Risk Management and Inter-Bank Dealings
A.P.(DIR Series) Circular No.19 (January 24, 2002)

RESERVE BANK OF INDIA
EXCHANGE CONTROL DEPARTMENT
CENTRAL OFFICE
MUMBAI 400001

A.P.(DIR Series) Circular No.19

January 24, 2002

To

All Authorised Dealers in Foreign Exchange

Dear Sirs/Madam,

Risk Management and Inter-Bank Dealings

Attention of authorised dealers is invited to the Reserve Bank Notification No.FEMA/25/2000-RB dated May 3, 2000.

2. Directions relating to forward exchange cover and other derivative products, Rupee Accounts of non-resident banks and inter-bank dealings, are contained in the enclosure. These directions supercede the existing instructions, namely, :

(i) Chapter 3 (Part C & D and Annexure II) of ECM,

(ii) Chapter 5 (Part A & B and Annexure) of ECM,

(iii) Instructions contained in A.D.(M.A. Series) Circular No.1 dated January 19, 2000.

3. Detailed guidelines contained in Part B and C of the enclosure are being issued as required under Regulation 6 of the Reserve Bank Notification No.FEMA/5/2000-RB dated May 3, 2000, which permits authorised dealers to keep deposits with his branch, head office or correspondent outside India and also to accept deposit kept by a branch or correspondent outside India of an authorised dealer and hold in its books in India.

4. Authorised dealers may bring the contents of this circular to the notice of their constituents concerned.

5. The directions contained in this circular have been issued under Section 10(4) and Section 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999).

Yours faithfully,

Grace Koshie

Chief General Manager

PART – A

RISK MANAGEMENT

Section I
Facilities for Residents other than authorised dealers:

Forward Exchange Contracts

A.1(i) Authorised dealers may enter into forward contracts with residents in accordance with the provisions contained in paragraph 1 of Schedule I to Reserve Bank Notification No. FEMA25/RB-2000 dated 3rd May 2000.

(ii) While booking contracts for their constituents, authorised dealers should verify suitable documentary evidence, irrespective of the underlying transaction being a current account transaction or a capital account transaction, to ensure that an exposure exists, to the extent of the amount of cover sought. Full particulars of contract should be marked on such documents under proper authentication and copies thereof retained for verification.

A.2 Authorised dealers may also allow importers and exporters to book forward contract on the basis of a declaration of an exposure and based on past performance subject to the conditions prescribed by Reserve Bank of India in this regard.

A.3 A forward contract cancelled with one authorised dealer can be rebooked with another authorised dealer subject to the following conditions:

(a) the switch is warranted by competitive rates on offer, termination of banking relationship with the authorised dealer with whom the contract was originally booked, etc.

(b) the cancellation and rebooking are done simultaneously on the maturity date of the contract

(c) the responsibility of ensuring that the original contract which has been cancelled rests with the authorised dealer who undertakes rebooking of the contract.

Contracts other than Forward contracts

A.4 (i) Authorised dealers in India may enter into contracts other than forward contracts with residents in India in accordance with the provisions contained in paragraph 2 of Schedule I to the Reserve Bank Notification No. FEMA 25/RB-2000 dated 3rd May 2000.

(ii) Authorised dealers should ensure that the Board of Directors of the corporate has drawn up a risk management policy, laid down clear guidelines for concluding the transactions and institutionalize the arrangements for a quarterly review of operations and annual audit of transactions to verify compliance with the regulations. The quarterly review reports and the annual audit reports should be obtained from the concerned corporate by the authorised dealers.

(iii) Authorised dealers may forward a report containing full details of the transactions undertaken by residents in terms of Paragraph 2 of Schedule1 to the Regional Office of the Reserve Bank within whose jurisdiction it is functioning, within a week of its conclusion.

(iv) Foreign currency – rupee swaps between corporates who run long-term foreign currency or rupee exposures may be arranged by authorised dealers subject to the conditions prescribed by the Reserve Bank of India.

