GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:2088
ANSWERED ON:06.08.2010
FOREIGN EXCHANGE DERIVATIVE
Shekhar Shri Neeraj

Will the Minister of FINANCE be pleased to state:

(a) the value of foreign exchange derivatives made by the exporters and importers during each of the last three years;

(b) the existing limit set by the Reserve Bank of India (RBI) in this regard;

(c) whether any cases of violation / exceeding of such limit have come up during the same period;

(d) if so, the details thereof and action taken in e3Ch such case;

(e) the details of losses suffered, if any, by the importers and exporters during the same period; and

(f) the reaction of the Government thereto?

Answer

The Minister of State in the Ministry of Finance (SHRI NAMO NARAIN MEENA)

(a): Reserve Bank of India (RBI) has informed that it does not collect specific data regarding the value of foreign exchange derivatives made by the exporters and importers. However, RBI has furnished details of Notional Principal amount of Foreign Exchange Derivatives and Credit Equivalent value of Foreign Exchange Derivatives outstanding from all Scheduled Commerciaf Banks(SCBs), as detailed below:

(In Rs. crore)

Value Name	Outstanding of all Scheduled Commercial Banks as at end of		
	31-03-2008	31-03-2009	31-03-2010
Notional Principal amount of Foreign Exchange Derivatives#	56,10,136	51,50,583	37,81,905
Credit Equivalent value of Foreign Exchange Derivatives#	1,50,304	2,83,286	1,45,039

includes forward contracts, futures, currency options and others
Source: Off-site returns, audited (RBI)

(b): Generally, the foreign exchange derivative contracts are expected to be entered into by banks based on the forex exposures (risk) of the client. As per Foreign Exchange Management Act (FEMA) Regulations, the existence of an underlying foreign exchange exposure is a pre- requisite for undertaking any foreign exchange derivative transaction. The underlying exposure, in fact, sets up the limit for entering into foreign exchange derivatives by exporters and importers AD Category-! banks are expected to verify the underlying exposure before entering into derivative transactions The customers can, thus, enter into forex derivatives based on the following:

Actual Underlying: The exchange rate risk arising from the actual underlying can be hedged in respect of transactions for which sale and /cr purchase of foreign exchange is permitted under the Foreign Exchange Management Act, 1999.

Economic exposure: The exchange rate risk emanating from the transactions denominated in or indexed to a foreign currency but settled in fNR is also permitted to be hedged.

Potential exposures: Such exposures are permitted to be hedged based on the past performance of the exporters and importers,

pending receipt of actual documentary evidence of the underlying exposure, up to the average of the previous three financial years` (April to March) actual import/export turnover or the previous year`s actual import/export turnover, whichever is higher, subject to conditions.

(c) & (d): RBI has not observed any such violations by SCBs.

(e) & (f): On the representations received from some Smsii & Medium Enterprise (SME) exporters on the issue of losses suffered, RBI has observed that the term `losses` would mean losses occurring due to derivative transactions, from the point of view of customers. It has also stated that where a customer uses a derivative contract only to hedge a genuine underlying exposure and not take a view on prospective market movements, a Marked-to-Market(MTM) value agahst the customer will not put him to any actual loss. However, if the customer has entered into a derivative contract without adequate underlying exposure, he has essentially taken a financial bet to the extent of absence of underlying and may suffer a loss if market rates move adversely from his point of view. It would, therefore, .not be feasible to determine, for the purposes of aggregation, the `actual losses` suffered by customers, as this will involve looking into each individual transaction. Further, these losses need to be considered net of the profits made by the same customers when markets moved in their favour.