NON - FUND BASED CREDIT FACILITIES

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NON-FUND BASED FACILITIES

- **Non-fund based facilities are such facilities extended by banks which do not involve outgo of funds from the bank when the customer avails the facilities but may at a later date crystallise into financial liability if the customer fails to honour the commitment made by availing these facilities.**
- **The banker undertake a risk to the amount on happening of a contingency.**

ADVANTAGES OF NON-FUND BASED FACILITIES

- No immediate outlay of funds;
- Future or contingent deployment of funds;
- Risks are similar to funded exposure and procedure is same;
- Earnings by way of Up Front commission, fees and exchange income;
- Source for mobilisation of deposits;
- Comparative easy monitoring;
- Costs less to Banker;
- Low probability of default.

VARIOUS TYPES OF NON BORROWING FACILITIES

- Letters of Credit
  - Inland LCs
  - Foreign (Import) LCs
- Guarantees
  - Inland Guarantees
  - Foreign Guarantees

BANK GUARANTEE

GUARANTEE

Section 126 of Indian Contract Act,1872 defines guarantee:

"A contract to perform the promise or discharge the liability of a third person in case of his default."

GUARANTEE PARTIES INVOLVED

- The parties to the contract of guarantee are:

a. Applicant : The principal debtor : The person at whose request the guarantee is executed.

b. Beneficiary : The person to whom the guarantee is given and who can enforce it in case of default.

c. Guarantor : The person who undertakes to discharge the obligations of the applicant in case of his default.

- Thus, a contract of guarantee is a collateral contract, consequential to a main contract between the applicant and the beneficiary.

GUARANTEE TYPES

Guarantee may be classified by nature as under:

1. ***Inland Guarantee***

   and

   Foreign Guarantee.

2. ***Financial Guarantee***

   and

   Performance Guarantee.

BANK GUARANTEE

Guarantee issued must be unconditional and for:

- **Definite period**
- **Definite amount**
- **Definite purpose**

Guarantee may be based on location of beneficiary, Purpose and Currency:

<u>Inland:</u> Issued with in India in favour of beneficiary located in India for any contract or purpose originating within India.

<u>Foreign:</u> Issued in India in favour of beneficiary located in any other country in Foreign Currency.

VARIOUS TYPES OF BANK GUARANTEES

As per nature of contract, Bank Guarantees are classified in three types;

1) Financial Guarantee

2) Performance Guarantee

3) Deferred Payment Guarantee

FINANCIAL GUARANTEE

- **Financial Guarantees are issued by bank on behalf of customer's requirement to deposit a cash security or earnest money.**
- **Most Government department insist that before contract is awarded to contractor, insist on a Earnest Money Deposit.**
- **Issued in respect of Excise / Custom duties and Octroi under dispute etc.**
- **Issued in respect liabilities towards tax, excise duties, custom duties etc. to Govt. authorities in relation of specific transaction;**
- **Issued for covering payments for supplies/services favouring Oil Companies, SAIL, Railways etc.**

PERFORMANCE GUARANTEE

- **Performance Guarantees are issued by the bank on behalf of its customer whereby the bank assure a third party, that the customer will perform the contract as per condition stipulated in the contract.**
- **These are issued on behalf of customer, who enters into contracts to do certain things on or before a given date.**
- **It involves a contractual obligation.**

DEFERRED PAYMENT GUARANTEES

- **It is issued in favour of suppliers to guarantee payment of installments for capital goods purchased on deferred payment basis.**
- **It required when goods or machinery are purchase on long term credit and payment is made through cheque or bills of different dates.**
- **Bank issue guarantee of payment of installments on due date, in event of default by buyer.**

For example: Rs. 50 Lacs is cost of Machinery. Repayable in 5 yearly installments. Default in payment by the buyer.

