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Module-A BFM

CAIIB PAPER2

International Banking

CAIIB Paper 2 (BFM) Module A: International Banking

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CAIIB Paper 2 (BFM) Module A Unit 1 Exchange Rates and Forex Business

Foreign Exchange - Definition and Markets

Foreign Exchange Management Act (FEMA), 1999, (Section 2) defines foreign exchange as:

Foreign Exchange means foreign currency, and includes:

- All deposits, credits and balances payable in foreign currency, and any drafts, traveller's cheques, letters of credit and bills of exchange, expressed or drawn in Indian currency and payable in any foreign currency,
- Any instrument payable at the option of the drawee or holder, thereof or any other party thereto, either in Indian currency or in foreign currency, or partly in one and partly in the other." Thus, broadly speaking, foreign exchange is all claims payable abroad, whether consisting of funds held in foreign currency with banks abroad or bills, checks payable abroad.

Foreign Exchange Markets

Foreign exchange markets comprise a large spectrum of market participants, which include individuals, business entities, commercial and investment banks, central banks, cross border investors, arbitrageurs and speculators across the globe, who buy or sell currencies for their needs.

The world currency market is a very large market, with a large number of participants.

Major participants of FOREX markets are:

- **Central Banks –** managing their forex reserves and using currency markets strives to reduce the volatility and smoothen out the value of their home currency.
- **Commercial Banks** - offering exchange of currencies to their big and retail clients and hedging and investing their own assets and liabilities, as also on behalf of their clients, and also speculate on the exchange rate movements in the markets.
- **Investment Funds/Banks** - moving funds from one country to another using exchange markets as a vehicle for investments as also hedging their investments in various countries/currencies.
- **FOREX Brokers** - acting as middleman, between other participants, and at times taking positions on their books.
- **Corporations –** moving funds between different countries and currencies for investment or trade transactions or even speculation in currency markets.

Thus, the characteristics of foreign exchange market can be listed as under:

- A 24-hour market
- An over the counter market as well exchange driven market
- A global market with no barriers/no specific location
- A market that supports large capital and trade flows
- Highly liquid markets
- High fluctuations in currency rates. (every seconds)
- Settlements affected by time zone factor
- Markets affected by governmental policies and controls

Factors Determining Exchange Rates

The quotations in the FOREX markets depend on the delivery type of the foreign currencies, i.e., exchange of streams of the two currencies being dealt with. The spot rates, being the base quotes in the FOREX markets are more dynamic and are effected by varied reasons, a few of which are fundamental and other technical.

The main factors, which influence movement of exchange rates, can be summarized as under:

Fundamental Reasons

These include all those causes or events, which affect the basic economic and monetary policies of the concerned government. The causes normally affect the long-term exchange rates, while in the short-run, many of these are found ineffective.

In a long run, exchange rates of all currencies are linked to fundamentals, as given under:

- **Balance of payment** - generally a surplus lead to a stronger home currency, while a deficit weakens the same.
- **Economic growth rate** – a high growth leads to a rise in imports and a fall in the value of home currency, and vice versa.
- **Fiscal policy** – an expansionary policy, e.g., lower taxes can lead to a higher economic growth.
- **Monetary policy** – the way, a central bank attempts to influence and control interest and money supply can impact the value of currency of their country.
- **Interest rates** - high domestic interest rates tend to attract overseas capital, and thus the currency appreciates in the short term. In the longer term, however, high interest rates slow the economy down, thereby weakening the currency.
- **Political issues** - political stability is likely to lead the economic stability, and hence a steady currency, while political instability would have the opposite effect

Technical Reasons

- Government controls can lead to an unrealistic value of a currency, resulting in violent movement in exchange rates.
- Freedom or restriction on capital movement can affect exchange rates to a larger extent. This is a phenomenon, which was seen in Indonesia, Thailand, Philippines, Korea, etc.

Speculation

- Speculative forces can have a major effect on exchange rates. In an expectation that a currency will be devalued, the speculator will short sell the base currency (say $) for buying it back cheaper at a later date.
- This very act can lead to movements in the market, as the expectation for devaluation grows extends to other market participants as well.

Exchange Rate Mechanism

Types and Calculation

- **Due to the vastness of the market, operating in different time zones, most of the FOREX deals are done on SPOT basis**, meaning thereby that the delivery of the funds takes place on the second working day following the date of deal/contract.
- The rate at which such deals are done is known as SPOT rates. Spot rates are the base rates for other FX rates. The date of delivery of funds on the date, on which the exchange of currencies actually takes place, is also referred to as "value date' or 'settlement date". The delivery of FX deals can be settled in one or more of the following ways:

Ready or Cash

- **Settlement of funds takes place on the same day (date of deal),** e.g., if the date of Ready/Cash deal is 3 October 2016 (Monday), settlement date will also be 3 October 2016.

Tom

- Settlement of funds takes place on the next working day of the date of deal, e.g., say 1st Nov 2021), e.g., Bank A bought USD 1,000,000 against INR from Bank B @ 74.9600 Value Tom i.e. 2nd Nov 2021.
- This means that the delivery of USD 1,000,000 by Bank B and the settlement of INR 7,49,60,000 by Bank A takes place on the next working day, i.e. 2nd Nov 2021. This is known as a Tom deal. If the settlement date of TOM deal, i.e. 2nd Nov 2021 is not a working day, settlement date would be 3rd November 2021provided it is a working day for the markets where currency is to be settled). Intervening Saturdays and Sundays will also postpone the settlement date to next working day.

Spot

- Settlement of funds takes place on the second working day following the date of contract/deal, e.g., say 1st Nov 2021, e.g., Bank A, Mumbai bought USD 1,155,000 against EUR from Bank B, Frankfurt @ EUR/USD 1.1550 Value Spot i.e. 3rd Nov 2021.
- This means that the delivery of USD 1,155,000 by Bank B, Frankfurt and the settlement of EUR 1,000,000 by Bank A takes place on the spot date i.e. on the second working day following the date of the deal i.e. 3rd Nov 2021. This is known as a Spot deal. If the date of Spot deal is 1st November 2021, settlement date will be 3rd November 2021, presuming both markets in Mumbai and Frankfurt are working on 1st, 2nd and 3rd November 2021. If not, it will the next working day in both the countries. Intervening Saturdays and Sundays will also postpone the settlement date to next working day.

Forward

- **Delivery of funds takes place on any day after Spot date**, e.g., if the date of forward deal is 3 October 2016 (Monday), for value settlement date 30 October 2016 or 30 November 2016, it is a forward deal.

Cross Rate

- When we deal in a market where rates for a particular currency pair are not directly available, the price for the said currency pair is then obtained indirectly with the help of cross rate mechanism. **This can be explained with the following example:**
- Suppose, we intend to get a quote for Euro/INR and no one is prepared to quote Euro/INR directly in the market. We can work out a Euro/INR quote through Euro/USD and USD/INR quotes.
- Euro/USD quote would be available in the international markets and USD/INR would be available in the domestic market. By crossing out USD in both the quotes, we can arrive at an effective Euro/ Rs. Quote
- This is the basis for working out cross rates. Cross rate mechanism is a possible solution for calculation of rates for currency pairs which are not actively traded in the market.

- For example, we need to quote GBP against INR, but in India, usually GBP is not quoted directly, as such we need to take rates for USD/INR and GBP/USD to compute GBP/INR rate.
- **If, USD/INR is 68.10/11, and GBP/USD is 1.2100/10, then, to GBP/INR rate, we need to cross (multiply) both the given rates, which would give us GBP/INR rate as Rs. 82.40/82.48.**
- Or say if USD/JPY is 116.50/60, the rate for Rupee/JPY would be Rs. 58.40/46 per 100 JPY (JPY being quoted per 100 units, due to their values).

Forward Margins –

- Premium and Discounts Forward rates are derived from spot rates, and are a function of the spot rates and the forward premium or discount of the currency being quoted.
- **Forward rate = Spot rate + Premium (or – Discount).**

Fixed vs. Floating Rates

- **The fixed exchange rate is the official rate set by the monetary authorities for currencies**. It is usually pegged to one or more currencies. **Under floating exchange rate, the value of the currency is decided by supply and demand factors for that particular currency**.
- In some cases, even fixed exchange rates are allowed to fluctuate between definite upper and lower bands, as fixed by the monetary authority of the country.

Bid and Offer Rates

- **The buying rates and selling rates are also referred to as bid and offer rates**. In a USD/INR quote, of 68.10/11, the quoting bank is bidding for USD at 68.10 and is offering to sell the USD at 68.11. On the other hand, in a GBP/USD rate 1.2100/10, the quoting bank is willing to buy GBP at 1.2100 and willing to sell at 1.2110

Exchange Arithmetic - Theoretical Overview

- **All foreign exchange calculations have to be worked out with extreme care and accuracy and the decimal point has also to be correctly placed**. Constant check is also required to minimize the risk of mistake, as the markets work on very thin margins. An error in one quote may erode earnings from several trades/transactions.

Chain Rule

- **It is used in attaining a comparison or ratio between two quantities linked together through another or other quantities and consists of a series of equations,** commencing with a statement of the problem in the form of a query and continuing the equation in the form of a chain so that each equation must start in terms of the same currency as that which concluded the previous equation.

Per Cent and Per Mille

- **A percentage (%) is a proportion per hundred**, e.g., 1% is one part in every hundred parts such as Rupee 1 per Rupees 100, while per mille means per thousand, e.g., 1 per mille is one part in every thousand, such as Rupee 1 per Rupees 1,000.

Value Date

- **This is the term used to define the date on which a payment of funds or an entry to an account becomes actually effective and/or subjected to interest,** if any. In the case of payments on Telegraphic Transfers (TT) the value date is usually the same in both centres

Arbitrage in Exchange

- Arbitrages consist of the simultaneous buying and selling of a commodity or currency in two or more markets to take advantage of temporary discrepancies in prices.

Foreign Exchange Dealing Room Operations

The FOREX dealing room operations comprise functions of a service branch to meet the requirements of customers of other branches/divisions to buy or sell foreign currency, manage foreign currency assets and/or liabilities, fund and manage NOSTRO accounts as also undertake proprietary trading in currencies. It acts as a separate profit centre for the bank/institution.

While conducting treasury management operations, relating to foreign exchange operations of the Bank, the treasurer has to ensure that the operations are in compliance with the:

- Internal Control Guidelines of the Reserve Bank of India
- FEDAI regulations
- Internal guidelines of the Bank.

Management and Control of a Dealing Room

- **Reserve Bank of India, has advised that the Board of Directors of banks should frame an appropriate policy and fix suitable limits for its FOREX dealing functions**.
- The management of dealing room operations should focus on risk associated with foreign exchange dealing room operations, which arise due to complex nature of foreign exchange markets and the volatile nature of exchange rate movements.
- The major risks associated with foreign exchange dealing operations, where the management needs to frame policies and keep a constant vigil, can be summarized as under.

Functions of Integrated Treasury

The broad functions of an Integrated Treasury are as follows:

- Meeting CRR and SLR requirements and having an optimum mix of investment portfolio.
- Liquidity and funds management – analysis of major cash flows, funding mix and yields expected in credit and investments.
- Asset liability management, growth rate of the balance sheet, pricing of assets and liabilities in accordance with the prescribed guidelines.
- Risk management – market risk associated with bank's assets & liabilities, credit risk on treasury products, operation risk on payments and settlements.
- Transfer pricing – bench mark rates to various business groups, ensuring that the funds are deployed optimally.
- Derivative products – developing of IRS and other derivative products to hedge bank's exposure and also selling such products to customers.
- Arbitrage – simultaneous buying and selling of same type of assets in two different markets in order to make risk less profits.
- Capital adequacy – focussing on quality of assets and return on investments and evaluating the efficiency of deployed funds.

- Minimizing the level of provision requirements due to build up of NPA.

Internal Control Guidelines of RBI

It is very important that the dealing room adheres to the internal control guidelines of RBI in the regular conduct of the dealing room operations of the Bank. The following are some of the important Internal Control Guidelines of RBI which needs to be put in place by Banks:

- The data processing systems used must be appropriated to the nature and volume of activities in order to ensure functional separation.
- Access rules for performing distinct functions should be defined in detail and drawn up for persons unconnected with the dealing activities.
- Confidentiality of data in the systems may be ensured in case of outsourcing of IT services to the external agencies.
- Global limits for Inter-Bank deals (both domestic & overseas) to be put in place consistent with the overall risk management processes.
- Adequacy of capital to undertake aggressive dealing activities bearing in mind the Bank's capital and earnings performance.
- Appropriate VAR models for quantifying the extent of market risk for a given level of confidence.
- Periodic review and validation of existing models to test the robustness of such models.
- Every dealer should be advised of the limits (including the stop loss limits) allocated and work within the limits.
- All deals done have to be within the corresponding limits fixed viz., the counter-party exposure limits, stop loss limits, country-wise exposure limits (in respect of foreign exchange dealings) and within the Net Overnight Open Position Limits (NOOPL), Individual GAP Limits (IGL), Aggregate GAP Limits (AGL), etc., as approved by the Bank's Board.
- Evaluation of foreign exchange profits & losses at the closing rates of every month as announced by FEDAI.

Front Office	*Mid Office*	*Back Office*
Fund Management Nostro Accounts	Market Risk	Confirmation of deals
Foreign Exchange Advisory Management	Liquidity Risk	Settlement of deals
ALM & Maturity Mismatches	Country Risk	Accounting of deals
Dealing in the Inter-Bank Market	ALCO Committee	Reconciliation
Trading in the Inter-Bank Market	Reporting to the Top Management	Audit facilitation & reporting
Compliance	Compliance	Compliance

RBI/FEDAI Guidelines

The Reserve BANK of India, being the central bank of the country and the custodian of nation's foreign exchange reserves, has prescribed guidelines for authorized dealers, permitted by it, to deal in foreign exchange and handle foreign currency transactions. FEMA 1999, also prescribes rules for persons, Corporates, etc., in handling foreign currencies, as also transactions denominated therein.

The Reserve Bank of India issues Authorized Dealers' (AD) licenses to banks and all-India financial institutions to undertake foreign exchange transactions in India. At present there are over 90 ADs, which include all public sector banks, foreign and a large number of private banks, a few all-India financial institutions and a few Scheduled cooperative banks.

The RBI also issues Money Changer licenses to a large number of established firms, companies, hotel, shops, etc., to deal in foreign currency notes, coins and traveller's cheques, to facilitate encashment foreign currency for foreign tourists. Entities authorized to buy and sell foreign currency notes, coins and traveller's cheques are called Full Fledged Money Changers (FFMCs) while those authorized only to buy are called Restricted Money Changers (RMCs).

Categorization of Authorized Dealers: In the year 2006, the categorization of dealers authorized to deal in foreign exchange has been changed by the Reserve Bank of India. The entities so authorized are called as Authorized Persons, with category, denoting **their level of authority to undertake variety of transactions, as under:**

- **Authorized Dealer – Category I**: They can handle all current and capital account transactions according to RBI directions issued from time-to-time. Eg., Commercial banks, State and Urban Cooperative Banks
- **Authorized Dealer – Category II:** Entities that can deal in transaction of foreign exchange which are of non-trade nature. Eg., Upgraded FFMCs, Other cooperative banks, Regional Rural Banks.
- **Authorized Dealer – Category III:** Institutions that can deal with forex transactions which are incidental to financing of international trade related activities undertaken by these institutions, eg., Exim Bank, SIDBI.
- **Full Fledged Money Changer**: Purchase of foreign exchange and sale for private and business visits abroad. Eg., Other FFMCs, Dept of Post.
- **Foreign Exchange Operations**, undertaken without any boundaries or controls, can adversely affect the movement of exchange rates and the value of currency, besides profitability of the entity dealing in an undisciplined manner. Hence, RBI has prescribed broad guidelines with regard to foreign exchange operations in order to have regulated and disciplined market operations.
- RBI guidelines include those related to open positions, gaps, borrowing and lending in foreign currencies, interbank dealings in India and Overseas Markets, hedging of bank's own exposures as well as that of its resident and non-resident clients.

Foreign Exchange Dealers Association of India, (FEDAI), on the other hand, is a non-profit making body, formed in 1958 with the approval of Reserve Bank of India, consisting of Authorized dealers as members. FEDAI prescribes guidelines and rules for market operations, merchant rates, quotations, delivery dates, holidays, interest on defaults, etc. In terms of RBI directives, all authorized dealers are members of FEDAI and it is mandatory for them to follow the guidelines/directives issued by FEDAI.

A few of the major FEDAI guidelines/rules can be summarized as under:

- All export bills to be allowed standard transit period (NTP – normal transit period), as prescribed, for the purpose of allowing concessional interest rates and calculation of notional due dates.
- Export bills drawn in foreign currency, purchased/discounted/negotiated, must be crystallized in rupee liability, in case of delay in realization of export bills. The same would be done at TT selling rate. The prescription of crystallization of

export bills on the 30th day from the due date/notional date, has since been relaxed. Authorized Dealer Banks should formulate their own policy for crystallization of foreign currency liability into Rupee liability. The policy in this regard should transparently available to the customers.

- Unpaid foreign currency import bills drawn under letters of credit shall be crystallized as per the stated policy of the Bank in this respect.
- All forward contracts must be for a definite amount and period with specific delivery dates.
- Option period can be specified by the customer, in case of forward contracts, but in any case, the delivery period under the contract shall not exceed beyond one month. All such contracts must state the start and end dates.
- Cancellation of forward contracts - All contracts, which have matured and have not been picked up, shall be automatically cancelled on the THIRD working day, after the maturity date.
- All cancellations shall be at bank's opposite TT rates, TT selling rate for purchase contracts and TT buying rate for sale contracts.
- In the event of delay in payment of interbank foreign currency funds, interest at 2% above the prime rate of the currency of the specified banks shall be paid by the defaulting bank.
- In the event of delay in payment of rupee settlement funds, interest for delayed period at 2% above the NSE MIBOR ruling on each day shall be paid.
- All currencies to be quoted as – per unit of foreign currency = INR, while JPY, Indonesian Rupiah & Kenyan Shilling are to be quoted as 100 units of foreign currency = INR.
- FEDAI also prescribes code of conduct for FOREX dealers, as also guidelines with regard to dealings with FOREX brokers.

Example 1

Inflow of USD 100,000.00 by TT for credit to your exporter's account, being advance payment for exports (credit received in NOSTRO statement received from New York correspondent). What rate you will take to quote to the customer, if the market is 68.09/11?

Answer

It will be purchase of USD from customer for which USD will have to be sold in the market. Say when USD/INR is being quoted as 68.09/11, meaning that market buys USD at INR 68.09 and sells at INR) 68.11. We shall have to quote rate to the customer on the basis of market buying rate, i.e. 68.09 less margin, as applicable, to arrive at the IT Buying Rate applicable for the customer transaction.

Example 2

Retirement of import bill for GBP 100,000.00 by TT Margin 0.20%, ignore cash discount/premium, GBP/ USD 1.2175/85, USD/INR 68.14/15. Compute Rate for Customer

Answer

For retirement of import bill in GBP, we need to buy GBP, to buy GBP we need to give USD and to get USD, we need to buy USD against Rupee, i.e. sell Rupee.

At the given rates, GBP can be bought at 1.2185 USD, while USD can be bought at 68.15. The GBP/INR rate would be 83.0408 (1.2185X68.15), at which we can get GBP at market rates. Thus the interbank rate for the transaction can be taken as 83.0408.

Add Margin 0.20% 0.1660.

Rate would be 83.0408 +0.1660 = 83.2068 or say 83.2070 for effecting import payment. (Bill Selling Rate).

Example 3

On 15 September, a customer requests for booking of a forward contract for export bill of USD 150,000.00, to be realized in the month of December.

Given that USD/INR spot is 68.45/50 and forward premium is as under:

October: 18/19 paise

November: 30/32 paise

December: 41/43 paise

Margin to be charged 0.05 paise per USD.

Answer

For calculating rate for forward purchase contract, we need to take forward premium for November, the one that the market would pay, i.e. 30 paise. Spot rate as 68.45, getting forward interbank rate as 68.75 and deduct 0.05 paise as margin to arrive at 68.70 the customer forward rate for delivery of export proceeds during December, full month at the option of the customer (Forward TT Buying Rate). Forward margin for the period prior to the start of the delivery period would be passed on, as the customer has an option to deliver currency on the first day itself, i.e. 1st December.

Management and control of a Dealing room

Reserve Bank of India, has advised that the Board of Directors of banks should frame an appropriate policy and fix suitable limits for its FOREX dealing operations.

The management of dealing room operations should focus on the risks associated with foreign exchange dealing room operations, which in turn arise from the complex nature of foreign exchange markets and the volatile nature of exchange rate movements.

The major risks associated with foreign exchange dealing operations, where the management needs to frame policies and keep a constant vigil, can be summarized as under:

- Operational Risk
- Exchange Risk
- Credit Risk
- Settlement risk
- Liquidity Risk
- Gap Risk/Interest Rate Risk
- Market Risk
- Interest rate risk
- Equity Price risk
- Currency risk
- Legal Risk
- Systemic Risk
- Country Risk
- Sovereign Risk

The following are some of the risk containment measures which need to be adhered to during the course of dealing room operations:

- Every dealer should be advised of the limits allocated to him/her and work within the limits.
- All deals done with counter-parties are to be within the corresponding limits.
- Overall position to be arrived at the end of the day and well within the NOOPL, AGL, IGL, as approved by the Bank's Board.
- Adequate monitoring of the mismatches in maturities, positions, etc. should be ensured.
- Evaluation of foreign exchange profits & losses should be carried out periodically.
- Reconciliation of balances in the RBI accounts, Nostro and Vostro accounts should be done periodically, say, atleast once in a month.

- Debits/Credits in Mirror accounts, confirmation of balances should be obtained periodically from the Nostro correspondents and confirmation should be provided to the Banks maintaining Vostro (INR) accounts.

Derivative Products

Financial Management of the Multinational Enterprises (MNEs) and Multinational Corporations (MNCs) in the 21st Century has resulted in International trade volumes across the globe and prevalence of risk in all aspects of trade became prevalent. The development and growth of Financial Derivatives products has been one of the extraordinary and important features of the financial markets. Derivatives came into existence because of the prevalence of risk in every business and became an important tool in hedging such risks.

A derivative is a financial product whose value is derived from the value of another underlying asset or exposure viz., Commodity, Equity, Bond, Foreign Currency Position, etc., and includes Futures, Forward contracts, Option contracts, Swaps, etc. These instruments can be used for two very distinct objectives:

- **Speculation –** use of derivative instruments to take a position with the expectation of a profit,
- **Hedging** – use of derivative instruments to reduce the risks associated with the everyday management of corporate cash flows.

Foreign Currency Futures

- A Foreign Currency Futures Contract which is traded in an exchange is an alternative to a forward contract that calls for future delivery of a standard amount of foreign exchange at a fixed time, place and price.
- It is similar to Futures Contracts that exist for other products/commodities such as Cattle, Rubber, Metals, Pulses, Interest-bearing deposits, Gold, etc. The most important market for foreign currency futures is the International Monetary Market (IMM), a division of the Chicago Mercantile Exchange (CME).

Forward Contracts – Characteristics

- Agreement between the Bank and the customer agreeing on a price for a particular amount specified for delivery at a future date.
- Delivery either under Option basis or on a fixed date.
- Generally for periods upto one year and can extend beyond one year depending on the maturity of the underlying (LTFX contracts – Long-term forward contracts).
- Documentary evidence and genuineness of the underlying. Verification of the underlying and marking on the original documents.
- Maturity of the hedge should not exceed maturity of the underlying.
- Contracts should be in alignment with credit limits and due diligence is to be carried out.

- Contracts are to be utilized either prior to maturity or on maturity date. If not utilized on the maturity and it is cancelled, profits or losses are settled, as the case may be.
- If cancelled after maturity date, losses are recovered but profits will not be passed on.

Forward Contracts v/s Futures Contracts

- Forwards are of any size while Futures are standardized.
- Forwards are generally for maturities up to one year and beyond while futures are generally up to one year.
- Forwards are between Clients and Banks while futures are between clients and the Exchange.
- Prices in a forward contract are determined by bid/ask quotes while prices in futures determined through an outcry on the floor of the exchange or through Electronic trading platform.
- In forward contracts, there are no explicit collaterals while initial margins and on mark to market basis additional margins are needed in a futures contract.
- Forward contracts are delivered/utilized or cancelled on due dates while settlement under futures take place through off-setting of positions or through physical delivery some times.
- Forward markets are open 24 hours as per the conveniences of the parties while futures markets function during traditional exchange hours.
- While in forward contracts, parties are in direct contact, the parties in future contracts are not known to each other, but deal through the exchange.
- There is no explicit commission earned under forward contracts and Bank earns through the bid/ ask spreads while under futures, a single commission concept is prevalent.

Options

- Option is a contract giving the purchaser the right but not the obligation to buy or sell a given amount of the security/stock/currency at a fixed price per unit for a specified time period. The two basic options are Call and Put options.
- Under CALL Option, the Buyer has the right to purchase the currency (generally Imports) and under the PUT Option, Buyer has the right to sell the currency (generally Exports).
- The Buyer of the Option is called the holder while the Seller of the option is referred to as the writer or the grantor of the Option.

Every option has 3 different price elements:

- The strike or exercise price, which is the exchange rate at which the option can be purchased or sold.
- The premium, which is the cost of the option paid at the time the option is purchased.
- The actual spot rate in the market at the time the option contract is purchased.

Pricing of an option combines the following 5 elements:

- Present spot rate
- Time to maturity
- Forward rate for the underlying matching maturity
- Interest rates for the intervening currency/stock/security
- Volatility, i.e. (standard deviation from spot to forward rates)

Types of Option - An American Option gives the buyer the right to exercise the option at any time between the date of writing and the expiration or maturity date. A European Option can be exercised only on its expiration date, not before. The premium, or option price, is the cost of the option.

SWAPS

- Swaps are derivative instruments that represent an agreement between two parties to exchange a series of cash flows over a specific period of time. Swaps offer great flexibility in designing and structuring contracts based on mutual agreement. This flexibility generates many swap variations, with each serving a specific purpose.

Factors influencing SWAPS

- Investment objectives or repayment scenarios may have changed.
- Increased financial benefit in switching to newly available or alternative cash flow streams.
- The need may arise to hedge or mitigate risk associated with a floating rate loan repayment.

Types of SWAPS

- **Interest Rate Swap:** An interest rate swap is a contractual agreement to exchange a series of cash flows where cash flows at a fixed rate of interest are exchanged for those referenced to a floating rate. While one leg of cash flow is based on a fixed interest rate, the other leg is based on a floating interest rate over a period of time. There is no exchange of the principal amounts. The size of the swap is referred to as the notional amount and is the basis for calculating the cash flows.
- **Currency Swap**: A currency swap is contractually similar to an interest rate swap where cash flows in one currency are exchanged for cash flows in another currency. The transactional value of capital that changes hands in currency markets surpasses that of all other markets. Currency swaps offer efficient ways to hedge forex risk as well interest rate risk at one go.
- **Zero Coupon Swaps**: Similar to the interest rate swap, the zero coupon swap offers flexibility to one of the parties in the swap transaction. In a fixed-to-floating zero coupon swap, the fixed rate cash flows are not paid periodically, but just once at the end of the maturity of the swap contract. The other party who pays floating rate keeps making regular periodic payments following the standard swap payment schedule. A fixed-fixed zero coupon swap is also

available, wherein one party does not make any interim payments, but the other party keeps paying fixed payments as per the schedule.

- **Equity Swap**: An equity swap is an exchange of future cash flows between two parties that allows each party to diversify its income for a specified period of time while still holding its original assets. The two sets of nominally equal cash flows are exchanged as per the terms of the swap, which may involve an equity-based cash flow (such as from a stock asset, called the reference equity) that is traded for fixed-income cash flow (such as a benchmark interest rate).
- **Basis Swap**: Where cash flows on both the legs of the swap are referenced to different floating rates. A Basis swap could be an Interest Rate Swap or a currency swap where both legs are based on a floating rate. A basis swap involves a regular exchange of cash flows, both of which are based on floating interest rates. Most swaps are based on payment of a fixed rate against a floating rate, say, SOFR (Secured Overnight Financing Rate). In the basis swap both legs are calculated on floating rates.

FX Global Code

FX Global Committee at their global meet in London has endorsed the publication of the FX Global Code, a **uniform code across the globe for the wholesale foreign exchange markets which aims at the following:**

- Principles of good practices,
- Engaging local participants actively,
- Promoting healthy & disciplined dealing room trading, etc.
- Hongkong Monetary Authority (HKMA), Monetary Authority of Singapore (MAS), Reserve Bank of Australia (RBA), Bank of Korea and RBI apart from the Federal Reserve Bank, USA have already endorsed the FX Global Code,
- The revised FEDAI Code of Conduct Adoption and Implementation in the Indian Foreign Exchange Market is implemented w.e.f. 1st Sept 2021.

