RISK MANAGEMENT & INTER-BANK DEALINGS

1. Products and Operational Guidelines

The product/purpose-wise facilities for persons resident in India (other than AD -1 banks) are grouped under the following subheads:-

a) Contracted Exposure

b) Probable Exposure

c) Special Dispensation

A. Contracted Exposure

Banks (AD-1) are required to evidence the underlying documents so as to establish the existence of underlying foreign currency exposure. Banks have to satisfy the genuineness of the transaction through verification of documentary evidence irrespective of the transaction being a current or a capital account. A maximum period of 15 days is allowed for production of the documents by the Users/customers. If the documents are not submitted by the customer within the timeframe, the contract may be cancelled, and the exchange gain, if any, need not be passed on to the customer. In the event of non-submission of the documents by the customer within 15 days on more than three occasions in a financial year, booking of permissible derivative contracts in future may be allowed only against production of the underlying documents, at the time of booking the contract.

The products available under the facility include:-

a) Forward Foreign Exchange Contracts

b) Cross Currency Options (not involving Rupee)

c) Foreign Currency - INR Options

d) Foreign Currency-INR Swaps

e) Cost Reduction Structures

f) Hedging of Borrowings in foreign exchange

a) Forward Foreign Exchange Contracts

The participants are market makers (banks AD-1) and Users/customers resident in India.

<u>Purpose</u>

To hedge:-

■ Exchange rate risk in respect of transactions involving sale and/or purchase of foreign exchange is permitted under FEMA 1999.

■ Exchange rate risk in respect of the market value of Overseas Direct Investments (in equity and loan) contracts.

■ Exchange rate risk of transactions denominated in foreign currency but settled in INR including hedging the economic (currency indexed) exposure of importers in respect of customs duty payable on imports.

<u>Operational Guidelines</u>

GURUJI2.COM

■ The maturity of the hedge should not exceed the maturity of the underlying transaction.

■ Where the exact amount of the underlying transaction is not ascertainable, the contract may be booked on the basis of reasonable estimates with periodical review of estimates.

■ Foreign currency loans/bonds will be eligible for hedge only after final approval/Loan Registration Number is allotted by RBI.

■ Global Depository Receipts (GDRs)/American Depository Receipts (ADRs) are eligible for hedge only after the issue price has been finalized.

■ Forward contracts booked by residents irrespective of the type and tenor of the underlying exposure, once cancelled, cannot be rebooked with the exception of exporters who are allowed to cancel and rebook forward contracts to the extent of 25% of the contracts booked in a financial year for hedging their contracted export exposures.

■ Balances in the Exchange Earner's Foreign Currency (EEFC) accounts sold forward by the account holders shall remain earmarked for delivery and such contracts shall not be cancelled. They are, however, eligible for rollover, on maturity.

■ Forward contracts involving INR as one of the currencies booked by residents in respect of hedge transactions, if cancelled with one AD bank, can be rebooked with another AD bank subject to some conditions.

■ All non-INR forward contracts can be rebooked on cancellation subject to some conditions, etc.

b) Cross Currency Options (not involving Rupees)
The participants are market makers (banks AD-1) as approved by RBI for the purpose and Users/customers resident in India.

<u>Purpose</u>
To hedge:-

■ Exchange rate risk arising out of trade transactions.

■ Contingent foreign exchange exposure arising out of submission of a tender bid in foreign exchange.

<u>Operational Guidelines</u>

■ Banks can only offer plain vanilla European options (option may be exercised only at the expiry date of the option i.e. at a single pre-defined point in time).

■ Customers can buy call or put options.

GURUJI24.COM

■ These transactions may be freely booked and/ or cancelled subject to verification of the underlying.

■ All guidelines applicable for cross currency forward contracts are applicable to cross currency option contracts also.

■ Cross currency options should be written by banks on a fully covered back-to-back basis, etc.

c) Foreign Currency - INR Options

The participants are market makers (banks AD-1) as approved by RBI for the purpose and
Users/customers resident in India.

Purpose

To hedge:-

■ Foreign currency exposures

■Contingent foreign exchange exposure arising out of submission of a tender bid in foreign exchange.

Operational guidelines

■ Banks having a minimum CRAR of 9% can offer foreign currency- INR options on a back-to-back basis.

■ For the present, banks can offer only plain vanilla European options.

■ Customers can buy call or put options.

■ All guidelines applicable for foreign currency-INR foreign exchange forward contracts are applicable to foreign currency-INR option contracts also.

