<u>Master Circular- Risk Management And Inter-Bank Dealings</u>

As on July 1, 2003

Reserve Bank of India
Exchange Control Department
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Master Circular No./1/2003-04 July 1,2003

To

All Authorised Dealers in Foreign Exchange

Dear Sirs / Madam,

<u>Master Circular- Risk Management and Inter-Bank Dealings</u>

Instructions contained in the undernoted circulars pertaining to forward exchange cover, other derivative products, Rupee accounts of Non-resident banks and inter-bank dealings etc., have been consolidated in this master circular.

1. A.P (DIR Series) Circular No. 92 dated April 4, 2003
2. A.P.(DIR Series) Circular No. 93 dated April 5, 2003
3. A.P.(DIR Series) Circular No. 98 dated April 29, 2003
4. EC.CO. FMD Circular No. 8/ 02.03.75/2002-03 dated February 11, 2003
5. EC.CO. FMD Circular No.14/ 02.03.75/2002-03 dated May 9, 2003.

Yours faithfully,
(Grace Koshie)
Chief General Manager

As on July 1, 2003

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PART – A

RISK MANAGEMENT

Section I

Facilities for Residents other than authorised dealers:

Forward Contracts

A 1. A person resident in India may enter into a forward contract with an authorised dealer in India to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Act, or rules or regulations or directions or orders made or issued thereunder, subject to following terms and conditions-

a) the authorised dealer through verification of documentary evidence is satisfied about the genuineness of the underlying exposure, irrespective of the transaction being a current or a capital account transaction. Full particulars of contract should be marked on such documents under proper authentication and copies thereof retained for verification. However, authorised dealers may allow importers and exporters to book forward contracts on the basis of a declaration of exposure subject to the conditions mentioned in paragraph A 2 of this circular.

b) the maturity of the hedge does not exceed the maturity of the underlying transaction,

c) the currency of hedge and tenor are left to the choice of the customer,

d) where the exact amount of the underlying transaction is not ascertainable, the contract is booked on the basis of a reasonable estimate,

e) foreign currency loans/bonds will be eligible for hedge only after final approval is accorded by the Reserve Bank where such approval is necessary or loan identification number is given by the Regional Office of the Reserve Bank.

f) Global Depository Receipts (GDRs) will be eligible for hedge after the issue price has been finalised,

g) 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 may ,however, be rolled-over,

h) forward contracts booked in respect of foreign currency exposures of residents falling due within one year may be cancelled and rebooked. This facility may be made available only to customers who submit details of exposure to authorised dealers as per the format enclosed. (Annexure V) .Forward contracts booked to cover exposures falling due beyond one year once cancelled, cannot be rebooked. Authorised dealers may continue to offer this facility without any restrictions in respect of export transactions. All forward contracts may be rolled over at on-going market rates.

i) Substitution of contracts for hedging trade transactions may be permitted by an authorised dealer on being satisfied with the circumstances under which such substitution has become necessary.

A.2 Authorised dealers may also allow importers and exporters to book forward contracts on the basis of a declaration of an exposure and based on past performance subject to the following conditions:
a. The forward contracts booked in the aggregate should not exceed the limits worked out on the basis of the average of the previous three financial years' (April to March) actual import/export turnover. This is subject to the condition that at any point of time forward contracts so booked

shall not exceed 25% of the limit within a cap of US $ 100 million. These eligible limits are to be computed separately for export and import transactions.
b. Any forward contract booked without producing documentary evidence will be marked off against this limit.
c. Importers and exporters should furnish a declaration to the authorized dealer regarding amounts booked with other banks under this facility.
d. an undertaking may be taken from the customer to produce supporting documentary evidence before the maturity of the forward contract.
e. Importers/exporters desirous of availing limits higher than US $ 100 million may forward their applications to the Chief General Manager, Reserve Bank of India, Excahnge Control Department, Forex Markets Division, Central Office, Mumbai-400 001 (Fax No. 22611427, e-mail ecdcofmd@rbi.org.in) justifying the need for higher limits. Forward contracts booked under the enhanced limits will be on a deliverable basis. Details of the import/export turnover of the past three years, delayed realisations/ payments during these years and existing limits, duly authenticated by the authorised dealer, may also be furnished in the enclosed format (Annexure VI)..

