

In Conversation with

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MCX has innovated quite a lot of products (from gold mini to gold guinea to gold petal or silver micro and so on) in precious metals. What is the motive behind having so many products? How have they been doing in the marketplace?

We launched contracts with smaller lot sizes—gold mini, gold petal, gold guinea, silver mini and silver micro—to specifically cater to the price risk management needs of small and medium enterprises (SMEs). Moreover, with the smaller sized bullion contracts, we have been able to attract retail participants. By enabling SMEs and retail participants to participate in the commodity futures market, these small contracts promote market inclusiveness.

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The smaller lot sizes of these contracts, favourable transaction costs and terms, and appeal of physical delivery have made these contracts immensely popular. These small denomination contracts enable more effective hedging as they can be used to lock-in prices at a granular level. Thus, these contracts enable hedgers to effectively even out price fluctuations, and investors to size their position better and control their risks efficiently.

These contracts were designed based on our prolonged deliberations with varied market participants and research. For assessing the

feasibility and market acceptance of smaller sized contracts, we interacted with SMEs, investors and members of the trade associations such as the members of bullion associations, and the community at large, who traditionally preferred physical trading over the futures trading. To encourage them to participate in these contracts, besides engaging with them, we conducted awareness and training programmes.

RBI is planning to launch Gold Linked Financial Products. Is there any scope for a robust derivative exchange like MCX to participate in the process?
As and when banks offer Gold Linked Financial Products to clients, they would be exposed to volatility in gold prices against which they would need an effective hedge. MCX, being the world's no. 1 exchange for gold and silver, is in a position to offer suitable hedging products to banks that will enable them to manage risks. Apart from meeting the hedging need, MCX futures can also offer investment products to suit the risk and investment appetite of banks' clients. Indeed, Gold Linked Financial Products could have gold futures as the underlying, instead of banks storing gold and distributing units to clients, as it has been estimated that gold futures offer one of highest risk-adjusted-returns (Sharpe ratio) among the various asset classes. Therefore, investment of Gold Linked Financial Products in gold futures would reduce unproductive storage of gold and generate superior returns for investors.

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Besides, by being able to participate in domestic commodity exchanges, banks can also buy gold from MCX and deliver to their customers as and when they place a demand, thus reducing the need for hoarding of gold.

In Gold contract (standard contract) it is written that it should be serially numbered gold bars supplied by LBMA approved suppliers or other suppliers as may be approved by MCX. Will MCX approve domestic refiners to supply the metal in coming days?
MCX has listed products manufactured by a domestic refinery-cum-mint as deliverable on the exchange. MMTC-PAMP India's one-kilo 999 silver bullion bar and 8 gram 9999 minted gold coin have been notified for delivery on MCX. In October 2012 and November 2012, MCX's Silver 1000 contracts witnessed deliveries of 1010 Kg and 2143 Kg MMTC-PAMP silver bars, respectively.

Enactment of FCRA Amendments is keenly awaited anytime. How significant is that event for the development of the derivatives markets? What changes can one expect post-enactment of FCRA Amendments?
Forward Contracts Regulation Act (FCRA), 1952 regulates the functioning of commodities futures market in India and vests the

regulator, the Forward Markets Commission (FMC), with powers and functions for its regulation and development.

Since inception, the national commodity derivatives exchanges have been fulfilling an unmet demand for managing risks arising from volatility in input/outputs by offering exchange-traded commodity futures and providing an efficient and transparent mechanism to trade.

Yet, the market is still at an initial stage of its developmental trajectory, as it operates under the outdated FCRA. The shortcomings of this guiding Act include:

- **Economic**
  - Hedging products, such as options and weather derivatives, which can be tailored to the risk appetite of farmers to hedge against risks, are currently not permissible.
  - Financial institutions are currently barred from participating in futures market.
- **Regulatory**
  - FMC is dependent on the government, both financially and for day-to-day operations.
  - Financial dependence on government is limiting the investment in infrastructure, technology, human resources, thereby, preventing future development and affecting quality of regulation.

Currently, the regulated exchanges in India compete with the illegal and unregulated 'Dabba' trading platforms, with various unofficial sources having estimated its size to be multiple times that of the regulated exchange-traded platforms. However, FMC currently does not have adequate wherewithal in the form of skilled human resources or financial resources to tackle this menace of dabba trading. It cannot even take pro-active steps to take cognizance and impose penalty on dabba traders. Hence, it is necessary to have an empowered regulator. The current size and rapid growth rates of the market warrant an autonomous and strong regulator. There is an immediate requirement for the regulator to build its capacities and enhance infrastructure for proper development and regulation of the market.

A powerful FMC would nudge other regulators to permit financial institutions participate in futures market. Participation of institutions such as banks would lead to:

- Market inclusion of farmers due to their strong credibility in rural areas
- Effective dissemination of futures prices through strong bank branch networks.
- Big Indian corporates that are currently using global exchanges for hedging start using services and products offered by the Indian commodity derivative exchanges.
- Indian businesses becoming competitive in a globalizing economy as the benefits percolate to more number of stakeholders
- Improvement in the efficiency of price discovery through wider participation, effective risk management and fair returns to farmers, which will spur greater investment in agriculture
- A liberalized and enlarged market has the potential to create over a million jobs in broking (spot and futures), warehousing, logistics, quality assaying, etc.

All of the above would be possible if the benefits of commodity futures market are taken to all sections of the society through a dedicated, strong and competent regulatory framework. This is possible only after the FCRA Amendment Bill 2010 is passed by the parliament.

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