

**Report of the Working Group to evolve Guidelines for  
the use of Inspecting Officers of DBOD and ECD for the  
scrutiny of Foreign Exchange Transactions of banks and  
operations of Foreign Branches of Indian banks**

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Letter of Transmittal

Bombay  
5th March 1984

To

Shri A. Ghosh,  
Deputy Governor,  
Reserve Bank of India,  
Bombay.

Sir,

We have great pleasure in submitting to you the Report of the Working Group set up by the Reserve Bank of India to evolve guidelines for the use of the Inspecting Officers of the Department of Banking Operations and Development and the Exchange Control Department for the scrutiny of foreign exchange transactions of banks and operations of foreign branches of Indian banks. As stated in the Report, the Group considered it desirable that the various facets of foreign exchange business handled by banks in India and abroad and the guidelines for the scrutiny thereof should be discussed in detail with the intention that these could be suitably incorporated in the Inspection Manual of DBOD to serve not only as instructions for the guidance of Inspecting Officers but also as basic knowledge for the benefit of those who are not well-versed in the subject. While this and some intervening developments like the abolition of the sterling rates schedule and delinking of interest element from exchange rates necessitating modifications to the Report have somewhat delayed its finalisation, the Group expresses the hope that the recommendations and the guidelines, which are summarised

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in Chapter 16, will be found useful.

2. As Dr.(Kum.) M. Tyagarajan, who represented the Department of Economic Analysis and Policy on the Working Group, is out of Bombay on leave for a month, this letter is not being signed by her.

Yours faithfully,

Sd/-

(V. Subramanian)

Sd/-

(S.S. Thakur)

Sd/-

(S.S.H. Jhurani)  
Member Secretary

CHAPTER 1  
I N T R O D U C T O R Y

At the Conference of the In-charges of the Department of Banking Operations and Development held in February 1981, during the course of discussion on the subject of important aspects to be looked into when scrutinising foreign exchange transactions of banks, it was pointed out that the Department of Banking Operations and Development (DBOD) and the Exchange Control Department (ECD) were feeling the inadequacy of experienced and trained staff for scrutinising foreign exchange transactions which were becoming more and more intricate and complex. It was then suggested that a small Committee comprising officers from DBOD and ECD could be constituted for preparing guidelines indicating the specific aspects that should be looked into by the Inspecting Officers at the time of scrutinising foreign exchange transactions of banks and that this Committee could also consider the Inspection Manual (Foreign Exchange Business) and examine the areas in which it needs up-dating.

1.2 Accordingly, a Working Group was set up in August 1981 to evolve guidelines for the scrutiny of foreign exchange transactions of banks and operations of foreign branches of Indian banks, with the following terms of reference:

- (a) examine the important aspects to be covered while scrutinising the foreign exchange transactions of banks in the course of their inspection by the Reserve Bank of India,

- (b) review the system of internal control on various aspects of foreign exchange business, viz., inter-bank dealings, banker-broker relationship, rupee accounts of foreign banks, verification of balances, mode of currency valuation, method of booking profit/loss and suggest suitable guidelines for the use of the inspecting officers of both Department of Banking Operations and Development and Exchange Control Department,
- (c) examine the control systems in the Head Offices of banks over the working of the foreign branches including general supervision, control over foreign exchange transactions, guarantee and other contingent liabilities, fixing of limits for various currencies, country-wise risk exposure, control over the advances portfolio of the foreign branches, etc., and suggest modifications, if any, necessary in such control systems,
- (d) examine the system of inspection of foreign branches of Indian banks by the Reserve Bank of India and suggest a suitable policy for such inspections in regard to periodicity, coverage, etc., and
- (e) any other related matter which the Group may like to go into.

A copy of the Memorandum setting up the Working Group is given in Appendix I.

1.3 Shri R.C.Mody, the then Additional Chief Officer, Industrial Credit Department (now Industrial and Export Credit Department) was nominated as the Chairman of the Group, which besides Shri Mody consisted of Shri S.S.Thakur, Controller, Exchange Control Department, Shri V.M.Sunder Raj, then Director, Economic Department, and Shri S.S.H.Jhurani, Deputy Chief Officer, Department of Banking Operations and Development (Member-Secretary). In the place of Shri Mody, Shri V. Subramanian, Additional Chief Officer, Department of Banking Operations and Development, was nominated as the Chairman of the Group in December 1981, vide the Memorandum given in Appendix II. Further, consequent on the reorganisation of the Economic Department, in the place of Shri Sunder Raj, Dr.(Kum) M. Tyagarajan, Adviser, Department of Economic Analysis and Policy, attended the meetings of the Group.

1.4 The Group held ten meetings. In order to draw on the expertise of the Inspecting Officers of the Department of Banking Operations and Development and the Exchange Control Department as also the members of faculties of the Bankers Training College and the Reserve Bank of India Staff College, who had <sup>had</sup> sufficient experience of scrutinising foreign exchange transactions of banks and/or were associated with courses on the subject, the Group invited their suggestions. A summary of the replies received is given in Appendix III. Further, with a view to knowing the existing systems of internal

controls exercised by banks on various aspects of foreign exchange business and control systems in the Head Offices of Indian Banks over the affairs and working of foreign branches, two questionnaires were sent to 12 Indian banks and 3 foreign banks operating in India. Copies of the questionnaires are furnished in Appendices IV and V and the information received from the banks has been summarised in Appendices VI and VII.

