



DERIVATIVES

Currency risk and hedging

Why the exchange rate is a risk, and how exporters, importers and investors manage it

Rules as on 16 October 2026; all example figures are illustrative

For training and education only. Not investment advice.

Currency risk is the chance the exchange rate moves against you before you pay or receive a foreign amount.

It arises whenever a payment or receipt is fixed in one currency but settled later. A hedge locks the rate today, removing the risk of a move — and also the chance of a favourable one.

Who carries currency risk



Exporter

Sells abroad and receives foreign currency later. Loses out if the rupee strengthens, because each unit of foreign money then buys fewer rupees.



Importer

Buys from abroad and pays foreign currency later. Loses out if the rupee weakens, because each unit of foreign money then costs more rupees.



Overseas investor

Holds assets priced in foreign currency, directly or through an international fund. The rupee's move is part of the return.

The exporter fears a stronger rupee; the importer fears a weaker one. A hedge fixes the rate for either.

An importer's forward, with real arithmetic

THE SET-UP

An importer must pay USD 100,000 in three months.

Assume a three-month forward rate of ₹88 per US dollar (real forward rates differ from today's). The importer books the forward, fixing the cost at ₹88,00,000.

- 1 If the rupee weakens to ₹90: without a hedge the cost is $100,000 \times ₹90 = ₹90,00,000$.
- 2 With the forward the importer still pays ₹88,00,000 — a saving of ₹2,00,000.
- 3 If the rupee strengthens to ₹86: without a hedge the cost is ₹86,00,000.
- 4 With the forward the importer still pays ₹88,00,000 — ₹2,00,000 more than the market. The gain is given up.

The forward fixes the cost at ₹88,00,000, whichever way the rupee moves.

Illustration with an assumed exchange rate and round figures. Not the rate for any actual day.

Three tools to hedge currency risk

Tool	What it is	Key feature
Forward	A custom contract with a bank to exchange a set amount at a set rate on a future date.	Over-the-counter; an obligation for both sides; no exchange margin.
Futures	A standard exchange contract to buy or sell a currency amount at a set rate on a set date.	Trades on an exchange; standardised; daily margin; cash-settled in rupees.
Option	The right, not the obligation, to exchange at a set rate, for a premium paid up front.	Caps the loss from an adverse move while keeping the gain; premium is the cost.

Source: RBI directions on currency futures (from 2008) and exchange contract specifications; general derivative features.

Currency derivatives in India: the rules

The instruments are familiar worldwide. The conditions India attaches to them are what people miss.

1

Hedging only, for the rupee

Currency derivatives involving the rupee, OTC or exchange-traded, are allowed only to hedge a foreign-exchange exposure, not to speculate.

2

An exchange market since 2008

Rupee currency futures have traded on Indian exchanges since 2008; pairs include the US dollar, euro, pound and yen, cash-settled in rupees.

3

A cap on exchange contracts

With a valid exposure, rupee exchange contracts are allowed without proof up to a cap: USD 100m until RBI cut it to USD 5m on 10 Oct 2026.

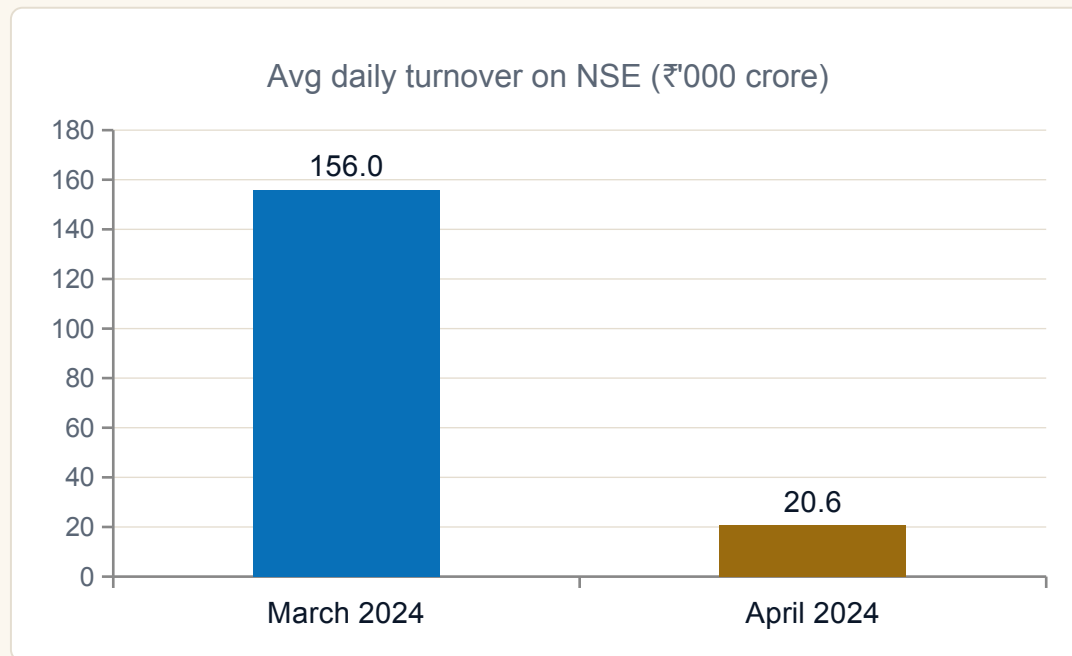
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Bank hedges versus exchange

