

## FOREX & INTEREST RISK MANAGEMENT POLICY

### CEAT Limited

### Policy Document on Foreign Exchange and Interest Risk Management

#### 1. Purpose

This Foreign Exchange (FX) and Interest Risk Management Policy (hereafter the "Policy") establishes guidelines for CEAT Limited (hereafter "CEAT" or the "Company") to manage its foreign exchange risks. This Policy describes how the Company defines, measures and mitigates its exposures and assigns responsibilities for managing CEAT's FX risk management program. It also establishes accounting guidelines for foreign exchange derivative instruments in accordance with Indian Accounting Standards as may be applicable.

#### 2. Objective:

It is the Company's objective to identify its material foreign currency exposures and to manage those exposures with appropriate hedging instruments. In general, the Company seeks to minimize the volatility of currency fluctuations and the impact of the volatility on the profitability of the Company. More specifically, the Company wants to manage:

- a) volatility that currency fluctuations can potentially have on cash flows
- b) cost of its FX risk management program
- c) hedging of foreign currency exposures at optimal cost
- d) impact on P&L statement of currency exposures

The appropriate balancing of these factors is subject to management discretion and will vary as business and financial conditions evolve.

The Company will not speculate on FX hedging transactions

The Company shall at all times, comply with the conditions, requirements and guidelines as may be prescribed by the Reserve Bank of India or any other statutory authority from time to time.

#### 3. Risk Profile (Types of Exposures):

CEAT is exposed to exchange rate fluctuation risk as its exports and imports are priced in various currencies – predominantly in U.S. Dollars and Euro and long-term foreign currency debt.

Risk identification shall be as follows:

- a) Exposure from import of capital items, raw materials and other materials
- b) Exposure from goods or services exported by the Company
- c) Exposure from foreign currency long term and short term loans.
- d) Exposure from investment made in foreign currency
- e) Exposure from payments/expenses made in foreign currency
- f) Exposure from dividend receivable from overseas subsidiaries
- g) Any other foreign exchange exposure that may arise from time to time

There are primarily two types of risk exposures:

- A. **Implicit exposure (Off Balance Sheet exposure):** Implicit transaction exposure begins when a purchase/sales order is raised to a supplier/customer respectively. For risk mitigation purpose, highly probable forecasted sales/purchases can also be considered as an off-balance sheet exposures.
- B. **Explicit exposure (On Balance sheet exposure):** Explicit transaction exposure begins when a receivable or payable is entered on the balance sheet and remains until cash is received or paid.

#### 4. Imports - Risk identification and hedging strategy

##### 4.1. Identification of import exposure for raw materials and other materials:

This happens in two stages:

- a) Off Balance sheet: From date of Purchase Order (PO) commitment till acceptance of the invoice or on basis of highly probable import purchases.
- b) On Balance sheet: From the date of booking of invoice till payment date.

##### 4.2. Identification of import exposure for capital goods:

This happens in two stages:

- a) From the date of PO issuance or signing of contract till the acceptance of the invoice.
- b) Date of purchase invoice till payment date.

##### 4.3. Hedging Strategy for import of raw materials and other materials (trade exposures):

Exposure	Existing Hedging practice	Hedging Practice to be followed after implementation of this Policy
<b>Off Balance sheet:</b> Highly probable imports as confirmed by FRMC substantiated by PO released or pending to be released to the extent of reporting date plus 3 months.	Such percentage deemed appropriate in consultation with the Chief Financial Officer (CFO) from time to time for all PO commitments from PO date till delivery date.	<ul style="list-style-type: none"><li>▪ Minimum 50% to be covered.</li><li>▪ Such higher percentage as may be decided in consultation with the CFO from time to time for all PO commitments from PO date till the date of acceptance made or hedging highly probable import purchases. The company may follow a layered hedging approach wherein the hedging for near months is relatively higher than for farther months.</li></ul>
<b>On Balance sheet :</b> From the date of booking of invoice till date of payment:	100% of Invoices booked from acceptance date till payment maturity date	<ul style="list-style-type: none"><li>▪ Minimum 50% to be covered.</li><li>▪ Such higher percentage in consultation with the CFO from time to time.</li></ul>