■ Banks having adequate internal control, risk monitoring/ management systems, mark to market mechanism, etc. are permitted to run a foreign currency- INR options book on prior approval from the RBI, subject to conditions.

■ Banks may quote the option premium in Rupees or as a percentage of the Rupee/foreign currency notional.

■ Option contracts may be settled on maturity either by delivery on spot basis or by net cash settlement in Rupees on spot basis as specified in the contract, etc.

d) Foreign Currency-INR Swaps

The participants are market makers (banks AD-1) and:-

Users such as:-

(i) Residents having a foreign currency liability and undertaking a foreign currency-INR swap to move from a foreign currency liability to a Rupee liability.

(ii) Incorporated resident entities having a rupee liability and undertaking an INR – Foreign currency swap to move from rupee liability to a foreign currency liability subject to certain minimum prudential requirements such as management systems, natural hedges, etc.

Purpose

To hedge exchange rate and/or interest rate risk exposure for those having long-term foreign currency borrowing or to transform long-term INR borrowing into foreign currency liability.

Operational guidelines

■ Swap transactions involving upfront payment of Rupees or its equivalent in any form shall not be undertaken.
■ The term “long-term exposure” means exposures with residual maturity of one year or more.
■ The swap transactions, once cancelled, shall **not be** rebooked or re-entered, by whichever mechanism or by whatever name called.
■ Banks should not offer leveraged swap structures.
■ The maturity of the swap should not exceed the remaining maturity of the underlying loan, etc.

e) Cost Reduction Structures
(i.e. cross currency option cost reduction structures and foreign currency-INR option cost reduction structures)
The participants are market makers (banks AD-1) and:-
Users :- listed companies and their subsidiaries/joint ventures/associates having common treasury and consolidated balance sheet or unlisted companies with a minimum net worth of Rs. 200 crore.

Purpose

To hedge exchange rate risk arising out of trade transactions, ECBs, FCLs availed of domestically against FCNR (B) deposits.

Operational Guidelines
■ Writing of options by the Users on a standalone basis is not permitted.
■ Users can enter into option strategies of simultaneous buy and sell of plain vanilla European options, provided there is no net receipt of premium.
■ Leveraged structures, digital options, barrier options, range accruals and any other exotic products are not permitted.
■ The portion of the structure with the largest notional, computed over the tenor of the structure, should be reckoned for the purpose of underlying.
■ The delta of the options should be explicitly indicated in the term sheet.
■ Banks may, stipulate additional safeguards, such as, continuous profitability, higher net worth, turnover, etc depending on the scale of forex operations and risk profile of the users.
■ The maturity of the hedge should not exceed the maturity of the underlying. In case of trade transactions being the underlying, the tenor of the structure shall not exceed two years.
The MTM position should be intimated to the users on a periodical basis, etc.

f) Hedging of borrowing in Foreign Exchange

{As per the provisions of FEMA (Borrowing and Lending in Foreign Exchange) Regulations 2000 and the **products** are Interest Rate Swap, Cross Currency Swap, Coupon Swap, Cross Currency Option, Interest Rate Cap, or Collar (Purchases), and Forward Rate Agreement (FRA)}.

The participants are Market-makers (banks) including branches outside India of an Indian Bank and Offshore banking unit in a SEZ in India. Users include persons resident in India who have borrowed foreign exchange in accordance with the provisions of FEMA.

Purpose

For hedging interest rate risk and currency risk on loan exposure and unwinding from such hedges.

Operational Guidelines

■ The stated products should **not** involve the rupee under any circumstances.
■ Final approval has been accorded or Loan Registration Number allotted by the RBI for borrowing in foreign currency.
■ The notional principal amount of the product should not exceed the outstanding amount of the foreign currency loan.
■ The maturity of the product should not exceed the unexpired maturity of the underlying loan.
■ The contracts may be cancelled and rebooked freely.

B. **Probable Exposure based on past performance**

The participants are Market Makers (banks AD-1) and Users - importers and exporters of goods and services.

Purpose

To hedge currency risk on the basis of a declaration of an exposure and based on past performance up to the average of the previous three financial years' (April to March) actual import/export turnover **or** the previous year's actual import/export turnover, whichever is higher. Probable exposure based on past performance can be hedged only in respect of trades in **merchandise goods as well as services.**

Products

Forward foreign exchange contracts, Cross currency options (not involving the rupee), Foreign currency-INR options and Cost reduction structures.

