CHAPTER 11

BANKING INSTRUMENTS

11.1. **General.** Import is regulated by the Directorate General of Foreign Trade (DGFT) under Ministry of Commerce and Industry, Department of Commerce, Government of India. Authorised dealers, while undertaking import transaction, should ensure that the imports into India are in conformity with the Export Import Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by Government of India vide Notification No G.S.R. 381(E) dated 03 May 2000 and the directions issued by Reserve Bank of India under Foreign Exchange Management Act from time to time.

11.1.1 Importer should follow normal banking procedures and adhere to the provisions of Uniform Customs and Practices for Documentary Credits (UCPDC) while opening Letters of Credit for import into India.

11.2. **Letter Of Credit (LC).** A letter of credit is a written understanding given by the buyer's bank (the issuing bank) on behalf of and at the request of its customer (the applicant) routed through the agency of a bank in the seller's country (advising bank) to the seller beneficiary that it (issuing bank) guarantees to pay the seller for the goods within a specified time provided that the conditions laid down in documentary credit are fully satisfied. A LC can be established in any of the 27 Public Sector banks besides SBI.

11.3. **Reasons for using LC.** In international trade, buyer and seller being located in different countries may not know each other well. The two countries will have different legal systems, currencies, trade and exchange regulations. Due to this fact both the Buyer and Seller, need some conditions to be fulfilled, to suit their requirements, before releasing the payments and goods respectively. The buyer and seller want the following:-

(a) Seller would want:-

(i) To be paid as soon as he ships the goods.

(ii) An assurance that he will be paid by the buyer or his bank as per contractual obligations.

(iii) Convenience of receiving payments in his own country.

(b) Buyer would want:-

(i) To pay for the goods only after they are shipped by the seller.

(ii) An assurance that seller will ship the goods ordered for and deliver them in time.

11.4. **Basic forms of LsC.** Basic forms of LsC are enumerated below:-

(a) Revocable letter of credit.
(b) Irrevocable letter of credit.
(c) Confirmed letter of credit.
(d) Revolving letter of credit

11.5. **Revocable Letter of Credit.** A revocable letter of credit is one which may be amended or cancelled by the issuing bank at any moment without prior notice to the beneficiary. Therefore such a type of letter of credit does not give complete sense of security to the beneficiary. However when the revocable letter of credit is made available at a branch of a bank concerned, the notice of amendment or cancellation is effective only upon receipt of such notice. If such a bank has undertaken liability (i.e. Paid, negotiated or accepted) against documents, which appear on the face of it to be in conformity with the terms and conditions of the credit before notice of amendment/cancellation, then the issuing Bank is bound to reimburse such a bank. If the letter of credit is silent as to whether it is revocable or irrevocable, the credit is deemed as IRREVOCABLE.

11.6. **Irrevocable Letter of Credit.** When the issuing Bank gives a definite, absolute and irrevocable undertaking to honour its obligations provided the beneficiary complies with all the terms and conditions such a credit is known as an irrevocable letter of credit. That means that the letter of credit cannot be amended, cancelled or revoked without the consent of the parties to the letter of credit. This gives the beneficiary definite protection.

11.7. **<u>Confirmed Letter of Credit.</u>** A confirmed letter of credit is one when another Bank in the beneficiary's country adds its confirmation at the request of the issuing Bank. This undertaking of the confirming Bank to pay/negotiate/accept is in addition to the undertaking of the issuing bank. This is an added protection to the beneficiary. This is not to be agreed as it undermines the credibility of our Nationalized Banks.

11.8. **<u>Revolving Letter of Credit.</u>** In such credits, the amount is restored, after it has been utilized, to the original amount. Such credits are used when the buyer is to receive partial shipment of goods at specific intervals for a long duration. It can be cumulative or non-cumulative in nature. It avoids opening letter of credit for each and every consignment**.**

11.8.1. The above LsC can be divisible, non-divisible. Divisible LsC are opened when more than one Beneficiary is allowed and payment has to be made as per consignment.

11.9. **<u>Procedure for Opening LC.</u>** The procedure for opening of an LC would generally include steps as given below: -

(a) **<u>Step-1.</u>** **Receipt of PBG and Readiness of Goods**. Contract concluding Dte/ receives readiness of goods for shipment as per contractual terms from the supplier.

(b) **<u>Step-2.</u>** The Contract concluding authority / Dte seeks FFE release from the appropriate authority. The IFA is to note the FFE and budget outgo and the approval of CFA is obtained.

(c) **<u>Step-3.</u>** On release of FFE the contract concluding authority forwards the case for opening of LC to PCDA who after proper scrutiny of all details for correctness authorises the bank to open LC. The bank establishes the LC and intimates the PCDA and the contract concluding authority.

11.10. **<u>Payment Through Letter of Credit.</u>** The letter of credit mechanism works as follows: -

(a) Buyer requests the issuing / opening bank to open an LC.

(b) Issuing/ opening Bank conveys LC through Advising bank.

(c) Advising bank advises the credit to beneficiary.

(d) Beneficiary after complying with terms and conditions against stipulated documents gets the value either from the Advising bank or Nominated bank as per the terms of LC.

(e) After passing on the value, negotiating Bank claims reimbursement from the issuing/opening Bank or nominated bank as per the terms of LC.

(f) Ultimately issuing/opening Bank recovers the amount from the applicant. It is the definite commitment of issuing/ Opening Bank to reimburse to the negotiating bank whether applicant provides the value of negotiation or not.

