RBI/2019-20/210  
A.P.(DIR Series) Circular No. 29  
April 7, 2020

To,
Authorised Dealers Category – I

Madam / Sir,

Risk Management and Inter-bank Dealings – Hedging of foreign exchange risk


2. As announced in the Statement on Developmental and Regulatory Policies dated December 5, 2019, the existing facilities for non-residents and residents to hedge their foreign exchange risk on account of transactions permitted under Foreign Exchange Management Act (FEMA), 1999 have been revised. The revised directions are provided at Annex–I to this circular. All previous operational guidelines, terms and conditions in this regard shall stand withdrawn from the date that these directions come into effect.

3. Necessary amendments (Notification No.FEMA.398/RB-2020 dated February 18, 2020) to Foreign Exchange Management (Foreign Exchange Derivatives Contracts) Regulations, 2000 (Notification No.FEMA.25/RB-2000 dated May 3, 2000) (Regulations) have been notified in the Official Gazette vide Gazette Id no. CG-MH-E-06032020-216549 dated March 3, 2020, a copy of which is annexed to this circular. These regulations have been issued under clause (h) of sub-Section (2) of Section 47 of FEMA, 1999 (42 of 1999).
4. The directions shall come into effect from June 1, 2020 and replace the existing directions in Part A - Section I and II and Part D of the Master Direction on Risk Management and Interbank Dealings dated July 5, 2016, as amended from time to time.

5. The following reports prescribed in Part E of the Master Directions on Risk Management and Inter-Bank Dealings dated July 5, 2016, as amended from time to time, shall stand withdrawn from the date that these directions come into effect.

   i. Cross Currency Derivative Transactions (Half yearly) – Annex IV
   iii. Details of Forward cover undertaken by FPI clients (Monthly) – Annex XIII
   iv. Details of Forward Contracts/Options booked and cancelled by SMEs and Resident Individuals, Firms and Companies within the first week of the following month (Quarterly) – Annex XIV
   v. Derivative Transactions undertaken by Non-Resident Importer/Exporter(Quarterly) – Annex XIX

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,

(Dimple Bhandia)
General Manager-in-Charge
1. Definitions

i. Anticipated exposure – An exposure to the exchange rate of INR against a foreign currency on account of current and capital account transactions permissible under FEMA, 1999 or any rules or regulations made thereunder, which are expected to be entered into in future.

ii. Contracted exposure – An exposure to the exchange rate of INR against a foreign currency on account of current and capital account transactions permissible under FEMA, 1999 or any rules or regulations made thereunder, which have already been entered into.

iii. For the purpose of (i) and (ii), the term exposure would also include those arising out of transactions between residents that are denominated in a foreign currency but settled in INR or are linked to a foreign currency or are linked to a benchmark denominated in foreign currency.

iv. Hedging – The activity of undertaking a derivative contract to offset the impact of an anticipated or a contracted exposure.

v. User – Any person as defined under para 2 (u) of FEMA, 1999 whether resident in India or resident outside India.

vi. Financial Sector Regulator means the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), Pension Fund Regulatory and Development Authority (PFRDA) or any other statutory authority empowered to regulate a financial institution under the Indian laws.

vii. A Covered call (put) option means a written option where the writer has a long (short) position in the asset underlying the option.

viii. 'SEBI' shall mean the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992 (15 of 1992).

ix. 'IRDAI' shall mean the Insurance Regulatory and Development Authority of India established under the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999).
x. ‘PFRDA’ shall mean the Pension Fund Regulatory and Development Authority established under the Pension Fund Regulatory and Development Authority Act, 2013 (23 of 2013).

xi. Net worth shall have the same meaning as defined in Section 2(57) of the Companies Act, 2013 (as amended).

xii. Non-deliverable derivative contract (NDDC) means a foreign exchange derivative contract involving the Rupee, entered into with a person resident outside India and which is settled without involving delivery of the Rupee.

xiii. Exchanges shall mean ‘recognised stock exchange’ (excluding stock exchanges set up in International Financial Services Centres (IFSCs)) and shall have the meaning assigned in section 2(f) of the Securities Contracts (Regulations) Act, 1956.

