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MCX LAUNCHES FUTURES WITH PHYSICAL DELIVERY

This is the first such facility to be introduced in the Indian commodity market

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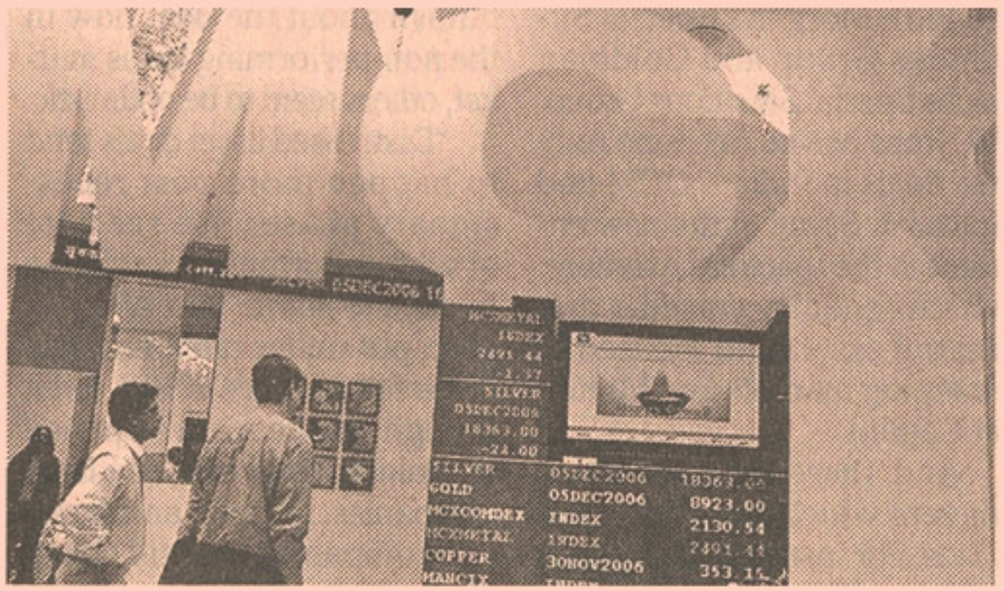
The Multi Commodity Exchange of India (MCX) has launched the Exchange of Futures for Physicals (EFP) transaction facility for the first time in the Indian commodities market.

An EFP transaction is exchange of futures contracts for a physical commodity transaction between two market participants. Through EFP, either new futures positions are created, existing futures positions are closed or futures positions are swapped with physical commodity positions.

This is an important step towards greater integration of the commodity futures markets with the physical market. It should greatly enhance the utility of commodity futures trading for commodity value-chain stakeholders. Among other benefits, by using EFPs, market participants can separate the logistics of commodity trade from the pricing of commodities, allowing them to optimise both independently.



Using Exchange of Futures for Physicals, market participants can separate the logistics of trade from pricing of commodities

To start, MCX will be offering EFP in gold and gold mini, silver and silver mini, copper, zinc, aluminium, nickel, lead, chana, wheat and mentha oil.

EFP allows individuals/companies to choose their trading partners, delivery site, the grade of product to be delivered and the timing of delivery, and simultaneously use the futures market for pricing their products.

The price risk is the main cause for defaults in physical trade. EFP allows one to eliminate this through the futures market.

For physical market players, EFP is the preferred method of commodity delivery, as it provides greater flexibility than the traditional exchange-set delivery modalities. This eliminates substantial sales and/or supply risk. Moreover, EFP can be effectively used to take positions in less liquid far-month contracts.

Without an EFP, the sale or purchase of a physical product and the separate entry of a futures order may result in price slippage, due to market volatility or fluctuating trading volumes on the spot market and/or the futures market.

Also, high-volume transactions on exchanges usually get affected by relative depth in the market at that point of time. These shortfalls can be overcome by EFP transactions. In addition, EFP ensures that large physical trades with corresponding futures transactions do not interfere with the regular futures market functioning.

Globally, almost all benchmark commodity exchanges facilitate EFP transactions. Many more futures positions are closed out through EFPs than through standard delivery procedures. On Minneapolis and Kansas exchanges, farmers take positions in regular red winter wheat contracts, but deliver other wheat grades through EFP.

Interestingly, in China, the Dalian Commodity Exchange achieved effective integration of maize futures with the cash market through EFP. On Nymex and Comex, EFPs are employed as a means of delivery in gold and energy futures and also to integrate futures with physical, OTC and swap deals.