

Out Of The Woods, Striding On With Vigour And Strength

Indian commodity futures market is going through exciting times. Initial years saw unprecedented growth of MCX, when the commodity derivatives market was opened by the NDA government in 2002. The three national commodity derivatives exchanges i.e. National Multi Commodity Exchange Ltd. (NMCE) at Ahmedabad (promoted by Central Warehousing Corporation and Mr. Kailash Gupta), National Commodity and Derivatives Exchange Ltd. (NCDEX) at Mumbai (promoted by NSE, ICICI, LIC and NABARD) and Multi Commodity Exchange Ltd. (MCX) at Mumbai started their operations during FY2002-03 and FY2003-04, respectively. These exchanges had a explosive growth and the average daily volume (ADV) picked up from meagre ₹1970 crore to ₹58,471 crore in FY2011-12. The growth of MCX was unprecedented and they had a market share of 86% and the exchange got a global ranking of 3rd in 2011 based on the number of contracts traded (FIA Annual Volume Survey). In the same financial year, the MCX became the first listed exchange in India and the IPO received a overwhelming response, which was highly oversubscribed by a number of times (53) especially from the retail investors. The number of shareholders were about 2 lakhs. Thereafter, the exchange also saw a tumultuous period from July 2013 onwards, starting with the imposition of Commodity Transaction Tax (CTT), to be followed immediately by NSEL-spawned payment crisis, forensic audit report of PwC, exit of most of the senior management personnel and the exit of the new MD & CEO within a period of about three months. In 2014, the market was questioning the survival ability of MCX, especially when the Statutory Auditors of the company in their report of August 2014 also raised doubts about the ability of the company to continue as a going concern beyond calendar year 2014 and the regulator (FMC) denied permission for contracts beyond December 2014.

However, MCX as a case study was able to meet all the external and internal crisis/challenges and did a total turnaround under the leadership of Mr. P.K. Singhal, Deputy Managing Director, who was the only continuing senior executive in the exchange and was looking after the day to day affairs of the company in the absence of MD & CEO as also any of the senior level executives. The work done by Mr. Singhal with the support of the middle level executives, aided by the confidence that there is nothing wrong in the systems and procedures of the exchange, and was well appreciated by the market participants as also by the regulators and subsequent to June 2014, the operations of the exchange started improving month over month.

The exchange also played a catalytic role in promoting awareness to educate current and potential hedgers on the need of risk management besides the benefits of using the commodity futures market for price risk management. During 2015-16, as many as 379 awareness programmes were conducted by MCX all across the country towards this purpose. In doing so, emphasis was placed on educating the smaller stakeholders, such as the Small and Medium Enterprises (SME) sector, exposed to risks in bullion, metal, and energy prices. Despite being an exchange focused on metal and energy, as many as 117 training programmes exclusively for farmers were conducted during 2015-16, covering 3683 farmers. Similarly, MCX tied up with 9 universities and educational institutions, besides undertaking capacity building programmes, for promoting financial literacy and spreading awareness about the commodity futures ecosystem in the academic world.

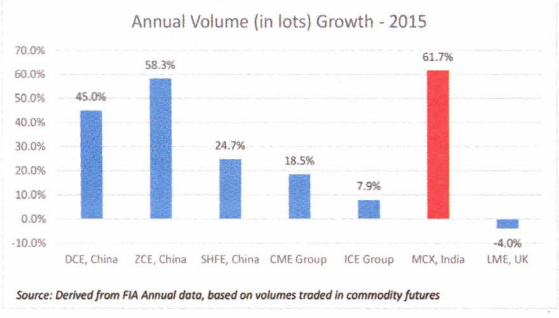
The end result has been quite tangible and encouraging. MCX's average daily turnover that stood at ₹18,616 crore in March 2014 jumped to ₹21,123 crore in March 2015 and was ₹23,118 crore in March 2016 (despite the drastic fall in the prices of key commodities traded on MCX). The market share of MCX, which stood at 77.1 per cent in March 2014, jumped to 88.8 per cent in March 2015 and touched 89 per cent in March 2016. The proverbial phoenix seems to have risen from the ashes!

MCX BOUNCES BACK

Pushing those to the past, all indications now are that the worst is over for MCX and the exchange is now well poised for moving on to the high growth orbit. The revised MoU in July 2015 with the CME Group, world's most diversified group of exchanges, was another feather in the cap of MCX and was like a coup as the CME Group also has a relationship with the top Indian Stock Exchange. As per the understanding with the CME Group, both the exchanges would be jointly working in a number of initiatives to develop the Indian derivative market and to make it at par with international markets. Although looking small, this MoU has proved that the worst is over for MCX and the international leading exchange like CME has reposed its confidence on MCX.