CAIIB Paper 2 BFM Module A Unit 2: Liberalised Remittance Scheme (LRS) and Other Remittance Facilities for Residents

Introduction

- **Introduced w.e.f. 4th Feb 2004:** Liberalised Remittance Scheme (LRS) for Resident Individuals
- Facilitates resident individuals to remit funds abroad for permitted current or capital account transactions or a combination of both.
- **Available to**
  - Resident individuals (including Minors),
- **Not Available**

- Corporates, Partnership Firms,
- HUFs,
- Trusts
- NRI

Capital Account Transactions And Current Account Transactions

- **As per Sub-section 2 (e) of Foreign Exchange Management Act 1999 (FEMA),** Capital account transaction means a transaction which alters the assets/liabilities, including contingent liabilities, outside India of persons resident in India or assets/liabilities in India of persons resident outside India.
- **Example:** A resident individual by investing abroad in the equity of the Overseas company obtains shares allotted in his/her favor resulting in creation of an asset outside India.
- Likewise, a resident individual by investing in property abroad gets the ownership of the property purchased resulting in creation of an asset outside India.
- **As per Sub- As section 2 (j)** Current account transaction means a transaction other than capital account transaction and includes payments connected to trade, interest on loans and income on investments, expenses connected to travel, family maintenance, medical treatment, etc.
- **Example:** A parent remitting funds to the dependent son/ daughter abroad towards education expenses, maintenance of the student abroad, etc.

Key Sections Under FEMA Vis-À-Vis Liberalized Remittance Scheme

- **Section 4:** Save otherwise as provided in the Act, no person resident in India, shall acquire, hold, own, possess or transfer any foreign exchange or foreign security or any immovable property situated outside India, unless it was acquired while being a non-resident. However, under the contours of liberalization, resident individuals are permitted to invest abroad in property or equity - subject to adhering to the extant guidelines.
- **Section 6:** Any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction ie., any class or classes of capital account transactions which are permissible and the limits up to which such transactions are permissible as per the extant regulations under the Act.
- **Section 10 (6):** Any person (other than the Authorized Person) who has acquired or purchased foreign exchange does not use it for such purpose or does not surrender it to the authorized person within the specified period if such foreign exchange is not used or uses the foreign exchange so acquired or purchased, for any other purpose not permissible under the provisions of the Act, shall be deemed to have committed contravention of the provisions of the Act. In a nutshell, this section is about utilization of foreign exchange availed from an Authorized Dealer for the purpose for which such foreign exchange has been availed.

- **Section 11**: To secure compliance of the provisions of this Act, RBI may give to the Authorized Person any directions with regard to making payments or desist from doing any act relating to foreign exchange or foreign security, with regard to furnish such information, in such manner as it deems fit, with regard to failure to furnish such information or filing any returns impose penalty which may extend to Rs. 10,000 and in case of continuing contravention, with an additional penalty which may extend to Rs. 2,000 for every day. In a nutshell, this section is about how foreign exchange business has to be conducted by Authorized Persons and the power of RBI to penalise APs in case of any breach in procedure.
- **Section 13**: Any person contravenes any of the provisions of the Act or contravention of any rule, regulation or notification, shall upon adjudication be liable to pay penalty up to thrice the amount involved in such contravention where such amount is quantifiable or up to Rs. 2,00,000 where the contravention is not quantifiable. Where the contravention is a continuing one, further penalty may extend up to Rs. 5,000 for every day after the first day during the period of such contravention. In a nutshell, this section is about the penalties which may be imposed for contraventions of the provisions of the FEMA.

Permissible/Non-Permissible Remittances Under LRS

- **Schedule I –** Non-permissible remittances (Prohibited remittances) The following remittances are not permitted
- **Schedule II –** remittances permissible subject to approval of the respective Government Departments/Ministries
- **Schedule III -** Remittances for resident individuals – permissible under the delegated powers of the Authorized Dealers

Schedule I – Non-permissible remittances (Prohibited remittances)

The following remittances are not permitted:

- Remittances for margins or margin calls to Overseas exchanges/Overseas Counterparties.
- Payment of commission on exports made towards equity investments in JVs/WOS abroad.
- Payment related to "Call Back Services" of telephones. Remittance towards banned/proscribed magazines. Purchase of FCCBs issued by Indian companies abroad.
- Remittance of dividends by any company to which the requirement of dividend balancing is applicable.
- Remittance of interest income on funds held in Non Resident Special Rupee accounts.
- Remittance out of lottery winnings, remittance for purchase of lottery tickets. Remittance of income from racing, riding or any other hobby.
- Payment of commission on exports under Rupee State Credit Route.

Schedule II – remittances permissible subject to approval of the respective Government Departments/Ministries

- Remittances towards Cultural tours – approval from Department of Education and Culture - Ministry of Human Resources Development.
- Advertisements in Foreign Print Media by State Governments/PSU Undertakings – Ministry of Finance.
- Remittances towards Freights of Vessels chartered by PSUs – Ministry of Surface Transport.
- Payment of Imports through Ocean Transport on CIF basis by Government dept/PSUs – Ministry of Surface Transport.
- Remittances of hiring charges of transponders by TV Channels, Internet Service Providers, etc. – Ministry of Information & Broadcasting, Ministry of Information Technology.
- Remittance of prize money, sponsorship of sports activities abroad by a person other than International/ National/State level sports bodies and where the amount involved exceeds USD100,000 - Department of Youth Affairs & Sports, Ministry of Human Resources Development.

Schedule III - Remittances for resident individuals – permissible under the delegated powers of the Authorized Dealers

- Private visits to any country (other than Nepal & Bhutan)
- Gift or donation
- Going abroad for employment
- Emigration
- Maintenance of close relatives abroad
- Travel for business by resident individuals - attending international conferences, specialized training, etc.
- Accompanying as attendant to a patient going abroad for medical treatment
- Expenses in connection with medical treatment abroad
- Studies abroad
- Purchase of Objects of Art subject to Foreign Trade Policy
- Others viz., remittances towards health insurance, etc.

Operational Guidelines

General Guidelines

- PAN is mandatory under the scheme irrespective of the amount of remittance.
- Remit funds abroad for permissible current (Sch III remittances) or permissible capital account transactions or a combination of both.
- AD Banks to frame appropriate guidelines for Customer Interface

- Customer to designate a particular branch of the Bank through which all remittances (under LRS) are to be made, especially, with regard to capital account transactions.
- Transactions freely allowed up to an overall limit of USD 250,000 per FY for any permissible current or capital account transactions or combination of both. No restrictions on the frequency of remittances in an FY.
- However, once a remittance of USD 250,000 is utilized in an FY, no further remittances allowed. even if the proceeds of investments have been brought back in to the country in respect of investments abroad.
- If a sole proprietorship firm intends to remit the money under LRS by debiting its current account then the eligibility of the proprietor in his individual capacity has to be reckoned.
- International Credit Cards, International Debit Cards and ATM Cards can be used for current account transactions.
- Citizens of a foreign state (other than Pakistan) and resident in India on account of employment or deputation of specified duration or for a specific job or assignments, the duration of which **does not exceed 3 years**, is a resident but not permanently resident.
- Such individuals are eligible to make remittances under LRS subject to deduction of taxes, contributions to Provident Fund and other deductions.

Documentation

RBI does not prescribe the documents which should be verified by the AD while permitting remittances for various transactions, especially, current account transactions.

The following are the documents which generally need to be obtained while handling requests from Residents for remittances towards LRS:

- Form A2 vis-à-vis FEMA Declaration – Online submission of Form A2 allowed.
- Simplified documentation for individuals for amounts up to USD 25,000, subject to the satisfaction of the AD Bank*
- Declaration of source of funds.
- PAN, irrespective of the amount.
- Copy of confirmed ticket and VISA, if the remittance is for travel abroad.
- Where the services of Tour Operators are being availed, the tour operator can collect the amount from the resident individual either in INR or in FC. In which case the tour operator can open a Special foreign currency account with a Bank in India.
- Tax Collected at Source (TCS) applicable in respect of release of exchange by the tour operators irrespective of the threshold limits.

Remittances Under LRS For Current Account Transactions

Private visits to any country (other than Nepal & Bhutan)

- Transactions freely allowed up to an overall limit of USD 250,000 per FY
- Irrespective of the number of visits undertaken in a FY, cash towards release of exchange can be accepted up to Rs. 50,000/- beyond which transaction to be routed through the a/c.
- Unutilized foreign exchange to be surrendered to the AD within 180 days from the date of return to India.

Note:

Release of foreign exchange in form of foreign currency notes (cash):

- Foreign exchange in full may be released in the form of FC Notes or up to the cash limit specified by the Haj Committee of India, to the Haj Pilgrims.
- Travelers proceeding to Islamic Republic of Iran, Russian Federation (including erstwhile CIS countries) – full exchange may be released in the form of FC Notes.
- Travelers proceeding to Iraq and Libya - USD 5000/-
- All other countries - USD 3000/-

Gift to a person resident outside India

Companies Act, 2013 defines "relative" as one who is related to another if:

*(*a)They are members of HUF,

Documentary evidence, wherever applicable

(b) they are husband and wife,

(c) one person is related to other in such a manner as prescribed

under the Act. i.e., father (including step father), mother (including step mother), son (including step son), daughter, daughter's husband, brother (including step brother), sister (including step sister), etc.

Note:

(i)Certain relatives who were included which was included under Companies Act 1956 are not included under the definition of relative for gifting.

These excluded persons are: Step daughter, father's father, father's mother, mother's father, mother's mother., Son's son., Son's son's wife, son's daughter, son's daughter's husband, daughter's son, daughter's son's wife, daughter's daughter's husband, brother's wife, sister's husband.

(ii) A resident cannot gift to another resident, in foreign currency or foreign security, for the credit of the latter's foreign currency account held abroad, under this scheme.

Donation to a person outside India or to an Organization outside India

Emigration – as prescribed by the country of Immigration

Note:

- Foreign exchange beyond USD 250,000 may be released if it is so required by the country of Emigration for meeting any incidental expenses in the country of Immigration subject to suitable documentary evidence submitted by the individual to the satisfaction of the AD Bank.
- This should not, however, be for earning points/credits to become eligible for Immigration by way of Overseas Investments in Government Bonds, Lands, Commercial Enterprises, etc.
- Foreign Bank guarantees towards Overseas employers/Immigration not permitted.

Going abroad for employment

Maintenance of Close relatives abroad – relative as defined u/s 2(77) of Companies Act 2013.

Purchase of Objects of Art

Subject to Foreign Trade Policy, Resident Individuals importing objects of art for personal purposes not connected with trade or commercial purpose.

Business trips

- **Travel for business.*1**
- **Attending conferences.*2**
- **Specialized training. *3**

***1, *2, *3 If an employee is being deputed by an entity for any of the above and expenses are borne by the Company, these are outside the purview of the LRS and may be permitted without any limit.**

Expenses in connection with medical treatment abroad –

- Authorised Dealers may release foreign exchange up to an amount of USD 2,50,000 or its equivalent per FY without insisting on any estimate from a hospital/doctor.
- For amount exceeding the above limit, Authorised Dealers may release foreign exchange under general permission based on the estimate from the doctor in India or hospital/doctor abroad.
- A person who has fallen sick after proceeding abroad may also be released foreign exchange by an Authorised Dealer (without seeking prior approval of the Reserve Bank of India) for medical treatment outside India.
- In addition to the above, an amount up to USD 250,000 per financial year is allowed to a person for accompanying as attendant to a patient going abroad for medical treatment/ check-up.

Studies abroad –

After having obtained admission in the Overseas University

Note:

- Foreign exchange beyond USD 250,000 may be released if it is so required by the University where the admission is secured, subject to suitable documentary evidence submitted by the individual to the satisfaction of the AD Bank.
- Foreign Bank guarantees towards educational purposes in favor of Overseas Universities/entities are not permitted.
- In terms of FEMA, students going abroad for studies are considered as NRIs and the existing resident account needs to designated as NRO in which case they can make use of remittance facilities available to NRIs.
- They can remit up to USD 1 Mn from their NRO accounts per FY provided the credits in the NRO are legitimate dues, due in India, to the erstwhile resident.

Tax Collected At Source (TCS)

- 1st October 2020: The Finance Act, 2020 has a new insertion in the Income Tax Act on Tax Collected at Source (TCS) at 5% on foreign remittance LRS.
- The threshold for TCS is Rs 7 lakhs for an entire FY and TCS is applicable > 7 lakhs.
- In case of non-availability of PAN/Aadhar – TCS is at 10%.
- TCS is also applicable for transactions involving transfer from domestic rupee account to the NRO account under LRS.
- Remittances under LRS, towards studies abroad where the source of funds is educational loan, 0.5% will be the TCS and applicable over the threshold limit of Rs. 7 lakhs.

Given below are some examples for levy and calculation of TCS, under LRS:

Customer A	Makes a remittance of Rs 6,50,000 Date: Apr 04, 2020	No tax will be collected
	Makes a remittance of Rs 9,50,000 Date: May 05, 2020	5% tax will be collected on Rs 9,00,000 (Rs 6,50,000+9,50,000–7,00,000)
	Makes a remittance of Rs 40,000 Date: Dec 10, 2020	5% tax will be collected on incremental Rs 40,000 (as the remitter has crossed Rs 7 lakh earlier)
Customer B	Makes a remittance of Rs 20,00,000 in the same FY Date: Apr 30, 2020	5% tax will be collected on Rs 13,00,000 (Rs 20,00,000 – 7,00,000
Customer C	Makes a remittance of Rs 10,00,000 for pursuing education through a loan obtained from any Financial Institute	0.5% tax will be collected on Rs 3,00,000 (Rs 10,00,000 – 7,00,000

LRS VIS-À-VIS Capital Account Transactions

Remittances to International Financial Services Centres (IFSCs)

With a view to deepen the financial markets in the International Financial Service Centres (IFSCs), an opportunity is provided to the resident individuals to diversify their portfolio wherein residents are permitted to make remittances under LRS to IFSCs, set up in India under the Special Economic Zone guidelines, subject to the overall limit permissible under the extant guidelines.

The following provisions need to be adhered to by the resident individuals:

- The remittances shall be made only for making investments in IFSCs in securities, other than those issued by entities/companies resident (outside IFSC) in India.
- Opening of a non-interest-bearing Foreign Currency account (FCA) in IFSCs permitted for making the above permissible investments under the LRS.
- Any funds lying idle in the account for a period up to 15 days from the date of credit into the account shall be immediately repatriated to domestic INR account of the investor in India.
- No domestic transactions are permissible to be settled with other residents through these FCAs held in IFSC.
- AD Banks allowing such remittances on behalf of resident individuals shall comply with all other terms and conditions including reporting requirements under the Scheme.

Remittances of capital account nature can be made, under LRS, for the following:

Opening of foreign currency accounts abroad.

- Purchase of Immovable Property abroad.

Making Investments abroad in the form of:

✓ Acquisition & holding of shares both in Listed/Unlisted Cos
✓ Acquisition of debt instruments
✓ Acquisition of qualification shares of an Overseas Co., for holding the post of Director,
✓ Acquisition of shares of a foreign company towards professional services rendered or in lieu of Director's remuneration,
✓ Units of Mutual Funds, Venture Capital Funds, Unrated debt securities, Promissory Notes, etc.,
✓ Setting up of JVs/WOS outside India where the JV/WOS is engaged in a bonafide business activity*.

Extending loans including loans in INR to NRIs who are close relatives.

A resident individual is prohibited from making direct investments in a JV/WOS which is engaged in the following:

✓ In real estate business,
✓ Banking business, or
✓ In the business of financial service activities.

The following are also to be complied with reference to LRS for capital account transactions:

- ✓ The resident individual to designate a Branch of an AD Bank through which all the remittances relating to Capital account transactions are to be effected.
- ✓ The individual should have maintained **account with the Branch for a minimum period of one year** prior to the date of remittance and the dealings should be satisfactory.
- ✓ Investment in Property by resident individuals up to the limit of USD 250,000 in a FY.
- ✓ No Credit facilities to be extended to facilitate capital account transactions.
- ✓ Remittances can be consolidated in respect of family members subject to individual family members complying with the terms & conditions & all the family members are co-owners, co-partners of the Overseas Property, ie., Joint ownership.

Remittances under LRS for Overseas Direct Investments (ODI)

A resident individual (either singly or in association with another resident individual/Indian party), may make Overseas Direct Investments in equity shares and compulsorily convertible preference shares of a JV/WOS outside India.

Direct Investment outside India means (Regn. 2 (e))

- ✓ Investments by way of contribution to the capital
- ✓ Subscription to Memorandum of Association of the foreign entity
- ✓ Purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange but does not include Portfolio Investments.

A resident individual is prohibited from making direct investments in a JV/WOS which is engaged

- ✓ In real estate business
- ✓ Banking business, or
- ✓ In the business of financial service activities**.**

- Investments can be either in listed companies or unlisted companies or a combination of both subject to a maximum overall limit for all purposes put together at USD 250,000/FY.

- No credit facilities to be extended to facilitate capital account transactions.

- Opening of Bank account abroad permitted for facilitating and putting through the investment transactions.

- Remittances can be consolidated in respect of family members subject to individual family members complying with the terms and conditions and all the family members are co-owners, co-partners of the Overseas Investments.

In respect of investments in the existing JV/WOS, valuation shall be as follows (Regn. 6 (6)):

- Where investments are more than USD 5 Mn (or equivalent in other currencies): valuation by Category I Merchant Banker registered with SEBI or an Investment Banker/Merchant Banker outside India registered with appropriate regulatory authority in the host country.
- Where investments is less than USD 5 Mn (or equivalent in other currencies), a Certificate by a C.A. or a C.P.A.

✓ Repatriate all dues viz., Dividends, Royalties, Technical fees, etc., within 60 days of such amounts falling due.
✓ Disinvestments shall be allowed only after one year from the date of making the first investment.
✓ No write-off allowed in respect of disinvestments by resident individuals.
✓ A resident individual is prohibited in making Direct Investments in FATF Non-compliant countries.
✓ The JV/WOS should be engaged in bonafide business activity.
✓ The JV/WOS should be an operating entity only and no step-down subsidiary is allowed to be acquired by the JV/WOS.
✓ The permissible ceiling shall be within the overall limit under LRS and the investments made out of balances in the EEFC/RFC accounts shall be restricted to the LRS limit.
✓ Resident individuals should not be on the RBI Caution list or list of defaulters to the banking system or under Investigation by any Investigation or Enforcement Agency or regulatory body concerned.

Documentation for ODI

- Form A2 vis-à-vis FEMA Declaration – Online submission of Form A2 allowed.
- Simplified documentation for individuals for amounts up to USD 25,000, subject to the satisfaction of the AD Bank*
- Declaration of source of funds
- PAN
- Form ODI (in respect of investment in WOS/JV abroad)

Part I of Form ODI to be submitted within 30 days of making the first remittance.

Designated AD Bank to report to RBI in Form ODI (Part I & II) within 30 days from the date of making the remittance by the resident individual.

* Documentary evidence, wherever applicable.

▪ Resident individual should submit share certificates/any other document as evidence, within 6 months from the date of making the remittance.

▪ Post investment changes/alterations in share holding pattern to be reported to the Designated AD within 30 days from date of such changes.

- Submit every year, before 31st December, the Annual Performance Reports - APRs. FLA not required.
- Disinvestments allowed after one year from the date of remittance. Disinvestments shall be repatriated to India immediately and in any case not later than 60 days from date of disinvestment & same is to be reported to the designated AD within 30 days from the date of receipt of disinvestment proceeds.

Loans by resident individuals to NRI close relatives

The following are required to be complied:

- Loan is free of interest.
- Minimum maturity: one year.

For borrower's personal requirements or for business purposes. Loan shall not be utilized for:

- Business of chit funds/Nidhi funds.
- Agricultural, plantation or real estate activities, construction of farm houses, trading in TDRs, etc.

- Proceeds may be credited to the NRO account of the NRI/PIO.
- The loan amount shall not be remitted outside India.
- Repayment shall be from inward remittances or transfer from NRO/NRE/FCNR accounts.

Reporting Requirements Under LRS

Earlier reporting of LRS by the AD Banks was based on the declarations made by the resident individuals and no independent reliable sources for verification were available.

However, with effect from April 2018, a daily reporting system by AD Banks of transactions undertaken by the resident individuals has been put in place by RBI.

- ADs are required to upload daily transaction-wise information undertaken by them under the LRS.
- The reporting of daily transactions are to be reported on the XBRL platform by close of business of the next working day.*
- NIL report to be uploaded if there are no transactions on a particular business day.
- The data on such daily reporting is made available to all the AD Banks.

CAIIB BFM Module A Unit 3: Correspondent Banking and NRI Accounts

Correspondent Banking - Accounts and Other Services

Correspondent banking in its true sense, is the relationship between two banks which have mutual accounts with each other, or one of them has account with the other. However, in a larger sense, this means a relationship and servicing of banking needs, as agents, without having account relationship also. This was due to a large number of banks offering correspondent banking services and it was not possible to have and maintain accounts with a large number of them, but the growing needs of the international business, required help and services from a large number of banks, across the globe.

Functions Handled by Correspondent Banks

Account Services

- These services require having account relationship with the foreign bank.
- Clearing House Functions
- Collections: Correspondent banks provides services as agents for collection of export/import bills as well as cheques, in their country.
- Payments
- Overdrafts and loan facility
- Investment Services

Other Services

- Letter of Credit advising
- LC Confirmations
- Bankers Acceptances
- Issuances of Guarantees-bid-bond, performance etc.
- Foreign Exchange Services, including derivation products
- Custodial services
- Trade referrals and credit reports on foreign parties
- Services related to investment of overnight surplus funds, short-term deposits, as also securities etc.
- Other fund raising services, like placement of shares, bonds ADR/GDR etc.
- Training and seminars on various topics/on latest developments.

Banks Accounts

- **NOSTRO Account**: A nostro account refers to an account that a bank holds in a foreign currency in another bank.
- **VOSTRO Account**: A vostro account is an account a correspondent bank holds on behalf of another bank. These accounts are an essential aspect of correspondent banking in which the bank holding the funds acts as custodian for or manages the account of a foreign counterpart.
- **LORO Account**: Loro Account is a Current Account Maintained by one Domestic Bank on behalf of other domestic bank in foreign bank in foreign currency. In

other word Loro Account is a Nostro Account for one bank who opened the bank and Loro Account for other bank who refers first one account.

- **Mirror Account**: Mirror Account is the reflection of NOSTRO Account in the books of the principal bank. This is maintained for reconciliation purpose and is maintained in both foreign currency and rupees.

Electronic Modes of Transmission/ Payment Gateways

SWIFT: The Society for Worldwide Interbank Financial Telecommunication, legally S.W.I.F.T. SCRL, provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment.

CHIPS

- **The Clearing House Interbank Payments System (CHIPS**) allows large interbank transactions in the U.S. to clear.
- CHIPS is slower but less expensive than the other major interbank clearing house known as Fedwire, making it more amenable to larger transactions that can take longer to clear.
- CHIPS works by netting debits and credits across transactions, providing both clearing and settlement services to its customer banks.

Fedwire

- **Fedwire (formerly known as the Federal Reserve Wire Network) is a real-time gross settlement funds transfer system** operated by the United States Federal Reserve Banks that allows financial institutions to electronically transfer funds between its more than 9,289 participants (as of March 19, 2009).

Chaps

- The Clearing House Automated Payments System (CHAPS) is a U.K.-based system that facilitates large British pound-denominated money transfers.
- Multinational banks principally use CHAPS.
- CHAPS allows funds to be transferred almost instantaneously, minimizing the risk of loss or theft.

Target (Trans-European Automated Real-time Gross Settlement Express Transfer)

- TARGET has a decentralised structure (see diagram), linking together 16 national real-time gross settlement (RTGS) systems and the ECB payment mechanism (EPM). It is owned by the Eurosystem, which consists of the ECB and the 12 national central banks (NCBs) of the euro area.
- TARGET2 is the real-time gross settlement system for the Eurozone, and is available to non-Eurozone countries. It was developed by and is owned by the

Eurosystem. TARGET2 is based on an integrated central technical infrastructure, called the Single Shared Platform.

RTGS

- The acronym **'RTGS' stands for Real-Time Gross Settlement**. Simply put, it is the process of continuous (real-time) settlement of funds, which occurs individually, on an order by order basis, without netting. In other words, your request to transfer or settle funds is carried out immediately, instead of the same happening in batches (as is the case in NEFT).
- 'Real Time' indicates that the processing of instructions happens at the time they are received rather than at some later time. 'Gross Settlement' indicates that the settlement of fund transfer instructions occurs individually (on an instruction-by-instruction basis). Considering that the settlement of funds takes place in the books of the Reserve Bank of India, the payments made through RTGS are final and irrevocable.
- **RTGS is available 24x7x365** with effect from December 14, 2020.
- The RTGS system is primarily meant for large value transactions. The minimum amount to be remitted through **RTGS is ₹ 2,00,000/- with no upper or maximum ceiling.**

NEFT

- **National Electronic Fund Transfer (NEFT)** is a nation-wide payments system that allows the transfer of funds from one bank's account to another. With an increased focus on online banking, NEFT has become one of the most popular ways of transferring funds. Since it can electronically transfer funds from any bank branch to any individual, it has eliminated the need to visit a bank branch for transfer of funds.
- W.e.f. December, 14th 2020, the transfer of funds through RTGS is available for customers **24/7 x/365 days with the minimum amount of Rs. 2,00,000** with no upper or maximum ceiling. Under the normal circumstances, the beneficiary Bank branches are expected to receive the funds in real time as soon as funds are transferred by the remitting Bank. The beneficiary bank must credit the beneficiary's account within 30 minutes of receiving the funds transfer message.

NRI Banking

If you are a **Non-Residential Indian (NRI) or a Person of Indian Origin (PIO), you will have different banking and investment needs**. Since you are residing abroad, most of your income and savings will be in foreign denominations, **e.g. US dollar, Euro, etc. As such, you might need an account that would suit your requirements.**

Many major banks and financial institutions in India offer the facility of opening an NRI Account. These accounts provide numerous facilities with respect to the currency denomination, transferability of the amount, tax, etc. But do you know everything about

NRI Accounts? Let's learn in detail what is an NRI Account and the different types of NRI Accounts.

Resident

- If an individual is in India for at least 182 days in the preceding Financial Year (say, for example 2019-20)
- If an individual is in India for at least 365 days in the last 4 Financial Years (for example 2015-16, 2016-17, 2017-18, 2018-19) and at least 60 days in the preceding Financial Year 2019-20, is treated as a Resident.

Non-resident

Individuals not satisfying the conditions (a) or (b) above will be treated as NRIs.

Amendment effective from 1st April 2020.

If an individual is in India for at least 120 days (as compared to the previous threshold of 182 days) in the previous Financial Year (say 2019-20) AND stayed in India for at least 365 days or more in the last 4 Financial years i.e. 2015-16, 2016-17, 2017-18, 2018-19) and the taxable income in India exceeds Rs. 15 lakhs, THEN the Non-Resident Indian will be treated as Resident for the taxation purposes and the income will be taxed accordingly.

Resident but Not Ordinarily Resident – RNOR (for the purposes of Income Tax)

Should have stayed outside India for 9 years out of the last 10 preceding Financial Years

OR

Should have stayed in India for less than 730 days in the last 7 Financial Years

OR

PIO/Indian Citizen with more than Rs. 15 lacs income earned from Indian sources, stayed in India for 120 days or more in the previous FY plus 365 days or more in the preceding last 4 FYs

OR

Deemed resident with more than Rs. 15 lacs income earned from Indian sources.

Deemed Resident (for the purposes of Income Tax)

- An NRI who is not a tax resident of any country and has more than Rs. 15 lacs income in India earned from Indian Sources.
- The status of deemed residency is applicable only for NRIs who hold Indian Citizenship and not applicable to PIOs.

Impact of the amendments to the Finance Act 2020

- A deemed resident in India with more than Rs. 15 lacs income from India and who is not a tax resident of any other country.
- A PIO or an Indian Citizen with more than Rs. 15 lacs income from Indian sources.

As per the FEMA 1999, Non-Resident Indian is:

(a) A person resident outside India who is a citizen of India, i.e.

- Indian citizens who proceed abroad for employment or for carrying on any business or vocation or for any other purpose in circumstances indicating indefinite period of stay outside India.
- Indian citizens working abroad on assignments with Foreign governments, government agencies or International/Multinational Agencies like United Nations Organizations (UN), International Monetary Fund (IMF), and World Bank, etc.
- Officials of Central and State Governments and Public Sector Undertaking deputed abroad on assignments with Foreign Govt. Agencies/Organizations or posted to their own offices including Indian Diplomatic Missions abroad.