Operational Guidelines

■ Corporate having a minimum net worth of Rs 200 crore and an annual export and import turnover exceeding Rs 1000 crore and satisfying all other conditions as stipulated in section 2 only eligible to use cost reduction structures.

GURUJI24.COM

■ The contracts booked during the current financial year (April-March) and the outstanding contracts at any point of time should not exceed the eligible limit i.e. the average of the previous three financial years' actual export turnover or previous year's actual export turnover whichever is higher for exports and 25% of the eligible limit i.e. the average of the previous three financial years' actual import turnover whichever is higher for imports.
■ All forward contracts booked under this facility by both exporters and importers (from 16.12.2011 onwards) will be on fully deliverable basis. In case of cancellations, exchange gain, if any, need not be passed on to the customer.
■ These limits shall be computed separately for import/export transactions.
■ Higher limits will be permitted on a case-by-case basis on application to RBI. The additional limits, if sanctioned, shall be on a deliverable basis.
■ Any contract booked without producing documentary evidence will be marked off against this limit, etc.

C. **Special Dispensation**

i) **Small & Medium Enterprises (SMEs)**

Purpose

To hedge direct and / or indirect exposures of SMEs to foreign exchange risk

Product

Forward foreign exchange contracts

Operational Guidelines

SMEs having direct and/or indirect exposures to foreign exchange risk are permitted to book/ cancel/ roll over forward contracts without production of underlying documents to manage their exposures effectively, subject to certain conditions such as:-

a) Such contracts may be booked through banks (AD-1) with whom the SMEs have credit facilities and the total forward contracts booked should be in alignment with the credit facilities availed by them for their foreign exchange requirements or their working capital requirements or capital expenditure.
b) Bank should carry out due diligence regarding the 'user appropriateness' and 'suitability' of forward contracts to the SME customers
c) SMEs availing the facility are required to submit a declaration to the bank regarding the amounts of forward contracts already booked, if any, with other bank/s under the facility.

ii) **Resident Individuals**

The participants are Market Makers (banks) and Users – Resident Individuals.

Purpose

To hedge their foreign exchange exposures arising out of actual or anticipated remittances, both inward and outward, can book forward contracts, without production of underlying documents, up to a limit of USD 100,000, based on self declaration.

Product

Forward foreign exchange contracts.

Operational Guidelines

■ The contract would normally be on a deliverable basis and can be cancelled and rebooked in case of exigencies. The notional value of the outstanding contracts should not exceed USD 100,000 at any time.
■ The tenure of the contract booked up to one year only.
■ The contracts may be booked through the banks with whom the individual has banking relationship. The bank is required to carry out a due diligence on the applicant for its satisfaction.

OTC Forex Derivative Contracts entered by Resident in India – General Guidelines

In addition to the guidelines discussed above, the resident individuals and Market Makers are required to follow scrupulously the general guidelines as under:-

■ In case of all forex derivative transactions (except INR- foreign currency swaps), banks must obtain a declaration from the clients that the exposure is unhedged and has not hedged with another bank.
■ In case the hedging is undertaken in parts with more than one bank, the same should be details should be provided in the declaration
■ Derived foreign exchange exposures are not permitted to be hedged.
■ In any derivative contract, the notional amount should not exceed the actual underlying exposure at any point in time.
■ Only one hedge transaction can be booked against a particular exposure/ part thereof for a given time period
■ The market-makers (banks) should carry out proper due diligence regarding 'user appropriateness' and 'suitability' of products before offering derivative products (except forward contracts) to users, etc.

D. **Currency Futures on recognized Stock/New Exchanges**

In addition to the existing foreign exchange hedging tools available to residents, currency futures contracts have been permitted to be traded in recognized stock exchanges or new exchanges recognized by SEBI subject to certain directions/instructions issued by RBI and SEBI from time to time as under:-

i) Permission

a) Currency futures are permitted in US Dollar (USD) - Indian Rupee (INR), Euro (EUR)-INR, Japanese Yen (JPY)-INR and Pound Sterling (GBP)-INR.

b) Only 'persons resident in India' may purchase or sell currency futures contracts to hedge an exposure to foreign exchange rate risk or otherwise.

ii) Features

Standardized currency futures shall have the following features:

CAJUNK24.COM

a) USD-INR, EUR-INR, GBP-INR and JPY-INR contracts are allowed to be traded.
b) The size of each contract shall be USD 1000 for USD-INR contracts, Euro 1000 for Euro-INR contracts, GBP 1000 for GBP-INR contracts and JPY 100,000 for JPY-INR contracts.
c) The contracts shall be quoted and settled in Indian Rupees.
d) The maturity of the contracts shall not exceed 12 months.
e) The settlement price for USD-INR and Euro-INR contracts shall be the RBI Reference Rates and for GBP-INR and JPY-INR contracts shall be the exchange rates published by the RBI in its press release on the last trading day.

iii) Membership

■ The membership of currency futures market of a recognized stock exchange is separate from the membership of the equity derivative segment or the cash segment.

