SECTION- III

HEDGING THE PRICE RISK OF COMMODITIES

14. ADs can hedge the price risk of commodities that are traded on exchanges or over-the-counter (OTC) of their customers through standard exchange traded futures/options and OTC derivatives on commodities subject to prior approval of Bangladesh Bank. The use of commodity derivatives will only be permitted when customers have genuine underlying commodity price risk exposure(s). This can be monitored by the ADs through checking of the underlying risk exposure documents. Any kind of speculation through the use of commodity derivative instruments will not be permissible.

ADs must completely hedge the commodity price risk arising from the commodity hedge transactions by booking back to back transactions with banks having international standing or their branches operating in Bangladesh.

While applying to Bangladesh Bank for commodity hedge transactions the suitability and appropriateness form (As per Appendix 5/7 and Appendix 5/8) must be submitted. To become eligible for offering commodity derivative products, ADs must have the ability to monitor the credit and market risk arising from such products. They should also forward relevant commodity price forecasts to customers before the product is offered to the customers. The forecast(s) should also be forwarded to Bangladesh Bank along with the application.

ADs should follow IFRS-9 (Financial Instruments) for accounting of gain or loss on the commodity hedging instrument and the hedged item.

The following reporting requirements must be followed by the ADs:

- All the details of commodity hedge transactions that have been approved and booked with the clients should be reported to Bangladesh Bank on a monthly basis.

- At maturity of each transaction, ADs must send a detailed report to Bangladesh Bank.

- Audited financial statements must have adequate disclosures of commodity hedge transactions.

Prior to engaging in a transaction, ADs must advise client of all costs, charges and commissions related to the commodity hedge. ADs must explicitly mention all the downside risks and worst-case-scenarios of a commodity derivative hedge to the client prior to entering into a transaction.

Relevant BRPD Circular/Circular Letter (s) should be referred to for assigning risk weightage for all the commodity transactions for capital adequacy, etc.