(b) A person of Indian origin (PIO) is one who is a citizen of any other country (other than Bangladesh or Pakistan or such other country as may be specified by the Central Government), satisfying the following conditions:

- Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955); or,
- Who belonged to a territory that became part of India after the 15th day of August, 1947; or,
- Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b); or,
- Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c).

Types of NRI Accounts

- Non-Resident External (NRE) Accounts
- Non- Resident Ordinary (NRO) Accounts
- Foreign Currency Non-Resident (FCNR) Accounts
- Special Non-Resident Rupee Account-SNRR account

Non-Resident External (NRE) Accounts

- **The Non-Resident External (NRE) Account allows you to transfer your foreign earnings easily to India**. However, this type of account is rupee dominated and can be opened in the form of Current, Savings, Fixed or Recurring Deposits.
- It is vital to know that there is no tax levied on the interest earned from these accounts, i.e. they are tax exempt, and they are also easily repatriable, i.e.

transferable. These accounts can be jointly opened with close relative Resident Indian on Former or Survivor basis.

Non- Resident Ordinary (NRO) Accounts

- **The Non-Resident Ordinary (NRO) Account are primarily opened for depositing rupees earned in India**. **Foreign earnings can also be deposited in this account.** When an Indian citizen goes abroad for a job with an intention to stay there, his resident accounts should be converted into an NRO Account by the bank. Therefore, it is essential to inform the bank about the individual's departure abroad.
- Also, it is vital to know that NRO Accounts are rupee dominated and can be opened in the form of Savings, Current, Recurring Deposits or Fixed Deposits. These accounts can be jointly opened with any Resident Indian on Former or Survivor basis.

Foreign Currency Non-Resident (FCNR) Accounts

The Foreign Currency Non-Resident (FCNR) Account can be opened in different currencies such as US Dollars, Canadian Dollars, Australian Dollars, Sterling Pounds, Euro, Japanese Yen, etc. These FCNR Accounts can be opened in the form of term deposits for the following maturity periods:

- 1 year and above but less than 2 years
- 2 years and above but less than 3 years
- 3 years and above but less than 4 years
- 4 years and above but less than 5 years
- 5 years.

Special Non-Resident Rupee Account-SNRR account

- **SNRR account has been allowed to be used for specified transactions in trade, foreign investments, External Commercial Borrowings, etc**., in lieu of sending inward/outward remittances by a person resident outside India in a convertible foreign currency for each transaction with a resident or vice-versa, all precautions need to be taken by Authorized Dealer (AD) banks to ensure identification of the counterparty of such transactions.
- Some of such precautions are listed out in FAQs below. The onus of ensuring the use and identification of SNRR transactions as per guidelines falls on the AD banks.

Facilities To NRIs

NRIs can freely invest in shares and securities of Indian companies. On repatriation basis or non-repatriation basis as direct investment in shares/debentures (Debts) offered by companies or under Portfolio Investment Scheme i.e. investment in secondary market/through a recognized stock exchange. NRIs can also invest in securities other than shares and convertible debentures.

Investments in Shares/Securities

Investments by NRIs have been broadly categorized into two segments:

- On Repatriation basis.
- On Non-repatriation basis,

Investment in shares/convertible debentures on repatriation basis:

Non Resident Indian [NRI] being an Indian citizen as also a foreign citizen of Indian origin is permitted to freely invest in shares and/or convertible debentures of Indian company carrying on almost every kind of business in India barring a few cases wherein prior approval of the Reserve Bank of India is necessary These investment may be made on repatriation basis or non-repatriation basis. Repatriation is governed by various Investment caps/ceilings.

As the company is required to comply with the procedural aspects such as submission of necessary details, reports, certificates of Chartered Accountant etc., the NRI is not required to undertake any procedural aspect whatsoever.

The investment on repatriable basis can be made in shares, bonds, securities, from the funds brought from abroad in freely convertible currencies or by debit to NRE/FCNR account of the investor.

General permission has been granted under the regulations, to any person, resident outside India, to purchase equity or preference shares or convertible debentures of an Indian company, subject to conditions and industry company investment caps, as stipulated.

However, investment in shares and securities by NRIs have been further classified under following categories:

- Investment under Foreign Direct Investments
- Investment under Portfolio Investment Scheme
- Purchase and sale of shares on non-repatriable basis
- Purchase and sale of securities other than shares and convertible debentures of an Indian company

Other Investment Avenues

Units of UTI, mutual funds

- NRIs are permitted to invest in units of UTI or other mutual funds on repatriable as well as non-repatriable basis.

Company deposits

- NRIs are permitted to invest in company deposits on repatriable basis, provided the deposits are for a minimum period of 3 years, are within the ceiling prescribed by RBI for the company to accept deposits and are made out of fresh remittances or from balances held in NRE/FCNRB deposits.

Investment in partnership firm or proprietorship concern

- An NRI is permitted to invest in a partnership firm or a proprietorship concern, by way of capital contribution, provided (i) the concern is not engaged in agricultural/plantation activity or real estate business or dealing in immovable property, with a view to earning profit from it, and (ii) the contribution should be by way of fresh inward remittances into India or out of balances held in NRE/FCNRB deposits accounts. The amount so invested shall be permitted to be repatriable out of India, subject to payment of taxes.

Investment in Immovable Property

- A person resident outside India, who is a citizen of India, is permitted to acquire any property in India other than agricultural/plantation/farm house, and transfer the same to any person resident in India or to a person resident outside India, who is an Indian citizen.
- NRI can acquire such a property, out of funds received in India by way of inward remittance from any place outside India, or from the balances held in any non-resident rupee account or foreign currency account maintained in India.
- NRI can also acquire such a property by way of gift by a person resident in India, or from a person resident outside India, who is a citizen of India or from a person of Indian origin, resident outside India.
- NRI can also acquire any immovable property in India by way of inheritance from a person resident outside India, who had acquired such property in accordance with the foreign exchange law, prevailing at the time of such acquisition by him.

Repatriation of sale proceeds of immovable property: Banks are allowed to permit repatriation of sale proceeds of immovable property, other than agricultural land/plantation/farm house, by an NRI, provided:

- The property so acquired was in accordance with the foreign exchange laws in force at the time of acquisition by him.
- The sale proceeds required to be repatriated does not exceed the foreign exchange brought in to acquire the property
- In case of residential property, the repatriation of sale proceeds is restricted to not more than two properties
- Banks are now permitted to allow repatriation of funds out of balances held by NRIs in their Non. resident accounts up to USD 1 million per financial year, representing sale proceeds of immovable property held by them, without any lock in period, subject to payment of applicable taxes.

Further, a non-resident Indian is also permitted to acquire any commercial or other property, which is incidental or necessary to his business interests in India, like, branch offices, etc., and which is permitted under the law of the land.

(a)Citizens of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Macau or Hong Kong, irrespective of their residential status, cannot, without prior permission of the Reserve Bank, acquire or transfer immovable property in India, other than on lease, not exceeding five years.

(b)Foreign nationals of non-Indian origin who is resident in India (except 10 countries listed at (a) above) can acquire immovable property in India.

Other investments

A Non-resident Indian can purchase without limit:

On repatriation basis

- Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;
- Bonds issued by a public sector undertaking (PSU) in India, and
- Shares in Public Sector Enterprises being disinvested by the Government of India.

On non-repatriation basis

- Dated Government securities (other than bearer securities) or treasury bills or units of domestic mutual funds;
- Units of Money Market Mutual Funds in India; and
- National Plan/Savings Certificates.

Advances To Non-Residents and Third Party Advances Against NRI Deposits/Guarantees, Other Loans

Loans against the Non-Resident deposits can be granted in India to the account holder or third party subject to usual norms and margin requirement. The loan amount shall not be used for re-lending, carrying on agricultural/plantation activities or investment in real estate. ADs can sanction loans in India to the account holder/third parties without any limit, subject to usual margin requirements. These loans cannot be repatriated outside India and can be used in India only for the purposes specified in the regulations.

In case of loans sanctioned to a third party, there should be no direct or indirect foreign exchange consideration for the non-resident depositor agreeing to pledge his deposits to enable the resident individual/firm/company to obtain such facilities

Housing Loan in Rupees to Non-resident Indians

Banks may grant housing loan to non-resident Indians, for acquisition of a residential accommodation in India, subject to following conditions:

- The quantum of loan, margin money and the period of repayment shall be same as applicable for resident Indians.
- The loan amount shall not be credited to NRE/FCNR (B) account.
- The loan shall be fully secured by equitable mortgage of the property proposed to be acquired and if necessary, also by lien on the borrower's other assets in India,
- Repayment shall be by remittance from abroad or by debit to his NRE/FCNR (B)/NRO account or rental income derived from renting out the property acquired by utilization of the loan.

Prohibited transactions for NRIs

The following transactions are prohibited for NRIs

- Purchase of Agricultural Property, Plantations and Farm Houses.
- Dealing in Real Estate Activities, commercial properties, etc.
- Trading in Transferable Development Rights (TDRs).
- Opening PPF accounts., (however, if opened earlier as a resident, such accounts may be continued to be operated).
- Contributions towards government linked schemes viz., NSCs, etc.
- Intra-day trading in securities, short selling, etc.

CAIIB BFM Module A Unit 4: Documentary Letters of Credit

Introduction

A Letter of Credit/Documentary Credit is a very common and instrument, used for trade settlements across the globe. It is a link between buyers and sellers, reinforcing the buyer's integrity by adding to it his banker's undertaking to pay, while sellers need to make shipments of goods specified and present shipping documents to banks, before getting the payment. Thus, for international trade, where buyers and sellers are located far apart in different countries, or even different continents, the letter of credit acts as a most convenient instrument, giving assurance to the sellers of goods for payment and to the buyers for shipping documents, as called for under the credit.

UCP 82 (1933)

The first document issued under the title **"Uniform Customs and Practice" based on the draft document circulated in 1929 contained the following provisions:**

- Responsibility of the Bank to examine all documents and papers with care so as to ascertain that on their face, they appear to be in order.

- The word ‘honor ‘ and the detailed requirements of transport and insurance documents were introduced.
- When a Documentary Credit requires presentation of other documents, without further definition, banks will accept such documents as tendered without any responsibility on their part.
- The stipulation that when the expiry date of a documentary credit falls on a Sunday, or a legal holiday or a local holiday, the period of validity will be extended to the next following business day.
- The terms “effectiveness of documents, transmission/translation of documents and the meaning of the words “first half”, “second half”, “beginning of the month”, “middle of month”, and “end of month” were also explained.

UCP 151 (1951)

- This was the first revision of the UCP rules wherein the use of the terms “Applicant” instead of “Principal” was used and the methods of settlement – Payment, Acceptance, Negotiation and Purchase were introduced.
- The very important concept that “in documentary credit operations, all the parties deal in documents and not in goods”, and that “Banks must determine compliance on the basis of documents alone”. was highlighted.
- Provision with regarding to “the issuing bank had “reasonable time” to examine the documents and the stipulation that the “description of the goods on the commercial invoice must correspond with the description in the credit” was also highlighted.

UCP 222 (1962)

- The UK and the Commonwealth Banks adopted the UCPDC for the first time including the provision that the Documentary Credit is binding on all the parties.
- A rule that “a credit is separate from the Sales or other contracts on which it may be based” and that the “confirming bank negotiates without recourse” were introduced.
- The details of how to handle the documents of the second beneficiary if first beneficiary fails to substitute its own documents was introduced.

UCP 290 (1974)

- Introduction of the term “nomination” and its use.
- The addition of details regarding inconsistency between documents, a new article covering “Combined Transport”, “Assignment of Proceeds”, and the default period for presentation within 21 days after the date of issuance of the BL or other transport document.

UCP 400 (1983)

This revision resulted in restructuring of the entire text and brought out the **layout of the UCP as is prevalent today and some of the important provisions were:**

- The requirement that the advising bank is to take reasonable care to check the authenticity of Credit.
- Introduction of the term "Deferred Payment Undertaking" as a settlement means.,
- Separate article covering "Original documents" and "Bank-to-Bank Reimbursement".
- Definition of "transhipment".

UCP 500 (1993)

This version is the first UCP that many of the documentary credit practitioners across the globe have experienced and the revision consisted of many changes:

- "Credit is irrevocable" if the doc. Credit is silent on this issue,
- Banks to advise a credit that could not be authenticated,
- Reasonable time, not to exceed 7 banking days following the date of presentation of documents, in which to determine compliance or non-compliance,
- The requirement that non-documentary conditions were to be disregarded,
- Indication of who can sign transport documents and redefining of the word "transshipment".

UCP 600 (2007)

UCP 600 represents the latest and current version of UCP to align with ISP 98 which covers:

- New articles covering "definitions" and "interpretations".
- Removal of reference to "revocable credits".
- New sub-article covering "documents lost in transit".
- Setting of the maximum examination period as "5 banking days following the day of presentation".
- The stipulation that documents are to appear to fulfil their function where the credit is silent with regard to the data content.
- Possibilities for handling discrepant documents.

Definition of Letter of Credit

A documentary credit or/and letter of credit, (DC or LC) can be defined as a signed or an **authenticated instrument issued by the buyer's banker, embodying an undertaking to pay to the seller a certain amount of money,** upon presentation of documents, evidencing shipment of goods, as specified, and compliance of other terms and conditions.

An LC can also be defined as an undertaking issued by the bank, on behalf of the importer or the buyer, in favour of the exporter or the seller, that, if the specified documents, showing that a shipment has taken place, or a service has been supplied, are presented to the issuing bank or its nominated bank, within the stipulated time and all other LC terms are complied with, the exporter/seller will be paid the amount specified.

Thus, in an LC transaction, following parties are involved:

- The buyer/importer or the applicant - **on whose behalf LC is opened.**
- The seller/exporter or the **beneficiary of the LC.**
- The opening bank (buyers bank), **who establishes the LC.**
- The advising bank (bank in seller's country), **who acts as an agent of the issuing bank and authenticates and advises the LC.**
- The confirming bank - **who undertakes to pay on behalf of the issuing bank.**
- The negotiating/nominated bank (sellers bank or bank nominated by the opening bank), **who negotiates the LC and makes payment to the beneficiary.**
- Reimbursing bank - **who reimburses the negotiating or confirming bank.**

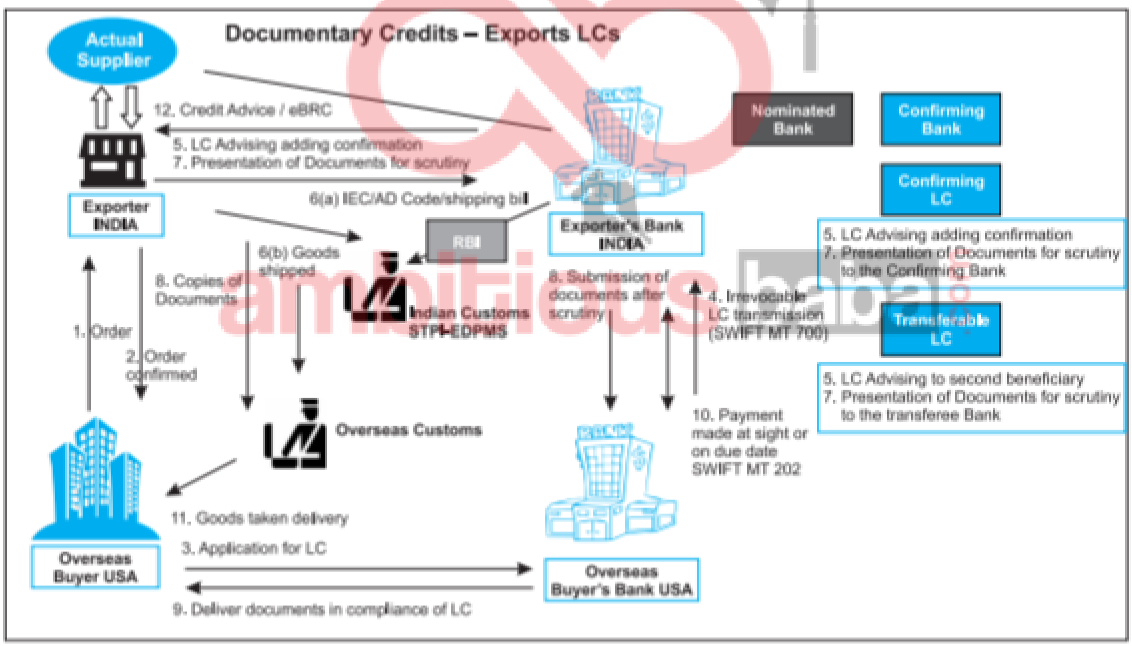
Types of Letter of Credit

- **Revocable LC:** A revocable LC is a credit, the terms and conditions of which can be amended/ cancelled by the Issuing Bank. This cancellation can be done without prior notice to the beneficiaries. An irrevocable credit is a credit, the terms and conditions of which can neither be amended nor cancelled.
- **Irrevocable LC:** An irrevocable letter of credit is an agreement between a buyer (often an importer) and the buyer's bank. The bank agrees to pay the seller (the exporter) as soon as certain conditions are met. Because it is irrevocable, the terms of the letter cannot be changed without the agreement of everyone involved.
- **Irrevocable Confirmed Letter of Credit:** An irrevocable letter of credit cannot be changed or cancelled unless everyone involved agrees. Irrevocable letters of credit provide more security than revocable ones. A confirmed letter of credit is one to which a second bank, usually in the exporter's country adds its own undertaking that payment will be made.
- **Transferable LC:** A Transferable LC is letter of credit where the Beneficiary (Transferor or 1st Beneficiary) may request the Transferring Bank to make the credit available in whole or in part to one or more other beneficiaries called Transferee(s) or 2nd beneficiary (ies).
- **Red Clause:** A red clause letter of credit is a specific type of letter of credit in which a buyer extends an unsecured loan to a seller. Red Clause Letters of Credit permit documentary credit beneficiaries to receive funds for any merchandise outlined in the letter of credit.

- **Green Clause:** A letter of credit which contains a clause authorising the nominated bank to make advances to the seller against security (such as a payment guarantee from a third party or the pre-shipment storage of the goods in the name of the nominated bank or the issuing bank) before shipment /presentation of documents.
- **Back to Back LC:** Back-to-Back Letter of Credit is a negotiable instrument in which the seller gets a Letter of Credit from the buyer and the seller further transfers the Letter of Credit to its supplier.
- **Standby LC:** A standby letter of credit (SLOC) is a legal document that guarantees a bank's commitment of payment to a seller in the event that the buyer–or the bank's client–defaults on the agreement.
- **Revolving LC:** A revolving letter of credit is a single letter of credit that covers multiple transactions over a long period of time. It is very specific in a way that it is used for regular shipments of the same commodity between the same buyer (importer) and the seller (exporter).

Operations of Letter of Credit

With the involvement of the several parties, the ***LC transaction operates between the two nations, a explained in the following diagram:***



As shown in the diagram above, the transaction flows as under:

- The buyer and seller enter into the sales contract, for purchase/sale of certain amount of specified goods at specified rates, but agree to cover the transaction under Letter of Credit.
- The buyer in country A (applicant/opener) requests his bank, to open LC in favour of the seller in country B (beneficiary) for the specified amount.

- The buyer's bank, i.e. opening bank, issues the LC and sends the same to the beneficiary in country B, through its own branch or correspondent.
- The advising bank in country B, advises the LC to the beneficiary after authenticating signatures/swift.
- If the seller desires for the LC to be confirmed by some bank, in his own country, normally the advising bank agrees to do so, at the request of the opening bank and as per arrangement and on the behalf of the opening bank. Now the advising bank would also be called the Confirming Bank.

The seller now prepares the goods, and ships them as per instructions in the LC, submits the documents called for in the LC to the negotiating bank, which examines the same and if found to be in conformity with the LC terms, negotiates the documents and pays to the beneficiary. This bank now becomes the **negotiating bank**.

Uniform Customs and Practice For Documentary Credits

Were first framed by the ICC (International Chamber of Commerce) in 1933. Since then these rules have been revised six times, viz., 1951, 1962, 1984,1994 and 2007. UCP-600, which is effective from 1/7/2007, is the latest revision.

UCP 600 - Important Changes:

UCP 600

- ICC Paris appointed a Task Force, after approval of the Banking Commission in 2003, to undertake revision of the UCP 500. The Task Force after working for over three years prepared a draft of the new UCP. The Drafting group constituted members from 9 countries, which had 15 meetings before the draft was finalized.
- A Consultative group, comprising of 41 members from 26 countries was formed to discuss the Draft. The Draft was also referred to National Committees, including ICC India, and key issues were identified, taking in to account various ICC opinions, DOCDEX decisions, papers, court decisions, etc.
- **DOCDEX** is one of the options available to the parties of the LC to resolve letter of credit disputes. Its full form is "ICC's Documentary Credit Dispute Resolution Expertise". After extensive working, discussions, deliberations on various articles, practices, and need to simplify the Articles, the ICC Banking commission approved the Draft of UCP 600, in its meeting on 25th October 2006, bringing the new UCP in to force w.e.f. 1st July 2007.

Main Features of UCP 600

- The UCP 600 was a major review in the history of Uniform Rules for Documentary Credits. It is leaner, with only 39 Articles, as compared to 49 in the earlier version. While some articles of the earlier version were deleted, some of the articles were merged, and a few new articles added. The major thrust was on a simplified language of articles.

Groupings

The Articles of UCP 600 can be grouped as under:

- **Article 1-5:** Definitions, Interpretations, Independence of LCs and Underlying contracts.
- **Article 6-10:** Availability, Expiry date and place, Obligations of issuing and Confirming bank, Advising credits and Amendments.
- **Article 11-17:** Pre-advised credits, Nominated bank, Reimbursement arrangements, Complying presentations, Original documents, etc.
- **Article 18:** Commercial invoice.
- **Article 19-27:** Transport documents.
- **Article 28**: Insurance documents.
- **Article 29-33.** Extension, Tolerance, Partial and Instalment drawings and Hours of presentation.
- **Article 34-37:** Disclaimers.
- **Article 38-39:** Transferability and Assignment of proceeds.

Liabilities, Responsibilities and Rights of The Parties

The Applicant

- **The applicant of the L/C must give complete and precise instructions for issuance of Letter of Credit and any amendment thereof.** The LC must not include excessive details or give any reference of credit previously issued, to avoid any confusion or **misunderstanding (Article 5).**
- The applicant should indemnify banks against any obligations imposed by **foreign laws (Article 18).**

The issuing Bank

- Issuing bank is the party acting on behalf of the applicant and should, therefore, ensure itself about the creditworthiness of the applicant.
- The issuing bank gives a definite undertaking to make payment in case of sight and accept and pay on maturity in case of acceptance or deferred payment, to authorize bank to negotiate and to reimburse the negotiating bank, provided that the stipulated documents are presented **under the Letter of Credit (Articles 2, 9).**

Advising Bank

- The advising bank has option to choose as to whether it wishes to advise a LC or not. If it agrees to advise the LC, then it must do so by taking reasonable care in checking the authenticity of the credit.
- In case, it decides not to advise a LC, then it must inform the issuing bank immediately. If the advising bank is unable to establish the authenticity of LC

then it must immediately inform the issuing bank and must also inform the beneficiary **about the same (Article 9).**

Confirming Bank

- A confirming bank gives a definite undertaking in addition to that of issuing bank, at the request of the issuing bank, to make payment on presentation of documents as per the terms and conditions of the LC, The confirming bank, advising bank and nominated bank can be the same.
- In case, it does not agree to add its confirmation, it must inform the issuing bank without delay. It may also choose to advise amendments without adding its confirmation, however, intimation must be sent to the **issuing bank and the beneficiary (Article 8).**

Negotiating Bank

- It is the responsibility of the negotiating bank or nominated bank to examine the documents as per UCP or International Standard Banking Practice (ISBP), and take a decision to negotiate the documents, only if they appear on their face to be in compliance with **the terms and conditions of the LC (Articles 12, 14).**

Reimbursing Bank

- **Article 13 deals with Bank-to-Bank Reimbursement clause. Reimbursing bank shall reimbursed claiming bank**, the amount of claim lodged, subject to the condition that it has received reimbursement authorisation from the issuing bank and has accepted the same. The reimbursements and all the parties concerned are bound by Uniform Rules for Bank-to-Bank Reimbursements (URR-725) as discussed later in this chapter.

Beneficiary

The beneficiary of the LC also has various rights and responsibilities under Letter of Credit transactions. A beneficiary can in no case avail himself of the contractual relationship existing between the banks or between **the applicant and the issuing bank (Article 4).**

Protection to Banks

- Banks do not assume any responsibility for genuineness of the documents submitted or any discrimination in the contents mentioned in the **documents (Article 34).**
- Banks are not responsible for any loss arising due to delay in transmission or loss of messages, documents, or telecommunication. No responsibility is taken by the banks for errors in translation/interpretation of technical terms **(Article 35**).

- Banks also do not take responsibility for any loss arising due to close of their business by the acts of god, commotions, civil riots, floods or any other causes **beyond their control (Article 36).**

Documents Under LC- Scrutiny, Crystallisation, Follow-up for Bills Under LC and Safeguards For Banks

Document under LC and Scrutiny of Documents

Bill of Exchange

Bills of exchange, being one of the most important financial documents, is drawn by the beneficiary on the LC issuing bank. It envisages the issuing bank to make the payment immediately, if it is drawn a sight or accept and pay on due date, **if it is drawn on acceptance basis. It should, in normal due course satisfy the following requirements:**

- It should be drawn by the beneficiary on the issuing bank and payable at tenor mentioned in the Letter of Credit
- It should indicate the issuing bank's name and Letter of Credit number along under which it is drawn.
- It should, unless and otherwise specified, be drawn in the currency of Letter of Credit and should not exceed the amount of Letter of Credit.
- Any corrections should be duly authenticated.

Invoice

An invoice is a commercial document and is a basic necessity of trade documents. It is prepared by the beneficiary giving details of goods, quantity and value in unit terms, weight and total value of goods. **Following specific points should be kept in mind, while preparing or examining the invoice:**

- It should be made out by the seller/beneficiary, as stipulated in the Letter of Credit.
- It should, unless and otherwise specified in the Letter of Credit, be made out in the name of the applicant/openers of the LC.
- Description of goods must correspond with the description of goods given in the LC.
- Invoice must indicate the order number/contract number/proforma invoice number and number of LC along with issuing bank's name.
- The invoice value should not, invariably, exceed the LC value.
- Terms of sale contract, such as FOB, C&F, CIF, etc., should be indicated in the invoice. Other particulars like Bill of Lading number, shipping marks, import license number (if any), gross weight, net weight, packing details, etc., should also be mentioned in the invoice.

- If invoice is issued for an amount in excess of the amount permitted by credit (when not specifically prohibited by terms of LC), as per Article 18b of UCPDC, the drawing should not exceed the amount mentioned in the LC.

Bill of Lading

Bill of lading is a transport document evidencing movement of goods from the port of acceptance to port of destination. It is a receipt issued by the ship owner or its authorized agent, stating that the goods indicated therein (quantity, quality, description, etc.) are shipped on specific date and through specific vessel and deliverable to the person mentioned therein as the consignee or to his order, after payment o all dues to the shipping company.

- The bill of lading should be in complete set of negotiable copies, along with a number non-negotiable copies, as stipulated in the Letter of Credit.
- It should bear the signature of the ship owner or its authorised agent.
- The description of goods should correspond with the requirements in terms of Letter of Credit and as mentioned in the invoice.
- Bill of lading should bear the Letter of Credit number along with the name of the issuing bank.
- Payment of freight should be clearly indicated in the Bill of Lading, as per the requirement of the Letter of Credit.
- The Letter of Credit should call for "shipped on board" Bill of Lading, and accordingly, the BL should bear such clause.
- It should be drawn to the order of the shipper, blank endorsed or in favour of the issuing bank, as stipulated in the Letter of Credit.
- The date of shipment should be within the date stipulated in the Letter of Credit
- Partial shipments or trans-shipment, if permitted in the Letter of credit should be clearly indicated in the Bill of Lading.
- The gross weight, net weight should be as indicated in the invoice.
- The BL should not generally be dated prior to the date of issuance of LC, unless specifically provided therein.
- The BL should not be claused, unless specifically permitted under the LC.

Insurance Policy/Certificate

- It must be issued and signed by the insurance company or their agents. (Article 34a)
- It should not be issued by the broker. (Article 34b)
- The date of issuance of insurance must be on or before the date of shipment or it must be endorsed by specific notation that the cover is effective from the date of shipment. (Article 34c)
- The currency of issuance must be same as the currency of LC. [Article 34f(i)]

- Unless otherwise specified, it should be issued for an amount of 110% of CIF/CIP value of goods. (Article 34f(ii))
- The policy should clearly indicate the voyage it is covering, i.e., the port of shipment, port of destination and should also mention the point of termination of insurance coverage.
- Claims should be made payable in the country of applicant.
- All originals (if issued more than one) must accompany the documents.
- The policy must be blank endorsed.
- The description of goods in the insurance policy/certificate should be in conformity with that given in the LC.

