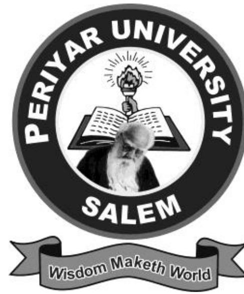

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B.B.A. BANKING
THIRD YEAR
PAPER - X : FOREIGN EXCHANGE

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BLACK	**INTRODUCTION**
Unit - I	**Foreign Exchange**
Unit - II	**Exchange Arithmetics - I**
Unit - III	**Export Financing**
Unit - IV	**Export Import Bank of India**
Unit - V	**Import Financing**

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PAPER - X : FOREIGN EXCHANGE

1.0 introduction

The importance of international trade in the economy of a country is too will known to need emphasis. A number of advantages flow from international trade. Many developed countries of the world owe their present status to international trade; many developing countries place their hopes of development on it. A common man, who is not keenly interested in these developments, is still reaping it s fruits when he is using many items of common use. A large number of these items are either imported or some components of them are imported. Even if an item is indigenously produced, it may be found that it is made on a machine which is imported.

Foreign exchange meaning:

International trade refers to trade between the residents of two different countries. Each country functions as a sovereign state with its own set of regulations and currency. The difference in the nationality of the exporter and the importer present certain peculiar problems in the conduct of international trade and settlement of the transactions arising thereform.

Important among such problems are:

(a) different countries have different monetary units;

(b) restrictions imposed by countries on import and export of goods;

(c) restrictions imposed by nations on payments from and into their countries; and

(d) differences in legal practices in different countries.

The existence of national monetary units poses a problem in the settlement of international transactions. The exporter would like to get the payment in the currency of his own country. For instance, if an ameresport of new york export machinery to indian ports, mumbai, the former would like to get the payment in us dollars. Payment of indian rupees will not serve their purpose because indian rupee can not be used as currency in the usa. On the other hand, the importers in india have their savings and borrowings in india in rupees. Hence the exporter requires payment in the currency of the exporter’s country whereas the importer can pay only in the currency of the importer’s country. A need, there are, arises for conversion of the currency importer’s country into that of the exporter’s country.

Foreign exchange is the mechanism by which the currency of the country gets converted in to the currency of another country.

The conversion of currencies is done by banks who deal in foreign exchange. These banks maintain stocks of foreign currencies in the form of

balances with banks abroad. For instance, indian bank may maintain an account with bank of america, new york in which dollar balances are held. In the earlier example, if india imports pay the equivalent rupees to indian bank, it would arrange to pay amerexport of new york in dollars from the dollar balances held by it with bank of america.

1.1. Administration for foreign exchange

Under the foreign exchange management act, the responsibility and authority of administration of foreign exchange is vested with the reserve bank of india. The union government has been empowered to make rules under the act and give to reserve bank such general or special directions as it thinks fit. The reverse bank must give with such directions. The reserve bank has also been vested with wide powers to enable it to discharge its responsibilities under the act. Any person who deals with foreign exchange has to abide by the directions given by the reverse bank, with behalf.

While the reserve bank has full authority to administer foreign exchange in india, it is recognized that it cannot do so by itself. Foreign exchange is received or required by a large number of exporters in the country spread over a vast geographical area, it would be impossible for the reserve bank to deal with them individually. Therefore provision has been made in the act enabling the reserve bank to delegate its powers and functions, with the prior approval of the central government, to others. The persons to whom the powers or functions are delegated may be authorized dealers or authorised money changers.

Authorised dealers

A major portion of dealing in foreign exchange from the customers (importers, exporters and others receiving or marking personal remittances) is dealt, with by such of the banks in india which have been authorised by the reserve bank to deal in foreign exchange. The reserve bank may, on an application made to it in this behalf, authorize any person to deal in foreign exchange. However, authorization in the form of license to deal in foreign exchange is ordinarily granted only to scheduled banks in india. Authorisation has also been granted to certain financial institutions to undertake specific types of foreign transactions incidental to their main business.

The reserve bank may refuse to grant authorisation in its opinion the applicant is not equipped or otherwise unfit to undertake foreign exchange business. Similarly, the license already granted may be revoked if it is in public interest or if the authorized dealer has not complied with the conditions subject to which the authorisation was granted or has contravened any of the provisions of foreign exchange regulations.

An authorized dealer must comply with the directions and instructions of the reserve bark given from time to time. The exchange control manual embodies such directions of standing nature issued by the reserve bank to authorised dealers. All amendments to the exchange control manual am intimated to authorized dealers by the reserve bank in the form of its ad (ma series) circulates. Further, general and procedural directions are given in the form of its ad (gp series) circulars. Thus in carrying out its dealings, an authorised dealer is guided by the latest edition of the exchange control manual, amended up to date by ad (ma series) circulars.

1.2. Administration of foreign exchange market in india

An authorized dealer shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declarations and give such information as well reasonably satisfy that the transaction will not be in contravention or evasion of foreign exchange regulations. The authorised dealer should refuse to undertake the transaction if the condition is not complied with. If the authorised dealer believes that the other person contemplates any contravention or evasion of foreign exchange regulations, the matter should be reported to the reserve bank.

With regard to charging of commission, quotation of rates, etc, the authorised dealer should also comply with the rules of foreign exchange dealers association of india (fedai).

Foreign exchange dealer's association of india

Fedai was established in 1958 as an association of all authorized dealers in india. All authorized dealers, currently numbering over 70, are its members. It has its headquarters at mumbai and local offices at bangalore, calcutta, chennai and new delhi. The affairs of fedai are managed by a managing committee at the head office and respective local offices. The committees are represented equally by banks incorporated in india and outside india.

The principal functions of fedai are:

The rules of foreign exchange ……….cover various aspects like however ours of business, charges for foreign exchange transactions, quotation of rates to customers, inter - bank dealings etc. All authorized dealers have given undertakings to the reverse bank to abide by these rules.

a). To coordinate with reserve bank of india in proper administration of foreign exchange control.

b) to circulate information likely to be of interest to its members. (information of international trade received from organizations like the international chamber of commerce is passed to the members. It also acts as a

clearing house for exchange of information among members.) Thus fedai provides a vital link in the administrative set-up for foreign exchange in india. It is the mouth piece of the authorised dealers representing their views to the reserve bank and other international agencies.

Authorized money changers

to provide facilities for enchashment of foreign currency for tourists, etc., reserve bank has granted limited licenses to certain established firms, hotel and other organization permitting them to deal in foreign currency notes, coins and travelers cheques subject to directions issued to them from time to time. These firms and organization are called “authorized money changers”. An authorized money changer may be a “full-fledged money changer” or a “restricted money changer”. A full-fledged money changer is authorized to undertake both purchase and sales transactions with the public. A restricted money changer is authorized only to purchase foreign currency notes, coins and travelers cheques subject to the condition that all such collections are surrendered by him in turn to an authorised dealer in foreign exchange.

1.2. Functions of a foreign exchange department

foreign exchange is a highly specialized business and is, therefore, concentrated in selected branches of the bank. In most of the banks., the decision-making is done at the corporate level. The foreign exchange department, also called the international banking division or international division, is headed by a senior executive of the bank. An in-depth knowledge of the rules and regulations of foreign exchange business inparticular and banking in general and high level of awareness of the happening the international economic and political arena is expected from the executive heading the department. Since foreign exchange business requires quick decision, the executive is vested with enough powers to take decisions on most of the situations that would arise in the dealing of the bank. Matters involving very large amounts and those beyond the discretionary power of the executive are referred to the chief executive of the bank or its board of directors.

while policy decisions are taken and foreign exchange resources are managed at the corporate level, the actual dealing with the customers takes place at select branches of the bank authorized to deal in foreign exchange. Such branches are mostly concentrated in metropolitan cities and other places where either import or export trade predominates or inflow of foreign remittances is expected to be high. These branches can, however, function only with in the guidelines prescribed by the head office, from time to time.

There may also be an intermediary tier at the zonal or regional level. In order to decentralize decision- making and reduce the problem if

communication from head office to branches spread over the length and breath of the country, special departments or cells have been set up at these levels. They perform some of the functions like advising branches on the exchange rate to be quoted to customers, maintenance of foreign exchange balances abroad, etc.

Banks have also set up at select metropolitan centres special branches dealing exclusively in foreign exchange, designated as overseas branches. Besides as dealing directly with customers engaged in foreign trade, they also take on the role of special foreign exchange cells at national/zonal-levels.

The foreign exchange department at the central/zonal office or the overseas branch is divided into well-defined sections, each undertaking a specialized activity, each section is further sub-divided into sub-sections or desks rendering specific tasks. There is no uniformity among banks either in the allocation of the tasks or in the designations of the officers managing the sections and sub-sections. Yet, an attempt is made to delineate the important functions performed by the foreign exchange department of a bank.

Functions of foreign exchange department of a bank

1. Financing exports

The financial needs of the exporter, right from the moment he conceives of the project and till he realizes export proceeds, are met by banks. The credit extended to be exporter to procure raw materials, process them and prepare them for shipment to the importer is known as packing credit or pre-shipment credit. On shipping the goods, the exporter will draw a bill of exchange, with or without a letter of credit, and discount it with the bank. The credit extended to the exporter after shipment is known as post-shipment finance.

Besides financing, the other services rendered by banks to exporters is advising, confirming letter of credit issued in favour of the exporters by their correspondents; abroad. Even if the exporter does not require any financial accommodation from the bank, the exchange control regulations require him to receive the export proceeds only through an authorized dealer. Therefore, exports bills are to be collected through a bank. The bank may also execute guarantees on behalf of its export customers.

2. Financing imports

Letters of credit are issued by banks on behalf of their importer-customers. The opening of the letter of credit by the bank, whereby it undertakes to make payment to the exporters on shipments, enables the importer to conclude the deal with ease. The importer may be financed by the bank for the import. This finance may take any of form, cash credit or loans, as the case may

be, and against hypothecation or pledge or mortgage of the item imported. The exporter abroad is paid by the bank in foreign exchange. The bank may issue deferred payment guarantees on behalf of the importer for items purchased on long-term credit. The importing of goods into india is subject to the import policy of the government and exchange control regulations of the reserve bank. The bank takes care to see that they are adhered to.

3. Remittance facilities.

An importer in india has to pay the overseas exporters. Similarly, an indian exporter has to receive payment from abroad. A person in india may like to subscribe to a magazine published abroad. An indian who is employed abroad may like to remit funds for maintenance of his family in india. Thus all transactions in foreign exchange ultimately result in either remittance of funds into india (inward remittance) or remittance finds from india (outward remittance)

The payment of funds into or from india can be arranged to any of the credit instruments. The instruments employed may include telegraphic transfer, mail transfer. Demand draft, foreign traveller's cheques, bill of exchange or any other instruments.

For the benefit of indians residing abroad, banks open and maintain non-resident accounts

4. Dealings in foreign exchange

Banks buy and sell foreign exchange from and to the public. To carry out the function, banks have to keep, sufficient stocks of foreign exchange. These are kept in the form. Of bank accounts abroad. Banks in india maintain accounts with, banks in important financial centres abroad through which all sales and purchases of foreign exchange are routed. For example a foreign demand draft in pound-sterling issued by the bank would be made payable by the bank in london with which it maintains an account. On presentation of the draft at london, the bank's account would be debited. Bank's dealing in foreign exchange may sometimes necessitate it to sell or buy, from other banks in the place or the reserve bank, the required foreign currency.

Subject to the rules and regulations of the reserve bank and foreign exchange dealers association of india, banks have to quote rates for foreign exchange to be purchased from and sold to the customer. Subject of these regulations, the rate quoted would depend upon the rates prevailing in the inter bank or international markets and the bank's margin of profit, etc.

1.5. Exchange control – introduction

Exchange control refers to the control, by the government or a centralized agency, of transactions involving foreign exchange. In a broad sense, any stipulation or regulation which restricts the free play of forces in an exchange market can be termed as exercise, of exchange control. The rate of exchange under exchange control regime tends to be different from the one that would exist in the absence of such control.

The origin of exchange control can be traced back to nineteen-thirties. After the first world war, many countries of europe found themselves with depleted gold reserves and foreign exchange. They imposed payment restrictions to prevent massive capital withdrawals and stability in the domestic economy. Since then exchange control has been adopted by a large number of countries and for different purposes.

At present almost all countries in the world have some form of exchange control or the other. In some countries the control exists in its extreme form with. All its complexities. All receipts are centralized in a specified authority and an payments are rationed by it. When some countries proclaim that they have abolished exchanged control, they only mean that control has been minimised. In such cases the government may allow free market, but will intervene when if feels that the situation in the market is going out of control. It may otherwise try to influence the exchange rates indirectly through changes in interest rates. Thus, it is difficult to conceive of an exchange market which is absolutely free from any sort of control.

1.6. Objectives of exchange control

the purposes for which exchange control is imposed are many and important among them are enumerated below:

[a] stability of exchange rates:

a constantly changing exchange rate may not be conducive to the economy and the government may therefore adopt exchange control methods to stabilize the exchange -rate of the currency instead of leaving it to be determined by market forces. The objective in pursuing this policy should be to prevent those fluctuations of the free market rate that are purely speculative or temporary. The policy should not interfere with change in rates caused by real alterations in the respective values of the currencies. But the difficulty lies in identifying the speculative and temporary changes and isolate them from the fundamental changes.

[b] overvaluation of currency:

the exchange control may aim at keeping the currency overvalued. That is, the currency is kept at a higher value in terms of foreign currency than that would prevail if market forces were allowed to determine the rate. When the currency is overvalued imports become cheaper. Therefore, overvaluation may be resorted to encourage import of essential commodities into the country. When the country is at war, exports become difficult but the country has to import both raw materials and finished goods. In such a situation, the right to purchase foreign exchange is confined to government agencies. The demand for foreign currency is kept low and thus its price too. In other words, the exchange value of the local currency is kept high so that the government can import its requirements cheaply than would be possible otherwise.

[c] under valuation of currency:

The exchange control may be with a view to keep the currency undervalued. The effect and purpose of under valuation of currency is opposite to that of overvaluation of currency. When the currency is undervalued, exports are cheaper and imports become costlier. Thus, under valuation of the currency leads to increase in exports and reduction in imports and ultimately results in the improvement of balance of payment of the country. The policy of under-valuation may be helpful during depressions when selling is difficult. Under-valuation of the currency may help the task by stimulating exports through lower prices.

[d] balance of payment deficits:

In a situation of worsening balance of payments, the government may like to conserve foreign exchange through payment restrictions or otherwise. Exchange restrictions may be to prevent large-scale flight of capital from the country. The erratic and uncontrolled movement of capital will not only affect the balance of payments position but also disturbing to the domestic economy.

[e] reserve foreign exchange for essentials:

exchange control may be imposed to acquire foreign exchange to be utilized for importing certain essential commodities from abroad. In times of war the government may reserve foreign exchange to import essentials of war. During times of peace, government may payments to acquire sufficient foreign exchange to service its external debit. This may be the case where the government is unable to find sources of fresh debts or to renew the existing debts.

[g] economic planning-

for a proper execution of the economic, plans, exchange control helps to a. Great extent by controlling the foreign exchange market, encouraging exports and restricting imports to essentials and making available the resources for the development of the economy and the inflow of capital from abroad.

[h] develateralism-

exchange control may be with a view to encourage trade with a particular country or group of countries. This may be achieved by offering different types of rates for different countries or for different commodities. Thus exchange control may aim at developing discriminatory bilateralism.

