

**GOVERNMENT OF INDIA
FINANCE
LOK SABHA**

UNSTARRED QUESTION NO:2059
ANSWERED ON:12.12.2008
DERIVATIVE TRANSACTIONS
Mahtab Shri Bhartruhari

Will the Minister of FINANCE be pleased to state:

- (a) whether certain banks flouting Reserve Bank of India`s guidelines have indulged in foreign exchange derivative transactions; and
(b) if so, the steps taken by the Government in this regard?

Answer

MINISTER OF STATE IN THE MINISTRY OF FINANCE (SHRI PAWAN KUMAR BANSAL)

(a) & (b) : In the wake of media reports that appeared in newspapers in 2007 about the losses suffered by some customers of the banks due to derivative transactions, the Reserve Bank of India (RBI) carried out special scrutinies of a few banks (HDFC Bank, Kotak Mahindra Bank, ICICI Bank, Citibank, State Bank of India and Yes Bank) and extensive coverage of the derivatives portfolio during Annual Financial Inspection (AFI) of banks which were active in derivative transactions. RBI also held discussions with the Chief Executives of 22 banks that were seen to be active in the derivative business. The discussions were focused on the derivative policies of the banks, their compliance with the FEMA Regulations and the RBI guidelines, systems in place in the banks for assessing the suitability and appropriateness of derivative products vis-a-vis client sophistication, exposures to users including the SMEs, their Marked-to-Market (MTM) positions, details of court cases, if any, customer defaults, and the systemic impact of these transactions, etc.

Based on the information gathered during the course of discussions and findings during the special scrutinies of the select banks and extensive coverage of the derivatives portfolio during AFIs, RBI observed that though the banks were expected, under the current FEMA regulations to ensure that the Board of Directors of the bank customers had drawn up risk management policies, laid down clear guidelines for concluding the transactions with banks, provided for institutionalised arrangements for periodical review of operations, ensured annual audit of transactions to verify compliance with the regulations, and to obtain periodical review reports and annual audit reports from the concerned users. However, the banks reported that most of the clients refused to provide such policy documents to the banks citing reasons of confidentiality. Consequently, the banks took a declaration from the users that such a risk management policy was in place in their organizations to comply with the requirement.

Further, RBI also observed that on a number of occasions, the clients had either not disclosed or misrepresented to the banks the derivative limits enjoyed by them under this facility with other banks and had thus, obtained from all banks, in aggregate, far higher limits than would be permissible under the regulations. These clients had also used the same underlying to book derivative deals with a number of banks by giving, apparently, false declarations. On the basis of its observations, RBI initiated various steps including undertaking a review of the prudential framework prescribed for the off-balance sheet exposures of the banks. As a result of the review, RBI has strengthened the prudential norms for the banks` off-balance sheet exposures.