Certificate of Origin

- Certificate of origin determines the origin of goods. It must be issued and signed by an independent authority, such as Chamber of Commerce, informing origin of goods, value, invoice number, Bill of Lading number, etc.
- Details appearing in the certificate of origin must be consistent with other documents. It must be ensured that origin of goods is not from any war-fighting country, i.e., consisting of banned hazardous goods

Crystallisation of Foreign Currency Liability

- **The issuing bank on receipt of documents drawn under its Letter of Credit, has an obligation to pay immediately**, if the documents are drawn at sight or accept and agree to pay on due date, if the documents are drawn on acceptance basis, provided the documents are drawn strictly as per the terms of the LC.

Follow-up of Bills under LC

- **As per the extant guidelines, the foreign currency liability of import bill drawn under LC,** is crystallised into Indian rupees on a stipulated day as per individual Bank's policy after receipt of documents at the counters of the issuing bank, in case of sight bills and on due date, in case of usance bills.
- In case the importer has been sanctioned import loan facility, the rupee liability is debited to the loan account.

Evidence of Import by the Importer

- Authorized dealers, while opening Letter of Credit for their importer clients or effecting payment for imports, shall take an undertaking from the importer that they shall submit exchange control copy of Bill of Entry within the prescribed period.
- The submission of Bill of Entry, duly approved by the customs ascertains that there is actual import of goods in the country.

Safeguards for Banks

- Every bank has its own internal guidelines for sanctioning Letter of Credit facility to their importer client. Since the transaction involves overseas payments and movement of goods. Reserve Bank of India has advised banks to have thorough and clear-cut guidelines while sanctioning such facility.
- The importer clients should be well-versed with, the trade, for which he is importing goods and banks are required to follow due diligence and 'Know Your Customer' guidelines meticulously.

Standby Letter Of Credit (Similar To Guarantees)

International trade has been dominated by LC transactions, whereby the seller is assured of payment by submitting documents in compliance and conformity with the terms and conditions of the letter of credit. Standby Letter of Credit has often been used in situations where there is non-performance' or to put it in a layman's word, almost a substitute of guarantee. The usage of standby LC is mostly witnessed in countries like the USA, where guarantees are not used, and standby LC acts as a substitute for guarantee. This type of Letter of Credit is opened by banks in countries, where there is restriction on issuance of guarantees and therefore standby LCs provide a suitable substitute for performance or financial guarantees. The documents required are bare minimum, like proof of delivery of goods, proof of non-performance or simple claim form. However, until very recently, its usage was very much restricted in India, but, with several measures being adopted to liberalise the trade regulations and simplify procedures for imports, the Reserve Bank of India, has approved to adopt International Standby Practices (ISP-98), a set of rules, relating to standby LCs, formulated by International Chamber of Commerce in 1998. As such, it is now in order for the authorised dealers to issue stand by LCs, either under ISP-98 or UCPDC-600, as agreed upon mutually by the parties concerned.

Usage of Standby LC by Authorized Dealers

Banks can establish stand-by LC for the following transactions:

As a document of promise in respect of non-performance' situation especially as a substitution to the guarantees which Authorized Dealers are permitted to issue under FEMA, 1999, such as issuing a guarantee in respect of any debt, obligation or other liability incurred by:

- An exporter on account of exports into India.
- Owed to a person resident in India by a person resident outside India for a bona fide trade transaction, duly covered by a counter guarantee of a bank of international repute/resident abroad.
- Exporters may also opt to receive stand by LC in respect of exports from India.

Commercial Standby LC for Import of Goods

Banks have been permitted by Reserve Bank of India, to issue standby LCs towards import of goods into. Since standby LCs covering import of goods are susceptible to certain attendant risks in the absence of evidence of shipment/insurance cover, importers should be advised and explained of the risk factors involved/chances of abuse in acceding to the request for establishment of standby LCs for import of goods into India. **The following safeguards may be taken where standby LCs are issued:**

The facility of issuing commercial standby may be extended on a selective basis and to the following categories of importers only:

- Where such standbys are required by applicants, who are independent power producers/importers of crude oil and petroleum products.
- Special category of importers, viz. Export House/Trading/Star Trading House/Super Star Trading house/100% EOUs.
- Public sector Units/Public Limited Companies with good track record.

Implications of some of the Articles of ISP-98

Before issuing Stand-by LC, the bank as well as the opener/applicant must understand the implications of the clauses of the ISP-98, detailed as under:

- **Article 1.02**: ISP-98 Rule supplements the applicable law to the extent not prohibited by that law. Hence, if there is any provision in the rule which conflict with the Indian law, such provision would not be applicable.
- **Article 1.09**: Business Day - Business day means a day on which the place of business at which the relevant act is to be performed is regularly open; and Banking Day means a day on which the relevant bank is regularly open at the place at which the relevant act is to be performed.
- **Article 3.13**. Expiration Date on Non-Business Day.
- **Article 3.14:** Closure on a Business Day and authorisation of another reasonable place for presentation
- **Article 5.01:** Timely Notice of Dishonour - The article provides for timely notice of dishonour as per the provisions contained therein.
- **Articles 10.0 and 10.02** relating to syndication/participation under the standby LC may be taken note of by the banks issuing such standbys under syndication/consortium loan arrangements among authorised dealers.

Uniform Rules for Bank-To-Bank Reimbursements (URR-725)

Reimbursement of the value of documents negotiated. The International Chamber of Commerce has Banks, while issuing Letter of Credit, incorporate a clause authorising the negotiating bank to claim brought out the uniform rules for bank-to-bank reimbursement, set out in ICC Publication No. 725. The responsibilities of issuing bank, claiming bank, reimbursing bank and all other related parties, as incorporated in the Letter of Credit, have been specified in said rules.

General Provisions and Definitions

Application of URR

- Following standard clause should be incorporated in the reimbursement authorisation by the issuing bank that it sends to reimbursing bank, to bind all the parties concerned. drawn under Documentary Credits, ICC Publication No. 725. This means that reimbursing bank is bound by all the rules set up in URR, by accepting reimbursement instructions. The claiming bank is, however, not a party to it and the arrangement of reimbursement is solely between the issuing bank and reimbursing bank.

Definitions

- **Issuing bank:** The bank that has issued the letter of credit and provided reimbursement authorisation.
- **Reimbursing bank:** The bank having accepted the reimbursement authorisation instructions from the issuing bank provides reimbursement.
- **Claiming bank**: The bank that pays and incurs a deferred payment undertaking accept draft(s) or negotiates under a credit and presents a reimbursement claim to the reimbursing bank.
- **Reimbursement authorization**: Instructions/authorization, independent of the credit, issued by issuing bank to a reimbursing bank to reimburse the claiming bank.

Reimbursement Authorizations

- The reimbursing bank is no way concerned or bound by any provisions incorporated in the Letter of Credit even if any reference has been made in the reimbursement authorisation of any terms and conditions of the Letter of Credit. The reimbursement authorisation is totally a separate transaction from the credit.

Liabilities and Responsibilities

- The issuing bank is responsible for providing information required to the reimbursing bank under these rules.
- The issuing bank must not request a certificate of compliance to be submitted by the claiming bank these rules to reimbursing bank.
- The reimbursement authority must not have an expiry date.

International Standard Banking Practice - 745 (ISBP 745)

The ISBP (full title: International Standard Banking Practice for the Examination of Documents under Documentary Credits) is an ICC publication which provides important guidance regarding the examination of documents presented against letters of credit. It is important to note that the ISBP cannot in any way change the UCP 600 rules which apply to letters of credit, but it is nonetheless a valuable companion guide to UCP.

ISBP was initially approved by the ICC in 2002 and this first version acted as a companion guide to Uniform Customs and Practice (UCP) 500 which were the current rules that governed letters of credit at that time,

When the rules were revised to UCP 600 in July 2007, the ISBP was duly updated by the ICC publication No.681, thus aligning the ISBP with the newly updated UCP.

A fully revised version of ISBP, ICC publication 745 was published in July 2013. This entailed a substantial update to the former version and includes a number of both new and reworded interpretations as well as some significant additions resulting from various official opinions published by the ICC. ISBP has therefore become an absolutely essential publication for anyone who is involved in letters of credit.

The objective of ISBP is given below:

- To encourage a uniformity of practice worldwide to reduce the number of credits rejected by banks owing to discrepancies.
  The ISBP provides practices that should be applied by documentary credit practitioners helping to reduce discrepant presentations.

Incoterms

Parties to contract are, often, not aware of different trade practices in their respective countries which can cause misunderstanding resulting in unnecessary disputes. As such ICC published a set of international rules for the interpretation of trade terms known as **"Incoterms"** The ICC publication on Incoterms has been updated several times, with latest version being Incoterms-2010. The full form of Incoterms "International Commercial Terms".

Incoterms apply to contract of sale but not contract of carriage. They deal only with the relationship between seller and buyer. These can be broadly classified into four categories. Some of the incoterms are

(a) Departure:

(i) Ex-works (named place) e.g. Ex-works Jamnagar, or Ex-works Pune.

(b) Main Carriage Paid:

- **CFR: Cost** and Freight (named port of destination) e.g. CFR JNPT, CFR Chennai
- **CIF:** Cost, Insurance and Freight (named port of destination) e.g. CIF JNPT, or CIF Chennai port
- **CPT:** Carriage Paid To (named place of destination) CPT Dubai
- **CIP:** Carriage and Insurance Paid to (named place of destination) CIP Dubai

(c) Main Carriage Unpaid:

- **FCA** Free Carrier (named place) FCA Mumbai
- **FAS:** Free Alongside Ship (named port of shipment) FAS, Mumbai port
- **FOB:** Free On Board (name port of shipment) FOB, Mangalore

(d) Arrival:

- **DAT**-Delivered At Terminal (named terminal at port or place of destination) DATS
- **DAP** - Delivered At Place (named place of destination) DAP Sharjah
- **DDP** Delivered Duty Paid (named place of destination) DDP Sharjah

Case Study

Case 1. Case of Date of documents

Bank A issues LC dated 1.10.2016, in favour of a beneficiary in UK. The last date of shipment as per LC is 15.10.2016 and last date of negotiation 31.10.2016.

The beneficiary presents documents to Bank B, for negotiation on 05.10.2016, with documents evidencing shipment of goods on 30.09.2009, which sends the documents to the opening bank, asking to reimburse as per LC terms.

The opening bank, on receipt of documents notices that, the shipment was made on 30.09.2009 and the invoice was dated 2.09.2016, while the inspection certificate, analysis certificate and packing list were dated 25.09.2016.

The issuing bank on receipt of documents rejected the documents, notifying discrepancy that documents were dated prior to date of credit.

Article 14(i), specifically provides that documents could be dated prior to the date of LC, but should not be dated after the date of presentation.

While, the LC is silent about the date of documents, documents presented need to be dated as per LC terms, if so provided in the LC.

As such, assuming that the LC did not provide for dates of the documents, the rejection by the opening bank is not as per UCPDC. Hence as per Article 14(1), the negotiating bank has acted correctly and there is no discrepancy in the documents presented by the beneficiary/exporter.

Case 2. Notice of Dishonor

The LC issuing bank on receipt of documents on 07.03.2017 (Tuesday) took two days to examine the same and referred the documents to the applicants for their acceptance on 09.03.2017 (Thursday). The applicants came up with a discrepancy in documents, on 14.03.2017 (Tuesday) evening, stating that the documents need to be rejected as the BL was not stamped with “On board” stamp and initialed by the shipping company.

The issuing bank sent a Swift message of rejection to the negotiating bank on 15.03.2017.

On receipt of Swift message from the issuing bank, informing rejection of documents and discrepancy, as informed by the applicant, the negotiating bank referred the matter back to the opening bank stating that the message of refusal and notification of discrepancy was not received within the time period of 5 working days, and as such claimed to be reimbursed as per LC terms.

Article 16d of UCP states that the notice of refusal and discrepancy must be given latest by the closing hours of the 5th working day from the date of presentation. In the instant case, the opening bank was correct in sending the swift message on 15.03.2017, which was 5th working day, subsequent to the date of receipt of documents.

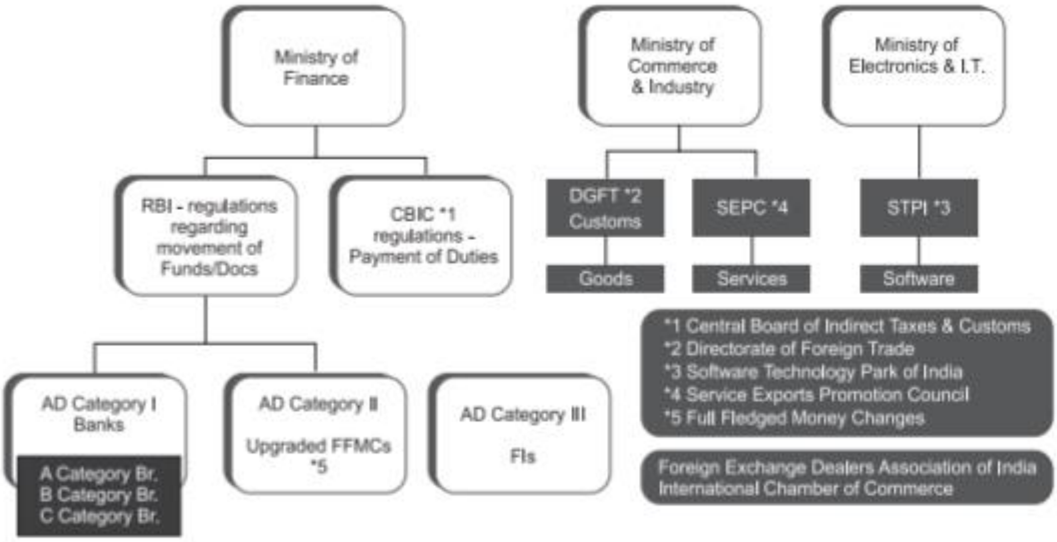
Since, 11th and 12th were Saturday and Sunday and 13.03.2017, being a holiday in India, on account of Holi, the opening bank was right in sending the notice of refusal/discrepancy on 15.03.2017, which was in compliance with the meaning of the said article.

CAIIB BFM Module A Unit 5: Facilities for Exporters and Importers

Introduction

In India, **export trade is regulated by the Directorate General of Foreign Trade (DGFT), which functions under the Ministry of commerce and Industries, of Government of India.** While the policies and procedures granted under FEMA regulations are governed by the RBI regulations/guidelines. Similarly, import trade is also governed by DGFT, with regulations relating to imports and other payments, as provided under FEMA, are governed by RBI regulations.

Exchange Control regulations as well as Imports and Exports Trade Control regulations are applicable to all transactions related to international trade. **The Reserve Bank of India, with powers delegated under FEMA 1999, regulates the Exchange Control and receipts/payments of foreign exchange part through various guidelines**, FEMA amendments, while the office of the Director General of Foreign Trade (DGFT), regulates the Trade Control part, through the EXIM Policy and periodic announcements with a view to expand or control the international business of the country.



Exchange and Trade Control Guidelines For Exporters

Importer-Exporter Code Number

Every person/firm/company engaged in Export-Import trade has to apply for and obtain an importer exporter Code Number (IEC Number) from the Director General of Foreign Trade (DGFT). This is a registration number of the firm/company for international trade and the exporter/importer has to invariably quote this code number in all declarations/forms, etc., a few of which are explained below:

Export Declaration Forms

Section 7(1), (3) of FEMA, all export of goods from India, **whether in physical form or any other form,** requires to be declared in the prescribed forms to the effect that full value of exports will be realized within the prescribed period and in the prescribed manner. The prescribed forms are EDF and SOFTEX forms which are used for the purposes noted below:

(i) EDF Form :	Exports other than software made by all modes.
(ii) SOFTEX Form :	Export of software in non-physical form. With the introduction of Electronic Data Interchange (EDI) system at certain Customs offices, where shipping bills are processed electronically, the GR form has since been replaced by a declaration in form EDF (Electronic Declaration Form). The EDF form should be submitted in duplicate (to be annexed to the relative shipping bill) to the concerned Commissioner of Customs. After verifying and authenticating the declaration in form EDF, the commissioner of customs will handover to the exporter one copy of the shipping bill marked 'Exchange Control Copy' in

	which form EDF has been approved for being submitted to the authorized dealer.

Exemptions

Following exports/shipments out of India are exempted from Export Declaration Forms, **in terms of the cases indicated in Regulation 4 of Foreign Exchange Management (Export of Goods and Services) Regulations dated January 12, 2016:**

(a) Trade samples of goods and publicity material supplied free of payment;

(b) Personal effects of travellers, whether accompanied or unaccompanied;

(c) Ship's stores, trans-shipment cargo and goods supplied under the orders of Central Government of such officers as may be appointed by the Central Government in this behalf or of the military, naval or air force authorities in India for military, naval or air force requirements;

(d) By way of gift of goods accompanied by a declaration by the exporter that they are not more than five lakh rupees in value;

(e) Aircrafts or aircraft engines and spare parts for overhauling and/or repairs abroad subject to their reimport into India after overhauling/repairs, within a period of six months from the date of their export;

(f) Goods imported free of cost on re-export basis;

(g) The following goods which are permitted by the Development Commissioner of the Special Economic Zones, Electronic Hardware Technology Parks, Software Technology Parks or Free Trade Zones to be re-exported, namely:

- Imported goods found defective, for the purpose of their replacement by the foreign suppliers/ collaborators;
- Goods imported from foreign suppliers/collaborators on loan basis;
- Goods imported from foreign suppliers/collaborators free of cost, found surplus after production operations

goods listed at items (1), (2) and (3) of clause (i) to be re-exported by units in Special Economic Zones, under intimation to the Development Commissioner of Special Economic Zones/concerned Assistant Commissioner or Deputy Commissioner of Customs;

(h) replacement goods exported free of charge in accordance with the provisions of Foreign Trade Policy in force, for the time being;

(i) goods sent outside India for testing subject to re-import into India;

(j) defective goods sent outside India for repair and re-import provided the goods are accompanied by a certificate from an authorised dealer in India that the export is for repair and re-import and that the export does not involve any transaction in foreign exchange;

(k) exports permitted by the Reserve Bank, on application made to it, subject to the terms and conditions, if any, as stipulated in the permission.

Prescribed Time Limits

For Submission of Export Documents

- **The exporter is required to submit the export documents, along with the duplicate/exchange control copy of EDF form within 21 days from the date of export,** or from the date of certification of the SOFTEX form: to an authorised dealer, for collection, purchase, discount or negotiation, as the case may be, provided that, subject to the directions issued by the Reserve Bank from time to time, the authorized dealer may accept the documents pertaining to export submitted after the expiry of the specified period of 21 days, for reasons beyond the control of the exporter.

For Realisation of Export Bills

It is obligatory on the part of the exporter that the amount of exports is realized and repatriated into India, within the stipulated time period.

The amount representing the full export value of goods/software/services exported shall be realised and repatriated to India within **nine months** from the date of export.

- The Reserve Bank may for reasonable and sufficient cause direct that the said exporter/s shall cease to be governed by sub-regulation (2);
- Provided that no such direction shall be given unless the unit has been given a reasonable opportunity to make a representation in the matter.
- On such direction, the said exporter/s shall be governed by the provisions of sub-regulation (1) until directed otherwise by the Reserve Bank.

Prescribed Method of Payment

The amount representing the full export value of the goods exported shall be received through an AD Bank in the manner specified in the Foreign Exchange Management (Manner of Receipt & Payment) Regulations, 2016 notified vide Notification No. FEMA.14 (R)/2016-RB dated May 02, 2016. Every receipt in foreign exchange by an authorized dealer, whether by way of remittance from a foreign country or by way of reimbursement from his branch or correspondent outside ***India against payment for export from India, or against any other payment, shall be as mentioned below:***

- Form of bank draft, pay order, credit to Exporter Bank's Nostro account, Inward Remittance, etc.
- Foreign currency notes, travellers checks from the buyer.

- Payment out of FCNR, NRE account of the buyer.
- Through International credit cards, when goods are sold during the overseas visit of the exporter concerned.
- In Indian rupees, when transaction are with persons resident in Nepal.
- In the form of gold/silver/platinum by gem and jewellery units situated in SEZs, provided the contract provides for the same.

Facilities for Exporters - Facilities/Remittances Connected With Exports

Agency Commission on Exports

Agency commission can be allowed either by remittance or deduction from invoice value by the ADS subject to the condition that:

- it has been declared in the relative EDF/SOFTEX form, and accepted by the customs authorities, and that the relative shipment has already been made. In cases where the commission has not been declared on EDF/SOFTEX form, remittance may be allowed after satisfying the reasons adduced by the exporter for not declaring commission on Export Declaration Form, provided a valid agreement/written understanding between the exporters and/or beneficiary for payment of commission exists.
- The relative shipment has already been made.

Reduction in Invoice Value

- **Exporters may allow reduction in invoice value, on account of cash discount to overseas buyers**, **for prepayment of usance bills.** The discount can be allowed for the unexpired period at the stipulated fate of interest or a LIBOR of the currency.

Claims Against Exports

- Banks can allow claims against export bills, provided the relative export proceeds have been realized and repatriated to India, and the exporter is not in the caution list of the Reserve Bank of India.

Refund of Export Proceeds

- Refund of export proceeds can be allowed by the AD, through whom the proceeds of the export bill were originally received, provided the exporter has submitted the evidence of re-import of goods into India on account of poor quality, trade dispute, etc.

Extension of Time Limit

- **If the export bill is not realized within the prescribed period, for reasons beyond control**, the exporter is required to make an application in form ETX to the AD, which has handled the export bill, and seek extension of time limit for realization of export proceeds.

Write off of unrealized export bills

- An exporter who has not been able to realize the outstanding export dues despite best efforts, may either self-write off or approach the AD Category - I banks, who had handled the relevant shipping documents, with appropriate supporting documentary evidence.
- RBI has prescribed limits and conditions for self write off as well as write off by A.D.s, which should be adhered to

Effective Date of Realization

- In terms of FEDAI rules, the effective date of realization of an export bill is the date of credit in the bank's '**NOSTRO' account in case of Foreign Currency bills,** and in case of Rupee bills the effective date of realisation is the date **of debit in the 'VOSTRO' account.**
- As such, in case of foreign currency bills, the value date of credit is taken as the date of credit and interest charged up to this date on advance allowed against the particular export bill.

Foreign Currency Accounts

- Overseas Foreign Currency Account
- Diamond Dollar Account (DDA)
- EEFC Account

Export Finance

The Reserve Bank of India has framed specific guidelines for finance to exporters, so as to allow finance at concessional interest rates, to make exporters compete with their competitors from other countries, and also to boost the exports from the country. **The RBI first introduced the scheme of Export Financing in 1967.** The scheme is intended to make short-term working capital finance available to exporters at internationally comparable interest rates. Export credit is available both in rupee as well as in foreign currency.

The Reserve Bank of India has also permitted banks to allow both Packing credits as well as post-shipment advances to exporters in Indian rupees as well as in foreign currencies.

Let us see the rules related to rupee advances first, before going to the foreign currency export credit to exporters.

Pre-shipment finance can be of two types:

- Packing Credit (EPC or PCL).

- Advance against Govt. receivables, i.e. Duty Drawback, etc.

Post-shipment finance can be of various types, as under:

- Export bills purchased/discounted/negotiated (FBP/FBD/FBN).
- Advance against bills sent on collection.
- Advances against exports on consignment basis.
- Advances against undrawn balances.
- Advances against Duty Drawback.

Pre-Shipment Finance

As given above, pre-shipment finance, generally known as Packing Credit Loan (PCL) or Export Packing Credit (EPC), is essentially a working capital advance allowed for the specific purpose of procuring/ processing/manufacturing of goods meant for export. It could cover all costs prior to shipment of finished goods, i.e. packing, local transportation, labour charge, etc.

A. Pre-sanction

- The borrower is bank's customer.
- They should have Export/Import Code number (IEC) allotted by Director General of Foreign Trade.
- Their name should not appear under the caution list of RBI.
- They should not be under the Specific Approval list of ECGC.
- They have the capacity to execute the order within stipulated time and has a genuine and valid export order or Letter of Credit for export of goods.
- All 'Know Your Customer' guidelines are complied with.

B.Post-sanction

- No PCL has been availed by him against the same order/LC from any other bank. For this reason only, the Bank which has granted the Pre-Shipment facility should note the fact of its credit facility on the reverse side of the original LC or original Contract so that it is a warning to any other bank which is handling the exporter's documents.
- Bank should call for Credit Report/Status Reports on the foreign buyers.
- The exporter should submit stock statements for the goods on which PCL has been allowed.
- If the exports are covered under letters of credits, banks would need to be satisfied about the standing of the credit opening bank.
- Banks may also look into the regulations, the political and financial conditions of the buyer's country.

C.Special Cases for allowing Packing Credit Advances

(a) Packing credits can be allowed to sub-suppliers also at the first stage under the Rupee credit scheme. Packing credit can be granted on the basis of the inland LC opened by a bank at the request of the Export Order holder.

(b) Banks have been authorized to grant pre-shipment advances for exports of any commodity without insisting on prior lodgment of letters of credit/firm export orders under "Running Account' facility subject to the following conditions:

- The facility may be extended, provided the need for 'Running Account facility has been established by the exporters to the satisfaction of the bank.
- The banks may extend the 'Running Account' facility only to those exporters whose track record is good.

Post-Shipment Finance

Post-shipment finance is essentially an advance against receivables, which are in the form of export. It Post Shipment Finance involves handling of export documents, sending the documents to the foreign bank and collecting the funds thereof. involves handling of exports, sending it to the foreign bank/buyer and collecting proceeds thereof.

The responsibility of an AD is increased in the post-shipment part, since the realisation of export proceeds of the export bills is monitored by the Reserve Bank of India.

A.Export bills purchased/discounted

- The export bills, representing genuine trade transactions, strictly drawn in terms of the sale contract firm contract/order may be discounted or purchased by the banks, against proper sanctioned limits.
- The bills drawn on sight basis, i.e. Documents against Payment, are purchased and those drawn on usance i.e. Documents against Acceptance basis, are discounted by the bank.

B.Export bills negotiated

- **Negotiation of documents takes place, when export documents, drawn under Letter of Credit**, are presented to the bank and financed by the bank. These documents should be scrutinized carefully with the terms and conditions of the LC, before negotiation, since the LC issuing bank undertakes to honour its commitment to pay/accept/reimburse, only, if the beneficiary submits the stipulated documents conforming to terms of LC.
- Further, as the operation of Letter of Credit is governed by Uniform Customs & Practices for Documentary Credits (2007 Revision) of the International Chamber of Commerce.

C.Advances against bills sent on collection basis

- In some cases the bills will be sent on collection basis, either when the export credit limits are fully utilized, or in cases when the bills, drawn under LC, are discrepant or even when, the exporter himself requests for sending the bills on collection basis, in order to delay the realisation in anticipation of the strengthening of the foreign currency.

D.Advances against exports on consignment basis

- Goods are exported on consignment basis for approval and sale abroad and remittance of sale proceed by agent/consignee at the risk of the exporters. Under such type of exports, the sale proceeds are remitted for the part of goods sold, and in case of unsold goods, goods are sent back to the exporter.
- The overseas branch/correspondent of the bank is instructed to deliver the documents to title of goods, to the consignee, against Trust Receipt.

E.Advances against undrawn balances

In certain line of export trade, it is the practice of the exporter to leave a part of the amount unpaid for some time, as undrawn balances, which is settled by the buyer after satisfying himself about the weight, quality, etc., on arrival and inspection or analysis of the goods.
Authorized dealers can handle such bills, provided the undrawn balance is in conformity with the normal level of balance left undrawn in the particular line of export trade, subject to a maximum of 10% of the full export value.

F.Advances against duty drawback

- In case of certain commodities, particularly engineering items, the domestic cost of production is higher in relation to international prices, due to which the exporters of such commodities are given support from the government, to make them competitive in the overseas market.

Crystallization of Overdue Bills

- All export bills drawn in foreign currency, purchased, discounted or negotiated, enter into the forward foreign currency position of the bank, and the liability of the exporter is to realise the same by the given due date and deliver the foreign currency to the bank.
- In case of non-realisation of export bill by the given due date, the foreign currency liability of the exporter would continue, till the bill is realized or the liability is converted into the home currency, i.e., Indian rupee in our case, and liability fixed for the exporter.

Export Credit in Foreign Currency

- India have been permitted to extend export credit in foreign currency to its exporter clients, at LIBOR With a view to make credit available to exporters at internationally competitive interest rates, banks in linked rates.

