Commodity Hedging by Entities in the Special Economic Zones
A.P.(DIR Series)Circular No.44 (November 12, 2002)

RESERVE BANK OF INDIA
EXCHANGE CONTROL DEPARTMENT
CENTRAL OFFICE
MUMBAI-400 001

A.P.(DIR Series)Circular No.44

November 12, 2002

To

All Authorised Dealers in Foreign Exchange

Madam/Sirs,

Commodity Hedging by Entities in the Special Economic Zones

Attention of authorised dealers is invited to paragraph 6 of Notification No.FEMA25/RB-2000 dated 3rd May, 2000 and paragraph A.6(i) Part A of the enclosure to A.P. DIR(Series) Circular No.19 dated January 24, 2002.

2. The Notification referred to above has since been partially modified vide Notification No.FEMA-66/2002-RB dated 27th July 2002 (copy enclosed) and accordingly, it has been decided to grant general permission to entities in the Special Economic Zones (SEZs) for undertaking hedging transactions in the international commodity exchanges/markets to hedge their commodity price risk on import/export, provided, such transactions are undertaken on "stand-alone" basis. By "stand-alone" it is meant that units in the SEZs would be completely isolated from financial contacts with their parent or subsidiaries in the mainland or within the SEZs as far as their import/export transactions are concerned.

3. Authorised Dealers may bring the contents of this circular to the notice of their concerned constituents in the SEZs and allow such transactions to be undertaken under the terms and conditions set out in the Annexure.

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

Yours faithfully,
Grace Koshie
Chief General Manager

ANNEXURE

[A.P.(DIR Series) Circular No.44
dated November 12, 2002]

Guidelines/Terms & Conditions for undertaking hedging transactions

1. The focus will be on risk containment. Only off-set hedge will be 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 net inflow of premium direct or implied. 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. All payments/receipts incidental to hedging may be effected by the authorised dealer 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. These month-end reports may be kept on record for internal audit/inspection purpose.

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. Unreconciled items should be followed up with the Broker and reconciliation completed within three months.

6. The corporate/firm should not undertake any arbitraging/speculative transactions. The responsibility of monitoring transactions in this regard will be that of the authorised dealer.

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

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Notification No.FEMA.66/2002-RBl

dated 27 July 2002

In exercise of the powers conferred by clause (h) of sub-section (2) of Section 47 of the Foreign Exchange Management Act, 1999 (Act 42 of 1999) and in partial modification of its Notification No.FEMA.25/RB-2000, dated May 3, 2000, the Reserve Bank of India makes the following amendments in the Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, as amended from time to time, namely :

1. (i) These Regulations shall be called the Foreign Exchange Management (Foreign exchange derivative contracts) (Second Amendment) Regulations, 2002.

   (ii) They shall come into force from with effect from their publication in the Official Gazette.

2. In the Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, in paragraph 6, the following proviso shall be added, namely :

> 'Provided that a unit in the Special Economic Zone (SEZ) may, without prior approval of the Reserve Bank, enter into a contract in a commodity exchange or market outside India to hedge the price risk in the commodity on export/import, subject to the condition that such contract is entered into on a "stand-alone" basis.

Explanation : - The term "stand-alone" means that the unit in the SEZ is completely isolated from financial contracts with its parent or subsidiary in the mainland or within the SEZ(s) as far as its import/export transactions are concerned.'

Sd/-
(K.J.Udeshi)
Executive Director