Impact of Buyer’s Credit ban on Import Financing in India —

What are the options for Importers to still get cheap foreign currency financing?

by Divya Tailang | interlinkages.online

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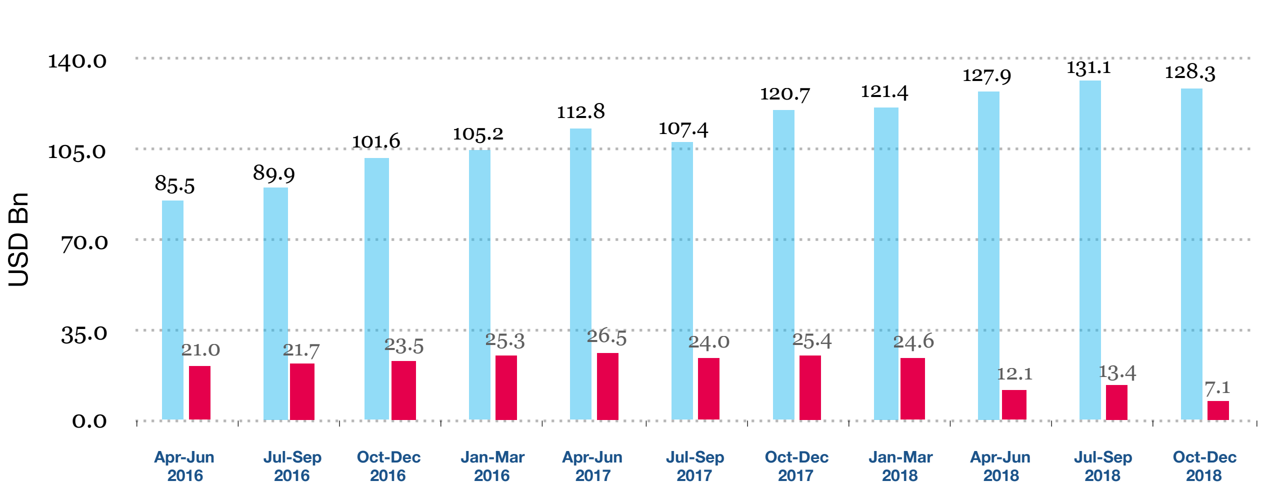
Buyer's Credit ban on Import Financing in India

Its been a year since billionaire jeweler Nirav Modi and his uncle Mehul Choksi allegedly cheated the Indian banking system of nearly USD 2 Billion through fraudulent Letter of Undertakings (LoUs) issued by Punjab National Bank. These LoUs were used to support foreign currency borrowings called Buyer's Credit from the overseas branches of many Indian banks. This was the biggest fraud in the history of Indian Banking .On Mar14, 2018 RBI, to prevent further misuse, RBI barred Indian banks from issuing LoUs and Letter of Comforts, the instruments which were primarily used to support Buyers Credit by Importers in India. The total short-term Trade credits (Buyers Credit and Suppliers Credit below 3 years) outstanding in India before the ban on LoUs was estimated at approx. USD 90 Billion and Buyers Credit formed majority of this outstanding. Buyers Credit was used as a cheap source of financing working capital cycles by the Importers. While a large percentage of the overall Buyers Credit Outstanding was taken by Large Corporates to avail financing rates close to Libor, it was also used as a primary source of Import financing by many Small and Medium Enterprises as the cost of borrowing Libor linked Buyers Credit was usually below 5% (all in) Vs the Rupee borrowing rate of approx. 10-12% depending on the credit profile of the borrower.

We have compiled below the quarterly disbursements of Trade Credits from April 2016 to Dec 2018 and compared it to Goods Imports in the same period.

Chart 1: Indian Imports vs Trade Credit Disbursements (USD Bn)



Source: RBI, Balance of Payments Quarterly reporting & DGCI&S and Ministry of Commerce & Industry.

Impact of Buyer's Credit ban on Import Financing in India

RBI banned the issuance of Buyers Credit in March 2018, the impact is summarized below:

Immediately after ban on LoUs, trade credit flows declined by 50.5% quarter on quarter in Apr-June18 quarter as Buyers Credit accounted for majority of Trade credits and even though the fall in Buyers Credit was partly substituted by increase in Suppliers Credit, it could not offset the gap fully.

