Annex VII

[See Part A, Section I, paragraph 2 (iii)]

Foreign currency- Rupee Options

1. AD Category-I banks are permitted to offer foreign currency – Rupee options under the following terms and conditions:

a) This product may be offered by AD Category-I banks having a minimum CRAR of 9 per cent, on a back-to-back basis.

b) AD banks 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) For the present, AD Category-I banks 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. However, zero cost option structures can be allowed.

e) AD Category-I banks 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) AD Category-I banks 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 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) AD Category-I banks can use the product for the purpose of hedging trading books and balance sheet exposures.

3. Risk Management and Regulatory Issues

a) AD Category-I banks wishing to run an option book and act as market makers may apply to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Forex Markets Division, Amar building 5th Floor, 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. AD Category-I banks 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).

c) For the present, AD Category-I banks are expected to manage the option portfolio within the risk management limits already approved by the Reserve Bank.

d) AD Category-I banks 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) AD Category-I 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

A D Category-I banks are required to report to the Reserve Bank on a weekly basis the transactions undertaken as per the formats 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. Training

AD Category-I 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.

Reports to be submitted to the Reserve Bank:

[For the week ended__________________]

I. Option Transaction Report

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

*Mention balance sheet, trading or client related.

II. Option Positions Report

Currency Pair	Notional Outstanding		Net Portfolio Delta	Net Portfolio Gamma	Net Portfolio Vega
	calls	puts			
USD-INR	USD	USD	USD		
EUR-INR	EUR	EUR	EUR		
JPY-INR	JPY	JPY	JPY		

(Similarly for other currency pairs)

Total Net Open Options Position (INR):

The total net open options position can be arrived using the methodology prescribed in A. P. (DIR Series) Circular No. 92 dated April 4, 2003.

III. Change in Portfolio Delta Report

Change in USD-INR delta for a 0.25% change in spot ($-appreciation) in INR terms =

Change in USD-INR delta for a 0.25% change in spot ($-depreciation) in INR terms =

Similarly, Change in delta for a 0.25% change in spot (FCY appreciation & depreciation separately) in INR terms for other currency pairs, such as EUR-INR, JPY-INR etc.

IV. Strike Concentration Report

	Maturity Buckets					
Strike Price	***1 week***	***2 weeks***	***1 month***	***2 months***	***3 months***	***> 3 months***

This report should be prepared for a range of 150 paise around current spot level. Cumulative positions to be given.

All amounts in USD million. When the bank owns an option, the amount should be shown as positive. When the bank has sold an option, the amount should be shown as negative. **All reports may be sent via e-mail by market-makers . Reports may be prepared as of every Friday and sent by the following Monday.**