■ The membership of both trading and clearing in the currency futures market is subject to the guidelines issued by SEBI.

■ Banks authorized by RBI under FEMA are permitted to become trading and clearing members of currency futures market on their own account or on behalf of their clients subject to fulfilling the minimum prudential requirements. Those banks who do not meet the minimum prudential requirements and AD-1 banks which are Urban Co-operative banks or State Co-operative Banks can participate in the currency futures market only as clients subject to approval from RBI.

iv) Position Limits

The banks shall operate within prudential limits such as Net Open Position (NOP) and Aggregate Gap (AG) limits. The exposure of the banks, on their own account, in the currency futures market shall form part of their NOP and AG limits. The position limits for various classes of participants in the currency futures market shall be subject to the guidelines issued by the SEBI.

v) Risk Management Measures

The trading of currency futures shall be subject to maintaining initial, extreme loss and calendar spread margins and the Clearing Corporations / Clearing Houses of the exchanges should ensure maintenance of such margins by the participants on the basis of the guidelines issued by the SEBI from time to time.

vi) Surveillance & Disclosures

The surveillance and disclosures of transactions in the currency futures market shall be carried out in accordance with the guidelines issued by the SEBI.

vii) Authorization to Currency Futures and Clearing Corporations

Authorization issued by RBI under FEMA 1999 is mandatory for recognized stock exchanges and their respective Clearing Corporations/Clearing Houses to undertake currency future business.

E. **Currency Options on recognized Stock/New Exchanges**

GURUJI2K.COM

Being part of expansion, residents are permitted to trade plain vanilla currency options contracts in recognized stock exchanges or new exchanges recognized by SEBI subject to some conditions as under:-

i) Permission

a) Exchange traded Currency option contracts are permitted in USD -Indian Rupee (INR).
b) Only 'persons resident in India' may purchase or sell exchange traded currency options contracts to hedge an exposure to foreign exchange rate risk or otherwise.

ii) Features

Standardized exchange traded currency options shall have the following features:

a) The underlying for the currency option shall be US Dollar- INR (USD-INR) spot rate.
b) The options shall be premium styled European call and put options.
c) The size of each contract shall be USD 1000.
d) The premium shall be quoted in Rupee terms. The outstanding position shall be in USD.
e) The maturity of the contracts shall not exceed twelve months.
f) The contracts shall be settled in cash in Indian Rupees.
g) The settlement price shall be the Reserve Bank's Reference Rate on the date of expiry of the contracts

iii) Membership

■ Members registered with the SEBI for trading in currency futures market shall be eligible to trade in the exchange traded currency options market of a recognized stock exchange.

Banks authorized by RBI under FEMA are permitted to become trading and clearing members of currency futures market on their own account or on behalf of their clients subject to fulfilling the minimum prudential requirements such as:-

a) Minimum net worth of Rs. 500 crore.
b) Minimum CRAR of 10%.
c) Net NPA should not exceed 3%.
d) Made net profit for last 3 years.

Banks who do not meet the above minimum prudential requirements and AD-1 banks which are Urban Co-operative banks or State Co-operative Banks can participate in the exchange traded currency options market only as clients subject to approval from RBI.

iv) Position limits

The banks shall operate within prudential limits such as Net Open Position (NOP) and Aggregate Gap (AG) limits. The exposure of the banks, on their own account, in the currency futures market shall form part of their NOP and AG limits. The position limits for various classes of participants in the currency futures market shall be subject to the guidelines issued by the SEBI.

v) Risk Management measures

The trading of exchange traded currency options shall be subject to maintaining initial, extreme loss and calendar spread margins and the Clearing Corporations / Clearing Houses of the exchanges should ensure maintenance of such margins by the participants on the basis of the guidelines issued by the SEBI from time to time.

vi) Surveillance & Disclosures

The surveillance and disclosures of transactions in the exchange traded currency options market shall be carried out in accordance with the guidelines issued by the SEBI.

vii) Authorizations to the exchanges/clearing corporation for dealing in currency options

Authorization issued by RBI under FEMA 1999 is mandatory for recognized stock exchanges and their respective Clearing Corporations/Clearing Houses to undertake business relating to traded currency options.