1.5 The Group considered whether it should only formulate guidelines regarding the scrutiny of foreign exchange transactions of banks and operations of foreign branches of Indian banks for the Inspecting Officers of DBOD and ECD as required by its terms of reference or should also examine the relevant instructions contained in the Inspection Manual of DBOD and bring them up-to-date. It was felt that with the coming into force of the 1978 edition of the Exchange Control Manual which has delegated wider powers to authorised dealers and other developments in the field of foreign exchange business handled by banks, the instructions given in the Inspection Manual, which was written in 1976, needed amplification and up-dating. Accordingly, the various facets of foreign exchange business and guidelines for the scrutiny thereof have been discussed in greater detail in the report with the intention that these could be suitably incorporated in the Inspection Manual to serve as instructions for the

guidance of Inspecting Officers and basic knowledge for the benefit of those who are not well-versed in the subject.

1.6 The Group is thankful to the banks which responded to its questionnaires and furnished other useful information as also to the Officers of DBOD and ECD who made suggestions regarding aspects of foreign exchange business that may be scrutinised during inspections.

1.7 The Group would like to record its deep appreciation of the invaluable role played by Shri S.S.H.Jhurani, its Member-Secretary, whose knowledge and painstaking efforts could make it possible for the Group to cover the various aspects of foreign exchange business in detail. The Group is also thankful to Shri V.Subrahmanyam, Joint Controller, Exchange Control Department, for the contributions made by him in preparing the report.

## CHAPTER 2

### SYSTEMS OF INSPECTION BY DEPARTMENT OF BANKING OPERATIONS & DEVELOPMENT AND EXCHANGE CONTROL DEPARTMENT.

#### System of inspection by Department of Banking Operations and Development.

Presently, the Department of Banking Operations and Development (DBOD) conducts two types of regular inspection, viz., financial inspection of public and private sector banks and annual appraisal of public sector banks. The financial inspection of public sector banks is carried out once in five years while the periodicity of inspection of other banks depends on the size of each bank. During the course of financial inspection of a bank, its foreign exchange business is also scrutinised.

2.2 A set of inspection forms for statistical data on foreign exchange business has been devised with a view to enabling the Inspecting Officers to collect the basic material required for the purpose of inspection. Although the forms have been devised for compilation by the Head/Principal Offices of banks, some of them are used by the officers inspecting branches for collection of the branch-wise data.

2.3 The Officers inspecting branches which handle foreign exchange business are required to submit a separate note on the pattern outlined in the Inspection Manual of DBOD. The violations of the provisions of the Exchange Control Manual and other serious irregularities are to be reported in the

relative Annexures, in duplicate, to the branch inspection notes and one copy thereof is forwarded to the local Exchange Control Department, under advice to the Central Exchange Control Department, in order to expedite follow-up action thereon. The Principal Inspecting Officer is required to prepare a consolidated note on the foreign exchange business of a bank on the basis of information furnished in branch inspection notes as well as features observed and/or data collected by him. The outline of the consolidated note is given in the Inspection Manual. A suitable mention is to be made in the consolidated note that the violations and other serious irregularities have already been brought to the notice of the local Exchange Control Department, as indicated above, and such information need not be repeated in the consolidated note which should cover only important aspects on foreign exchange business of the bank besides any other policy matters which the Principal Inspecting Officer feels would require examination by the Central Offices of DBOD and/or ECD. The following statistical data, etc., are required to be furnished in the Annexures to the consolidated note.

(i) Overdue export bills negotiated/sent for collection which have not been reported by the bank to the Exchange Control Department and/or for which Exchange Control permission for extension of time for realisation has not been obtained or has expired.

(ii) Import bills (against cash import licences) in respect of which remittances were made six months after the date of

shipment, without the approval of the Exchange Control Department.

(iii) Irregular or overdue forward purchase and sale contracts outstanding as on the date of inspection.

(iv) Long-outstanding larger items (i.e., items amounting to foreign currency equivalent of Rs.10,000 or more) in accounts with branches outside India (including Head Office in the case of foreign banks), banks and/or correspondents outside India, which have remained unadjusted/unresponded to for more than three months.

(v) Currency-wise spot, forward and net foreign exchange position of the bank as on the date of inspection.

(vi) Cases of serious omissions, discrepancies, etc., in the figures of sales, purchases and balances as reported in the bank's returns to the Exchange Control Department.

(vii) Income from foreign exchange business by way of exchange, commission and interest of the Indian branches/Indian offices of the foreign bank during the last three calendar years.

(viii) Note on the serious violations/contraventions of or non-compliance with the provisions of the Exchange Control Manual, Rules of the Foreign Exchange Dealers Association of India, etc.

(ix) Particulars of exchange profit/loss booked by the bank on devaluation/revaluation of currencies and the manner in which it has been disposed of/adjusted.

(x) Position of deposits and advances of the foreign branches of Indian banks.

(xi) Country-wise profit/loss of the foreign branches of Indian banks during the last three calendar years.

(xii) List of advances at the foreign branches of Indian banks which are considered by the bank as bad or doubtful of recovery and have been fully or partly provided for by it.

(xiii) Suit-filed and decreed debts at the foreign branches of Indian banks other than those at item (xii) above.

(xiv) Comments on advances at the foreign branches of Indian banks which are having major undesirable features other than those at items (xii) and (xiii) above.

A copy of the consolidated note on the foreign exchange business of the bank is forwarded to the Exchange Control Department for necessary follow-up action.