GUARANTEE EXCLUSIONS

- **Guarantees in favour of shipping companies to obtain delivery of goods in the absence of Bills of Lading should not be issued unless the import bills of the customer are routed through the Branch and adequate margin is taken for issue of the guarantee.**

GUARANTEE EXCLUSIONS

- **Wherever specific sanction is not available, Branches should obtain prior approval from Head Office before issuing any guarantee where Foreign Exchange is involved.**
- **Partly secured guarantee involving excise or disputed tax payment should <u>not be</u> issued without prior permission of Head office**

GUARANTEE ONEROUS CLAUSE

Any provision in the guarantee which is likely to give rise to further pecuniary liability like interest or liability which is unlimited in terms of money as well as validity period is considered as an ONEROUS CLAUSE:

- **Auto Renewal / Extension.**
- **Jurisdiction clause in different places.**
- **Where time limit is specified for payment say 24 hours, 48 hours etc.**
- **Payment of interest on invoked amount.**

DELEGATION OF POWERS

- **Delegation provides full powers at all levels to sanction issue of guarantees for periods up to 3 years in case of guarantees fully secured by cash margin or term deposit or counter guarantee of other Banks/FIs.**
- **Restrictive powers for issue of guarantees not fully secured for periods up to 3 years provided there is no onerous clause in the guarantee.**
- **Ref. HOBC No.107/163 dated 22-11-2013**

DELEGATION OF POWERS

- **Guarantees beyond 3 years (fully/partly secured) can be sanctioned by scale VI onwards as per their respective delegated powers.**
- **Guarantees in favour of Banks/FIs/ Other lending institutions can be sanctioned by scale V onwards only as per their respective delegated powers in SME/SBS model.**

APPLICATION

The branch should obtain request letter for issue of guarantee which contains the following :

- **Authority to –adjust margin money, appropriate principal or collateral securities on default & recover all charges in respect of issue of guarantee.**
- **The customer also accepts the responsibility to get back the original guarantee.**

GUARANTEE LIMITATION CLAUSE
SOME IMPORTANT CLAUSES REQUIRED

- **All guarantees must carry limitation clauses invariably.**
- **Minimum claim period to be mentioned in the BG is 1 year (Ref: Circular Letter no. 192 dated 20.01.2014).**

(1) Limitation clause as to time and amount.

GUARANTEE LIMITATION CLAUSE

Notwithstanding anything contained herein above our liability under this guarantee is restricted to Rs. -------- (Rs. ----------------) and this guarantee is valid up to -------------and we shall be released and discharged from all liabilities hereunder unless a written claim for payment under this guarantee lodged on us within -------- months from the date of expiry of this guarantee i. e. on or before -------------- irrespective of whether or not the original guarantee is returned to us.

GUARANTEE CONFIRMATION CLAUSE

All guarantees must contain the following clause <u>in the forwarding letter of</u> the guarantee:

"The confirmation of this bank guarantee is available with our controlling office. The beneficiary in his own interest should obtain such confirmation from the controlling office at the following address………"

INVOCATION OF GUARANTEE

- **Whenever a guarantee is invoked, the amount claimed there under should be settled without delay.**
- **Branches are not empowered to postpone beyond 3 days from the date of invocation payment of a guarantee.**
- **Invocation has to be made by the same authority in whose favour guarantee is issued.**
- **In case the payment is to be refused, controlling authorities permission must be obtained before refusal.**

SECURITY DOCUMENTS

LG11 or LG12– Counter Guarantee and Indemnity. Copy of original contract certified as true copy and marked "Annexure A" should be attached to the counter guarantee taken.

LG13 Letter of appropriation.

LG14/15 Counter guarantee from guarantor.

LG500 Supplemental agreement of hypothecation.

Extension of equitable mortgage.

LG - 444 - Renewal documents

PRECAUTIONS

- Letter requesting for guarantee should be taken each time a guarantee is issued.
- Guarantees should be serially numbered.
- Guarantees should be signed by two delegatees. The name, designation and code no. of the officers signing the guarantee should be incorporated.

Thanks

LETTER OF CREDIT

LETTER OF CREDIT

- **Letter of Credit is an undertaking issued by a Bank (Issuing Bank), on behalf of the buyer (the importer), to the seller (the exporter) to pay for goods and services provided that the seller presents documents which comply with the terms and conditions of the Letter of Credit.**
- **In a simple words, If LC opened on seller name as beneficiary, seller will receive amount though the buyer's bank (opening bank) on the agreed time.**

LETTER OF CREDIT & DOCUMENTARY CREDIT

All Letters of Credit for export import trade is handled under the guidelines of Uniform Customs and Practice of Documentary Credit of International Chamber of Commerce (UCPDC 600).

The ICC Banking Commission approved UCPDC 600 in 25 October 2006, which came into effect from 1st July 2007.