F. **Commodity Hedging**

Residents in India engaged in import and export trade or as otherwise approved by RBI from time to time are permitted to hedge the price risk of permitted commodities in the international commodity exchanges/markets. This facility should not be used in conjunction with any other derivative product. The role of banks is to arrange remittance of foreign currency amounts towards margin requirements from time to time and issuance of guarantees/standby LCs to cover the specific payment obligations related to the commodity derivative transactions entered into by customers.

The facility is divided into following categories:

1. **Delegated Route**:

This category includes transactions such as :-

a) Hedging of price risk on actual Import/Export of commodities
b) Hedging of anticipated imports of crude oil
c) Hedging of price risk on domestic purchase and sales

Domestic purchases and sales include: (i) Select Metals, (ii) ATF (Aviation Turbine Fuel), and (iii) Domestic purchases of crude oil and sales of petro-products

d) Hedging of price risk on inventory

2. **Approval Route**

GURU24.COM

The participants are Residents in India, who are exposed to systemic international price risk in commodities. Banks (AD-1) are the facilitators. The purpose is to hedge systemic international price risk in commodities. The products are standard exchange traded futures and options (purchases only) in international commodity exchanges. If risk profile warrants - may use OTC contracts overseas.

Operational guidelines

Applications of companies/ firms which are not covered by the delegated authority may be forwarded to the Reserve Bank for consideration through the International Banking Division of the bank concerned in the prescribed format.

3. Entities in Special Economic Zones (SEZ)

The participants are entities in SEZ and banks. The products are standard exchange traded futures and options (purchases only) in international commodity exchanges. If risk profile warrants - may use OTC contracts overseas.

Operational guidelines

Banks may allow entities in the Special Economic Zones (SEZ) to undertake hedging transactions in the overseas commodity exchanges/markets to hedge their commodity prices on export/import subject to the condition that such contract is entered into on a stand-alone basis.

G. **Freight Hedging**

Domestic oil refining companies and shipping companies exposed to freight risk, are permitted to hedge their freight risk by the banks authorized by the RBI. Other companies exposed to freight risk can seek prior permission from the RBI through their bank. This facility must not be used in conjunction with any other derivative product. The facility is divided into following categories viz. Delegated Route and Approval Route (Detailed guidelines are provided in RBI M. Cir. dt. 01.07.13).

2. **Facilities for Persons Resident outside India**

The participants are banks (AD-1) and Users – Foreign Institutional Investors (FII), Investors having Foreign Direct Investments (FDI), Non Resident Indians (NRIs), Non Resident exporters and importers, Non Residents lenders having ECBs designated in INR and Qualified Foreign Investors (QFIs).

a) Foreign Institutional Investors (FII)

Purpose: To hedge:-

i) Currency risk on the market value of entire investment in equity and/or debt in India as on a particular date.

ii) Initial Public Offers (IPO) related transient capital flows under the Application Supported by Blocked Amount (ASBA) mechanism.

Products:

Forward foreign exchange contracts with rupee as one of the currencies and foreign currency-INR options. Foreign Currency - INR swaps for IPO related flows.

(Operational guidelines are detailed in the Circular)

b) Facilities for Non-resident Indians (NRIs)

Purpose: To hedge:

i) Exchange rate risk on the market value of investment made under the portfolio scheme in accordance with provisions of FERA or FEMA.

ii) Exchange rate risk on the amount of dividend due on shares held in Indian companies.

iii) Exchange rate risk on the amounts held in FCNR (B) deposits.

iv) Exchange rate risk on balances held in NRE account

<u>Products</u>:
Forward foreign exchange contracts with rupee as one of the currencies, and foreign currency-INR options. Additionally, for balances in FCNR (B) accounts -Cross currency (not involving the rupee) forward contracts to convert the balances in one foreign currency to other foreign currencies in which FCNR (B) deposits are permitted to be maintained.