NOTE : *Authorised dealers should not allow the swap route to become a surrogate for forward contracts for those who do not qualify for forward cover.*

Other Derivatives – Foreign Currency Options:

A.5 (i) Authorised dealers in India may write cross currency options in accordance with the provisions contained in paragraphs 2&3 of Schedule I to the Reserve Bank Notification No FEMA 25/RB-2000 dated 3rd May 2000.

(ii) Option should be written on a fully covered back-to-back basis. The cover transaction may be undertaken with a bank outside India, or an internationally recognized option exchange or another authorised dealer in India.

(iii) Authorised dealers desirous of writing options, should obtain one time approval, before undertaking the business, from the Chief General Manager, Exchange Control Department, (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai, 400 001.

Hedging of commodity price risk in the International commodity markets

A.6 (i) Residents in India, engaged in import and export trade, may hedge the price risk of commodities in the international commodity exchanges/markets. Applications for commodity hedging may be forwarded to the Reserve Bank through the International Banking Division of an authorised dealer giving the details laid down in Schedule III to the Reserve Bank Notification No. FEMA 25/RB-2000 dated 3rd May 2000. A one-time approval will be given by Reserve Bank along with the guidelines for undertaking this activity.

(ii) Authorised Dealers have to submit a monthly statement to RBI giving the details of the hedging activities undertaken by their clients. They also have to certify that all hedging positions were supported by underlying physical exposures.

Facilities for Foreign Institutional Investors (FIIs)

A.7 (i) Designated branches of authorised dealers maintaining accounts of FIIs provide forward cover to such customers subject to the conditions set down in paragraph 1 of Schedule II to the Reserve Bank Notification No. FEMA 25/RB-2000 dated 3rd May 2000.

(ii) The eligibility for cover may be determined on the basis of the declaration of the FII. A review may be undertaken on the basis of market price movements, fresh inflows, amounts repatriated and other relevant parameters to ensure that the forward cover outstanding is supported by underlying exposure.

(iii) A monthly statement should be furnished to the Chief General Manager, Reserve Bank of India, Exchange Control Department (Forex Markets Division), Central Office, Mumbai-400 001 before the 10th of the succeeding month indicating the name of the FII / fund, the eligible amount of cover and the actual cover taken.

Facilities for Non-resident Indians (NRIs)
And Overseas Corporate Bodies (OCBs)

A.8 Authorised Dealers may enter into forward contracts with NRIs/OCBs as per the guideline set down in paragraph 2 of Schedule II to the Reserve Bank Notification No. FEMA 25/RB-2000 dated 3rd May 2000.

Section II

Facilities for Authorised Dealers
Management of Bank's Assets-Liabilities:
A. 9 Authorised dealers may use the following instruments to hedge their assets-liability portfolio

(i) Interest rate swaps,
(ii) Currency swaps, and
(iii) Forward rate agreements.

Authorised dealers may also purchase call or put options to hedge their cross currency proprietary trading positions.
The use of these instruments is subject to the following conditions:
(a) An appropriate policy in this regard is approved by their top management.

(b) The value and maturity of the hedge should not exceed that of the underlying

(c) No 'stand alone' transactions can be initiated. If a hedge becomes naked in part or full owing to shrinking of the portfolio, it may be allowed to continue till the original maturity and should be marked to market at regular intervals.

(d) The net cash flows arising out of these transactions are booked as income and expenditure and reckoned as exchange position wherever applicable.

Hedging of Gold Prices
A.10 Banks authorised by Reserve Bank to operate the Gold Deposit Scheme may use Exchange-traded and over-the-counter hedging products available overseas to manage the price risk. However, while using products involving options, it may be ensured that there is no net receipt of premium, either direct or implied. Banks, which are allowed to enter into forward Gold contracts in India in terms of the guidelines issued by the Department of Banking Operations and Development (including the positions arising out of inter-bank Gold deals) are also allowed to cover their price risk by hedging abroad in the manner indicated above.