2. Directions for Authorised Dealers
   A. General directions
      i. Authorised Dealers shall classify a user as per the User Classification Framework provided at Annex II to this direction and shall comply with the guidelines applicable in each case.
      ii. Authorised Dealers shall offer derivative contracts to a user as per the user’s classification in para (i) above. While offering a derivative contract involving INR, other than NDDCs, to a user, and during the life of such contracts, Authorised Dealers shall ensure that:
         a. The contract is for the purpose of hedging as defined in these directions.
         b. The notional and tenor of the contract does not exceed the value and tenor of the exposure.
         c. The same exposure has not been hedged using any another derivative contract.
         d. In case the exposure ceases to exist, in full or in part, the user has appropriately adjusted the hedge to ensure adherence to “b” above, unless the original derivative contract is assigned against any other
unhedged exposure. No adjustment to the hedge is required to be made if, in the considered opinion of the Authorised Dealer, the change in exposure is not material.

e. In cases where the value of the exposure falls below the notional of the derivative, the notional should be suitably adjusted unless such divergence has occurred on account of change in market value of the exposure, in which case the user may, at his discretion, continue with the derivative contract till its original maturity.

f. Where the value of the exposure is not ascertainable with certainty, derivative contracts may be booked on the basis of reasonable estimates. Such estimates should be reviewed periodically to ensure compliance with (d) and (e) above.

iii. Authorised Dealers shall allow users to freely cancel and rebook derivative contracts. However, net gains (gains over and above losses if any) on contracts booked to hedge an anticipated exposure shall be passed on to the eligible user only at the time of the cash flow of the anticipated transaction. In case of part delivery, net gains will be transferred on a pro-rata basis.

iv. Authorised Dealers may, in exceptional cases, pass on the net gains on contracts booked to hedge an anticipated exposure whose underlying cash flow has not materialised, provided it is satisfied that the absence of cash flow is on account of factors which are beyond the control of the user. Such instances along with specific justification, shall be kept on record by the Authorised Dealer.

v. All derivative contracts shall be subject to the Suitability and Appropriateness policy prescribed vide circular no. DBOD.No.BP.BC. 86/21.04.157/2006-07 dated April 20, 2007 on Comprehensive Guidelines on Derivatives (as amended from time to time).

vi. Authorised Dealers specifically designated by a user for the purpose of monitoring of transaction on exchanges shall ensure that all positions of the
user in all contracts involving INR on all the exchanges put together, is backed by a contracted exposure to INR.

vii. Authorised Dealers may call for such documents from the eligible users as they deem necessary for complying with the requirements of these directions.

viii. Authorised Dealers, unless permitted by Reserve Bank to run books in contracts not involving INR, shall offer such contracts on a fully covered back-to-back basis.

ix. Existing contracts booked under the provisions of the earlier direction may be continued till the date of their expiry.

x. Banks in India having an Authorised Dealer Category-1 license under FEMA, 1999, and operating International Financial Services Centre (IFSC) Banking Units (IBUs) (as specified in circular no.RBI/2014-15/533.DBR.IBD.BC.14570/23.13.004/2014-15 dated April 1, 2015 (as amended from time to time)), shall be eligible to offer non-deliverable derivative contracts involving the Rupee, or otherwise, to persons not resident in India. Banks can undertake such transactions through their IBUs or through their branches in India or through their foreign branches (in case of foreign banks operating in India, through any branch of the parent bank).

B. Specific Directions

i. Domestic non-retail corporates having an INR liability may, at their discretion, convert it into a foreign currency liability through a currency swap.

ii. For derivative contracts involving INR, Authorised Dealers shall allow a user to book derivative contracts up to USD 10 million equivalent of notional value (outstanding at any point in time) without the need to establish the existence of underlying exposure.

iii. Authorised Dealers may deal with a non-resident user (or its central treasury or its group entity, where applicable) either directly or through the overseas bank of such user (including overseas branches of Authorised Dealer) or
through other overseas entities eligible to deal in derivatives as per local regulations.

iv. In case of a central treasury of a non-resident user, the Authorised Dealer shall ensure that the central treasury is appropriately authorised by the user to deal for and on its behalf.

v. Authorised Dealer shall ensure that in the case of a non-resident user all payables incidental to the hedge are met by the user out of repatriable funds and / or inward remittance through normal banking channels.