[i] encourage local industries:

the government may desire to protect the local industries from competition from abroad. Imports may be restricted so that the local industries are allowed to grow. This paves the way for better utilization of the resources of the country and also conserve its foreign exchange reserves-.

thus exchange control is practiced for varied reasons. Each country may have more than one reason among those listed aimed above for its policies.

1.7. Methods of exchange control

Exchange control may take any of the following forms:

1. Exchange intervention
2. Exchange restriction
    - [a] blocked accounts
    - [b) transfer moratoria
    - [c) multiple exchange rates
3. Exchange clearing arrangement
4. Indirect methods
    - [d] import restrictions and tariffs
    - [e] export subsidy
    - [f] interest rate changes

1. Exchange intervention

exchange intervention or official intervention refers to the buying and selling of foreign exchange in the market by the government or its agency [central bank] with a view to influencing the exchange rate. In a free market, the rate of exchange is determined by the force of demand of supply. Official intervention is an attempt to counter the effect of demand and supply of the currency and to keep the rate of exchange at a level desired by the government.

The intention of the government is to keep the exchange rate of the currency of the country at a fixed level. Than the currency is said to be 'pegged' at that level. If the pegged rate is higher than the rate which would prevail in the free market, the currency is said to be 'pegged up' or simply 'pegged'.

Intervention may be for 'pegging down' the currency or keeping its value lower than the free market rate. When the rate of exchange of the domestic currency is rising in the market, the government may sell the currency in large quantities and thus bring down its rate. Large reserves of domestic currency are required for pegging down operations. As compared to pegging up, pegging down seems easier because it is not difficult to have reserves to domestic currency. Though it is true, pegging down is also not without limitations. Domestic resources can be raised by taxation or public borrowing, both the which cannot go beyond certain limit. The other method is creation of more money by resorting to printing of currency. This is an unlimited source, but it has serious repercussions on the economy. Increased money supply will lead to inflation in the country. The inflation will cause a permanent reduction in the value of the currency. It may be remembered that the purpose of pegging down is to keep the rate of the currency at a lower level than the free market level. It is not to lower the level of market rate itself.

For the success of intervention, two conditions are essential. The control of foreign exchange transactions should be centralized with the government. All proceeds of foreign exchange from exports and other transactions should be paid to the government. Similarly, all requirements of foreign exchange for imports and other payments should be obtained from the government. Secondly, the government should have sufficient reserves of foreign currency and domestic currency. In practice, there is a limit to both foreign and domestic resources and the possibility of intervention is limited to this extent. The judicious policy that can be followed is that of using intervention to avoid minor fluctuations in rates.

2. Exchange restriction

Exchange restriction refers to the policy of the government whereby the supply of domestic currency in the exchange market is restricted. The exchange value of the domestic currency is maintained by restricting its supply. Exchange intervention tries to achieve object of maintaining the currency high by the government supplementing the demand the currency in the market. This means the government should have sufficient foreign currency reserves to offer to the market. This method was found insufficient where the magnitude of the

problem was large or where the government did not have sufficient foreign exchange reserves.

Exchange restriction achieves the same objective in an easier way by simply restricting the supply of the domestic currency in the market.

(a) blocked accounts.

Under this system all payments to foreign country will not be made directly but paid to the central bank of the country imposing the restriction. The central bank will keep the amount in an account with it in the name of the foreign creditor. This amount is. Not available to the foreign creditor in the currency of his country but can be used by him to make purchases from the country blocking the account. This system is known as “blocking of account” because the bank accounts and other assets of the foreigners are denied conversion into their own currencies.

The country which blocks the accounts of foreigners may allow the use of the balance on the accounts within the country. The foreign creditors may thus make some imports from the balance in the account. Transfer from one blocked account to another blocked account may be permitted. These relaxation may encourage illegal dealing in foreign exchange. For example, foreign exporters may under invoice their consignments so that a lesser amount is blocked. The difference may be collected by them in local currency when they go to the country of the importer. When compensatory payment takes place in the manner, the government loses foreign exchange to that extent that should ordinarily have flown into its reserves.

The system of blocked accounts causes great hit ships to the foreign creditors, who use the amounts in any other currency for any purpose. Further blocked accounts reduce international trade since other countries would not like to export to the country and get their funds blocked. The blocking of accounts also results in black marketing in ‘foreign exchange where local disbursements of funds in the blocked accounts are allowed. The foreign creditors whose account is blocked would like to sell it to others event at a lower rate.

(b) transfer moratoria

the effect of transfer moratoria is similar to that of the blocked accounts. The government puts a ban on of all payments to outsiders, whether on current or capital accounts. The local debtors are made to pay the amounts due to the foreign creditors to the central bank of the country. The funds are released to the foreigners when the balance of payments and reserve position of the country improves.

(c) multiple exchange rates.

Multiple exchange rates refer to the policy of employing different rates of exchange for transactions involving different commodities and also for different, currencies. The aim is exports and discourage imports to the extent possible. By quoting an unfavorable for imports, the imports are discouraged when the government wants to restrict imports of a particular commodity. Thus multiple exchange rates substitute trade control methods like import quantity control and quota system and tries to achieve the same result by increasing the cost of imports.

Different rates may be fixed for different currencies. For example, when the dollar/ sterling rate of exchange is $2 per 1 sterling, the rupee rate may be fixed at rs. 50 per 1 sterling and rs. 37 per $1. The purpose may be to control direction of trade of the county. In the present case, rupee is overvalued in terms of dollar relative to the pound - sterling. This may result in more imports from dollar countries and more exports to sterling countries.

Another variation of multiple rates is adoption of different rates for commercial and capital transaction. The aim is to prevent flight of capital from the country.

The advantages of multiple rates is that they encourage exports and discourage imports and thus help to improve the balance of payments position of the country. However, it is a complex and confusing system. There is a tendency for the number of rates to get multiplied. The rates an purely arbitrary and keep on changing!" This creates uncertainty. Further, multiple rates result in inefficient use of domestic resources. It is discriminatory affecting only a few of the competitors. The multiple rate system is disapproved by the imf and its members are urged to adopt a single rate of exchange.

3. Exchange clearing arrangements

Exchange clearing arrangement is a system of bilateral settlement of mutual claims on international transactions. Under this arrangement two countries engaged in trade settle their dues through their respective central banks instead of allowing direct payments between buyers and sellers. For example, let us assume that cleaning agreement with the uk. Then the reserve bank of india will open account itself in the name of bank of england. All import-, into india, for imports from uk, are required to pay the amount to the account of rank of england with the reserve exports to england are paid for by the reserve bank from the account of bank of england, similarly bank of england would open an account of the rbi with it -which would be fed with imports into the uk from india and utilized for payments for exports from uk to india., thus no foreign exchange reserves and transfers are involved in the

settlement of transactions between the central banks of two countries. The basic assumption of the agreement is that the import and export between the countries would mutually offset and' ultimately there would be no need for any payments.

Indirect methods

Among the indirect methods of exchange control, import tariffs and quotas and export subsidies fall under the category of trade control. The other method is the variation of interest rates. Interest rate has an influence on the movement of capital and investments from other countries. When large inflow of capital is required the country may increase interest rates. But it will affect the domestic economy. These indirect methods are mostly applied for purposes other than to influence the exchange rates. Their effect on exchange rates is also not as effective as that of direct methods.

1.8. Exchange control regulation

Exchange control was introduced in india on september 3, 1939 on the outbreak of the second world war by. Virtue of the emergency powers derived under the financial provisions of the defense of india rules, mainly to conserve the non sterling area currencies and utilize them for essential purposes. In the closing stages of the war, it became clear that control over foreign exchange transactions would have to continue in some form or the other in the post war period in the interest of making the most prudent use of the foreign exchange resources. It was therefore decided to place the control on a statutory basis and, the foreign exchange regulation act of 1947 was enacted. This act has since been replaced by the act of 1973.

It was found necessary to continue exchange control introduced during the second world war on a systematic and long-term basis, in view of the substantial requirements of foreign exchange for the planned developmental efforts undertaken. Over the years, the scope of exchange control in india has steadily widened and the regulations have become progressively more elaborate with increasing foreign exchange outlays under successive five year plans and the relatively inadequate earnings of foreign exchange. Periodically, appraisals and reviews of policies and changes in the national policies and procedures are undertaken and such modifications made as are warranted by the national policies and priorities, and fluctuations in the level of foreign reserves caused by both national and international economic and other developments.

Exchange control in india is administered by the reserve bank of india. To a great extent, exchange control is related to and supplemented by trade control, which is the responsibility on the director general of foreign trade in. The ministry of commerce. Trade control is applied under the foreign trade

(development and regulation) act, 1992. While trade control is concerned with the physical transfer of goods, exchange control involves supervision over the settlement of financial transactions relating to exports and imports.

Model question:

1. Define foreign exchange
2. Explain in function of foreign exchange department of a bank.
3. Explain briefly about. Exchange intervention.

Exchange arithmetic – I

2.0. Introduction

The foreign exchange dealing of a bank with its customer is known as ‘merchant business’ and the exchange rate at which transaction takes place is the ‘merchant rate’. The merchant business in which the contract with the customer to buy or sell foreign exchange is agreed to and executed on the same day is known as ‘ready transaction’ or ‘cash transaction’. As in the case of inter bank transaction, a ‘value next day’ contract is deliverable on the next business day and a ‘spot contract’ is deliverable on the second succeeding business day following the date of the contract. Most of the transactions with customers are on ready basis. In practice, the term, ‘ready’ and spot’ are used synonymously to refer to transactions concluded and executed on the same day. We shall study how ready rates for merchant business are calculated in india.

2.1. Nostro account

Nostro account is an account maintained by bank in india with a bank abroad. For example, indian bank may maintain an account with grindlays bank, london obviously the accoun would be in pound - sterling. Similarly, it may have a dollar account with bank of america, new york. While corresponding with the foreign bank, indian bank would refer its accounts with the former as nostro account, meaning our account with you’. So, for indian bank nostro account means the bank account, it maintain abroad in foreign cuurency. All foreign exchange transctions are routed through nostro accounts. For example, if the bank issues a demand draft on london payable in pound - sterling, it would draw on grindlays bank london. When the drafts is presented in london, the grindlays bank will debit the indian bank’s account with it. Likewise, when a bill drawn on london is given to indian bank for purchase or collection, it would send if for collection to grindlays bank grindlays bank would collect and credit the account of the indian bank with the proceeds.

Vostro account

a foregin bank may open rupee account with an indian bank. While corresponding with the indian bank would refer the account as vostro account

meaning your account with us for example, a bank in middle east may open an account with an indian bank and draw drafts on the account. On presentation of drafts, the indian bank would pay to the debit of the foreign bank's account with it. For exchange control purpose, such principal accounts are known as non - resident bank account's.

it should be noted the credit to a non - resident bank account amounts to remittance of foreign currency from india to the country of the bank maintaining the vostro account. Similarly, debit to the account amounts to inflow of foreign exchange from the country concerned into india. For instance, when an import is made from sri lanka, the proceeds may be credited to the vostro account, the amount should have been remitted abroad. Besides, the balance in the account can be utilised to pay for any exports from india to that country. Thus debitting or crediting of vostro account is subject to the rules and regulations governing remittance of foregin exchange into and from india.

Basis for merchant rates

When the bank buys foreign exchange from the customer, it sells the same in the interbank market at a better rate and thus makes a profit out of the deal. In the interbank market, the bank will accept the rate as dictated by the market. It can therefore sell foreign exchange in the market at the market-buying rate for the currency concerned. Thus the interbank buying rate forms the basis for quotation of buying rate by the bank to its customer.

Similarly, when the bank sells foreign exchange to the customer, it meets the commitment by purchasing the required foreign exchange from the interbank market. It can acquire foreign exchange from the market at the market-selling rate. Therefore, the interbank selling rate forms the basis for quotation of selling rate to the customer by the bank.

The interbank rate on the basis of which the bank quotes its merchant rate is known as base rate.

Exchange margin

It the bank quotes the base rate to the customer, it makes no profit. On the other hand, there are administrative costs involved. Further, the deal with the customer takes place first. Only after acquiring or selling the foreign exchange from / to customer, the bank goes to the interbank market to sell or acquire the foreign exchange required covering the deal with the customer. An hour or two might have lapsed by this time. The exchange rates are fluctuating constantly and by the time the deal with the market is concluded, the exchange rate might have turned adverse to the bank. Therefore, sufficient margin should be built into the rate of cover the administrative cost, cover the exchange fluctuation and provide some profit on the transaction to the bank. This is done by loading

exchange margin to the base rate. The margin that is built in to the rate is determined by the concerned bank with in the range prescribed by the fedai.

2.2. Principal types of buying rates

The purchase transaction of a the bank acquires foreign exchange from the customer and pays him in indian rupees. Some of the purchase transaction result in the bank acquiring foreign exchange immediately, while some involve delay in the acquisition of foreign exchange. For instance, if the bank pays a demand draft drawn on it by its correspondent bank, there is no delay because the foreign correspondent bank would already have credited the nastro account of the paying bank while issuing the demand draft. On the other hand, if the bank purchases an 'on demand' bill from the customer, it has first to be sent to the drawee's place for collection.

The bill will be sent to the correspondent bank for collection. The correspondent bank will present the bill to the drawee. The nostro account of the bank with 'f correspondent bank be credited only when the drawee makes payment against the bill, suppose this takes 20 days. The bank will acquire foreign exchange depending upon the time of realization of foreign exchange by the bank, two types of buying rates are quoted in india. They are (i) 71, buying rate, and (if) bill buying rate. Tt buying rate (tt stands for telegraphic transfer).

This is the rate applied when the transaction does not involve any delay in of the foreign exchange by the bank. In other words, the nostro, account of the bank would already have been credited. The rate is calculated by deducting from the interbank buying rate the exchange margin. Fedai has prescribed the exchange margin at 0.025% to 0.08% for tt buying rate. The bank has the discretion to charge exchange margin at any rate within the -.-"rnge prescribed,

Though the name implies telegraphic transfer, it is not necessary that proceeds of the transaction is received by telegram. Any transaction where no delay is involved in the bank acquiring the foreign exchange will be done at the 17 rate. Examples of transactions where tt rate is applied are: (1) payment of demand drafts, mails transfers, telegraphic transfers, etc., drawn on the where bank's nostro account is already credited, and (ii) foreign bills collected.

The method of calculating tt buying rate is shown. Below. It is assumed that the foreign exchange to be purchased is us dollars.

Tt buying rate

Dollar,/ rupee market spot buying rate	= rs……………
Less: exchange margin	= rs ……….......
Tt buying rate*	= rs……………

*rounded off to nearest paise.

Example 1. On 15th september, you a mail transfer from your new york correspondent for usd 5,000 payable to your customer. Your account with correspondent bank has been. Credited with the of the transfer in reimbursement.

Assuming rupees—/us dollars are quoted. In local interbank market as under:

spot	usd i	= rs. 34,2500/2700
spot/ october		2200' /2300

Calculate the exchange rate and the rupee amount payable to the customer bearing in mind that

(i) you require an margin of 0.080% to be loaded in the rate, and

(ii) rupee equivalent should be nearest to the whole rupee.