PART -B
Accounts of Non-resident Banks

General

B.1(i) Credit to the account of a non-resident bank is a permitted method of payment to non residents and is, therefore, subject to the regulations applicable to transfers in foreign currency.

(ii) Debit to the account of a non-resident bank is in effect an inward remittance in foreign currency.

(iii) In the case of individual payments of USD 10000 or more, the purpose of remittance as given by the recipient should be reported in the statement annexed to R Return.

(iv) Authorised dealers may issue encashment certificates in accordance with the procedures laid down.

Rupee Accounts of Non-Resident Banks

B..2 (i) Banks may open/close rupee accounts (non-interest bearing) in the names of their overseas branches or correspondents without prior reference to Reserve Bank. Opening of rupee accounts in the names of branches of Pakistani banks operating outside Pakistan requires specific approval of Reserve Bank.

(ii) The Head/Principal Office of each bank should furnish an up-to-date list (in triplicate) of all its offices/branches, which are maintaining rupee accounts of non-resident banks as at the end of December every year giving their code numbers allotted by Reserve Bank. The list should be submitted before 15th January of the following year to the Central Office of Reserve Bank (Central Statistical Division). The offices/branches should be classified according to area of jurisdiction of Reserve Bank Offices within which they are situated.

Form A3
B.3 All debits/credits to the accounts of non-resident banks should be reported in form A3.

Funding of Accounts of Non-resident Banks
B.4 (i) Banks may freely purchase foreign currency from their overseas correspondents/branches at on-going market rates to lay down funds in their accounts for meeting their bona fide needs in India

(ii) Transactions in the accounts should be closely monitored to ensure that overseas banks do not take a speculative view on the rupee. Any such instances should be notified to the Reserve Bank.

NOTE:

A) *Forward purchase or sale of foreign currencies against rupees for funding is prohibited.*

B) *Offer of two-way quotes to non-resident banks is also prohibited.*

Transfers from other Accounts:

B.5 Transfer of funds between the accounts of the same bank or different banks is freely permitted.

Conversion of Rupees into Foreign Currencies

B.6 Balances held in Rupee accounts of non-resident banks may be freely converted into foreign currency. All such transactions should be reported in Form A2 and the corresponding debit to the account should be in form A3 under the relevant R Returns.

Responsibilities of Paying and Receiving Banks

B.7 In the case of credit to accounts the paying banker should ensure that all Control requirements are met and are correctly furnished in form A1/A2 as the case may be. The receiving banker after ensuring that the funds are eligible for credit should submit form A1/A2 under cover of the R Return.

Refund of Rupee Remittances

B.8 Requests for cancellation or refund of inward remittances may be complied with without reference to Reserve Bank after satisfying themselves that the refunds are not being made in cover of transactions of compensatory nature.

Overdrafts/Loans to Overseas Branches/Correspondents

B.9 (i) Banks may permit their overseas branches/ correspondents temporary overdrawals not exceeding Rs.500 lakhs in the aggregate, for meeting normal business requirements. This limit applies to the amount outstanding against all overseas branches and correspondents in the books of all the branches of the bank in India. This facility should not be used to postpone funding of accounts. If overdrafts in excess of the above limit are not adjusted within five days a report should be submitted to the Central Office of Reserve Bank (Forex Markets Division) within 15 days from the close of the month, stating the reasons therefor. Such a report is not necessary if arrangements exist for value dating.

(ii) Banks wishing to extend any other credit facility in excess of (i) above to overseas banks should seek prior approval from the Chief General Manager, Reserve Bank of India, Exchange Control Department (Forex Markets Division) Central Office, Mumbai.

Rupee Accounts of Exchange Houses

B.10 Opening of rupee accounts in the names of exchange houses for facilitating private remittances into India requires approval of Reserve Bank. Remittances through exchange houses for financing trade transactions are permitted upto Rs.2, 00,000 per transaction.

PART -C

Inter-Bank Foreign Exchange Dealings

General

C.1 The Board of Directors of authorised dealers should frame an appropriate policy and fix suitable limits for various Treasury functions.