A 3. A forward contract cancelled with one authorised dealer can be rebooked with another authorised dealer subject to the following conditions:
a) the switch is warranted by competitive rates on offer, termination of banking relationship with the authorised dealer with whom the contract was originally booked, etc.
b) the cancellation and rebooking are done simultaneously on the maturity date of the contract ,
c) the responsibility of ensuring that the original contract has been cancelled rests with the authorised dealer who undertakes rebooking of the contract.

A 4 Authorised Dealers may also enter into forward contracts with residents in respect of transactions denominated in foreign currency but settled in Indian Rupees. These contracts shall be held till maturity and cash settlement would be made on the maturity date by cancellation of the contracts. Forward contracts covering such transactions once cancelled, are not eligible to be rebooked.

Contracts other than Forward Contracts

A.5 Authorised dealers in India may enter into contracts, other than forward contracts with residents in India in accordance with the following provisions:
(i) A person resident in India who has borrowed foreign exchange in accordance with the provisions of Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000 , may enter into an Interest rate swap or Currency swap or Coupon Swap or Foreign Currency Option or Interest rate cap or collar (purchases) or Forward Rate Agreement (FRA) contract with an authorised dealer in India or with a branch outside India of an authorised dealer for hedging his loan exposure and unwinding from such hedges,
Provided that –

a) the contract does not involve the rupee
b) final approval has been accorded or loan identification number issued by the Reserve Bank for borrowing in foreign currency.
c) the notional principal amount of the hedge does not exceed the outstanding amount of

the foreign currency loan.

d) the maturity of the hedge does not exceed the unexpired maturity of the underlying loan.

(ii)A person resident in India, who owes a foreign exchange or rupee liability, may enter into a contract for foreign currency-rupee swap with an authorised dealer in India to hedge long term exposure under the following terms and conditions:

1. No swap transactions involving upfront payment of rupees or its equivalent in any form shall be undertaken.
2. Swap transactions may be undertaken by banks as intermediaries by matching the requirements of corporate counter-parties
3. While no limits are placed on the authorised dealers for undertaking swaps to facilitate customers to hedge their foreign exchange exposures, limits have been put in place for swap transactions facilitating customers to assume a foreign exchange liability, thereby resulting in supply in the market. While matched transactions may be undertaken, a limit of USD 50 million is placed for net supply in the market on account of these swaps. Positions arising out of cancellation of swaps by customers need not be reckoned within the cap.
4. With reference to the specified limits for swap transactions facilitating customers to assume a foreign exchange liability, the limit will be reinstated on account of cancellation/ maturity of the swap and on amortization, up to the amounts amortized.
5. In the case of swap structures where the premium is inbuilt into the cost, authorised dealers should ensure that such structures do not result in increase in risk in any manner. Further, such structures should not result In net receipt of premium by the customer.
6. The above transactions if cancelled, shall not be rebooked or re-entered, by whatever name called.`

NOTE:

i. Authorised dealers should not offer leveraged swap structures to clients.

ii. Authorised dealers should not allow the swap route to become a surrogate for forward contracts for those who do not qualify for forward cover.

(iii) A person resident in India may enter into a foreign currency option contract with an authorised dealer in India to hedge foreign exchange exposure arising out of his trade :

Provided that in respect of cost effective risk reduction strategies like range forwards, ratio-range forwards or any other variable by whatever name called there shall not be any net inflow of premium. These transactions may be freely booked and/or cancelled.

(iv) Foreign currency – rupee options have been introduced with effect from July 7, 2003. Authorised dealers will be permitted to offer the product on back to back basis or run an option book as per the terms and conditions specified in Annexure VII.

Explanation

The contingent foreign exchange exposure arising out of submission of a tender bid in foreign exchange is also eligible for hedging under this sub-paragraph.

A 6 (i). Authorised dealers should ensure that the Board of Directors of the corporate has drawn up a risk management policy, laid down clear guidelines for concluding the transactions and institutionalised the arrangements for a periodical review of operations and annual audit of transactions to verify compliance with the regulations. The periodical review reports and annual audit reports should be obtained from the concerned Corporate by the authorised dealers.

