GOVERNMENT OF INDIA
FINANCE
LOK SABHA

UNSTARRED QUESTION NO:3858
ANSWERED ON:16.12.2011
DERIVATIVES TRADE
Singh Shri Yashvir

Will the Minister of FINANCE be pleased to state:

(a) whether banks have been permitted to sell forex derivative products with a bet against a bet;

(b) if so, the details thereof;

(c) whether such products come under the official definition of `Hedging` as laid down by the Reserve Bank of India (RBI);

(d) if so, the details thereof alongwith the official definition of hedging;

(e) whether banks are permitted by RBI to sell long term Hedging contracts to the exporters against the strengthening of US dollar against rupee; and

(f) if so, the details thereof and if not, the reasons therefor?

Answer

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

(a) & (b): As per Reserve Bank of India (RBI) Comprehensive Guidelines on Derivatives dated 20.04.2007,`Market-makers may undertake a transaction in any derivative structured product (a combination of permitted cash and generic derivative instruments) as long as it is a combination of two or more of the generic instruments permitted by RBI and does not contain any derivatives as underlying`. Hence, while two derivative products can be used together in a structure, a derivative built upon a derivative cannot be undertaken. Persons resident in India are permitted to enter into foreign exchange derivative contracts with Authorised Dealer (AD) banks to hedge an underlying foreign exchange exposure in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Foreign Exchange Management Act, 1999.

(c) & (d): `Hedging` has not been officially defined by RBI. The term is used in genera! sense of the word to mean, to reduce / offset an already existing risk (forex risk in the current context), generally by undertaking a contrary position to reduce the downside risk.

(e) & (f): As per RBI guidelines, Authorised Dealer banks can offer permitted foreign exchange derivative contracts to residents for hedging an underlying exposure permitted under FEMA, 1999. Generally, for hedging an exposure to foreign exchange risk, an opposite position is taken with the help of derivatives to reduce the downside risk. However, in case of cost reduction structures involving two or more parts, while structure as a whole could be hedging the exposure to risk, the same may not be true if viewed for individual parts.