Solution

the rate applicable is the tt buying rate. The rate quoted to the customer will be based on the market-buying rate of rs. 34.25

dollar / rupee market spot buying rate	=	rs. 34.2500
less: exchange margin at 0.08% on rs.34.25	=	rs. 0.0274
	=	rs. 34.2226

rounded off, the rate quoted to the customer would be rs. 34.22 per dollar.

amount payable to the customer for usd .5.000 at the rate of rs. 34.22 per dollar is 1,71,100

2. Bill buying rate

This is the rate to be applied when a foreign bill is purchased. When a bill is purchased, the proceeds will be realized by the bank after the bill is presented to the drawee at the overseas centre. In the case of usance bill, the proceeds will be realized on the due date of the bill which includes the transit period of the bill. If a sight bill on london is purchased, the realization will be after a period of about 20 days (transit period). The bank will be able to dispose- of the foreign exchange only after this period. Therefore, the rate quoted to the customer would be based not on the spot rate in the interbank market, but on the interbank rate for 20 days forward. Likewise, if the bill purchased is 30 days usance bill, then the bank will realize after about 50 days (20 days transit plus 30 days usance bill, period). Therefore, the bank, would be able to dispose. Of foreign exchange only after 50 days-, the rate to the customer would be based on the interbank rate for 50 days forward.

Two points need noting in loading the bills buying rate with forward margin. First, forward margin is normally available for periods of a calendar month and not for 20 days etc. Secondly, forward margin may be at premium or discount. Premium is to be added to the spot rate and discount should be deducted from it. While making calculations, the bank will see that the period for which forward margin is loaded is beneficial to the bank.

Let us suppose that on 23rd january interbank quotation for us dollar was as under.

Spot usd 1	=	rs. 38.5000/5500
Spot/january		2000/2100
/february		5000/5100
/march		7500/7600

the bank wants to calculate bill-buying rate for a sight bill. The transit period is, say 20 days. The bill on the 12th february. Apparently, the forward rate relevant is spot/february rate as is valid for the entire month of february. However, it should be that forward dollar is at premium. The customer will be getting more rupees per un forward rate than under the spot rate. As we have already seen. The represents interest differential up to the last day of february. Xi –be benefit does not fully accrue on 12th february, when the bill is expected to mature, the bank will not concede premium up to this, month. It will concede premium only up to the last bill buying rate for dollar on the spot/january forward rate completed month and base an the bank takes spot/february forward premium the base rate will be rs.39.00. By taking only spot/january premium, the bank offers only rs.38.70 per dollar, which is beneficial to the bank.] In case of a 30 day's usance bill submitted on the same rate, the expected due date (called the notional due date) is l4th march. The bank will concede premium only up to february. Thus, where the foreign currency is at premium, while calculating the bill buying rate, the bank wild round off the transit and usance periods to lower month.

let us assume that on 18th april, the dollar is at discount and the quotation in the interbank market is as under:

Spot usd 1	=	rs. 37.7500/8000
Spot/april		1300/1200
/may		3000 /2900
/june		5500/5400

The bank is required to quote a rate for purchasing a sight bill on new york. Transit period is 20 days. The bill will fall due on the 8th may. Since

dollar is at discount, forward dollar fetches lesser rupees than spot dollars. In other words, longer the forward period involved, the bank is able to get dollar from the customer at cheaper rate. Therefore, the bank will deduct discount upto may end while quoting for thlis bill. In case of usance bill for 30 days, the due date falls on 7th june, the bank will base its rate to the customer on spot/june forward rate. Hore, the du(— date :a1 the bill is rounded off to the higher month, i.e. End of the month in which it falls. Thus where the foreign currency is at discount, while calculating the bill buying rate, the bank will round off the transit and usance periods to higher month.

It may be worth reciting again the rule for loading -torward margin in the bill buying rate: for calculating bill buying rate, if the forward,is at premium round off the transit period and usance period to lower month; if margin is at discount round off the margin to the higher month.

As noted under tt buying rate, the bank would include exchange margin in the rate quoted to the customer while quoting for purchase of bills also. The fedal has allowed the banks to load exchange margin of 0. 125% to 0. 150% in the rates quoted for purchase of bills. A further margin of 0. 125% to 0. 150% is follovjed for usance bills on dp (documents against payment) terms.

it should have been observed that there, be than one bill rate, each for a different period of usance of the bill. The method of calculating bill buying rate is tabulated below assuming usd dollar to be the foreign currency.

Bill buying rate

Dollar/rupee market spot buying rate = rs .

Add: forward premium

(for transit and usance; rounded off to lower month) or

2.3 principal types of selling rates

When a bank sells foreign exchange, it receives indian rupees from the customer and parts with foreign currency. The sale is effected by issuing a payment instrument on the correspondent bank with whom it maintains the nostro account. Immediately on owe, the bank buys. The requisite foreign exchange from the market and gets its nostro account credited with the amount so that when the payment instrument issued by it is presented to the correspondent bank, it'can be honoured by debit to the nostro account. Therefore for all wm an ready/spot basis to the customer, the bank resorts to the interbank market immediately and the base rate is the interbank spot selling rate. However, depending upon the work involved, viz., whether the sale involvto handling of documents by the bank or not, two type a of selling rates are quoted in india. They are:.

(i) it selling rate; and

(ii) bills selling rate.

I. Tt selling rate

This is the rate to be used for all transactions, which do not involve handling of documents by the bank. Examples of wes for which this rate can be quoted are issue of demand drafts, mail transfers, telegraphic transfers, etc.

The tt selling rate is calculated on the basis of interbank selling rate. The rate to the customer is calculated by adding exchange margin to the interbank rate. The exchange margin allowed by pedai on it selling rate is 0. 12 5% to 0. 150%.

2. Bills selling rate

the rate is to be used for a transactions, which involve handling of documents by the bank: for example, payments against import bills.

the bills selling rate is calculated by adding exchange margin to the tt selling rate. That means the exchange margin enters into the bills selling rate twice, once on the interbank rate and again on the tt selling rate. The rate of exchange margin allowed by fedai on bills selling rate is 0. 175% to 0.200%.

the method of calculating selling rate in tabulated below with us dollar, representing the foreign currency.

2.3. Exchange arithmetic – ii

an exporter in india contracts to sell to a firm in landon machinery at a price of gbp 10,000. Before agreeing to this price, the exporter calculates his cost of production adds a reasonable margin for profit and satisfies that the proceeds of gbp 10,000 would coves- this amount. He bases his calculations an the exchange rate prevailing as on the date of his quotation. For example, if the exchange rate on the date is rs.50 per sterling pound, he expects to receive rs, 5,00,000 on execution of the contract.

The exchange rate is not stable: it is changing every day. By the time, the exporter executes his contract and his bill is realized, which may be after lapse of 3 month or six months the rate of exchange might turned adverse for him. For example, if the raft prevailing on the date when the bill is realized or purchased by his banker is rs. 45, he would receive only rs.4,50,00 as against his estimate of rs.5,00,000. Thus he may have to bear a shortfall of rs.50, 000. True the rate may turn favorable to him and bring him expected profits. But the fact remains that the amount that he would receive on execution of the contract remains uncertain.

This uncertainty about the rate that would prevail on a future date is known as the exchange risks for the exporter, the exporter the exchange risk is

that foreign currency in which. The transaction is designated may depreciate in future and may -bring less than the expected realization on local currency terms.

The importer too faces exchange risk when the transaction is designated in a foreign currency. The risk is that the foreign currency may appreciate in value and he may be compelled to pay in local currency an amount higher than that was originally contemplated. Importers generally make arrangements for loans for payment for the imports. If the foreign currency appreciates subsequent to the arrangement of the loan, the importer may find that the resources are not sufficient to meet the importer bill putting him in a difficult situations

2.5. Features of a forward exchange contract

forward exchange contract is a device, which can afford adequate protection to an importer or an exporter against exchange risk. Under a forward exchange contract a banker and a customer or another banker enter into a contract to buy or sell a fixed amount on a future date at a predetermined rate of exchange.

our exporter, for instance, instead of groping in the dark or making— a wild guess about what the future rate would be, enters into a contract with his banker immediately -starkediately. He agrees to sell foreign exchange of specified amount and currency at a specified future date. The exporter is thus assured of his price in the local currency, in our example, the exporter may enter into a forward contract with the bank for 3 months delivery at rs. 49.50. This rate, as on the date of contract, is known as 3 months forward rate. When the exporter submits his bill under the contract, the banker would purchase it at the rate of re.49.50 irrespective of the spot rate the prevailing.

when rupee was devaluated by about 18% in july 199 1, many importers found that their liabilities has increased overnight. The devaluation of the rupee had the effect of appreciation of foreign currency in terms of rupees. Those importers who had booked forward contracts to cover their imports were a happy lot.

Date of delivery

according to rule 7 of fedai, a ‘forward contract’ is deliverable at a future date, duration of the contract being computed from the spot value date of the transaction. Thus us, if a 3 months forward contract is booked on 12th february, the period of two months should commence from 14th february and the forward contract will fall due on 14th april.

Date of delivery under forward contracts will be:

in case of bills / documents negotiated, purchased or discounted: date of negotiation/ purchase/ discount and payment of rupees to customer.

In case of bills/documents sent for collection: date of payment of rupees to the customer on realization.

in case of retirement/crystallization of import bills/ documents: the date of retirement or crystallization of liability, whichever is earlier.

2.6. Fixed and option forward contracts

The forward contract under which the delivery of foreign exchange should take place on a specified future date is known as fixed forward contract'. For instance, if on 5th march a customer enters into a three months forward contract with his bank to sell gpb 10, 000, it -means the customer would be presenting a bill or any other instrument on 7th june to the 'lank gpb 10,000. He cannot deliver foreign exchange prior to or later than the determined date.

We saw that forward exchange is a device by which the customer tries to cover the exchange. The purpose will be defeated if he is unable to deliver foreign exchange exactly on the date. In real situations, it is not possible for any exporter to determine in advance the precise date on which he will be tendering export documents. Beside internal factors relating to production, many other external factors also decide the date on which he is able to complete shipment and present documents to the bank. A; the most the exporter can only estimate the probable date around which he would be able to complete his commitment.

With a view to eliminating the difficulty in fixing the exact date for delivery of foreign exchange, the customer may be given a choice of delivering the foreign exchange during a given period of days. An arrangement whereby the customer can sell or buy form the bank foreign exchange on any day during a given period of time at predetermined rate of exchange is known as option forward contract'. The rate at which the deal takes place is the option forward rate. For example, on 15th september a customer enters into two months forward sale contract with the bank with p'non over november. It means the customer can sell foreign exchange to the bank on any day between lot november and 30th november. The period from 1st to 30th november is known as the 'option period.

Rules regarding option forward contract (rule 7 of fedal).

1. The option period of delivery should be specified as a calendar week (1st to 7th, 8th to 15th, 16th to 23rd or 24th to last working day of the

month) or a calendar fortnight (i 1st to 15th or 16th to last working day of the month).

2. The option of delivery should not exceed a period of one calendar month; form let to last working day of the month.

(prior to june 1991 revision, rule 4 of fedai governed forward contracts. There the calendar month meant the period between any two corresponding dates in consecutive months (15th january to 14 february). -ustomer booked a forward contract on 25th july with option over the third month, the option period would -be 25th september to 24th october).

3. As between a bank and a customer the option is that of the customer. So the bank cannot force the customer to deliver foreign exchange on any specific date. It is upto the customer to choose any date within the option

Sx-gooking of ‘forward contracts:

The stages involved in booking and’utilization of a forward contract may be summarized as under.

1. The transaction of booking of forward contract is initiated with the customer enquiring of his rate at which required forward currency is available. Before quoting a rate, bank should get details about (i) the currency, (ii) the period of forward cover, including the particulars of option, and (iii) the nature and tenor of the instrument. For instance, when the customer says simply ‘dollar’, the bank should ascertain whether it is us dollar or canadian dollar or australian dollar. Similarly, if it is a bill transaction, it should be ascertained whether it is sight bill or 30 days bill, etc, in the case of usance bills, whether the due date is calculated from sight or from the date of bill of lading. Differences on these counts would vary the rate applicable.

2. The branch may not be fed with forward rates of all currencies by the dealing room. Even for major currencies, forward rates for standard delivery period may only be available at the branch. If the rate for the currency and/or delivery period is not available, the branch should contact the dealing room over phone or telex and obtain the rate.

(d) no usance option may be stated in any contract for the purchase of bills. That is, the contract should not give option to the customer to tender eight bell or in the alternative 30-day’s bill, etc. It can be either eight bill or a usance bill -of a specified usance as mentioned in the contract.

(c) the first portion of the contract is relevant for booking of the contract. The second portion is used for recording deliveries under the contract.

(f) the contract should be complete in all respects.

6. The number of copies of the contract prepared will depend upon the requirements of the bank. The original of the contract duly signed by the bank, along with the duplicate, is sent to the customer. The duplicate signed by the customer is returned to the bank for its records.

7. The details of the contract are entered in a forward contract register. The register also provides for recording details of documentary evidence verified.

8. The documents. Are. Verified and marked with the bank stamp and signature of the bank official, after entering the particulars of the forward contract booked. It is returned to the customer.

9. The due date of the contract should be diarised in a register and followed up on the due date.

10. A minimum of rs.250 is recovered room the customer as charges for booking the forward contract.

11. When the customer delivers foreign exchange on the due date, the transaction is done at the rate agreed.

the method of calculation of forward rates is similar to that for ready rates. The only difference is that in the case of forward rates, the forward margin that is included in the rate will be for forward period as well. That is, the forward discount or the forward premium included in the buying rate will be not only for the transit period and usance, but also for the forward period. For instance, if the bank buys a 30 days' sight bill for 2 months forward, the total forward discount' will be for (30 days usance + 20 days transit + 2 numfte toward, rounded off to higher month) 4 months.

For selling rates, forward margin is not considered while calculating ready rate& in the case of forward rates. The forward margin for the forward period will be included. In other respects, the calculation is same as that of ready rates.

5.5 calculation of fixed forward rates;

the method of calculation of forward rates is tabulated below, separate table for tt buying is not given since the method is same as that for bill buying rate. For tt buying rate, forward margin will be included only for forward period.

EXPORT FINANCING

3.0. Introduction

All the financial requirements of an exporter, from the time he enters into a sale contract and starts working on it and till he receives final payment from the importer, are met by commercial banks. The facilities available from banks are generally divided into two broad heads: (i) pre-shipment finance, and (ii) post-shipment finance.

Pre-shipment finance or packing credit is the advance granted to the exporter to procure, process, manufacture-, pack and prepare the goods for export. In other words, it is the facility extended to the exporter before and till foods, are shipped for export,

Post-shipment finance refers to the credit facilities extended to the exporter from the time goods are shipped and till the export proceeds are realized. Post-shipment finance may take any of the following forms:

(a) negotiation of a bill drawn under a letter of credit;

(b) purchase of a bill not drawn under a letter of credit;

(c) advance against bill sent for collection; and

(d) advance against export incentives like duty drawback.

3.1. Packing credit

Definition

A pre-shipment credit or packing credit is any loan or advance to an exporter for financing the purchase, processing, manufacturing or packing of goods meant for export.

Eligibility (c)

(a) direct exports.

The pre-shipment credit can be granted to bonafide exporters generally on the strength of letter credit established by banks of standing abroad in favour of the exporter. If no letter of credit has been established, the credit can be granted on strength of a firm a order. The bank should ensure that the letter of credit or the firm order is lodged with it. In case the exporter is not able to lodge the letter of credit or firm order immediately, the packing credit may be granted on the strength of cables, letters, etc., exchanged between the exporter and the importer. In such cases, it should be ensured that the letter of credit or firm order is lodged by the exporter after a reasonable period of time.