(ii) Cross currency options should be written on a fully covered back-to-back basis. The cover transaction may be undertaken with a bank outside India, an off-shore banking unit situated in a Special Economic Zone or an internationally recognized option exchange or another authorised dealer in India.

(iii) Authorised dealers desirous of writing options, should obtain one time approval, before undertaking the business, from the Chief General Manager, Exchange Control Department, (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai, 400 001.

Hedging of commodity price risk in the International Commodity Markets

A.7 (i) Residents in India, engaged in import and export trade, may hedge the price risk of all commodities in the international commodity exchanges/markets. Applications for commodity hedging may be forwarded to Reserve Bank for consideration through the International Banking Division of an authorised dealer along with its recommendation giving the following details:

1. A brief description of the hedging strategy proposed; namely:-

a) Description of business activity and nature of risk

b) instruments proposed to be used for hedging

c) names of commodity exchanges and brokers through whom risk is proposed to be hedged and credit lines proposed to be availed. The name and address of the regulatory authority in the country concerned may also be given

d) size/average tenure of exposure and/or total turnover in a year, together with expected peak positions thereof and the basis of calculation.

2. copy of the Risk Management Policy approved by the Management covering;

a) risk identification

b) risk measurements

c) guidelines and procedures to be followed with respect to revaluation and/or monitoring of positions

d) names and designations of officials authorised to undertake transactions and limits

3.any other relevant information.

A one-time approval will be given by Reserve Bank along with the guidelines for undertaking this activity.

Commodity Hedging by entities in Special Economic Zones

(ii) General permission has been granted to entities in 'Special Economic Zones' 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.

Note: The term "stand alone" means the unit in SEZ is completely isolated from financial contacts with its parent or subsidiary in the mainland or within the SEZs as far as its import/export transactions are concerned.

Facilities for Foreign Institutional Investors (FIIs)

A.8 (i) Designated branches of authorised dealers maintaining accounts of FIIs may provide forward cover /option contracts with rupee as one of the currencies to such customers subject to the following conditions:

1. FIIs are allowed to hedge the market value of their entire investment in equity and/or debt in India as on a particular date. If a hedge becomes naked in part or full owing to shrinking of the portfolio, for reasons other than sale of securities, the hedge may be allowed to continue to the original maturity, if so desired.
2. these forward contracts, once cancelled cannot be rebooked but may be rolled over on or before maturity.
3. the cost of hedge is met out of repatriable funds and /or inward remittance through normal banking channel.
4. all outward remittances incidental to the hedge are net of applicable taxes.

ii) The eligibility for cover may be determined on the basis of the declaration of the FII. A review may be undertaken on the basis of market price movements, fresh inflows, amounts repatriated and other relevant parameters to ensure that the forward cover outstanding is supported by underlying exposure.

(iii) A monthly statement should be furnished to the Chief General Manager, Reserve Bank of India, Exchange Control Department (Forex Markets Division), Central Office, Mumbai-400 001 before the 10th of the succeeding month indicating the name of the FII / fund, the eligible amount of cover and the actual cover taken.

Facilities for Non-resident Indians (NRIs) and Overseas Corporate Bodies (OCBs)

A.9 Authorised dealers may enter into forward / option contracts with NRIs/OCBs as per the following guidelines to hedge:

1. the amount of dividend due to him/it on shares held in an Indian company.
2. the balances held in the Foreign currency Non-Resident (FCNR) account or the Non-Resident External Rupee (NRE) account. Forward contract with the rupee as one of the legs may be booked against balances in both the accounts. With regard to balances in FCNR(B) accounts, cross currency (not involving the rupee) forward contracts may also be booked to convert the balances in one foreign currency to another foreign currency in which FCNR(B) deposits are permitted to be maintained.
3. the amount of investment made under portfolio scheme in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 or under notifications issued thereunder or is made in accordance with the provisions of the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 and in both cases subject to the terms and conditions specified in the proviso to paragraph A 8 above.

Facilities for hedging of Foreign Direct Investment in India.

A 10.(i) Authorised Dealers may enter into forward / option contracts with residents outside India to hedge the investments made in India since January 1,1993, subject to verification of the exposure in India.

