RBI/2005-06/75
A.P. (DIR Series) Circular No. 03 **July 23, 2005**

To

All Banks Authorised to Deal in Foreign Exchange

Madam / Sir,

Risk Management and Inter- bank Dealings - Commodity Hedging

Attention of Authorised Dealer (AD) banks is invited to paragraph 6 of Notification No. FEMA25/RB-2000 dated May 3, 2000, as amended from time to time. At present, Reserve Bank, on case by case basis, permits residents in India to enter into contracts in commodity exchanges or markets outside India to hedge the price risk on import/export of a commodity, subject to certain terms and conditions.

2. It has now been decided to delegate the authority to select commercial bank ADs to grant permission to **companies listed on a recognized stock exchange** to hedge the price risk in respect of any commodity (except gold, silver, petroleum and petroleum products) in the international commodity exchanges/markets. Commercial bank ADs satisfying the minimum norms as given below and interested in extending this facility to their customers may forward the application for approval, to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Central Office, Forex Markets Division, Amar Building, 5^{th} Floor, Mumbai – 400 001.

Minimum norms which are required to be satisfied by the ADs:

i) Continuous profitability for at least three years
ii) Minimum CRAR of 9%
iii) Net NPAs at reasonable level but not more than 4 per cent of net advances
iv) Minimum net worth of Rs 300 crore.

ADs may grant permission to corporates **only after** obtaining approval from the Reserve Bank. Reserve Bank retains the right to withdraw the permission granted to the bank, if considered necessary.

3. 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. 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 in the Annex to this circular. 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. Necessary advice may be given to the customers before they start their hedging activity.

4. Banks which have been granted permission to approve commodity hedging 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.

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

6. Necessary amendments to the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations 2000, are being issued separately.

7 Commercial bank ADs may bring the contents of this circular to the notice of their constituents and customers concerned.

8. The directions contained in this circular have been issued under Section 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions/approvals, if any, required under any other law.

Yours faithfully

(Vinay Baijal)
Chief General Manager

Annex
[A. P. (DIR Series) Circular No. 03 dated July 23, 2005]

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. 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.

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 controls are satisfactory. These certificates may be kept on record for internal audit/inspection.