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EXECUTIVE SUMMARY

Research project titled “A Study on the Level of Compliance to Commodity Risk Disclosure Regulations in India & Abroad” given by Multi Commodity Exchange of India Ltd.

ICSI-CCGRT has successfully completed the research project and below please find the executive summary of the same.

SEBI vide its SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015, requires every listed company to disclose commodity price risk or foreign exchange risk and hedging activities in their Annual Report.

In order to comprehend whether companies engaged in commodity derivatives have provided requisite disclosure, the team of researchers have analysed Annual Reports of Top 500 Indian Listed Companies as per their Market Capitalization and annual reports of other 25 Indian listed companies which have commodity exposure. These companies have been analysed based on their exposure in 62 different sectors (Oil & Gas, Refineries/ Petro- Products, Transport, Textile, Fertilizers, Jewellery, Banking etc.). All these 525 companies have been further analysed based on their exposure to specified commodity goods, notified under SCRA by SEBI vide Circular No. SEBI/HO/CDMRD/DMP/CIR/P/2016-105 dated on 28th Sept., 2016. The team analyzed the Annual Reports of the Companies to ascertain the magnitude of disclosures pertaining to commodity price risk and commodity hedging activities. Further the research team has also looked into disclosures pertaining to foreign exchange risk and hedging activities.

In order to understand the international perspective of market risk disclosures, the team also studied 63 companies which are listed on different stock exchanges across the globe and analyzed Commodity Risk Disclosures in their Annual Reports as required by the respective regulations governing those companies. Examples of various regulations requiring market risk disclosures are Item 305 of SEC (Securities Exchange and Commission) Regulation S-K, “Quantitative and Qualitative Disclosures about Market

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Risk”, Sarbanes Oxley Act (SOX) and International Financial Reporting Standards (IFRS)etc.

Major Observations

The quality of disclosure by companies was evaluated on the basis of the Researcher’s subjective assessment of the breadth of such disclosures. Accordingly, the companies were bucketed under one of the 4 categories in decreasing quality of their risk disclosures: those with ‘**detailed**’ disclosures, those with ‘**sketchy**’ disclosures, with ‘**passing remarks**’ and finally those that ‘**did not disclose**’ risks at all.

- **Commodity Risk Disclosure:** The team found that in 525 Indian Listed Companies with exposure to different commodities near to One Half (44.38%) of the Companies did not disclose “Commodity Risk”, One Fourth (26.86%) Companies just gave Passing Remarks and, 16.76% Companies gave Sketchy Disclosures in their annual reports. While only 12.00% Companies provided detailed disclosures of Commodity Price Risk in their Annual reports.
- **Foreign Exchange Risk Disclosure:** Out of 525 Indian Listed Companies, 41.33% did not disclose “Foreign Exchange Risk”, 17.72% provided Passing Remarks, 11.05% Companies gave Sketchy Disclosures and only 29.90% Companies provided detailed disclosures in their Annual reports.
- **Companies listed across the global exchanges:** A comparative study between these Indian Listed Companies and 67 Companies listed across global exchanges like NASDAQ, NYSE, LSE, XETRA and other developing countries Stock Exchanges revealed that companies listed abroad have given more detailed disclosures of Market Risk, which were further bifurcated into Qualitative and Quantitative disclosures.
- **Indian companies listed abroad vide ADR/GDR:** Every Indian Company which is listed outside India vide their ADR is required to file Annual Report in the Form 20-F as Per Securities and Exchange Commission (SEC), USA. While analysing annual reports of such companies, it was found that these companies have given detailed risk

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disclosures including commodity risk disclosure in their annual filings with SEC while such details have not been provided in their respective Indian Annual Reports.

- **Primary Data Analysis:** The Research team also conducted primary data analysis, through which information was collected from various Companies in the form of the Questionnaire. It was observed that several listed Companies are not much aware about the requirements for commodity price risk or forex risk disclosure, as defined by SEBI (LODR) Regulations, 2015.

Thus, it was concluded from the analysis of the Annual Reports of the companies under study that:

- Disclosures in the financial statement, MD&A and corporate governance did not reflect the commodity price risk exposures and the associated hedging activities through financial instruments
- Disclosures about derivatives and other financial instruments were made in isolation and did not communicate the linkages between the risk exposure and risk management adopted by the companies.
- There is lack of awareness among listed companies and their officials in respect of SEBI (LODR) disclosure requirements.

Major Suggestions

- The Regulators may require the companies to give separate disclosures for each type of market risk exposure in their annual reports. i.e. commodity price risk, foreign exchange risk, interest rate risk and their respective hedging activities separately. Data analysis of 525 Indian listed companies revealed that some of the companies disclosed only foreign exchange risk while some disclosed only commodity price risk and hedging activities in their annual reports. Hence there is a need to define that companies should give separate disclosures for each type of risk in their annual reports.

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- In line with international practice, the Regulator may consider providing detailed disclosure requirement detailing out the various methods that can be adopted for disclosing commodity risk and commodity risk management in Annual Reports. As in US, Companies may have the discretion to choose among three alternative methods: sensitivity analysis, value-at-risk (VaR), and the so-called “tabular” method
- There is a need for creating awareness among listed companies and their officials regarding the provisions of SEBI (LODR) Regulations, 2015 in respect of detailed disclosures of Commodity risk and Commodity Hedging in their Annual Reports. The Regulator and the Exchanges may initiate the same by conducting various Seminars/ Programs /Workshops/ Webinars etc.

Keywords: Corporate Governance, Commodity, Foreign Exchange, Risks, Disclosure, Annual Report, JEL Classification: General Financial Markets (G1)

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