2.4 The Inspecting Officers are required to conduct a critical study of the organisational set-up, internal control machinery, nature and trend of foreign exchange business, financing of exports and imports, booking of forward exchange contracts, exchange rates, currency position and cover operations, agency arrangements with foreign correspondents, conduct of non-resident accounts, operations in foreign currency accounts, income from foreign exchange business, booking of exchange profit, loans and overdrafts to foreigners and foreign controlled companies/firms, borrowings from

overseas branches and correspondents, blocked accounts, conduct of accounts of foreign embassies/foreign governments/other foreign government establishments, bilateral trade accounts, outward/inward remittances, issue of guarantees and submission of returns to the Exchange Control Department. The Inspecting Officers carry out a test check of a few selected transactions under each category. Because of the special nature and various technicalities of the foreign exchange transactions, the Inspecting Officers have been instructed that before undertaking a scrutiny, they should familiarise themselves with the Guidelines for Internal Control over Foreign Exchange Business, the important provisions of the Exchange Control Manual and the Rules of the Foreign Exchange Dealers Association of India as also the circulars issued by the Exchange Control Department and FEDAI from time to time. Detailed instructions in regard to the various aspects to be seen during the financial inspection have been furnished in Chapter 5 of the Inspection Manual.

2.5 During annual appraisal inspections (which are confined to public sector banks), the Inspecting Officers are expected to cover broadly the systems and procedures in respect of foreign exchange business and furnish their critical comments in the paragraph on foreign exchange business in the report. No separate note is, however, required to be furnished.

System of inspection by  
Exchange Control Department.

2.6 Till 1970, during the course of inspection of a bank conducted by DBOD, the Exchange Control Department used to

generally depute a suitable Clerk Grade I/Staff Officer Grade 'A' for the limited purpose of verification of some of the returns submitted by authorised dealers. DBOD expressed difficulty in undertaking a detailed verification of certain routine aspects of the foreign exchange business of banks because if the Inspecting Officers of the Department were to be so burdened, the completion of inspections would be delayed. Further, DBOD was of the view that the foreign exchange business of a bank cannot in any manner be segregated from its other operations and that in any case all important aspects of the foreign exchange business of a bank were examined in detail by the Inspecting Officers of the Department. In view of the foregoing, the idea of setting up Inspection Units in the Exchange Control Department was mooted. It was proposed to confine the activities of the Inspection Units to the carrying out of ad-hoc inspections of a special nature besides scrutiny of some specific aspects of the foreign exchange business of authorised dealers for verifying whether they are complying strictly with the instructions issued by the Exchange Control Department. To start with, Inspection Units were set up in early 1970 at Bombay, Calcutta, Madras and New Delhi. However, as the Inspection Units were small, it was decided that DBOD would continue to conduct inspections of authorised dealers even from the Exchange Control angle and that ECD would continue to depute a suitable Clerk Grade I/Staff Officer Grade 'A' for the limited purpose of verification of returns as before. The main areas covered by the Inspection Units in

their ad-hoc inspections were collection and processing of Exchange Control data, export transactions, remittances against imports, loans and overdrafts, ordinary non-resident, non-resident(External) and blocked accounts, inter-bank dealings and cover operations, forward contracts, sundry remittances and complaints. Apart from the above, the Inspection Units conducted inspections of full-fledged/restricted money changers, travel agents and airline/shipping companies and certain special inspections relating to realisation of export proceeds.

2.7 In 1976, additional Inspection Units were set up at Ahmedabad, Bangalore, Cochin and Kanpur in order to relieve the pressure on the four existing Inspection Units. After the publication of the 1978 edition of the Exchange Control Manual which delegated to authorised dealers wider powers, it was considered necessary to tighten supervision over their transactions. Accordingly, ECD has since set up Inspection Units at all its full-fledged offices. The Inspection Division in Central ECD co-ordinates the work of Inspection Units at all the Regional Offices and exercises surveillance over them.

2.8 As stated earlier, the main activities of the Inspection Units are to carry out ad-hoc inspections of a special nature besides a scrutiny of some specific aspects of the foreign exchange business of authorised dealers. The services of the Inspection Units are also utilised to investigate into complaints, news and comments published in newspapers, suspected malpractices, parliamentary questions and specific

problem areas for making policy decisions. Since January 1980, the Units have undertaken inspection of authorised dealers from export statistics/follow-up angle for ensuring that the export transactions are correctly reported in 'R' returns and the effective follow-up of export bills exists, as also to verify whether authorised dealers have implemented the Guidelines for Internal Control over Foreign Exchange Business issued by ECD. In order to keep liaison, all serious irregularities coming to the notice of ECD during its inspections are advised to DBOD.