##### 4.4. Hedging Strategy for import of Capital goods (Capex exposures):

Exposure	Existing Hedging practice	Hedging Practice to be followed after implementation of this Policy
<b>Off balance sheet :</b> Date of PO issuance or signing of contract till the acceptance of the invoice	Such percentage as may be decided in consultation with the Managing Director (MD) from time to time.	<ul style="list-style-type: none"><li>▪ 100% of the Capex PO's shall be covered within 15 working days of the raising the same.</li></ul>

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<b>On balance sheet :</b> Date of invoice/buyer's credit till date of actual payment of invoice/repayment of buyer's credit.	Buyers Credit or any foreign currency loan availed from the date of drawn down till maturity.  Interest rate exposure such as LIBOR to be hedged in consultation with CFO.  Foreign Currency exposure to be hedged to protect decision to borrow in FX vis-à-vis borrowing in INR on fully hedged basis by comparing the all-in hedged costs and the concurrent INR borrowing cost. The hedging instruments have been discussed in section 6.03	<ul style="list-style-type: none"> <li>100% to be covered.</li> <li>IRS AND Interest currency hedge shall be in consultation with the CFO.</li> </ul>
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## 5. Exports - Risk identification and hedging strategy

### 5.1. Identification of export exposure for export of goods and services:

This happens in two stages:

- Off Balance sheet: highly probable sales based on past performance or from date of sales order till date of booking of sales invoice.
- On Balance sheet: From the date of booking of sales invoice till receipt of payment.

### 5.2. Hedging Strategy for export of goods and services:

Exposure	Existing Hedging practice	Hedging Practice to be followed after implementation of this Policy
<b>Off balance sheet :</b> Highly probable exports as confirmed by FRMC substantiated by SO released or pending to be released to the extent of reporting date plus 3 months.	Hedging exports on past performance basis for current month plus three months- The outstanding at any point of time should not exceed the eligible limit i.e. the average of the previous three financial years' actual export turnover or the previous year's actual export turnover, whichever is higher.	<ul style="list-style-type: none"> <li>Minimum 50% to be covered.</li> <li>Such higher percentage as may be decided in consultation with the CFO from time to time for all SO commitments from SO date till delivery date or hedging highly probable export sales. The company may follow a layered hedging approach wherein the hedging for near months is relatively higher than for farther months.</li> </ul>
<b>On Balance sheet :</b> From the Date of booking of Sales invoice till receipt of payment:	100% of the Sales Invoices (net of advances) from date of shipment till the maturity	<ul style="list-style-type: none"> <li>Minimum 50% to be covered.</li> <li>Such higher percentage in consultation with the CFO from time to time.</li> </ul>

## 6. Foreign currency term loans - Risk identification and hedging strategy

**6.1. Identification of exposure for Foreign Currency Loans:** Foreign Currency Term Loan exposure happens at the time of drawdown of loan till the maturity of the loan. It is to protect the decision to borrow in foreign exchange on fully hedged basis vis-à-vis alternative rupee borrowing cost prevailing at that point in time. This also includes the currency risk and the interest rate exposure for e.g. LIBOR etc.

### 6.2. Hedging Strategy for foreign currency loans:

Exposure	Existing Hedging practice	Hedging Practice to be followed after implementation of this Policy
<b>Foreign Currency Long Term Loans-</b> <ul style="list-style-type: none"> <li>▪ Currency risk on principal and interest</li> <li>▪ Interest rate risk on floating rate LIBOR</li> </ul>	All loans in Foreign currency from date of drawdown till maturity (protect decision to borrow in FX vs INR on fully hedged basis). Interest rate exposure such as LIBOR is hedged in consultation with the CFO.	<ul style="list-style-type: none"> <li>▪ 100% of foreign currency long term loan shall be covered.</li> <li>▪ IRS AND Interest currency hedge shall be in consultation with the CFO.</li> <li>▪ Foreign currency exposure to be hedged to protect decision to borrow in foreign currency viz. a viz. borrowing in INR on fully hedged basis by comparing the all in hedge cost and concurrent INR borrowing cost.</li> <li>▪ Upon specific approval from the CFO and MD, Foreign currency long term loan can be unhedged if there is an equivalent foreign currency assets that can form a natural hedge.</li> </ul>