3. Directions for Exchanges

i. Users may take positions (long or short), without having to establish existence of underlying exposure, up to a single limit of USD 100 million equivalent across all currency pairs involving INR, put together, and combined across all exchanges.

ii. Exchanges authorised by RBI to offer currency derivatives shall provide facility to users, intending to take position beyond USD 100 million (or equivalent) in contracts involving INR in all exchanges put together, to designate an Authorised Dealer/Custodian.

iii. For users referred to in the previous para, the exchanges shall provide information on day-end open positions as well as intra-day highest position of the user to the designated Authorised Dealer/Custodian.

iv. The onus of complying with the directions shall rest with the user. In case of any contravention, the user shall render itself liable to any action under the Foreign Exchange Management Act (FEMA), 1999.
User Classification Framework

1. User Classification
   i. For the purpose of offering derivative contracts to a user, the Authorised Dealer shall classify the user either as a retail user or as a non-retail user.
   ii. The following users shall be eligible to be classified as non-retail users:
       a. All entities regulated by a financial sector regulator subject to general or special permission of the concerned regulator
       b. Exim Bank, National Bank of Agriculture and Rural Development (NABARD), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI)
       c. Companies with a minimum net worth of Rs 500 crores
       d. Persons resident outside India other than individuals
   iii. Any user who is not eligible to be classified as a non-retail user shall be classified as a retail user.
   iv. Any user who is otherwise eligible to be classified as a non-retail user shall have the option to get classified as a retail user.

2. Directions in case of retail users
   i. Eligible products – Forwards, purchase of call and put options (Only European options), purchase of call and put spreads, swaps.
   ii. All forward contracts with retail clients shall be executed at the ongoing interbank / market rates and shall be time stamped. For all other derivative contracts, the mid-market mark of the derivative shall be disclosed to the client before entering into the contract and the same must be included in the term sheet. Mid-market mark of a derivative is the price of the derivative that is free from profit, credit reserve, hedging, funding, liquidity, or any other costs or adjustments.
   iii. All applicable fees / commissions / service charges etc. related to the contract shall be charged by the authorised dealer separately and shall not be part of the price of the contract.
3. Directions in case of non-retail users
   i. Eligible products – Any derivative contract, including covered options, which the Authorised Dealer can price and value independently and is approved by the board of the Authorised Dealer, provided that the potential loss from the derivative transaction to the user, in any scenario, does not exceed the loss that the user would face if he had left the position unhedged. The responsibility of adhering to this restriction would lie on the Authorised Dealer offering the product to the user.
   ii. All new products must be cleared by the Board (or its equivalent) of the Authorised Dealer before being offered to its customer
18th February 2020

No. FEMA.398/RB-2020

Foreign Exchange Management (Foreign Exchange Derivative Contracts) (First Amendment) Regulations, 2020

In exercise of the powers conferred by clause (h) of sub-section (2) of Section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank hereby makes the following amendments in the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No. FEMA 25/RB-2000 dated May 3, 2000), namely:

1. **Short title & commencement**
   
   i. These Regulations may be called the Foreign Exchange Management (Foreign Exchange Derivative Contracts) (First Amendment) Regulations, 2020.
   
   ii. These regulations shall come into force from the date of their publication in the Official Gazette.

2. **Amendments**

   i. In para 2 (Definitions) of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) the text of the definition of “authorised dealer” at sub para (ii) shall be substituted by the following:

   '>authorised dealer' means a person authorised as such by Reserve Bank under sub-section (1) of section 10 of the Act;

   
   ii. In para 2 (Definitions) of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) the existing definition of ‘Foreign exchange derivative contract’ at sub para (v) shall be substituted by the following:

   “Foreign exchange derivative contract” means a financial contract which derives its value from the change in the exchange rate of two currencies at least one of which is not Indian Rupee or which derives its value from the change in the interest rate of a foreign currency and which is for settlement at a future date, i.e. any date later than the spot settlement date, provided that contracts involving currencies of Nepal and Bhutan shall not qualify under this definition.

   iii. In para 2 (Definitions) of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) the following may be added after the existing definitions:
(xii) ‘Contracted exposure’ refers to currency risk arising on account of current and capital account transactions permissible under the Act or any rules or regulations made thereunder, that have been entered into.

