Annexure II

Guidelines for hedging of commodity price exposures

These guidelines cover Indian entities who are exposed to commodity price risk. The operative procedure is aimed at ensuring hedging of genuine exposures. Indian corporates who seek to hedge commodity price exposures (excluding oil and petroleum products) should submit their applications to the International Banking Division of an authorised dealer giving the following details.

i) Name and address of the organisation.

ii) A brief description of the hedging strategy proposed:

a. description of business activity and nature of risk.
b. instruments proposed to be used for hedging.
c. exchanges and brokers through whom the risk is proposed to be edged and credit lines proposed to be availed. The name and address of the regulatory authority in the country concerned may also be given.
d. Size/average tenure of exposure/total turnover in a year expected with peak positions thereof and the basis of calculation.

iii) Copy of the Risk Management Policy approved by the Board of Directors covering:

a. risk identification
b. risk measurements
c. guidelines and procedures to be followed with respect to revaluation/monitoring of positions
d. names and designations of the officials authorised to undertake transactions and limits.

iv) Any other relevant information

2. The authorised dealer will forward the application to Reserve Bank together with its recommendations for consideration. While forwarding the proposal, the authorised dealer should ensure that it is supported by a copy of the Memorandum on the Risk Management Policy placed before the Board of Directors with specific reference to hedging of commodity price exposure. The Memorandum should, inter alia, incorporate details relating to

a. Risk identification i.e. mis-match between purchases and sales in respect of the commodity concerned, producers' risk etc.

b. Estimate of maximum exposure in physical positions.
c. Estimate of maximum exposure to future positions.
d. Risk monitoring and reporting.

3. i) The focus will be on risk containment. Only off-set hedge will be permitted.

ii) All standard exchange traded futures will be permitted. If the risk profile warrants, Corporates may also use futures contracts based on average prices.

iii) As regards options, only purchases will be allowed. However, it is open to the corporates to use combinations of option strategies involving a simultaneous purchase and sale of options as long as there is no net inflow of premium, direct or implied. Corporates are also allowed to cancel an option position with an opposite transaction with the same broker.

iv) Tenure of exposure shall be limited to 6 months. Tenure beyond 6 months would require Reserve Bank's specific approval.

v) Corporates who wish to hedge commodity price exposure shall have to ensure that there are no restrictions on import/export of the commodity hedged under the Exim Policy in force.

4. In respect of gold, corporates may hedge the exposures arising from export commitments on the international exchanges as also through London Bullion Market Association (LBMA) approved brokers in the London market.

5. After grant of approval by Reserve Bank, the corporate concerned should negotiate with off-shore Exchange brokers subject, inter alia, to the following:-

i. Brokers must be clearing members of the Exchanges, with good financial track record.
ii. Brokers should be furnished with a list of the corporate's authorised traders/officers along with copies of their specimen signatures.
iii. Trading will only be in standard Exchange-traded futures contracts/options (purchases only).
iv. Brokers shall be contractually obliged to confirm each and every deal on the same day.

6. The corporate should open a Special Account with the authorised dealer. All payments/receipts incidental to hedging may be effected by the authorised

dealer through this account without further reference to the Reserve Bank.

7. A copy of the Broker's Month-end Report(s), duly confirmed/ countersigned by the corporate's Financial Controller along with confirmation that all off-shore positions are/were backed by physical exposures should be submitted monthly, to Reserve Bank through the authorised dealer within 15 days of the close of the month.

8. The periodic statements submitted by Brokers, particularly those furnishing details of transactions booked and contracts closed out and the amount due/payable in settlement, should be checked by the corporate. Unreconciled items should be followed up with the Broker and reconciliation completed within three months.

9. The corporates should not undertake any arbitraging/speculative transactions. The responsibility of monitoring transactions in this regard will be that of the authorised dealer.

10. An annual certificate from Statutory Auditors should be submitted by the company to the authorised dealer. The certificate should confirm that the prescribed terms and conditions have been complied with and that the corporate's internal controls are satisfactory. Authorised dealers may forward a copy thereof to the Reserve Bank.