TRADE FINANCE

Types of Trade Settlement

- Open Account: Long experience of trading between buyer and seller
- Advance Payment
- Documentary D/P Collection
- Documentary D/A Collection
- Documentary Letters of Credit
- Factoring

Payment and Short Credit Mechanisms

Open Account:

- Seller bills buyer and dispatches goods
- No security for payment
- Simple to administer and few banking fees/costs
- Advantageous to importer
- May be difficult for regulatory reasons

Documentary Collections

- To ensure the buyer should not be able to take possession of the goods until the buyer has paid or given a negotiable payment undertaking.
- Main international rules and practices applicable to such operations have been codified by the International Chamber of Commerce (ICC), and published in the Uniform Rules for Collections (URC). Latest version of the URC drawn up in 1995.

Parties to a Documentary Collection

- Exporter
- Remitting Bank
- Presenting or Collecting Bank
- Additional intermediary bank possible
- Importer

Types of Payment

- Documents against Payment (D/P)
- Documents against Acceptance (D/A)
- Buyer needs documents to collect goods
- No bank undertaking to pay

Letters of Credit

- Banks pay exporter against presentation of shipping documents
- Exporter obtains independent bank payment undertaking
- Financing of exports become easier for exporter
- Exporter ensures fulfilment of exchange control regulations in importer's country
- For importer no payment without shipping and other documents to ensure quantity and quality
- Importer does not have to make advance payment to exporter

Factoring

- Factoring companies buy trade debts at a discount and manage client corporations' collection procedures
- Factor Buys Invoices from Seller
- Seller can obtain immediate discounted payment or payment on receivables maturity date
- Payment may be with or without recourse

Export Finance in India

- Export Finance is made available to exporters for the specific purpose of procuring/ purchase, processing/ production/ manufacturing, packing and shipment of goods meant for exports
- Mainly working capital advance extended to exporters to meet their pre and post shipment requirements.
- Banks are required to reach a level of outstanding export credit equivalent of 12% of each bank's Net Bank Credit.

Pre-shipment Export Finance

- This is extended to the customers for procuring goods, purchase of raw materials, processing them and converting them into finished goods for the purpose of exports
- The type of limit depends upon the nature of production and procurement system concerning the commodity to be exported
- Clean Export Packing Credit (EPC) can be granted when first class clients have to give advance payment to the suppliers
- The clean advance is converted to EPC hypothecation/ pledge or secured shipping loan depending upon the nature of the commodity.
- Packing credit hypothecation is extended where raw materials, work-in-process and finished goods meant for exports are available as security. The processing/ manufacturing may be undertaken by the exporter himself or through sub-contractors as captive units.
- Sometimes exporters have to obtain the raw materials in bunched lots or the material procured may be sizeable in nature. In such cases packing credit loan can be granted in the form of pledge.
- Once the goods are ready for shipment and the exporter/ supplier has handed over the goods to the transporter/ clearing and forwarding agents for effecting the shipment, the advance can be granted as secured shipping loan.
- Where the exporter procures goods from sub-suppliers, back to back L/C facility can be extended. EPC can be granted to sub-suppliers.
- EPC is usually released on the basis of L/Cs or a confirmed order. If EPC is granted on the basis of a cable or telex message from the overseas buyer, then the exporter has to submit the original L/C or order once it is received. The L/C or order is stamped with the Bank's stamp in order to prevent the exporter from availing of EPC from another source.
- Pre-shipment advance is usually granted up to a maximum of 360 days or expiry of relative LC or order, whichever is earlier.

- Pre-shipment Credit can be in Indian Rupees or in Foreign Currency. This facility was given as exporters complained that interest in India was high.
- If pre-shipment advances are not adjusted by submission of export documents within 360 days from the date of advance, the advances will cease to qualify for prescribed rate of interest for export credit to the exporter *ab initio.*
- Further, subject to mutual agreement between the exporter and the banker it can also be repaid / prepaid out of balances in Exchange Earners Foreign Currency A/c (EEFC A/c) as also from rupee resources of the exporter to the extent exports have actually taken place.
- Repayment / liquidation of packing credit with proceeds of export documents could also be made with export documents relating to any other order covering the same or any other commodity exported by the exporter.
- While allowing substitution of contract in this way, banks should ensure that it is commercially necessary and unavoidable.
- Banks may release the packing credit in one lump-sum or in stages as per requirements
- Ordinarily, each packing credit sanctioned should be maintained as a separate account for the purpose of monitoring of sanction and end-use of funds.
- In the case of clients with good track record banks may extend Pre-shipment Credit **'Running Account'** facility, without insisting on prior lodgement of letters of credit/firm export orders. However, letters of credit/firm orders should be produced within a reasonable period of time to be decided by the banks. Banks should mark off individual export bills, as and when they are received for negotiation/ collection, against the earliest outstanding pre-shipment credit on 'First In First Out' (FIFO) basis.

