भारतीय रिज़र्व बैंक

RESERVE BANK OF INDIA

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RBI/2011-12/382
DBOD.BP.BC.No.76 /21.04.103/2011-12 **February 2, 2012**

All Scheduled Commercial Banks
(excluding RRBs)

Dear Sir,

Second Quarter Review of Monetary Policy 2011-12 –
Unhedged Foreign Currency Exposure of Corporates

Please refer to paragraphs 102 and 103 of the Second Quarter Review of Monetary Policy 2011-12 (extract enclosed) on ‘Monitoring of Unhedged Foreign Currency Exposure of Corporates by Banks’.

2. In terms of our circular Nos. DBOD.BP.BC.37/21.04.048/2001-2002 dated October 27, 2001 and DBOD.BP.BC.51/21.04.103/2003-2004 dated December 5, 2003 on ‘Unhedged Foreign Currency Exposures of Corporates’, banks were advised to monitor and review on a monthly basis, through a suitable reporting system, the unhedged portion of the foreign currency exposures of those corporates whose total foreign currency exposure is relatively large (say, above US$ 25 million or its equivalent). Further, they were also advised to extend foreign currency loans above US $ 10 million (or such lower limits as may be deemed appropriate vis-à-vis the banks’ portfolios of such exposures) only on the basis of a well laid out policy of their Boards with regard to hedging of such foreign currency loans.

3. The above instructions were reiterated vide our circular No. DBOD.BP.BC.96/21.04.103/2008-09 dated December 10, 2008 on ‘Unhedged Foreign Exchange Exposure of Clients – Monitoring by Banks’ and banks were further advised that their Board policy should cover unhedged foreign exchange exposure of all their clients including Small and Medium Enterprises (SMEs). Banks were also advised that for arriving at the aggregate unhedged foreign exchange exposure of clients, their exposure from all sources including foreign currency

borrowings and External Commercial Borrowings should be taken into account and in the case of consortium / multiple banking arrangements, the lead role in monitoring the unhedged foreign exchange exposure of clients, as indicated above, would have to be assumed by the consortium leader / bank having the largest exposure. Banks have also been advised, vide our circular No. DBOD.BP.BC.94/08.12.001/2008-2009 dated December 8, 2008 on ‘Lending under Consortium Arrangement / Multiple Banking Arrangements’, to exchange information among themselves in respect of borrowers enjoying credit facilities from more than one bank, which should, *inter alia*, cover information relating to their derivative transactions and unhedged foreign currency exposures.

4. Recent events relating to derivative trades have shown that excessive risk taking by corporates could lead to severe distress to them and large potential credit loss to their bankers in the event of sharp adverse movements in currencies. In view of the importance of prudent management of foreign exchange risk, it has been decided that banks, while extending fund based and non-fund based credit facilities to corporates, should rigorously evaluate the risks arising out of unhedged foreign currency exposure of the corporates and price them in the credit risk premium. Further, banks may also consider stipulating a limit on unhedged position of corporates on the basis of bank’s Board approved policy.

5. Banks are also advised to adhere to the instructions relating to information sharing among themselves as indicated in our circular DBOD.No.BP.BC.94/08.12.001/2008-2009 dated December 8, 2008 on ‘Lending under Consortium Arrangement / Multiple Banking Arrangements’.

Yours faithfully,

(Deepak Singhal)
Chief General Manager-in-Charge

Extract from Second Quarter Review of Monetary Policy 2011-12 announced on October 25, 2011.

V. Regulatory and Supervisory Measures for Commercial Banks

Monitoring of Unhedged Foreign Currency Exposure of Corporates by Banks

102. Unhedged forex exposure of corporates is a source of risk to corporates and a source of credit risk to financing banks. If the unhedged position is large, it can have serious consequences for the solvency of corporates in the event of large depreciation of the home currency and can result in large credit losses to the financing banks. Considering that a significant part of corporates' foreign currency commitments tended to remain unhedged, banks were mandated in October 2001 to monitor and review on a monthly basis the unhedged portion of the foreign currency exposures of large corporates whose total foreign currency exposure was relatively large (say, above US $25 million or its equivalent). Banks were further advised in December 2003 to put in place a policy that explicitly recognized and took into account risks arising on account of unhedged foreign exchange exposures of their clients. Banks were also advised that foreign currency loans above US $10 million, or such lower limits as may be deemed appropriate *vis-a-vis* the banks' portfolios of such exposures, could be extended by banks only on the basis of a well laid out policy of their Boards with regard to hedging of such foreign currency loans. These instructions to banks were reiterated in December 2008. Further, banks were advised in December 2008 to exchange information among themselves in respect of borrowers enjoying credit facilities from more than one bank, which should, *inter alia*, cover information relating to derivative transactions and unhedged foreign currency exposures of the borrowers.

103. Recent events relating to derivative trades showed that excessive risk taking by corporates could lead to severe distress to them and large potential credit loss to their bankers in the event of sharp adverse movements in currencies. The recent episode of volatility in rupee exchange rate when the rupee depreciated by more than 10 per cent in a short period of 6 weeks has sharply underlined the importance of prudent management of foreign exchange risk. It is, therefore, proposed that:

• while extending fund based and non-fund based credit facilities to corporates, banks should rigorously evaluate the risks arising out of unhedged foreign currency exposure of the corporates and price them in the credit risk premium. Banks may also consider stipulating a limit on unhedged position of corporates on the basis of their Board's approved policy.