Gold Card Status for Exporters

Based on the indications made by the government (Ministry of Commerce and Industry), in the Foreign Trade Policy 2003-04 to launch a Gold card scheme for creditworthy exporters with good track record for easy availability of export credit on best terms, the RBI, in consultation with select banks and exporters, has drawn up a gold card scheme, which envisages certain additional benefits based on the record of performance of the exporters. The gold card holder would enjoy simpler and more efficient credit delivery mechanism in recognition of his good track record.

The salient features of the scheme are:

- All creditworthy exporters, including those in small and medium sectors, with good track record would be eligible for issue of Gold Card by individual banks as per the criteria to be laid down by the latter.
- Gold Card under the Scheme may be issued to all eligible exporters including those in the small and medium sectors who satisfy the laid down conditions,
- The scheme will not be applicable for exporters blacklisted by ECGC or having overdue bills in excess of 10% of the previous year's turnover.
- Gold Card holder exporters, depending on their track record and credit worthiness, will be granted better terms of credit including rates of interest than those extended to other exporters by the banks.
- Applications for credit will be processed based on simpler norms and under a process faster than for other exporters.
- Banks would clearly specify the benefits they would be offering to Gold Card holders.
- The charges schedule and fee-structure in respect of services provided by banks to exporters under the Scheme will be relatively lower than those provided to other exporters.
- The sanction and renewal of the limits under the Scheme will be based on a simplified procedure to be decided by the banks. Taking into account the anticipated export turnover and track record of the exporter the banks may determine need-based finance with a liberal approach.
- ‘In-principle’ limits will be sanctioned for a period of 3 years with a provision for automatic renewal subject to fulfilment of the terms and conditions of sanction.
- A stand-by limit of not less than 20% of the assessed limit may be additionally made available to facilitate urgent credit needs for executing sudden orders. In the case of exporters of seasonal commodities, the peak and off-peak levels may be appropriately specified.

- In case of unanticipated export orders, norms for inventory may be relaxed, taking into account the size and nature of the export order.
- Requests from card holders would be processed quickly by banks within 25 days/15 days and 7 days for fresh applications/renewal of limits and ad hoc limits, respectively.
- Gold Card holders would be given preference in the matter of granting of packing credit in foreign currency.
- Banks would consider waiver of collaterals and exemption from ECGC insurance on the basis of card holder's creditworthiness and track record.
- The facility of further value addition to their cards through supplementary services like ATM, Internet banking, International debit/credit cards may be decided by the issuing banks.
- The applicable rate of interest to be charged under the Gold Card Scheme will not be more than the general rate for export credit in the respective bank. In keeping with the spirit of the Scheme, banks will endeavour to provide the best rates possible to Gold Card holders on the basis of their rating and past performance.
- Gold Card holders, on the basis of their track record of timely realization of export bills, will be considered for issuance of foreign currency credit cards for meeting urgent payment obligations, etc.
- Banks may ensure that the PCFC requirements of the Gold Card holders are met by giving them priority over non-export borrowers with regard to granting loans out of their FCNR (B) funds, etc.
- Banks will consider granting term loans in foreign currency in deserving cases out of their FCNR (B), RFC, etc. funds.

Export Data Processing and Monitoring System (EDPMS)

For better monitoring of export of goods and software and facilitating AD banks to report various returns through a single platform, the Reserve Bank of India has launched a comprehensive IT-based system called Export Data Processing and Monitoring System (EDPMS). The EDPMS has been operationalized with effect from 1st March, 2014.

Features of EDPMS

- AD banks can access the updated list of caution listed exporters through EDPMS on daily basis. Hence, banks can now refer to the updated caution list of exporters on a regular basis.
- RBI will caution/de-caution the exporters based on the recommendation of AD banks. ADs may forward its findings to the concerned regional office of RBI recommending inclusion of the name of the exporter in the caution list. This will require the banks to report cases where the exporter is not traceable or not making any serious efforts for realization of export proceeds.

- The guidelines require banks to record advance remittances received for exports in EDPMS. Besides, banks will also be required to record old outstanding advances received. This would require banks to develop a recording mechanism to ensure that all advances have been captured in the EDPMS.

Factoring and Forfaiting

Besides the regular financing avenues from banks, the exporters also have access to other avenues of financing which also act as risk management products. Factoring and forfaiting are the two products, which allows the exporters to sell their book debts and raise finance upfront. Let us see how these products work and what benefits accrue to the exporters.

Factoring

Factoring is defined as a continuing agreement between a financial institution (known as "Factor") and the business concern (the exporter/seller) selling goods or services to track customers on Open Account Basis, whereby the factor purchases the clients' book debts, either with or without recourse to the client and in relation thereto controls the credit extended to the customers and administers the sales ledger.

A factor provides different services, which can be described as under:

- **Debt Administration:** Managing the sales ledger of the client, saving his administrative cost of book keeping, invoicing, credit control and debt collection. This would also include work of following up for the debt collection.
- **Credit Protection:** As professionals, factors, will have the facility for credit intelligence to enable them to assess credit risk and advise their clients accordingly. The database on the individual buyers built up over a period of time, by the factor could be used by the client for a fee.
- **Factor Financing:** While in India financing is an essential activity for a factor, in certain countries it may not be an essential service. Generally, a factor will be willing to advance up to 75-80% of the outstanding debts.

Advantages of Factoring

- Immediate financing up to 75-80% of the invoice value.
- No need for LC, thus saving costs for the importer.
- Credit check on importers/buyers.
- Sales ledger maintenance.
- Credit protection on all approved debtor limits.
- Advisory services for new areas, countries.

Forfaiting

- **Another product for financing of export receivables is Forfaiting**. It can be defined as a mechanism for financing by discounting of export receivables, without recourse to the exporter/seller, for a medium term, on a fixed rate basis, for the full value of the contract/invoice.

- In another words, forfaiting is the purchase by the financer, of medium term export claims on the buyers, without recourse to the exporters. It is a source of finance and not a type of credit insurance, as such no other costs, other than financing costs are involved in the transaction.

Benefits of Forfaiting to Exporters

- Takes away political and commercial risks associated with export receivables.
- Makes available 100% finance against the invoice drawn.
- Without recourse facility.
- Freedom from credit administration, and follow-up.
- Cost saving on export credit insurance, besides related paperwork.
- Fixed rate financing, freedom from movement of interest rates for the tenor of the bill.

FACTORING	FORFAITING
Suitable for on-going open account sales not backed by LCs or accepted bills of exchange.	Suitable for one-off transactions backed by LCs or accepted (avalised) bills of exchange.
Short term in nature.	Medium to long term in nature (1 to 5 years).
Factoring can be with recourse or without recourse.	Forfaiting is generally without recourse.
Requires continuous arrangement between factor and client, whereby all sales are routed through the factor.	Seller need not route other business through the forfaiter. Deals are concluded transaction-wise.
Factor assumes responsibility of collection and helps client reduce overheads for the same.	Forfaiter's responsibility extends to collection of forfaited debt only.
Charges include those for financing, collection, administration, credit protection and MIS.	Charges include discount and commitment charges.
Factoring is commonly for domestic and international transactional.	Forfaiting is commonly for international transactions only.

Exchange and Trade Control Guidelines for Importers

Keeping in view the need to conserve the precious foreign exchange, and to guard the country from scrupulous imports and bogus outward remittances, various export-import regulations and exchange control guidelines have been prescribed from time to time. While the physical movement of goods into India is regulated by Foreign Trade Policy formulated by the Director General of Foreign Trade (DGFT), the regulations relating to payment of such imports are governed by Exchange Control Regulations framed the basis of **Foreign Exchange Management Act, 1999 (FEMA 1999).**

- **Importer-Exporter Code (IEC):** As explained earlier, first and foremost, the importer customer has to have a valid IEC, issued by the office of DGFT.

- **Approved commodity:** Freely Permissible or Import licenses: While ADs are required to ensure that the goods imported or intended to be imported are as per the current Foreign Trade policy, the goods can be can be freely imported, or can be imported under specific license issued for the purpose by the DGFT This has to be ensured prior to making import remittance, handling of import bills for collection or opening of letters of credit for import of goods. For this purpose, the ADs should verify the Foreign Trade Policy or the public notices issued by the DGFT.
- **Payments for imports:** Any person who wants to make a remittance for imports, should make an application (as prescribed by RBI) to the authorised dealer. The Application should contain the details of the currency, the total value of imports, commodity, the license number, etc., along with an undertaking by the importer that they will comply with the Exchange Control Regulations.

Import Finance

Import Letter of Credit

- **This is the most used method of financing imports. The importer gets LC limits sanctioned from his bank and establishes LC on DA basis (usance),** there by getting credit from the overseas supplier on the strength of his banks credibility (LC).
- At times import LC are also used to generate liquidity, by way of establishing DALCs for commodities, which can be sold immediately on sight basis, or for cash.
- We have seen how Letters of credit work, in earlier unit. LC transaction also support Buyers credit and suppliers' credit, being other modes for financing of imports, are discussed later in this unit.

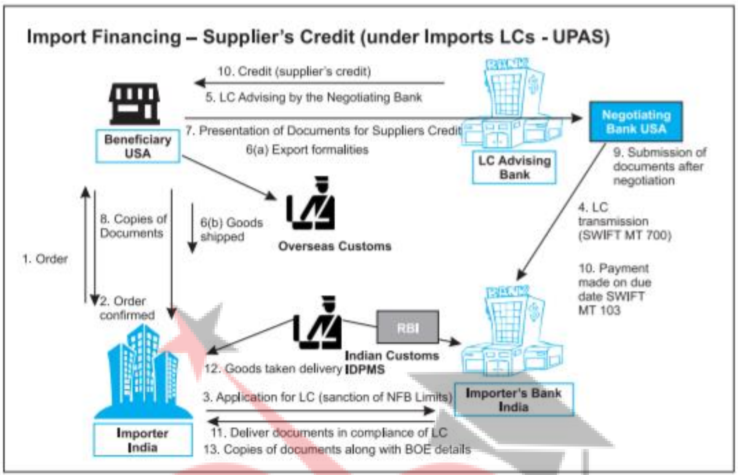
Import Loan

- **Such loans are at times granted against imported raw material, or goods meant for trading.** The loans can be against pledge of goods or hypothecation to the financing bank. Importers prefer such loans, even at higher rates of interest, waiting for the prices of the goods to go up and to take benefit of depreciating domestic currency.

Trade Credit – Supplier’s Credit And Buyer’s Credit

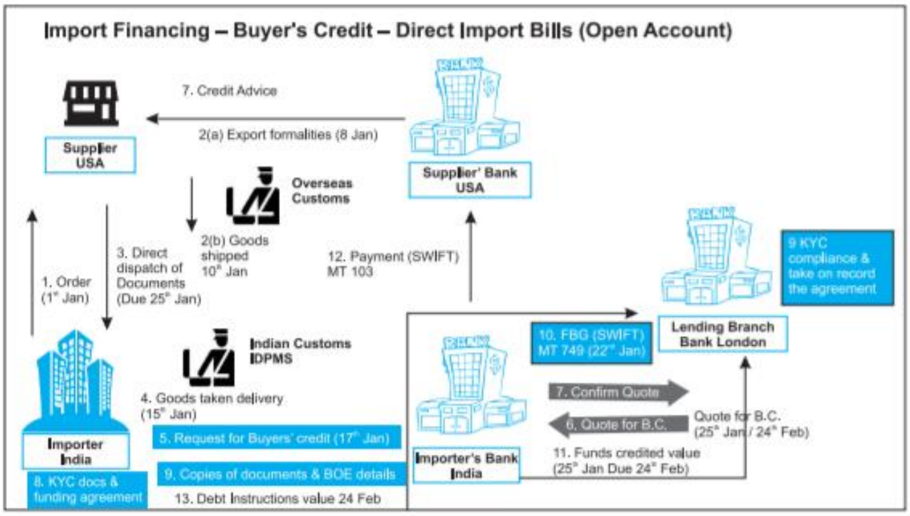
- Supplier’s Credit Supplier’s Credit is credit directly extended by the overseas supplier of goods to the importer. As in domestic markets, in the international markets also, the payment terms are either sight or on credit. The period of credit, normally depends on the necessity for the exporter/seller of the goods to increase sales, the demand of the goods in the market, requirement of the importer and the current market practices.

- The exporter may avail finance against the bills, after making the shipment, from his banker and the bank would receive funds on the maturity date. However, the exporter shall be liable to repay his bank, in case the overseas buyer does not make payment on due date. The period of supplier's credit, reckoned from the date of shipment, is to 3 years for import of capital goods. For non-capital goods, this period is up to 1 year or the operating cycle, whichever is less. The maximum amount of supplier's credit, per import transaction, that banks can approve is USD 50 mn.



Buyer's Credit

- The buyer's credit is credit arranged by the importer (buyer), from a bank/financial institution outside his country, to settle the payment of imports. In short, it is credit arranged by the buyer to settle import payments, irrespective of the period of credit.
- In this type of credit, the supplier of the goods need not worry about the payment, as the payment is assured by the bank/financial institution, provided he completes his responsibility as per the requirement of the buyer. The modus operandi is that, in some cases on one hand the supplier (exporter) is not ready to give any credit (supplier's credit) while the buyer (importer) is also not in a position to make immediate payment.
- As such, the importer approaches his bank and requests for arrangement of payment to the exporter on immediate terms. The bank, through their own resources, or correspondent relationships, ties up with a foreign bank/financial institution, and after agreeing upon on the pricing/costing, makes arrangement to make payment to the exporter on submission of shipping documents. The importer then repays on the due date.
- Like in the case of supplier's credit, the period of buyer's credit, reckoned from the date of shipment, is to 3 years for import of capital goods. For non-capital goods, this period is up to 1 year or the operating cycle, whichever is less. Like supplier's credit, the maximum amount of buyer's credit, per import transaction, that banks can approve is USD 50 mn.



CASE STUDY

1.Total interest on the export bill discounted, will be charged up to;

(i) notional due date 25.10.2016

(ii) value date of credit 27.10.2016

(iii) date of realisation 30.10.2016

(i) date of credit to nostro account 29.10.2016

Ans. 1: USD 50,000.00 @ 68.20 = Rs. 3,410,000.00 - less 12% for insurance and freight cost i.e Rs. 409200 = Rs.3,000,800.00 (fob value of the order. Less margin 25% i.e. Rs. 750,200.00 balance Rs. 2,250,600.00

Ans. 2: 67.89 - Bill buying rate on 31.8.2008 - 67.85 plus 4 paise premium for 30 days, this being a DA bill.

Ans. 3: USD 48,000.00 @ 67.89 = Rs. 3258720.00 less 15% margin on DA bill, i.e. Rs. 488808.00 = Rs 2,769,912.00

Ans.4: Bill submitted on 31.8.2016, drawn on 30 days DA plus normal transit period of 25 days - 31.8.2016 plus 30 days plus 25 days, i.e. total 55 days from 31.3.2016 i.e. 25.10.2016.

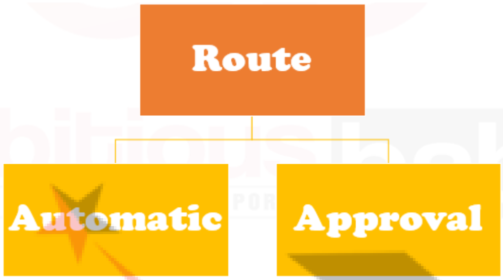
Ans 5: Interest is charged up to the date the funds have been credited to the banks NOSTRO account, the effective date of credit is the value date of credit, i.e. 27.10.2010.

CAIIB BFM Module A Unit 6- External Commercial Borrowings and Foreign Investments in India

Introduction

External Commercial Borrowings (ECBs) are commercial borrowings raised by eligible resident entities from recognized lenders towards medium and long term foreign currency denominated debts including Indian Rupee denominated borrowings with a **minimum average maturity period of 3 years and above.**

The eligible resident Indian entities are also eligible to borrow for periods of less than 3 years, subject to the extant guidelines of the Reserve Bank of India.



Automatic route where the cases will be examined by the Authorized Dealers Category I (AD Cat I Banks).

Approval route, under which prospective borrowers are required to obtain RBI approval by routing their requests through their AD Banks for examination.

FCY Denominated ECB can be in any freely convertible foreign currency and includes bank loans, floating/fixed rate notes/bonds/debentures (other than fully and compulsorily convertible instruments), trade credits beyond 3 years, Foreign Currency Convertible Bonds (FCCBs), Foreign Currency Exchangeable Bonds (FCEBs) and Financial Leases.

INR Denominated ECB, which includes bank loans, floating/fixed rate notes/bonds/debentures (other than fully and compulsorily convertible instruments), trade credits beyond 3 years, Foreign Currency Convertible Bonds (FCCBs), Foreign Currency Exchangeable Bonds.

(FCEBs) and Financial Leases and includes Plain Vanilla Rupee denominated bonds issued overseas which can be either placed privately or listed on exchanges - as per host country regulations.

External Commercial Borrowings – Concepts

Eligible Borrowers

- All entities eligible to receive FDI.
- Entities recognized as Startup by the Central Government as on date of raising ECB.
- Port Trusts, Units in SEZ, SIDBI, EXIM Bank.

- Registered entities engaged in micro-finance activities viz., registered Not for Profit Companies, registered societies/trusts/co-operatives and Non-Government Organizations are permitted only to raise INR ECBs.

End Use

The negative list for which ECB proceeds cannot be utilized would include the following:

- Real estate activities
- Investment in capital market
- Equity investment
- Working capital purposes except from foreign equity holder
- General corporate purposes except from foreign equity holder
- Repayment of Rupee loans except from foreign equity holder
- On-lending to entities for the above activities.

ECBs – Recognized Lenders

- The lender should be resident of FATF (Financial Action Task Force) compliant country or IOSCO (International Organization of Securities Commission) compliant country.
- Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognized lenders.
- Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad.
- Foreign branches/ subsidiaries of Indian banks are permitted as recognized lenders only for FCY ECBs.
- Foreign branches/ subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/ underwriters/ market-makers/ traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed

Minimum Average Maturity

Minimum average maturity period (MAMP) will be 3 years, including borrowing by startups.

Category	MAMP
Manufacturing sector companies may raise ECBs up to USD 50 million or its equivalent per financial year.	**1 Year**
ECB is raised from foreign equity holder and utilized for **a. working capital purposes** **b. general corporate purposes** **c. for repayment of rupee loans raised domestically for purposes other than capex,**	**5 years**
ECB is utilized for **a. working capital purposes or general corporate purposes** **b. for repayment of Rupee loans availed domestically for non-capex**	**10 years**
ECB is utilized for **a. repayment of Rupee loans availed domestically for capex,**	**7 years**
For startups	**3 years**

All-in-Cost ceiling

- For new ECBs - Benchmark rate plus 500 bps spread.
- For existing ECBs linked to LIBOR whose benchmarks are changed to ARR - Benchmark Rate plus 550 bps spread.
- For INR denominated ECBs - Benchmark rate plus 450 bps spread. Benchmark rate in case of Rupee denominated ECB will be prevailing yield of the Government of India securities of corresponding maturity.
- All-in-cost includes rate of interest, other fees, expenses, charges, guarantee fees, ECA charges, whether paid in foreign currency or INR but will not include commitment fees and withholding tax payable in INR.
- In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread. Additionally, for FCCBs the issue related expenses should not exceed 4% of issue size and in case of private placement, these expenses should not exceed 2% of the issue size, etc.

ECBs – Other Operational Concepts

- Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to INR is freely permitted.
- The ECB borrower will be required to cover principal as well as coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (ie., the day liability is created in the books of the borrower).
- All eligible borrowers can raise **ECB up to USD 750 million** or equivalent per financial year under Automatic Route.
- However, entities recognized as Startup by the Central Government can **can raise maximum of USD 3 million or equivalent per financial year.**
- In case of FCY denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for **ECBs raised under the automatic route cannot exceed 7:1.**
- Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted.
- ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization.
- Until utilization of ECB proceeds, funds can be invested in liquid assets
  - ✓ Deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's;
  - ✓ Treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above.
  - ✓ Deposits with foreign branches/subsidiaries of Indian banks abroad.

- ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to Lender's Rupee accounts with AD Category I banks in India.

- ECB borrowers are also allowed to park ECB proceeds in term deposits with AD **Category I banks in India for a maximum period of 12 months** cumulatively. These term deposits should be kept in unencumbered position.
- Any draw-down in respect of an ECB should take place only after obtaining the LRN from the Reserve Bank on submission of Form ECB.
- The borrowers are required to report actual ECB transactions in Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach RBI within seven working days from the close of month to which it relates.
- Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the RBI through revised Form ECB at the earliest, in any **case not later than 7 days from** the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.
- **Refinancing of existing ECB**: Refinancing of existing ECB by fresh ECB is permitted, provided the outstanding maturity of the original borrowing (weighted outstanding maturity in case of multiple borrowings) is not reduced and the all-in-cost of fresh ECB is lower than the all-in-cost (weighted average cost in case of multiple borrowings) of existing ECB.
- Foreign branches of Indian banks are permitted to participate in refinancing of existing ECB, only for highly rated corporates (AAA) and forMaharatna/Navratna Public Sector Undertakings.

Reporting Requirements

Loan Registration Number (LRN) –

- Drawdown of ECBs should happen only after obtention of LRN from the RBI.
- The borrowers are required to submit Form ECB through the AD Category I Bank who in turn will forward the application to RBI, Department of Statistics and Information Management, External Commercial Borrowings Division for their perusal and issuance of LRN.
- The borrowers are required to report the actual ECB transactions through ECB 2 returns through the AD Category I Bank on a monthly basis so as to reach **within 7 days from the close** of the relevant month.
- Changes, if any, in the ECB parameters, after obtention of the LRN should also be incorporated in the monthly returns.
- Any borrower, who is otherwise in compliance of the ECB guidelines, can regularize the delay in reporting by payment of Late Submission Fees (LSF) for the period of delay and the delays may **range from up to 30 days from** the due date of submission to **beyond 3 years f**rom the due date of submission.
- The late submission may **also range from Rs. 5,000 to Rs. 1,00,000 per year depending** on the extant delayed submission.

Conversion Of ECB Into Equity

- The activity of the borrowing company is covered under the automatic route of FDI. Conversion should be with the lender's consent and without any additional cost and adhering to the sectoral cap as per the FDI Policy.
- If the borrower has availed any credit facilities from the Indian banking system, all prudential guidelines issued by the Department of Banking Regulation of RBI to be complied with, including consent of other lenders.

Foreign Investments

Objectives

Foreign Investments (FDI & FPI)

- Different modes of Foreign Investments
- Restrictions on Foreign Investments
- Control and reporting

Foreign Investments – Revised Framework

Relevant regulators under the NDI Rules

- Department of Economic Affairs, Fin. Min. notifies Non-Debt Instruments (NDI) rules.
- RBI – Nodal authority for Valuations & Reporting.
- Various Government Ministries – Cases requiring approvals (earlier FIPB)
- DIPP and Ministry of Commerce – formulates FDI Policy

Key changes in the above context

- FIPB abolished in 2019.
- On-line reporting to RBI through AD Banks - filing SMF through FIRMS portal)
- Late submission fee introduced.
- FEMA 20 of 2000., FEMA 20(R)., Master directions., replaced with the NDI rules (33 Rules and 10 Schedules)

Key Concepts

Foreign Direct Investment

- Any investment in Equity instruments
- Made by a Person Resident Outside India (PROI)
- On a repatriable basis

(a) In an unlisted Indian company

(b) 10% or more of the paid up equity capital, on a fully diluted, basis in a listed company

(c) In an LLP towards capital contribution [Fully diluted basis means the total number of shares that would be outstanding if all possible sources of conversion are exercised].

- In case an existing investment by a PROI in equity instruments of a listed Indian company falls to a level below 10 percent of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI. Once an FDI, always an FDI.

Foreign Portfolio Investment

- Investment made by a PROI in less than 10% of the paid-up equity capital, on a fully diluted basis of a listed company.
- Foreign Portfolio Investor (FPI) means a person registered in accordance with the Provisions of SEBI (FPI) Regulations 2019 wherein FPIs can invest in securities in the primary and secondary markets including shares, debentures and warrants of companies, listed or to be listed on a recognized stock exchange in India.
- The 10 percent limit for foreign portfolio investors shall be applicable to each foreign portfolio investor or an investor group as referred in Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

Downstream Investments (Indirect Foreign Investments)

- Investments in the equity instruments of **another Indian company by an Indian entity (including an LLP)** which has received foreign investment and is not owned and not controlled by resident Indian citizens. In other words, is owned or controlled by person resident outside India.
- Downstream investments also mean Investment by an Investment Vehicle whose sponsor or manager of investment manager is not owned and not controlled by resident Indian citizens. In other words, is owned or controlled by persons resident outside India.

➢ **Sectoral Cap** - Is the ceiling limit up to which a PROI can subscribe to the Paid-up capital of Indian Investee Company as prescribed under Sector-wise/Activity-wise by Department of Industrial Policy & Promotion, Govt. of India

➢ If the foreign investment in the investing entity is 50% or more, then the entire downstream investment will be regarded as indirect foreign investment.

Foreign Venture Capital Investments (FVCI) – FVCI is incorporated outside India and can invest in Domestic Venture Capital Fund or a Venture Capital undertaking (Domestic unlisted Company).

They are SEBI registered Investment Vehicle.

✓ Foreign investment in Investment Vehicle means it is an entity registered under SEBI., eg.,
✓ Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014,
✓ Infrastructure Investment Trusts (InvIts) **governed by the SEBI (InvIts) Regulations, 2014.**

- ✓ Alternative Investment Funds (AIFs) governed **by the SEBI (AIFs) Regulations, 2012.**

Start-up Company - Start-up Company means a Private Company incorporated under the **Companies Act, 2013 or a Registered Partnership Firm or an LLP**, recognised as such by the DIPP, Ministry of Commerce and Industry, ***Government of India and complying with following conditions:***

- ✓ Start-up recognition will be restricted to 7 years from the incorporation/registration.
- ✓ In case of bio-technology sector, start-up recognition will be up to 10 years.
- ✓ Turnover for any FY since incorporation/registration does not exceed INR 100 crores.
- ✓ The entity is working towards innovation, development or improvement of product or processes or services, or operating on a scalable business model with high potential for employment generation/ wealth creation.

Eligible Foreign Investors

- PROI - Non resident entities, NRIs, OCIs, Foreign Nationals
- NRIs resident in Nepal and Bhutan subject to the inward remittances received in free foreign exchange
- Erstwhile OCBs who are not under the RBI caution list
- Foreign Portfolio Investors
- Foreign Venture Capital Investors

Eligible Investee Entities

- Indian companies as defined under the Companies Act 2013
- Trusts being Venture Capital Funds regulated by SEBI
- LLPs
- Special Investment Vehicles
- Start-up companies

Eligible Investment Instruments

- Fully paid Equity shares.
- Partly paid Equity shares, provided 25% of total consideration is received upfront and balance within 12 months.
- Fully, Compulsorily and mandatorily convertible debentures/Preference shares.
- Share warrants provided at least 25% of consideration is received upfront and balance within 18 months of issuance.
- Convertible notes issued by Startup entities, repayable at the option of the holder or converted into equity within a period not exceeding 5 years from the date of issue of the CN.
- Bonus Shares/Rights Shares/ESOPs.
- Swap of equity instruments (FDI & ODI structure) - NRI owned companies.
- Import of capital goods/machinery.

- Conversion of ECB into equity shares.

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- Indian companies as defined under the Companies Act 2013
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- Swap of equity instruments (FDI & ODI structure) - NRI owned companies.
- Import of capital goods/machinery.
- Conversion of ECB into equity shares.
- Import of capital goods/machinery.
- Conversion of ECB into equity shares

Prohibited Sectors

Rules Governing Pledge of Shares

Any person resident outside India holding equity instruments in an Indian Company may pledge in favor of a Bank in India

- To secure credit facilities being extended to such Indian company.,
- For genuine business purposes.,
- Submission of a declaration/annual certificate from the statutory auditor of the investee company that the loan proceeds will be utilized for the said purpose.

Any person resident outside India holding equity instruments in an Indian Company may pledge in favor of Overseas Bank

- To secure credit facilities being extended to PROI who is the promoter of such Indian company or the overseas group company.,
- Loan is availed only in an Overseas bank.,
- Loan is utilized for genuine business purposes and not for **investments.,**
- Loan proceeds should not result in any capital inflow in to India.,
- Submission of a declaration/annual certificate from the statutory auditor of the investee company that the loan proceeds will be utilized for the said purpose.