(b) indirect exports

packing, credit can be granted to manufactures/ suppliers who do not have letters of credit or export orders in their own name and are routing their

exports through the state trading corporation/minerals and metals trading corporation or other export house, agencies, etc. Adopting the following procedure:

(i) the export house should issue a letter stating out the details of the export order and the portion thereof to be executed by the manufacturer and also certifying that the export house has not obtained/will not ask for packing credit facility in respect of such portion of the order as is to be executed by the manufacturer.

(ii) the export house should open inland letter of credit in favour of the – supplier giving relevant particulars of the export letter of credit/order and the outstanding in the packing credit account should be extinguished by negotiation of bills under such an inland letter of credit. If it is inconvenient for the export house to open such an inland letter of credit in favour of the manufacturer, the latter should draw bills on the export house in respect of the goods supplied for export and adjust packing credit advance from proceeds of such bills.

(iii) the manufacturer should give an undertaking that the advance payment if any, received from the export house against the export order would be credited to the packing credit account

(c) sub-suppliers

Packing credit can be granted to sub-suppliers of raw materials, components of exported goods, on the basis of the inland letter of credit opened in favour of the supplier by the exporter concerned. On supply made by the supplier to the exporter, the exporter’s bank will pay the supplier and absorb the amount in the packing credit account of the exporter.

Exporter oriented units/export processing zone units supplying goods to another eou / epz unit for export purposes are also eligible for packing credit.

(d) deemed exports.

packing credit can be. Extended to parties against orders for supplies to projects financed by multilateral or bilateral agencies. Funds (such as ibrd,adb,opec) which is recognized as deemed export under the export import policy provided.,

3.2. Type of account

normally, packing credit will be extended in the form of a loan account., a separate account being maintained for each export order. The request from the party should be supported by lodgment of letter of credit or firm order as mentioned in a, (a) under eligibility above. However, depending upon the merits of the case, banks may extend packing credit as a running account (i.e.,

single cash credit account for all export ordered and also waive the condition of prior lodgement of letter of credit / firm order, provided the

Following conditions are fulfilled:

(i) the need for running account facility has been established by the exporter to the satisfaction to the bank.

The exporter's track record continues to be good;

(ii) the letter to credit/firm order should produced within 30 days;

(iii) the packing credit account should be maintained separately and not mixed with normal current account or cash credit account of the customer

3.3. Period of loan and interest

the period for which a packing credit may be grated depends upon the circumstances of the individual. Case, such as the time required for procuring, manufacturing or processing and shipping the related goods. But as a general - guidance, it should not exeedl.180days. If the exporter requires extension of period of advance, the bank may grant it taking into account the circumstances of the case. In exceptional cases, the bank may also consider granting packing credit for periods upto 270 days. Currently, interest is chargeable at 10% for period up to 180 days and at 13% for period beyond 180days and upto 270 days provided the bank agrees for extension. Concessional interest is not available beyond 270days in any case and beyond 180 days where extension is not sought by the exporter or it is denied by the bank. If the advance is not adjusted within360 days, domestic rate plus 2% is chargeable from day one of advance.

where the export house and the supplier/ manufacturer avail the packing credit for the same order, the period for which the concessions! Rate of interest is available may be apportioned between the two. For example, pre-shipment finance at 10% pa. May be made available to the supplier for 90days and to the export house for the balance of.90days

the concessional rates of interest and the periods for which they are available are determined by the reserve bank.

Quantum of advance

normally the amount advanced as pre-shipment finance should not exceed the fob price or the domestic cost of production whichever is lesser. Margin may also be stipulated depending upon the party's worth and the commodity to be exported. If the letter of credit or firm order is on cif/cfr basis, the value should be reduced to fob value and finance eligible should be calculated on that value.

Advance exceeding that fob value, but upto the domestic cost of production, can be made in case the commodity is eligible for duty drawback

and the advance is covered by export production finance guarantee of eggs. As soon as the shipment is made, the bill amount should be adjusted towards the packing credit account and any amount adjusted out of duty drawback to be received later.

Advance exceeding the fob value, but upto the raw material cost, can also be made in the case of export of hps groundnuts and defiled / defatted cakes. The excess is to be adjusted within 30 days from the date of export.

If the exporter has an intention of transferring funds to his eefc account out of exports under a letter of credit or frim order, packing credit can be granted only for the balance amount.

3.4. Sources of repayment

The packing credit account should be repaid out of the proceeds of foreign bills of exchange drawn under the export contract. It may also be repaid out of export incentives like duty drawback.

3.5. Substitution of commodity/fresh export.

In case the exporter is not able to export against the original contract due to reasons beyond his control, the packing credit may be adjusted by negotiating export bills relating to another contract, provided the goods financed against are exported under the substituted contract within a reasonable time. Substitution of commodity fresh export.

In respect of exporters with good track record, banks may:

(i) permit liquidation of packing credit by exporting some other commodity where it becomes commercially necessary and unavoidable; and

(ii) mark off the existing packing credit with export proceeds of documents against which no packing credit has been drawn by the exporter.

the relaxation is not to be extended to transactions of sister/ associate/group concerns. Banks should ensure that the exporter has not availed of packing credit from another bank against the documents submitted. Banks should also satisfy themselves about the valid reasons as to why the packing credit extended for shipment of a particular commodity be liquidated by the normal method.

Rupee payment

if the export cannot take place at all, the account may be adjusted out of local funds. But interest at domestic rate plus 2% should be charged on the account from the date of advance.

Appraisal

Packing credit is to be adjusted out of the export bills tendered by the borrower on shipment of goods. Therefore, the packing credit limit should be considered along with limit for purchase of foreign bills.

The normal credit appraisal norms used by the bank are applied in the case of grant of packing credit also. The bank has to decide on the basis of the borrower's character, capital, etc., besides his experience in export. In addition, the bank should judge if export would take place. This entails enquiring into if exchange control regulations have been or will be fulfilled. The applicant has an importer-exporter code number allotted by the regional trade control authorities.

(a) the exporter's name is not in the exporter's caution list of the reserve bank.

(b) the goods to be exported are not banned for export.

(c) the letter of credit/firm order provides all essential details like the type and quality of goods to be exported, price, quantity, shipment date etc. They do not violate any of our exchange control regulations relating to terms and method of payment.

(d) there is sufficient time allowed in the letter of credit/firm order to enable the exporter to manufacture the goods and export them.

(e) the country to which exports to be made is not under political or economic stress, which may delay remittance of foreign exchange -by the country. Ecgc may help in getting information in this regard.

(f) if the letter of credit is restricted to some other bank, the exporter gives an undertaking to route the bills through the bank making the advance.

Conduct of account

separate loan account should be maintained for each export contract unless it is decided to grant the running account facility. The loan should be disbursed in stages depending upon the requirements of the exporter. Lump sum disbursement disregarding the actual requirement for the purpose of the loan should be discouraged.

All the goods that are purchased out of the loan are either hypothecated or pledged to the bank. Thus packing credit may be secured by hypothecation or pledge of goods. But the credit may remain a clean advance also. This may be the case where payment is to be made in advance for procurement of required material or where payment is made for services.

The normal precautions and procedures followed in advances against goods should be followed in the case of packing credits also. This includes periodical inspection of godowns and stock verifications. Margin may also be stipulated taking into account the worth of the party and the nature of goods to be exported.

Where the packing credit is in the form of cash credit account, the bank should see that the operations in the account are confined only to export transactions. All export proceeds should be credited to this account. Earliest debit in the account would be adjusted first out of the credits made into the account, irrespective of the contract to which such debits and credits relate.

Documentation

All documents taken for advance against goods, viz., demand promissory note, hypothecation or pledge agreement, etc., should be taken for packing credit also in addition some banks have a separate packing credit agreement.

3.6. Pre-shipment credit in foreign currency

Under the pre-shipment credit in foreign currency (pcfc) exporters are allowed to avail pre-shipment credit in a convertible' currency at interest rates not exceeding 2%over 6 months. The credit will be self-liquidating in nature and will be adjusted by discounting the relative export bill designated in foreign currency.

The credit under the scheme is available for a maximum period of 180days. If extended beyond this period, 2% penal interest is charged. If the pcfc is not adjusted within 360days, it will be adjusted at the tt selling rate for the currency concerned and will be treated as a rupee advance.

Pcfc can be extended in one convertible currency in respect of an export order invoiced in another convertible currency. For instance, an exporter can avail of pcfc in us dollar against an export order invoiced in deutsche mark. The risk and cost of cross currency transaction will be that of the exporter.

If pcfc has been availed by the exporter against an export order, the export bill drawn under that will have to be discounted with the bank under the export bills discounting scheme, pcfc will be adjusted by discounting the bill. Interest at libor plus 2% is changed on the bill thus discounted. The bank will realize the bill in foreign currency and adjust the foreign currency liability under export bills discounted account. The balance, if any will be converted at the ruling it buying rate and paid to the exporter.

Other conditions and eligibility are similar to that of packing credit in rupees.

3.7. Advance against duty drawback

The import duty paid on raw materials or components for export products or the excise duty paid on items indigenously produced for export and repaid to the exporter on completion of the export. The item, on which duty drawback is available, is determined by government policies.

The need for advance against duty drawback a arises because of the delay involved in verifying the claims of the exporter by the authorities concerned and payment of the drawback by %them. The funds are locked up during this interval and the export seeks financial assistance from the bank to tide over the situation.

Normally, the exporter can claim the- drawback amount from the customs authorities only after export of goods by producing the necessary documents to them. But bank finance against incentives may be made available either at the pre-shipment stage or at the post-shipment stage.

Advance at the pre-shipment stage may take the from of packing credit being granted at a - level higher than the fob value of the contract. As already discussed under shipment finance, bank can grant packing credit advances upto certain percentages above the fob value, but not exceeding the domestic cost of production in respect of goods which are entitled for duty drawback from the government. In such cases, the excess over the fob value advanced by the bank amounts to advance against duty drawback. Advance against drawback at the pre-shipment stage is granted only. Exporters of good standing on their furnishing satisfactory evidence to the bank as to the amount of their entitlements. The exporter should also undertake to authorise the bank to receive the entitlement when he makes claim with the concerned authorities.

Advance may also be made at the post-shipment stage as a separate limit. The advance will be disbursed when the exporter makes a claim with the concerned authorities and produces copies of the claims to the bank.

As per the reserve bank of india directive, advance -against incentives can be granted for a maximum period of 90 days at an interest rate of 10% per annum. The advance is to be adjusted out of the incentives to be received by the bank on behalf of the exporter. All claims are now payable directly to the bank. A deceleration by the exporter authorizing payment to the bank should be registered with the concerned authorities.

The bank may prescribe a margin after considering the merits of each case. If there a part of packing credit, the documents taken for packing credit would be sufficient for this facility also. If the facility is granted as a separate limit, an agreement for hypothecation of book debts may be taken. The advance can be covered under export production finance guarantee or export finance

guarantee of ecgc. It is to be adjusted out of the incentives received from the government. If the advance is not adjusted within 90 days, it is treated as overdue. If the account is adjusted out of local funds, i.e., not the export incentive, domestic rate of interest is charged from the date of advance.

Model questions

1. Briefly explain packing credit
2. Explain critically about the duty drawback foreign.
3. How do you appraise the loan application meant for packing credit ?

Export financing – II

3.8. Introduction purchase negotiation of export bill

When a bill is drawn under a letter of credit, the bank has credit to look to the conditions to be fulfilled in the preparation of the documents. But where the transaction is not covered by a letter of credit, only the sale contract between the exporter and the should be relied upon. The bank may have a general scrutiny of the sale contract to see that the documents tendered are in order. Besides, specific instructions should be obtained from the exporter regarding such matters as the tenor- of the bill, whether the documents should be delivered against payment or acceptance, the bank through whom the documents are to be submitted, the commission and other charges to be recovered from the drawee or from the proceeds, case- in-need if any for the bill, etc,. The bill is purchased at the bill buying rate.

3.9. Procedure on purchase/negotiation of bill:

1. All documents should be verified along with the covering schedule received from the exporter. They should be branded with the bank's round/collection stamp. Fbp/fbn should be entered on all documents. While entering the number, the bank should follow the uniform procedure suggested by the reserve bank.

The uniform numbering suggested by reserve bank includes an alphabetical prefix n(bill negotiated), p (bill purchased), d(bills discounted),c (bills sent for collection), a consignment. Export(account sale)], m[others(miscellaneous)] and a six digit serial number starting with 000001 1 on 1 1st january each year.

2. The documents will normally be sent in two sets unless the letter of credit or the instructions of the drawer prevents it. All documents are endorsed in favour of the collecting bank before they are sent.,

3. The bank has an obligation to reserve bank to see that the proceeds are received in india in full. To do so, the bank may provide columns in the bills registered of entering the gr/pp form number and due date before which the duplicate has to be sent to reserve bank or, a separate due date registered may be maintain for this as purpose.

4. In respect of bills purchased or negotiated, the bank should submit to the reserve bank a statement in form enc every fortnight along with r returns.

5. On purchase/ negotiation of the bill, the account of the customer is credited with, the value of the bill, converting into indian rupees by applying the sight and relevant bill buying rate.

6. Simultaneous with purchase of the bill. The bank should recover interest for the normal transit period plus usance of the bill at the rate applicable for exports. There are two exception to this rule;

(i) in the case of tt (documentary) bills, where in reimbursement of documentary bill is obtained by tt; bank shall recover interest at the time of negotiation for 5days. If, however, the bank is permitted to draw a tt directly in respect of negotiation under a letter of credit, no such interest shall be charged to the customer.

(ii) in the case of export bills despatched by courier service, interest shall be charged for a period of 10 days only provided;

(a) courier charges are recovered from the customer, and

(b) courier service pertains only to point-to -point service and it is not up to a point other than final destination of the documents (place of importer).

7. The bank should follow up the bills sent and keep a watch that payment advises are received from the collecting bank in time. In case of delay, it should take up the matter both with the collecting bank and the exporter. If the bill was drawn under a letter of credit and the documents were in order, the prime responsibility- of the credit. Opening bank exists

8. If the importer defaults, the bank may ask the exporter to find out an alternative buyer. If am alternative buyer cannot be found on suitable terms, the goods may be reimported. The decission will depend upon the cost of reimporting (i.e., additional freight involved against the value of goods).

9. If the shipment is lost before payment against the consignment is received, the bank should prefer claim with the insurance company for the loss.

10. For any reason (other than the bank's own default or negligence) if the bill is not paid, the bank should lodge the claim with ecgc under the policy and guarantee issued by the corporation covering the transaction.

Interest on post-shipment advance:

interest on post-shipment credit upto.90 days is chargeable at 1.0% pa. And from 9l days and upto 180 days at 13% pa. For periods beyond 180 days banks are free to their own interest rates.

Collection of exports bills:

An export bill which is not purchased or negotiated by the bank may be taken up for collection. While collecting the bill for the customer, the banker acts as an agent for the former. . He takes steps to collect a bill on behalf of and on account of the customer and in accordance with the instructions of the latter. The amount of the bill is credited to the customer's account only after

realization of the bill. Therefore, there is no risk involved for the bank. However, the work involves expense. Further, the bank has an obligation to see that the exchange control requirements are not violated. Therefore, this service is rendered only to known and worthy customers of the bank.

Uniform rules for collection:

Collection of a foreign bill involves many parties: the exporter(principal or drawer), his banker(remitting bank), the importer (the drawee), and the bank in his country (collecting bank). To have a common code of understanding and standardized procedure and practice for the purpose, the uniform rules for the collection of commercial paper, a publication of the international chamber of commerce, was first brought out in 1956. If was revised in 1967 and further in 1978, and was titled uniform rules for collection'.

