

[See Part A, Section I, paragraph 5 A (i)]

A. ⁷Hedging of Commodity Price Risk in the International Commodity Exchanges/ Markets

1. AD Category I banks can grant permission to companies to hedge the price risk in respect of any commodity (except gold, platinum and silver) in the international commodity exchanges/ markets.

The Reserve Bank retains the right to withdraw the permission granted to any bank, if considered necessary.

2. Before permitting corporates to undertake hedge transactions, authorized dealer would require them to submit a Board resolution indicating (i) that the Board understands the risks involved in these transactions, (ii) nature of hedge transactions that the corporate would undertake during the ensuing year, and (iii) the company would undertake hedge transaction only where it is exposed to price risk.

3. Before permitting unlisted companies to undertake hedge transactions in respect of price risk on import/ export of commodities, Authorized Dealer would require them to submit a brief description of the hedging strategy proposed, namely:

- description of business activity and nature of risk,
- instruments proposed to be used for hedging,
- the names of the commodity exchanges and brokers through whom the risk is proposed to be hedged and the credit lines proposed to be availed. The name and address of the regulatory authority in the country concerned may also be given,
- size / average tenure of exposure and/or total turnover in a year, together with expected peak positions thereof and the basis of calculation.

⁷ A.P. (Dir Series) Circular No 68 dated January 17, 2012

along with a copy of the Board Risk Management Policy approved by its Management covering;

- risk identification
- risk measurements
- guidelines and procedures to be followed with respect to revaluation and/or monitoring of positions
- names and designations of officials authorised to undertake transactions and limits

4. Authorised Dealers may refuse to undertake any hedge transaction if it has a doubt about the bonafides of the transaction or the corporate is not exposed to price risk. The conditions subject to which ADs would grant permission to hedge and the guidelines for monitoring of the transactions are given below. It is clarified that hedging the price risk on domestic sale/purchase transactions in the international exchanges/markets, even if the domestic price is linked to the international price of the commodity, is not permitted, except certain specified transactions as approved/may be approved by the Reserve Bank. Necessary advice may be given to the customers before they start their hedging activity.

5. AD Banks may submit an annual report to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Central Office, Forex Markets Division, Amar Building, 5th Floor, Mumbai – 400 001 as on March 31 every year, within one month, giving the names of the corporates to whom they have granted permission for commodity hedging and the name of the commodity hedged.

6. Applications from customers to undertake hedge transactions not covered under the delegated authority may continue to be forwarded to the Reserve Bank by the Authorised Dealers Category I, for approval.

Conditions/ Guidelines for undertaking hedging transactions in the international commodity exchanges/ markets

1. The focus of hedge transactions shall be on risk containment. Only off-set hedge is permitted.

2. All standard exchange traded futures and options (purchases only) are permitted. If the risk profile warrants, the corporate/firm may also use OTC contracts. It is also open to the Corporate/firm to use combinations of option strategies involving a simultaneous purchase and sale of options as long as there is no net inflow of premium direct or implied, subject to the guidelines detailed in Annex XVII. Corporates/firms are allowed to cancel an option position with an opposite transaction with the same broker.

3. The corporate/firm should open a Special Account with the Authorised Dealer Category-I bank. All payments/receipts incidental to hedging may be effected by the Authorised Dealer Category-I through this account without further reference to the Reserve Bank.

4. A copy of the Broker's Month-end Report(s), duly confirmed/countersigned by the corporate's Financial Controller should be verified by the bank to ensure that all off-shore positions are/were backed by physical exposures.

5. The periodic statements submitted by Brokers, particularly those furnishing details of transactions booked and contracts closed out and the amount due/payable in settlement should be checked by the corporate/firm. Un-reconciled items should be followed up with the Broker and reconciliation completed within three months.

6. The corporate/firm should not undertake any arbitrage/speculative transactions. The responsibility of monitoring transactions in this regard will be that of the Authorised Dealer Category I.

7. An annual certificate from Statutory Auditors should be submitted by the company/firm to the Authorised Dealer Category I. The certificate should confirm that the prescribed terms and conditions have been complied with and that the corporate/firm's internal controls are satisfactory. These certificates may be kept on record for internal audit/inspection.

B. Hedging of commodity price risk on petroleum & petroleum Products by domestic crude oil refining companies

1. The hedging has to be undertaken only through AD Category I banks, , subject to conditions and guidelines as also given in (a) and (b) of this Annex.

2. While extending the above hedging facilities, AD Category I banks should ensure that the domestic crude oil refining companies hedging their exposures should comply with the following:

- to have Board approved policies which define the overall framework within which derivatives activities are undertaken and the risks contained;
- sanction of the company's Board has been obtained for the specific activity and also for dealing in OTC markets;
- the Board approval must include explicitly the mark-to-market policy, the counterparties permitted for OTC derivatives, etc.; and
- domestic crude oil companies should have put up the list of OTC transactions to the Board on a half yearly basis, which must be evidenced by the AD Category I bank before permitting continuation of hedging facilities under this scheme.

3. The AD Category I banks should also ensure “user appropriateness” and “suitability” of the hedging products used by the customer as laid down in Para 8.3 of 'Comprehensive Guidelines on Derivatives' issued vide our circular DBOD.No.BP.BC. 44 /21.04.157/2011-12 dated November 2, 2011.