MCX launches Exchange of Futures for Physicals (EFP) for the 1st time in India

1st December'09: MCX, India's leading commodity exchange has launched the Exchange of Futures for Physicals (EFP) transaction facility for the first time in the Indian commodities market. This is an important step towards achieving greater integration of the commodity futures markets with the physical market and it will greatly enhance the utility of commodity futures trading for commodity value chain stakeholders.

An EFP transaction is an 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. Among other benefits, by using EFPs market participants can separate the logistics of commodity trade from the pricing of commodities, allowing them to optimize both independently.

To start with, 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. Price risk is the main cause for defaults in physical trade. EFP eliminates this very risk 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 over come by EFP transactions. In addition, EFP ensures that large physical trades with corresponding futures transactions do not interfere with the regular futures market functioning.

Mr. B. C. Khatua, Chairman, FMC via his congratulatory message to the team commented that "As a regulator we issue policy guidelines on product innovation from time to time and I am happy to note that MCX has been fulfilling its responsibility of product innovation on an ongoing basis. The launch of EFP by MCX is a good example of product innovation and signals healthy development of Indian commodities market."

Speaking on the development**, Mr. Lamon Rutten**, CEO, MCX said, "The introduction of EFP by MCX is expected to go a long way in closely and more efficiently connecting the country's burgeoning commodity futures market with its vast underlying spot markets. Through the introduction of EFPs, MCX is bringing a valuable and easy-to-use risk management tool to the whole value chain, thus contributing to the efficiency and competitiveness of Indian commodity markets."

Internationally, almost all benchmark commodity exchanges facilitate EFP transactions. Many more futures positions are closed out through EFPs than through standard delivery procedures. The popularity of EFP transactions, for years, belies doubt, if any, over the possibility of its success in India. 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. It is indeed time for Indian commodity markets to introduce international best practices such as EFPs, in order to reach the next level of growth.

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