The current 1995 revision of the rules (publication no .522 of the international chamber of commerce) has been adopted with effect from let january, 1996. They have been accepted in many countries. They are binding on the parties involved in the collection of foreign bills in the countries where they have been accepted, unless otherwise expressly agreed. Fedai has approved the adoption of the rules in india.

The rules cover comprehensively the procedure to be followed for presentation, payment, acceptance, protest, advice of fate, etc., and the responsibilities and liabilities of the bank involved. In the discussion that follows the provisions of the rules have been taken into account; the articles referred to are of the uniform rules for collection.

Procedure at the bank

The bank which receives the bill for collection should verify that the collection order gives complete instructions as required. It should verify that all documents as listed in the collection order are received. In case of any discrepancy it should immediately be brought to the notice of the drawer. The bill should be sent without delay to a bank in the drawee's country. In. Its covering letter, all the instructions of the drawer should be clearly incorporated.

All advice received from the collecting banker should be promptly intimated to drawer. Similarly, when intimation of payment is issued from the collecting bank, the proceeds of the bill should be forthwith placed to the credit of the customer's account, subject, of course to the advances if any, made by the bank to the drawer against the bill.

The rate of exchange to be applied on realization of the bills is the tt buying rate. Since the rate does not include bank's commission, it is recovered separately at the rates prescribed by the fedai.

(b) negotiation under reserve.

Even where the confirmation of the opening bank is sought by cable, it take some time to get it. If the party is in urgent need of funds and cannot wait and the bank's rating of the customer is high, the documents may be negotiated by the. Bank on the understanding that if the documents are not accepted by the opening bank and the negotiating bank is not reimbursed, the negotiating bank shall have the right to receive. Back the amount paid to the exporter along with interest and other charges. As already noted negotiating under reserve is done only for customers of good standing.

(a) negotiation against indemnity.

Where the bank is not satisfied with the informal arrangement of negotiation under reserve, it may adopt a more legalistic method of obtaining an indemnity bond in favour of the bank under which he promises to reimburse the bank for any loss that the bank may be put, to on account of negotiating the document with discrepancy. The indemnity bond should include all discrepancies found in the documents. Normally it also provides immunity to the bank against any other discrepancy that may be found later.

(d) take under collection.

If the bank does not want to take risk, it may not make immediate payment against the documents and take the documents only for collection.

Where the documents are presented by a. Person other than the customer of the bank, the negotiating bank may request that the documents be presented through the exporter's bank. Here too, if discrepancies are found in the documents, the bank may:

(a) pay after getting confirmation from the opening bank; or

(b) pay against indemnity of the exporter's bank; or

(c) refuse to accept the documents.

Model questions

1. Briefly explain about the exports how they get finance at the post –shipment stage?
2. Explain about discrepancies in export documents ?

3.6. Export financing - iii

The financing of an export transaction can be through seller's credit or buyer's credit. Seller's credit or supplier's credit is the normal procedure where the exporter avails credit himself from the bank or uses his own funds and allows the importer to pay at a later date. The transaction is financed by the exporter (seller or supplier) or by his borrowing and hence it is known as the "supplier's or seller's credit". The exporter may avail pre-shipment finance from his bank which enables him to procure the raw materials required, manufacture as finished product and ship it to the importer. At the post shipment stage he may allow the importer to pay the amount in installments. He would then avail post-shipment finance for a similar term from his bank. In addition to granting pre-shipment and post-shipment finance, the exporter's bank may be required to execute performance guarantee on behalf of the exporter guaranteeing the performance of his obligations under the contract of age.

The seller has given an undertaking to his bank to repay the loan he has borrowed. The understanding is independent of the payment of the contract amount by the importer. Therefore, seller bears the risk of' non-payment by the importer (this know as the credit further his borrowing from as the exchange, risk.) The exporter should. Therefore, take adequate steps to guard himself against this india, ecgc's exchange risk policy protects the exporter against exchange risk.

2. Buyer's credit

Under buyer's credit the exporter's bank directly finances the importer or the importer's bank. The exporter gets payment immediately. At the pre-shipment stage, the buyer's credit may take the form of the importer opening a 'red clause' 'letter of credit authorizing the exporter's bank to extend pre-shipment finance to the exporter. At the post-shipment stage the exporter's bank would make immediate payment to the exporter by extending loan to importer. That is, the exporter is paid out of the loan granted to the importer. The importer's bank would guarantee the repayment of the loan by the importer. Or, the loan may be granted to the importers bank instead of to the importer.

The seller receives the amount due under the contract immediately and is not responsible for payment by the importer. Therefore, the credit risk is borne by the bank in the buyer's credit. If the loan is granted in foreign currency, repayment would come in that currency and therefore the bank is bearing the exchange risk also.

The exchange control regulation in india require that banks should obtain prior approval of the reserve bank before agreeing buyer's credit to importer abroad.It is also stipulated that the exporter will have to the contract itself for the exchange fluctuations risk to be borne by the financial india.

3. Deferred payment exports

an export contract providing for payment from the date of shipment is known as deferred payment contract. Payment may be made by the importer over a period in installments. All deferred payment contract requires prior approval of the reserve bank. Exports on deferred payment terms are allowed in respect of selected engineering goods.

4. Turnkey projects

Projects which involve rendering of like civil construction, erection, commissioning of plant or supersession along with the of equipment are known as turnkey projects, all requirements of project like issuing, of guarantees by bank on behalf of exporters, opening of site offices, opening and operating of foreign currency accounts abroad, bridging finance by way of remittance from india on repatriation basis or overdraft arrangements with overseas banks, third country imports and payment of commission to agents and governed by exchange control regulations. All proposals for turnkey projects, whether on deferred terms or not, require prior approval of the reserve bank.

5. Construction contract

the turnkey project as defined above may be entrusted to two different exporters, one undertaking the construction contract and the other exporting services/ technical know-how. Thus construction contract involves erection, civil works and commissioning apart from supply of equipment.

6. Export of consultancy services

in the case of pure services contracts/ assignments involving supply of technical/ managerial know-how, engineering services, professional consultancy, etc., the contractor is not responsible for organizing supplies of machinery, equipment and or materials going in the turnkey / construction project. At best he may have to procure tools, instruments etc., for his own personnel for performing the jobs. It certain cases he may be called upon to give performance guarantee limited to the scope of his work and for satisfactory performance of the personnel supplied and technical services rendered.

3.7. Financing of project exports

Working group

various aspects of project contracts require approval of several institutions in india such as reserve bank, exim bank ecgc and the financing bank. With view to obviating the necessity for exporters to approach different agencies for obtaining approvals and avoiding delays, a working group comprising representatives of exim bank, reserve bank, ecgc and the bankers of the exporter with exim banks as the focal point is functioning to grant package clearance to proposals submitted by exporters. In case of contracts of high value representatives of finance and commerce ministries of government of india will also ordinarily participate in the meetings of the working group. In order to obtain immediate clarification and thus quicken the disposal by the working group/ exporters are also encouraged, particularly where high value proposals are involved.

for executing a project abroad, the exporter has to pass through the follow stages.

obtaining pre-bid clearance from the working group.

submission of bids to the employer.

obtaining post-did clearance from the working group.

taking up and completion of the project.

Pre-did clearance:

exporter desiring to submit bids for deferred payment exports or turkey projects should apply to their bankers in form dpx-1 in ten copies, at least ten working days before the last date for submission of the bid. If the contract is for rs. 25 crores or less, the bank concerned, and if the contract is for value above rs. 25 crores but with rs. 100 crores the exim bank can grant clearance in principle provided the following conditions are fulfilled:

(a) The period of deferred credit should conform to the maximum period allowed by exchange control regulations. For capital/ producer goods and turnkey projects the period of credit that may be offered is as under:

Contact value	capital/ producer goods	trunkey project
Up to rs. 1. 0 lakhs	3 years	4years
Over rs.50 lakhs	5 years	6 years
Over rs.50 lakhs but not	8 years	9 year
Exceeding	rs. 1 crore	
Over rs. I crore	1 years	12 years

consumer durables and miscellaneous engineering goods should ordinarily be exported only on cash terms. In exceptional cases, deferred payment terms may be extended upto one year from the date of shipment., where the value of individual i export order is rs. 10 lakhs or more, credit period may be increased upto a urn of two years.

(b) moratorium for repayment of principal should not exceed one year in respect of export of capital/produce goods and two years for turnkey projects. No moratorium for export of consumer durables and for payment of interest.

(c) deferred receivables should be received in equal half yearly installments over the agreed period with relation to the mean date of shipment or the date of respective shipments.

(d) the rate of interest on deferred receivables should normally cover the cost of post-shipment credit to the exporter at the prevailing rate.

(e) down payment together with advance payment should not be less than 10 per cent of the contract value. The rate of agency commission should not exceed 5 per cent of the contract value.

(f) down payments and deferred payments receivable should be secured by a letter of credit/ bank guarantee or promissory note from the foreign government.

(g) bridge finance for meeting temporary shortfalls in working capital. Should not normally exceed 10 per cent of the working group.

proposals not conforming to the above and those in excess of re. 100 crores should be got cleared by the working group.

once the proposal is cleared the bankers of the exporter may furnish the bid bond. If the bid is successful, the exporters may enter into the contract with the overseas buy buyer and apply for post-award clearance.

Post-bid clearance:

within fifteen days of entering into contract, the exporter should submit to his bankers an application in form dpx-3 (in respect of deferred payment supply contract) or in form pex-4 aspect of civil construction contracts.), in ten' copies along with eight copies of the contract. If there are any indian subcontractors, they should be advised by the: prime contractor to submit similar application to the bankers of the prime contractor for obtaining approval of the portion of the contract to each sub-contractor.

depending upon the fact whether the pre-bid clearance was granted by the bank itself, exim bank or by the working group, the bank will grant the post bid approval or forward the application to exim bank or the working group as the case may be for their approval. The approvals given by these institutions are

only approvals in principle. In all cases, the final approvals for various fund based and non-fund based facilities as well as requisite exchange control approvals will be issued separately by the concerned institution and the exporter's bankers on the basis of the decisions taken while granting the package post-award clearance.

all exports under deferred payment terms should be declared on gr/pp form bearing domicile prefix of that office of reserve bank in whose jurisdiction their head office is functioning. Likewise, all sub suppliers should declare their exports on forms bearing the same domicile prefix as that used by the prime contractor for the exports, irrespective of the location of the office of the sub supplier.

all gr/pp forms should bear a suitable notation on the top of the form indicating the project/job for which supplies are being made and number and date of reserve bank's approval.

3.8. Other services to exporters 1. Advising letters of credit:

the letter of credit issued in favour of exporters in india is normally advised through a bank in india. A bank in india may receive a request to advise the letter of credit from its correspondent bank abroad.

the letter of credit may be received through cable or by airmail. Where the credit is received by cable, 'the bank should verify the authenticity by means of the test code incorporated in the message. It should also be noted, if there is a mention about airmail confirmation. In the absence of any such notation, the cable message will be the operative instrument. The bank should incorporate the cable message in its own format and send it to the beneficiary. The standard formats used for this purpose are designed to convey to the beneficiary the fact that the bank is only an advising bank and does not undertake any under the credit that is being advised.

where the letter of credit is received by airmail, the bank should verify the authenticity of the letter of credit by comparing the signature on the credit with the specimen signatures supplied by the issuing bank; the letter of credit may be advised in either of the two ways:

(a) the credit received is incorporated in the format of the advising bank and forwarded to the beneficiary.

(b) more commonly, the credit received is forwarded in original to the beneficiary. The advising bank may certify that the signatures on the credit have been verified, by way of a rubber stamp affixed on the letter of credit. Or, a covering letter from the bank may accompany the credit. Such letters of credit are called band-on credits.

Whether it is cable credit or airmail credit, the bank should ensure the following:

The letter of credit conforms to the exchange control requirements in india, proper record is maintained for the letters of credit advised.

commission for advising the credit is recovered from the beneficiary. If the beneficiary fails to pay, the bank can recover it from the opening bank.

a notation is made in the credit that stamps worth rs.2 should be affixed on the instrument before documents are negotiated under the credit. A statement, in form stat 9, is sent to the reserve batik every month on all letters of credit advised, including those confirmed by it.

advising amendments: if the credit is amended, the bank should follow the same procedure for advising the amendment as is followed for advising the letter of credit. Record of the amendment advised should be kept along with the record of advising of the letter of credit.

1. Confirming letters of credit

a letter of credit may be confirmed by the bank in india when a request to this effect is received from the opening bank of the credit. The branch which receives the request to confirm should consult the head office to verify that the limit fixed for the opening bank for confirming letters of credit on its behalf is not exceeded.

the letter of is confirmed by making -an appropriate note in the letter of credit under the signature of the of' officials of the confirming bank. The confirmed credit is then advised to the beneficiary. For the risk involved in confirming letters of credit, the bank can avail of the transfer guarantee of the ecgc.

2. Transfer of letters of credit

a request may be received from the beneficiary of the credit to transfer a part or whole of the credit to other exporters. The bank should verify that (i) the

credit is transferable; and (ii) the second beneficiary is an exporter -having an exporter's code number.

if the entire credit is transferred to the another exporter and the first beneficiary does not mind the importer and the second beneficiary knowing each other, the transfer can be effected by simply making an endorsement to this effect and forwarding it to the second beneficiary, in other cases, the bank may get the original credit lodged with it and issued another credit, in favour of the second beneficiary. The credit thus issued will conform to the requirements of ucp for transferring credits.

if partial shipment is allowed, the first beneficiary may require the, credit to be transferred to more than one second beneficiary for part of the amount each. If no secrecy need be maintained, photostat copies of the original credit may be taken and forwarded to the second beneficiaries along with a letter of the bank apportioning the credit to each, to the extent stipulated by the first beneficiary. In other cases, bank will issue fresh credits. In all cases the original credit is lodged with the bank.

Model questions

1. Define the financing of project exports.
2. What are turnkey projects?

EXPORT IMPORT BANK OF INDIA

4.0. Introduction

The export-import bank of india (exim bank) is a public sector financial institution established on january 1, 1982. Was established by an act of parliament for the purpose of financing, facilitating, promoting foreign trade of india. It is the principal financial institution for coordinating the working of institutions engaged in financing export and import. The exim bank act also empowers the bank to finance. Export of consultancy and related services, assist indian joint ventures in third countries, conduct export market studies, finance export oriented industries and provide international merchant banking - services. Exim bank concentrates on medium and long term financing leaving the short term financing to be handled by commercial banks.

The activities of the bank extend to different fields of lending, offering advisory services and promotional activities

4.1. Lending to indian exports 1. Suppliers credit

Funds are provided on deferred payment terms, to indian exporters of plant equipment and related services which enable them, to extend deferred credit to the overseas buyer. This programmer covers project exports which could be turnkey projects or construction projects.

The credit extended to the exporters on deferred payment terms is subject to the stipulation of the reserve bank with regard to period of credit, quantum of finance etc.,

The credit is provided by exim bank in participation with commercial banks. Where individual contract value is not more than rs. 3 crores, banks may provide the credit and avail 100% refinance from the exim bank.

The exporter is expected to obtain an advance and down payment of atleast 15% of the contract value. Down payment and payment of deferred instalment should be secured by a letter of credit and / or a guarantee from a bank in the country of import or any third country as may be acceptable to the exim bank. Where the importer is the government or public sector undertaking, a guarantee from the government and / or promissory note from the government and / or undertaking may be acceptable. In order to ensure release of foreign exchange according to the agreed schedule, a letter from the central bank of the concerned foreign country giving an undertaking regarding prompt release of exchange towards the receivable may also be required.

