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Beyond the X factor

MCX's chief economist responds to a columnist's arguments on commodity market regulation



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This is in response to "The X factor in regulation" (Ajay Shah, January 4). The author's single variable, linear model approach of regulation doesn't sit well with the experience of practitioners. Modern day exchange management and regulations require a multivariate, simultaneous equation model approach.

There are also good arguments against the price war culture, a business practice seemingly favoured by the author. Also, the author, in discussing the MCX's decisions, argues the commodity market is underregulated. But exchanges other than MCX also had problems.

Certain facts need to be stated. Pricing is done under rules and regulations of the Exchange and under the power of the Board, subject to the policy guidelines of the regulator, FMC. All Exchange rules, bye laws and regulations clearly provide that these become effective on approval of FMC and would be subject to all provisions and directives of FMC issued from time to time.

By the way, setting up an Exchange has become tough. When Exchanges applied for recognition by FMC earlier, they gave a transaction charge of Rs5 to Rs6 per lakh to show financial viability. The capital adequacy then was much lower than the net worth of Rs100 crore proposed for new Exchanges.

FMC has not decided any upper or lower slab and has given freedom to all Exchanges to decide their own slabs, which have to be in the ratio of 1:4. FMC also let Exchanges take permission in case they wanted the upper and lower slabs to be in a ratio beyond 1:4.

This has been the pricing policy for the last three years and all Exchanges have been following this. This point needs to be highlighted when discussing any responses to pricing strategies.

More generally, the author's views on commodity market regulation are myopic. He focuses critically on the FCRA of 1952 and he gives credit to offshoot legislation SCRA of 1956. The fact is that the commodity market in India has come into sharp policy focus only in 2003. Amendments to the FCRA Bill are now pending in Parliament. Many benefits, including for rural markets and producers, are already visible and there will be more once FCRA is approved along with the new warehousing law.

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The larger objective of the regulator is always developmental, with stable growth, financial soundness, growth-oriented policies and protection of users' interest. The author has ignored all this in criticising FMC's decision on MCX. MCX, it should be noted, is among the top ten Exchanges of the world, with innovative products, global alliances and evening trading. has restarted an industry moribund for the last four decades.

MCX shareholders are among the best names in Indian business: SBI, Financial Technologies (I) Ltd, Citigroup, Merrill Lynch Group, IL & FS group, Corporation Bank, NABARD, ICICI Group, Passport, NSE, GLG Financials, Union Bank, Bank of India, Canara Bank, Bank of Baroda, HDFC Bank, New Vernon, Kotak Mahindra Group, Alexandra, State Bank of Indore, State Bank Of Hyderabad, SBI Life, State Bank of Saurashtra, State Bank of Patiala, State Bank of Travancore, State Bank of Mysore, State Bank of Bikaner & Jaipur, Fidelity group, etc.

Plus, any argument about MCX and its response to regulation should take prominent note of the fact that MCX operates in over ten regulatory regimes in India and abroad and therefore has experience of multiple domestic and global regulators. This is an experience no commodity or securities exchange can claim.

In summary, the author's critique of commodity market regulation is off the mark.