RESERVE BANK OF INDIA
Foreign Exchange Department
Central Office
Mumbai - 400 001

RBI/2012-13/426
A. P. (DIR Series) Circular No. 86 **March 1, 2013**

To,

All Authorised Dealer Category - I Banks

Madam / Sir,

Risk Management and Inter-Bank Dealings

Attention of Authorized Dealers Category – I (AD Category – I) banks is invited to A.P. (DIR Series) Circular No.92 dated April 4, 2003 issued on Risk Management and Inter-Bank Dealings.

2. As per para C.2 of the above mentioned circular "The overnight open exchange position and the aggregate gap limits are required to be approved by Reserve Bank." Further, Annex I of the said circular provided the detail guidelines for the Foreign Exchange Exposure Limits of the Authorised Dealers.

3. In view of the various developments in the forex markets a group comprising officials of Reserve Bank of India, representatives of select banks and the Foreign Exchange Dealers Association of India (FEDAI) went into the various issues involved in the guidelines relating to the Foreign Exchange Exposure Limits of Authorised Dealers. Based on the recommendations of the group, it has been decided to revise the existing guidelines on calculation of the Foreign Exchange Exposure Limits of the Authorised Dealers. The revised guidelines are provided in the Annex.

4. Further, for the present , it has been decided to withdraw the restrictions placed on open positions limit of the Authorised Dealers involving Rupee as one of the currencies, (on both overnight and intra-day open positions) vide A.P. (Dir Series) Circular No.58 dated 15th December 2011. Consequently, the instructions issued vide A.P. (Dir Series) Circular No.129 dated 21st May 2012 and A.P. (Dir Series) Circular No. 13 dated 31st July 2012 also stand withdrawn.

5. Until further review, the following instructions shall however continue to be effective:

i. The positions in the exchanges (both Futures and Options) cannot be netted/offset by undertaking positions in the OTC market and vice-versa. The positions initiated in the exchanges shall be liquidated/closed in the exchanges only.

ii. The position limit for the trading member AD Category-I bank in the exchanges for trading Currency Futures and Options shall be US$ 100 million or 15 per cent of the Outstanding open interest, whichever is lower.

6. 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) and are without prejudice to permissions /approvals, if any required under any other law.

Yours faithfully,

(Rudra Narayan Kar)

Chief General Manager- in-Charge

Annex

A. Guidelines for Foreign Exchange Exposure Limits of Authorised Dealers Category – I

The Foreign Exchange Exposure Limits of Authorised Dealers would be dual in nature.

i. Net Overnight Open Position Limit (NOOPL) for calculation of capital charge on forex risk
ii. Limit for positions involving Rupee as one of the currencies (NOP-INR) for exchange rate management.

For banks incorporated in India , the exposure limits fixed by the Board should be the aggregate for all branches including their overseas branches and Off-shore Banking Units. For foreign banks, the limits will cover only their branches in India.

i. **Net Overnight Open Position Limit (NOOPL) for calculation of capital charge on forex risk**

NOOPL may be fixed by the boards of the respective banks and communicated to the Reserve Bank immediately. However, such limits should not exceed 25 percent of the total capital (Tier I and Tier II capital) of the bank.

The Net Open position may be calculated as per the method given below:

1. **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 future income/expenses not yet accrued but already fully hedged (at the discretion of the reporting bank);
- **v)** Net of amounts to be received/paid in respect of currency futures, and the principal on currency futures/swaps.

c) Net Options Position

The options position is the "delta-equivalent" spot currency position as reflected in the authorized dealer's options risk management system, and includes any delta hedges in place which have not already been included under 1(a) or 1(b) (i) and (ii) above.

2. **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 1 above).

ii. Calculate the net open position in gold.

iii. Convert the net position in various currencies and gold into Rupees in terms of existing RBI / FEDAI Guidelines. All derivative transactions including forward exchange contracts should be reported on the basis of Present Value (PV) adjustment.

iv. Arrive at the sum of all the net short positions.

v. Arrive at the sum of all the net long positions.

Overall net foreign exchange position is the higher of (iv) or (v). The overall net foreign exchange position arrived at as above must be kept within the limit approved by the bank's Board.

Note: Authorised Dealer banks should report all derivative transactions including forward exchange contracts on the basis of PV adjustment for the purpose of calculation of the net open position. Authorised Dealer banks may select their own yield curve for the purpose of PV adjustments. The banks however should have an internal policy approved by its ALCO regarding the yield curve/(s) to be used and apply it on a consistent basis.

3. **Offshore exposures**

For banks with overseas presence, the offshore exposures should be calculated on a standalone basis as per the above method and should not be netted with onshore exposures. The aggregate limit (on-shore + off-shore) may be termed Net Overnight open Position (NOOP) and will be subjected to capital charge. Accumulated surplus of foreign branches need not be reckoned for calculation of open position. An illustrative example is as follows:

If a bank has, let us say three foreign branches and the three branches have open position as below-

Branch A: + Rs 15 crores

Branch B: + Rs 5 crores

Branch C: - Rs 12 crores

The open position for the overseas branches taken together would be Rs 20 crores.

4. **Capital[1] Requirement**

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

As prescribed by the Reserve Bank from time to time

5. **Other Guidelines**

i. ALCO / Internal Audit Committee of the Authorized Dealers should monitor the utilization of and adherence to the limits.

ii. Authorized Dealers should also have a system in place to demonstrate, whenever required, the various components of the NOOP as prescribed in the guidelines for verification by the Reserve Bank.

iii. Transactions undertaken by Authorized Dealers till the end of business day may be computed for calculation of Foreign Exchange Exposure Limits. The transactions undertaken after the end of business day may be taken into the positions for the next day. The end of day time may be approved by the bank's Board.

ii. **Limit for positions involving Rupee as one of the currencies (NOP-INR) for exchange rate management**

a. NOP-INR may be prescribed to Authorised Dealers at the discretion of the Reserve Bank of India depending on the market conditions.
b. The NOP-INR positions may be calculated by netting off the long & short onshore positions (as arrived at by the short hand method) plus the net INR positions of offshore branches.
c. Positions undertaken by banks in currency futures / options traded in exchanges will not form part of the NOP-INR.

d. As regards option position, any excesses on account of large option Greeks during volatile market closing / revaluations may be treated as technical breaches. However, such breaches are to be monitored by the banks with proper audit trail. Such breaches should also be regularized and ratified by appropriate authorities (ALCO / Internal Audit Committee).

B. Aggregate Gap Limits (AGL)

i. AGL may be fixed by the boards of the respective banks and communicated to the Reserve Bank immediately. However, such limits should not exceed 6 times the total capital (Tier I and Tier II capital) of the bank.

ii. However, Authorised Dealers which have instituted superior measures such as tenor wise PV01 limits and VaR to aggregate foreign exchange gap risks are allowed to fix their own PV01 and VaR limits based on their capital, risk bearing capacity etc. in place of AGL and communicate the same to the Reserve Bank. The procedure and calculation of the limit should be clearly documented as an internal policy and strictly adhered to.

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