2. Consultancy and technology services finance programme

Indian consultants executing overseas contracts involving consultancy and technology services wherein deferred payment terms need to be offered to

the clients can utilize the facility. The credit will be extended by the exim bank in participation in commercial banks.

The exporter is normally expected to obtain an advance / down payment of 25% of the contract value and remaining portions will be covered by credit under the programme. The currency of the credit would normally be in indian rupees. Loans in other currencies can also be considered if required.

3. Overseas investments financing programme

Exim bank provides financing, where an indian company establishes a joint ventures overseas and requires funds towards equity participation. The joint venture should have been approved by the government of india as well as the concerned authorities in the host country. Rupee funds are provided by exim bank in the form of long-term credit normally not exceeding ten years. The equity shares issued to the indian promoter are required to be pledged to the exin bank together with a mandate/ assignment in its favour in respect of receivables arising from know how/management fees, royalties, dividends, etc., on the investments. The bank may also stipulate as collateral security charges on the assets of the promoters in india and personal guarantees. The indian promoters are required to obtain the ecgc's overseas investment policy and assign it in favour of the exim bank/ participating bank.

4. Pre-shipment credit

Credit is available to eligible exporters to buy raw materials and inputs required to produce capital equipment that has to be exported. Exim bank participates in the credit, if the requirement is for periods in excess of 180 days. Pre-shipment credit upto 180 days is available'from commercial banks and therefore, exim bank does not entertain proposals not exceeding this period.

4. Export -oriented units

Units registered as 100% export-oriented units set upto be set up in free trade zones and domestic tariff area [dta] units exporting not less than 25% of their annual sales are eligible for financial assistance from exim bank for acquisition of land, building, plant, and machinery and other miscellaneous fixed assets along with money for working capital and preliminary/pre-operative costs.

6. Computers software exports

Under the government ' india policy on computer software exports and development. Exim bank has been designated as an agency for facilitating speedy clearance and meeting foreign exchange requirements towards imports for computer software export where export obligation of 35% of foreign exchange is undertaken.

Exim bank offers an integrated package covering foreign currency and rupees term finance for acquisition of imported and indigenous computer/ computer-based systems for export purpose. Foreign currency loans are made available for financing import of computer systems and equipment and rupee term loans for acquiring indigenous. Computer/computer-based systems and other assets for export purposes. Exim bank undertakes financial and technical analysis of software export proposals and monitors the progress of software exports. It arranges for clearance of imports and finance under one window.

The working capital requirements will be met by commercial banks.

7. Export marketing fund

Export marketing fund is a component of world bank loan to india for industrial exports. Government of india has designated exim bank as the agency to manage the fund.

Finance is available in foreign currency upto 50%of the cost of the eligible activities covered by grant finance. Term loan in rupees, subject to a maximum of equivalent of usd 1 million, is available for finance. (grant finance is available for front-end activities which form part of a systematic market entry plan.)

8. Export product development

The scheme enables indian firms to undertake product development, research and development for exports.

9. Project preparatory services overseas

The scheme is to provide loan/grant finance for using indian consultancy inputs at preparatory stages in projects overseas. The programme is designed to support studies covering the following stages: pre-investments, project formulation, project implementations typical sectors for which assistance can be considered include agriculture/ energy industry/ water supply and sewerage/ education/ health. Maximum loan is rs 20 lakhs and grant rs 10 lakhs.

4.2. Lending to foreign government, companies etc.,

1. Buyers credit

Credit is extended by exim bank to buyers abroad to enable them to import engineering goods and projects from india on deferred credit terms. Similar to direct lending to exporters, the facility is to be secured by a letter of credit or bank guarantee or guarantee from government or promissory note from government. An undertaking letter from the central bank of the country regarding prompt release of exchange towards receivables may also be required.

Exim bank will directly enter into an agreement with the overseas borrower outlining the terms and conditions of the credit covering the export contract.

2. Lines of credit

Exim bank extends lines of credit to overseas governments or agencies nominated by them, to enable buyers in these countries to import capital/ engineering goods from india on deferred credit terms. This facility enables indian exporters to offer deferred credit to customers in these countries, as per terms and conditions already negotiated between exim bank and overseas government, the exporter can obtain payment from exim bank against negotiation of shipping documents, without recourse to the exporters.

The exim bank advises approval of the contract to the borrower, with copy to the exporter. The buyer, on advice from the borrower, establishes an irrevocable letter of credit and advices it through a bank in india designated by exim bank on shipment, the exporter submits the documents to the designated bank for negotiation. Bank forwards documents to the buyer and copies of the documents to exim bank. Exim bank reimburses the eligible value to the negotiating bank for onward payment to the exporter. In then debits the borrowers account and arranges to collect interest and principal receivable on due dates under the terms of the line of credit agreement between exim bank- and the respective government agency.

3. Re-lending facility

Credit is made available to overseas bank for their lending to importers of capital goods from india. Overseas banks thus would intermediate between foreign buyer and exim bank, who intermediate with the supplier.

The borrowing bank may i- a commercial bank, a central bank, an investment bank or merchant bank of a country with a good credit standing. The loan made by the se banks to the importers should be for import of capital goods/ equipments and/or services from india.

4.3. Lending to commercial banks in india

1. Refinance of export credit

under this programme, commercial banks in india, who are authorized dealers in foreign exchange, can obtain from exim bank 100 per cent refinance on term loans extended for exports of eligible indian goods. Such credit enables indian exporters to offer credit terms to foreign importers. An export contract 1 up to rs .3 crores can alone be brought under this programme. For contracts above rs.3 crores, commercial banks can obtain financing participation under exim banks other programmes including risk syndication facility.

2. Export bills recounting facility

commercial banks(authorized dealers)can rediscount their short-term finance export bill portfolio with exim bank. Exim bank provides funds under this programme for a period of 90 days against export bills that have equal period to run before realization. The bill eligible for rediscount should not have a usance exceeding 180 days and at the time of rediscount should have an unexpired usance of 90 days on rediscount the commercial bank is paid 100% of the bill valueless rediscounting charges)

3. Syndication for export credit risks

under this commercial banks can support export proposals without blocking their funds for long time. They can participate in the syndicate arrangements.

at the working group meeting which accords clearance to the export proposals, the participation arrangement for the funding of export credit is also determined. Exim bank and other banks participating in the funding of the loan would syndicate the respective credit risks to other eligible commercial banks, who would then assume the part of total risk.

Risk will be assumed by risk participating banks as a percentage of the credit extended for the particular contract, expressed in indian rupees, irrespective of the currency of the contract. The risk is assumed prorata on all outstanding amounts by way of principal, interest and other money which becomes due and payable by the borrower.

4. Bulk import finance

Bulk imports of consumable inputs and chanalised items, imports made on short term credit/cash basis and imports of plant/ machinery for domestic production are financed by commercial banks and term lending institutions. Under this scheme, promissory notes drawn in favour of commercial banks by their importer customers are discounted. Exim bank will issue letter for commitment finance on request from commercial banks indicating their requirement. The quantum of finance depends on the condition that import order should not be less than rs. 1 crore.

4.4. Non-leading services

Exim bank issue guarantees on behalf of exporters construction and turn key projects.

Guarantee facility for banks

Under this scheme exim bank extends guarantee to commercial banks against the post-shipment supplier's credit-from one year to three years -and the amount of cover is equivalent to the amount covered by the exporter under

ecgc. The guarantee commission payable by the bank as per the fedai rule is 1.80% on an annualized basis banks can avail refinance facility from exim bank at 1% lesser than the rbi facility.

Incase of defaults, the guarantee will be converted to a refinance facility and the interest rate charged will be 2% below the rate charged by the banks to their customers, subject to 9 minimum of 13% per annum. Since the exim. Bank will pay under the, guarantee within 30 days, it will protect the loan asset from being classified as non-performing asset by the bank. Also, if the claim is rejected by ecgc, the amount will be written off by exim bank and the commercial bank will not be liable to repay.

Advisory services

Through its international merchant banking division, exim bank offers the following advisory services:

(i) work closely with indian companies in designing financing packages for joint ventures in third countries; (ii) advice indian companies, executing contracts abroad, on sources of favorable financing overseas; (iii) provide access to ensure financing sources and global credit sources to indian companies engaged in exports; (iv) advice on exchange control practices globally; and (v) advice and design financial packages for export-oriented industries in india. These services are being added to, in order that tailor-made financing packages for high value export contracts are available.

Promotional activities

Under the export import bank of india act, 1981, the promotional activities expected of exim bank are.

(i) undertaking and financing of research surveys, techno-economic or another study in connection with the promotion and development of international trade

(ii) providing technical administrative and financial assistance of any kind for export and import.

(iii) planning, promoting, developing and financing export-oriented concerns; and

(iv) collecting, compiling and disseminating market and credit information in respect of international trade.

4.5. Foreiting

Forfeiting is the system of advancing against book debts. Factoring involves assignment of book debts by clients in favour of the factoring company for a consideration. The factor assumes the credit and collection function for its client by purchasing his receivables, maintaining the sales

ledger, attending to other book keeping duties and performing ancillary functions.

Factoring differs from bills discounting in as much as the factor purchases the entire debts of the unit and is responsible for their collection. While in bills discounting the credit risk rests with the seller.

Forfeiting is similar to export factoring with tile difference that while export factoring ping is generally for short term, forfaiting is for medium term to cover exports on deferred forfeiting affords advantage of better liquidity and faster turnover of recourses, credit risks, elimination of exchange risks, etc., to the exporter.

Forfeiting by exim bank

Briefly, the procedure involved in the scheme of forfeiting by the exim bank is as follows;

(a) exporter initiates negotiations with the prospective overseas buyer with regard to the basic control price, period of credit, rate of interest etc.

(b) after successful negotiations, he furnishes the particulars such and country of overseas buyer, contract value, nature of goods, of credit, name and guaranteeing bankers to the exim bank and requests for an quote.

Exim bank obtains the indicative quote of forfeiting discount together with corninitment fee and other charges, if any to be paid by the exporter from an overseas forfeiting agency,

(c) on receipt of the indicative quote from tile exim bank the exporter finalizes the terms of contract, loading the discount and other charges in the value and approaches exim bank for obtaining a firm quote. Exim bank arranges to get the same from an appropriate overseas forfeiting agency and furnishes the same to the exporter. At this stage, exporter would be required to confirm acceptance of the arrangement to exim bank within a specific period as stipulated by that bank.

(d) the export contract should clearly indicate that the overseas buyers shall prepare a series of availised promissory notes in favour of the exporter and hand them over against the shipping documents to his banker. The promissory notes will be endorsed with the words ‘without recourse’ by the exporter and handed over to his banker in india for onward transmission to the exim bank.

the role of exim bank is as an intermediary between the indian exporter and the overseas forfeiting agency. -exim bank will receive availised bills of exchange or promissory notes, as the case maybe, and send them to the forfeiter for discounting and. Arrange for crediting the discounted proceeds to the nastro

account of the exporter's bank who win repatriate the proceeds to india for payment to the indian exporter.

exim bank will issue a certificate to the exporter with a copy to his bank indicating the rate of forfeiting discount. While completing the respective gr/pp form(s),the exporter should indicate the total invoice value of the goods inclusive of the forfeiting discount and should show the amount of discount against the item 'other deductions' to arrive at net realizable value. Copies of these certificates should be attached to both the copies of gr/pp form.

Model questions

1. Define the role of exim bank in foreign exchange actions?
2. List down non – lending of the exim bank?

EXPORT CREDIT GUARANTEE CORPORATION OF INDIA LTD

4.6. Introduction

International trade is highly competitive. To be successful, an exporter has to offer good quality material at competitive prices and provide longer and liberal terms of credit to importers. At the same time, selling in international market is highly risky. Some of the risks are in common with those involved in internal trade. Some risks are aggravated in or are peculiar to international trade.

Two major risks in international trade are: risk of loss of or damage to the goods and risk of non-realisation of export proceeds. The former is a risk which is covered by general insurers (under marine insurance). The latter risk to or credit risk which is not covered by general insurer.

Non-receipt of export proceeds may be due to failure of the buyer to accept and/or pay for the goods. This is known as commercial risk. Non-realization may also be due to reasons beyond the control of the buyer. Such difficulties may be attributed to political and economic changes. An outbreak of war or civil war may block or delay the payment for goods exported. Economic difficulties or balance of payments problem may lead a country to impose restrictions on either import of certain goods or on transfer of payments for goods imported. The loss on account of these risks may spell disaster for any exporter.

While the policies issued by eric provided adequate cover to exporters, it was thought that its functions should be extended. Encouragement to exporters consisted not only in affording protection against credit risks, but also in facilitating their getting timely and liberal credit facilities from banks. The availability of policies to the exporter was an indirect benefit to banks end

should encourage their lending to exports sector. But this incentive was not thought to be sufficient to prompt the flow of bank finance to exports. As a direct encouragement to banks, guarantees were begun to be issued in their favour. The guarantee fundamentally protects the bank against failure of the exporter to repay the bank advance. Consequently, the eric was transformed into export credit and guarantee corporation ltd., in 1964. It has since been renamed as export credit guarantee corporation of india ltd.

Ecgc is a company wholly owned by the government of india. It functions under the administrative control of the ministry of commerce and is managed by a board of directors representing government, banking, insurance, trade, industry, etc.,

The functions of ecgc is reflected in the different schemes it has evolved to protect the exporter and the exporter's bank.

4.7. Standard policies

The standard policies issued by the ecgc are meant to provide cover for shipments on short-term credit.

(1) risks covered. The risks covered may be broadly grouped into

(a) commercial risks, and

(b) political risks.

Commercial risks covered are: (i) insolvency of the buyer; (ii) buyer's protracted default to pay for goods accepted by him; and (iii) buyer's failure to accept goods subject to certain conditions. Political risks covered are:

Imposition of restrictions on remittances by the government in the buyer's country or any government action which may block or delay payment of the exporter;

War, revolution or civil disturbances in the buyer's country;

New import licensing restrictions or cancellation of a valid import licence in the buyer's country; cancellation of export licence or imposition of new export licencing restrictions in india;

Payment of additional handling, transport or insurance charges occasioned by interruption or diversion of voyage which cannot be recovered from the buyer; and

Any other cause of loss occurring outside india not it normally insured by commercial insurers, and beyond the control of the exporter and, or the buyer.

(2) risks not covered

The following risks are not covered by the

Commercial disputes raised by the buyer, unless the exporter obtains a degree from the competent court of law in the buyer's country his favors;

Causes inherent in the nature of goods;

Buyer's failure to obtain necessary import or exchange authorisation from authorities in his country;

Insolvency or default of an agent of the exporter or of the collecting bank;

Loss or damage to goods which can be covered by commercial insurers;

Exchange fluctuation,

(3) types of policies

The policy insured may cover risks from the date of shipment or from the date of contract. In either case the policy may cover both political and commercial risks (comprehensive policy) or it may cover only political risks. Thus the policy may be any one of the following:

(i) shipment (comprehensive risks) policy;

(ii) shipment (political risks) policy;

(iii) contract (comprehensive risks) policy; or

Iv) contract (political risks) policy.

Where the export is covered by a letter of credit or where the export is made to an associate concern, risk due to failure of the buyer is not envisaged. Therefore in those cases the policy covering in political ask alone may be preferred.

Contract policies, which covers from the date of contract, are issued only in special cases when the goods to be exported are manufactured to non-standard specification of a buyer, in such a case, if the- export is frustrated, the exporter may not find an alternative buyer.