#### Recommendations

2.9 It will be seen from the foregoing that the various aspects pertaining to the foreign exchange business of a bank are scrutinised during its financial inspection by DBOD. While in the case of annual appraisal inspection of public sector banks, the systems and procedures are broadly seen, no separate note on foreign exchange business is prepared. Thus, the annual appraisals do not effectively serve the purpose of scrutiny of the foreign exchange business of authorised dealers. Even in regard to financial inspections, having regard to the time-lag between successive inspections which is as much as five years in the case of public sector banks, the scrutiny which is confined to only a test check of a few transactions in each category, as indicated in the Inspection Manual, cannot be considered adequate. As regards the inspections and scrutinies carried out by ECD, they are only selective covering specific aspects and that too not of all authorised dealers on a regular basis. Having regard to certain adverse features in

respect of foreign exchange operations of banks which have of late come to surface, there is a need for a separate periodical inspection of certain aspects of foreign exchange business so that the general inspection is not burdened with detailed examination of these aspects. The introduction of such a system will make the scrutiny of the foreign exchange operations more incisive and meaningful and follow-up action will also be more effective. It is understood that the Working Group under the Chairmanship of Shri V.G. Pendharkar to review the existing system of inspection by DBOD has recommended that general inspections should be annual so that there can be a system of rating of a bank's performance in each of the key areas. It has further observed in its report that there is a need for other types of scrutinies limited in scope and it has suggested that short inspections may be undertaken, among other things, to ensure that the Exchange Control regulations and the Reserve Bank's Guidelines for Internal Control over Foreign Exchange Business are complied with. This Group endorses the view of the Pendharkar Working Group and recommends further that such portfolio inspections of foreign exchange operations of banks actively engaged in foreign exchange dealing operations (presently about a dozen) may be conducted once a year and in the case of other authorised dealers once in two years. While aspects relating to import and export finance are relevant for an assessment of the quality of advances and the method of booking foreign exchange profit in regard to the scrutiny of the profit and loss account and examination of the profitability of the bank, other aspects pertaining to the

organisation of Dealing Department, cover and dealing operations, management of risks through dealers' limits, forward exchange contracts, Non-resident(External) and FCNR accounts, Rupee(Vostro) accounts of Exchange Houses and overseas correspondents/Head Offices/branches, reconciliation of Nostro balances and returns submitted to ECD, can be covered during the short inspections so that regular inspections are not burdened with a probe into these aspects except to the extent necessary to make an evaluation of the efficacy of internal controls over the foreign exchange operations. Such short inspection of foreign exchange business can be carried out jointly by DBOD and ECD. In case this recommendation is accepted, the formats of the branch inspection note and the consolidated note on the foreign exchange business as also the Annexures thereto given in the Inspection Manual, will require to be suitably amended.

2.10 The Group feels that there is a dearth of experienced and well trained officers at all levels in DBOD and ECD to scrutinise the foreign exchange transactions of banks and operations of foreign branches of Indian banks and, therefore, recommends that a pool of officers conversant with the Exchange Control regulations and having the necessary expertise should be built up to facilitate the portfolio inspections. It is necessary that the officers (in Grade 'C' and above) undertaking such inspections should have undergone training (say for two months) in a commercial bank authorised to deal in foreign exchange and attended the advance foreign exchange course of the Bankers Training College as also the Bourse programme

conducted by the College or authorised dealers (like Citibank and Grindlays Bank p.l.c.). On a selective basis, officers (in Grade 'D' and above) should also be sent abroad for a month or so to study and have insight into the working of the active overseas money and foreign exchange markets. DBOD and ECD should also arrange for in-house training programmes for Officers (in grades 'A' and 'B'). The officers so trained should be retained in DBOD/ECD for a period of at least five years if not more for being deployed for the purpose for which they have been trained.

2.11 As regards the aspects to be seen during the general inspections and the short inspections, the instructions given in the Inspection Manual need some elaboration. These aspects, which are intended as guidelines to the Inspecting Officers, are dealt with in detail in the subsequent Chapters 3 to 12.

CHAPTER 3FOREIGN EXCHANGE POSITION, FOREIGN  
CURRENCY ACCOUNTS AND CONTROL OVER  
RECONCILIATION OF NOSTRO BALANCESWhat is meant by exchange position

An exchange position is made up of all sale and purchase transactions, ready or forward, in a given currency for which a firm rate has been quoted, whether such transactions have been completed or not. The transactions may arise from dealings with customers, branches and correspondents, in local as well as international foreign exchange markets and with the Reserve Bank. Broadly, the following items enter into exchange position.

Purchases or Assets Side.

- (i) Foreign currency notes on hand.
- (ii) Balances in Nostro accounts as per the bank's books.
- (iii) Inward remittances received from banks/branches abroad and paid. These will include T.Is., D.Ds., and M.Is., in foreign currencies.
- (iv) Outward foreign bills negotiated, purchased or discounted, both demand and usance, including foreign currency cheques and drafts, for which cover has not yet been received.
- (v) Forward purchase contracts.
- (vi) Purchases of exchange, both ready and forward, undertaken to cover sales to customers and to maintain position and/or working balances in Nostro accounts.
- (vii) Any other foreign exchange transaction which has

resulted or is likely to result in a credit to a Nostro account, and for which a firm rate has been quoted.

(viii) Import bills received under letters of credit pending retirement.

3.2 Because of different methods of accounting followed by banks (upto 31st December 1983), import bills received under letters of credit may or may not be included in exchange position. The various methods are described below :-

(a) There are banks which do not respond to debits in their Nostro accounts in respect of import bills but only record receipt of documents in Import Bills Received Register. The rate of exchange is not fixed (unless import bills are under forward sale contracts with importers) and banks provide a clause in the presentation memo that import bill is 'Payable at the rate of exchange ruling on the date of payment'. However, since foreign currency amounts of import bills received under letters of credit are debited to Nostro accounts, banks replenish the accounts by making spot purchases of foreign currencies. Further, to protect against exchange risk, the spot purchases may be covered by banks by forward sales in foreign exchange market or they may insist on importers to enter into forward contracts for the retirement of import bills. When bills are paid by importers, banks respond to debits in Nostro accounts and foreign currencies sold to importers are entered in exchange position as ready sales. Till then,

exchange positions in various currencies may not reveal true picture and may adversely affect income of banks in case of wide fluctuations in exchange rates or devaluation/revaluation of foreign currencies.

