

# Emerging Challenges for the Depositories



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## Background

India has been an agrarian economy for several decades though in the recent past the contribution of agriculture in GDP has come down 20% to from 50% in the decade of 70's through 90's. However 70% of the population continues to depend on agriculture for their livelihood. The Government has also invested heavily in agricultural

infrastructure especially in irrigation to bring in more and more land under cultivation and reduce dependency on rain gods. However, one area that did not get adequate attention in terms of resource allocation is the post-harvest infrastructure needed for ensuring robust ecosystem which secures a fair deal to farmers, consumers and manufacturers. Consequently, in order to bridge the gap between the farmers and the consumers, a host of intermediaries and services in the form of traders, brokers, collateral agencies, etc., were evolved which has made the entire chain inefficient in terms of better price realization for farmers and consumers alike. One of the major infrastructure requirements in order to maintain an orderly supply of agri-commodities in all seasons to consumers is the chain of warehouses with adequate regulatory oversight which can cater to all types of agri-commodities. Such infrastructure requires huge capital investments and it has come partly from Central warehousing corporation, State warehousing corporations and Indian Food Corporation. In private sector there are very few players who offer warehousing services on a commercial basis.

Since the institutional mechanism for organized development of post-harvest infrastructure is missing, the farmers usually go to the mandi with all their stock and dump the same at unremunerative prices. The traders and other wealthy intermediaries corner the same and store in private warehouses against which they obtain the bank loans. During the off season, they release the stock and make substantial gains which otherwise should be the rightful remuneration for the toil of the farmer. The banks in order to mitigate their risks, engage the collateral service providers who monitor the stock in warehouses for its quality and quantity for a price. In the event of a dispute either with the collateral manager or with the warehouse service provider, they end up in a civil litigation which takes several years to

resolve. If only a regulatory regime is put in place for an orderly development of institutional framework to deal with post-harvest infrastructure, the farmer in the first place would not have sold the entire produce and instead store in a warehouse and borrow against the same to meet his legitimate needs and realize better price at a later date which otherwise currently is gobbled up by the intermediaries. The farmers would also be able to sell his stock on any of the electronic commodity platforms and deliver the goods without physically moving them from warehouses. The commodities markets would have truly served the farmers and the consumers alike.

With a vision to develop an orderly warehousing service industry, Warehousing Development & Regulatory Act was passed in 2007 under which WDRA was established in 2010. WDRA is charged with the responsibility of

1. Safeguarding the interest of farmers and other stakeholders connected with financing farmers against storage of the agricultural goods
2. Issuance of negotiable warehouse receipts in electronic form and to stop issuance of physical warehouse receipts
3. Registering warehouses engaged in storage of agricultural goods
4. After stabilization of the system for agricultural goods, warehousing of non-agricultural goods to be included

As per the extant regulations in the case of registered warehouses, the responsibility of quality and quantity of the commodities stored in the warehouses lies with the warehouseman. Accordingly the commodities when taken to the warehouses for storage is assessed by the Assayers to ensure quality and quantity. Presently assayers are appointed independently by the warehouses. However, WDRA is in the process of registering Assayers to bring in uniformity in the process of measuring the various parameters of the commodities.

Further, since the responsibility of the quality and quantity of any commodity stored in a warehouse is on the warehouses, WDRA has initiated process of audit and inspection of the registered warehouses. The frequency of audit and inspection of such warehouses depends on the asset under custody of the warehouses.

Further, as per the extant rules, Securities and Exchange Board of India casts the onus on good delivery on deliveries resulting from derivatives trades on the commodity exchanges. The commodity exchanges therefore have a concept of accredited warehouses. Being registered with Warehousing Development and Regulatory Authority (WDRA) is a pre-condition for a warehouse to be accredited by any commodity exchange.

In the earlier regime, the warehouses were entrusted with the issuance of the warehouse receipts in the

physical form. The physical warehouses receipts were not negotiable instruments. WDRA has formulated Repository regulations which empower repository to issue electronic warehouse receipts. CDSL Commodity Repository Limited (CCRL) is the repository which has been given the registration by WDRA to operate in this space. CCRL has issued byelaws and business rules to handle the repository business. The advantage of holding electronic warehouse receipts is ease in obtaining finances against commodities where the banks and other financial institutions can assuredly extend finance knowing fully well that multiple finances cannot be obtained on the same electronic warehouse receipts unlike physical warehouse receipts. The depositor who has stored his commodities in the registered warehouses against electronic warehouse receipts can undertake sale or pledge of the commodities partially based on his needs.