11.11. **Essential Elements of LC.** Following essential elements are to be clearly stipulated while opening LC:-

(a) Type of LC
(b) Name and address of applicant and beneficiary
(c) Amount of credit and currency
(d) Validity of LC
(e) Latest shipment date (delivery date as per contract)
(f) Basis of delivery (FOB/FCA/CIP/CIF)
(g) Contract No. and date
(h) Shipment from …………. To …………
(j) Consignee and ultimate Consignee
(k) Part shipment allowed/not allowed
(l) Documents required to be produced by the beneficiary for release of payment from LC.
(m) LD Clause
(n) Any other special instructions.

11.12. **<u>Documents to be Provided by The Seller</u>.** Paid shipping documents are provided to the Bank by the Supplier as proof of dispatching goods as per contractual terms so that the supplier gets his payment from LC. The Bank forwards these documents to the Buyer for getting the goods/stores released from Port/Airport. Documents include: -

(a) Clean on Board Airway Bill/Bill of Lading
(b) Original Invoice
(c) Packing List
(d) Certificate of Origin from Seller's Chamber of Commerce
(e) Certificate of Quality and current manufacture from OEM
(f) Dangerous Cargo Certificate, if any.
(g) Insurance Policy of 110% if CIF/CIP contract.
(h) Certificate of Conformity & Acceptance test at PDI, signed by Buyer's and Seller's QA Deptt.
(j) Phyto-sanitary/Fumigation Certificate.
(k) Performance Bond/Warranty Certificate
(l) Authenticated signature of the supplier or his authorised rep should be available with the bank and verified by them before releasing LC payment. The above details should form part of the contract.

11.13. **<u>Extension of LC.</u>** Following points should be checked before initiating the case for extension of LC:-

(a) Extension of delivery date in the contract and corresponding amendment in LC for latest date of shipment.
(b) Performance Bank Guarantee (PBG) extension.
(c) Onus of charges for LC extension.

11.13.1. IFA clearance and CFA approval should be obtained prior to extension of LC.

11.14. **<u>Direct Bank Transfer.</u>** A transferable credit is a credit under which the Beneficiary may request the bank authorised to pay, incur a deferred payment undertaking, accept or negotiate or in the case of a freely negotiable credit, the bank specifically authorised in the credit as a transferring bank to make the credit available in whole or in part to one or more than one beneficiaries. Direct Bank Transfer shows high degree of trust between parties. Buyer ensures that the payment is released only after receipt of the following:-

(a) Clean on Board Airway Bill/Bill of Lading

(b) Original Invoice

(c) Packing List

(d) Certificate of Origin from Seller's Chamber of Commerce

(e) Certificate of Quality and current manufacture from OEM

(f) Dangerous Cargo Certificate, if any.

(g) Insurance Policy of 110% if CIF/CIP contract.

(h) Certificate of Conformity & Acceptance test at PDI, signed by Buyer's and Seller's QA Deptt.

(j) Phyto-sanitary/Fumigation Certificate.

(k) Performance Bond/Warranty Certificate

11.14.1 The above details should form part of the contract.

11.14.2. After obtaining the above documents, the concerned Dte. authorises PCDA for Direct Bank Transfer. PCDA in turn authorises the Buyer's bank to make direct transfer of funds to Seller's bank account.

11.15. **Advantages.** Following advantages accrue in comparison to payments through LsC:-

(a) Payment released only after receipt of goods.

(b) Payment to be made only after full satisfaction to the quality, quantity etc.

(c) Cost-effective-inexpensive compared to LsC.

11.15.1. For contracts below USD 50,000.00, DBT payment terms should be insisted upon, at the time of concluding the contract.

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11.16. **<u>Specified time limit and Delivery Schedule.</u>** The normal delivery schedule for spares procurement in case of LC and DBT payment terms should be as follows:-

(a) **<u>L/C Payments</u>.** Six months from the date of signing of contract which will include:-

(i) Obtaining export license and giving notification of readiness for opening of L/C by seller – 45 days.

(ii) Obtaining Foreign Exchange Release and opening of L/C through CDA by buyer – 45 days

(iii) Validity period of L/C – 90 days. The LC will be opened three months prior to the expiry of delivery period only. In case the spares under procurement are in large quantity or their technical production cycle is long as specified by the seller in the RFP, then the LC shall be opened for more than one quarter as agreed by the TPC/CNC.

(b) **<u>DBT Payments</u>.** Preferably within three months of signing of the contract.

11.17. **<u>Performance Bank Guarantee (PBG)</u>.** A written undertaking through the bank to perform the promise/terms and conditions of the contract and to ensure the discharge of liability of supplier in case of his default.

11.18. **<u>Essential Elements of PBG</u>.** Essential elements of PBG are:-

(a) Amount.

(b) Address of Beneficiary, Applicant and Bank.

(c) Validity date.

(d) Contract Number and Date.

(e) Bank should release the amount without any demur on receipt of a written order from beneficiary.

11.19. **<u>Salient Features of Guarantees.</u>** Salient features of Guarantees are given below:-

(a) Guarantees are absolute in character and independent of underlying contract.

(b) Obligation to pay not to perform.

(c) Un-conditional and without demur payment against valid claim.

(d) For specified amount and period.

(e) Issued against matching counter-guarantee from the applicant.

11.20. **Invocation of Guarantees.** Guarantees can only be invoked after fulfilling the following conditions:-

(a) Should reach issuing Bank on or before expiry date.

(b) Should be in strict conformity with Guarantee terms.

(c) Issuing Bank not to enquire into merits of claimer or take views on dispute between applicant and beneficiary.

(d) On compliance of terms of guarantee, payments effected immediately and unconditionally.

11.21. **Confirmation of PBG.** Advice of SBI should be taken as to whether the foreign bank providing Bank Guarantee for advance is a first class bank of international repute before taking a decision whether such PBG should be further confirmed by SBI/any other scheduled bank.