(ii) Residents outside India may also enter into forward sale contracts with authorised dealers to hedge the currency risk arising out of their proposed foreign direct investment in India. Such contracts may be allowed to be booked only after ensuring that the overseas entities have completed all the necessary formalities and obtained necessary approvals (wherever applicable) for the investment. The tenor of the contracts should not exceed six months beyond which permission of the Reserve Bank would be required to continue with the contract. These contracts, if cancelled, shall not be eligible to be rebooked for the same inflows and exchange gains, if any, on cancellation shall not be passed on to the overseas investor.

Note: All foreign exchange derivative contracts permissible for a person resident outside India once cancelled, are not eligible to be rebooked.

Section II

<u>Facilities for Authorised Dealers</u>

Management of Bank's Assets-Liabilities:
A.11 Authorised dealers may use the following instruments to hedge their assets-liability portfolio :
Interest rate swaps,
Currency swaps, and
Forward rate agreements.
Authorised dealers may also purchase call or put options to hedge their cross currency proprietary trading positions.
The use of these instruments is subject to the following conditions:
(a) An appropriate policy in this regard is approved by their Top Management.
(b) The value and maturity of the hedge should not exceed that of the underlying
(c) No 'stand alone' transactions can be initiated. If a hedge becomes naked in part or full owing to shrinking of the portfolio, it may be allowed to continue till the original maturity and should be marked to market at regular intervals.
(d) The net cash flows arising out of these transactions are booked as income and expenditure and reckoned as exchange position wherever applicable.

Hedging of Gold Prices
A.12 (i) Banks authorised by Reserve Bank to operate the Gold Deposit Scheme may use exchange-traded and over-the-counter hedging products available overseas to manage the price risk. However, while using products involving options, it may be ensured that there is no net receipt of premium, either direct or implied. Banks, which are allowed to enter into forward gold contracts in India in terms of the guidelines issued by the Department of Banking Operations and Development (including the positions arising out of inter-bank gold deals) are also allowed to cover their price risk by hedging abroad in the manner indicated above.
(ii) Authorised banks are permitted to enter into forward contracts with their constituents (exporters of gold products, jewellery manufacturers, trading houses, etc.) in respect of the underlying sale, purchase and loan transactions in gold with them subject to the conditions specified by Reserve Bank.

Hedging of Tier I Capital

A.13 Foreign banks may hedge the entire Tier I Capital held by them in Indian books subject to the following conditions:

i)the forward contract should be for tenors of one year or more and may be rolled over on maturity. Rebooking of cancelled hedge will require prior approval of Reserve Bank.

ii)the capital funds should be available in India to meet local regulatory and CRAR requirements .Therefore ,foreign currency funds accruing out of hedging should not be parked in nostro accounts but should remain swapped with banks in India at all times.

ii)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 Indian rupees at all times in terms of our Department of Banking Operations and Development (DBOD)"s circular No..IBS.BC.65/23.10.015/2001-02 dated February 14,2002.

PART -B

Accounts of Non-resident Banks

General

B.1 (i) Credit to the account of a non-resident bank is a permitted method of payment to non-residents and is, therefore, subject to the regulations applicable to transfers in foreign currency.

(ii) Debit to the account of a non-resident bank is in effect an inward remittance in foreign currency.

Rupee Accounts of Non-Resident Banks

B.2 (i) Banks may open/close rupee accounts (non-interest bearing) in the names of their overseas branches or correspondents without prior reference to Reserve Bank. Opening of rupee accounts in the names of branches of Pakistani banks operating outside Pakistan requires specific approval of Reserve Bank.

(ii) The Head/Principal Office of each bank should furnish an up-to-date list (in triplicate) of all its offices/branches, which are maintaining rupee accounts of non-resident banks as at the end of December every year giving their code numbers allotted by Reserve Bank. The list should be submitted before 15th January of the following year to the Central Office of Reserve Bank (Central Statistical Division). The offices/branches should be classified according to area of jurisdiction of Reserve Bank Offices within which they are situated.

Funding of Accounts of Non-resident Banks

B.3 (i) 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 bona-fide needs in India.

(ii) Transactions in the accounts should be closely monitored to ensure that overseas banks do not take a speculative view on the rupee. Any such instances should be notified to the Reserve Bank.

NOTE:

Forward purchase or sale of foreign currencies against rupees for funding is prohibited.
Offer of two-way quotes to non-resident banks is also prohibited.