Operational Guidelines

Transfer of non-debt instruments

Foreign Direct Investment – Transfer of Non-debt Instruments

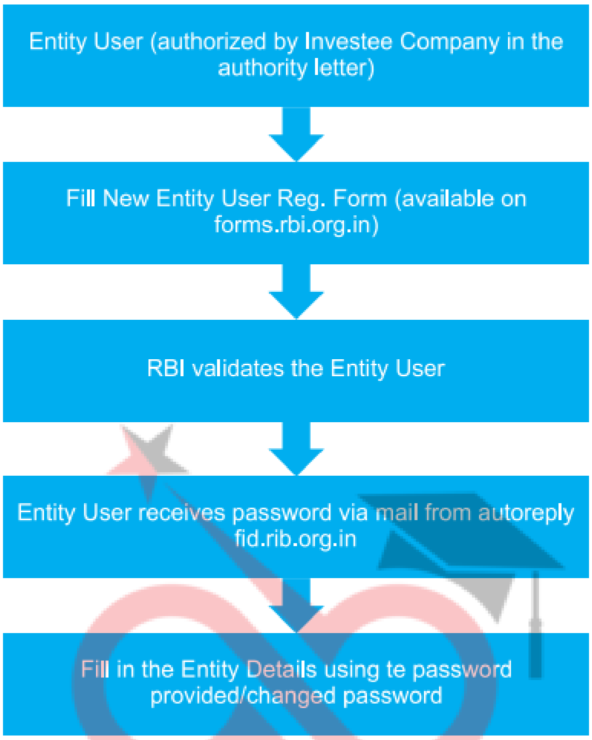
Nature of Transfer	*Mode of Transfer*	*Rule*	*Pricing Guidelines*	*Reporting*
NR to NR (Excl. NRI/OCI/ OCB)	Sale or Gift	Automatic route (if the FDI is allowed under automatic route)	NA	NA
NR to R	Sale or Gift	Automatic route	Yes	FCTRS
R to NR	Sale	Automatic route. Should comply with FDI guidelines	Yes	FCTRS
R to NR	Gift (Relatives)	RBI approval. (Shall not exceed 5% of paid up capital $50000 max)	NA	FCTRS
R to NR lender	Pledge	Under ECB; (AD NOC)	NA	NA
NR to R (Bank/ Lender/NBFC)	Pledge	Automatic	NA	NA
NR to NR (Overseas lending bank)	Pledge	Automatic	NA	NA

Escrow a/c is permitted under transfer lending Inward/BG

Process of reporting on FIRMS (Foreign Investment Reporting and Management Systems)

- Process of Reporting on FIRMS – Entity Master
- Entity master creation is independent of AD Bank.
- One entity can have one Entity user only. Changes in entity user will require contact with help deskin "Contact Us" tab of FIRMS portal.
- Email provided in the form should be correct since all communications will be via email from FIRMS system.
- Entity user named in Authorization Letter himself/herself cannot sign the same.

- RBI office having jurisdiction over registered address of the entity will be the governing office approving the Entity User as well as Forms reported in FIRMS.
- Figures of existing shareholding should be correctly captured on fully diluted basis.
- For any technical assistance contact email: helpfirms@rbi.org.in



Process of reporting on FIRMS (Foreign Investment Reporting and Process of reporting on FIRMS – SMF (Single Master Form)

- Process of Reporting on FIRMS – SMF Business User
- Business User creation can happen only if Entity Master is in place.
- Ensure correct IFSC code of the bank is available.
- Authority letter for Business User is not same as that for Entity Master.
- Board Resolution is not required for Business User creation.
- For any resolution in Business User creation, entity has to contact the concerned bank to whom the application was made.
- Forms are available - FC-GPR, FC-TRS, LLP I, LLP II, CN, ESOP, DI, DRR and InVi.

Ensure Entity Master is available

↓

Fill New Business User Reg. Form (available on forms.rbi.org.in)

↓

AD Bank selected validates the Business User form and approves/rejects the same

↓

Business User receives password via mail from autoreply fid.rib.org.in

Process of reporting using various reporting forms

Various Reporting Forms

FORM	PURPOSE	RESPONSIBILITY FOR FILING	TIMEFRAME
Foreign Currency - Gross Provisional Return (FC-GPR)	• Reporting of capital instrument issued to a person resident outside India and where such issue is reckoned as Foreign Direct Investment. • Reporting of conversion of ECB into Equity.	Investee Entity	Within 30 days from the date of issue of capital instruments
Annual Retrun of Foreign Liabilities and Assets (FLA)	Annual reporting by Indian company which has received FDI or LLP which has received capital contribution in the previous year(s) including the current year.	Investee Entity	On or before the 15th of July
Foreign Currency-Transfer of Shares (FC-TRS)	Transfer between resident to NR Sale of shares on Stock Exchange *	Resident transferor/ transferee or the person resident outside * Responsibilty of the NR	Within 60 days of transfer of capital instruments of receipt/remittance of funds whichever is earlier. In case of transfer as per Regulation i.e. deferred payment transfer, reporting be done on receipt of every tranche of payment.
Employees' Stock Option (ESOP)	Stock option to persons resident outside India	Issuing Indian Company	Within 30 days from the date of issue

Import Financing Buyer's Credit (open account)

Various Reporting Forms

FORM	PURPOSE	RESPONSIBILITY FOR FILING	TIMEFRAME
LLP (I)	LLP receiving amount of consideration for capital contribution and acquisition of profit shares	Investee Indian LLP	Within 30 days from the date of receipt the amount of consideration
LLP (II)	Disinvestment/transfer of capital contribution profit share between a resident and non resident (or vice versa)	Investee Indian LLP	Within 60 days from the date of receipt funds
Depository Receipt Return (DRR)	Reporting of issue/transfer of depository receipt issued in accordance with the Depository Receipt Scheme, 2014 by the Domestic Custodian	Domestic Custodian	Within 30 days of close of the issue/program
Downstream Investment (Form DI)	An Indian company making downstream investment in another Indian company which is considered indirect foreign investment for the investee company	Indian Entity or Investment Vehicle making DI	Within 30 days of such investment
Form InVi	An investment vehicle which has issued its unit person resident outside India	Indian Investment Vehicle	Within 30 days of issuance of units in Investment Vehicle
Form Convertible Notes (CN)	Issuance & Transfer of CNs by Indian startup company	Issuing company/ Transferor/ Transferee	Within 30 days of issuance/ transfer

Table on late submission fee (current scale)

Late submission fee (LSF) ...		
Amount involved in reporting	LSF as % of amount	Max. LSF
Up to INR 1Cr	0.05%	INR 10 lakhs or 300% of amount involved (whichever is lower)
More than INR 1Cr	0.15%	INR 1Cr or 300% of amount involved (whichever is lower)
• % of LSF doubled for every 12 months of delay • Includes Sundays/Holidays • The period shall begin from ... day after due date till preceding day of reporting		

Snap Shot of Non-Debt Instruments (NDI) Rules

- Rules 1 & 2 – Short title, definitions, etc.
- Rule 3 – Restrictions on investments in India by PROI
- Rule 4 – Restrictions on receiving investments
- Rule 5 – Permission for making investment by a PROI
- Rule 6 – investment by person resident outside India – Sch. I, VI, VIII, IX
- Rule 8 – Issue of ESOPs & SWEAT Equity shares
- Rule 9 – Transfer of equity instruments of an Indian company by or to a person resident outside India.
- Rule 10 – Investments by SEBI registered FPIs Sch. II & X
- Rule 12 – Investments by NRI or OCI – Sch. III, IV, X
- Rule 16 – Investments by FVCI -Sch. VII
- Rule 20 – Reporting requirements
- Rule 21 – Pricing guidelines
- Rule 23 – Downstream investments
- Rules 24 to 33 – Acquisition & transfer of immovable property in India by NRIs/OCIs/purpose of acquiring property, etc., including miscellaneous provisions

List of Documents for Obtention of Foreign Investments (Illustrative List)

- Application (for Inward) along with FEMA declaration signed by Investee Company.
- Brief profile of Investee Company providing main business activities of the entity with 5-digit NIC code as per NIC 2008 list.
- Copy of MOA of Indian Investee Company.
- Copy of MOU/share purchase agreement or declaration that there is no such agreement.
- 6 Point KYC SWIFT of the remitter/investor as per RBI format.
- NOC from joint account holder if shares are being issued on single name (applicable for remittances received from joint accounts only).
- Declaration stating Capital instruments against this remittance would be issued within 60 days in accordance with the provisions.
- Scan email acknowledgement received by the investee company from FIRMS helpdesk w.r.t to Entity master.

- Undertaking from customer confirming FCGPR & related documents will be reported in FIRMS portal within 30 days from date of allotment of shares.

List of Documents for Refund of Foreign Investments (Illustrative List)

- Application (FCTRS Outward) + Form A2 signed by Investee Company.
- FIRC in original obtained and endorsed and retained along with the records.
- Copy of UIN letter/ FIRMS FCGPR reporting Ref Number.
- Letter from the Company mentioning reason for return of funds.
- Board resolution from the company confirming excess funds have been received as share application money and the excess funds are being repatriated back to the investor.
- Letter confirmation that no interest element involved in refund of excess share application funds.
- Branch has to intimate to RBI about refund, once refund transaction is processed.

CAIIB BFM Module A Unit 7- Risk In Foreign Trade- Role Of ECGC

Definition of Risk And Risks In International Trade

A risk can be defined as an uncertain event with financial consequences resulting in loss or reduced earnings. An activity which may give profits or result in loss may be called a risky proposition, due to the uncertainty or unpredictability of the activity or trade in future. While, in human life, risk is related to illness, impairment or loss of life, in commercial and business activities, the business profit or loss would depend upon how the business is run or its affairs managed.

- **Buyer Risk:** The seller faces risks relating to non-acceptability, non-payment, quality acceptance, credit risk, etc.
- **Seller Risk:** The buyer faces the risk relating to the seller not shipping the goods after receiving advance payment, may ship poor quality goods and may ship the goods after considerable delay, which may either lead to cancellation or delays in further orders taken by the buyer or even penalties in delays/non-shipment.
- **Shipping Risk:** Includes risks arising due to other intermediaries in the international trade, like shipping companies, handling agents, port authorities, local transporters, or even loaders, etc.
- **Other Risks:** Some of the other risks like bank failure risk, settlement risk, risk of competition, genuineness of documents, price risk, legal risk, spread risk, market risk (absorption/rejection), etc. could affect the parties to the international trade.

We can also categorise the risks in International trade as under:

- **Credit Risk**: Relates to credit worthiness of the buyer, and could result in non payment of export bills due to any reasons, like financial crunch, defaults, insolvency, etc.
- **Legal Risk:** Relates to any amendment in the laws of the sellers or buyer's country, which could result in inability of the seller to export or of the buyer to remit proceeds of invoices. This could be due to embargoes on countries, ban or restriction on export of particular goods, ban or restriction on remittance of funds to particular countries, etc.
- **Country Risk and Political Risk**: Relates to the developments in the country of buyer or seller, leading to default in export or payments. This could be due to uncertainty in laws, uncertainty in financial position of the countries, inharmonious relationship between countries, or fluid political situation. Countries' bad forex reserves position could lead to shortage of foreign exchange and inability to buy foreign exchange, resulting in externalization issues.
- **Operational Risk**: Relates to operational issues at both ends or even at supporting organizations place. Strikes at seller's factory or even at sellers' raw material suppliers' factory, transporters, loaders, banks, clearing agents, etc.
- **Exchange Risk**: Relates to adverse movement in currencies. Any exporter or importer faces exchange risk, directly or indirectly. Invoicing in currency, other than home currency, strengthening or weakening of currency in which imports are billed, weakening of currency from where competitors import goods or supply goods to the same buyers/countries, etc.

Export Credit Insurance In International Trade

- **Exports grow on the backing of export financing by banks. Governments, in order to support exports, provide cheap financing options and provide comfort to exporters and financing banks, by way of export credit insurance.** Export credit insurance, provides protection against losses from political and commercial risk to the exports and financing institutions.
- Countries have set up special corporations to provide these services of export credit insurance. Some general insurance companies also provide credit guarantee for exports. Credit insurance lowers the cost of borrowing/financing, as the government agency bears the risk of default as per policy terms. Usually, the insurance is on risk sharing basis—as such it covers a large part of credit default, but requires the insured exporter/financer to bear some part of the loss.

ECGC LTD. – Role And Products

About ECGC Ltd (earlier known as Export Credit Guarantee Corporation Ltd.)

ECGC Ltd is a credit guarantee institution, set up for the promotion of exports, by protecting the exporters from any financial loss due to the buyer's failure to pay or due to the problem of externalization in the country of import, by issuing various types of policies to the exporters. At the same time, ECGC issues various types of guarantees to banks, financing exporters, which protect banks in case of loss from their advances to exporters

At present, ECGC has set before itself the following objectives:

- To encourage and facilitate globalization of India's trade.
- To assist Indian exporters in managing their credit risks by providing timely information on worthiness of the buyers, bankers and the countries.
- To protect the Indian exporters against unforeseen losses, which may arise due to failure of the buyer, bank or problems faced by the country of the buyer by providing cost effective credit insurance covers in the form of Policy, Factoring and Investment Insurance Services comparable to similar covers available to exporters in other countries.
- To facilitate availability of adequate bank finance to the Indian exporters by providing surety insurance covers for bankers at competitive rates.
- To achieve improved performance in terms of profitability, financial and operational efficiency indicators and achieve optimum return on investment.
- To develop world class expertise in credit insurance among employees and ensure continuous innovation and achieve the highest customer satisfaction by delivering top quality service.
- To educate the customers by continuous publicity and effective marketing.

Main Activities of ECGC

ECGC provides a wide range of credit risk insurance cover to exporters against loss in export of goods and services. It also offers guarantees to banks and financial institutions to enable exports to obtain facilities, credit or otherwise, from banks They provide credit reports of overseas buyers also.

Some of the main policies offered by ECGC to the exporters are:

- Standard Policies to exporters to protect them against payment risks involved in exports on short-term credit.
- Small Exporters Policy basically a Standard Policy, but incorporating certain improvements in terms of cover to enable to encourage small exporters.
- Specific Shipment Policies designed to protect firms in India, against payment risks involved in

(a) Exports on Deferred Payment Terms

(b) Insurance for Buyers' Credit and Lines of Credit

(c) Services rendered to Foreign Parties

(d) Construction Works and Turnkey Projects Undertaken Abroad.

- Exports (Specific Buyer) Policy.
- Export Turnover Policy.
- Buyer Exposure Policy.
- Consignment Exports Policy.
- Multi-buyer Exposure Policy.
- IT-Enabled Services Policy-Single Customer (SITES).
- Policy for SME Sector.

(B)The guarantees policies offered by ECGC to the banks are:

- Export Credit Insurance for Banks (Whole turnover – Packing Credit)-ECIB (WT-PC).
- Export Production Finance Guarantee.
- Export Credit Insurance for Banks (Whole turnover- Post shipment Credit)-ECIB (WT-PS).
- Export Finance Guarantee.
- Export Performance Indemnity.
- Export Finance (Overseas Lending) Guarantee.
- Transfer Guarantees.

Besides the above, ECGC also offers some Special Schemes, such as Factoring, Buyer's Credit Cover, Lines of Credit Cover, Overseas Investment Insurance, Transfer guarantees, (covering risk on transfer of funds), Scheme for Small Exporters, Exchange Fluctuation Risk Insurance Scheme, Customer Specific Covers etc.

ECGC Policies

Standard Policies

The Standard Policies of ECGC provide cover for exporters for short-term exports. The different types of policies are:

- **Shipment (Comprehensive Risk) Policy** – to cover both commercial and political risks from of shipment.
- **Shipment (Political Risks)** – to cover only political risks from the date of shipment.
- **Contracts (Comprehensive Risks) Policy** – to cover both commercial and political risks from the date of contract.
- **Contracts (Political Risks) Policy** – to cover only political risks from the date of contract.

Standard policies cover following risks:

- **Commercial Risks** – covering Insolvency of the Overseas Buyer, Protracted Default by the overseas buyer to pay for goods accepted by him within a specified period usually 4 months from the due date, – Buyers' failure to accept goods subject to certain conditions.
- **Political Risks** – which covers imposition of restrictions on remittance by the Government in buyers' country or any Government action which may block or delay payment to exporter, war, revolution or civil disturbances in buyers' country, New Import Licensing restrictions or cancellations of a valid import license in the buyers' country, interruption or diversion of voyage outside India resulting in payment of additional freight or insurance charges which cannot be recovered from the buyer, any other cause of loss occurring outside India, not normally insured by general insurers and beyond the control of both the exporter and the buyer.

Standard policies do not cover following risks:

- Commercial disputes raised by the buyer.
- Causes inherent in the nature of goods.
- Buyer's failure to obtain necessary import or exchange authorization from authorities in his country.
- Default or insolvency of any agent of the exporter or collecting bank. Loss or damage to goods which can be covered by general insurers.
- Exchange rate fluctuation risk.
- Failure of the exporter to fulfill the terms of the export contract or negligence on his part. The cover granted by ECGC on Standard policies is 90% of the value of exports. The premium for such policies varies for different countries and payment terms.

Small Exporters' Policy

- **The Standard Policy (Shipments comprehensive Risks Policy) issued by the Corporation to exporters is a declaration type of policy and is issued to cover shipments that may be made in period of 24 months ahead**. For the purpose of issuing the Policy, a Small Exporter is defined as an exporter whose anticipated total **export turnover for the period of 12 months ahead is not more than Rs. 50 lacs. (Projected Export Turnover)**
- This policy provides cover against Commercial risks, covering insolvency of the buyer, failure of the buyer to make the payment due within 2 months from the due date, buyer's failure to accept the goods, due to no fault of the exporter, provided that legal action against the buyer is considered to be inadvisable.

It also provides cover against Political risks, covering:

- ✓ Imposition of restrictions by the Government of the buyers' country or any Government action which may block or delay the transfer of payment made by the buyer.
- ✓ War, civil war, revolution or civil disturbances in the buyers' country.

- ✓ New import restrictions or cancellation of a valid import license.
- ✓ Interruption or diversion of voyage outside India resulting in payment of additional freight or insurance charges which cannot be recovered from the buyer.

Small exporters policy does not cover losses arising due to the following risks:

- Commercial disputes including quality disputes raised by the buyer, unless the exporter obtains a decree from a competent court of law in the buyers' country in his favour.
- Causes inherent in the nature of the goods.
- Buyer's failure to obtain necessary import or exchange authorization from authorities in his countr
- Insolvency or default of any agent of the exporter of the collecting bank.
- Loss or damage to goods, which can be covered by general insurers.
- Exchange rate fluctuation.
- Failure of the exporters to fulfill the terms of the export contract or negligence on his part.
- Non payment under LC due to any discrepancy pointed out by the LC opening bank.

This policy is issued for a period of 12 months,

Specific Shipment Policies – Short-Term

The Specific Shipment Short-Term Policies provides cover against commercial and political risks involved in export of goods on short-term credit not exceeding 180 days. Cover under these policies can be taken for shipment(s) made/to be made by the exporter to a buyer under a contract. These policies can be availed of by exporters who do not hold Comprehensive policy covering shipments in the specific contracts.

Short-term policies could be:

- Specific shipments policy covering commercial and political risks
- Specific shipments (political risk) policy, to cover only political risk 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, and
- Specific Shipments (insolvency and default of L/C opening bank and political risks) Policy.

Commercial risks covered by the Short-Term policies, include:

- Insolvency of the buyer,
- Failure of the buyer to make the payment due within a specified period normally 4 months from the due date,
- Buyers' failure to accept the goods (subject to certain conditions).

Political risks covered under this policy are:

- Imposition of restrictions by the Government of the buyer's country or any Government action, which may block or delay the transfer of payment made by the buyer,
- War, civil war, revolution or civil disturbances in the buyer's country,
- New import restrictions or cancellation of a valid import licence, interruption of voyage outside India, resulting in payment of additional freight or insurance charges which cannot be recovered from the buyer,
- Any other cause of loss occurring outside India, not normally insured by general insurers and beyond the control of both the exporter and the buyer.

Short-Term policies do not cover following losses:

- Commercial disputes including quality disputes raised by the buyer unless the exporter obtains a decree from a competent court of law in the buyer's country in his favour,
- Causes inherent in the nature of goods,
- Buyer's failure to obtain necessary import or exchange authorization from authorities in his country,
- Insolvency or default of any agent of the exporter or of the collecting bank,
- Loss or damage to goods,
- Exchange rate fluctuation,
- Failure of the exporter to fulfill the terms of the export contract or negligence on his part.

Exports (Specific buyers) Policy

Exports-Buyerwise Policies – Short Term (BP-ST) provides cover to Indian exporters against commercial and political risks involved in export of goods on short-term credit to a particular buyer. All shipments to the buyer in respect of whom the policy is issued will have to be covered However, there is a provision to permit exclusion of shipments under LC. These policies can be availed of by exporters who do not hold Standard Policy and also by exporters already having Standard Policy. These policies are of three types:

- Buyerwise (commercial and political risks) Policy – short-term.
- Buyerwise (political risks) Policy – short-term.
- Buyerwise (insolvency & default of L/C opening bank and political risks) Policy short-term,

Buyer Exposure Policy

- A variant to this policy is Buyer Exposure policy, which is specifically designed for large exporters to enable them to cover their exposure on a particular buyer on the basis of expected exposure. **Two types of exposure policies** – one for covering the risks on a specified buyer and another for covering the risks on all buyers – are offered.

Export Turnover Policy

- **Export Turnover policy is a variation of the standard policy for the benefit of large exporters who contribute not less than Rs. 10 lacs per annum towards premium**. Therefore, all the exporters whose turnover is likely to **exceed the premium payable to ECGC by Rs. 10 lacs in a year are entitled to avail of it.**

ECGC'S Products For Banks

- While it is essential that exporters continue to get timely and adequate export credit both at pre-shipment and post-shipment stage, so that the best possible potential for exports can be realized, banks will be willing to release such facilities freely only if the advances are utilized properly and realized in time.
- ECGC, with the intention of giving protection to the bankers against losses on account of their financial lending to their exporter clientele, has been providing credit insurance to financial institutions/banks.
- This in turn leads to an additional security for the bankers and thus translates into adequate financial support to exporters. ECGC issues following types of insurances looking to the various needs of exporters/financial institutions

- Packing Credit Insurance
- Export Production Finance Guarantee
- Post-shipment Export Credit Insurance
- Export Finance Guarantee
- Export Performance Guarantee
- Export Finance (Overseas Lending) Guarantee

Packing Credit Insurance

- Any loan given to an exporter for the manufacture, processing, purchasing or packing of goods meant for export against a firm order or letter of credit qualifies for packing credit guarantee.
- It is issued for a **period of 1 year against a proposal made** for the purpose and covers all advances that may be made by the bank during the period to a given exporter within an approved limit.
- The claim is payable, in case the pre-shipment credit granted is not paid within 4 months from the due date of the loan.
- Export Credit Insurance for Banks (Whole turnover – Packing Credit)-ECIB (WT-PC), is issued by ECGC to banks wherein a higher percentage of cover is available

at a lower premium since a large volume of business is offered to cover in this guarantee.

- Bank is required to notify the limits sanctioned to their exporter customer within 30 days of the sanction and banks are required to take the approval of the Corporation if they exceed an agreed value, called the Discretionary limit.
- The premium on WTPC insurance is borne by the exporters.

Export Production Finance Guarantee

- This guarantee covers the advances given by banks against incentives/receivable at the Pre-shipment stage.
- While the extent of cover and the premium are the same as for packing credit insurance, banks having ECIB (WT-PC) are eligible for concessional premium rate and higher coverage.

Post-Shipment Export Credit Insurance

- A bank or a financial institution dealing with foreign exchange is eligible to obtain this Whole-turnover Cover for all its accounts (ECIB – WT-PS). The period of cover is 12 months and all post-shipment advances granted to exporters by way of purchase/discount/negotiation of export documents or advances granted against export bills sent on collection basis, as per RBI guidelines are eligible to be covered by this insurance.
- The insurance protects banks against losses that may be incurred in extending post-shipment advances due to protracted default or insolvency of the exporter-client.
- The extent of cover varies from 90% to 95% in respect of exporters who are Policyholders of ECGC and 50% to 75% for non-Policyholders, depending upon the claim premium ratio of the bank.
- For bills drawn on Associates of Policyholders coverage is 60% and of non-Policyholders it is 50%.
- The premium on WTPS insurance is borne by the Banks.

Export Finance Guarantee

- When banks grant post-shipment advances to their exporters against export incentives receivables in the form of cash assistance, duty drawback, etc., it can be covered under this guarantee.

Export Performance Indemnity

- It is issued by ECGC in the nature of a counter guarantee to the bank against possible losses that they may suffer on account of the guarantees issued by them on behalf of its exporter clients.

- Guarantees are required to be issued on account of exporters clients, in favour of overseas buyers, for performance of contracts, Bid-bonds, quality, etc.
- Guarantees are also required in favour of customs, for import of capital as well as raw material free of customs duty, or on reduced duty, against export commitments.

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.
- The premium on such guarantee are payable in Indian Rupees.

Other Special Guarantees and Schemes

Exchange Fluctuation Risk Cover Scheme

- The cover under the scheme is available for payment **scheduled over a period beyond 12 months up to a maximum period of 15 years.**
- Cover under the scheme is available for payments specified in US dollar, Pound Sterling, EURO, Japanese Yen, Swiss Francs, UAE Dirham and Australian Dollars.
- However, cover can be extended for payments specified in other convertible currencies at the discretion of the ECGC.
- The contract cover provides a deductible of 2%. Loss or gain within a range of 2% of the reference rate will go to the exporters' account.
- If loss exceeds 2%, then ECGC will make good the portion of loss in excess of 2%, but not exceeding 35% of the reference rate.
- In other words, gains/losses up to 2% and beyond 35% of reference rate will be to the exporters' account.
- Gains or losses over 2% and up to 35% will be to ECGC's account.

Maturity Factoring

- ECGC's full-fledged factoring service takes care of the export credit guarantee for the exporters, besides their financing needs. Factoring service covers financing and collection of series of receivable transactions between the buyer and the seller. It also includes credit protection, thereby improving exporter's cash flows.

ECGC factoring service provides:

- ✓ Facilitates purchase of account receivables.
- ✓ Provides up to 90% finance against approved transactions.
- ✓ Full credit guarantee on buyer's default or insolvency.
- ✓ Maintenance of sales ledger.

- ✓ Follow-up for collection of export proceeds.

Eligibility:

- ✓ Exports with good track record.
- ✓ Dealing on DA terms/open account terms with buyers.
- ✓ Having unexpected bulk orders to execute.
- ✓ Exporters facing large working capital shortfall by way of bill financing.

The facility allows exporters to avail additional finance, eliminates the need for routing export bills through commercial banks and also the need for following up with the buyers for payments. Export factoring also reduces the administrative costs to the exporters.

Insurance Cover for Buyer's Credit and Line of Credit

- ✓ Buyer's Credit is a credit extended by a bank in India to an overseas buyer enabling the buyer to pay for machinery and equipment that he may be importing from India for a specific project.
- ✓ A Line of Credit is a credit extended by a bank in India to an overseas bank, institution or government for the purpose of facilitating import of a variety of listed goods from India into the overseas country.
- ✓ ECGC has evolved schemes to protect the lending banks from certain risks of non-payment.
- ✓ These covers take the form of an agreement between the lending bank and ECGC and are issued on a case to case basis.
- ✓ Credit terms and the length of the credit period should be in conformity with what is appropriate for the export of the relevant items.
- ✓ Risks Covered: Political and Loss Coverage is 90%. Period of Cover can be as per the agreement.

Overseas Investment Insurance Cover

- ECGC has evolved a scheme to provide protection for Indian Investments abroad.
- Any investment made by way of equity capital or untied loan for the purpose of setting up or expansion of overseas projects will be eligible for cover under investment insurance.
- The investment may be either in cash or in the form of export of Indian capital goods and services.
- 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.

Main features of the Overseas Investment Insurance

- ✓ For investment in any country to qualify for investment insurance, there should preferably be a bilateral agreement protecting investment of one country in the other.
- ✓ ECGC may consider providing cover in the absence of any such agreement provided it is satisfied that the general laws of the country afford adequate protection to the Indian investments.
- ✓ The period of insurance cover will not normally exceed 15 years in case of projects involving long construction period. The cover can 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.

Only political Risks are covered as under:

- ✓ War, Civil War, Revolutions in buyer's country
- ✓ Expropriation
- ✓ Restrictions on remittances
- ✓ Loss Coverage is up to 90%.
- ✓ Cover is available up to 15 years, expandable up to 20 years with reduced insured amount and reduced
- ✓ loss coverage with proportionate reduction in premium.