NEED OF LETTER OF CREDIT

International trade covers very large distance between two countries and exporter & importers are not known to each other. Letter of credit can resolve the complications arise in international trade of two countries separated by differences in:

a) **Physical barriers - long distances;**
b) **Political systems /legal systems;**
c) **Currencies;**
d) **Trade and exchange regulations;**
e) **Markets and marketing conditions;**
f) **Trade practices;**
g) **Financial and commercial conditions.**

MAJOR ADVANTAGES TO BUYER

Letter of Credit plays a major role in this transaction. Both exporter and importer are benefited to do business through letter of credit. Major advantages to buyer (importer) from letter of credit are as follows:

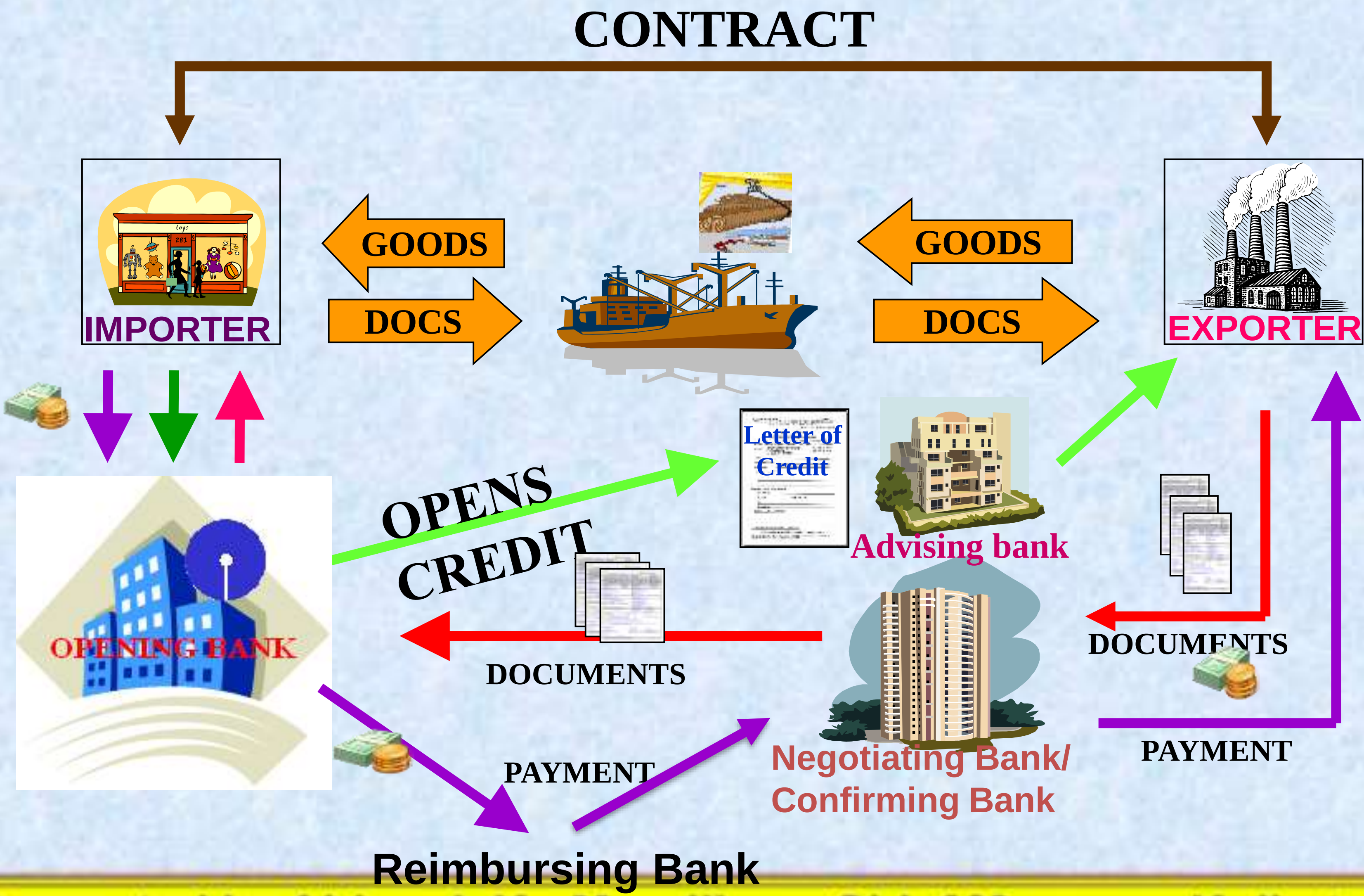
- **No cash advance payment has to be made to the seller;**
- **Seller is paid only after shipment and delivery of documents within the LC validity;**
- **possibility to obtain more favourable payment terms;**
- **Shipment schedule ensured.**

