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September 16, 2021

(Updated as on February 21, 2025)

To,

All Eligible Market Participants

Madam/Sir,

Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives)

Directions, 2021

Please refer to Paragraph 11 of the [Statement on Developmental and Regulatory Policies](#) announced as a part of the [Bi-monthly Monetary Policy Statement for 2020-21 dated December 04, 2020](#), regarding review of the *Comprehensive Guidelines on Derivatives (CGD)*.

2. The draft Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2020 were released for public comments on [December 04, 2020](#). Based on the feedback received from the market participants, the draft Directions were reviewed and have since been finalised. The Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021 are [enclosed](#) herewith.

Yours faithfully,

(Dimple Bhandia)
Chief General Manager

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बढ़ाए



FINANCIAL MARKETS REGULATION DEPARTMENT

Notification No. FMRD.FMD.08/02.03.247/2021-22 dated September 16, 2021

Master Direction – Reserve Bank of India (Market-makers in OTC Derivatives)

Directions, 2021

(Updated as on February 21, 2025)

In exercise of the powers conferred under Section 45W of the Reserve Bank of India Act, 1934 (02 of 1934) (hereinafter called the Act) read with Section 45U of the Act, the Reserve Bank of India (hereinafter called the Reserve Bank) hereby issues the following Directions. A reference is also invited to the Foreign Exchange Management Act, 1999 (42 of 1999) and Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 ([Notification no. FEMA.25/RB-2000 dated May 3, 2000](#)), as amended from time to time.

1. Short title, commencement and applicability

- 1.1 These Directions shall be called the Master Direction - Reserve Bank of India (Market-makers in OTC Derivatives) Directions, 2021.
- 1.2 These Directions shall come into force on January 03, 2022.
- 1.3 These Directions shall apply to entities permitted to act as market-maker in OTC derivatives in terms of the Governing Directions.

2. Definitions

2.1 In these Directions, unless the context otherwise requires:

- (ia) Bond forward means a rupee interest rate derivative contract in which one counterparty (buyer) agrees to buy a specific government security from another counterparty (seller) on a specified future date and at a price determined at the time of the contract.
- (i) 'Company' shall have the same meaning as assigned to it in Section 2(20) of the Companies Act, 2013 (18 of 2013).
- (ii) 'Credit default swap' means an OTC derivative in which one counterparty (protection seller) commits to pay to the other counterparty (protection buyer) in the case of a credit event with respect to a reference entity and in return, the protection buyer makes periodic payments (premium) to the protection seller until the maturity of the contract or the credit event, whichever is earlier.



- (iii) 'Currency swap' means an OTC derivative which commits two counterparties to exchange streams of interest payments and/or principal amounts in different currencies on specified dates over the duration of the swap at a pre-agreed exchange rate.
- (iv) 'Derivative' shall have the same meaning as assigned to it in Section 45U(a) of the Act.
- (v) 'Electronic Trading Platform (ETP)' shall have the same meaning as assigned to it in Paragraph 2(1)(iii) of [the Electronic Trading Platforms \(Reserve Bank\) Directions, 2018 dated October 05, 2018](#), as amended from time to time.
- (vi) 'Exchange' means 'recognised stock exchange' and shall have the same meaning as assigned to it in Section 2(f) of the Securities Contract Regulation Act, 1956 (42 of 1956).
- (vii) 'Foreign exchange forward' means an OTC derivative involving the exchange of two currencies on a specified date in the future (more than two business days later) at a rate agreed on the date of the contract.
- (viii) 'Foreign exchange call option (European)' means an OTC derivative that gives the buyer the right, but not the obligation, to buy an agreed amount of a certain currency with another currency at a specified exchange rate on a specified date in the future.
- (ix) 'Foreign exchange put option (European)' means an OTC derivative that gives the buyer the right, but not the obligation, to sell an agreed amount of a certain currency for another currency at a specified exchange rate on a specified date in the future.
- (x) 'Foreign exchange swap' means an OTC derivative involving the actual exchange of two currencies (principal amount only) on a specified date (the short leg) and a reverse exchange of the same two currencies at a date further in the future (the long leg), at rates agreed at the time of the contract.
- (xi) 'Forward rate agreement' means a cash-settled OTC derivative between two counterparties, in which a buyer will pay or receive, on the settlement date, the difference between a pre-determined fixed rate (FRA rate) and a reference interest rate, applied on a notional principal amount, for a specified forward period.



