

June 03, 2008

To

All Authorised Dealer Category - I Banks

Madam / Sir,

**Risk Management and Inter-Bank Dealings - Commodity Hedging  
Exposures of domestic oil refining and marketing companies**

Attention of Authorised Dealer Category – I (AD Category – I) banks is invited to Regulation 6 of Notification No. FEMA.25/RB-2000 dated May 3, 2000, as amended from time to time, in terms of which residents in India are permitted to enter into a contract in a commodity exchange or market outside India to hedge price risk in a commodity, subject to terms and conditions. Further, in terms of A.P. (DIR Series) Circular No.03 dated July 23, 2005, select commercial bank ADs have been delegated the authority to grant permission to companies listed on a recognized stock exchange to hedge commodity price risk in the international commodity exchanges /markets. Also, in terms of A. P. (DIR Series) Circular No.17, dated November 6, 2007 domestic oil refining and marketing companies were permitted to hedge commodity price risk based on the inventory volumes, subject to conditions.

2. Companies engaged in crude oil refining and marketing have been representing to the Reserve Bank for further liberalization of hedging facilities for petroleum and petro products in view of the volatile prices in the market. With a view to facilitating domestic crude oil refining companies to hedge their commodity price risk exposure dynamically, as announced in the Annual Policy Statement for the Year 2008-09 (para 129), it has been decided to extend the following facilities:

**A. Hedging of domestic purchases of crude oil and sales of petro-products:**

As per the prevailing trade practices, indigenously produced crude oil is purchased at international prices by the refineries. However, hedging of price risk on domestic purchases of crude oil is not permitted. In order to enable domestic crude oil refining companies to hedge their risk exposures, it has been decided to permit them to hedge their commodity price risk on domestic purchase of crude oil and sale of petroleum products on the basis of underlying contracts linked to international prices on overseas exchanges / markets. The hedging will be allowed strictly on the basis of underlying contracts.

**B. Hedging of anticipated imports of crude oil:**

In order to provide greater flexibility, it has been decided to permit domestic crude oil refining companies to hedge their commodity price risk on crude oil imports in overseas exchanges / markets, on the basis of their past performance up to 50 per cent of the volume of actual imports during the previous year or 50 per cent of the average volume of imports during the previous three financial years, whichever is higher. Contracts booked under this facility will have to be regularized by production of supporting import orders during the currency of hedge. An undertaking may be obtained from the companies to this effect.

3. The hedging has to be undertaken only through AD Category – I banks, who have been specifically authorised by Reserve Bank in terms of A. P. (DIR Series) Circular No. 03 dated July 23, 2005, subject to the conditions and guidelines annexed thereto.

4. While extending the above hedging facilities, AD Category – I banks should ensure that the domestic crude oil refining companies hedging their exposures should comply with the following:

- i. to have Board approved policies which define the overall framework within which derivatives activities are undertaken and the risks contained;
- ii. sanction of the company's Board has been obtained for the specific activity and also for dealing in OTC markets;
- iii. the Board approval must include explicitly the mark-to-market policy, the counterparties permitted for OTC derivatives, etc.; and
- iv. domestic crude oil companies should have put up the list of OTC transactions to the Board on a half yearly basis, which must be evidenced by the AD Category – I bank before permitting continuation of hedging facilities under this scheme.

5. The AD Category – I banks should also ensure “*user appropriateness*” and “*suitability*” of the hedging products used by the customer as laid down in Para 8.3 of 'Comprehensive Guidelines on Derivatives' issued vide our circular DBOD No. BP.BC. 86/21.04.157/2006-07 dated April 20, 2007.

6. Applications from domestic crude oil companies to undertake hedge transactions not covered under the delegated authority may continue to be forwarded to Reserve Bank by the AD Category – I banks, for approval, as hitherto.

7. Necessary amendments to Notification No. FEMA.25/RB-2000 dated May 3, 2000 [Foreign exchange Management (Foreign Exchange Derivatives Contracts) Regulations, 2000] are being notified separately.

8. AD Category - I banks may bring the contents of the circular to the notice of their constituents and customers concerned.

9. 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,

**(Salim Gangadharan)**  
Chief General Manager-in-Charge