Presently a little more than 140 commodities which are largely agri-commodities or horti-commodities are part of the list of commodities that can held through electronic warehouse receipts. The other horti-commodities or agri-commodities that are presently not covered in the list and also the metals and precious metals would be available in the repository in future in a phased manner.

#### **About CCRL**

CDSL Commodity Repository Limited (CCRL), a subsidiary of Central Depository Services (India) Limited [CDSL], received its license to operate as Commodity Repository on September 26, 2017 from its regulator, Warehousing Development and Regulatory Authority (WDRA). Both BSE Limited (BSE) and Multi Commodity Exchange of India Limited (MCX) have taken up 24% of the nominal capital of CCRL. WDRA registers Warehouses after due inspection and scrutiny on various infrastructural and financial fronts. Once registered, such warehouses are authorized to issue negotiable warehouse receipts in electronic form (eNWR) or in physical form. Alternatively, non-negotiable warehouse receipts (eNNWR) could be issued by the concerned warehouse. With the Repository becoming live now, such Warehouses are required to issue electronic negotiable warehouse receipt (eNWR) / electronic non-negotiable warehouse receipt (eNNWR) from a yet to be specified date. The date will be notified shortly by WDRA. Till such time, physical warehouse receipts and electronic warehouse receipts would continue to co-exist in a WDRA registered warehouse. Currently a little more than 1300 Warehouses are registered with WDRA of which a little more than 700 warehouses are active, which in 3 or 4 years is slated for an exponential increase. Out of the total of about 70,000 warehouses reportedly in operation in the country, not all the warehouses would qualify to be registered with WDRA presently, as many of the warehouses are either field warehouses or structurally inferior warehouses. Further the warehouses that are presently accredited by the

commodity exchanges having nationwide presence viz. National Commodity and Derivatives Exchange Limited (NCDEX), Multi Commodity Exchange of India Limited (MCX), National Multi Commodity Exchange of India Limited (NMCE) or any other exchange that may decide to operate in the commodity space would be a sub set of the WDRA registered warehouse as WDRA registration is a pre-condition for a warehouse to be accredited by a commodity exchange.

We have conducted six outreach programs at Kochi, Jaipur, Bikaner, Indore, Rajkot and Coimbatore keeping in mind the harvesting period of certain commodities.

For Clearing Members who already trade in NCDEX or MCX or NMCE a brief on the new concept of holding and transacting in electronic warehouse receipts (eNWR – electronic negotiable warehouse receipts / eNNWR – electronic non-negotiable warehouse receipts) is given below.

The regulator for the commodities being stored in the warehouses in the form of electronic/physical warehouse receipts is Warehousing Development and Regulatory Authority (WDRA). Presently the eNWRs can only be delivered in off market mode in addition to your ability to pledge / unpledge the same. The onmarket transactions where the eNWRs can be delivered in NCDEX or MCX or NMCE will follow shortly. Every Clearing Member who is registered with SEBI can become a Repository Participant (RP) in addition to being a DP (of CDSL) in the securities market. This will help the member in opening securities demat account as well as commodity demat account along with the broking account for its clients. We are given to understand that by October 2018, BSE Limited (BSE) and National Stock Exchange of India Limited (NSE) will also enter the commodity trading segment. Hence a clearing member who has registered itself as an RP entity can easily use this RP. We would like to mention here that in CCRL, you are merely required to scan and upload the supporting documents which incidentally is similar to the documents one would take to open a demat account for holding securities as a Depository Participant (DP).

Please find appended “check list” for ready reference towards registration as Repository Participant (RP) with CCRL.

1. Bipartite agreement between CCRL and the RP
2. RP Master Creation Form
3. Board Resolution
4. Details of registration
5. Organization structure
6. Key Management Personnel
7. Compliance officer details
8. Details of Director
9. Undertaking
10. RP Creation checklist

All the other documents as per check list are to be “Digitally signed” and emailed to CCRL except “RP Master Creation Form” and “Agreement between CCRL

and RP” as signed copy need to be sent to CCRL. We have an RP Membership committee that approves admission of any entity as an RP of CCRL. Immediately after the approval is received from the membership committee for an entity to act as an RP, the RP would be required to execute a bipartite agreement on a non-judicial stamp paper Rs.600/- (Mumbai)

### **CCRL system**

The CCRL has made available a technology platform to facilitate the following:

1. Account opening/ modification
2. Deposit
3. Pledge/ De-pledge (Pledge Closure)/ Invocation (Confiscation)
4. Freeze/Unfreeze
5. E-auction
6. Off – market transaction
7. On market transactions (Delivery towards settlement on recognized Commodity Exchanges)
8. Withdrawal
9. Revalidation/ Extension of validity

### **Account Opening**

Users of this system viz. Depositor/ Clients [farmers, Farmers Producer Organization (FPOs), adatiyas, corporates etc.], Traders, Banks (Public, Private, Cooperative), NBFCs, Warehouse Service Providers (Public and Private), Warehouses (public, private, licensed, leased etc.), Bidders, Clearing Corporation, Clearing House of recognized Commodity Exchanges and Repository Participants. Accounts cannot be opened in the name of an HUF entity as regulations do not allow holding or transacting in warehouse receipts.