The Trade credit flows in Oct-Dec18 quarter further dropped to only USD 7.06 Billion which is a 72% drop from the levels of USD 25.5 Bn in the same quarter last year thus highlighting the seriousness of the issue.

On the other hand, the Imports in India have increased quarter on quarter with 6% increase in Oct-Dec18 quarter over the same period last year.

With Increase in Imports and significant drop in Trade credits to support imports, the Trade credit to Import ratio fell from 20.2% immediately before the LoU issuance was discontinued to a dismal level of 5.5% in Oct-Dec18 quarter.

It can be safely assumed that with the lack of availability of foreign currency denominated Buyers Credit to support imports, many Importers might have made up for the Trade credit shortages by borrowing under their expensive rupee line of credits or moved to domestic procurements (which might have been costlier than imports). This was mainly the case with SMEs in India who were either not aware of alternative methods like Usance Payable at sight (UPAS), Suppliers Credit or did not have the bank limits available for structuring alternate products.

While the Buyers Credit in its previous form has been discontinued by RBI, all is not lost and importers still have options to finance their imports in foreign currency. We explain below two most widely used structures which are very popular globally but have not been used much by SMEs in India — **Usance Payable at Sight (UPAS) and, Reimbursement Finance (RA/IRU)**. These are Win-Win solutions which provide Foreign currency payment to Exporter at sight, but Importer can avail credit period using Non-Fund LC facility. This can be used by exporters for Export finance also where Exporter gets paid upfront by availing UPAS/RA and Importer gets credit period.

Prerequisites of availing Import Financing solutions (UPAS and RA)

Step 1. For availing these Import financing solutions Importers need to have approved Non-Fund based Letter of Credit facility limits with banks in India with Usance LCs allowed.

Points to note:

a. If the facility allows only Sight LCs, importer needs to approach their bank to change the LC limit to Usance LC limits.

b. If Importer has only Fund based limits or previously Buyers Credit limits, he/she should request the bank to provide a LC sub-limit for issuing import Usance/Deferred LCs.

c. Please request LC limit enhancements if limits are not sufficient to cover Imports

Step 2. Importer and Exporter need to negotiate trade terms where Importer can open an Import Usance LC from a bank acceptable to Exporter, but the Exporter will get paid upfront by discounting the LC (under UPAS/RA structure). The discounting will be arranged by the Importer

If Importer's Banks are not acceptable to the Exporter then LC Confirmation from an acceptable bank in any other country can be arranged

Option 1.

Usance Payable at Sight (UPAS) explained

Usance credit payable at sight is a structure where the LC issued by Importer's bank is a Usance LC and contains clauses that allow the Exporter to get paid immediately through a financing bank while the Importer pays after the end of the usance period, thus availing credit period. The associated expenses including draft acceptance charge, discounting interest and service charge are paid by the Importer.

Benefits of Usance Payable at Sight

- Importers are able to avail credit period equal to the usance period of the LC even if the Exporter requires immediate payment. In the process Importers can still avail the commercial discounts offered by the customer for immediate payments
- Importers can use their Non fund based lines to avail this financing (like Buyers Credit) and do not need to draw down on expensive Rupee financing and this will not show as debt on their balance sheet.
- Importers can get the UPAS financing from any other bank and do not have to be dependent on its own working capital bank. The Importer can choose a bank which offers the lowest cost of financing as that bank would be taking a risk on Importer's LC issuing bank and not the Importer.