MAJOR ADVANTAGES TO SELLER

Major advantages to seller (exporter) from letter of credit are as follows:

- **Obligation of the buyer's bank for payment;**
- **Payment is assured if credit terms are fulfilled;**
- **Date of receipt of payment can be determined;**
- **Seller need not bother about the fluctuation of currency;**
- **Seller need not bother about the import regulation of buyer country.**
- **A financing possibility by discounting receivables under LC.**

Mechanics of Documentary Credit



PARTIES TO LETTER OF CREDIT

1) Opener/Buyer
2) Beneficiary/Seller
3) Issuing Bank
4) Advising Bank
5) Confirming Bank
6) Nominated Bank/Negotiating Bank
7) Reimbursing Bank

PARTIES OF LETTER OF CREDIT

- **Applicant:** **Applicant is the party who opens Letter of Credit. He is the buyer / importer of the goods (generally borrower of the issuing bank). The applicant arranges to open letter of credit with his bank as per the terms and conditions of Purchase order and business contract between buyer and seller. The applicant has to make payment if documents as per LC are delivered.**
- **Beneficiary party: The seller or exporter is the beneficiary in whose favour the letter of credit is issued. It gets payment against documents as per LC from the nominated bank within validity period for negotiation.**

PARTIES OF LETTER OF CREDIT

- **Issuing Bank: Issuing Bank is the bank that opens letter of credit. Letter of credit is created by issuing bank who takes responsibility to pay amount on receipt of documents from supplier of goods (beneficiary under LC).**
- **Advising Bank: Advising bank, as a part of letter of credit takes responsibility to communicate with necessary parties under letter of credit and other required authorities. The advising bank is the party who sends documents under Letter of Credit to opening bank.**

PARTIES OF LETTER OF CREDIT

- **Confirming Bank: Confirming bank as a party of letter of credit confirms and guarantees to undertake the responsibility of payment or negotiation acceptance under the credit.**
- **Negotiating Bank: Negotiating Bank, who negotiates documents delivered to bank by beneficiary of LC. Negotiating bank is the bank that verifies documents and confirms the terms and conditions under LC on behalf of beneficiary to avoid discrepancies.**
- **Reimbursing Bank: Reimbursing bank is the party who authorized to honour the reimbursement claim of negotiation/ payment/ acceptance.**

TYPES OF LETTER OF CREDIT

- **Revocable LCs: In revocable LC, the buyer and the bank that established the LC are able to manipulate the LC or make corrections without informing or getting permissions from the seller. According to UCPDC 600, all LCs are irrevocable, hence this type of LC is obsolete.**
- **Irrevocable LC: A letter of credit that does not allow the issuing bank to make any changes without the approval of the beneficiary, applicant bank and confirming bank, if any.**

TYPES OF LETTER OF CREDIT

- **Deferred or Usance LC:.A letter of credit, that ensures payment after a certain period of time. The date of payment is accepted by both buyer and seller. The bank may review the documents early but the payment to the beneficiary is made after the agreed-to time passes. It is also known as Usance LC.**
- **Sight LC: A letter of credit that demand payment on the submission of the required documents. The bank reviews the documents and pays the beneficiary if the documents meet the conditions of the letter.**

TYPES OF LETTER OF CREDIT

- **With & Without Recourse LC: Where the beneficiary holds himself liable to the holder of the bill if dishonoured, it is considered with-recourse LC. Where he does not hold himself liable, the credit is said to be without-recourse LC.**

  As per RBI directive (Jan 23, 2003), banks should not open such LCs. Under LC, the Banks can negotiate bills bearing the 'without recourse' clause.