Customer Specific Policy Cover

- In order to cater to the specific need for export credit insurance cover, of reputed large value exporters which otherwise could not be fully addressed under any one of standard products, the **customer specific policies have been introduced and are issued to large exporters on a selective basis on the** merits respective requests for such cover.
- Normally such policies are issued without changing the basic risk cover profile of the export transaction.

Some of the features of customer specific policies are as under:

- ✓ Policies can be issued combining feature of more than one standard type (Off the shelf) policies;
- ✓ Policies are issued with the base cover of an appropriate standard policy with added feature from other standard policies if required;
- ✓ Customer specific policies are considered only in respect of cases where anticipated **annual premium is more than Rs. 10 lakhs.** The customer's policies are issued in line with **the credit insurance covers approved by IRDA**.

CLAIMS

- Exporters to submit the claim forms within 12 months from the due date of the unpaid bills and ensuring that the premium on the policies are up to date.
- Claims will not be settled by ECGC for more than four buyers during the policy period.
- Claims will be paid directly to the Bank who had handled the export documents.
- Bank can appropriate the claim amount directly to post shipment advance account, if any.
- Settlement of claim amount by ECGC does not relieve the Exporter of the responsibility of realizing the proceeds and all further recoveries to be shared with ECGC on a pro-rata basis as and when received.

CAIIB AFM Module A Unit 8: Exim Bank - Role, Functions and Facilities

Exim Bank – Role, Functions And Facilities

The EXIM Bank of India was established in 1981, under the **Export Import Bank of India Act 1981**, an Act of Parliament, as a principal financial institution for providing financial assistance and services and country, especially on a long-term basis. It arranges lines of credit to other Governments, for promoting exports for coordinating the functions of institutions engaged in financing of export import trade in the of goods made in India.

The functions and operations of Exim Bank evolve around following philosophy:

- To make India's exports internationally competitive, by offering finance at competitive rates and conditions.
- To develop alternate financing solutions.
- To provide data, information and advice for new export opportunities to Indian exporters.
- To provide selective production, marketing and financing for Indian products to make them internationally competitive.
- To respond to export problems of Indian Exporters and pursue policy resolutions.

EXIM Bank Products

Buyer's Credit:

- **Buyer's Credit is a credit facility programme that motivates Indian exporters to explore new geographies** Through this programme, the overseas buyer can open a letter of credit" in favour of the Indian exporter and can import goods and services from India on deferred payment terms.

Corporate Banking:

EXIM Bank offers various financing products to Corporates as under:

- Research & Development Finance for Export Oriented Units
- Pre-Shipment/Post-Shipment Credit Programme
- Lending Programme for Export Oriented Units
- Import Finance Programme
- Production Equipment Finance Programme
- Financial assistance to Special Purpose Vehicles (SPVs) of a cluster of SMEs
- Lending Programme for Financing Creative Economy
- Finance for Grass Root Enterprises

Lines of Credit:

- **EXIM Bank have been extending Lines of Credit (LOC) to enable Indian exporters to enter new geographies or expand their business in existing export markets without any payment risk from overseas importers.** They lay special emphasis on extending LOC as an effective market entry tool as well as a means of market diversification for Indian exporters.

Overseas Investment Finance:

- EXIM Bank helps in enhancing export opportunities for India and driving the economic growth of the nation. They encourage and facilitate conditions for Indian companies to invest abroad for seeking resources, markets, efficiencies and strategic assets.

Project Exports:

- EXIM Bank has been one of the prime drivers in encouraging project exports from India; and has enabled Indian companies to secure contracts across various geographies over the past three decades and supplement the development objectives of host countries.

They extend funded and non-funded facilities to the following export of projects and services:

- Civil Engineering and Construction Projects

- Turnkey Projects
- Technical and Consultancy Service Contracts
- Supplies

Other Services and Programmes

- **Consultancy and technology services** wherein Indian consultants are assisted by way of long term financial assistance, manpower and expert recruitment, preparation of project reports, plans, transfer of technology, etc.
- **Overseas investment finance** wherein corporates interested in joint ventures abroad, are provided equity finance by Exim Bank. The equity participation can be by way of export of plant and machinery, for which long-term export finance is considered by Exim Bank.
- **Import loans** for financing imports from third countries for projects to be executed in foreign countries.
- **International merchant banking services** include foreign currency financing and advisory services for raising low cost finance for projects abroad to be executed by Indian companies.
- **Export Marketing Fund (EMF)**: Exim Bank is the nodal agency, designated by the Government of India (GOI), to manage the Export Marketing Fund (EMF) to accelerate the export growth of target products with industrialized markets. EMF-1 was a component of World Bank loan to India of USD 250 million for Industrial Export (Engineering products) project, while EMF-2, amounting to USD 37 million is a component of a World Bank loan to India for export development. EXIM Bank has also launched Export Marketing Finance EMF-3 from its own resources.

The activities which are eligible for EMF support include:

- ✓ Desk research
- ✓ Overseas field market research
- ✓ Minor product adaptation
- ✓ Overseas travel
- ✓ Product inspection services
- ✓ Training

Establishing overseas operations:

- ✓ Travel to India by overseas buyers
- ✓ Front-end promotional expenditure
- ✓ Research and development
- ✓ Equipment for plant modernization/capacity enhancement
- ✓ Tooling, jigs and fixtures
- ✓ Testing quality control equipment

Product Liability Insurance (PLI): In developed countries product liability consciousness of the public is very high, resulting in a large number of litigation and high awards.

Export Vendor Development Lending Programme (EVDLP): Manufacturer, exporters and trading export houses source goods from vendors for export on a regular basis.

EXIM Bank line of credit programme for other countries:

- Under this route, EXIM Bank grants line of credit to governments of other countries, for supporting their development plans, which allows the Indian exporter to get instant credit from EXIM Bank, upon exporting the goods/services and submission of export documents through their regular bankers.
- The beneficiary government gets **a long tenor of say 3-5 years to** pay for the products and services, thus allowing them deferred payment credit.

Reserve Bank of India - Role and Exchange Control Regulations In India

Reserve Bank of India, being the central bank of the country, is empowered under the statute to control and regulate the foreign exchange reserves and policies related to international trade, inflow/outflow of foreign exchange, as also has supervisory powers over the persons authorized to deal in foreign exchange.

FEMA Regulations

As per Section 11(1) of FEMA 1999, Reserve Bank of India, is empowered to issue any direction with regard to making payment or doing or desist from doing any

act relating to foreign exchange or foreign security, for the purpose of securing compliance with the provisions of the FEMA, and any rules, regulations, notifications or directions made thereunder.

Under Section 11(3) of FEMA 1999 RBI may, after giving reasonable opportunities of being heard, impose on the **authorized person a penalty which may extend to Rs. 10,000.00 (Rupees Ten thousand) for contravention of any direction given under FEMA or failure** to file any return under this Act. In case of continuing contraventions, an additional penalty, which may extend up to Rs. 2,000.00 per day, for which such contravention continues, may be imposed.

The data is to be submitted to RBI in the form of returns/statements, some of which are:

- **R Return -** Bank-wide single return of fortnightly data on forex operations
- **BAL Statement -** statement showing balances in NOSTRO, VOSTRO accounts
- **STAT 5 -** data on transactions related to FCNRB deposits
- **STAT 8 -** data on transactions in NRE and NRO deposit accounts
- **NRDCSR -** consolidated data on non-resident deposits
- **International Banking Statistics** - quarterly data on all international assets and liabilities
- **Statement of Remittances sent under Liberalized Scheme for Residents** - Monthly. Under the RBI's Liberalized Remittance Scheme, Authorized Dealers can allow remittances by resident individuals up to USD 2,50,000 per Financial Year (April-March) for any permitted current or capital account transaction or a combination of both. The Scheme is not available to corporates, partnership firms, HUF, Trusts, etc.
- **Statement of Trade Credit** - Buyer's Credit and Supplier's Credit – Monthly
- **XOS –** half-yearly exports outstanding statements, showing all overdue exports bills remaining unrealized. With effect from March 01, 2014, details of all export outstanding bills can be obtained from the EDPMS. AD category - I banks were, however, required to report the old outstanding bills prior to March 01, 2014 in XOS on half yearly basis as at the end of June and December every year.

- **BEF -** statement showing details of imports where remittances have been effected but proof of imports (bill of entry) not submitted by the remitter. However, after introduction of IDPMS, submission of BEF statement has been discontinued and the data of pending Bills of Entries are available to RBI, through the IDPMS system.
- **FEMIS -** daily data on forex dealing room operations.
- **ECB-2 -** Reporting of actual transactions of External Commercial Borrowings (ECB) under Foreign Exchange Management Act, 1999 (for all categories and any amount of loan)

Foreign Exchange Management Act, (FEMA) 1999

FEMA, 1999 was enacted by the statute of the parliament, and was brought into force w.e.f. 1.6.2000. The Act is applicable to all transactions in foreign exchange, undertaken in India or by persons resident in India.

Earlier **Foreign Exchange Regulation Act 1973 (FERA, 1973) regulated the area of foreign exchange,** which had its origin from Defence of India Rules 1935, and later on FERA 1947. The foreign exchange regulations have come a long way since 1935, 1947 and 1973, and with the introduction of a liberalized regime under FEMA 1999, there has been a considerable relaxation in regulatory provisions related to foreign exchange transactions.

The objective of FEMA is to facilitate external trade and payments and to promote the orderly development and maintenance of foreign exchange markets in India, while the objective of FERA was to conserve the foreign exchange resources of the country and to ensure proper utilisation thereof in the interests of the economic development of the country.

Remittances which Require prior Approval of the Government (Schedule II)

Purpose of Remittance	*Ministry/Department of Govt. of India whose approval is required*
1. Cultural Tours	Ministry of Human Resource Development, (Department of Education and Culture)
2. Advertisement in foreign print media for the purposes other than promotion of tourism, foreign investments and internatioal bidding (exceeding USD 10,000) by a State Government and its Public Sector Undertakings	Ministry of Finance (Department of Economic Affairs)
3. Remittance of freight vessel chartered by a PSU	Ministry of Surface Transport (Chartering Wing)
4. Payment of import through ocean transport by a Govt. Department or a PSU on c.i.f. basis (i.e. other than f.o.b. and f.a.s. basis)	Ministry of Surface Transport (Chartering Wing)
5. Multi-modal transport operators making remittance to their agents abroad	Registration Certificate from the Director General of Shipping
6. Remittance of hiring charges of transponders by (a) TV Channels (b) Internet Service Providers	Ministry of Information and Broadscating Ministry of Communication and Information Technology
7. Remittance of container detention charges exceeding the rate prescribed by Director General of Shipping	Ministry of Surface Transport (Director General of Shipping)
8. Omitted	
9. Remittance of prize money/sponsorships of sports activity abroadby a person other than International/National/State levels sports bodies, if the amount involved exceeds USD 100,000	Ministry of Human Resource Development, (Department of Youth Affairs and Sports)
10. Omitted	
11. Remittance for membership of P&I Club	Ministry of Finance (Insurnace Division)

Foreign Travel

The main provisions with regard to foreign travel are:

- Drawal of exchange for travel to Nepal and Bhutan is prohibited.
- Payment in rupees for purchase of foreign exchange may be done in cash, if the rupee equivalent is not more than Rs. 50,000.
- In case the rupee equivalent exceeds Rs. 50,000, the payment should be made by crossed cheques, a banker's cheques or a pay order or a demand draft or through NEFT/RTGS.
- Out of the total foreign exchange drawn, foreign currency notes and coins can be given by the authorized dealer, up to: (a) the entire amount in case of travel to

Islamic Republic of Iran, Russian Federation or other states of erstwhile Russia, (b) Up to USD 5,000 for travel to Libya or Iraq, and (c) not exceeding USD 3,000 in all other cases.

- A person resident in India can possess or retain foreign currency notes up to USD 2,000 or its equivalent, subject to specific rules on acquiring of such foreign exchange. However, a resident can possess foreign currency coins without any limit.

(vi) While selling foreign exchange for travel abroad, the passport of the traveler need not be endorsed, unless specifically requested for by him.

The traveler should surrender unspent foreign exchange within 180 days from the date of return.

The unspent foreign exchange can be deposited by the resident in the Resident Foreign Currency Account (RFC), with any Authorized Dealer.

Other Remittances

FEMA also allows residents to make remittances for following purposes also:

- **Gift remittance** per remitter/per donor up to USD 250,000 in one financial year, to relatives, friends, etc., abroad.
- **Donation** per remitter/per donor up to USD 250,000 in one financial year to charitable/religious cultural organisations.
- **Subscription to Magazines/Periodicals** can be allowed by the Authorized Dealers, except for the banned/proscribed magazines.
- **Consultancy Services** USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,00,000 per project for any other project.
- **International Debit/Credit Card ATM Card**: Residents can use their Credit/Debit or ATM cards while on visits abroad, which can be paid off through the designated AD branch, up to the entitlement of foreign exchange for visits abroad.

Prohibitions:

- Remittance out of lottery winnings.
- Remittance of income from racing/riding etc., or any other hobby.
- Remittance for purchase of lottery tickets, banned proscribed magazines, football pools, sweepstakes, etc.

- Payment of commission on exports made towards equity investment in Joint Ventures/Wholly owned Subsidiaries abroad of Indian companies.
- Remittance of dividend by any company to which the requirement of dividend balancing is applicable.
- Payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.
- Payment related to Call Back Services of telephones.
- Remittance of interest income on funds held in Non-Resident Special Rupee (Account) Scheme.

Indian Investments Abroad

From FERA 1973 - which had its main aim to conserve foreign exchange, India moved to FEMA 1999, which had its motto to facilitate external trade and payment and to maintain orderly growth of exchange markets. Section 6(3) of FEMA also authorised RBI to regulate the transfer or issue of any foreign security by a person resident in India and the classes of permissible Capital a/c transactions & limit up to which exchange is admissible, (in consultation with Central Government)

(ii)For Indian investments abroad, FEMA Notification No 1920 - RB - 2000 dated 3rd May 2000 - Transfer or Issue of any Foreign Security - As amended by various notifications, as also directions issued by way of AP (Dir Series) Circulars, are applicable.

(iii) Extant guidelines/regulations prohibit following investments abroad:

- Investments in Real Estate and Banking
- Investments by Indian Entity Caution Listed - under investigation by the Enforcement Directorate - Defaulter to the Banking system etc.
- Investments by Trusts

(iv)Indians can invest abroad by way of:

- **Joint Venture:** A foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment.
- **Wholly Owned Subsidiary:** A foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the India party.

(v)Eligible investors

Corporates including registered partnership firms

- Individuals
- Mutual funds

Foreign Currency Account in India

Resident Indians can maintain following foreign currency accounts in India:

Exchange Earners Foreign Currency (EEFC) Accounts

- Resident persons, companies or firms can open and maintain EEFC accounts, for the purpose to transacting foreign exchange business. Every recipient of foreign exchange is allowed to retain 100% of the amount in a foreign currency account, with any AD.

Resident Foreign Currency (RFC) Accounts

- Returning Indians, who were non-residents earlier and are now returning to India for permanent settlement, are permitted to open a foreign currency account with any AD, to keep their foreign currency assets held outside India, or any other monetary benefits from the employer outside India.

Resident Foreign Currency (Domestic) Account - RFCD

- **A person resident in India is allowed to open and maintain a Resident Foreign Currency account with an AD,** out of the foreign exchange acquired by him in the form of currency notes, or travellers cheques, while on a visit to any country outside India, (not from business), or as an honorarium or gift for service rendered in India to any person who is not a resident of India, and is on a visit to India, or represent unspent foreign exchange acquired for travel abroad.

Diamond Dollar Account (DDA)

- **The facility of opening Diamond Dollar Accounts has been granted to diamond exporters, as the products they export is imported in raw form, from abroad**. India imports, rough diamonds and exports polished diamonds to various countries in the world. As such, since the diamond exports usually need to remit a large part of their realisation of export proceeds for payment of import bills, they can park their foreign currency funds in these Diamond Dollar accounts and remit funds to retire their import bills, without incurring any exchange risk.

Role of FEDAI and FEDAI Rules

About FEDAI

Foreign Exchange Dealers Association of India (FEDAI) a Self Regulatory Organization (SRO), was formed in August 1958 with the approval **of Reserve Bank of India**, to take over certain functions then undertaken by the Exchange Banks' Association (foreign banks) operating at Mumbai, Kolkata, Chennai, Delhi and Amritsar.

It was set up as an Association of banks dealing in foreign exchange in India (typically called Authorised Dealers - ADs) and incorporated **under Section 25 of The Companies Act, 1956.** Its major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market.

Presently some of the functions of FEDAI are as follows:

- Guidelines and Rules for Forex Business.
- Training of Bank Personnel in the areas of Foreign Exchange Business.
- Accreditation of Forex Brokers.
- Advising/Assisting member banks in settling issues/matters in their dealings.
- Represent member banks on Government/Reserve Bank of India/Other Bodies.
- Announcement of daily and periodical rates to member banks.

The FEDAI rules (9th edition) UPDATED UPTO 30112016, presently applicable to authorised dealers are as under:

General Guidelines/Instructions

- The directives issued by the Reserve Bank of India in respect of interest rates on Export & Import finance shall be adhered to by the Authorised Dealers.
- The member banks are totally free to determine their own charges for various types of forex transactions, keeping in view the advice of RBI that such charges are not to be out of line with the average cost of providing services.

- With a view to simplifying and liberalising import authorised dealers are permitted to open standby letters of credit on behalf of their importer constituents for importing goods into India, permissible under Foreign Trade Policy. RBI in terms of its AP (Dir Series) Circular No.84 dated 3rd March 2000 permitted authorised dealers to open standby letters of credit subject to adherence to the guidelines issued by FEDAI.
- Banks should prominently display their card rates for foreign currencies on their website and/or their B Category branches. Banks should also declare threshold amounts up to which they are committed to apply card rates.
- Information regarding various forex related programmes, exchange rates advised at various times, important circulars issued by FEDAI etc.
- FEDAI reference to Authorised Dealer is the reference to all Authorised Dealers (Category-1) banks and other Financial Institutions who are members of FEDAI, wherever applicable.

Interest for delayed delivery

In the event of late delivery of any currency (including Indian Rupee) in foreign exchange contract, interest for the number of days of delay (regardless of the causes for delay) shall be payable by the seller-bank**. The interest for the overdue period shall be payable at the rate of 2% over the benchmark rate of the currency concerned.** The benchmark rates for the currencies are listed below:

- INR-NSE - MIBOR overnight rate
- STG-Base rate of Barclays Bank
- USD - Prime rate of Citibank NA
- EUR - Marginal Lending Facility rate of European Central Bank
- JPY- Prime rate of Bank of Tokyo-Mitsubishi UFJ Ltd.
- CHF - 3 month rate of Swiss National Bank
- CAD-Prime rate of Bank of Nova Scotia

In case of transactions in currencies not mentioned above, the seller bank shall pay interest at 2% over notional overdraft rate payable by the buyer bank. The rate of interest applied would be the average rate based on rates on each day of delay.

Short Notes on Other Topics

External Commercial Borrowings

External Commercial Borrowings (ECBs) are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, and non-permitted end-uses, maximum all-in-cost ceiling, etc. The parameters apply in totality and not on a standalone basis.

The framework for raising loans through ECB, comprises the following three tracks:

- **Track I:** Medium term foreign currency denominated ECB with minimum average maturity of 35 years
- **Track II:** Long term foreign currency denominated ECB with minimum average maturity of 10 years.
- **Track III:** Indian Rupee (INR) denominated ECB with minimum average maturity of 375 years.

Forms of ECB: The ECB Framework enables permitted resident entities to borrow from recognized non-resident entities in the following forms:

- Loans including bank loans
- Securitized instruments (e.g. floating rate notes and fixed rate bonds, non-convertible, optionally convertible or partially convertible preference shares/debentures)
- Buyers' credit
- Suppliers' credit
- Foreign Currency Convertible Bonds (FCCBs)
- Financial Lease
- Foreign Currency Exchangeable Bonds (FCEBs)

American Depository Receipts (ADRs)

Introduced to the financial markets in 1927, an American depositary receipt (ADR) is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on American markets just like regular stocks, and are issued/sponsored in the U.S. by a bank or brokerage.

- **Unsponsored ADRs** : This is an arrangement which is not initiated by the company concerned, but is generally set up by one or more US brokers. Unsponsored shares trade on the over-the-counter (OTC) market. These shares are issued in accordance with market demand, and the foreign company has no formal agreement with a depositary bank. Unsponsored ADRs are often issued by more than one depositary bank. Each depositary services only the ADRs it has issued.

- **Sponsored ADRS**: In this case the issuing company actively promotes the company's ADRs in the USA, choosing a single depository bank, which assumes sole responsibility for administration and dividend payment. In this case, the administrative costs involved in issuing the ADRs are borne by the issuing company. The proceeds of the ADR issue are also received by the company.
- **Global Depository Receipts (GDRs)** : A global depositary receipt (GDR) is a bank certificate issued in more than one country for shares in a foreign company. The shares are held by a foreign branch of an international bank. The shares trade as domestic shares but are offered for sale globally through the various bank branches. A GDR is a financial instrument used by private markets to raise capital denominated in either U.S. dollars or euros.
- **Foreign Currency Convertible Bonds (FCCB)** : Foreign currency convertible bonds (FCCBs) are a special category of bonds. FCCBs are issued in currencies different from the issuing company's domestic currency. Corporates issue FCCBs to raise money in foreign currencies. These bonds retain all features of a convertible bond, making them very attractive to both the investors and the issuers.
- **Foreign Currency Exchangeable Bonds (FCEBs):** Until 2008, the only options available for an Indian corporate to raise overseas debt were either by way of external commercial borrowings ('ECBs') or by way of foreign currency convertible bonds (FCCBs'). There was, however, no mechanism whereby the promoters of Indian companies could unlock value in their group companies to raise funds abroad. On February 15, ’08, Finance Ministry notified the scheme for the issue of Foreign Currency Exchangeable Bonds Scheme, 2008 (Scheme) allowing Indian companies to leverage value in their listed group companies by way of issue of Foreign Currency Exchangeable Bonds (FCEBs').

CAIIB Paper 3 (AFM) Module A Unit 9 - International Financial Service Centre (IFSC), GIFT City

Introduction

An International Financial Service Centre (IFSC) caters to customers outside the jurisdiction of the domestic economy.

Such centres deal with flows of finance, financial products and services across the borders with emphasis on the following:

- Fund raising services for Individuals, Corporates and Governments.
- Asset Management and Global Portfolio Diversification undertaken by pension funds, insurance companies and mutual funds.
- Wealth management.
- Global tax management and cross border tax liability optimization, which provides a business opportunity for financial intermediaries, accountants and law firms.
- Global and regional corporate treasury management operations that involve fund-raising, liquidity investment and management of asset-liability matching.
- ✓ Risk management operations such as insurance and reinsurance
- ✓ Merger and acquisition activities among trans-national corporations

Scope Of IFSC In India

- Banks in International Financial Service Centres operate as foreign banks in the home country and are not subject to domestic reserve requirements on deposits.
- They seek deposits from non-resident citizens and can extend loans only to non-residents.
- Banks in IFSCs are also permitted to lend in foreign currencies to both resident corporates (for trade transactions) and non-residents.
- The main objective of the IFSC is to develop a strong global connect and focus on the needs of the Indian economy as well as to serve as an international destination for the Corporates in their financial activities.
- **The SEZ Act 2005 (Special Economic Zones Act, 2005**) allows setting up an IFSC in an SEZ or as an SEZ after obtaining approval from the Central Government.
- India has many restrictions on the financial sector, such as partial capital account convertibility, high SLR requirements and foreign investment restrictions, an SEZ can serve as a testing ground for financial sector reforms before they are rolled out in the entire nation.
- Apart from SEZ related incentives, as per the **SEZ Act, there is an exemption from the Securities Transaction Tax levied u/s 98 of the Finance Act, 2004**, in case of taxable securities transactions that are entered into by non-residents through an IFSC.

Gujarat International Financial Technology Tec-City (GIFT City)

- ✓ Established at Gandhinagar, Gujarat
- ✓ Started functioning from 5th Dec 2019
- ✓ With 225 companies including 3 PSBs, 9 Private. Sector Banks & 3 MNC Banks.

Opportunities At Gift City

- Access to large hinterland economy
- Access to international markets
- Connecting 30 Mn strong Indian diaspora which has a combined worth of USD 3 trillion to India through the IFSC
- Inbound and outbound gateway for international financial services
- Potential to be a leading destination for Global in-house Centers with a globally competitive cost structure
- Attracting global talent to the world class fin tech hub in Gift city
- Emerging as a leading hub for fund administration.

Key business opportunities – (segment-wise)

- **Wholesale banking** – ECB and Trade Finance., Factoring and Forfaiting Services, Guarantee and Indemnity business, Equipment leasing, Credit enhancement & Insurance, Risk Participation, Participation in Intl. trade finance services, Participation in aircraft leasing, syndicated loans.
- **Capital markets** – merchant banking, trading and clearing members of IFSC Exchange, funding of alternative investment funds, custodian of securities.
- **Retail Banking** – private banking, wealth management, retail banking products such as structured deposits, deposit accounts, certificate of deposits.
- **Treasury management** – ALM, Derivatives in Forex, Credit and interest rates, consolidate group-wise derivative trading, including NDF in INR and other foreign currencies to manage risk.
- **Other opportunities** – distributor of MF units, insurance and other financial products, Investment advisory services, Portfolio Management Services, trustee and fiduciary services Regional Administrative Office (RAD) and Representative office.

Guidelines For Setting Up Of IFSC Banking Units (Ibu) By Indian Banks

Eligibility –

- Indian banks viz., Banks in the Public Sector and the Private Sector authorized to deal in foreign exchange will be eligible to set up IBUs.
- Each eligible bank would be permitted to set up only one IBU in each IFSC.

Licensing –

- Eligible Banks interested in setting up IBUs will be required to obtain prior permission of the RBI for opening an IBU.

- For most regulatory purposes, an IBU will be treated on par with a foreign branch of an Indian bank.

Capital –

- The parent bank will be required to provide a minimum capital of USD 20 Mn or equivalent in any foreign currency to its IBU which should be maintained at all times.

Reserve requirements –

- The liabilities of the IBU are exempt from, both, CRR and SLR requirements of RBI.
- Resources and deployment – The funds raised will be from Non Residents and Overseas branches

Resources and deployment

- The funds raised will be from Non Residents and Overseas branches of Indian Banks.
- Deployment of funds can be with, both, persons resident in India as well as persons resident outside India.
- However, deployment of funds with persons resident in India shall be subject to the provisions of FEMA 1999.

Operational Aspects

- Cash transactions and savings bank accounts are not permitted. Deposits can be maintained in current accounts and term deposits.
- Indian KYC-AML and delinquency norms are applicable.
- Deposits with IBUs are not insured.

Role Of IFSCA

- International Financial Services Centres Authority (IFSCA) is a unified authority for the development and regulation of financial products, financial services and financial institutions in the IFSC in India.
- IFSCA has been established on April 27th 2020 under the IFSCA Act 2019 with headquarters in Gandhinagar, Gujarat.
- Since it requires a high degree of inter-regulatory coordination within the financial sector
- IFSCA has been established as a unified regulator with a holistic vision in order to promote ease of doing business in IFSC and provide world class regulatory environment.
- **Main objectives** : to develop a strong global connect and focus on the needs of the Indian economy as well as to serve as an international financial platform for the entire region and the global economy as a whole

Regulatory Framework

Indian and Foreign Banks intending to set up an IBU in IFSC are required to obtain license from IFSCA.

The Parent Bank is required to satisfy the following conditions:

- Maintain necessary regulatory capital subject to a minimum of USD 20 Mn at the Parent Bank level.
- Obtain No Objection letter from home country regulator for setting up an IBU in IFSC.
- Letter of comfort from Parent Bank regarding liquidity and resource support to IBU.
- IBUs are not required to maintain SLR and CRR.
- IBUs are required to maintain LCR and Net Stable Funding Ratio at IBU level. However, the same may be maintained at the parent level with IFSCA permission.
- Leverage ratio for IBUs may be maintained by the Parent Bank and at the level specified by the home regulator and subject to the regulations applicable to the parent bank.
- IBUs are required to maintain a retail deposit reserve ratio on daily basis at 3% of the deposits raised from individuals outstanding as at the end of the previous working day.
- IBUs are required to comply with the prudential directions and instructions issued by their home regulator unless otherwise specified by the IFSCA.