- (xii) 'Governing Directions' for an OTC derivative means the following:
- (a) Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 ([Notification no. FEMA.25/RB-2000 dated May 3, 2000](#)) and Master Direction – Risk Management and Inter-Bank Dealings ([Notification no. FMRD Master Direction No. 1/2016-17 dated July 05, 2016](#)), as amended from time to time, for foreign exchange derivatives.
 - (b) Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 ([Notification no. FMRD.DIRD.20/2019 dated June 26, 2019](#)), as amended from time to time and Reserve Bank of India (Forward Contracts in Government Securities) Directions, 2025 ([Notification no. FMRD.DIRD.17/14.03.042/2024-25 dated February 21, 2025](#)), as amended from time to time for interest rate derivatives.
 - (c) Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022 ([Notification no. FMRD.DIRD.11/14.03.004/2021-22 dated February 10, 2022](#)), as amended from time to time, for credit derivatives.
- (xiii) 'Interest rate cap' means a series of interest rate call options (European) (called caplets) in which the buyer of the option receives a payment at the end of each period when the underlying interest rate is above a rate agreed in advance.
- (xiv) 'Interest rate floor' means a series of interest rate put options (European) in which the buyer of the option receives a payment at the end of each period when the underlying interest rate is below a rate agreed in advance.
- (xv) 'Interest rate call option (European)' means an OTC derivative that gives the buyer the right, but not the obligation, to buy an interest rate instrument or receive an interest rate on a notional principal at a pre-determined price/rate on a specified date in the future.
- (xvi) 'Interest rate put option (European)' means an OTC derivative that gives the buyer the right, but not the obligation, to sell an interest rate instrument or pay an interest rate on a notional principal at a pre-determined price/rate on a specified date in the future.
- (xvii) 'Interest rate swap' means an OTC derivative in which two counterparties agree to exchange one stream of future interest payments for another, applied on a notional principal amount, over a specified period.



(xviii) 'Market-maker' means an entity which provides prices to users and other market-makers.

Explanation: Authorised Persons, authorised as such under Section 10(1) of the Foreign Exchange Management Act, 1999 (42 of 1999), permitted to undertake foreign exchange derivative transactions with users and other Authorised Persons, shall be treated as market-makers for such transactions.

(xix) 'Non-deliverable derivative' shall have the same meaning as assigned to it in the Governing Directions.

(xx) 'Over-the-counter (OTC) derivative' means a derivative (deliverable and non-deliverable) other than those which are traded on exchanges and shall include those traded on electronic trading platforms (ETPs).

(xxi) 'Person resident in India' shall have the same meaning as assigned to it in Section 2(v) of the Foreign Exchange Management Act, 1999 (42 of 1999).

(xxii) 'Person resident outside India' shall have the same meaning as assigned to it in Section 2(w) of the Foreign Exchange Management Act, 1999 (42 of 1999).

(xxiii) 'Structured derivative' means an OTC derivative other than a generic derivative.

For the purpose of this definition, a generic derivative means the following:

- (a) Forward rate agreement;
- (b) Foreign exchange forward;
- (c) Interest rate swap;
- (d) Foreign exchange swap;
- (e) Currency swap;
- (f) Credit default swap;
- (g) Interest rate call/put option (European);
- (h) Interest rate cap (European);
- (i) Interest rate floor (European);
- (j) Foreign exchange call/put option (European); and
- (k) Bond Forward.

(xxiv) 'User' shall have the same meaning as assigned to it in the Governing Directions.

2.2 Words and expressions used, but not defined in these Directions, shall have the same meaning as assigned to them in the Act.



3. Governance

3.1 The Board of Directors (or equivalent forum) and senior management of the market-maker should have a good understanding of the nature of the derivative business undertaken by their respective entities and need to demonstrate through their actions that they have a strong commitment to an effective risk management and compliance environment throughout the organization in respect of the derivative business. In particular, the Board of Directors (or equivalent forum) shall ensure implementation of:

- (i) Adequate and effective risk management and internal control policies and procedures, commensurate with the complexity of the products;
- (ii) Appropriate organization structure (with clear lines of responsibility and accountability), staff and other resources for prudent conduct of the derivative business, risk management function, internal control function and internal audit;
- (iii) Adequate and effective measures towards regulatory compliance; and
- (iv) Adequate and effective measures to address observations from internal and external audits.

3.2 Consistent with its general responsibility for corporate governance, the Board of Directors (or equivalent forum) of the market-maker shall approve written policies which define the overall framework within which the derivative business shall be conducted, and the related risks managed. Such framework shall, at a minimum, cover the following aspects:

- (i) Establish the entity's overall appetite for taking risk and ensure that it is consistent with its strategic objectives, capital strength and capability to manage risk effectively;
- (ii) Specify permitted activities, products and limits for the derivative business;
- (iii) Establish policies for:
 - (a) Introduction of new OTC derivative products based on the broad principles enumerated in para 4 of these Directions;
 - (b) Conduct of pre-trade due diligence based on the broad principles enumerated in para 5.1.3 of these Directions;
 - (c) Risk management based on the broad principles enumerated in para 6 of these Directions;



- (d) Internal control based on the broad principles enumerated in para 7 of these Directions; and
 - (e) Conduct of internal audit based on the broad principles enumerated in para 8 of these Directions.
- (iv) Detail the type and frequency of reports which are to be made available to the Board of Directors (or equivalent forum) and its committees.