(xiii) ‘Anticipated exposure’ refers to currency risk arising on account of current and capital account transactions permissible under the Act or any rules or regulations made thereunder, that are proposed to be entered into in future.

(xiv) ‘Currency risk’ means the potential for loss on account of movement in exchange rates of Rupee against a foreign currency or on account of movement in exchange rates of one foreign currency against another or on account of movement of interest rate applicable to a foreign currency.

(xv) ‘Hedging’ means the activity of undertaking a foreign exchange derivative transaction to manage currency risk.

(xvi) ‘Exchange traded currency derivatives’ means a standardised foreign exchange derivative contract traded on a recognised stock exchange to buy or sell one currency against another on a specified future date, at a price specified on the date of contract.

iv. In para 2(Definitions) of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) the existing sub- paras (iii), (iv), (va), (vi) (viii),(ix) and (xi) shall stand deleted.

v. In para 4 (Permission to a person resident in India to enter into a Foreign Exchange Derivative contract) of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) the existing text shall be replaced with the following:

“Permission to enter into a foreign exchange derivative contract - A person, whether resident in India or resident outside India, may enter into a foreign exchange derivative contract or exchange traded currency derivative contract in accordance with provisions contained in Schedule I of this regulation.


vii. In sub-para (c) of para 7(Remittance related to a Foreign exchange derivative contract), the reference to Regulation 5 shall stand replaced by Regulation 4.

ix. The existing text under Schedule I of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 (Notification No.FEMA 25/RB-2000 dated May 3, 2000) shall be substituted by the following:

1. A person, whether resident in India or resident outside India, may enter into a foreign exchange derivative contract with an authorised dealer. Contracts involving Rupee subject to the following condition(s):

   i. that such contracts shall be for the purpose of hedging a contracted or anticipated exposure

       Provided that contracts not based on a contracted or anticipated exposure may be undertaken, as may be permitted by the Reserve Bank of India

       Provided further that transactions that involve the Rupee but are settled by delivery of a foreign currency shall be undertaken only by an authorised dealer or a person not resident in India and such other persons as may be permitted by the Reserve Bank of India, in terms of the directions issued in this regard by the Reserve Bank of India.

   ii. that such person shall share the details of the exposure with the authorised dealer when called upon to do so by the authorised dealer.

2. A person may enter into an exchange traded currency derivative contract on an exchange recognised under section 4 of the Securities Contract (Regulation) Act, 1956. Contracts involving Rupee shall be subject to the following condition(s):

   i. that such contracts shall be for the purpose of hedging a contracted exposure as defined in these regulations.

   ii. that such person shall designate an Authorised Dealer in India for monitoring of their positions taken beyond such position limits as may be prescribed by the Reserve Bank of India to an exchange.

   iii. that such person shall share the details of the contracted exposure with the Authorised Dealer when called upon to do so by the dealer.


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(Dimple Bhandia)
General Manager (Officer-in-Charge)
The principal regulations were published in the Gazette of Government of India-Extraordinary-Part-II, Section 3, Sub-Section (i) vide G.S.R.411(E) dated May 8, 2000 and subsequently amended vide–

G.S.R.756(E) dated 28.09.2000,
G.S.R.264(E) dated 09.04.2002,
G.S.R.579(E) dated 19.08.2002,
G.S.R.222(E) dated 18.03.2003,
G.S.R.532(E) dated 09.07.2003,
G.S.R.880(E) dated 11.11.2003,
G.S.R.881(E) dated 11.11.2003,
G.S.R.750(E) dated 28.12.2005,
G.S.R.222(E) dated 19.04.2006,
G.S.R.223(E) dated 19.04.2006,
G.S.R.760(E) dated 07.12.2007,
G.S.R.577(E) dated 05.08.2008,
G.S.R.440(E) dated 23.06.2009,
G.S.R.895(E) dated 14.12.2009,
G.S.R.635(E) dated 27.07.2010,
G.S.R.608(E) dated 03.08.2012,
G.S.R.799(E) dated 30.10.2012,
G.S.R.330(E) dated 23.05.2013,
G.S.R.374(E) dated 02.06.2014,
G.S.R.365(E) dated 01.06.2016
G.S.R.260(E) dated 17.03.2017 and
G.S.R.1324(E) dated 24.10.2017

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