Exposure	Existing Hedging practice	Hedging Practice to be followed after implementation of this Policy
<b>Foreign Currency Short Term Loans</b> <ul style="list-style-type: none"> <li>▪ Currency risk on principal and interest</li> <li>▪ Interest rate risk on floating rate LIBOR</li> </ul>	All loans in Foreign currency from date of drawdown till maturity (protect decision to borrow in FX vs INR on fully hedged basis). Interest rate exposure such as LIBOR is hedged in consultation with the CFO.	<ul style="list-style-type: none"> <li>▪ 100% of foreign currency loan shall be covered.</li> <li>▪ IRS AND Interest currency hedge shall be in consultation with the CFO.</li> <li>▪ Foreign currency exposure to be hedged to protect decision to borrow in foreign currency viz. a viz. borrowing in INR on fully hedged basis by comparing the all in hedge cost and concurrent INR borrowing cost.</li> <li>▪ PCFC can be considered as natural hedge against debtors.</li> </ul>

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## 7. Permitted hedging instruments

- a) **Forward Contracts:** A currency forward contract is one where a company enters into an agreement with a bank to buy or sell a specific amount of foreign currency at some future date at a predetermined rate of exchange (forward rate). The forward rate is the price based on the current exchange rate, interest differential for the contract time, a cost to cover the potential negative changes to the interest risk differential and a flexible built-in commission for the forward contract provider. The forward rate agreed upon by the customer and the bank will be applied when the transaction is actually effected.
- b) **Plain vanilla options:** A vanilla option is a normal call or put option that has standardized terms and no special or unusual features.
- c) **Call spread option:** A call spread is an option spread strategy that is created when equal number of call options are bought and sold simultaneously.
- d) **Range forwards:** Range forward is a currency forward structure that uses a range of exchange rates rather than a single rate. A range forward contract is constructed so that it provides full protection against adverse exchange rate movements, while retaining some upside potential to capitalize on favourable currency fluctuations. It can be designed as a zero cost structure.
- e) **Seagull option:** It is a three-legged option strategy, often used in forex trading, which can provide a hedge against the undesired movement of an underlying asset. A seagull option is structured through the purchase of a call spread and the sale of a put option (or vice versa). **This structure can be utilised only with prior approval of the CFO.**

*Instruments from (b) to (e) can be utilised only after overall minimum hedge ratio of 50% is satisfied.*

## 8. Permitted hedging instruments of foreign currency loans

The company may use into the following hedging instruments to hedge itself from currency and interest rate risk arising out of foreign currency loan exposures :

- a) **Full currency swap:** This instrument hedges both principal and interest components of the foreign currency loan as they are swapped to Rupee. Effectively, an FCS converts the FC loan to a Rupee equivalent term loan. It also allows for locking the floating Libor to fixed rate thereby hedging the interest rate risk too.
- b) **Principal only swap :** Here, the FX risk on only the principal component of the foreign currency loan is hedged
- c) **Coupon only swap :** Here, the FX risk on only the coupon payments of the foreign currency loan is hedged
- d) **Interest Rate swaps :** This instrument is used to convert the floating Libor rate to a fixed rate thereby hedging the interest rate risk on the loan
- e) **Forward Rate Agreements:** A series of forward rate agreements can be used to fix the interest payments on all interest reset dates of the loan.

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**9. Investment in foreign currency and investment income - Risk identification and hedging strategy**

**9.1. Identification of exposure for Investments in foreign currency:**

From the date of the investment till redemption or disinvestment.

**9.2. Hedging Strategy:**

As may be decided from time to time in consultation with the CFO.

**10. Outward remittances in foreign currency - Risk identification and hedging strategy**

**10.1. Identification of exposure for payments/expenses in foreign currency:**

For one time expenses: from the date of receipt of invoice till the date of payment.

For recurring expenses: from the date of the commitment till each payment.

**10.2. Hedging Strategy:** As may be decided from time to time in consultation with the CFO.

**11. Dividend from overseas subsidiaries - Risk identification and hedging strategy**

**11.1. Identification of exposure for dividend from overseas subsidiary:**

From the date of the declaration of the dividend by the shareholders of the overseas subsidiary till the receipt of dividend.

**11.2. Hedging Strategy:**

As may be decided from time to time in consultation with the CFO.

**12. Income from royalty or technical know-how - Risk identification and hedging strategy**

**12.1. Identification of exposure of royalty income**

As and when identified and recorded in the books of accounts as per the accounting policy.

**12.2. Hedging Strategy:**

As may be decided from time to time in consultation with the CFO.