4. Products

4.1 The policy for the introduction of new OTC derivative products shall, at a minimum, include the process for evaluation and approval of new products.

4.2 Permitted Products

- 4.2.1 Market-makers shall deal only in derivative products permitted in terms of the Governing Directions.
- 4.2.2 Market-makers may deal in derivative products which have cash instrument(s) and/or permitted derivative(s) as components.
- 4.2.3 Market-makers shall not deal in derivative products containing a derivative instrument as underlying, unless specifically permitted in terms of the Governing Directions.
- 4.2.4 Market-makers shall not deal in derivative products, either directly or on a back-to-back basis, which they cannot price independently.

4.3 Due diligence

- 4.3.1 Due diligence for the introduction of a new product shall, at a minimum, include an assessment of the following aspects of the product:
 - (i) Objective(s);
 - (ii) Type of targeted client and how the product addresses their need(s);
 - (iii) All risks that a client would potentially face;
 - (iv) Pay-off profile;
 - (v) Pricing;
 - (vi) Costs and fees, along with analysis of their components, to be incurred by a client; and
 - (vii) Measures necessary to mitigate any conflict of interest.
- 4.3.2 The Chief Compliance Officer (CCO) and the Chief Risk Officer (CRO) shall sign off before approval of new products.



4.3.3 All new products shall be approved by the Board of Directors (or equivalent forum) which shall, *inter alia*, ensure that all regulations applicable to the product are documented and are complied with.

4.4 Pricing and valuation

4.4.1 Details of pricing and valuation methodology of the products shall be documented.

4.4.2 Products shall be valued on the basis of the following preferential hierarchy:

- (i) Marking the product (or its component(s)) to market;
- (ii) Marking the product (or its component(s)) to a model.

4.4.3 In cases where a model is used for valuation of a product:

- (i) The purpose, design, input variables, underlying assumptions, quantitative algorithms and limitations of the model, including third-party models, shall be adequately understood and documented;
- (ii) Inputs underpinning the model shall be observable market variables, where available;
- (iii) If any of the input variables are non-observable/subjective, their use shall be justified, and their calculation methodology shall be documented; and
- (iv) The model shall be periodically validated through independent review and back-testing.

5. User dealing conduct

5.1 Pre-trade conduct

5.1.1 **User classification:** The user shall be classified and offered derivative products in terms of the Governing Directions.

5.1.2 **Product disclosure statement:** A product disclosure statement containing standard information about the product shall be made available to the user for providing adequate information to decide if the product will meet its needs and to facilitate comparison with other products. This statement shall, at a minimum, contain the following information about the product:

- (i) Features;
- (ii) All contract terms and conditions including those for termination/unwinding;
- (iii) Benefits;
- (iv) All risks;
- (v) Pay-off profile;



- (vi) Costs and fees, including break-up and details wherever required as per the Governing Directions; and
- (vii) An illustration of how the product works.

5.1.3 Due diligence: Due diligence in respect of following aspects shall be carried out before undertaking a derivative transaction with the user. Such due diligence will not be mandatory in case of plain vanilla foreign exchange forward and foreign exchange call/put option (European) – deliverable and non-deliverable – with tenor up to 13 months.

- (i) **Product suitability:** The product offered to the user shall be consistent with the objective and risk appetite of the user. In case a product is not found suitable for a user in the assessment of the market-maker, the user shall be informed of the opinion. If the user nonetheless wishes to proceed, the market-maker shall document its analysis and its discussions with the user. The approval for such transactions shall be escalated to next higher level of authority at the market-maker as also for the user.
- (ii) **User appropriateness:** A product shall be offered only to those users who, in the considered assessment of the market-maker:
 - (a) Have the necessary knowledge and skill to understand the nature, pricing and risks of the product;
 - (b) Have the financial ability to bear these risks; and
 - (c) Have a risk management framework consistent with the product being offered.
- (iii) **Risk disclosure statement:** A risk disclosure statement shall be provided to the user for each derivative transaction. This statement shall, at a minimum, contain the following information:
 - (a) Description and rationale of the transaction;
 - (b) Sensitivity analysis identifying the various parameters that affect the product; and
 - (c) Comprehensive scenario analysis covering key upside and downside risks on the pay-off profile.



- (iv) **Structured derivatives:** Enhanced due diligence, commensurate with the complexity of the product, shall be carried out before offering a structured derivative to the user.

5.1.4 **Authority verification:** Due diligence shall be carried out to verify that the persons undertaking the derivative transaction are duly authorised.

