Client Briefing April 2019

INR Interest Rate Derivatives Market

Background

On 27 March 2019, the Reserve Bank of India published the Non-resident Participation in Rupee Interest Rate Derivatives Markets (Reserve Bank) Directions, 2019 (the "Directions"), concerning Rupee interest rate derivative transactions in India, undertaken on recognised stock exchanges, electronic trading platforms (ETP) and over-the-counter (OTC) markets. The Directions give non-residents access to the interest rate derivatives market in India by allowing them to enter into Rupee interest rate derivative transactions either to hedge an exposure to Rupee interest rate risk or for purposes other than hedging.

Hedging transactions

A non-resident[1] may enter into Rupee interest rate derivatives in India to hedge[2] its interest rate risk using any permitted interest rate derivative product transacted on recognized stock exchanges, ETPs or OTC markets. The conditions include the following:

- A non-resident must ensure that its interest rate derivative transactions conform to the provisions of Section 45(V) of the RBI Act, 1934, as well as applicable provisions of the Foreign Exchange Management Act, 1999 and the rules, regulations and directions issued thereunder.

- Market-makers[3] are required to ensure that transactions by a non-resident are being carried out for the purpose of hedging. As a result, market-makers have the right to request any relevant information from the non-resident, who, in turn, is obliged to provide such information.

Transactions for purposes other than hedging interest rate risk

Non-residents, other than individuals, may enter into Overnight Indexed Swap (OIS)[4] transactions for purposes other than hedging interest rate risk. These transactions may be entered into directly with a market-maker in India, or by way of a 'back-to-back' arrangement through a foreign branch/parent/group entity (foreign counterpart) of the market-maker. A 'back-to-back' arrangement involves the non-resident entering into the transaction with a foreign counterpart of the market-maker at which point the foreign counterpart must immediately enter into an off-setting transaction with the market-maker in India.

OIS Transactions. OIS transactions by non-residents for purposes other than hedging interest rate risk are subject to certain limits: (i) the Price Value of a Basis Point (PVBP), as published by the Clearing Corporation of India Ltd ("CCIL") on a daily basis, of all outstanding OIS positions transacted by all non-residents must not exceed INR 3.50 billion (PVBP cap); (ii) non-residents must not undertake any further OIS transactions for purposes other than hedging after the PVBP cap is reached; and (iii) the PVBP of all outstanding OIS positions for any non-resident (including related entities) must not exceed 10% of the PVBP cap.

Interest rate futures. Foreign Portfolio Investors (FPIs), collectively, may also transact in interest rate futures (IRF) up to a limit of net long position of INR 50 billion.

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[1] A person resident outside India as defined in section 2 (w) of Foreign Exchange Management Act, 1999 (42 of 1999).
[2] Hedging is the activity of undertaking a derivative transaction to reduce an identifiable and measurable risk. For the purpose of these rules, the relevant risk is Rupee interest rate risk.
[3] Entities regulated by the Reserve Bank of India that provide bid and offer prices to non-residents.
[4] An interest rate swap based on the Overnight Mumbai Interbank Outright Rate (MIBOR) benchmark published by Financial Benchmarks India Pvt. Ltd (FBIL).

Pre- and post-trade matters

Accounts. All payments related to interest rate derivative transactions of a non-resident may be routed through a Rupee account of the non-resident or, where the non-resident doesn't have a Rupee account in India, through a vostro account maintained with an authorised bank in India. The market-maker must maintain complete details of such transactions.

Compliance. The Market-maker must ensure that non-resident clients are from a Financial Action Task Force (FATF) compliant country. Market-makers must also ensure that non-resident clients comply with applicable KYC requirements.

Reporting. All OTC Rupee interest rate derivative transactions must be reported by market-makers and ETPs to the trade repository of CCIL, clearly indicating whether the trade is for hedging or other purposes. Market-makers must report trade details, including particulars of the non–resident client for OIS transactions under the 'back-to-back' arrangement, to the trade repository of CCIL. Cross-border remittances arising out of transactions in Rupee interest rate derivatives must be reported by banks to the Reserve Bank at monthly intervals in the prescribed format.

Concluding remarks

We suspect many of our clients will be interested in the trading opportunities presented by the opening up of the onshore Indian Rupee interest rate derivative market. We are aware that a number of sell-side entities are already facilitating onshore market access and contacting clients with the requisite documentation to paper these relationships.

If you require advice on draft trading documentation for these products, or if you wish to discuss these matters in more detail, please contact your relationship partner or James Haddad at james.haddad@chanceryadvisors.com or Dan Harris at daniel.harris@chanceryadvisors.com.

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