

RBI/2022-2023/94

A. P. (DIR Series) Circular No. 20

December 12, 2022

All Authorised Dealer Category – I Banks

Madam / Sir,

**Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022**

Attention of Authorised Dealer Category - I (AD Cat-I) banks is invited to Regulation 6 and 6A of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000 ([Notification No. FEMA. 25/RB-2000 dated May 3, 2000](#)), as amended from time to time, issued under clause (h) of sub-section (2) of Section 47 of Foreign Exchange Management Act, 1999 (Act 42 of 1999) as amended from time to time.

2. Within the contours of the Regulations, the Reserve Bank issues directions to Authorised Persons under Section 11 of the Foreign Exchange Management Act, 1999 (Act 42 of 1999). These Directions lay down the modalities for the AD Cat-I banks for facilitating hedging of commodity price risk and freight risk in overseas markets by their customers / constituents.

3. The Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022 are [enclosed](#) herewith. AD Cat-I banks may bring the contents of these Directions to the notice of their customers / constituents concerned.

4. The directions contained in this circular have been issued under Sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and are without prejudice to permissions/ approvals, if any, required under any other law.

Yours faithfully,

(Dimple Bhandia)  
Chief General Manager

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हिन्दी आसान है, इसका प्रयोग बढ़ाइए



## **FINANCIAL MARKETS REGULATION DEPARTMENT**

**A. P. (DIR Series) Circular No. 21 dated December 12, 2022**

### **Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022**

The Reserve Bank of India, in exercise of the powers conferred under Sections 10(4) and 11(1) of the Foreign Exchange Management Act (FEMA), 1999 (42 of 1999), hereby issues the following Directions.

#### **1. Short title and commencement**

- (i) These Directions shall be called the Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022.
- (ii) These Directions shall come into force on December 12, 2022.

#### **2. Definitions**

- (i) Hedging – The activity of undertaking a derivative transaction to reduce an identifiable and measurable risk. For the purpose of these directions, the relevant risks are commodity price risk and freight risk.
- (ii) Eligible entities – Eligible entities refers to residents other than Individuals.
- (iii) Direct Exposure to Commodity Price Risk – An eligible entity will be said to have direct exposure to commodity price risk if
  - (a) It purchases/sells a commodity (in India or abroad) whose price is fixed by reference to an international benchmark; or
  - (b) It purchases/sells a product (in India or abroad) which contains a commodity and the price of the product is linked to an international benchmark of the commodity.
- (iv) Indirect Exposure to Commodity Price Risk – An eligible entity will be said to have indirect exposure to commodity price risk if it purchases/sells a product (in India or abroad) which contains the commodity and the price of the product is not linked to an international benchmark of the commodity.
- (v) Exposure to Freight Risk – An eligible entity will be said to have exposure to freight risk if it is engaged in the business of refining oil or is engaged in the business of shipping.
- (vi) Bank(s) – Bank(s) refer to banks licensed as Authorised Dealer – Category I under Section 10 of FEMA, 1999.



(vii) 'International Financial Service Centre' shall have the same meaning as assigned to it in the Section 2(q) of the Special Economic Zones Act, 2005.

**3. Eligible commodities** – Commodities whose price risk may be hedged are:

(i) In case of direct exposures to commodity price risk: All commodities (except Gems and Precious stones). Price risk of gold may only be hedged as provided at Para 5 (ii) of these directions.

(ii) In case of indirect exposures to commodity price risk: Aluminium, Copper, Lead, Zinc, Nickel, and Tin. This list of eligible commodities would be reviewed annually.

**4. Permitted products** – Permitted products refer to the following:

(i) Generic Products

- (a) Futures and forwards
- (b) Vanilla options (call option and put option)
- (c) Swaps

(ii) Structured Products

- (a) Products which are combination of either cash instrument and one or more generic products
- (b) Products which are combination of two or more generic products

**5. Hedging of commodity price risk**

(i) Eligible entities having exposure to commodity price risk for any eligible commodity may hedge such exposure in overseas markets using any of the permitted products.

(ii) Eligible entities having exposure to price risk of gold may hedge such exposure only on exchanges in the International Financial Services Centre (IFSC) recognised by the International Financial Services Centres Authority (IFSCA).

**6. Hedging of freight risk:** Eligible entities having exposure to freight risk may hedge such exposure in overseas markets by using any of the permitted products.