5.2 Trade conduct

5.2.1 Transactions shall be undertaken in a fair and transparent manner.

5.2.2 Transactions, including roll-over, restructuring and novation, shall be undertaken at prevailing market rates. Requirements stipulated in the Governing Directions, in this regard, shall be complied with.

5.3 Post-trade conduct

5.3.1 A deal confirmation shall be provided to the user, for each transaction individually or on a consolidated basis, for all transactions undertaken by the user on a particular day. Confirmation of the same shall be obtained from the user in a manner that ensures its legal enforceability.

5.3.2 Mark-to-market value of all the positions shall be provided to the user as per the periodicity mutually agreed between the market-maker and the user, and whenever demanded by the user.

5.4 Information

5.4.1 All material information given to the user shall be in writing (including in electronic form).

5.4.2 Information given to the user shall be clear and unambiguous in language and presentation. Warnings and important information shall be prominently presented and clearly explained.

5.4.3 Wherever an opinion is expressed, there shall be a reasonable basis for expressing the opinion and it shall be unambiguously stated that it is a statement of opinion.

5.4.4 Information given to the user shall be adequate and sufficient to help them make an informed decision.

6. Risk management

6.1 All risks to which the market-maker is exposed on account of its derivative business shall be identified and risk tolerance levels shall be set.



- 6.2 Processes shall be established to manage these risks.
- 6.3 A clear and comprehensive set of limits shall be established to manage these risks.
- 6.4 Stress testing of risk positions shall be conducted.
- 6.5 Effective policies, procedures and controls shall be implemented to manage model risk.
- 6.6 Legal risk, i.e. the risk that a derivative contract is not legally enforceable, should be recognized and the market-makers should seek to manage the same by use of standard documentation (e.g. the ISDA master agreement). Specific documentation, if used, should be subject to documented legal advice.
- 6.7 Counterparty credit risk from the derivative contract should be recognized and the market-makers should seek to manage the same by undertaking counterparty credit assessment and, wherever permitted, by exchanging appropriate collateral with the counterparty.

7. Internal control

- 7.1 Policies and procedures shall be established to apply internal controls at various stages in the workflow of processing and monitoring transactions.
- 7.2 There shall be clear separation, both functionally and physically, between the front office, which is responsible for the conduct of trading operations, and the back office, which is responsible for processing the resultant trades.

8. Internal audit

8.1 Derivative business shall be subjected to internal audit to review the adequacy and test the effectiveness of the risk management system and internal controls. The audit shall, at a minimum:

- (i) Investigate unusual occurrences such as significant breaches of limits, unauthorized trades and unreconciled valuation or accounting differences;
- (ii) Evaluate the reliability and timeliness of information reported to senior management and the Board of Directors (or equivalent forum);
- (iii) Trace and verify information provided on risk exposure reports to the underlying data sources;
- (iv) Undertake an appraisal of the effectiveness and independence of the risk management process;



- (v) Evaluate and independently verify whether model risk management practices are comprehensive, rigorous, and effective;
- (vi) Evaluate adequacy of the derivative valuation process and ensure that it is performed by parties independent of risk-taking activities. Auditors should test derivative valuation reports for accuracy; and
- (vii) Evaluate the product disclosure statements and risk disclosure statements provided to users.

8.2 Internal audit shall be conducted by qualified professionals, who are independent of the business line being audited.

8.3 Failure of management to implement the recommendations of the internal auditor within an agreed timeframe shall be reported to the Audit Committee of the Board of Directors (or equivalent forum).

9. Preservation of records

9.1 All business, control and monitoring records should be preserved up to the existing statutory retention periods. Wherever statutory retention periods are not stipulated, such records shall be preserved as per the internal policy of the market-maker subject to the condition that they are preserved for at least two years after the life of the product/transaction. Back up of crucial information and data shall be done and preserved according to the IT policy of the market-maker.

10. Repeal

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

- (i) [Circular no. DBOD.No.BP.BC.86/21.04.157/2006-07 dated April 20, 2007](#) on *Comprehensive Guidelines on Derivatives*;
- (ii) [Circular no. DBOD.No.BP.BC.27/21.04.157/2011-12 dated August 2, 2011](#) on *Comprehensive Guidelines on Derivatives: Modifications*;
- (iii) [Circular no. DBOD.No.BP.BC.44/21.04.157/2011-12 dated November 2, 2011](#) on *Comprehensive Guidelines on Derivatives: Modifications*; and
- (iv) [Circular no. DBR.No.BP.BC.103/21.04.157/2017-18 dated April 6, 2018](#) on *Comprehensive Guidelines on Derivatives: Modifications*.



10.2 Directions contained in the circulars listed under para 10.1 shall continue to apply to derivative transactions undertaken in accordance with the said directions, till their expiry.