(4) extent of cover

Ecgc normally pays 90 per cent of the losses on account of political or commercial risks. In the event of loss due to repudiation of contractual obligation by the buyer, ecgc indemnities the exporter upto 90 per cent of the loss if final and enforceable decree against the overseas buyer is obtained in the competent court of law in the buyer's country.

The corporation's liability is subject to two limits: (a) maximum liability, and (b) credit limit

A) maximum liability

Maximum liability is the limit upto which ecgc would accept liabilities for shipments made during the period of the -policy. If the policy is issued for four years, -the maximum liability is in respect of each policy year. The exporter should. Therefore estimate the maximum outstanding payments due from overseas buyers at any time during the policy period and obtain policy with maximum liability for. This amount. The maximum liability fixed under the policy can be enhanced subsequently if necessary.

B) credit limits:

Credit limit is the limit upto which ecgc accepts claims in respect of each buyer. The exporter should give complete information regarding the buyer and his banker in the credit limit application. In case the exporter has already obtained a credit report on the buyer, it may be furnished to ecgc in other cases, ecgc fixes- suitable credit limit on overseas buyers as commercial risks are not covered in the absence of a credit limit on buyer before making shipment.

(5) obtaining the cover

The exporter should submit a proposal to the ecgc after examine the proposal ecgc would send him an acceptance letter stating the terms of list its cover and premium.

The exporter is required to insure all shipments that may be made by him during the currency of the policy except those made against advance payment or irrevocable letters of credit confirmed by banks in india. However, with prior approval of ecgc, exports of certain commodities or export to certain countries can be excluded. This would mean adjustments in premium rates.

When payment risks become too high in a country, ecgc provides cover on such countries on a restricted basis. Policyholders intending to export to such countries are required to obtain specific approval of ecgc for each shipment/ contract upon payment of a specific approval fee if such approval is not taken, cover is not available even for political risks.

(6) premium

The premium rates are closely related to the risks involved and vary according to countries to which goods are exported and the payment terms. Premium is payable along with the monthly declaration

(7) reporting defaults

In the event of non-payment of any bill, exporter should take prompt and effective steps to prevent or minimize loss. A monthly declaration of all bills that remain unpaid for more than 30 days should be submitted to ecgc in the prescribed form, indicating actions taken in' each case.

Granting extension of time for payment, converting bills from d. P to d.a terms or resale of unaccepted goods ate lower price require proval of ecgc.

4.8. Settlements of claims

A claim will arise when any of the under the policy materialises. If an overseas buyer goes insolvent, the exporter becomes eligible for a claim one month after his lose is admitted to rank against the insolvent's estate or after four months from the due date, whichever is earlier. In case of protractered default claim is payable after four months from the due date. Claim in respect of additional adding, transport or insurance charges incurred by the exporter because of interruption or diversion of voyage outside india are payable after proof of loss is furnished. In all! Other cases, claim is payable after four months from the date of the event causing loss.

In case, proceeds of shipments are held up due to foreign exchange shortage in the buyer's country, ecgc considers claims after the waiting period as applicable for the country concerned. Exchange transfer delay claims should be made with documentary proof to the effect that:

(a) the buyer has made the payment in local currency; and

(b) he has complied with all exchange control regulations necessary to effect transfer of the payment.

Small exporters -policy

The small exporter's policy is basically the standard policy, incorporating certain improvements in terms of cover. It is issued to exporters whose anticipated export turnover for the next 12 months does not exceed rs.50 lakhs.

the small exporter's policy differs from the standard policy in the following respects:

period of policy. Issued for 12 months as against 24 months in case of standard

Minimum premium., the minimum premium payable is 0.3% of the anticipated turnover on dp and da terms of payment, plus where the exporter seeks cover also for lc shipments 0.10% of the anticipated turn- over on lc terms or rs. 1000 which ever is higher.

4.9. Specific policies

The standard policy, discussed above, is a whole turnover policy designed to provide a continuing insurance for the regular flow of an exporter's shipments of raw materials, consumer goods and consumer durables for which credit period does not exceed 180 days. Contracts for export of capital goods or turnkey projects or construction works or rending services abroad are not of a

repetitive nature. Such transactions are, therefore, insured by ecgc on a case-to-case basis under specific policies.

1. Specific policy for supply contracts

Specific policy for supply contracts covers experts of commodities for period beyond 180 days. The policy may take any one of the following four forms:

Specific shipments (comprehensive risks) policy- to cover both commercial and political risks at the post shipment stage;

Specific shipments (political risks) policy- to cover only the political risks at the post shipment stage in cases where the buyer is an overseas *government or payments are guaranteed by a government or by banks, or are made to associates;

Specific contracts (comprehensive risks) policy; and

Specific contracts (political risks) policy.

Contracts policy provides cover from the date of contract. Losses that may be sustained by an exporter at the pre-shipment stage due to frustration of contract are covered under this policy all addition to the cover provided by the shipments policy.

2. Insurance cover for buyer's credit wines of credit

Financial institutions in india, like those in several other countries, lend directly to buyers or financial institutions in developing countries for importing machinery and equipment from india. This kind of financing facilitates immediate payment to exporters and frees them from the problems of credit management as well as from the fear of loss on account of overseas credit risks.

Financing may take the form of buyer's credit or line of credit. Buyer's credit is a loan extended by a financial institution, or a consortium of financial institutions, to the buyer for financing a particular export contract. Under lines of credit, a loan is extended to the government or financial institutions in the importing country for financing import of specified items from the lending country.

ecgc has evolved schemes to protect financial institutions in india, which extend these types of credit for financing exports from india. Agreement will be drawn up on a case-to-case basis, having regard to the terms of the credit.

3-services policy

when indian firms render services to foreign parties they would be exposed to payments risks similar to those involved in export of goods. Services policy offers protection to indian firms against such payment risks.

The policy has been designed broadly on the lines of ecgc insurance policies covering export of goods and is issued to cover specific transactions. Two types of policies are issued:

(a) specific services contract (comprehensive risks) policy to cover commercial as well as political risks;

(b) specific services contract (political risks) policy to cover political risks only. Where the contracts are with overseas government or payments are guaranteed by overseas governments or are covered by bank guarantee/letters of credit, or are to associates, political risks policies are issued.

a wide range of services like technical. Cr professional services, hiring or leasing can be covered under the policies.

4. Construction works policy

ecgc’s construction works policy covers civil construction jobs as well as turnkey projects involving supplies and services. It provides cover for all payments that fall due to the contractor under the contract

two types of policies have been evolved to cover contracts with 11) government buyers, and (ii) private buyers. The former covers political risked in. Respect -of contracts with overseas government or where the payments are guaranteed by government. The latter covers comprehensive risks. In case of contracts with private employers, the policy may be issued to cover only political risks if the payments are guaranteed by a bank or covered by letter of credit.

5. Overseas investment insurance

Ecgc has evolved a scheme to provide protection for involvement of exporters in capital participation in overseas project. Any investments made by way of equity capital participations in overseas projects will be eligible for cover under investment insurance.

The investment may be either in cash or in the form of indian-capital goods and services. The cover would be available for the original investment together with annual dividends and interest payable.

The risks of war, expropriation and restriction on remittances are covered under the scheme. As the investor would be having a hand in the management of the joint venture, no cover for commercial risks would be provided under the scheme. For investment in any .country to qualify for investment insurance, there should preferably be a bilateral agreement protecting investment of one country in the 1 other or, in its absence, an investment protection code. Ecgc may consider providing cover in the absence of any agreement or code,

provided it is satisfied that, the general laws of the country afford adequate protection to the indian investment.

The period of insurance cover may be extended for a period of 15 years. In case of projects involving loan, erection period cover may be extended for a period of 15 years from the date of completion of the project subject to a maximum of 20 years from the date of commencement of investment. Amount insured shall be reduced progressively in the last five years of the insurance period.

Guarantees to banks

Ecgc's guarantees protect the banks from losses on account of their lendings to exporters. These guarantees have been designed to encourage banks to give adequate credit and other facilities for exports, both at pre-shipment and post shipment stages, on liberal basis.

Ecgc offers following types of guarantees to provide for varying requirements of bank. They are:

1. Packing credit guarantee;
2. Export production finance guarantee;
3. Post-shipment export credit guarantee;
4. Export finance guarantee;
5. Export performance guarantee;
6. Export finance, (overseas lending) guarantee; and
7. Transfer guarantee

1. Packaging credit guarantee,

This guarantee covers advances granted to exporters at the pre-shipment stage for the purpose of purchase, manufacture, processing and/or packaging of goods meant for export against firm contracts of sale, whether on credit terms or against irrevocable letters of credit. Advances given by banks to indian firms engaged export of services or to those which take up construction work abroad to meet preliminary expenses in connection with such contracts are also eligible.

The guarantee protects the bank against failure of the exporter to repay the advance because of his insolvency or protracted default to repay. The guarantee covers advances made by bank over a period of time, normally a year. On or before tenth of every month, the bank has to submit to ecgc, a declaration of credits granted and repayments received during the previous month. The premium is payable at 10 paise per rs. 100 per month or part

thereof on the basis of monthly declarations on the highest amount outstanding on any day during the month.

Ecgc bears loss to the extent of 66.67% subject to a maximum liability fixed under the guarantee. In case of guarantees on account of advances not exceeding rs.2 lakhs granted to small merchant exporters, ecgc ‘ a share is 90% of the lose.

2. Export production finance guarantee

The purpose of this guarantee is to enable banks to sanction advances’ at the pre-shipmen stage to the full extent of cost of production when it exceeds the fob value of the contract/order, the difference representing incentives available. The extent of cover and the premium rate are the same as of packaging credit guarantee

3. Post-shipment export credit guarantee

Post’ shipment finance given to exporters by banks through purchase, negotiation or discount of export bills or advances against such bills qualifies for this guarantee, it is necessary, however that the exporter concerned should hold suitable policy of ecgc to cover the overseas credit risks.

The premium rate for this guarantee is 7 paise per rs.100 per month. The extent of lose covered is 75%.

This guarantee can also be had, even where an exporter does not hold an ecgc policy for finance granted against lc bills, provided that the exporter makes shipments solely against lcs. The premium rate is 10 paise for rs.100 per month on the highest amount outstanding on any day during the month. Cover is 75%. Advances against bills under lcs opened by banks in countries placed under restricted cover is subject to prior approval of ecgc.

4. Export finance guarantee

This guarantee covers post-shipment advances granted by banks to exporters against incentives receivable in the form of cash assistance, duty drawback, etc. The premium rate is 7 paise per rs. 100 per month and the cover is 75%.

5. Export performance indemnity

The indemnity which is in the nature of a counter guarantee is issued to the exporter’s bank to protect against losses that it may suffer on account of guarantees given by it on behalf of the exporters.

The cover is available for such guarantees as bid bond guarantee, performance guarantee advance money guarantee, retention money guarantee, guarantee to a foreign bank for finance raised overseas, in case of participating in foreign tenders; guarantees issued for obtaining import licenses with export

obligations; guarantees to customs for clearing goods without payment of duty; guarantee in respect of export obligations to export ‘promotion councils, commodity boards, the state trading corporation of india, minerals and metals training corporation of india or recognized export houses.

Normally cover is extended upto 75% of loss, but in the case of guarantees in connection with bid bonds, performance bonds, advance payment and local finance guarantees in lieu of retention money, the cover may be increased up to 90% subject to proportionate increase in premium.

The premium rate for indemnity issued to cover bonds relating to exports on short-term credits is 0.9 % p.a for 75% cover and 1.08% for 90% cover. For bonds relating to exports on -deferred credit and turnkey projects the rate of premium is lower at 0.8% p.a. For 75% cover and 0.95% p.a for 90% cover.

6. Export finance (overseas lending) guarantee

If a bank financing an overseas project provides a foreign currency loan to the contractor it can protect itself from the risk of non-payment by the contractor by obtaining export finance (overseas lending) guarantee. Premium rate will be 90 paise per annum for 75% cover and rs.1.08 per annum for 90% cover. Premium is payable in indian rupees. Claims under the guarantee will also be paid only in. Indian rupees.

7. Transfer guarantee

This guarantee seeks to safeguard the banks on the confirmation they might add to letters of credit opened by banks abroad in favour of indian exporters. The guarantee covers risks of:

Insolvency of the opening bank;

Failure of the opening bank to pay within four months from the due date of payment;

Operation of law which prevents, restricts or controls transfer of the amount of the credit to india, in circumstances outside the control of the opening bank and confirming bank;

(iv) occurrence of war between the country of opening bank and india;

(v) occurrence of war, hostilities, civil war, rebellion, insurrection or other disturbances in the country of the opening bank.

The guarantee covers 75% of the loss in respect of risks (i) and (ii) and 90% for risks (iii) to (v)

The premium charges will normally be at the rates applicable under the ecgc’s insurance policy covering export of goods. The actual rate depend, upon the country in which the letter of credit is opened and the length of the period to be, covered

4.9. Ecgc guarantees on whole turnover basis

The two most popular guarantees issued by ecgc are the packing credit guarantee and post-shipment guarantee. As a further incentive to large-scale use of these guarantees, ecgc offers them on whole turnover basis also. When a bank opts for whole turnover packing credit guarantee or whole turnover post-shipment guarantee, it agrees to cover under the scheme, all eligible advances by declaring them to ecgc and paying premium on monthly basis.

The advantages that emanate from the use of whole turnover guarantee schemes are mainly three: (i) the bank gets higher percentage of cover: (ii) the rate of premium is reduced; and (iii) the trouble of getting individual guarantees is avoided.

1. Whole turnover packing credit guarantee

The salient features of whole turnover packing credit guarantee (wtpcg) are as under:

Advances covered

The wtpcg is issued to a bank if it is prepared to cover under the guarantee on it* packing credit advances to (a) small-scale industrial, units, and (b) government of india enterprises. No exception is available for advances granted to state government or joint sector units.

Premium

The rate of premium on the guarantee is 6 paise per rs. 100 per month as against 10 paise in the case of individual packing credit guarantee. Further, the guarantee fee is calculated on the average daffy product instead of on the highest balance outstanding in the month.

Illustration

During april, a packing credit account had the following balances:

on 1st	rs 50,000
on 10th	rs 60,000
on 22nd	rs 90,000

The premium can be calculated as under:

50,000 x 9 days	= 4,50,000
60,000 x 12 days	= 7,20,000
90,000 x 9 days	= 8,10,000
total	**= 19,80,000**

19,80,8000/30 = 66,000

Premium at 6 paise per rs 10066,000 x 60/(100 x 100) = rs 396

Extent of cover: the extent of cover provided is 75% as against the normal 66 2 3 %. In respect of advances to small-scale exporters with annual export turnover not exceeding rs 10 lakhs and his total annual turnover not exceeding rs 25 lakhs, the extent cover is 90%

Discretionary limit: every guarantee mentions a limit upto which the bank can allow packing credit advances to any of its exporter-clients without ecgc's approval. This limit, known as the 'discretionary limit', varies from the bank to bank and may change from one guarantee year to another. All limits in excess of the discretionary limit need the approval of ecgc. If this approval is not obtained, the corporation's liability is limited to the extent under the discretionary limit.

Declarations: a packing credit gets the cover under the guarantee by its declaration in the form specified and payment of premium to the corporation. The money declaration along with the premium is to be submitted by the head / zonal / regional office of the bank before the end of the succeeding month.

Annual statement: a complete statement of limits in force at the commencement of the guarantee is to be furnished to the corporation by the head office of the bank while obtaining the wtpcg, for the first time. Annual statements are thereafter to be furnished as on 30th september each year. Whenever new limits are sanctioned or existing limits are

Model question:

1. Explain the features of standard polices of the ecgc.
2. Examine the factures various types of guarantees of ecgc to banks
3. Define the various forms of post - shipment finance.