- **Restricted LC: A restricted LC is one wherein a specified bank is designated to pay, accept or negotiate payment will be made. The confirming bank's liability is similar to the issuing bank. The confirming bank has to negotiate documents if tendered by the beneficiary.**

TYPES OF LETTER OF CREDIT

- **Transferable LC: It is an LC, where the beneficiary is entitled to transfer the LC, in whole or in part, to the 2^{nd} beneficiary/s (supplier of beneficiary). The 2^{nd} beneficiary, however, cannot transfer it further, but can transfer the unused portion, back to the original beneficiary. It is transferable only once.**
- **A Back to Back credit: A pair of LCs in which one is to the benefit of a seller who is not able to provide the corresponding goods for unspecified reasons. In that event, a second credit is opened for another seller to provide the desired goods. Back-to-back is issued to facilitate intermediary trade. Intermediate companies such as trading houses are sometimes required to open LCs for a supplier and receive Export LCs from buyer.**

TYPES OF LETTER OF CREDIT

- **A Red Clause LC: It referred to a packing or anticipatory credit, has a clause permitting the correspondent bank in the exporter's country to grant advance to beneficiary at issuing bank's responsibility. These advances are adjusted from proceeds of the bills negotiated.**
- **A Green Clause LC: It permits the advances for storage of goods in a warehouse in addition to preshipment advance. It is an extension of the red clause LC.**
- **Standby Credits: is similar to performance bond or guarantee, but issued in the form of LC. The beneficiary can submit his claim by means of a draft accompanied by the requisite documentary evidence of performance, as stipulated in the credit.**

PROCEDURE FOR OPENING LC

Buyer entered in to a contract with overseas supplier to import machinery at his factory. As per their contract, buyer needs to open a Letter of credit (LC) in favour of exporter/seller. Banker has to verify the following documents of the buyer/importer:

- **IEC No. of the buyer,**
- **Whether Goods/Services under LC is permitted under Foreign Trade Policy or not,**
- **Import License of the buyer if applicable,**
- **FEMA Guidelines about the items imported.**
- **The customer's financial standing, line of business, frequency of imports, sales, account turnover, satisfactory track record of importer for import of goods, etc. are also scrutinised.**

SWIFT CODE

- **SWIFT is the short form of "Society or Worldwide Interbank Financial Telecommunication". In simple terms swift has two main roles in international financial transactions, firstly SWIFT provide a secure communications platform by which financial institutions can communicate each other reliably & fast and secondly SWIFT establishes standard message formats which can be used on secure SWIFT platforms.**
- **Today banks use SWIFT platform to communicate each other when sending a wire transfer, issuing a letter of credit, advising a discrepancy message etc.**
- **Each of these message formats have a different code, which is called swift message types. For example a bank must use MT700 Issue of a Documentary Credit when issuing a letter of credit and MT 734 advice of a refusal when giving its refusal message. (MT means Message Type)**
- **<u>Important Note</u>: According to the current letters of credit rules, UCP 600, a letter of credit will be deemed to be operative letter of credit if it is transmitted via an authenticated electronic platform such as SWIFT.**

STANDARD FORMS OF DOCUMENTATION

When making payment for product on behalf of its customer, the issuing bank must verify that all documents and drafts conform precisely to the terms and conditions of the letter of credit. The most common documents that must accompany the draft include:

- **<u>Commercial Invoice</u>: The billing for the goods and services. It includes a description of merchandise, price, FOB origin, and name and address of buyer and seller.**

STANDARD DOCUMENTS

- **Bill of Exchange: This is a financial document. Payment is made on this document. In a letter of credit transaction the right to draw a bill is conferred only on the beneficiary. The bill amount should be within the limit fixed in the letter of credit. The tenor, endorsement and the drawee should be the same as given in the letter of credit.**
- **Transport Documents: The mode of dispatch of goods or the transporting of goods would depend on terms of contract between buyer and seller and the same is incorporated in letter of credit. The two main modes of transport of goods are either by se or by air.**

STANDARD DOCUMENTS

- **<u>Bill of Lading</u>: A document evidencing the receipt of goods for shipment and issued by a freight carrier engaged in the business of forwarding or transporting goods. The documents evidence control of goods.**
- **<u>Airway Bill</u>: This is a document, which evidences that the goods have been received by an airline company or its agent.**
- **<u>Postal Parcel Receipt and Courier Receipts</u>: When the goods to be sent are small in quantity, then they can be sent through post or courier. The document issued by the postal department or courier are similar in nature to the airway bill.**