### **Deposit**

CCRL system will offer interface for the Depositor/ Client as well as the Warehouse Service Providers/ warehouses. Through this interface, a Depositor/ Client can initiate a request for depositing commodity. Such deposits, after meeting the quality standard as defined in AGMARK and FSSAI, will be converted to electronic Negotiable Warehouse Receipts (eNWRs). eNWRs under this system can be subjected to various financial transactions. If the commodities deposited do not meet the quality standards, they will remain as electronic Non-Negotiable Warehouse Receipts (eNNWRs).

### **Pledge/ De-pledge (Pledge Closure)/ Invocation (Confiscation)**

eNWRs can be pledged by the Holder with a Bank, NBFCs or any other entity. The facility in CCRL will enable such Pledge marking towards such Pledgee. The Pledgee will be having rights to create, pledge closure or invocation as required. In case of re-payment default by the Pledgor, Pledgee can invoke pledge and opt for e-auction through any of the empanelled e-auction platforms. This will enable the Pledgee to have a quick

and efficient disposal of goods at a market driven price. Additionally, the electronic system ensures that the same eNWR cannot be pledged multiple times. If the pledged eNWR's validity needs to be extended, it can be done without removing the Pledge, therefore making it much convenient for the Pledgee.

### **Freeze/Unfreeze**

At any point of time, whether for any punitive action or for any statutory order, an account or an eNWR can be frozen effectively disallowing any transaction. If there is statutory order to unfreeze or the earlier order to freeze expires, then unfreeze can be executed for the eNWR or specific quantity.

### **E-auction**

The Pledgee would like to recover their dues by disposing off the goods at appropriate time and price. Current practices do not allow them to reach larger audience of Bidders. Also the dependability on warehouses to dispose the goods makes the disposal more challenging.

### **Off-market trade**

When any entity wishes to sell goods to another trader through bilateral negotiation/ contract, eNWRs in CCRL system held by such entity can be transferred to the other party. The demat account of the seller will be debited and credited to the buyer.

### **On – market trade (Delivery towards settlement on recognized Commodity Exchanges)**

Every Commodity Exchange is running futures contract for the participants. Such participants have delivery obligations at the expiry of such futures contract. Currently, the efficacy of such settlement depends very heavily on proper monitoring and audit of warehouses from where such delivery will be effected. In CCRL system, such delivery will be effected through eNWRs as governed by Warehousing (Development & Regulation) Act. The confidence and trust in the system will be enhanced multiple times as WDRA will regulate all such warehouses issuing eNWRs. Further, in the near future eNWRs would be allowed to be delivered on the Commodity Exchanges.

### **Withdrawal**

The assurance of quality and quantity of goods as delivered with eNWR can be taken for granted as WDRA regulates all such warehouses directly. The electronic systems ensure that there is quick access to request generation and execution by all related parties in order to facilitate the client to lift the goods at the earliest.

### **Revalidation/ Extension of validity**

Every eNWR will be given a shelf life or validity. Once the shelf-life or validity of the eNWRs is towards its end, the Depositor/ Client holding the eNWR shall apply for extension of validity. If the Warehouse and Assayer

finds the quality good enough for extension of validity, the eNWR will get a new shelf life. This will help the holder to transact through this eNWR for extended period of time.

We envisage your prominent role in the Commodity Repository system being setup by CDSL Commodity Repository Ltd. (CCRL) under regulatory framework of WDRA as a Repository Participant (RP). This will enable you to have complete control on electronic transfer of goods for all your clients and allow you to continue to

maintain complete confidentiality of your clients. The RP with limited rights will be restricted to account opening and account maintenance activity of the clients.

You will appreciate that the commodity industry in India is on the cusp of expansion. Presently the financing on commodities is said to be about Rs.50,000 crores and is only slated to increase exponentially. Additionally, presently we have 143 commodities that can be held through eNWRs in the repository and hence financed through the repository.

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