(Operational guidelines are provided in the Circular)

c) Facilities for hedging Direct Investments in India

<u>Purpose:</u> To hedge:-

i) Exchange rate risk on the market value of investments made in India since 01.01.1993, subject to verification of the exposure in India

ii) Exchange rate risk on dividend receivable on the investments in Indian companies.

iii) Exchange rate risk on proposed investment in India

<u>Products</u>
Forward foreign exchange contracts with rupee as one of the currencies and foreign currency-INR options.
(Operational Guidelines are detailed in the Circular)

d) Facilities for hedging trade exposures, invoiced in Indian Rupees in India

<u>Purpose:</u>
To hedge the currency risk arising out of genuine trade transactions involving exports from and imports to India invoiced in Indian Rupees with banks in India
<u>Products:</u>

GURUJI24.COM

Forward foreign exchange contracts with rupee as one of the currencies and foreign currency-INR options.
(Operational Guidelines are detailed in the Circular)

e) Facilities for hedging ECBs designated in Indian Rupees in India

Purpose:

Currency risk arising out of ECBs designated in INR with banks (AD-1) in India.

Products:

Forward foreign exchange contracts with rupee as one of the currencies, foreign currency-INR options and foreign currency-INR swaps.
(Operational Guidelines are detailed in RBI M. Circular)

f) Facilities for Qualified Foreign Investors

Purpose: - To hedge:

i) Currency risk on the market value of entire investment in equity and/or debt in India as on a particular date.

ii) Initial Public Offers (IPO) related transient capital flows under the Application iii) Supported by Blocked Amount (ASBA) mechanism.

Products

Forward foreign exchange contracts with rupee as one of the currencies and foreign currency-INR options. Foreign Currency - INR swaps for IPO related flows
(Operational Guidelines are detailed in the Circular)

3. **Facilities for Authorized Dealers (Category – 1)**

a) Management of Banks' Assets – Liabilities

The users are banks (AD-1) and the purpose are for hedging of interest rate and currency risks of foreign exchange asset-liability portfolio. The products are Interest Rate Swap, Interest Rate Cap/Collar, Currency Swap, and Forward Rate Agreement. Banks may also purchase call or put options to hedge their cross currency proprietary trading positions.

Operational guidelines

■ An appropriate policy duly approved by the Top Management should be in place.
■The value and maturity of the hedge should not exceed those of the underlying.
■ No 'stand alone' transactions can be initiated.
■ If a hedge becomes naked, in part or full, owing to the contraction of the value of portfolio, it may be allowed to continue till the original maturity and should be marked to market at regular intervals.
■ The net cash flows arising out of these transactions are booked as income/ expenditure and reckoned toward foreign exchange position, wherever applicable.

CAIIBGURUJI24.COM

b) Hedging of Gold Prices

The Users are banks authorized by RBI to operate Gold Deposit Scheme. The purpose is to hedge price risk of gold and the products involved are exchange traded and over-the-counter hedging products available overseas.

Operational Guidelines

i) In option products, there is no net receipt of premium, either direct or implied.

ii) Banks (AD-1) are permitted to enter into forward contracts with their constituents in respect of underlying sale, purchase and loan transactions in gold with them subject to RBI specified conditions.

iii) The tenor of the contracts should not exceed 6 months.

c) Hedging of Capital

Users are the Foreign Banks operating in India and the products are Forward Foreign Exchange Contracts.

Operational Guidelines

Tier I Capital:-

i) It should be not parked in Nostro accounts as the funds are meant for meeting regulatory and CRAR requirements.

ii) Foreign Currency funds arising out of hedging should not be parked in Nostro accounts but can remain swapped with banks in India at all times.

iii) The forward contracts should be for tenors of one or more years and may be rolled over on maturity.

iv) Rebooking of cancelled hedges will require prior approval of the Reserve Bank.

Tier II Capital

i) Foreign banks are permitted to hedge their Tier II capital in the form of Head Office borrowing as subordinated debt, by keeping it swapped into rupees at all times.

ii) Banks are not permitted to enter into foreign currency-INR swap transactions involving conversion of fixed rate rupee liabilities in respect of Innovative Tier I/Tier II bonds into floating rate foreign currency liabilities.

d) Participation in Currency Futures markets in India

- Banks (AD-1) are permitted to participate in Currency Futures Markets in India subject to fulfilling the criteria as under:-

i) Minimum Net worth of Rs. 500 crore

ii) Minimum CRAR of 10%

iii) Net NPA should not exceed 3%

GURUJI24.COM

iv) Net profit for last 3 years

- State Co-operative Banks and Urban Co-operative Banks (AD-1) and banks which do not meet the minimum prudential requirements can participate in the currency futures market only as clients subject to approval of RBI.

