

Introduction of Foreign currency-Rupee Options

**Reserve Bank of India
Exchange Control Department**

Introduction of Foreign currency-Rupee Options

A **draft** circular on " Foreign currency-Rupee Options " is annexed herewith. Authorised Dealers may forward their comments to the Chief General Manager, Exchange Control Department, Forex Markets Division, Reserve Bank of India, Central Office, Mumbai 400 001, by FAX (022- 22611427) or email (arajlakshmi@rbi.org.in) , by 20th March 2002.

**A.Rajalakshmi
Asst. General Manager**

Draft Circular for Comments

**Reserve Bank of India
Exchange Control Department
Central Office
Mumbai-400 001**

A.P.(DIR Series) Circular No.

To,
All Authorised Dealers in Foreign Exchange
Madam / Sirs,

Foreign currency- Rupee Options

As a part of developing the derivative market in India and adding to the spectrum of hedge products available to residents and non-residents for hedging currency exposures, it has been decided to permit foreign currency – rupee options under the following terms and conditions:

1. a) All authorised dealers are permitted to offer this product on a back to back basis. Further those authorised dealers having adequate internal control, risk monitoring / management systems will be allowed to run an option book.
- b) To begin with, authorised dealers will be permitted to offer only plain vanilla European options.
- c) Customers can purchase call or put options. Writing of options by customers is not permitted.
- d) Customers can however enter into packaged products involving cost reduction structures provided -
 - i) the structure reduces the risk
 - ii) the structure does not involve customers receiving premium.

- e) Authorised Dealers may quote the option premium in Rupees or as a percentage of the Rupee notional (on an annualised basis).
- f) Option contracts may be settled either by delivery on spot basis or by net cash settlement in Rupees on spot basis as specified in the contract.
- g) 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 would include option transactions.
- h) Only one hedge transaction may be booked against a particular exposure for a given time period.
- i) Option contracts cannot be used to hedge contingent or derived exposures (except exposures arising out of submission of tender bids in foreign exchange).

2.The Users

- a) Customers who have genuine foreign currency exposures as given in 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 their own Board/Risk Committee/ALCO approval and a copy of the detailed memorandum put up to the Board.
- 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. For the present, authorised dealers are expected to manage the option portfolio within the risk management limits already approved by the Reserve Bank.
- c) 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

Banks are required to report to the Reserve Bank on a weekly basis the transactions undertaken, net open option position and a matrix of the change in delta expected for change in the spot value, as per the formats appended to this circular.

5.Accounting

FEDAI will be advising the banks the detailed accounting framework for option contracts.

6.Documentation

It is recommended that ISDA documentation may be used for recording option contracts.

7. Capital Requirements

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

8. Banks should train their staff adequately and put in place necessary risk management systems before they undertake foreign currency -rupee options. They should also take steps to familiarise their constituents with the product. FEDAI is also being requested to arrange suitable training programmes in this regard.

Option Transaction Report for the week

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

*Mention B/S as the client name along with the counter-party, if the transaction has been done for the balance sheet.

Option positions Report

USD notional Outstanding		Net Portfolio Delta	Net Portfolio Gamma	Net Portfolio Vega	Total Net Open Spot Position
Calls	Puts	USD	USD	USD	USD

Change in Delta-Report

Change in spot	Change in delta expected for the portfolio