(b) Some banks adopt the method of retiring import bills by effecting sale of foreign currency and debit the importer's account or grant him a loan equivalent to rupee amount at the rate of exchange (B.C. selling rate) prevailing on the date of receipt of documents. Such banks will not have 'Import Suspense Account' in their exchange position.

(c) The third method of accounting, which is more popular with banks, is to open an Import Suspense, Advance Bills Purchased, Letters of Credit Bills Receivable, Payments Against Documents or like account, debit thereto the rupee equivalent of foreign currency amounts of import bills received under letters of credit at notional rates and respond to the debits in Nostro accounts. The entries in Import Suspense or like account, which is maintained separately for import bills in each foreign currency, are expressed both in foreign currency and rupee equivalent, and are adjusted when bills are paid by importers at rates of exchange ruling on dates of payment or at agreed rates of forward contracts entered into by them. The balance in foreign currency outstanding in Import Suspense or like account is entered in exchange position for it represents

debits which would have remained outstanding in Nostro accounts if Import Suspense or like account is not maintained. Hence, overall exchange position remains unchanged.

3.3 However, with effect from 1st January 1984, in terms of the guidelines issued by FEDAI, with the approval of the Reserve Bank, a sight import bill received under a letter of credit and conforming to the terms of credit may be held in foreign currency for a maximum period of 10 days from the date of receipt of documents by the bank, and in case of non-payment by the drawee within 10 days, the importer's liability should be crystallised by converting the foreign currency amount of the bill into rupees at the B.C. selling rate prevailing on the 10th day or the forward exchange contract rate where applicable. All import bills under letters of credit should be reported as 'sales' to the Reserve Bank when the rupee liability is crystallised.

#### Sales or Liabilities Side

- (i) Overdrawn balances in Nostro accounts as per the bank's books.
- (ii) Outward remittances in foreign currencies, that is, telegraphic transfers, mail transfers or demand drafts (clean sales).
- (iii) Inward foreign bills covering imports which have been paid or for which exchange is fixed as per agreement between

the bank and importer.

(iv) Forward sale contracts.

(v) Sales of exchange, both ready and forward, undertaken to cover purchase from customers and to maintain position and/or working balances in Nostro accounts.

(vi) Any other foreign exchange transaction which has resulted or is likely to result in a debit to a Nostro account, and for which a firm rate has been quoted.

3.4 Under the Foreign Currency (Non-resident) Accounts Scheme, the exchange risk involved in maintaining non-resident accounts in designated foreign currencies and repatriating the balances in those currencies along with interest accrued thereon, is borne by the Reserve Bank. Purchases from and sales to authorised dealers of the designated foreign currencies by the Reserve Bank in respect of deposits and withdrawals in FCNR accounts are made at notional rates announced by the Reserve Bank from time to time. Hence, deposits and withdrawals in FCNR accounts need not be brought into exchange position.

3.5 Foreign (outward) bills negotiated, purchased or discounted, by virtue of a firm rate of exchange being quoted on the very day, will be included in exchange position on the same day although they will be paid abroad after some given time. On the contrary, an outward bill for collection does not enter into exchange position until it is paid and its proceeds are received. This is so because a firm rate of

exchange for a bill for collection can be quoted only at the time of converting the foreign currency proceeds into rupees for payment to beneficiary. However, if a customer enters into forward exchange contract with the bank in respect of a bill sent for collection, the transaction in the form of forward purchase contract is entered into exchange position on the date the contract is fixed, and not on the date on which foreign currency proceeds are converted for payment to the customer. The date on which the contract is fixed may not also synchronise with the date on which the bill is sent for collection. Similarly, in the case of inward foreign currency bills received for collection, the items will not enter exchange position until they are paid by importers and sale of foreign currency is effected. If, however, a forward contract is entered into by importer to cover an inward bill, the forward sale will find a place in exchange position on the date of fixing the contract. Deliveries under forward purchase and sale contracts are not entered into exchange position because these are transactions in fulfilment of existing commitments in the form of forward exchange contracts which have entered into exchange position on the dates they are fixed.

3.6 Effective from 1st January 1984, in those cases where foreign currency export bills negotiated, purchased or discounted remain unpaid for a period of 30 days after the transit period in case of demand bills and the due date in case of

usage bills, the foreign currency amounts of the bills should be delinked, i.e., converted into rupees, on the 30th day. The details of the guidelines issued by FEDAI in this regard are given in Chapter 5. Accordingly, such bills will enter exchange position thrice, that is, firstly when the bills are negotiated, purchased or discounted, secondly when the foreign currency amounts thereof are converted into rupees on the 30th day (notional sale), and thirdly when the bills are realised and the foreign currency proceeds are purchased by the bank.

3.7 A dealer may take over foreign currency purchases made by another branch of the bank in India or he may buy foreign currency from a correspondent or overseas branch to enable the latter to lay down rupees in Vostro accounts. Also, a sale of one foreign currency at a foreign centre against another foreign currency results in a purchase of the latter foreign currency, e.g., a sale of U.S. dollars in London, against pound sterling, whether in cover of customer transactions or against purchase from the local inter-bank market, results in indirect purchase of pound sterling. A dealer may also buy his pound sterling requirements from inter-bank market or the Reserve Bank. All these transactions enter into exchange position on purchases side. Likewise, a dealer may sell to the bank's branch in India in order to enable it to cover its exchange operations. He may sell foreign currency to a correspondent or an overseas branch of the bank if the latter has accumulated rupees in its Vostro

accounts and wants the whole or a part of the balance to be remitted. The dealer may also sell his surplus foreign currency to the Reserve Bank or in inter-bank market. All these transactions enter into exchange position on sales side.

