GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:5690
ANSWERED ON:30.04.2010
FOREIGN EXCHANGE DERIVATIVE VIOLATION
Naik Shri Shripad Yesso

Will the Minister of FINANCE be pleased to state:

(a) whether the Government propose to take action against some banks in Foreign Exchange Derivative Contracts case;

(b) if so, the complete details thereof and the details of such indigenous and foreign banks;

(c) whether there is a likelihood of several companies going bankrupt owing to forward contract including hedging with these banks; and

(d) if so, the details of the action being taken by the Government in this regard?

Answer

MINISTER OF THE STATE IN THE MINISTRY OF FINANCE (SHRI NAMO NARAIN MEENA)

(a) & (b): The Reserve Bank of India (RBI) has constituted an Inter Departmental Group (IDG) during October 2008 to review the derivative transactions of certain banks, which are active in derivative business, for assessing the systemic issues. These banks included a few Indian banks. RBI has come to the conclusion that this is not a systemic issue. Deviations from Foreign Exchange Management Act (FEMA) provisions/Regulatory guidelines were observed in the Annual Financial Inspection (AFI) 2007, AFI 20Q8 and scrutiny reports of these banks. RBI is in the process of calling explanation from the banks, where violations were observed during the course of inspection.

(c) & (d): The Marked-to-Market (MTM) positions show only the present value of the transactions. As most of the derivative contracts have been executed for long maturities, the MTM profile of such contracts would undergo changes over the period of the contract till the maturity of the contracts. Further, in arriving at the figure of MTM loss to the banks` customers, the gains wherever accrued to them on their underlying exposures should be reckoned to arrive at the actual MTM losses to the customers. Thus, the losses or gains on account of forex derivative contracts have to be seen holistically in conjunction with the gains and losses on the underlying exposure to get a true and fair picture of the MTM positions. Hence, mere MTM positions may not reflect the correct position of the losses/gains of the users.

In the light of the developments in the domestic and international financial markets, the existing guidelines on Over the Counter (OTC) forex derivatives were reviewed by RBI. The draft guidelines on OTC foreign exchange derivatives were placed on RBI`s website on November 12, 2009 for feedback. The feedback received from various sources, viz. banks, corporates, individuals and others, has been evaluated in consultation with the Technical Advisory Committee on Money, Foreign Exchange and Government Securities Markets.