Position and Gaps

C.2 The overnight open exchange position (vide Annexure I) and the aggregate gap limits are required to be approved by the Reserve Bank.

Inter-bank transactions

C.3 Subject to compliance with the provisions of paragraphs C.1and C.2, authorised dealers may freely undertake foreign exchange transactions as under:

a) With authorised dealers in India:

(i) Buying/Selling/Swapping foreign currency against rupees or another foreign currency

(ii) Placing/Accepting deposits and Borrowing/Lending in foreign currency.

b) With banks overseas:

(i) Buying/Selling/Swapping foreign currency against another foreign currency to cover client transactions or for adjustment of own position

(ii) Initiating trading positions in the overseas markets subject to Reserve Bank approval. Applications in this regard should be made to the Chief General Manager, Exchange Control Department (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai 400001.

NOTE : *A) Funding of accounts of Non-resident banks - Refer to paragraph B.4.*

B) Form A2 need not be completed for sales in the inter-bank market but all such transactions should be reported to Reserve Bank in R Returns.

Foreign currency accounts

C.4 (i) Inflows into foreign currency accounts arise primarily from client-related transactions, swap deals, deposits, borrowings etc. Banks may maintain balances in foreign currencies up to the levels approved by the Top Management. They are free to manage the surplus in these accounts through overnight placement and investments with their overseas branches/correspondents subject to adherence to the gap limits approved by Reserve Bank.

(ii) Banks may invest up to 15% of their unimpaired Tier I capital or US$ 10 million whichever is higher, and the entire amount representing un-deployed foreign currency deposit liabilities in overseas money market instruments and/or debt instruments issued by a foreign state with a residual maturity of less than one year and rated as A-1+/AAA by Standard and Poor or P-1/ Aaa by Moody's or F1+ /AAA by Fitch IBCA. For the purpose of investments in debt instruments other than money market instruments of any foreign state, bank's board may lay down country ratings and country wise limits separately wherever necessary.

NOTE : *For the purpose of this clause, 'money market instrument' would mean any debt instrument whose life to maturity does not exceed one year as on the date of purchase.*

(iii) Foreign currency funds representing deposit liabilities may be utilised for:

a) .making loans to resident constituents for meeting their foreign exchange requirements or for the rupee working capital/capital expenditure needs subject to the prudential/interest-rate norms, credit discipline and credit monitoring guidelines in force.

b) extending credit facilities to Indian wholly owned subsidiaries/ joint ventures abroad in which at least 51% equity is held by a resident company, subject to the guidelines issued by Reserve Bank (Department of Banking Operations & Development).

iv) Banks may write off/transfer to unclaimed balances account unreconciled debit/credit entries as per instructions issued by Department of Banking Operations and Development, from time to time.

Loans/Overdrafts

C .5 (i) Banks may avail of loans/overdrafts from their overseas branches and correspondents up to 15% of their unimpaired Tier-I capital or US$ 10 million or its equivalent, whichever is higher. The funds may be used for purposes other than lending in foreign currencies and repaid without reference to Reserve Bank. The aforesaid limit applies to the aggregate amount availed by all the offices and branches in India from all their branches/correspondents abroad. If drawals in excess of the above limit are not adjusted within five days, a report should be submitted to the Chief General Manager, Reserve Bank of India Exchange Control Department, Forex Markets Division, Amar Building, Fort, Mumbai 400001 within 15 days from the close of the month in which the limit was exceeded. Such a report is not necessary if arrangements exist for value dating.

(ii) Banks may avail of loans in excess of the limits prescribed in sub-paragraph (i) above solely for replenishing their rupee resources in India without prior approval of Reserve Bank. Such rupee funds may be used only for financing the banks' normal business operations and should not be deployed in the call money etc. markets. A report on each borrowing should be immediately forwarded to the Forex Markets Division, in the Central Office of Reserve Bank whose prior permission will be required for repayment of such loans. Such permission will be given only if the bank has no borrowings outstanding either from Reserve Bank or other bank/financial institution in India and is clear of all money market borrowings for a period of at least four weeks before the repayment.

