

Regulatory alert: Introduction of rupee derivatives in International Finance Service Centre (IFSC)

Issued on: 29 January 2020



Summary

The Reserve Bank of India (RBI) in its Statement on Development and Regulatory Policies dated 4 October 2019 had announced to permit rupee derivatives (with settlement in foreign currency) to be traded in IFSC. In this regard, the RBI has now issued directions to implement the same and the salient features of these directions are as below:

- Currency derivatives in any currency pair involving the rupee or otherwise are permitted on recognised stock exchanges set up in IFSCs;
- Contracts in the rupee shall be settled in a currency other than the Indian rupee; and
- Any person resident outside India may undertake these derivative contracts.

Background

The RBI had appointed a task force headed by former Deputy Governor Smt. Usha Thorat, to examine issues related to offshore rupee markets and recommend policy measures while factoring in the requirement of ensuring stability of the external value of the rupee. The task force in its report recommended several important measures to incentivise the non-residents to access the onshore foreign exchange market. One such recommendation was to enable rupee derivatives (with settlement in foreign currency) to be traded in IFSC in India.

The RBI in its Statement on Development and Regulatory Policies dated 4 October 2019, accepted the recommendations of the task force to permit rupee derivatives (with settlement in foreign currency) to be traded in IFSC. The RBI vide A.P. (DIR Series) Circular No. 17, dated 20 January 2020 has issued the directions for implementing the aforesaid recommendation, starting with Exchange Traded Currency Derivatives (ETCD).

Key features

The key features of the currency futures and currency options in IFSC (Reserve Bank) directions, 2020 are applicable to persons dealing in currency derivatives listed on recognised stock exchanges in IFSC are as under:

Permissibility

- Currency futures and options contracts are permitted in any currency pair involving rupee or otherwise.
- Only persons residing outside India under the Foreign Exchange Management Act, 1999 (FEMA Act) shall be eligible to undertake any currency futures and options contracts in IFSC.
- People residing in India under the FEMA Act shall not be eligible to undertake such currency derivative contracts in IFSC, unless specifically permitted by the RBI.

Features of the currency futures and option contracts

- All currency futures and options contracts in IFSC shall be settled in currency other than the Indian rupee.
- The settlement price for currency futures and options contracts involving rupee shall be the FBIL Reference rate¹, where available, on the last trading day of the contract/ on the expiry date of the contract.

For currency futures or options contracts involving rupee where FBIL reference rates are not available and for other currency pairs, the mechanism for arriving at the settlement price shall be decided by the recognised stock exchange in consultation with the SEBI.

- The premium for all currency option contracts shall be quoted in any currency other than the Indian rupee;
- The size, maturity and other specifications of such currency contracts shall be decided by the

recognised stock exchange in consultation with the SEBI.

Position limits

- The position limits for various classes of participants in the currency futures and options market shall be subject to the guidelines issued by SEBI².

Other features

- These directions also provide for other provisions such as margins requirement, surveillance and disclosures requirements and authorisation to recognised stock exchanges and their respective clearing corporations/ clearing houses.

Similarly, the RBI vide its notification dated 21 January 2020 has amended its directions relating to IFSC Banking Units (IBUs) thereby allowing them to participate in ETCD on rupee (with settlement in foreign currency) listed on stock exchanges set up at IFSC.

Our comments

The introduction of Indian rupee derivative in the IFSC is a welcome step to attract various foreign investors which otherwise trade in Indian rupee derivatives through other international finance centers such as London, Dubai and Singapore. With the introduction of the rupee derivatives, it now completes the range of asset class available for trading in the IFSC. Permitting International Banking Units (IBUs) to deal in rupee derivatives in IFSC shall provide level playing field to Indian banks to service non-residents viz-a-viz foreign banks. The implementation of the rupee derivatives in IFSC would not only bring large volumes and price discovery to onshore market but also address certain issues including restriction on non-residents in participation in domestic markets, limited time of operations of domestic exchanges, etc.

¹ 'FBIL Reference rate' means the rates of currency pairs computed and published on a daily basis, on all Mumbai business days, by Financial Benchmarks India Private Limited.

² SEBI vide Circular dated 17 May 2017 has prescribed the position limits for various classes of participants in case of cross-currency futures and options contracts (not involving INR) on exchanges in IFSC.

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