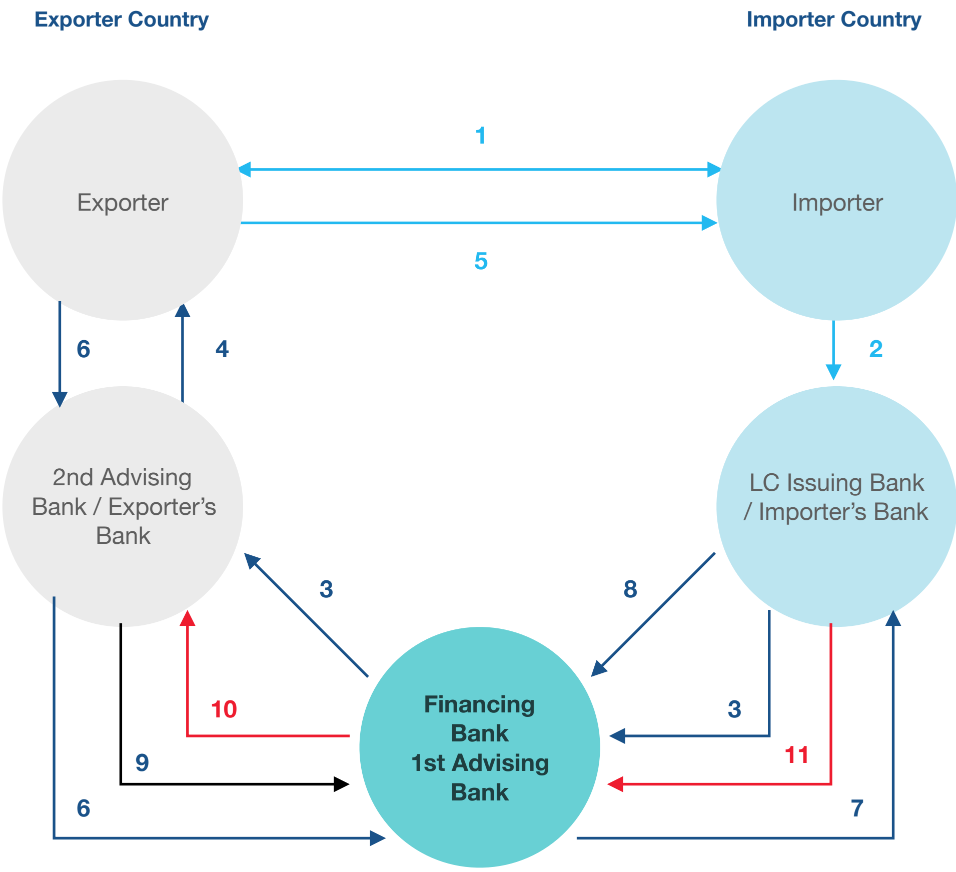
Process of Usance Payable at Sight

1. The Importer and Exporter get into a contractual Agreement to use Usance LC which gets paid at sight. Importer/Exporter identifies a Financing Bank (LC pre issuance stage)
2. Importer requests a Usance Letter of Credit (LC) from Issuing Bank (under its Non fund limits) e.g. 180 days usance. The LC would be restricted to the Financing bank
3. Issuing Bank sends the LC to Exporter's Bank (2nd Advising Bank) through identified Financing Bank (1st Advising Bank) restricting negotiation to Financing bank
4. Exporter's Bank notifies Exporter that the LC has been issued
5. Exporter ships goods to the Importer
6. Exporter send documents to the Exporter's bank who forwards it to the Financing Bank (1st Advising Bank)
7. Financing Bank (1st Advising Bank) checks and sends documents to the Issuing Bank for acceptance

8. Issuing Bank provides acceptance to Financing Bank including a Term Bill of exchange which Financing Bank will communicate to Exporters bank.
9. Financing Bank will purchase the drafts from Exporter's Bank
10. Financing Bank will provide funds to Exporter's Bank for payment to Exporter, so exporter is paid on sight.
11. On maturity date, Issuing bank will pay the funds to Financing Bank by debiting importer who avails a 180 days credit

Points to Note

1. The Exporter's Bank can be the Financing Bank, Advising Bank, Confirming Bank and Negotiating Bank. In that situation only 1st advising bank is needed. This is possible when the financing bank has a relationship with the exporter and holds 'Know Your Customer' (KYC) on Exporter.
2. In some cases Financing Bank insists on doing KYC on the exporter even to act as first advising/financing bank.



Option 2.