STANDARD DOCUMENTS

- **Warranty of Title: A warranty given by a seller to a buyer of goods that states that the title being conveyed is good and that the transfer is rightful. This is a method of certifying clear title to product transfer.**
- **Insurance Document: The goods shipped, if required to be insured under the terms of the letter of credit should be so insured. The type of insurance cover should be the same as specified in the credit.**
- **Letter of Indemnity: Specifically indemnifies the purchaser against a certain stated circumstance. Indemnification is generally used to guaranty that shipping documents will be provided in good order when available.**

INCOTERMS (INTERNATIONAL COMMERCIAL TERMS) 2000

- INCOTERMS introduced by International chamber of commerce in 1936. INCOTERMS or **International Commercial Terms** are a series of international sales terms widely used throughout the world.
- INCOTERMS are designed to create a bridge between different members of the industry by acting as a uniform language they can use.
- From 1st January 2000, the ICC once again updated Incoterms to follow the modern trends in international trade.
- INCOTERMS 2000 are the standard terms of trade that define the rights and obligations of the parties involved in trade.

INCOTERMS 2000

INCOTERMS 2000 are divided into 4 groups namely E,F,C & D.

GROUP – E (Ex Work or Factory Cost)

This group contains only one Incoterm namely EXW.

EXW (Ex. Works) - This term represents minimum liability on the part of the Seller. Seller's responsibility ends with delivering goods at his factory doc. The rest of the risk and expenses involved are borne by the Buyer and would have to be carried out through his agent at origin.

INCOTERMS 2000

GROUP – F (Freight Unpaid)

Consists of FCA, FAS & FOB terms. Under this category the seller pays for the pre carriage expenses at the origin and the main carriages as well as destination charges are borne by the buyer.

FCA (Free Carrier) - Seller delivers goods to the Buyer's nominated vehicle and his responsibility ceases with delivery. Unloading, transportation as well as Insurance from this point will be borne by the Buyer.

FAS (Free Alongside Ship) - Seller completes export formalities and delivers cargo alongside ship. From this point onwards the risk and costs including transportation and Insurance pass on to the Buyer.

FOB (Free on Board) - Seller is responsible for inland transportation, export clearance as well as delivery cargo onboard the Ship. Once onboard the Ship the risk and responsibility shifts to the Buyer who pays the transportation, Insurance and destination charges.

INCOTERMS 2000

GROUP – C (Freight Paid)

Under this group the Seller arranges for and pays for transportation but does not take on the risk.

CFR (Cost and Freight) - Seller pays transportation cost up to destination port. Insurance and risk are with the buyer from the time the seller delivers cargo on board.

CIF (Cost, Insurance & Freight) - Seller pays for transportation and insurance but the risk passes to the buyer as soon as the cargo is delivered on board the ship.

CPT (Seller pays Transportation) - Seller pays transportation cost. The risk and insurance lies with the buyer from the point of delivery of cargo to the carrier by the seller.

CIP (Carriage & Insurance Paid to) - Seller pays transportation and insurance. The risk passes to the buyer when seller delivers cargo to carrier.

INCOTERMS 2000

GROUP – D (Delivery at Destination)

Under this group the seller assumes all or most of the risk and takes responsibility of delivery at destination up to the agreed point of delivery.

DAF (Delivered at Frontier) - Seller responsible to deliver cargo up to the point of entry at destination. Risk and responsibility further passes on to the buyer.