Permissible Activities At IBUs

- IBUs can undertake transactions with
- ✓ Residents (for deployment of funds)
- ✓ Non-residents entities other than individuals including HNIs/retail customers (for both raising of resources and deployment of funds).
- All transactions shall in currency other than INR.
- IBUs can deal with WOS/JVs of Indian companies registered abroad.
- IBUs are not allowed to open SB accounts.
- They can open foreign currency current accounts of units operating in IFSCs and of Non-resident institutional investors to facilitate their investment transactions.
- They can open foreign currency current accounts (including escrow accounts) of their corporate borrowers subject to FEMA.
- No cheque facility will be available for holders of current accounts in the IBUs.
- All transactions are to be done through bank transfers.
- IBUs are permitted to undertake factoring/forfaiting of export receivables.
- IBUs shall obtain prior approval of RBI for offering derivative products.
- IBUs are allowed to open foreign currency Escrow accounts of Indian resident entities for the purpose of temporarily subscriptions to GDR/ADR issues, until issuance of receipts.

- IBUs are allowed to act as underwriter/arranger of INR denominated Overseas bonds issued by Indian entities in Overseas markets.
- Exposure ceiling for IBUs shall be 5% of the parent's Bank Tier I Capital in case of Single borrower and 10% of the parent Bank's Tier I Capital in the case of a borrower group.
- All AML/CFT instructions issued by RBI to be followed.
- The IBUs will be regulated and supervised by the RBI.
- The IBUs would operate and maintain balance sheet only in foreign currency and will not be allowed to deal in Indian rupees except for having a special rupee account for the purpose of defraying their administrative and statutory expenses. Such operations/transactions of these units in INR would be through the AD (distinct from IBU) which would be subject to the extant foreign exchange regulations.
- IBUs are not allowed to participate in the Indian domestic call, notice, term, forex, money and other onshore markets and domestic payment systems.
- IBUs will be required to maintain separate Nostro accounts with correspondent banks which would be distinct from Nostro accounts maintained by other branches of the same bank.
- IBUs may maintain SNRR (Special Non-Resident Rupee) accounts with the domestic AD and these accounts must be funded only by foreign currency remittances through international channel.
- The loans and advances of IBUs would not be reckoned as part of the Net Bank Credit of the Parent Bank for computing priority sector lending obligations.
- No liquidity support will be available to the IBUs from the RBI.

Relaxations For The FPI (Foreign Portfolio Investors) Entities At Gift City

- SEBI has permitted FPIs registered in India to trade on exchanges operating in the GIFT City.
- FPIs are also allowed to trade in commodity derivatives on IFSC exchanges.
- Companies do not pay securities transaction tax or commodity transaction costs.
- All exchanges operate 22 hours a day and FPIs permitted to operate without any additional documentation.
- Waiver of short term capital gains tax on derivatives trade (at present FPIs pay 30% as short term capital gains tax.)
- Allowing retail investors to trade to build liquidity in the market.

CAIIB Paper 2 (BFM) Module A Unit 10: Technology in International Banking

Introduction To Digitization In International Banking – An Overview

- In the Banking industry, especially with regard to International Banking, technologies are revolutionizing the profile of the banking industry and tearing the barriers to entry and opening doors for new financial service providers.
- Competition from the startups, internet giants and the financial service providers from outside of banking, along with the increased regulations are forcing banks to accelerate their digital revolution.

Building a truly digital bank

- Rethinking customer experiences and developing efficient, effective operating models that facilitate an open ecosystem of the participants are enabled by the underlying processes, technologies and organizational structures.
- Many of the Banks who started with technology have started reengineering their architecture in order to support the updated developments in the field of digital banking, especially with regard to International banking.
- Banks need to space out their architecture based on their specific strategy and readiness to compete in the digital arena.
- Their efforts will need to be strategic in order to reach the objectives with available capital and within an acceptable time frame, thereby increasing the customer's experiences in all the areas of international banking which the customer is involved with.

- Digital strategy is based on a Bank's specific goal, vision and mission. The competitive content and target business model needs to be identified for digital reinvention.
- **Digital capabilities assessment**: identify the business and IT Capabilities that the Bank should develop based on the existing models, technology driven in those models, assess the current digital maturity and the gaps existing, to help define the overall digital capability.
- Alignment with the existing platforms and the changes required to support the desired digital maturity.
- Organization, processes, culture, assets, technology and architecture are all affected by the digitization process and should be transformed to support a bank's digital ambition.
- IT architecture alignment is a crucial element in the transformation of the operating models and the evolution of the Bank's business and IT architecture.
- The entire process re-engineering should involve traditional systems of engagement and also the current digital enablers used in the front-office, back office and the other operational systems so that the experience of the customers, post advancement, will increase thereby leading to increased business growth
- Once the go-ahead is decided, the digital re-engineering roadmap with the operating model, target architecture, bank's budget plan, resources and the risk appetite need to be defined along with the timelines, costs, resources, risks and the expected returns.

The following may be broad thoughts on upgrading the bank's digital re-engineering plans:

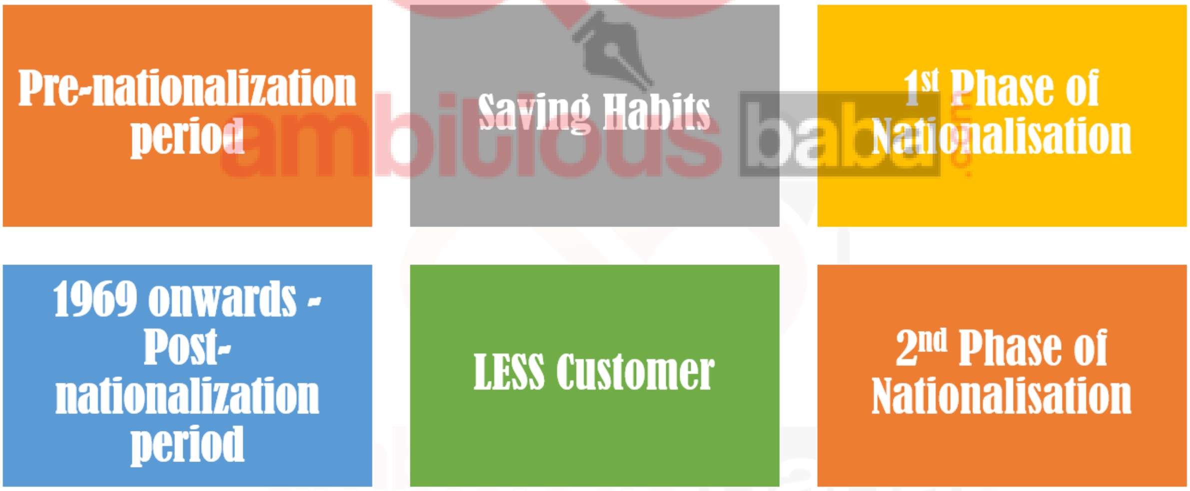
- Making the bank more relevant to Customers with more flexible financial and non-products.
- Relative benefits of speed vis-à-vis in-house talent.

- Developing the digital eco-systems and platforms that deliver traditional and non-traditional products to customers.
- Organization readiness to re-assigning, re-training and, if need be, recruiting additional resources.
- Becoming pro-active and agile to customers responses and market request.
- Self-assessment and driving team work to react to the changing market conditions and monitoring the progress at regular intervals and not simply following a plan.

Evolution Of Technology In International Banking

Technology has transformed the entire banking landscape in the past 5 decades and following is a brief takeaway on the stages in evolution of Banking technology in India.

- Pre-nationalization period – most of banking activities were manual in view of the fact that the country's population was illiterate.
- To take advantage of the increased savings habits and also the need for borrowing funds for the economic development, the customers increased their visit to the Bank's Branches for utilizing the manual services provided by the then Banks.
- To take advantage of the increased savings habits and also the need for economic development of the country and reaching the banking services to the nook and corner of the country, the Government under the Nationalization of Banks Act, nationalized 14 Banks into **government banks in 1969.**



- **1969 onwards - Post-nationalization period** – most of banking activities were centered around investment of surplus savings available with the population.
- Though the need for borrowing was prevalent, many of the customers were unable to reach out to the Banks and hence the lending by the financial intermediaries were the norm of the day who used to charge higher rates of interest for their lending.

- The country saw rapid progress through the nationalized banks and by 1980, the Banking Sector witnessed tremendous growth and appetite towards savings by the population who had surplus monies and borrowing by the community who had shortage of funds for their businesses increased.
- 1980 started the 2nd phase of nationalization wherein an additional 6 Banks were brought into the fold of the Government ownership.
- The hunger for technology in banking started during this period wherein the Banking sector wanted to take advantage of the technological developments that were witnessed across the global developed countries.
- There is no turning back since then and there has been good progress both in terms of business growth and the technological advancements in the banking space.
- What started as ALPMs (Advanced Ledger Posting Machine) in the 1980s got converted into the data entry machines which resulted into introduction of computers in Banking.
- To take advantage of Internet Banking, 1990s witnessed Banks taking strides into internet banking, ATMs, Credit Cards and the **Debit Cards, slowly the activities turned to on-line banking.**

Benefits And Limitations Of Technology In International Banking

Benefits: accuracy, speed, lower transaction costs ease of doing business, compliance, reduction in manpower, regulatory requirement, management Information system, continuity in business, etc.

Limitations: costs in Infrastructure, technical glitches, creating awareness amongst customers because of the widespread reach, putting in control limits for withdrawal and deposits may pose inconveniences to customers, customers service gets affected at times, security issues, cybercrime is on the increase and added to this is the frauds by external sources.

Digital Platforms In International Banking

Inward Remittances Online

- A secured portal for on-line inward remittances from across the Overseas locations.
- Online Money transfer from across the globe, by the NRIs from their country of location or any Overseas Bank from any country (FATF compliant countries) to any Bank account in India.
- NRIs to get registered on the Internet Banking Platform of their Bank and get the log-in ID and the password from the Bank subject to adhering to the internal guidelines of the Bank relating to registration.
- Register the receiver details, Bank details of the receiver, keep the receiver informed and book the transaction and the transfer the money.

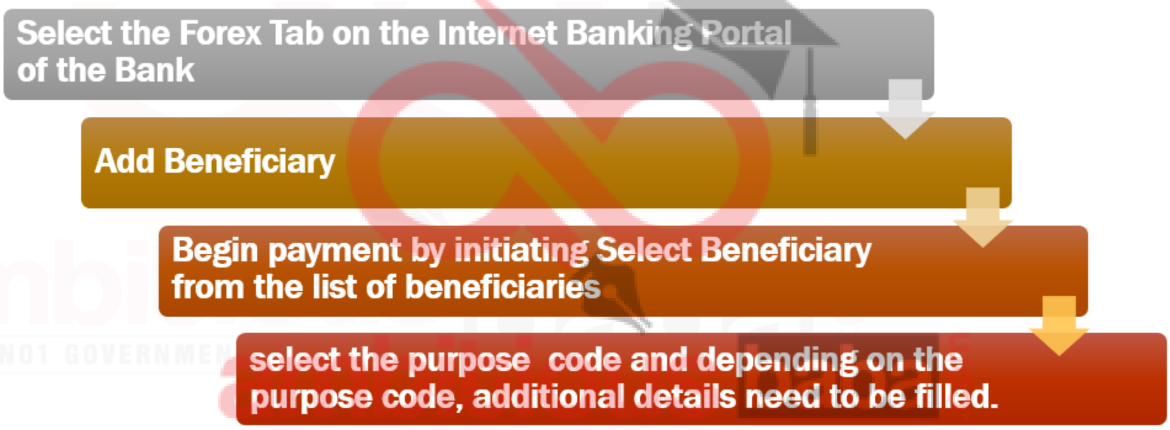
- Purpose code details to be filled in and many Banks only allow current account transactions and the regulatory guidelines needs to be adhered to be the remitter.

Benefits:

- Quick and seamless transfers from any country (as long as the country is FATF compliant),
- Fixed and fair exchange rates,
- 24/7 customer support.

Outward Remittances Online

- A quick and seamless on-line portal for outward remittances.
- Residents and NRIs, on request through an application form and subject to Bank's internal guidelines, will get on-boarded by the Bank for International Digital Banking.
- Log in ID and password generated by the Bank to the Customer's registered email-ID.
- Process flow



Banks may provide an internal control limit up to which the outward remittances can be initiated on line which would be well below the overall limit as prescribed under the regulatory guidelines

Status of the transaction initiated may be checked by the customer on-line including generating the MT 103. (Customer to Customer SWIFT transfer).

Benefits:

- Fast, easy and convenient way of outward remittances.
- Secure facility for transfer of money (in permissible currencies) via internet banking.
- All purposes as permissible under Schedule III remittances as per the provisions of FEMA and subject the permissible limits under the relevant provisions.

- Education, Family Maintenance, Self-transfer, Health services, NRE repatriation, etc., can be sent directly in beneficiary home currency (subject to permissible currencies) and facility available 24/7.
- World Check List (scrubbing the inward remittance (remitters) and the outward remittances (beneficiaries) to comply with the US/UN/FATF sanction and the related guidelines will also be complied by the Bank through these on-line portals.

Trade Finance Portal

- Web based online portal for International Trade transactions viz., Imports and Exports.
- A web based online trade portal of the Bank for the trade finance transactions which enables customers of the Bank to initiate, authenticate authorize trade finance transactions in a paperless environment making it a sustainable trading service.
- Anywhere, anytime banking for International trade transactions available on-line.
- All trade transactions relating to Imports (including Buyer's credit) and all trade transactions relating to Exports (including Pre-shipment and Post-shipment) may be handled on-line through the trade portal.

Benefits:

- Templated transactions and in compliance with the provisions relating to International Trade.
- Bulk upload facility available.
- Approval of the transactions by the corporate online through maker-checker facility.
- Copies of advices, ready reference to debit and credit entries, SWIFT copies available online.
- Details on limits sanctioned (LC/BG limits), limit availability, limits utilized, etc., available online.
- Role based dashboards, overview of pending actionable items viz., IDPMS, EDPMS, Forward contract confirmations, etc., available for different user categories.

Foreign Exchange Rate Portal

- Portal provided to the Corporates who meet the criteria set up by the Bank for getting on-boarded after getting the log-in ID and the password, as per the internal guidelines.
- Enables the corporates to directly log on to the Bank's Internet Banking Platform and access the Foreign Exchange Rate Portal.
- Corporates allowed to access the dealing room on a real-time basis for booking their foreign exchange requirements including Cash, tom, spot and forward contracts.

- Corporates confirming the deals through the portal are under obligation to comply with the regulatory guidelines with regard to submission of underlying documents.
- Non-compliance in respect of submission of documents will result in the deal automatically getting cancelled by the Bank and losses recovered from the Corporate in this regard.
- Banks insist for executing a one-time Indemnity agreement while on-boarding to indemnify the Bank for any losses that could arise from non-compliance of regulatory guidelines.

Benefits:

- Seamless interaction through the portal with the Bank's dealing room on rate movements.
- Advisory from the Bank's dealers on the Inter-Bank markets and the latest developments on the exchange front.
- Real time rate quotation basis.

Export Data Processing and Monitoring System (EDPMS)

The Reserve Bank of India (RBI) operationalized the Export Data Processing and Monitoring System (EDPMS) w.e.f. March 1, 2014 wherein the data pertaining to Export Declaration Forms (EDF)/ Shipping Bills (SB)/ SOFTEX would flow from the Customs/STPI/SEZ to the EDPMS Software and AD Banks were required to report lodgment and realization of these EDF/SB/SOFTEX in EDPMS.

Various enhanced versions of EDPMS with certain additional features which are supported through technology:

- Reporting of advance remittances related to exports.
- Reporting realization of EDF/SB/SOFTEX against inward remittances reported.
- System based caution listing of exporters whose EDF/SB/SOFTEX were outstanding beyond 2 years and where extension of due date was not granted by AD Bank/RBI.
- Issuance of e-BRC was introduced w.e.f. 16th Oct 2017, as a result of which AD Banks were to update the EDPMS with data of export proceeds on "as and when realized basis" to facilitate AD Banks to issue e-BRC only from the data available in the EDPMS.
- However, the export transactions relating to Service Exports are not supported under the EDPMS Platform.
- System based caution listing of exporters whose EDF/SB/SOFTEX were outstanding **beyond 2 years** and where extension of due date was not granted by AD Bank/RBI.
- Issuance of e-BRC [e Bank Realisation Certificate] was introduced w.e.f. 16th Oct 2017, as a result of which AD Banks were to update the EDPMS with data of export proceeds on "as and when realized basis" to facilitate AD Banks to issue e-BRC only from the data available in the EDPMS.

- However, the export transactions relating to Service Exports are not supported under the EDPMS Platform.

Import Data Processing and Monitoring System (IDPMS)

- In order to enhance ease of doing business and facilitate efficient data processing for payment of import transactions and effective monitoring thereof, IDPMS has been developed in consultation with the customs authorities and other stakeholders.
- Based on the AD Code declared by the importer, the Banks shall download the BoE (Bill of Entry) issued by EDI [Electronic Data Exchange] Ports from the BoE Master in the IDPMS.
- For non-EDI ports, AD Bank of the importer shall upload the BoE data in IDPMS as per message format "Manual BoE reporting" on a daily basis on receipt of BoE from the Customer/Customs office.
- **ADVANCE PAYMENT**: AD Banks will enter the BoE details for ORM associated with the advance payment for import transactions as per the message format "BoE Settlement.
- In case of payment after receipt of BoE, the AD Bank shall generate ORM (Outward Remittance Message) for import payment made by its importer as per the message format "**BoE Settlement".**
- Multiple outward remittances can be settled against single BoE and also multiple BoE can be settled against one Outward remittance.
- In case of Import of services, the IDPMS platform does not facilitate reporting of such transactions or remittances routed through the AD Banks.
- The AD Bank need to follow up with the Importer (for services) till such time the remittance towards which service imports are requisitioned are completed.

Fintech And Evolution Of Fintech In International Banking

Meaning and understanding FINTECH

- Fintech refers to the synergy between finance and technology.
- It can take the form of software, a service or a business that provides technologically advanced ways to make financial processes more efficient by disrupting traditional methods.
- Digitization of financial services, normally provided by Banks, Credit Card Companies, Credit Unions, Investment Banking and other businesses within the financial services industry.
- Used to automate investments, insurance, trading, banking services and risk management
- Fintech is equipping the banking industry with tools that makes it more efficient than before.
- Banking Institutions are using tools like the chat bots, to enhance customer experiences, mobile applications, etc to give the customers real time looks into their bank accounts and machine learning to secure against frauds.

- Fintech is a new Financial & technology Industry used to improve financial services activities.
- **FINTECH** is any innovative idea that improves financial service processes by proposing technological solutions according to different business situations, while the ideas could also lead to new business models or even new businesses.

Evolution of FINTECHs – A Snapshot

- **1866 –** the first transatlantic cable was successfully laid between New York and London providing fundamental infrastructure for the period of intense financial globalization. FINTECH Version 1.0
- **1918 –** FEDWIRE, the first electronic funds transfer with the help of telegraph and Morse Code
- **1950** – Diners Club and Amex Cards
- **1967 –** though financial services were strongly connected with technology, the financial services remained mostly analogue i.e. using signals, codes until the first ATM machine by Barclays was introduced thereby switching from Analogue mode to the Digital mode. This came to be known as the beginning of Modern FINTECH i.e. FINTECH Version 2.0
- **1967 –** first digital stock exchange and SWIFT (Society for Worldwide Inter-Bank Financial Telecommunication was established. Internet and Computers were brought into on-line banking.
- **2008 –** brought in FINTECH Version 3.0 as a result of the financial crisis that erupted across the globe where people start distrusting traditional banking services.
- **2009 –** Bitcoin introduced followed by other different crypto currencies. Google and Apple Pay introduces payment systems.
- **2010 -** FINTECH Version. 3.5 mainly by the Asian countries where Entrepreneurs, Investors, Consumer businesses and Banks were introduced to FINTECH and FINTECH business applications.

FINTECH - Global Perspective

- Global investments in FINTECH increased by more than 2200% from USD 930 Million in 2008 to more than USD 22 Billion in 2015.
- In Europe, USD 1.50 billion was invested in FINTECH in 2014 with London based companies receiving USD 539 Mn, Netherland based companies receiving USD 306 Mn, Sweden receiving USD 266 Mn, etc.
- FINTECH companies in USA raised USD 12.4 billion in 2018
- Sydney is the biggest FINTECH center and contributes 9% to the country's GDP.
- Monetary Authority of Singapore has pledged to spend USD 225 Mn in FINTECH in the next 5 years.
- South East Asian FINTECH companies have increased Venture Capital funding from USD 35 Mn to USD 679 Mn in 2018 and to USD 1.14 Billion in 2019.

FINTECH and India

- India has the highest FINTECH adoption rate globally.
- Of the 2,100 + FINTECH companies existing in India today, over 67% have been set up in the last 5 years.
- Of the 2,100 + FINTECH companies in India as of August 2020, 17% of the FINTECH companies are into digital payments, 17% of them are into lending, 14% into wealth, making India the second largest FINTECH hub after USA.
- Fintechs are set to grow from USD 66 Billion in 2019 to USD 133 Billion by 2023.
- As the country with second largest base of internet users, India has quickly adopted to the world of FINTECH.

Delivery Channels Under Fintech In International Banking

FINTECH and Artificial Intelligence

- Artificial intelligence is the simulation of human intelligence processes by machines which combines computer systems and robust databases to enable problem solving in the Banking space.

The following are some of the scenarios where AI may be used:

- Identify customers better – prospecting, sourcing, underwriting – onboarding of Customers, both Importers, Exporters, etc., who are involved in international trade with the Overseas buyers and suppliers.
- Source business better – cash flows, business models, structures and managing global value chains, change in consumer demand and to better manage risks involved in international trade.
- AI has the potential to be used to improve outcome from the international trade negotiations analyzing the economic trajectories of each economic partner under different assumption.
- Identify the needs of the Customers and analyzing their inward and outward volumes, their overseas counterparties, periodicity of payments, collections, etc.
- Business Intelligence of the Clients viz., processing ability, recovery analysis (credit management) understanding the maturity profile of receivables (Exports) and payables (Imports)
- Credit Scoring – check on the credit worthiness of the Clients – lending is all about availability of data through which willingness/ability to repay can be analyzed, assessing financial statements and analysis, etc.
- Fraud detection by fixing through threshold limits, regulatory compliance – working in tandem with the regulators, etc.

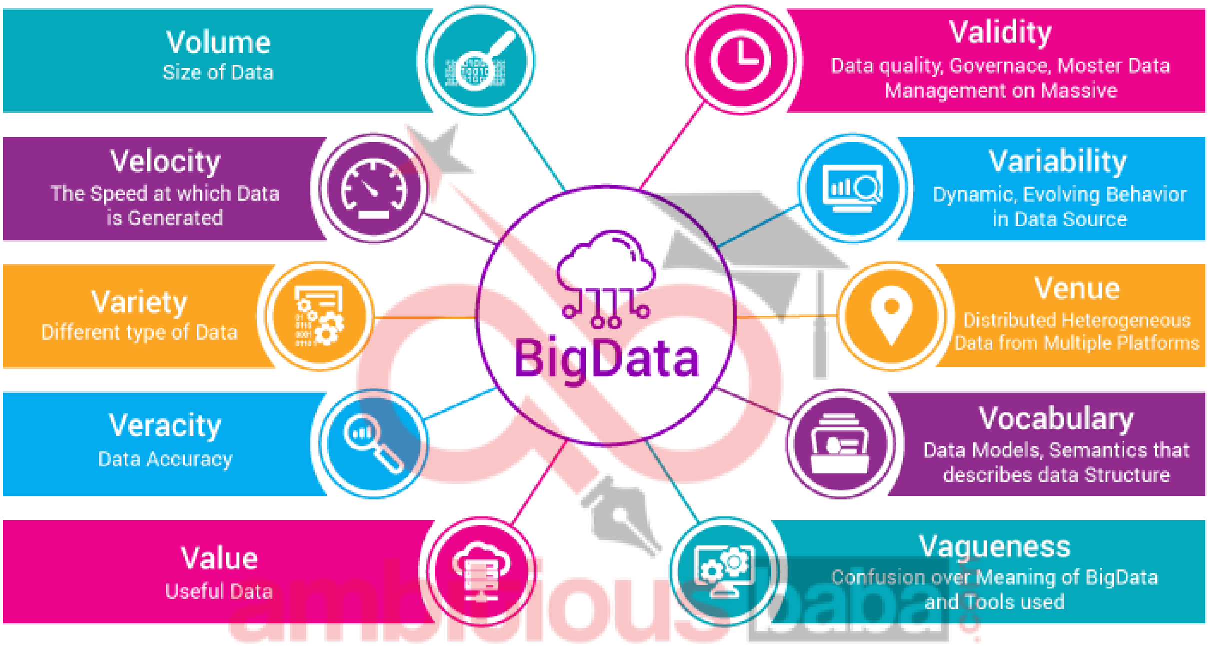
FINTECH and Big Data & Data Analytics

- Data analytics helps stakeholders in International Trade to create new portfolios by using historical data and analyzing past trends and patterns in terms of international geographies, which are more prone to volatile movements of rates, exploring opportunities with countries with political stability, countries with robust infrastructure development, etc.

- Big data is the use of advanced analytic techniques against very large, diverse data sets that includes both structured, semi-structured and raw data where refining these data helps in coming out with desired analysis.

The following are some of the application areas to big data analysis:

- ✓ Data on customers is of high value to FINTECH Companies
- ✓ Data on markets is of high value to FINTECH Companies
- ✓ Consumer Preferences, spending habits, investment behavior can be extracted and used to develop predictive analysis.
- ✓ Predictive analysis – refers to how consumers are likely to behave using past information and a mathematical algorithm.
- ✓ Data helps in formulating marketing strategies.
- ✓ Helps in fraud detection algorithm.



FINTECH and Robotic Process Automation (RPA)

- RPA refers to the process of assigning manual repetitive tasks to robots instead of humans in order to streamline workflows in financial institutions.

The most widespread applications are:

- ✓ Statistics and data collection
- ✓ Regulatory compliances management
- ✓ Communication and marketing through emails and chatbots
- ✓ Transaction management

FINTECH and Block Chain Management

- Blockchain is a system of recording information in a way that makes it difficult or impossible to change, hack, or cheat the system.
- A Blockchain is essentially a digital ledger of transactions that is duplicated and distributed across the entire network of computer systems on the Blockchain.

- Adopted at a large scale in the financial industry, primarily due to its ability to securely store transaction records and other sensitive data.
- Each transaction is encrypted and the chances of cyberattacks are relatively low when block chain technology is employed and has created tremendous strides in the area International Trade Finance.

Advantages:

- ✓ Disrupted Banks Trade Finance Technologies quite like the manner in which internet disrupted the media earlier.
- ✓ It is a very highly secure and transparent digital ledger and relatively economical to operate without intervention of any third party
- ✓ Creates a permanent record of all the trade transactions thereby creating a valid audit trail.

Advantages of Using Blockchain Technology in International Trade Finance

- **Real time review –** financial documents linked and accessible through block chain are reviewed and approved on real time, reducing the time it takes to initiate shipment.
- **Transparent factoring –** invoices accessed on block chain provide a real time and transparent view into subsequent short-term financing.
- **Disintermediation –** banks facilitating trade finance through block chain do not require a trusted intermediary to assume risk, eliminating the need for correspondent banks.
- **Reduced counter party risk –** BLs are tracked through block chain, eliminating the potential for double spending.
- **Decentralized contract execution –** as contract terms are met, status is updated on block chain in real time reducing the time and headcount required to monitor the delivery of goods.
- **Proof of ownership –** the title available within block chain provides transparency into the location and ownership of goods.
- **Automated settlement and reduced transaction fees –** contract terms executed via smart contracts eliminate the need for correspondent banks and additional transaction fees.
- **Regulatory transparency –** regulators are provided with a real time view of essential documents to assist in enforcement and AML activities.

Challenges in Using Blockchain Technology in Cross Border Transactions

- Regulatory and Compliance issues are the 2 biggest factors - this is believed to contribute towards internal resistance to adoption of blockchain which is to be addressed.
- An additional data layer along the payment process involving blockchain is to be introduced.

- Using the data layer, the regulatory and compliance requirements to be implemented around the details of the transaction.
- Transaction monitoring is another area which needs urgent attention.
- Validating the details of the originator, validating the details of the beneficiary, FATF sanctions, OFAC sanction screening, etc.
- The number and amount of suspicious transactions and the routing of transactions through high risk countries need to be monitored meticulously.

Blockchain Technology in the Indian Perspective

- Indian Block Chain Infrastructure Co. Pvt Ltd – a company formed by 15 Schedule Commercial Banks in June 2021 having an identical stake of 6.66% by each of the Banks.
- Block chain technology to use and /process Inland LC transactions within the country for domestic trade.
- System will verify data using invoices on the GST System and e-Way bills which will quicken the transactions and also eliminate risk of frauds.
- Eliminate paper work, reduce transaction time, secure environment.
- Network connectivity between Banks and the clients.
- Based on Infosys Finacle Connect.
- All the involved parties can share a digital ledger across a computer network without needing centralized authority or intermediaries.