- Banks shall operate within prudential limits, such as Net Open Position (NOP) and Aggregate Gap (AG) limits.

e) Participation in the exchange traded currency option markets in India

- Banks (AD-1) are permitted to participate in exchange traded currency option markets in India subject to fulfilling the criteria as under:-

a) Minimum Net worth of Rs. 500 crore
ii) Minimum CRAR of 10%
iii) Net NPA should not exceed 3%
iv) Net profit for last 3 years

- State Co-operative Banks and Urban Co-operative Banks (AD-1) and banks which do not meet the minimum prudential requirements can participate in the currency futures market only as clients subject to approval of RBI.

- Banks shall operate within prudential limits, such as Net Open Position (NOP) and Aggregate Gap (AG) limits.

4. **Accounts of Non-Resident Banks**

Credit and debit to the account of a non-resident bank are permitted. Credit relates to a permitted method of payment to non-residents and debit is in effect an inward remittance in foreign currency.

Rupee Accounts of non-resident banks
Banks (AD-1) can open/close rupee accounts (non-interest bearing) in the names of their overseas branches or correspondents without reference to RBI. Accounts in the names of branches of Pakistani banks operating outside Pakistan require RBI approval.

Funding of accounts of Non-resident Banks
Banks may freely purchase foreign currency from their overseas correspondents/branches at on-going market rates to lay down funds in their accounts for meeting their bonafide needs in India. Close monitoring is required to ensure that overseas banks do not take a speculative view.
<u>Other issues</u>

- Transfer of funds between the accounts of the same banks or different banks is freely permitted.

- Balances held in Rupee accounts of non-resident banks may be freely converted into foreign currency.
- In the case of credit to accounts the paying banker should ensure that all regulatory requirements are met.
- Requests for cancellation or refund of inward remittances may be complied with without reference to RBI.
- Banks may permit their overseas branches/ correspondents temporary overdrafts not exceeding Rs.500 Lakh in aggregate, for meeting normal business requirements. Any excess drawing beyond 5 days should be reported to RBI within 15 days of close of the month. For granting facility beyond the ceiling should be got approved by RBI.

- Opening of Rupee accounts in the names of Exchange Houses for facilitating private remittances into India requires approval of the Reserve Bank. Remittances through Exchange Houses for financing trade transactions are permitted up to Rs.2,00,000 per transaction.

5. **Inter-bank Foreign Exchange Dealings**

Banks (AD-1) should frame appropriate policy and fix suitable limits for undertaking various treasuring functions. The overnight net open exchange position and aggregate gap should be communicated to RBI upon approval by the respective bank's Board/Management Committee.
Foreign Exchange Exposure Limits of banks (AD) is dual in nature such as:-

1. Net Overnight Open Position Limit (NOOPL) for calculation of capital charge on forex risk.
2. Limit for positions involving Rupee as one of the currencies (NOP-INR) for exchange rate management.

1. <u>Net Overnight Open Position Limit</u>

NOOPL should not exceed 25% of the total capital (Tier I and Tier II capital) of the bank. The **Net Open position** can be calculated as under:

The open position must first be measured separately for each foreign currency. The open position in a currency is the **sum** of (a) the net spot position, (b) the net forward position and (c) the net options position.

<u>Net Spot Position</u>
The net spot position is the difference between foreign currency assets and the liabilities in the balance sheet. This should include all accrued income/expenses.

<u>Net Forward Position</u>
Net Forward Position is the net of all amounts to be received less all amounts to be paid in the future as a result of foreign exchange transactions which have been concluded.

Net Option Position

The options position is the "delta-equivalent" spot currency position as reflected in the authorized dealer's options risk management system, and includes any delta hedges in
Place which have not already been included in Net Spot Position and Net Forward Position.

Calculation

Banks may calculate the overall net open position as follows:

i) Calculate the net open position in each currency

ii) Calculate the net open position in gold.

iii) Convert the net position in various currencies and gold into Rupees in terms of existing RBI / FEDAI Guidelines. All derivative transactions including forward exchange contracts should be reported on the basis of Present Value (PV) adjustment.

iv) Arrive at the sum of all the net short positions.

v) Arrive at the sum of all the net long positions.

Overall net foreign exchange position is the higher of **(iv) or (v).** The overall net foreign exchange position arrived at as above must be kept within the limit approved by the bank's Board.

Offshore exposure

For banks with overseas presence, the offshore exposures should be calculated on a standalone basis as per the above method and should not be netted with onshore exposures. The aggregate limit (on-shore + off-shore) may be termed Net Overnight open Position (NOOP) and will be subjected to capital charge.