Reimbursement Authorization Structure (RA) explained

The Reimbursement Authorisation (RA) structure is similar to UPAS where the Importer gets a credit period and Exporter gets paid at sight, however the two structures are different when it comes to process and document flow. While the UPAS structure requires the LC and documents to be routed through the Financing bank, the RA structure does not require the LC and Trade documents to be routed through the Reimbursement bank instead the acceptance for LC and copies of other documents are sent to Reimbursement bank by the Issuing Bank through Swift network. This gives additional flexibility to get a Reimbursement bank anywhere in the world (as original trade documents are not routed through it). A Reimbursement Bank is a bank which has been authorized by the Issuing bank to provide reimbursement to the Exporters bank (claiming bank) by accepting and paying a time draft drawn on the reimbursing bank.

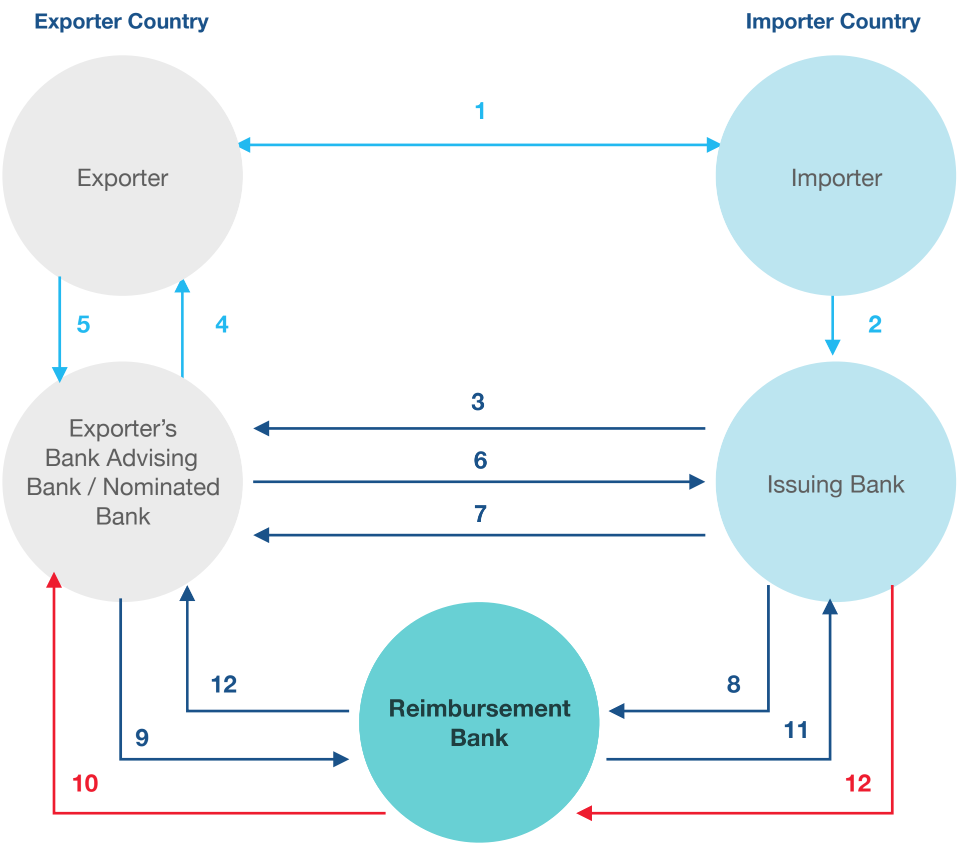
Benefits for the Importer

- Importers can avail credit period equal to the usance period of the LC even if the Exporter requires immediate payment. In the process Importers can still avail the commercial discounts offered by the customer for immediate payments
- Importers can use their Non-fund based lines to avail this financing (like Buyers Credit) and do not need to draw down on expensive Rupee financing and this will not show as debt on their balance sheet.
- Importers can get the Reimbursement financing from any other bank and do not have to be dependent on its own working capital bank. The Importer can choose a bank which offers the lowest cost of financing as that bank would be taking a risk on Importer's LC issuing bank and not the Importer.
- As the original documents are not required to be routed through the Reimbursing bank, the process is faster and the location of Reimbursement bank does not matter.

