PRESS RELEASE

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SECP rebuts criticism on cotton futures contract

ISLAMABAD – JUNE 2: Answering criticism in respect of approving trading of futures contract in cotton at the Pakistan Mercantile Exchange Limited (PMEX), the SECP has reiterated that the concerns raised in this regard are unsubstantiated. The SECP granted this approval after the PMEX had undertaken an extensive process of stakeholder consultation, which includes textile mills and cotton traders/brokers. Also, the said approval was granted by the SECP in accordance with its mandate to regulate matters relating to listed securities that include derivative products like futures contracts in commodities, under the 1969 Securities and Exchange Ordinance and the Securities and the 1997 Exchange Commission of Pakistan Act.

It needs to be understood that 'futures contracts' based on commodities are derivative, trading in which is clearly distinct from 'spot' or 'forward' trading. The SECP does not regulate spot or forward trading in commodities. A futures contract in commodity is a standardised marketable security based on a certain predetermined quantity and it may or may not involve physical delivery. On the other hand, spot or forward trading in commodity involves delivery and therefore clearly involves physical commodity itself with immediate or deferred delivery.

The futures contract in cotton utilizes trading price of an international contract for purposes of referencing and is settled in local currency similar to other futures contract in gold and silver presently traded at the exchange and therefore will not fuel speculation or lead to price volatility as feared by the Karachi Cotton Association (KCA). Since the underlying price is of an international deliverable contract, the cash settlement price will also be of that deliverable contract. The assertion that this cash-settlement procedure is in any way detached from underlying international physical futures trading is incorrect. There is no way that the listing of this contract on the PMEX can influence the price of the underlying cotton contract traded at the international exchange. Gglobally, commodity exchanges offer futures contract in a variety of commodities that are based on international contracts similar to the PMEX cotton contract, which are settled in local currency without involving any physical delivery.

In relation to cotton hedge market, it should be noted that forward or hedge trading in cotton as envisaged under the 1957 Cotton Act and carried out by the KCA prior to the government's order for its suspension in 1976, falls within the ambit of the Commerce Ministry. However, since the Cotton Act is not a special law to regulate trade in 'futures contracts', only a commodity exchange duly licensed/registered with the SECP can trade in 'futures contracts' in commodities.

Even today, the domestic stakeholders in raw cotton market use prices emanating from futures contract in international markets for reference purposes, the availability of the PMEX cotton futures contract locally will facilitate the stakeholders in their decision-making process through a conveniently accessible platform. Any concerns regarding price distortion are also irrelevant since this initiative will provide for a regulated platform for investors and stakeholders for trading in futures contracts in cotton, and will thus help reduce price volatility and risk associated with cotton and aid in price determination for this commodity. The cotton futures contract will therefore meet the needs of various market participants and have a positive impact on the cotton industry, the agricultural sector and the domestic economy as a whole.

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