Transfers from other Accounts

B.4 Transfer of funds between the accounts of the same bank or different banks is freely permitted.

Conversion of Rupees into Foreign Currencies

B.5 Balances held in rupee accounts of non-resident banks may be freely converted into foreign currency. All such transactions should be reported in Form A2 and the corresponding debit to the account should be in form A3 under the relevant R Returns.

Responsibilities of Paying and Receiving Banks

B.6 In the case of credit to accounts the paying banker should ensure that all Control requirements are met and are correctly furnished in form A1/A2 as the case may be.

Refund of Rupee Remittances

B.7 Requests for cancellation or refund of inward remittances may be complied with without reference to Reserve Bank after satisfying themselves that the refunds are not being made in cover of transactions of compensatory nature.

Overdrafts/Loans to Overseas Branches/Correspondents

B.8 (i) Banks may permit their overseas branches/ correspondents temporary overdrawals not exceeding Rs.500 lakhs in aggregate, for meeting normal business requirements. This limit applies to the amount outstanding against all overseas branches and correspondents in the books of all the branches of the bank in India. This facility should not be used to postpone funding of accounts. If overdrafts in excess of the above limit are not adjusted within five days a report should be submitted to the Central Office of Reserve Bank (Forex Markets Division) within 15 days from the close of the month, stating the reasons therefor. Such a report is not necessary if arrangements exist for value dating.

(ii) Banks wishing to extend any other credit facility in excess of (i) above to overseas banks should seek prior approval from the Chief General Manager, Reserve Bank of India, Exchange Control Department (Forex Markets Division) Central Office, Mumbai.

Rupee Accounts of Exchange Houses

B.9 Opening of rupee accounts in the names of exchange houses for facilitating private remittances into India requires approval of Reserve Bank. Remittances through exchange houses for financing trade transactions are permitted upto Rs.2,00.000 per transaction.

PART -C

Inter-Bank Foreign Exchange Dealings

General

C.1 The Board of Directors of authorised dealers should frame an appropriate policy and fix suitable limits for various Treasury functions.

Position and Gaps

C.2 The overnight open exchange position (vide Annexure I) and the aggregate gap limits are required to be approved by Reserve Bank.

Inter-bank transactions

C.3 Subject to compliance with the provisions of paragraphs C.1and C.2, authorised dealers may freely undertake foreign exchange transactions as under:

a) With authorised dealers 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 Off-shore Banking Units in Special Economic Zones

(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 .

Note

A: Funding of accounts of Non-resident banks - refer to paragraph B.3

B: Form A2 need not be completed for sales in the interbank market, but all such transactions shall be reported to Reserve Bank in R Returns

Foreign currency accounts

C.4 (i) 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 Top Management. 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 Reserve Bank.

(ii) Banks are free to undertake investments in overseas markets up to the limits approved by their Board of Directors. 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. For the purpose of investments in debt instruments other than the money market instruments of any foreign state, bank's Board may lay down country ratings and country - wise limits separately wherever necessary.

Note: For the purpose of this clause, 'money market instrument' would include any debt instrument whose life to maturity does not exceed one year as on the date of purchase.

(iii) Banks may also invest the undeployed FCNR (B) funds in overseas markets in long-term fixed income securities subject to the condition that maturity of the securities invested in do not exceed the maturity of the underlying FCNR(B) deposits.

(iv) Foreign currency funds representing surpluses in the nostro accounts may be utilised for:

a) making loans to resident constituents for meeting their foreign exchange requirements or for the rupee working capital/capital expenditure needs subject to the prudential/interest-rate norms, credit discipline and credit monitoring guidelines in force.

b) extending credit facilities to Indian wholly owned subsidiaries/ joint ventures abroad in which at least 51% equity is held by a resident company, subject to the guidelines issued by Reserve Bank (Department of Banking Operations & Development).

(v) Banks may write off/transfer to unclaimed balances account, unreconciled debit/credit entries as per instructions issued by Department of Banking Operations and Development, from time to time.