Export Packing Credit to Sub-Suppliers

- Packing credit can be shared between an Export Order Holder (EOH) and sub-supplier of raw materials, components etc. of the exported goods as in the case of EOH and manufacturer suppliers, subject to the following:
- (a) **Running Account facility is not contemplated** under the scheme. The scheme will cover the L/C or export order received in favour of Export Houses/ Trading Houses/Star Trading Houses etc. or manufacturer exporters only. The scheme should be made available to the exporters with good track record.
- (b) Bankers to an EOH will open an inland L/C specifying the goods to be supplied by the sub-supplier to the EOH against the export order or L/C received by him as a part of the export transaction. On the basis of such a L/C, the sub-supplier's banker will grant EPC as working capital to enable the sub-supplier to manufacture the components required for the goods to be exported. On supplying the goods, the L/C opening bank will pay to the sub-supplier's banker against the inland documents received on the basis of inland L/C. Such payments will thereafter become the EPC of the EOH.

Export Finance for Construction Contractors

- The packing credit advances to the construction contractors to meet their initial working capital requirements for execution of contracts abroad may be made on the basis of a firm contract secured from abroad, in a separate account, on an undertaking obtained from them that the finance is required by them for incurring preliminary expenses in connection with the execution of the contract e.g., for transporting the necessary technical staff and purchase of consumable articles for the purpose of executing the contract abroad, etc.

Export Finance for Services

- Pre-shipment and post-shipment finance may be provided to exporters of all the 161 tradable services covered under the General Agreement on Trade in Services where payment for such services is received in free foreign exchange. All provisions of export of goods shall apply mutatis mutandis to export of services unless otherwise specified.

Deemed Export

- Banks are permitted to extend rupee pre-shipment and post-supply rupee export credit at concessional rate of interest to parties against orders for supplies in respect of projects aided/financed by bilateral or multilateral agencies/funds (including World Bank, IBRD, IDA), as notified from time to time by Department of Economic Affairs, Ministry of Finance under the Chapter "Deemed Exports" in Foreign Trade Policy, which are eligible for grant of normal export benefits by Government of India.
- Packing Credit provided should be adjusted from free foreign exchange representing payment for the suppliers of goods to these agencies. It can also be repaid/prepaid out of balances in Exchange Earners Foreign Currency account (EEFC A/c), as also from the rupee resources of the exporter to the extent supplies have actually been made.

Post Shipment Export Finance

- Post-shipment finance means any credit provided by a bank to an exporter from the date of extending the credit after shipment of goods to the date of realisation of sale proceeds.
- Post-shipment advance mainly take the form of -
  - (i) Export bills purchased/ discounted/ negotiated
  - (ii) Advances against bills for collection
  - (iii) Advances against duty drawback receivable from Government

Advances against shipping documents

- May be granted against bills drawn under LCs or against non credit bills where goods are shipped under firm order. In such cases creditworthiness of both exporter and overseas buyer have to be assessed. Further economic and political conditions and exchange control regulations of the buyer’s country have to be checked.
- Credit can be granted for the normal transit period in the case of demand bills and a maximum period of 12 months in the case of usance bills.
- For export of capital goods, post shipment credit for a period exceeding one year can be granted.

Advances against duty drawbacks

- Banks may also grant post-shipment advances to exporters against their duty drawback entitlements and covered by ECGC guarantee as provisionally certified by Customs Authorities pending final sanction and payment.
- The advance against duty drawback receivables can also be made available to exporters against export promotion copy of the shipping bill containing the EGM Number issued by the Customs Department.
- Where necessary, the financing bank may have its lien noted with the designated bank and arrangements may be made with the designated bank to transfer funds to the financing bank as and when duty drawback is credited by the Customs.
- These advances granted against duty drawback entitlements would be eligible for concessional rate of interest and refinance from RBI up to a maximum period of 90 days from the date of advance.

Post Shipment Export Finance

- Post-shipment credit is to be liquidated by the proceeds of export bills received from abroad in respect of goods exported / services rendered. Further, subject to mutual agreement between the exporter and the banker, it can also be repaid / prepaid out of balances in Exchange Earners Foreign Currency Account (EEFC A/C) as also from proceeds of any other unfinanced (collection) bills.

Rupee Interest Rates to Exporters

- For the period upto June 30, 2010, a ceiling rate had been prescribed for rupee export credit linked to Benchmark Prime Lending Rates (BPLRs) of individual banks available to their domestic borrowers. Banks had, therefore, freedom to decide the actual rates to be charged within the specified ceilings.
- The Base Rate System will be applicable with effect from July 1, 2010. Accordingly, interest rates applicable for all tenors of rupee export credit advances will be at or above Base Rate.
- The Government of India has decided to extend interest subvention of 2% on rupee export credit with effect from April 1, 2011 to March 31, 2012 to some employment oriented export sectors.
- Accordingly, banks may reduce the interest rate chargeable to the exporters as per Base Rate system in the sectors eligible for export credit subvention by the amount of subvention available subject to a floor rate of 7%.