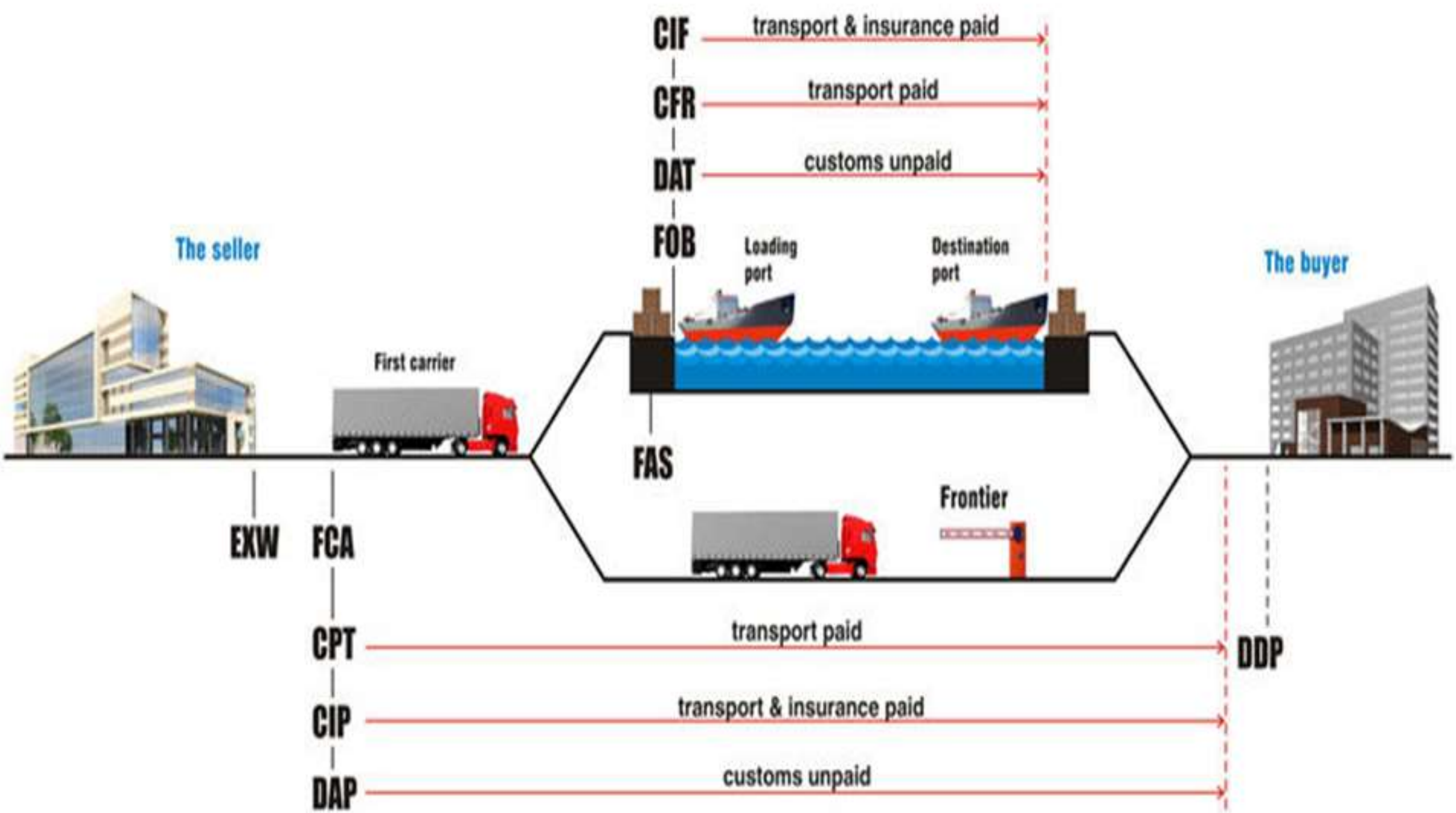
DES (Delivered Ex Ship) - Seller assumes risk until the ship with the cargo reaches the port of destination. Then the risk shifts to buyer from the point of discharge of vessel onwards.

DEQ (Delivered Ex. Quay Duty Paid) - Seller takes responsibility until the cargo is delivered after import clearance at destination and customs duty paid and delivered to the point on buyers dock.

DDU (Delivered Duty Unpaid) - Seller takes responsibility to deliver cargo at the destination port where the buyer takes on the responsibility for import clearance, Import duties and onward delivery.

DDP (Delivered Duty Paid) - Seller takes responsibility until the cargo reaches destination, clears the customs, pays the duty and delivers cargo at buyer’s dock.

INCOTERMS 2000 can be easily explained in the below mention figure



RISKS IN LETTER OF CREDIT TRANSACTIONS

Letter of credit transactions are not risks free. The risks inherent in these types of transactions include:

- **Fraud Risks: The payment will be obtained for non-existent or worthless merchandise against presentation by the beneficiary of forged or falsified documents. Credit itself may be funded.**
- **Sovereign and Regulatory Risks: Performance of the Documentary Credit may be prevented by government action outside the control of the parties.**

RISKS IN LETTER OF CREDIT TRANSACTIONS

- **Legal Risks: Possibility that performance of a documentary credit may be disturbed by legal action relating directly to the parties and their rights and obligations under the documentary credit.**
- **Force majeure risk: in which completion of the transaction is prevented by an external force, such as war or natural disaster.**


Suggestions
Comments?


THANK YOU