

RESERVE BANK OF INDIA
FINANCIAL MARKETS REGULATION DEPARTMENT
1st FLOOR, CENTRAL OFFICE, FORT
MUMBAI 400 001
FMRD.FMD. --- /CGM (TRS) - 2018 dated January __, 2018

**Hedging of Commodity Price Risk and Freight Risk in Overseas Markets
(Reserve Bank) Directions, __**

The Reserve Bank of India having considered it necessary in public interest, in exercise of the powers conferred by clause (h) of sub-section (2) of section 47 of the Foreign Exchange Management Act (FEMA), 1999 (42 of 1999) and of all the powers enabling it in this behalf, hereby issues the Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions, _ dated January __, __ (the Directions).

1. Short Title and commencement

1.1 These directions shall be referred to as the Hedging of Commodity Price Risk and Freight Risk in Overseas Markets (Reserve Bank) Directions, __ and they shall come into force with effect from ____.

2. Definitions:

- i. Hedging – The activity of undertaking a derivative transaction to reduce an identifiable and measurable risk. For the purpose of these directions the relevant risks are commodity price risk and freight risk.
- ii. Eligible entities – Eligible entities refer to resident entities other than Individuals.
- iii. Direct Exposure to Commodity Price Risk – An eligible entity will be said to have direct exposure to commodity price risk if
 - a. It purchases/sells a commodity (in India or abroad) whose price is fixed by reference to an international benchmark ; or
 - b. It purchases/sells a product (in India or abroad) which contains a commodity and the price of the product is linked to the price of the commodity by a defined formula.

- iv. Indirect Exposure to Commodity Price Risk – An eligible entity will be said to have indirect exposure to commodity price risk if it purchases/sells a product (in India or abroad) which contains a commodity and the price of the product is not linked to the price of the commodity by a defined formula.
- v. Exposure to Freight Risk – An eligible entity will be said to have exposure to freight risk if it is engaged in the business of import or export of goods or is engaged in the business of shipping.
- vi. Bank(s) – Bank(s) refer to AD Category – I bank(s).
- vii. Permitted Instruments – Permitted instruments refers to exchange traded futures and options and OTC derivatives.
- viii. Eligible Commodities – Eligible commodities refers to commodities whose price risk may be hedged as indicated below:
 - a. Direct exposures to commodity price risk: All commodities.
 - b. Indirect exposures to commodity price risk: Aluminum, Copper, Lead, Zinc, Nickel, and Tin. The list of eligible commodities, indirect exposure to whose price risk may be hedged overseas, would be reviewed annually.

3. Hedging of Commodity Price Risk: Eligible entities having exposure to commodity price risk for any eligible commodity may hedge such exposure in overseas markets using any of the permitted instruments.

4. Hedging of Freight Risk: Eligible entities having exposure to freight risk may hedge such exposure in overseas markets by using any of the permitted instruments.

5. Other Operational Guidelines:

- i. Banks may permit eligible entities to hedge commodity price risk and freight risk overseas using permitted instruments after satisfying itself that
 - a. The entity has exposure to commodity price risk or freight risk, contracted or anticipated.
 - b. The quantity proposed to be hedged and the tenor of the hedge is in line with the exposure.
 - c. In case of OTC derivatives, that the requirement to undertake such hedges is necessary in terms of the exposure of the entity.

- d. Such hedging is taken up under a Board approved policy and decisions are taken by the competent authority as per the powers delegated by the Board.
 - e. The entity has the necessary risk management policies in place.
 - f. The entity has reasonable understanding of the instruments proposed to be used for hedging.
- ii. OTC contracts shall be booked with entities regulated by the banking / financial / securities regulator of the host country. For this purpose, a list of acceptable jurisdictions shall be specified by FEDAI.
- iii. Structured derivatives may be permitted to eligible entities who are listed on recognized domestic stock exchanges and fully owned subsidiaries thereof or entities whose net worth is higher than INR 200 crores subject to the following conditions:
 - a. There is no net inflow of premium direct or otherwise.
 - b. No leveraged products is used.
 - c. No derivatives involving another derivative as underlying is used.
 - d. No exotic derivative products is used.
- iv. All payments/receipts related to hedging of exposure to commodity price risk and freight risk shall be routed through a special account with the bank for this purpose.
- v. The bank shall keep on its records full details of all hedge transactions and related remittances made by the entity for this purpose.
- vi. The bank shall obtain an annual certificate from the statutory auditors of the entity confirming that the hedge transactions and the margin remittances are in line with the exposure of the entity. The statutory auditor shall also comment on the risk management policy of the entity for hedging exposure to commodity price risk and freight risk and the appropriateness of the methodology to arrive at quantum of these exposures.
- vii. The bank shall undertake immediate corrective action in case of any irregularity or misuse of these directions and report the same to Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India.

6. Banks are permitted to issue Standby Letters of Credit (SBLC) / Guarantees on behalf of their clients in lieu of making a direct remittance of margin money for commodity and freight hedging transactions entered into by their customers.
7. The bank shall submit a quarterly report to the Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India, in the format provided in [Annexure I](#), in such manner as may be directed by Reserve Bank of India.