**7. Other operational guidelines**

(i) Banks may permit eligible entities to hedge commodity price risk and freight risk overseas, including IFSC, using permitted products and may remit foreign exchange in respect of such transactions after satisfying themselves that:

- (a) The entity has exposure to commodity price risk or freight risk, contracted or anticipated.



- (b) The quantity proposed to be hedged and the tenor of the hedge are in line with the exposure.
  - (c) In case of OTC derivatives, the requirement to undertake OTC hedges is justified.
  - (d) In case of hedging using a benchmark price other than that of the commodity exposed to, the requirement to undertake such hedges is justified.
  - (e) Such hedging is taken up by the management of the entity under a policy approved by the Board of Directors of a company or equivalent forum for other.
  - (f) The entity has the necessary risk management policies in place.
  - (g) The entity has reasonable understanding of the utility and likely risks associated with the products proposed to be used for hedging.
- (ii) OTC contracts shall be booked with a bank or with non-bank entities which are permitted to offer such derivatives by their regulators. For this purpose, a list of acceptable jurisdictions shall be specified by FEDAI.
- (iii) Structured products may be permitted to eligible entities who are (a) listed on recognized domestic stock exchanges or (b) fully owned subsidiaries of such entities or (c) unlisted entities whose net worth is higher than INR 200 crore, subject to the condition that such product are used for the purpose of hedging as defined under these directions.
- (iv) All payments/receipts related to hedging of exposure to commodity price risk and freight risk shall be routed through a special account with the bank for this purpose.
- (v) Banks shall keep on their records full details of all hedge transactions and related remittances made by the entity.
- (vi) Banks shall obtain an annual certificate from the statutory auditors of the entity confirming that the hedge transactions and the margin remittances are in line with the exposure of the entity. The statutory auditor shall also comment on the risk management policy of the entity for hedging exposure to commodity price risk and freight risk and the appropriateness of the methodology to arrive at the quantum of these exposures.
- (vii) Banks shall undertake immediate corrective action in case of any irregularity or misuse of these Directions. All such cases should be reported to the Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India.



**8. Standby Letters of Credit (SBLC) / Guarantees:** Banks are permitted to issue Standby Letters of Credit (SBLC) / Guarantees, for a maximum period of one year, on behalf of their clients in lieu of making a remittance of margin money for commodity hedging transactions entered into by their customers. Banks should ensure that these SBLCs / Guarantees are used by their clients for the intended purposes.

**9. Realisation and repatriation of foreign exchange:** Realisation and repatriation of foreign exchange due or accruing to an eligible entity resulting from permitted transactions under this direction shall be guided by the provisions of the Foreign Exchange Management (Realisation, repatriation and surrender of foreign exchange) Regulations, 2015.

**10. Report to Reserve Bank:** Banks shall submit a quarterly report to the Chief General Manager, Financial Markets Regulation Department, Reserve Bank of India through Extensible Business Reporting Language (XBRL) accessible at <https://xbrl.rbi.org.in/orfsxbrl/> in the format provided in [Annexure I](#). In case of no transactions, a “Nil” report shall be submitted by the bank.

#### **11. Repeal**

The following circulars issued by the Reserve Bank stand repealed as on the date on which these Directions come into force:

- (i) [A. P. \(DIR Series\) Circular No. 19 dated March 12, 2018](#) on Hedging of Commodity Price Risk and Freight Risk in Overseas Markets.
- (ii) [A. P. \(DIR Series\) Circular No. 16 dated January 15, 2020](#) on Hedging of Commodity Price Risk and Freight Risk in Overseas Markets – Amendment.

## Annexure I

### Report – Hedging of Commodity Price Risk and Freight Risk in Overseas Markets during the Quarter ending \_\_\_\_\_

**Name of the Authorised Dealer:**

**1.**

Commodity	Exposure (Quantity)		Hedges Booked (Quantity)		Gross Outflow (USD Million)	Gross Inflow (USD Million)
	Direct	Indirect	OTC	Exchanges		

**2. Total outstanding SBLCs / Guarantees issued for hedging of commodity price risk:**

SBLCs outstanding (USD Million)	Guarantees outstanding (USD Million)

**3. SBLCs / Guarantees invoked by the overseas counterparty (Customer wise):**

Date	Customer	SBLC / Guarantee Amount invoked (USD Million)