The capital requirement (Tier I) is as prescribed by RBI from time to time.

2. Limit for positions involving Rupee as one of the currencies (NOP-INR) for exchange rate management.

- The NOP-INR positions may be calculated by netting off the long & short onshore positions plus the net INR positions of offshore branches.
- Positions undertaken by banks in currency futures /options traded in exchanges will not form part of the NOP-INR.
- As regards option position, any excesses on account of large option Greeks during volatile market closing / revaluations may be treated as technical breaches.

CAIIB4U.COM

- NOP-INR is being prescribed to Authorised Dealers at the discretion of the RBI depending on the market conditions.

Aggregate Gap Limits (AGL)

- AGL should not exceed 6 times of total capital (Tier I & Tier II) of the bank.
- Banks (AD-1) which have instituted superior measures such as tenor wise PV01 limits and VaR to aggregate foreign exchange gap risks are allowed to fix their own PV01 and VaR limits based on their capital, risk bearing capacity etc. in place of AGL and communicate the same to the RBI.

Interbank transactions

Subject to the provisions of laid down policy as also fixing of suitable limits banks can freely undertake foreign exchange transactions as under:

a) With banks (AD) in India

i) Buying/Selling/Swapping foreign currency against Rupees or another foreign currency.

ii) Placing/Accepting deposits and Borrowing/Lending in foreign currency.

b) With banks overseas and offshore banking units in SEZ

i) Buying/Selling/Swapping foreign currency against another foreign currency to cover client transactions or for adjustment of own position.
ii) Initiating trading positions in the overseas markets.

Foreign currency accounts/investment in overseas markets

Inflows into foreign currency accounts arise primarily from client-related transactions, swap deals, deposits, borrowings, etc. Banks may maintain balances in foreign currencies up to the levels approved by the Board. They are free to manage the surplus in these accounts through overnight placement and investments with their overseas branches/correspondents subject to adherence to the gap limits approved by RBI.

Banks are free to undertake investments in overseas markets up to the limits approved by their Board. Such investments may be made in overseas money market instruments and/or debt instruments issued by a foreign state with a residual maturity of less than one year and rated at least as AA (-) by Standard & Poor / FITCH IBCA or Aa3 by Moody's.

'Money market instrument' would include any debt instrument whose life to maturity does not exceed one year as on the date of purchase. Banks may invest the un-deployed FCNR (B) funds in overseas markets in long-term fixed income securities

GURUJI24.COM

subject to the condition that the maturity of the securities invested in does not exceed the maturity of the underlying FCNR (B) deposits.

Surpluses in Nostro accounts can be utilized for making loans to resident constituents for meeting their foreign exchange requirements or for the Rupee working capital/capital expenditure needs of exporters/ corporate who have a natural hedge or a risk management policy for managing the exchange risk, extending credit facilities to Indian wholly owned subsidiaries/ joint ventures abroad in which at least 51 per cent equity is held by a resident company, and write-off/transfer to unclaimed balances account, un-reconciled debit/credit entries, etc.

Loans/Overdrafts

All foreign currency borrowings of banks (AD) viz. ECB, and loans/overdrafts from their H.O./Overseas Branches/Correspondents and overdrafts in nostro accounts (not adjusted within five days), shall not exceed 50% of their unimpaired Tier I capital or USD 10 million (or its equivalent), whichever is higher.
The amount of Loans/overdrafts so raised may be used for purposes other than lending in foreign currency to constituents in India and repaid without reference to the Reserve Bank.

Borrowings **outside** the ceiling of 50% unimpaired Tier I capital or USD 10 million (or its equivalent), whichever is higher include:

i) Overseas borrowings for the purpose of financing export credit
ii) Subordinated debt placed by head offices of foreign banks with their branches in India as Tier II capital.
iii) Capital funds raised/augmented by the issue of Innovative Perpetual Debt Instruments and Debt Capital Instruments, in foreign currency

Interest on loans/overdrafts may be remitted (net of taxes) without the prior approval of RBI.

6. **Reports to RBI**

Banks (AD-1) are required to report the Forex transactions periodically in the prescribed format (FTD, GPB, etc.) as detailed in the RBI M. Circular. Conditions /Guidelines for issuance of standby LC/Bank Guarantee for commodity hedging transactions, Guidelines on hedging of Commodity Price Risk in the International Commodity Exchanges/Markets, etc. are provided by way annexure in the Circular.

(Source: RBI M. Circular dt. 01.07.13)

o0o0o0o