodity price risk that they encounter, CAFRAL conducted a workshop on commodity risk management for bankers on 15 December 2016. It was attended by senior officers from risk management and other related departments of commercial banks.

A brief summary of the takeaways from the presentations and discussions with expert speakers of the program are listed below.

Mr. S.K. Mohanty, Executive Director, SEBI

He deliberated on the risk to the MSME section of Indian industry from commodity price volatility. The bulk of Indian MSMEs is commodity oriented whose price risks get transmitted to credit risk of their financing banks.

1. Banks could educate the SMEs about the benefits of hedging their risk on a commodity derivative platform. For the same reason the banks first must be convinced about the benefits of hedging and therefore pass on the advice to potential customers.
2. To facilitate hedging, banks can recognize risk management of borrowers and offer incentives to the hedgers.
3. Hence it is high time for bank managers and field officers to equip themselves with superior knowledge and skill set to understand and appreciate commodity markets.

Mr. Mrugank Paranjpe, MD and CEO, MCX

He said that volatility in commodity prices has deep impact on the banks as lenders to commodity-related businesses. Globally, banks typically hedge their commodity price risks in the derivatives market but are not permitted to trade in commodity derivatives. He had made a case for allowing banks to hedge their price risks in gold.

1. He urged that banks be allowed to participate in India's commodity derivatives market. For hedging against price risks arising out of their activities in gold imports, warehouse receipt financing and under the Gold Monetisation Scheme, there was an immediate need for hedging.

2. Besides, banks can promote 'indirect hedging', by incentivizing their commodity sector borrowers to hedge their exposure to commodity prices, which will diminish the probability of credit default.
3. Other key highlight was that brokerages sponsored by banks could be allowed to offer broking services in commodity derivatives, similar to providing such services in the securities markets including provision of professional clearing services for the commodity market participants through their superior risk management systems.

Shri Puneet Pancholi, GM, RBI

He was of the opinion that as volatility in commodity prices affects the credit risk of the banks, hence it is more suitable that the entities having direct exposure engage in hedging activities, which in turn will reduce the credit risk for the banks.

1. Banks have a responsibility in creating awareness among their borrowers regarding importance of commodity risk protection.
2. In open discussions on feasibility of bank's entry into commodity market, if and when, he thought that some issues such as exposure of banks to derivatives, efficiency of spot markets and ability of banks to handle physical delivery would be pertinent when deciding about banks' entry into commodity derivatives markets.

Panel Discussion: The panel discussion chaired by **Prof. Ashima Goyal, IGIDR,** who spoke of the role of banks in creating incentives for firms to hedge. When banks forward a loan to commodity businesses, hedging enables them to evaluate factors such as risk coverage, possible bankruptcy etc. which could be priced in the loan risk.

Mr. Muzammil Patel, Partner, Governance, Regulation and Risk Advisory, Deloitte who participated in the panel discussion held that banks can have risk management units that can facilitate structuring and development of the OTC markets in Indian commodities, if allowed.

Dr. Rajkumar S. Adukia, CA**,** Adukia & Associates argued for banks making hedging mandatory before financing commodities due to price risks associated with the commodities market.

Mr. Hemant Shah, CA, V.C. Shah & Co said that RBI should come out with policies for banks to hedge when lending to the commodity sector on the lines of its policies in forex or interest rate risks. Banks should also encourage customers to hedge risks to the extent they are capable of.

Mr. **Shantanu Sengupta,** Senior Economist, Reliance Industries Ltd.; **Mr. Siddharth Mishra,** DGM, RBI and **Mr. Piyush Bhatt,** Head of energy price risk management, Reliance Industries Ltd said that with the commodity markets currently under SEBI regulation, a lot of policy actions have been taken in the recent past. While RBI could possibly be actively working with SEBI to ensure that commodity participants are able to hedge their risk, the key challenge remains in education, one that of the banks and secondly that of their customers.

The conference and its key takeaways were highly appreciated by all participants.

The broad message of the workshop for the bankers was to equip themselves with superior knowledge and skill set to understand and appreciate commodity markets.

Compiled by Dr. Venkatachalam Shunmugam, Research, MCX (shunmugamv@mcxindia.com)

Ravi Sangvai, Program Director, CAFRAL (rvsangvai@rbi.org.in)