**13. FX Hedging Policy:**

**13.1. Functional & Non-Functional Currency:**

The functional currency viz. the currency of the primary economic environment in which an enterprise operates, shall be Indian Rupee (INR). It is used to define the currency in which the Company's financial statements will be measured. Any currency that is not the designated functional currency of the Company is a non-functional currency.

**13.2. Management of exposures:**

Exposures at CEAT, shall not be managed on a "Net basis", rather evaluation of exposures on a contract to contract basis shall be carried out and the exposure would be managed in accordance with the various parameters defined in this Policy.

Any other specific risk to be hedged in consultation with the CFO.

### 13.3. Hedge ratio :

The company should maintain a minimum hedge ratio of 50% on its exposures defined above at all times. The following hedging ratio ranges have been summarised below:

Type of Exposure	Minimum Hedge Ratio	Maximum Hedge Ratio
On B/S exposure - Trade payables and receivables	50%	100%
Off B/S exposure - Trade payables and receivables	50%	100%
On B/S exposure - Capex	100%	100%
Off B/S exposure - Capex (Within 15 working days)	100%	100%
Foreign currency Loans - currency risk	100%	100%
Foreign currency Loans - Interest rate and currency risk	0%	100%
Other Exposure	0%	100%

The hedge ratios specified above are subject to the overall threshold of 50% of exposure which must be through forward contracts or full currency swaps. Additionally hedge cover can be taken through other permitted hedging instruments as defined above.

### 14. Authority matrix for hedging operations

The "Authorized Officials" empowered to book, undertake, transact and/or cancel, revoke, extend, de-designate foreign exchange transaction on behalf of the Company shall be authorised by the Finance and Banking Committee (FBC) or any such committee that is empowered by the Board from time to time. The deals shall be booked by the Authorized Officials against the limit assigned to each of them by the FBC, or any such committee that is empowered by the Board.

The forward / options/derivative contracts or confirmation shall be signed jointly by any two of following "Authorized Signatories":

- (i) CFO
- (ii) Company Secretary
- (iii) Financial Controller
- (iv) Head-Treasury
- (v) Head- Accounts
- (vi) Such other officials as FBC, or any such committee that is empowered by the Board, may authorise, from time to time.

It shall be ensured that the above named Authorized Officials and Authorized Signatories shall always be separate set of officials and a clear demarcation of duties shall be maintained at all times

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## **15. Forex Risk Management Committee (FRMC)**

### **15.1. Composition**

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- Financial Controller
- Head-Treasury (Coordinator of the Committee)
- Head – Procurement (Or as nominated)
- Head – Exports (Or as nominated)
- Any other person nominated by the CFO as its members or permanent invitees/invitees

### **15.2. Meeting frequency**

The FRMC will meet at least on a monthly basis. However, the meeting could be convened anytime by the CFO if deemed necessary.

### **15.3. Quorum**

At least 3 members (either in person or via teleconference) with the mandatory requirement of Head-Treasury or VP-Finance.

### **15.4. Meeting minutes**

The minutes of meeting shall be documented and shared with the FRMC within two working days post the meeting.

### **15.5. Responsibility**

The Forex Risk Management Committee shall have the following responsibilities

- Ensure that there is a timely intimation of the company's exposures to the Treasury for risk management policy implementation.
- Monitor the Forex exposures and hedged positions on a periodic basis.
- Any recommendations of FRMC for change in the Policy if required which will be presented to the Board at the immediately subsequent Board Meeting by the CFO for implementation.

## **16. Internal Controls and Compliance**

### **16.1. Internal controls**

- All forward contracts entered with the Banks / authorised dealers shall be supported by a physical contract signed by Authorised Signatories. The discrepancies, if any, shall be resolved with the Banks / authorised dealers and any unresolved discrepancy will be reported in the MIS.
- Forward contracts, as per records of the Company, shall be reconciled with the records of the Banks / authorised dealers every month.
- It shall also be ensured that the person booking/undertaking the deal shall be different from the person making the accounting entries in respect of the deals.
- **Front Office and Back Office with clear segregation of duties roles, accounting and responsibilities is defined by the way of SOP and duly signed off by Head- Treasury and finance controller.**

### **16.2. Regulatory submissions**

As mandated by RBI guidelines from time to time to be complied with.