Export Credit in Foreign Currency

- With a view to making credit available to exporters at internationally competitive rates, ADs have been permitted to extend pre-shipment credit in foreign currency (PCFC) to exporters for domestic and imported inputs of exported goods at LIBOR related rates of interest.
- The facility may be extended in one of the convertible currencies, viz. US Dollars, Pound Sterling, Japanese Yen, Euro, etc.
- The foreign currency balances available with the bank in Exchange Earners Foreign Currency (EEFC) Accounts, Resident Foreign Currency Accounts RFC(D) and Foreign Currency (Non-Resident) Accounts (Banks) Scheme could be utilised for financing the pre-shipment credit in foreign currency.

PCFC

- To enable exporters to have operational flexibility, banks may extend PCFC in one convertible currency for an export order invoiced in another convertible currency. *For example*, an exporter can avail of PCFC in US Dollar against an export order invoiced in Euro. The risk and cost of cross currency transaction will be that of the exporter.
- PCFC should be self-liquidating in nature.
- Repayment may be with documents relating to any other export order: `running account' facility.
- Banks may avail of lines of credit from **other banks in India** if they are not in a position to raise loans from abroad on their own, subject to the condition that ultimate cost to the exporter should not exceed 200 basis points above LIBOR/ EURO LIBOR / EURIBOR.

Rediscounting of Export Bills Abroad Scheme (EBR)

- The exporters have the option to avail of pre-shipment and post-shipment credit either in rupee or in foreign currency. However, if the pre-shipment credit has been availed in foreign currency, the post-shipment credit has necessarily to be under the EBR scheme.
- The exporters, on their own, can also arrange for themselves a line of credit with an overseas bank or any other agency (including a factoring agency) for discounting their export bills.

Export Credit Guarantee Corporation

- Risks involved in export trade are usually more than that involved in internal trade.
- The risk of loss or damage to the goods is covered by marine and general insurance
- ECGC covers risks of exporters normally not covered by other institutions
- Standard Policies issued by ECGC cover commercial and political risks

Commercial Risks covered include:

- Insolvency of buyer
- Buyer's protracted default to pay for goods accepted by him
- Buyer's failure to accept the goods, when such non-acceptance is not due to the exporter's action

Political Risks covered include:

- Restrictions on remittances in the buyer's country or any Government action which may block or delay payment in Rupees to the exporter
- War, revolution or civil disturbances in the buyer's country
- Cancellation of export licence or imposition of new export licensing restriction in India

Following risks are not covered by the policy:

- Disputes in quality
- Causes inherent in the nature of the goods
- Default of an exporter or his agent
- Fluctuations in exchange rate

ECGC's other policies

- ECGC also covers advances made to exporters by banks at the pre-shipment and post-shipment stage. Guarantee protects the bank against failure of the exporter to repay the advance on account of his insolvency or protracted default to repay.
- The two most popular guarantees issued by ECGC are the packing credit guarantee and post-shipment guarantee. In order to encourage large scale use, they are available on whole turnover basis also.
- ECGC offers a number of special risk covers to take care of exporters executing projects abroad, exchange fluctuation etc.

Whole Turnover Post-shipment Guarantee Scheme

- The Whole Turnover Post-shipment Guarantee Scheme of the Export Credit Guarantee Corporation of India Ltd. (ECGC) provides protection to banks against non-payment of post-shipment credit by exporters.
- Banks may, in the interest of export promotion, consider opting for the Whole Turnover Post-shipment Policy. The salient features of the scheme may be obtained from ECGC.
- As the post-shipment guarantee is mainly intended to benefit the banks, the cost of premium in respect of the Whole Turnover Postshipment Guarantee taken out by banks may be absorbed by the banks and **not** passed on to the exporters.

Trade Finance for Imports

Trade Credits for Imports into India

- Trade Credits (TC) refer to credits extended for imports directly by the overseas supplier, bank and financial institution for maturity of less than three years.
- Depending on the source of finance, such trade credits include suppliers' credit or buyers' credit. Suppliers' credit relates to credit for imports into India extended by the overseas supplier, while buyers' credit refers to loans for payment of imports in to India arranged by the importer from a bank or financial institution outside India for maturity of less than three years. It may be noted that buyers' credit and suppliers' credit for three years and above come under the category of External Commercial Borrowings (ECB) which are governed by ECB guidelines.

Amount and Maturity

- AD banks are permitted to approve trade credits for imports into India up to USD 20 million per import transaction for imports permissible under the current Foreign Trade Policy of the DGFT with a maturity period up to one year from the date of shipment.
- For import of capital goods as classified by DGFT, AD banks may approve trade credits up to USD 20 million per import transaction with a maturity period of more than one year and less than three years from the date of shipment.
- No roll-over/extension will be permitted beyond the permissible period.

All-in-cost ceilings for Trade Credits

- All-in-cost over 6 month LIBOR
- Maturity Period: Up to one year: 350 bps
- Maturity Period: More than one year and up to three years: 350 bps
- The all-in-cost ceilings include arranger fee, upfront fee, management fee, handling/ processing charges, out of pocket and legal expenses, if any.

Based on Prof Abhijit Roy's Lecture for RBI Officers.