Salient points from the guidelines (effective starting 1st February 2011) released on 28th December 2010 on OTC FX derivatives are as follows

For complete details of the guidelines, please refer to
http://rbidocs.rbi.org.in/rdocs/notification/PDFs/APR32281210.pdf

Hedges using contracted exposures

- Lead time for submission of original documents for underlying changed to 15days from 5 days in previous draft
- Full particulars of the underlying contracts e to be marked on the original documents for authentication and retained for verification
- However, in cases where the submission of original documents is not possible, a copy of the original documents, duly certified by an authorized official of the user, to be obtained.
- In either of the cases, before offering the contract, the banks to obtain an undertaking from the customer regarding validity of underlying and also quarterly certificates from the statutory auditor
- Details of the underlying have to be recorded at the time of booking the contract; however a maximum period of 15 days allocated for production of the documents (original or certified copy as the case maybe)
- If the documents are not submitted by the customer within 15 days, the contract may be cancelled, and the exchange gain, if any, cannot be passed on to the customer.
- In the event of non-submission of the documents by the customer within 15 days on more than three occasions in a financial year, booking of permissible derivative contracts in future can be allowed only against production of the underlying documents, at the time of booking the contract

Hedges using past performance limits

- Probable exposure based on past performance can be hedged only in respect of trades in merchandise goods as well as services
- Any contract booked without producing documentary evidence will be marked off against the PP limit. Such contracts once cancelled, are not eligible to be rebooked. Rollovers are also not permitted
- The past performance limits once utilized cannot to be reinstated either on cancellation or on maturity of the contracts
- Corporates to give an undertaking that supporting documentary evidence will be produced before the maturity of all the contracts booked
- Importers and exporters to furnish a quarterly declaration to the banks, duly certified by the Statutory Auditor, regarding amounts booked with other banks under this facility
- Banks to arrive at the past performance limits at the beginning of every financial year. The drawing up of the audited figures (previous year) may require some time at the commencement of the financial year. However, if the statements are not submitted within three months from the last date of the financial year, the facility cannot not be provided until submission of the audited figures.

Cost Reduction Structures

- Cost reduction structures have been clearly defined as those structures constructed using option strategies of simultaneous buy and sell of plain vanilla European options, provided there is no net receipt of premium. Thus the cost reduction structures would include risk reversals, seagulls, 1:2 ratio forward, capped forward
- Leveraged structures, digital options, barrier options, range accruals and any other exotic products are not permitted – Thus, a knock in , knock out structures based on crosses such as EURUSD are now not allowed
- In case the underlying is a trade transaction, the tenor of the structure cannot exceed two years
- Writing of options by corporates, on a standalone basis, is not permitted
- For the users of these structures there are following restrictions:
    - Listed companies or unlisted companies with a minimum net worth of Rs. 100 crore. Subsidiaries or affiliates of listed companies which follow AS 30/32, having common treasuries and consolidate the accounts with parent companies are exempted from the minimum net worth criteria)
    - Adoption of Accounting Standards 30 and 32. Companies which are not complying fully with AS 30 and 32 should follow the accounting treatment and disclosure standards on derivative contracts, as envisaged under AS 30/
    - Corporate to have a risk management policy and a specific clause in the policy to allow using the type/s of cost reduction structures
    - For using cost reduction structures under past performance as underlying (rather than actual contracted exposure or ECBs), a corporate needs to have a minimum net worth of Rs 200 crores and an annual export and import turnover exceeding Rs 1000 crores

Other Important Points

- FCY/INR swaps, undertaken to move from a rupee liability to a foreign currency liability, is possible under following norms:
    - Corporate to follow prudential requirements, such as risk management systems and natural hedges or economic exposures.
    - In the absence of natural hedges or economic exposures, the INR-foreign currency swap (to move from rupee liability to a foreign currency liability) is restricted to listed companies or unlisted companies with a minimum net worth of Rs 200 crore
- Embedded cross currency option in case of foreign currency-Rupee swaps allowed. For example, an INR to JPY swap can have a USD/JPY option for protection
- While for hedges, the choice of currency of hedge and tenor, are left to the customer, however, where the currency of hedge is different from the currency of the underlying exposure, the risk management policy of the corporate, approved by the Board of the Directors, should permit such type of hedging