#### Net open positions

3.8 The foreign currency open position can be defined as the extent to which assets and outstanding contracts to purchase that currency exceed liabilities plus outstanding contracts to sell that currency and vice versa. In other words, a bank has a net open position in a foreign currency when its assets in that currency (including spot and forward purchase contracts) and its liabilities in the same currency (including spot and forward sale contracts) are not equal. An excess of assets over liabilities connotes a net 'long' or 'overbought' position and in the opposite case, an excess of liabilities over assets connotes a net 'short' or 'oversold' position. Such difference in assets and liabilities of a bank is also called its 'exposure in a particular foreign currency. An overbought position in a depreciating currency represents an exchange loss to the bank relative to the book value because as time passes, the assets will be convertible into fewer units of the rupee. Similarly, an oversold position in an appreciating currency represents an exchange loss to the bank relative to the book value because as time passes, the settlement of the liabilities will require conversion of more units of the rupee. In the event of both

assets and liabilities in a foreign currency being equal, the bank is said to carry a 'square' position. As indicated in paragraph 3.1.1 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank, net positions should be valued for each currency separately.

### Position Book

3.9 For each currency, a Position Book or Position Register should be kept. It is simply a journal of purchases and sales, regardless of maturity, in each foreign currency. The Position Book registers purchases and sales in terms of two currencies, the foreign currency for which the Position Book is kept and rupees. Purchases are treated as debits and sales as credits. Additional columns identify other particulars of the transaction, such as the date of the transaction, the rate, the value date on which the transaction matures and the name of the other party to the transaction as well as the contract number. At the end of the day, or as often as necessary, net balances are computed. In addition to the Position Book maintained by the Accounts Department, the dealer in foreign exchange keeps Position Sheet (or Pad) for each foreign currency which reflects purchases and sales in that currency as also balances, extended as often as necessary, to enable the dealer to read the positions readily. Dealer's transactions are entered in the Pad as they occur. Operating departments' transactions (say, relating to exports and imports) for amounts above

certain limits set by the bank are reported to the dealer and are entered in the Pad as they occur while transactions below the limits are generally reported to the dealer in totals either at intervals during the day or after the close of business. The Dealer's Pad should contain the opening position in the currency, brief particulars of the transaction, the rate at which the deal is concluded, the amount of the foreign currency bought or sold ( to the nearest 10, 100 or 1000 units depending on the value of the currency), time, broker/overseas and progressive net position. The time of the transaction is useful in case of a doubt or a dispute as also for assessing the quality of judgement in effecting the deal. The positions in various currencies as reflected in the Dealer's Pad and the Position Register maintained by the Accounts Department should be tallied daily and discrepancies, if any, reconciled before commencing dealing operations on the next day.

#### POS statement

3.10 Authorised dealers maintaining their own positions in the foreign currencies mentioned in paragraph B.1 of Chapter 31 of the Exchange Control Manual are required to submit to the Exchange Control Department a weekly statement in the form POS, giving details of their positions in the respective currencies as appearing in their books as at the close of business on each day (Monday to Friday) together with total merchant and inter-bank (including Reserve Bank and overseas banks) purchases

as also total merchant and inter-bank sales. The statements are required to be furnished as on Friday each week so as to reach the Reserve Bank by the succeeding Tuesday. POS statement also contains the rupee position as on Friday, cash balance as on Friday as per local books as well as overseas correspondents' books. The statement serves to check the following points :

(i) Whether the inter-bank dealings are out of alignment with the merchant base.

(ii) Whether the currency exposures in different currencies are abnormal.

(iii) Whether banks are maintaining unduly large credit balances in Nostro accounts and/or overdrawing the accounts much beyond the limit of Rs.20 lakhs without prior approval of the Reserve Bank.

(iv) Whether the reconciliation of Nostro accounts is in arrears.

### Cash Position

3.11 The cash position in a foreign currency is the actual balance in Nostro accounts in that currency and in determining the cash position, the transit period for remittances and the maturities of transactions are important considerations. The cash position will include many of the items in exchange position, but not all, and conversely, will include items which are not yet in exchange position. For instance, an outward foreign currency bill purchased will be in exchange position

on the date of its purchase but it will not enter cash position until it is paid. An inward foreign currency bill drawn under a bank's letter of credit will first enter cash position, since it is debited to the bank's Nostro account at the time of or immediately after negotiation, but it will not appear as a sale in exchange position until it is paid. Forward exchange contracts appear in exchange position on the date they are entered into because rates of exchange are fixed on that date, but they will enter cash position only when deliveries thereunder are effected for only then Nostro accounts are debited (in case of sales) or credited (in case of purchases). Thus, there is a need to reconcile cash position with exchange position regularly, preferably daily. In order to do this, items which are not common should be adjusted to obtain agreement. A possible method of verifying the accuracy of exchange position in each currency arrived at the close of each day in the Position Book, is as follows :

(Amounts in foreign  
currency)

