Draft Guidelines on Writing of plain vanilla European Call and Put currency options by resident exporters and importers of goods and services

Under the existing regulatory framework, persons resident in India are permitted to buy plain vanilla European call or put options to hedge foreign currency exposures in accordance with Schedule I of Notification No. FEMA/25/RB-2000 dated May 3, 2000 as amended from time to time from any AD Category-I bank who has been accorded onetime approval by the Reserve Bank to run a FCY-INR options book. Writing of options by the users, on a standalone basis, is not permitted. As announced in the First Bi-Monthly Monetary Policy Statement released on April 7, 2015, in order to encourage participation in the Over the Counter (OTC) currency options market and improve its liquidity, it has now been decided to permit resident exporters and importers of goods and services to write (sell) standalone plain vanilla European call or put options only against their actual contracted export or import exposures, i.e. covered call or covered put respectively, to any AD Cat-I bank in India subject to operational guidelines, terms and conditions given below.

1. Participants

a. Market-makers: AD Category-I banks in India
b. Option Writers: Resident exporters and importers of goods and services

2. Product

a. Covered Call: A resident exporter may write (sell) a standalone plain vanilla European call option to any approved AD Category-I bank in India against the cover of his contracted exposure arising out of exports of goods and services from India. The covered call offered to the AD Cat-I bank shall be a combination of an underlying export receivable in foreign currency and a short position in a plain vanilla European call option in the currency of export receivable.
b. Covered Put: A resident importer may write (sell) a standalone plain vanilla European put option to any approved AD Category-I bank in India against the cover

of his contracted exposure arising out of imports of goods and services into India. The covered put offered to the AD Cat-I bank shall be a combination of an underlying import payable in foreign currency and a short position in a plain vanilla European put option in the currency of import payable.

c. Being a combination of an underlying cash instrument i.e. the contractual export receivable or the import payable and a generic derivative product i.e. a plain vanilla European call or put option, covered call and covered put options shall be treated as structured derivative products in terms of the aforementioned Comprehensive Guidelines on Derivatives, as amended from time to time.

3. **Operational guidelines, terms and conditions**

a. All the guidelines contained in the Comprehensive Guidelines on Derivatives issued vide Circular DBOD.No.BP.BC.86/21.04.157/2006-07 dated April 20, 2007 and subsequent amendments thereto would apply, mutatis mutandis, to covered options. The AD Cat-I bank acting as counterparty to the writer (seller) of the option, shall ensure that option writer complies with the **Suitability and Appropriateness (S&A) norms** governing derivative products in general and structured products in particular as per the **Comprehensive Guidelines on Derivatives**, as amended from time to time.

b. AD Category-I banks may enter into covered options with their exporter or importer constituents only after obtaining specific approval in this regard from the competent authority (Board / Risk Committee / ALCO).

c. AD Category I banks may stipulate safeguards, such as, continuous profitability, higher net worth, turnover, etc. depending on the scale of forex operations and risk profile of the option writers. The responsibility of assessing the strength of risk management systems, financial soundness of the option writer shall rest with the concerned AD Cat-I bank.

d. Covered options shall be written only against contracted exposure. In other words, no standalone or naked options may be written against any probable forex exposure.

e. AD Cat-I banks, as buyers of covered options, may maintain a separate covered options portfolio in respect of each such customer showing details of each option contract written by the exporter / importer and the corresponding underlying foreign currency exposure . Banks may obtain necessary supporting documentary evidence at the time of entering into a covered option transaction.

f. Option writers can write covered options with a maximum notional of up to the value of the contracted exposure. If the covered option is written against only a portion of the underlying, the remaining portion of the contracted exposure may be hedged against exchange risk as per the extant guidelines provided there is a clear distinction made between the two activities. It may be noted that the contracted exposure against which a covered option has been written shall be treated as unhedged foreign currency exposure of the concerned exporter / importer, as the case may be, and shall not be eligible for hedging in any manner whatsoever.

g. The covered option can only be written in the currency of the underlying. Writing of covered options in a third currency shall not be permitted.

h. Option writers can write plain vanilla options of a maximum tenor of up to 12 months.

i. The maturity of the covered option should correspond to that of the underlying export receivable or import payable, as the case may be.

j. Covered option contracts shall be settled only by delivery on spot basis. Under no circumstances the option writer may access the forex market to undertake outright purchase or sale of foreign currency to fulfil his delivery obligation under the covered option written by him. Any residual mismatches, however, may be managed through appropriate forex swaps.

k. AD Cat-I bank at the time of entering into a covered option with its constituent may obtain an undertaking to the effect that the option writer has not sold an option against the same underlying to any other AD Cat-I bank or hedged it with any other AD Cat-I bank. The undertaking shall be obtained on the company's letterhead and signed by the Chief Financial Officer (CFO) or the senior most functionary responsible for company's finance and accounts and the Company Secretary (CS). In the absence of a CS, the Chief Executive Officer (CEO) or the Chief Operating Officer (COO) shall co-sign the undertaking along with the CFO.

l. AD Cat-I bank may satisfy itself regarding the existence of contracted exposure at the time of buying the option from the option writer and also during its tenor by evidencing appropriate documentation as necessary. If, anytime during the tenor of the covered option, the underlying against which it was written ceases to exist, the concerned AD Cat-I bank may immediately unwind the option position with an off-setting option with the customer. However, substitution with another underlying contracted exposure may be permitted by the bank on being satisfied with the circumstances.

m. Banks may quote option premium in Rupees or as a per cent of the notional amount in foreign currency or Rupee.

n. Except as mentioned in these guidelines, covered options shall not be undertaken in combination with any other derivative or cash instrument.

o. As provided under Comprehensive Guidelines on Derivatives, as amended from time to time, authorised dealers may maintain cash margin / liquid collateral in respect of covered options sold to them by exporters and importers, if necessary.

p. AD Cat-I banks entering into covered options with their constituents may report the same to CCIL's reporting platform for OTC foreign exchange derivatives in terms of our circular FMD.MSRG.No.75/02.05.002/2012-13 dated March 13, 2013, as amended from time to time.

4. In addition to the above, the **"General Instructions for OTC forex derivative contracts entered by Residents in India"** as laid down under Section II (B) of the A.P. (DIR Series) No. 32 dated December 28, 2010 titled Comprehensive Guidelines on Over the Counter (OTC)

Foreign Exchange Derivatives and Overseas Hedging of Commodity Price and Freight Risks, as amended from time to time, shall be applicable, *mutatis mutandis* to covered options.

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