IMPORT FINANCING

5.0. Opening a letter of credit

Banks can open letters of credit only on behalf of their own customers who maintain accounts with them and are known to be participating in the trade. By opening a letter of credit, the bank undertakers to make payment on behalf of the customer to the extent of the amount of the credit. The bank should., therefore, appraise the creditworthiness of the customer as if an advance is made to him. In particular, the bank would require the following information from the customer for considering sanction of the facility:

(a) nature of business of the unit-manufacturer, importer, exporter, or trader

(b) amount of the import requirements and the amount of limit required.

(c) terms of payment - sight or usance.

(d) nature of goods to be imported and if import license is obtained.

(e) details of past dealing of the unit (financial statements for the last three years may be required)

(f) security for the facility; additional security, if any, in addition to charging of the goods to be imported

(g) margin money agreed to be deposited for the facility, the margin agreed by the bank will depend upon various factors such as the reserve bank stipulations, the creditworthiness of the applicant, the commodity to be imported, etc. The margin may be deposited by the applicant or by a third party.

(h) in case the limit is for a large amount, details of the parties from whom the applicant intends to import may be obtained. The bank may obtain credit report on important intended exporter.

The reserve bank has suggested that this letter of credit should be opened normally for customers who enjoy credit facilities with the bank. In case a request to open letter of credit is received from a customer who is having only current account with the bank, it should be satisfied that.

(a) there is genuine need for establishing the credit.

(b) the customer has ability to retire the document under the credit without approaching the bank, for credit limits to retire such documents;

(c) the customer’s financial position as evidenced by the financial statements is satisfactory. His income and wealth tax assessment is also to be verified; and ties are also obtained

(d) adequate margin is taken; additional securities

When the customer has facilities with another bank and only a current account with the credit-opening bank, the bank should obtain in writing from the customer the reason for not approaching the other bank. Concurrence of the existing bank who had sanctioned facilities to the customer should also be obtained along with satisfactory report about him.

The limit will be sanctioned after a careful scrutiny of the proposal. For importers with large turnover, where more then one letter of credit may be established, a general limit for opening of letters of credit may be sanctioned. Individual letters of credit are issued as and when required by the party, within the overall limit sanctioned. Where frequency of transactions is not as expected, sanction may be accorded for individual letter of credit, as and when required by the party.

Documents to be verified

After obtaining sanction of the facility, when the importer wants a -letter of credit to be established, he should produce to the bank the following:

(a) application-cum-agreement for opening the credit;

(b) exchange control copy of the import license or particulars where required; and

(c) the sale contract between exporter and importer

5.1. Application for opening the credit

The application for letter of credit is a stamped document which, besides giving ,details required for opening the credit also acts as an agreement between the bank and the customer. It stipulates the conditions governing the letter of credit, contains an undertaking by the customer to make funds available in his account with bank when bills would be presented under the credit. It also grants right to the bank.over the goods covered by the documents presented under the credit till payment is made by the customer. In the application the customer agrees to subject the credit to the provisions of uniform customs and practice of documentary credits. The bank should verify that particulars required for opening the credit are clearly stated in the application. The application is a printed form calling for information like:

name and address of the beneficiary;

nature of credit - revocable or irrevocable, confirmed or unconfirmed, transferable, etc.

amount of the credit and currency.

details of goods to be imported their nature, quality, specification quantity and unit price,

trade terms - whether the price is on fob, cpr or cif basis;

details of bill of exchange to be drawn- tenor and drawer;

mode of transport and document evidencing shipment/bill of lading, airway bill, etc.,

documents to be tendered - nature of the documents and the number of copies of each document;

if insurance policy is to be obtained, risks to be covered -veered and value;

latest date of shipment and for negotiation;

whether partial shipment are allowed; and

(i) whether transhipment is allowed.

(ii) import license.

if the import is covered by a specific license, the exchange control copy of the license should be obtained. (iii) sale contract

the sale contract between the exporter and the importer should be verified by the bank and a note of verification should be made on the credit application. If the customer is not in a position to submit the sale contract, any one of the following documents may be accepted for scrutiny by the bank:

(a) order together with the order confirmation of overseas supplier

(b) performa invoice of overseas supplier duly countersigned by importer.

Scrutiny of documents

While scrutinizing the documents tendered by the applicant, the bank should pay attention to the following:

The documents are signed, dated and complete in all respects.

The license is not reported lost or cancelled by the reserve banks/ itc authorities the commodity to be imported is the same in all documents

Quantity restriction, if any, imposed in the license is not exceeded.

The value of the consignment is permitted under the license. License are issued for cif value. If the imports is made on fob basis, the license cannot be utilized to its aa value on fob basis. Provision has to be made on the fob value for insurance at 1 % and for freight at 10 % for carriage by sea and at2o%for carriage by air. For example, if the import is for re.20,000 on fob basis, it is taken that the license is utilized to the extent of rs.22,200 calculated as under.

fob value	rs. 20,000
insurance — 1%	rs. 200
freight — 10%	rs. 2,000
	rs. 22,200

(f) country of origin of‘ goods, -whether permissible.

(g) currency of letter of credit; if permissible.

(h) last date of shipment. It should not be beyond the validity of license.

(i) date of expiry of letter of credit. The payment for imports should be made ,vitl-l’a six months from the date of shipment. Therefore, in case of letters of credit calling for usance bills, it should be ensured that the credit provides for payment within six months from the latest date of shipment allo-wed in the license

If the contract term is cif, the letter of credit calls for freight paid bill of lading and insurance policy. If on fob or cfr] basis, the importer should arrange for insurance of goods.

(k) if transshipment is allowed, the insurance covers transshipment risk also. Establishing a letter of credit (1) limit.

The importer would submit an application for opening the letter of credit to the bank. When the application -as received, it should be verified that the outstanding under the letter of credit and bills - paid thereunder but still not realized by the customer together with the amount of the credit not required to be opened do not exceed the limit sanctioned to the customer.

(i) issue of letter of credit.

each bank has its own printed form of letter of credit. The letter of credit is prepared in 5 to 7 copies depending upon the requirements of the bank. The minimum is 5 copies to be used as:

(a) the beneficiary’s copy (the original):

(b) advising bank’s copy.

(c) copy to the applicant:

(d) copy to head office of the bank: and

(e) file copy.

The letter of credit should be complete and precise in all respects. To determine the method of payment, the credit should call for a certificate of origin from an independent third party like a chamber of commerce.

The original of the credit and the copy meant for the advising bank axe sent to the advising bank for onward transmission of the original to the beneficiary. If the advising bank is required to confirm the credit, it will be specifically stated in the covering letter.

(iii) if the applicant decides that only information about the establishment of the credit be sent by cable, a short cable message may be sent to the advising bank. The message gives only the essentials like the names of the beneficiary

and the applicant, amount, brief description of goods, last date of shipment and negotiation. The opening should make clear its intention that the message is only for information and not to be treated as letter of credit by adding the words 'airmailing details' or 'details to follow'. The regular letter of credits indicate prominently that it is in confirmation of the cable message already sent.

(iv) reimbursement clause.

If the opening bank maintains an account with the advising bank, it may authorize the latter to debit that account when bills are tendered under credit. The credit may also provide reimbursement to the negotiating bank at any other bank in the same centre or some other centre. In such a case the reimbursing bank will be sent a copy of the letter of credit with authority to debit the account of the opening bank with it when the negotiating bank informs it that bills have been negotiated under the credit as per the terms stipulated. (v) margin.

Margin as stipulated in the sanction letters should be obtained and kept in the margin on letter of credit opened account or other similar account.

(vi) endorsement on documents.

The fact of establishment of the credit should be endorsed on: a, the license; and b. The sale contract. (vii) commission.

The commission to be recovered is prescribed by fedai rules. In addition to the bank is entitled to recover actual cable charges and postage. (viii) 1) accounting entries.

On opening the letter of credit, the following vouchers are passed: dr.customer's liability on letter of credit issued. Cr banks liability on letter of credit issued

The rate applied for opening the accounts is the bills selling rate prevalent on the -2te of opening of the letter of credit.

Amendment

Subsequent to the opening of letter of credit, the applicant may approach the bank for advising certain amendments. The amendments may relate to (a) the amount (b) the date of shipment/ negotiation or (6) any other requirement of the credit. Such amendment may be advised by the opening bank provided they do not exceed the license provisions. The amendment is advised through the advising bank.

If the amendment involves increasing the limit of the letter of credit, additional commission should be recovered, further, for the enhanced limit accounting entries should be passed. If it involves extension of time limit of the

credit, additional commission for the extended period, if chargeable, should be recovered.

Cancellation

The liability under the letter of credit is reversed as and when bills are. Received and paid under it. If, at the end of the period of negotiation allowed under the credit, a portion or full value of the credit is unutilized it is automatically cancelled. However, the date is the valid for negotiation at the other end. Therefore, the opening bank should wait for a reasonable period after due date of the credit say, for month, and then reverse the entries on opening the letter of credit, cancellation of the credit should be intimated to the to the beneficiary through the advising bank.

5.2. Payment of import bills

Bills drawn on the import may be received by the bank:

(a) under a letter of credit opened by it; or

(b) other than under a letter of credit, le. Foreign inward bill for collection.

Bill received under a letter of credit

When a bill is received under a letter of credit opened by it, the bank should first verify that all the documents as mentioned in the covering schedule received from the negotiating bank are in fact received. It should then subject the documents to a thorough scrutiny to ensure that they strictly conform to the stipulation of the letter of credit.

If any discrepancies are found in the documents, the bank should immediate. A inform the negotiating bank of the discrepancy and hold the documents at the disposal of the negotiating bank. Simultaneously an intimation of the arrival of documents and discrepancies found therein should be sent to importer asking him to call on the bank to verify the documents and see. If they could be accepted. If the importer refuse to a accept the document, the fact should be intimated to the negotiating bank seeking their further advice in the matter. To the extent of the bills received, the liability in the letters of credit issued account should be reversed. In all other respects the procedure is same as if the bills were received for collection by the bank.

If the documents received are in order, the bank should immediately pay the negotiating bank, if reimbursement has not already been obtained by it. An intimation should be, sent to the importer asking him to retire the bills immediately.

The bill is received. In foreign currency and, therefore, the exact liability of the importer in rupees is determined only when he makes payment against

bills. On the date of retirement of the bill by the importer, the ruling bill selling rate is applied, if the amount of the bill and bank charges thereon are converted into rupees.

However, if the importer does not retire the bill within ten days of receipt of the bill by the bank, on the tenth day, the bank should convert the foreign currency amount into rupees at the ruling bill selling rate by passing the following vouchers:

Dr advance bills

Cr nostro account

If a forward contract had been booked for the in port, the conversion should be done at that rate. If the tenth day happens to be a holiday or a saturday, the conversation should be done on the succeeding working day.

The customer is liable to pay interest on the import bill at the following rates:

(a) from the date of negotiation of rate applicable to non-priority bill abroad to the date of debit sectors to advance bill account.

(b) from the date of debit to advance penal rate bills account to date of retirement of the bill

The bank should charge commission/ handing charges at the rate of 0.15 % on the bill amount at the time of converting foreign currency into indian rupees irrespective of the fact whether the bills is retired within 10 days or not.

Usance bills

Usance bills are to be stamped according to the current rates of stamp duty converting the foreign currency value into rupees at the rate prescribed by government of india from time to time. The bill should be presented to the customer for acceptance. If the bill is on d/a terms, the documents should be delivered to the customer retaining the accepted bills.

On receipt of the bill under the credit the liability entries, passed at the time of opening of the letter of credit are reversed. At the current bill selling rate the wowing entries are passed.

Dr customer's liability on acceptance

Cr. Bank's liability on acceptance

On payment to the negotiating bank on the due date of the bill, the above-entries are reversed.

Foreign inward bills for collection

When a bill is received from the correspondent bank for collection. The bank is acting as an agent for the correspondent bank. Therefore, the instructions given by the collecting bank should be scrupulously followed.

The documents received should be verified to see that they do not contravene the exchange control regulations of india. Any such discrepancy should be immediately brought to the notice of the collecting -bank and its instructions sought. All bills should have a certificate of origin as one of the documents to determine the currency of payment.

An intimation should be sent to the drawee of the bill to inspect the documents and retire them. Simultaneously an acknowledgement of receipt of documents for collection should be sent to the collecting bank.

When bill is retired by the drawee, the amount of the bill plus bank charges payable abroad should be converted at the bill selling rate and the amount should be recovered from the customers by debit to his account or by a cheque drawn on his account with his bank. Bank charges and commission for the bank in india can be recovered from the drawee. If he declines, the same can be deducted from the proceeds to be sent to the collecting bank abroad.

Usance bill

The bill should be got stamped according to the current rates by converting the foreign currency value into rupees at the rates prescribed by government of india from time to time and got accepted by the drawee. An intimation should be sent to the collecting bank of the fact of acceptance and the due date of the bill.

On the due date when payment is received, procedure to be followed is the same as that for sight bills.

Dishonor by importer

(1) bill received under letter of credit.

If the documents received under a letter of credit are in order, the issuing bank should make payment to the negotiating bank irrespective of the fact whether the importer pays or not.

If the bill is dishonored either by non-payment or by non-acceptance, it is in the interest of the credit-issuing bank to take proper care of the goods. Each import licence issued in india bears a clause that the bank becomes a joint holder under the license if a letter of credit is opened by it against the license. Therefore, as a joint holder, the bank _an get the goods cleared and arrange for

their warehousing. To avoid payment of the import duty immediately, the goods may be stored in the bonded warehouse, wherever possible. Also insurance should be kept alive.

To do the above, the bank should keep a watch on the arrival of the ship. The shipping company may send the bank (as the consignee on notify party) the steamer arrival notice. It may get the information through trade journals or clearing agent. For clearing the goods and arranging for their storage, the bank may utilize the services of approved clearing agents.

The goods cleared by the bank, if subject to licensing, may be sold to state trading corporation or government departments or actual users for which no permission from customs is necessary. Sale to others require prior permission of customs.

(ii) bill received for collection.

The collecting bank should be kept informed of the developments. It should be informed that under exchange control regulations in india, it is not possible for the bank to clear the goods and arrange for their storage. The bill should be protested for non-payment or non-acceptance as the case may be.

Import trust receipt

the importer has other facilities with the bank like key cash credit or open cash credit. When a bill received covering import of raw materials or other items, is released by payment by the importer out of his own sources or by debit to the cash credit account. The imported goods thus stand as security for the cash credit account. If the goods are to be charged as security for key cash credit facility (i.e. Pledge), it is essential that the goods are in the possession of the bank and not delivered to the importer. If the goods are delivered to the importer, the essential of pledge is lost and the bank loses its right over the goods. But unless the importer is allowed to take the delivery of the goods from the port and place them in the godown, pledge cannot be created.

The difficulty is obviated by taking a trust receipt from the importer and allowing him to take the delivery of the goods and place them in the godown. In the trust receipt the importer specifies the goods and agrees that he is holding the goods not as their owner but as an a agent for the bank. Thus the bank continues to have the rights of the pledgee.

The need for trust receipt facility also arise in case of letter of credit calling for usance bills. Suppose the letter of credit calls for 90 days sight bill. The exporter on shipment tenders the bill through the negotiating bank and gets it accepted by the issuing.

Model questions

1. Define "opening of letters of credit"
2. Explain defered payment import.
3. How the bill would receive and the letter of credit.

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