Loans/Overdrafts

C .5 (i) Banks may avail of loans/overdrafts from their Head Office, overseas branches, correspondents up to 25% of their unimpaired Tier-I capital or US$ 10 million or its equivalent, whichever is higher. The funds 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. As an exception to this rule authorised dealers are permitted to use borrowed funds as also foreign currency funds received through swaps for granting foreign currency loans in terms of IECD Circular No 12/04.02.02/2002-03 dated January 31,2003. The aforesaid limit applies to the aggregate amount availed of by all the offices and branches in India from all their branches/correspondents abroad. If drawals in excess of the above limit are not adjusted within five days, a report should be submitted to the Chief General Manager, Reserve Bank of India Exchange Control Department, Forex Markets Division, Amar Building, Fort, Mumbai 400001 within 15 days from the close of the month in which the limit was exceeded. Such a report is not necessary if arrangements exist for value dating.
(ii) Banks may avail of loans in excess of the limits prescribed in sub-paragraph (i) above solely for replenishing their rupee resources in India without prior approval of Reserve Bank. Such rupee funds may be used only for financing the banks' normal business operations and should not be deployed in the call money etc. markets. A report on each borrowing should be immediately forwarded to the Chief General Manager, Reserve Bank of India Exchange Control Department, Forex Markets Division, Amar Building, Fort, Mumbai 400001 whose prior permission will be required for repayment of such loans. Such permission will be given only if the bank has no borrowings outstanding either from Reserve Bank or other bank/financial institution in India and is clear of all money market borrowings for a period of at least four weeks before the repayment.
(iii) Interest on loans/overdrafts may be remitted (net of taxes) without the prior approval of Reserve Bank.

Reports to Reserve Bank
C.6 (i) The Head/Principal Office of each authorised dealer should submit to the Chief General Manager, Exchange Control Department (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai 400 001 daily statements of foreign exchange turnover in Form FTD and Gaps position and cash balances in Form GPB as per Annexure II. These statements should be transmitted online through wide area network (WAN).
(ii) The Head/Principal Office of each authorised dealer should submit a statement in duplicate in form BAL giving details of their holdings of all foreign currencies on fortnightly basis so as to reach the Regional Office of Reserve Bank under whose jurisdiction the Head/Principal Office is situated within seven calendar days from the close of the reporting period to which it relates.
*(*iii) The Head/Principal Office of each authorised dealer should forward a statement of Nostro/Vostro Account balances on a monthly basis in the format given in Annexure III to the Director, Division of International Finance, Department of Economic Analysis and Policy, Reserve Bank of India, Central Office Building, 8th Floor, Fort, Mumbai-400 001. The data may also be transmitted by fax or e-mail at the numbers/addresses given in the format.

(iv) Authorised dealers may consolidate the data on cross currency derivative transactions undertaken by residents in terms of Paragraph A 5 above and submit half-yearly reports to the Chief General Manager, Exchange Control Department, (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai-400 001 as per the format indicated in the Annexure IV.
(v) Authorised dealers may forward details of exposures in foreign exchange as on 1st April every year as per the format indicated in Annexure V to the Chief General Manger, Exchange Control Department, (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai, 400 001.

ANNEXURE I

(See paragraph C.2)

Guidelines for Foreign Exchange Exposure Limits of Authorised Dealers

1. Coverage

For banks incorporated in India, the exposure limits fixed by the Management should be the aggregate for all branches including their overseas branches. For foreign banks, the limits will cover only their branches in India.

2. Capital

Capital refers to Tier I capital as per instructions issued by Reserve Bank of India (Department of Banking Operations and Development).

3. Calculation of the Net Open Position in a Single Currency

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.

a) Net Spot Position

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.

b) Net Forward Position

This represents 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. These transactions, which are recorded as off-balance sheet items in the bank's books, would include:

(i) spot transactions which are not yet settled;

(ii) forward transactions;

(iii)guarantees and similar commitments denominated in foreign currencies which are certain to be called;

(iv)net of amounts to be received/paid in respect of currency futures, and the principal on currency futures/swaps.

c) Options Position

The options position is the "delta-equivalent" spot currency position as reflected in the authorised dealer's options risk management system, and includes any delta hedges in place which have not already been included under 3(a) or 3(b) (i) and (ii).

4. Calculation of the Overall Net Open Position

This involves measurement of risks inherent in a bank's mix of long and short position in different currencies. It has been decided to adopt the "shorthand method" which is accepted internationally for arriving at the overall net open position. Banks may, therefore, calculate the overall net open position as follows:

(i) Calculate the net open position in each currency (paragraph 3 above).