RBI's hedging rules change often. Bank (OTC) hedges may cover anticipated and contracted exposures; rupee exchange contracts need a contracted one.

Sources: RBI press releases, 4 Apr 2024 and 10 Oct 2026; RBI Master Direction on hedging.

The 2024 rule and what followed



What changed

- From 2024 RBI reiterated that a rupee derivative needs a real exposure to hedge.
- Users were reminded that a rupee contract needs a real exposure behind it.
- NSE daily turnover fell ~87% in April 2024, ahead of the 3 May start.
- It did not change what hedging is; it limited who may use the exchange.

Source: Business Standard, average daily turnover data for March and April 2024 (secondary).

What it means for a mutual fund investor



Overseas funds

An international fund converts rupees to foreign currency to invest, and back when it sells. The exchange rate is part of your return.



Often not hedged

Check whether the scheme hedges the currency. Whether it does, and how much, is set out in its scheme documents.



Separate the two effects

A good year in a foreign market can be reduced, or helped, by the rupee's move. Read the market return and the currency apart.

For an overseas fund, the investor usually carries the currency risk unless the scheme says it is hedged.

If you learnt this from older material

What older decks say

- You can take a position in rupee currency futures without any underlying exposure.
- Exchange-traded currency futures are a deep, retail-driven market.
- Hedging with a bank means heavy paperwork every time.
- The rules are much as they were a decade ago.

What holds now

- A rupee currency derivative is allowed only to hedge a real exposure.
- NSE volumes fell sharply in April 2024, as the rule's start neared.
- No-documents window: USD 5m (Oct 2026).
- Rules revised in 2020, restated in 2024, tightened in October 2026.

Hedging currency risk is unchanged in principle; India's rules have both tightened and been simplified.

Sources: RBI press releases on ETCDs, 4 Apr 2024 and 10 Oct 2026; RBI hedging directions, 2020.

Four things people get wrong



'Hedging is a bet on the rupee.'

A hedge removes the risk of a rate move. It is not a way to make money from the rupee's direction.



'Anyone can trade currency futures.'

For rupee pairs you need a genuine exposure to hedge. RBI restated this in 2024 and cut the no-paper window to USD 5 million in 2026.



'A hedge gets me a favourable rate.'

A hedge fixes the rate. If the rupee then moves your way, you give up that gain. The aim is certainty.



'My international fund has no rupee risk.'

Unless the scheme hedges the currency, the rupee's move is part of your return, up or down.

Check yourself

Q1

An importer owes USD 100,000 in three months and books a forward at an assumed ₹88. The rupee then rises to ₹90 in the market. What does the importer pay?

Q2

In India, what is the main condition for using a rupee currency derivative?

Q3

A client's international fund did well abroad but returned less in rupees. Why can that happen?

Sources and disclaimer

SOURCES FOR THE FIGURES IN THIS DECK

- Rupee exchange currency derivatives permitted only to hedge a contracted exposure; no-documents threshold USD 100 million (RBI, 4 April 2024), cut to USD 5 million (RBI, 10 October 2026).
- Underlying-exposure requirement reiterated by A.P. (DIR Series) Circular No. 13 of 5 January 2024; effective date deferred to 3 May 2024: RBI press release, 4 April 2024.
- Simplified Hedging Facility (2017; reduced documentation): RBI/2017-18/88, A.P. (DIR Series) Circular No. 11, 9 November 2017, effective 1 January 2018; hedging directions revised in 2020.
- Exchange-traded rupee currency futures from 2008; euro, pound, yen pairs added 2010; cash-settled in rupees: RBI directions, exchange specs.
- NSE currency-derivatives average daily turnover fell about 87% between March and April 2024, ahead of the rule's 3 May 2024 start: Business Standard, 2 May 2024.
- The importer example, and all exchange rates and amounts in it, are invented for illustration and are not the rate for any day.

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