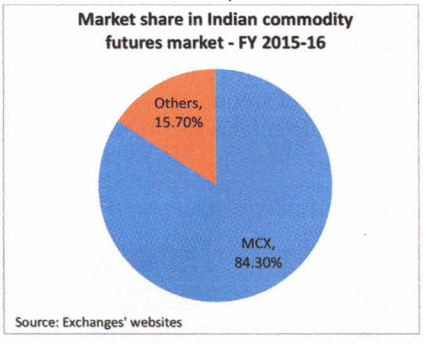
Nothing exemplifies this rebound better

than the position and growth of the exchange in the ranking compiled by the Futures Industry Association, an international body which tracks derivatives markets worldwide. According to data compiled from the latest Annual Volume Survey of FIA, the rank of MCX in the global league of commodity futures exchanges was sixth during the year 2015. FIA ranks exchanges according to the number of contracts traded on different exchanges, which for MCX was 216.3 million in 2015. What is especially significant for MCX was the jump in the number of contracts traded in 2015 over 2014. MCX could improve upon its position from the 7th position it occupied in FIA ranking in 2014 to 6th position in 2015 surpassing a large international exchange (London Metal Exchange), thanks to the astounding 62% rise in the number of contracts traded on its platform.



Source: Derived from FIA Annual data, based on volumes traded in commodity futures

Besides, within the domestic market, MCX has been able to maintain its market share over the last two years.



A promising policy environment helps
Along with the internal institutional changes in MCX, the external environment too seems to be turning in its favor. On September 28, 2015, the Forward Markets Commission (FMC), the regulatory agency supervising the commodity derivatives market in India, was formally merged with the Securities and Exchange Board of India (SEBI). This followed the announcement made in the Union Budget of 2015-16 and subsequent amendment to the Securities Contracts (Regulation) Act, 1956, or SCRA and repeal of the Forward Contracts (Regulation) Act, 1952 or FCRA. The merger of FMC with SEBI has been one of the most important steps in strengthening the regulatory structure of India's commodity markets. With higher power and autonomy under its command, SEBI is suited to better regulate and provide the appropriate guidance to India's commodity market. In the last few months, SEBI has initiated a number of measures to streamline the regulatory structure and processes in commodity markets, such as registration of market intermediaries, movement towards comprehensive risk management framework for commodity exchanges, streamlining and strengthening the framework of the investor redressal and arbitration mechanism at commodity exchanges, issuing guidelines on annual system audit, business continuity plan, and disaster recovery, etc. All these measures will surely lead to increasing the market integrity, and thus help the growth of the commodity derivatives market.

A potential benefit arising from the regulatory strengthening is the possible participation of different types of participant classes, especially financial institutions such as banks and mutual funds in this market as reiterated by Standing Council of Experts on International Competitiveness of Indian Financial Sector (September 2015). As the market has now come under the supervision of an empowered regulator, sectoral regulators, including RBI, can allow their respective regulated domestic entities to participate in the commodity derivatives market potentially contributing to the inherent strengths of the exchange being India's no.1 commodity markets player.

The other significant policy reform is the definitional change accorded to commodities under the amended SCRA. As commodities are now treated as 'securities', new types of derivative products can now be allowed in the commodity market. Derivative products like options and trading in indices and intangibles (such as weather, freight, etc), which have long been in demand in India but were not permitted under FCRA, can now be introduced, and the Finance Minister has already made an announcement to this effect in the Union Budget 2016-17.

Another major decision announced in the recent Union Budget has been the increase in the investment limit for foreign entities in Indian stock exchanges from 5% to 15% on par with domestic institutions. As per the Budget Speech of 2016 of the Finance Minister, this is expected to enhance global competitiveness of Indian stock exchanges and accelerate adoption of best in class technology and global market practices. This decision, apart from the removal of the distinction between FII and FDI announced earlier, makes MCX an attractive investment proposition for foreign investors proving that the turnaround in the exchange is just around the corner.

LOOKING AHEAD

With internal transformation and external reforms in the policy environment, the days ahead seems to hold a lot of possibilities for MCX. As India's largest commodity futures exchange and a number of promising opportunities knocking at the door, viz. introduction of options and indices and various new initiatives, it appears only a matter of time before the exchange regains its lost glory of being an institution of global reckoning.
SEBI has already indicated that it would allow commodity options as soon as it is satisfied with the adequacy of exchanges' risk management systems and the buzz is that it would have little qualms in allowing new derivative products in internationally-referenceable non-agricultural commodities, which are MCX's forte. The good times for MCX seem to have just begun!