(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.
(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 Reserve Bank.
5. Capital Requirement
As prescribed by Reserve Bank from time to time.

ANNEXURE II

FTD
(see Paragraph C.6 (i)
<u>Statement showing daily turnover of foreign exchange</u>

		Merchant			Inter bank		
		Spot, Cash, Ready, T.T. etc.	Forward	Cancellation of Forwards	Spot	Swap	Forwards
FCY/INR	Purchase from						
	Sales to						
FCY/FCY	Purchase from						
	Sales to						

<u>GPB</u>
<u>Statement showing gaps, position and cash balances</u>

US Dollars Balances (Cash Balance + All Investments)	:	IN USD MILLION
Net Open Exchange Position (Rs.)	:	O/B (+)/O/S (-) IN Rs.CRORE
Of the above FCY/INR	:	IN RS. CRORE
AGL maintained	:	VaR maintained:

US DOLLAR MATURITY MISMATCH IN MILLION

1 month	2 months	3 months	4 months	5 months	6 months	>6 months

Annexure III

[see paragraph C.6 (iii)]
<u>Statement of Nostro/Vostro Balances for the month of.</u>
Name & address of the Authorised Dealer.

Sr.no.	Currency	Net balance in Nostro Account	Net balance in Vostro Account.
1	USD		

2	EUR
3	JPY
4	GBP
5	Rupee
6	Other currencies (in US $ million)

Note: In case the variation in each item above (given at 1 to 5) exceeds 10% in a month, the reason may be given briefly, as a footnote.

The above statement should be addressed to:

The Director
Division of International Finance
Department of Economic Analysis & Policy
Reserve Bank of India,
Central Office Building, 8th Floor,
Mumbai – 400 001.
Phone: 022-2266 3791
Fax: 022-2262 2993, 2266 0792
e.mail: rkpattnaik@rbi.org.in
brijeshp@rbi.org.in

Annexure IV

[see paragraph C.6 (iv)]

Cross- currency derivative transactions - statement for the half-year ended….

Product	No. of transactions	Notional principal amount in USD
Interest rate swaps		
Currency swaps		
Coupon swaps		
Foreign currency option		
Interest rate caps or collars (Purchases)		
Forward rate agreement		
Any other product as permitted by Reserve Bank from time to time		

Annexure V

Information relating to exposures in foreign currency as on 1st April

Name of the corporate:

		Amount in USD million equivalent (1)	Of col.(1) amounts already hedged (2)
i)	Import transactions due within the year	@	£
ii)	Non-trade payments falling due within one year	£	£

iii)	Non-trade payments falling due beyond one year	£	£

Note

Authorised dealers may consolidate the above data for the bank as a whole for individual corporate and forward a report to Chief General Manager, Exchange Control Department, Reserve Bank of India, Central Office, Forex Markets Division, Mumbai-400 001 (copy to Chief General Manager, Department of External Investments and Operations, Reserve Bank of India, Central Office, Data Cell, Mumbai -400 001) before 30th June every year.

@ Calculated on the basis of last three years' average, duly factoring in subsequent major changes, if any.

£ Based on actuals.

Annexure VI

Statement giving details of import / export turnover, overdues etc.

Name of the constituent:

(Amount in USD million

Financial Year (April-March)	Turnover		Percentage of overdue bills to turnover		Existing limit for booking of forward cover based on past performance	
	Export	Import	Export	Import	Export	Import
2002-03						
2001-02						
2000-01						

Annexure VII

Foreign currency- Rupee Options

Authorised dealers are permitted to offer foreign currency – rupee options with effect from July 7, 2003. under the following terms and conditions:

a) This product may be offered by authorised dealers having a minimum CRAR of 9 per cent, on a back-to-back basis.

b) Authorised dealers having adequate internal control, risk monitoring/ management systems, mark to market mechanism and fulfilling the following criteria will be allowed to run an option book after obtaining a one time approval from the Reserve Bank:

i. Continuous profitability for at least three years

ii. Minimum CRAR of 9 per cent

iii. Net NPAs at reasonable levels (not more than 5 per cent of net advances)

iv. Minimum Net worth not less than Rs. 200 crore

c) Initially, authorised dealers can offer only plain vanilla European options.

