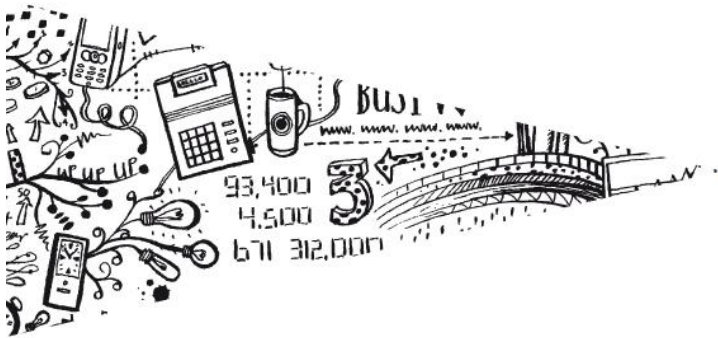


25 July 2011

EY Regulatory Alert

Hedging facilities for non-resident importers/ exporters



Background

The provisions under the Foreign Exchange Management Act (FEMA), 1999 permitted Foreign Institutional Investors and Non resident Indian to hedge their currency exposure in India, if Indian Rupee (INR) is one of the currency.

The Reserve Bank of India (RBI) had proposed in the Annual Policy Statement 2011-2012 to allow non-resident importers and exporters, in respect of exports and imports invoiced in INR, to hedge their currency risk in India.

Accordingly, the RBI, vide A. P. (DIR Series) Circular no. 3 dated 21 July 2011, in consultation with the Foreign Exchange Dealers Association of India and market participants, has liberalised the Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000 (Derivative Regulations) to enable non-resident importers and exporters to hedge their currency risk, in respect of exports from and imports to India, invoiced in INR, with Authorised Dealer Category-I banks (AD banks) in India.

Key Conditions

AD banks can opt for either Model I or Model II as given below and report the same as prescribed:

Model I

Non-resident exporter/ importer dealing through their overseas bank (including overseas branches of AD banks in India)

- ▶ Non-resident exporter/ importer to approach his overseas bank with appropriate documents with a request for hedging their INR exposure arising out of a confirmed import or export order invoiced in INR.
 - ▶ The overseas bank in turn to approach its correspondent in India (i.e. the AD bank in India) for a price to hedge the exposure of its customer (i.e. exporter/ importer) along with documentation furnished by the customer that will enable the AD bank in India to satisfy itself that there is an underlying trade transaction (scanned copies would be acceptable). The following undertakings also need to be taken from the customer:
 - That the same underlying exposure has not been hedged with any other AD bank(s) in India.
 - The customer will cancel the hedge contract immediately, if the underlying exposure is cancelled.
 - ▶ Know Your Customer (KYC) certification on the end client may also be taken as a one time document from the overseas bank by the AD bank in India.
- ▶ The AD bank in India based on documents received from the overseas correspondent should satisfy itself about the existence of the underlying trade transaction and offer a forward price (no two-way quotes should be given) to the overseas bank who, in turn, will offer the same to its customer. The AD bank, therefore, will 'not be' dealing directly with the overseas exporter/ importer.
 - ▶ The amount and tenor of the hedge should not exceed that of the underlying transaction and should be in consonance with the existing regulations regarding tenor of payment/ realisation of the proceeds.
 - ▶ On due date, settlement is to be done through the correspondent bank's Vostro or the AD bank's Nostro accounts.
 - ▶ The contracts, once cancelled, cannot be rebooked.
 - ▶ The contracts can be rolled over on or before maturity, subject to maturity of the underlying exposure.
 - ▶ On cancellation of the contracts, gains may be passed on to the customer, subject to the customer providing a declaration that he is not going to rebook the contract or that the contract has been cancelled on account of cancellation of the underlying exposure.

- ▶ In case the underlying trade transaction is extended, rollover can be permitted once based on the extension of the underlying trade transaction for which suitable documentation is to be provided by the overseas bank and the same procedure followed as in case of the original contract.

Model II

Non-resident exporter/ importer dealing directly with the AD bank in India

- ▶ The overseas exporter/ importer to approach the AD bank in India with a request for forward cover in respect of underlying transaction for which he furnishes appropriate documentation (scanned copies would be acceptable), on a pre-deal basis to enable the AD bank in India to satisfy itself that there is an underlying trade transaction, and details of his overseas banker, address etc. The following undertakings also need to be taken from the customer:
 - That the same underlying exposure has not been hedged with any other AD bank(s) in India.
 - The customer will cancel the hedge contract immediately, if the underlying exposure is cancelled.
- ▶ The AD bank may obtain KYC/ Anti- Money Laundering (AML) certification in the format

prescribed by the RBI. The format can be obtained through the overseas correspondent/ bank through SWIFT authenticated message. In case the AD bank has a presence outside India, the AD may take care of the KYC/ AML certification, through its bank's offshore branch.

- ▶ AD banks should evolve appropriate arrangements to mitigate credit risk. Credit limits can be granted based on the credit analysis done by self/ the overseas branch.
- ▶ The amount and tenor of the hedge should not exceed that of the underlying transaction and should be in consonance with the extant regulations regarding tenor of payment/ realisation of the proceeds.
- ▶ On due date, settlement is to be done through the correspondent bank's Vostro or the AD bank's Nostro accounts. AD banks in India may release funds to the beneficiaries only after sighting funds in Nostro/ Vostro accounts.
- ▶ The contracts, once cancelled, cannot be rebooked.
- ▶ The contracts can be rolled over on or before maturity, subject to maturity of the underlying exposure.
- ▶ On cancellation of the contracts, gains may be passed on to the customer, subject to the

customer providing a declaration that he is not going to rebook the contract or that the contract has been cancelled on account of cancellation of the underlying exposure.

- ▶ In case the underlying trade transaction is extended, rollover can be permitted once based on the extension of the underlying trade transaction for which suitable documentation is to be provided by the AD Bank and the same procedure followed as in case of the original contract.

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