Process of Reimbursement Finance

1. Contractual Agreement between Exporter and Importer to issue a Usance LC where exporter gets paid at sight and Importer gets credit period. Importer/ Exporter identifies the Reimbursement Bank (LC pre issuance stage)
2. Importer requests a Usance Letter of Credit (LC) from Issuing Bank (under its Non fund limits) e.g. 180days usance

3. Issuing Bank issues a Letter of Credit and sends the LC to the Exporter's Bank (LC includes a reimbursement bank and reimbursement clauses)
4. Advising Bank notifies Exporter that the LC has been issued
5. Exporters ships and presents documents to Advising Bank/Exporters Bank
6. Advising Bank sends documents to the Issuing Bank for acceptance
7. Issuing Bank provides acceptance to Advising Bank and authorizes Advising Bank to claim on Reimbursement Bank
8. Issuing Bank authorizes Reimbursement Bank to pay Advising Bank and gives Reimbursement authorization (sends Acceptance, copies of documents, Reimbursement undertaking)
9. Advising Bank sends reimbursement claim to Reimbursement Bank (MT742)
10. Reimbursement Bank makes payment to the Advising Bank who pays the Exporter
11. Reimbursement Bank will advise Issuing Bank of the payment, Interest and maturity date
12. On maturity date, Issuing bank will pay the funds to Reimbursement Bank



Sample Reimbursement Clauses to be added to LC
(Only for illustration as these clauses may differ from bank to bank)

LC Field	**Clause to be incorporated**
Field 40 E	UCP URR LATEST VERSION
Reimbursing Bank (Field 53a)	Name of the Reimbursement Bank (Swift Code)
Additional Conditions (Field 47a)	1. 'Name of Reimbursement Bank', (Swift BIC: _______) is nominated as the reimbursing bank 2. Negotiating Bank to claim reimbursement at **sight** from reimbursing bank after documents under LC have been presented to the LC issuing bank. Reimbursing bank will honor the claim post receipt of acceptance from _____________(LC issuing Bank). 3. The reimbursement under this credit is subject to ICC Uniform Rules for Bank to Bank Reimbursements under Documentary Credits, URR 725
Field 42 c (Drafts at)	XXX days from the date of acceptance but reimbursement can be claimed by negotiating bank at sight from 'Reimbursement Bank Name) **(SWIFT code)**
Charges (Field 71b)	Discounting interest/charges on account of applicant / other commercial arrangement as agreed.

Documentation Required (by Financing bank for making reimbursements):

- LC copy
- LC Amendment Copy (if any)
- Acceptance Message (from Issuing Bank to Nominated bank)
- Bill of Lading
- Commercial invoice

About the Author

Divya Tailang
Co-founder,
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Divya Tailang is the Cofounder and Director of Interlinkages Online, a Trade Finance Marketplace. Divya has over 14 years of experience in Corporate banking and International Trade Finance and has previously worked with large International banks across India, Hong Kong and USA before cofounding Interlinkages. Divya's Corporate Banking career is complemented by her prior work in the Manufacturing industry where she gained first-hand experience with cross border procurement, logistics and physical supply chain dynamics.

Divya has comprehensive background in Cross Border Financing, International Business Development and Structured Banking across both Mature and Emerging markets. Her experience includes structuring working capital optimization solutions like Supply chain financing, Receivable Financing, Liquidity Management solutions and non-traditional solutions like Royalty Monetization for bringing balance sheet efficiencies. During her tenure in the Banking industry, Divya primarily focused on North America-Asia corridors for diverse sectors and worked with many large retailers who procure from Asian suppliers

About Interlinkages

Interlinkages Online (www.interlinkages.online) is the first online platform which facilitates Importers and Exporters in accessing Trade Finance from banks around the world for their Letter of Credit backed imports or exports. The platform has a transparent deal matching mechanism which endeavors to make inaccessible banks accessible through a click of a button and provides seamless cross-border Trade Finance experience. Interlinkages delivers faster financing quotes and cost savings hassle free, for its clients through its online platform. Interlinkages team helps their clients be more profitable and grow their business by providing optimum solutions like Suppliers Credit, Usance Payable at Sight, LC Confirmations and Reimbursement Finance through its online platform. Interest cost savings for Interlinkages clients ranges from 0.20% - 1.50% per annum.

Interlinkages is headquartered in Hong Kong and has clients in India, Hong Kong, Singapore, Dubai and Bangladesh and has closed more than 200 transactions across 22 trade corridors

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