- (i) Foreign currency notes on hand
- (ii) Plus outstanding export bills negotiated, purchased or discounted
- (iii) Plus outstanding import bills drawn under letters of credit opened by the bank
- (iv) Plus undelivered foreign purchases
- (v) Plus ledger balance (if debit) in foreign currency Nostro

(Amounts in foreign  
currency)

account as per Indian books

or

Minus ledger balance (if credit)  
in foreign currency Nostro  
account as per Indian books

(vi) Minus undelivered forward sales

Net overbought (+)/  
oversold (-) positionForeign Currency Accounts

3.12 Authorised dealers may freely open and maintain accounts in any permitted currency with their branches and correspondents situated in the country of the currency concerned. An account with a bank in a country other than the country of the currency concerned can be opened only with prior approval of the Reserve Bank. The balances in foreign currency accounts (Nostro accounts) represent stocks of foreign currencies held by a bank with its correspondent banks (including its own branches or offices abroad). The bank's sales transactions will result in debits to its Nostro accounts in the concerned foreign currencies and the bank's purchase transactions will result in credits to its Nostro accounts in the relative foreign currencies. The accounts maintained by a bank in its own books to reflect transactions in foreign currency accounts are known as 'shadow accounts' or 'mirror accounts'. In the mirror accounts, the foreign currency

amount of each transaction and its rupee equivalent are posted. Debit balances in mirror accounts are assets and credit balances constitute liabilities.

3.13 Authorised dealers may maintain with overseas branches and correspondents, balances in foreign currencies at levels which are commensurate with normal needs of their business. They should ensure that balances are not accumulated in their accounts abroad which are in excess of immediate needs such as towards payments for imports or maturing deliveries under forward contracts. Authorised dealers should not lend foreign currencies to their overseas branches/correspondents or invest them in Treasury Bills, Call or Fixed Deposits, or in any other manner without prior approval of the Reserve Bank. However, in terms of A.D.(G.P.) circular No.62 of 1978, authorised dealers may freely agree to automatic arrangements with overseas branches/ correspondents whereby foreign currency funds rendered surplus on day-to-day basis may be transferred to 'special' interest bearing accounts with the facility of automatic retransfer to their current accounts.

3.14 Authorised dealers may avail themselves of loans, overdrafts and other types of credit facilities from their overseas branches and correspondents upto the maximum extent of Rs. 20 lakhs for meeting requirements of normal exchange business. This limit applies to the aggregate amount availed of by all offices/branches in India of the authorised dealer

from all overseas branches and correspondents of the authorised dealer. When the limit is exceeded because of unforeseen negotiations under letters of credit, etc., approval of the Reserve Bank need not be sought provided excess is adjusted within five days. These facilities cannot be used for purposes such as making loans and advances or for sale with a view to building up oversold position in the currency.

#### Control over Reconciliation of Nostro Balances

3.15 The instructions with regard to the control over reconciliation of Nostro balances are contained in Part 6 of the set of Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank, and these should be borne in mind by Inspecting Officer.

#### Guidelines for Inspecting Officers

3.16 The Inspecting Officers should familiarise themselves with the relevant Exchange Control regulations and instructions in the aforesaid Guidelines and verify whether these have been complied with by the bank. Broadly, the regulations and rules to be observed by authorised dealers are as follows :

(a) The basic rule governing exchange position is that authorised dealers should maintain at close of business each day square or near-square position in each foreign currency

after taking into account all their purchases and sales, spot and forward. Maintenance of overnight open positions in foreign currencies should be avoided.

(b) Authorised dealers should devise appropriate control systems to ensure that exchange positions in various currencies are maintained in accordance with the above rule.

(c) The bank's management should lay down the maximum position limits in each currency that may remain uncovered during the day (daylight limits) and the limits should be periodically reviewed. Any temporary excesses over the approved daylight limits should require approval of the top management.

(d) Managements should keep a close watch on the dealers' positions at the close of business each day (overnight limits).

(e) Authorised dealers should ensure that at the close of business each day, the maturities of forward contracts are not unreasonably mismatched.

(f) Management in each bank should lay down Individual Gap Limit (IGL) and Aggregate Gap Limit (AGL) in accordance with the Guidelines for Internal Control over Foreign Exchange Business.

(g) Accounting Department should prepare a statement of true exchange positions as on the last Friday of each month after reckoning the effect of all transactions in the pipeline as on that Friday and coming to notice subsequently.

3.17 The following records will generally be available in the Accounts Department.

- (i) Position Book, Register and/or card-sheets in each foreign currency, consolidated position sheets and daily currency position reports indicating maximum exchange positions held during the day and overnight positions submitted to higher authorities.
- (ii) Inter-bank spot and forward contracts register.
- (iii) Inter-bank liability ledger.
- (iv) Monthwise forward contracts maturity register.
- (v) Ledgers showing mirror transactions in Nostro accounts.
- (vi) Records indicating analysis of forward maturities and Gap statements submitted to higher authorities.
- (vii) Office copies of weekly statements of positions (POS) submitted to Exchange Control Department.
- (viii) Statements of Nostro accounts received from correspondent banks/branches abroad.