(iii) Interest on loans/overdrafts may be remitted (net of taxes) without the prior approval of Reserve Bank.

Reports to Reserve Bank

C.6 (i) The Head/Principal Office of each authorised dealer should submit to the Chief General Manager, Exchange Control Department (Forex Markets Division), Reserve Bank of India, Central Office, Mumbai 400 001 daily statements of foreign exchange turnover in Form FTD and Gaps position and cash balances in Form GPB as per Annexure II. These statements should be transmitted online through wide area network

(ii) The Head/Principal Office of each authorised dealer should submit a statement in duplicate in form BAL giving details of their holdings of all foreign currencies on fortnightly basis so as to reach the Regional Office of Reserve Bank under whose jurisdiction the Head/Principal Office is situated within seven calendar days from the close of the reporting period to which it relates.

ANNEXURE I

(See paragraph C.2)

Guidelines for Foreign Exchange Exposure Limits of Authorised Dealers

1. **Coverage**

For banks incorporated in India, the exposure limits fixed by the Management should be the aggregate for all branches including their overseas branches. For foreign banks, the limits will cover only their branches in India.

2. **Capital**

Capital refers to Tier I capital as per instructions issued by Reserve Bank of India (Department of Banking Operations and Development).

3. **Calculation of the Net Open Position in a Single Currency**

The open position must first be measured separately for each foreign currency. The open position in a currency is the sum of (a) the net spot position, (b) the net forward position and (c) the net options position.

a) **Net Spot Position**

The net spot position is the difference between foreign currency assets and the liabilities in the balance sheet. This should include all accrued income/expenses.

b) **Net Forward Position**

This represents the net of all amounts to be received less all amounts to be paid in the future as a result of foreign exchange transactions which have been concluded. These transactions which are recorded as off-balance sheet items in the bank's books would include:

i) spot transactions which are not yet settled;
ii) forward transactions;
iii) guarantees and similar commitments denominated in foreign currencies which are certain to be called;
iv) net of amounts to be received/paid in respect of currency futures, and the principal on currency futures/swaps.

c) **Options Position**

The options position is the "delta-equivalent" spot currency position as reflected in the authorised dealer's options risk management system, and includes any delta hedges in place which have not already been included under 3(a) or 3(b) (i) and (ii). For the present this is relevant for foreign branches of Indian banks.

4. **Calculation of the Overall Net Open Position**

This involves measurement of risks inherent in a bank's mix of long and short position in different currencies. It has been decided to adopt the "shorthand method" which is accepted internationally for arriving at the overall net open position. Banks may, therefore, calculate the overall net open position as follows:

i) Calculate the net open position in each currency (paragraph 3 above).
ii) Convert the net position into rupees at the FEDAI indicative spot rates for the day
iii) Arrive at the sum of all the net short positions.
iv) Arrive at the sum of all the net long positions.

Overall net foreign exchange position is the higher of (iii) and (iv). The overall net foreign exchange position arrived at as above must be kept within the limit approved by Reserve Bank.

5. Capital Requirement

As prescribed by Reserve Bank from time to time.

ANNEXURE II

FTD
(See Paragraph C.6)

Statement showing daily turnover of foreign exchange

		Merchant			Inter bank		
		Spot, Cash, Ready, T.T. etc.	Forward	Cancellation of Forwards	Spot	Swap	Forwards
FCY/INR	Purchase from						
	Sales to						
FCY/FCY	Purchase from						
	Sales to						

GPB

(See paragraph C.6)

Statement showing gaps, position and cash balances

US Dollars Balances : IN USD MILLION
(Cash Balance + All Investments)

Net Open Exchange Position (Rs.) : O/B(+)/O/S(-) IN Rs.CRORE

Of the above FCY/INR : IN RS. CRORE

AGL maintained : VaR maintained:

US DOLLAR MATURITY MISMATCH IN MILLION

1 month	2 months	3 months	4 months	5 months	6 months	>6 months