## **17. Roles and responsibilities**

### **17.1. Board of Directors ("Board")**

The ultimate responsibility for the oversight of risk management lies with the Board or any committee as empowered by the board. The Board also has responsibility to approve the policy initially and any changes to the policy subsequently will be approved by board or any such committee that is empowered by the Board as and when recommended by the FRMC.

### **17.2. CFO**

The key duties of the CFO with regards to market risk management shall include

- The CFO shall be the owner of the risk management policy and will ensure an overall adherence to the same.
- To oversee appropriate reporting mechanisms to the Board about the exposures, hedging positions and compliance with regulations and policy
- To chair FRMC meetings and convene ad hoc meetings in case of exigencies if deemed necessary. The CFO may also nominate any person as a member or invitee to the FRMC if deemed necessary

### **17.3. Head - Treasury**

The Head-Treasury will be in-charge of the execution of market risk management He will be responsible for the following:

- Execution of the risk management policy and its regular review
- Review of the hedging operations and open positions
- Monitor open exposures and the risk limits
- Overall control on remittance and receipt of funds
- Review of statutory/regulatory compliance
- Ownership of MIS from Treasury

### **17.4. MIS for periodic review:**

- Head Treasury shall submit to CFO a MIS on monthly basis to report the FX exposures to ascertain the effectiveness of this policy which shall, inter-alia, cover following aspects:
  - Hedged and unhedged exposures of the Company and their maturity profile.
  - MTM of the hedged positions and unhedged exposures of the Company
  - realised FX gain/(loss) during the month
  - Any specific transaction of importance
- Quarterly reporting to the board of directors on outstanding positions of FX exposures along with instrument type.

## **18. Deviation and Interpretation:**

- Any deviations from this Policy in case of any exigency, to be made only with the prior approval of the MD and will be reported in the subsequent board meeting.
- The power of interpretation of this policy and providing any clarification lies with the FRMC of the Company.

## **19. Applicability:**

This policy shall come into force from the date of its adoption at the meeting of the Board

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### **Statement of don'ts for hedging forex exposure**

To minimize forex risk while carrying out forex transaction, following shouldn't be practiced:

1. Non segregation of dealing and non-dealing function: Access to back office personnel to enter into deals with bank and access to front office personnel to settlements and confirmation leading to fraudulent activities.
2. Absence of risk limits: Counterparty limits not being defined leading to deals done with counterparty beyond Company's risk appetite and concentration risk
3. Minimum hedge ratio not defined for different exposure types: Lack of monitoring of exposure and hedged position for different exposures
4. Permissible hedging instruments not clearly defined: Exhaustive list of derivative instruments not defined leading to scope for complex instruments being used by treasury front office which may not be within Company's risk appetite.
5. Reporting and risk monitoring framework not formally defined: Periodic risk monitoring by way of tools such as stress testing needs to be incorporated so that risk is managed with Company's risk appetite
6. Standard operating procedures not in place: Though risk management policy gives direction for treasury risk management, SOPs specific to activities are required for operational guidance to treasury personnel
7. Stage of exposure recognition not properly defined: Exposure needs to be recognized at an earliest possible time for managing risk which the Company is facing. Delay in stage of exposure recognition leads to exposure to risk which could have been mitigated.
8. Dealing in forex / derivative products beyond available exposure leading to speculative positions which may expose Company to financial loss.

### **Statement of don'ts for approved policy:**

The following shall be adhered to for compliance with the policy.

1. List of hedging instruments given in the forex policy is exhaustive and the Company should not use any other derivative instrument to hedge forex or interest rate risk.
2. Seagull option should not be used unless minimum overall hedge ratio of 50% as specified in the policy is met by using forward contracts or Complete currency Swaps and without prior approval of CFO.
3. The Company should not hedge any risk other than foreign exchange / interest rate risk arising out of exposures mentioned in this policy, without prior approval of CFO.
4. Exposures as defined in this policy shall not be managed on net basis for hedging purpose, but the same should be managed on gross basis for each transaction.
5. Off balance sheet exposure arising out of import of capital goods should be based on PO issuance or signing of contract and should not be considered based on capex plan or projections not substantiated by signed PO or contract.
6. Foreign currency risk arising out of foreign currency loan not to be kept open without prior approval of CFO.
7. Deviation from the policy in case of exigency with prior approval of MD and to be reported to the board in subsequent board meeting.