d) i. Customers can purchase call or put options.

ii. Customers can also enter into packaged products involving cost reduction structures provided the structure does not increase the underlying risk and does not involve customers receiving premium.

iii. Writing of options by customers is not permitted.

e) Authorised dealers shall obtain an undertaking from customers interested in using the product that they have clearly understood the nature of the product and its inherent risks.

f) Authorised dealers may quote the option premium in Rupees or as a percentage of the Rupee/foreign currency notional.

g) 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. In case of unwinding of a transaction prior to maturity, the contract may be cash settled based on the market value of an identical offsetting option.

h) All the conditions applicable for booking, rolling over and cancellation of forward contracts would be applicable to option contracts also. The limit available for booking of forward contracts on past performance basis- i.e. contracts outstanding not to exceed 25 per cent of the average of the previous three years' import/export turnover within a cap of USD 100 mio- would be inclusive of option transactions. Higher limits will be permitted on a case-by-case basis on application to the Reserve Bank as in the case of forward contracts.

i) Only one hedge transaction can be booked against a particular exposure/ part thereof for a given time period.

j) Option contracts cannot be used to hedge contingent or derived exposures (except exposures arising out of submission of tender bids in foreign exchange).

2. Users

a) Customers who have genuine foreign currency exposures in accordance with Schedules I and II of Notification No. FEMA 25/2000-RB dated May 3, 2000 as amended from time to time are eligible to enter into option contracts.

b) Authorised dealers can use the product for the purpose of hedging trading books and balance sheet exposures.

3. Risk Management and Regulatory Issues

a) Authorised dealers wishing to run an option book and act as market makers may apply to the Chief General Manager, Reserve Bank of India, Exchange Control Department, Forex Markets Division, Central Office, Fort, Mumbai-400001 with a copy of the approval of the Competent Authority (Board/Risk Committee/ALCO) and a copy of the detailed memorandum put up in this regard. Authorised dealers who wish to use the product on a back-to-back basis may keep the above Division informed in this regard.

b) Market makers would be allowed to hedge the 'Delta' of their option portfolio by accessing the spot markets. Other 'Greeks' may be hedged by entering into option transactions in the inter-bank market. The 'Delta' of the option contract would form part of the overnight open position. As regards inclusion of option contracts for the purpose of 'AGL', the "delta equivalent" as at the end of each maturity shall be taken into account. . The residual maturity (life) of each outstanding option contracts can be taken as the basis for the purpose of grouping under various maturity buckets. (For definition of the various 'Greeks' relating to option contracts, please refer the report of the RBI Technical Committee on foreign currency-rupee options -- relevant extracts are given in Annexure II).

c) For the present, authorised dealers are expected to manage the option portfolio within the risk management limits already approved by the Reserve Bank.

d) Authorised dealers running an option book are permitted to initiate plain vanilla cross currency option positions to cover risks arising out of market making in foreign currency-rupee options.

e) Banks should put in place necessary systems for marking to market the portfolio on a daily basis. FEDAI will publish daily a matrix of polled implied volatility estimates, which market participants can use for marking to market their portfolio.

4. Reporting

Authorised dealers are required to report to the Reserve Bank on a weekly basis the transactions undertaken as per the format appended .

5. Accounting

The accounting framework for option contracts will be as per FEDAI Circular No.SPL-24/FC-Rupee Options /2003 dated May 29,2003.

6. Documentation

Market participants may follow only ISDA documentation.

7. Capital Requirements

Capital requirements will be as per guidelines issued by our Department of Banking Operations and Development (DBOD) from time to time.

8. Banks should train their staff adequately and put in place necessary risk management systems before they undertake option transactions. They should also take steps to familiarise their constituents with the product.

9. The need for continuance of the product will be reviewed after six months based on the market development.

10. Necessary amendments to the Foreign Exchange Management Regulations, 2000 are being issued separately.

11. Authorised dealers may bring the contents of this circular to the notice of their constituents concerned.

Option Transaction Report for the week ended__________________

Sr. no	Trade date	Client/ C-party Name	Notional	Option Call/Put	Strike	Maturity	Premium	Purpose*

**Mention balance sheet, trading or client related.*