#### Foreign Exchange Position

3.18 The Inspecting Officer should verify from the Position Book, Register and/or other relevant records whether the bank has been keeping unduly large overnight open positions (either oversold or overbought). To ascertain this, exchange positions on certain selected dates may be examined. He should also verify whether (a) the spot and forward contracts

concluded on each day are accounted for in exchange position on the same day; (b) there are any alterations/corrections in the dates of contracts in order to manipulate exchange position so as to show it at a level different from what it actually is; and (c) all items in the position records of the day are genuine purchases and sales (i.e., there are no 'planted' items in order to manipulate exchange position). It should also be verified :

(i) Whether any limit has been fixed for transactions to be reported by telex/telegram by 'B' category branches (i.e., offices and branches not maintaining independent foreign currency accounts but having powers of operating on the accounts maintained abroad by their head/principal offices or any other link offices) and if so, whether such transactions are promptly reported for taking into exchange position and explanation for non-reporting of the transactions is sought from the concerned branches. Further, whether the records maintained for the purpose of registering the reports from up-country centres are adequate and the reporting instructions to them need any modification.

(ii) Whether the statement of daily closing positions (Daily Currency Position Report), as indicated in paragraph 3.2.2 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank, is regularly submitted to the higher authorities at the close of business

daily and the bank's management has ensured that the dealers do not hold a position which can be considered as not being near square.

(iii) Whether the statement of true currency positions as on the last Friday of each month after reckoning the effect of all transactions in the pipeline as on that Friday and coming to notice subsequently, as indicated in paragraph 3.4.1 of the aforesaid Guidelines, is regularly submitted within a period of three weeks to the higher authorities indicating the steps taken/proposed to be taken for reducing the distortion, if any, and a copy of such statement has been furnished to the Reserve Bank. The particulars reported in the last statement of true currency positions so prepared and submitted to the management/ Reserve Bank may be checked to ascertain whether they are correct as per the bank's records.

(iv) Whether foreign currency notes held by the various offices of the bank are taken into account while computing exchange position; if not, the reasons therefor may be ascertained.

(v) Whether the consolidated foreign exchange position sheets, as indicated in paragraph 3.1.1. of the aforesaid Guidelines, are regularly submitted to the higher authorities.

(vi) Whether the particulars in POS statements submitted to the Exchange Control Department during the last one month were correctly reported as per the bank's records.

(vii) Whether the bank has fixed daylight and overnight open position limits in each currency and the limits are periodically reviewed. In those cases where the limits have been exceeded, the reasons for exceeding the limits, action taken by the bank and whether the excesses have been approved in writing by the higher authorities should be ascertained. The Inspecting Officer may give his observations on the excessiveness, if any, of the daylight and overnight position limits in the light of the volume of the bank's business, volume of its transactions always in the pipeline, trading expertise available in the bank and its capital plus reserves position.

(viii) Whether the bank has fixed individual gap limits (IGL) and aggregate gap limits (AGL) and they conform to the formula laid down in ECD's Guidelines; if not, in what respects do they differ. Further, whether (a) the limits fixed are adhered to and if not, the details thereof as also steps taken by the bank to rectify the position may be indicated; (b) statements of maturities (Form IC, 6 of ECD's Guidelines) are being submitted to higher authorities/Reserve Bank and if so, at what interval. Particulars reported in a few statements may be checked to see whether they are correct as per the bank's records.

#### Foreign Currency Accounts

(ix) The need for maintaining the various foreign currency

accounts by the bank may be examined.

(x) Whether balances held abroad are commensurate with the needs of the bank to meet its immediate commitments.

(xi) Whether any large balance has been held in an inoperative account for a long period and if so, the reasons therefor may be ascertained.

(xii) The arrangements, if any, made by the bank for automatic transfer of funds, as per A.D.(G.P.) circular No.62 of 1978, in order to secure the benefit of interest on overnight idle funds, may be looked into.

(xiii) Whether the bank is lending in foreign currencies to its overseas branches/correspondents or investing funds abroad in treasury bills, call, fixed deposits, etc., without RBI's prior approval.

(xiv) Whether there are overdrawn balances of Rs.20 lakhs and above for continuous period of more than 5 days and if so, the details thereof may be given indicating whether the matter has been reported to the Reserve Bank for post-facto approval as required in terms of paragraph 14 of Chapter 8 of the Exchange Control Manual.

(xv) Whether the bank has maintained an account with a bank in a country other than the country of the currency concerned and if so, when the account was opened and whether the Reserve Bank's prior approval has been obtained for opening the account, as required as per paragraph 5(ii) of Chapter 4

of the Exchange Control Manual.

(xvi) Whether there is an accumulation of foreign currency notes in branches and the system for the disposal of the notes needs improvement to shorten the time-lag for realising the value thereof.

(xvii) Whether the bank has introduced special weekly report in order to obtain information on the value of currency-wise accumulations of foreign currency notes at various branches and taken steps towards their prompt disposal. (Paragraph 3.4.2 of ECD's Guidelines).

(xviii) Whether the bank has been submitting BAL statements promptly and regularly to the Reserve Bank and the particulars reported in the last BAL statement furnished to the Reserve Bank are correct as per the bank's records. (Paragraph B.2 of Chapter 31 of the Exchange Control Manual).

Control over reconciliation  
of Nostro balances

(xix) Whether the reconciliation work in the bank is being attended to by a separate Department/Section (in larger banks) headed by an officer of sufficient rank; in case of smaller banks, whether the work has been entrusted to the Accounting Department under the charge of a separate official.

(xx) The procedure/policy followed by the bank for posting/rotation of staff in the Reconciliation Department may be looked into and it may be ascertained whether considerations

of knowledge and experience of the foreign exchange department are taken into account while posting the staff.

(xxi) Whether the officials attached to the Reconciliation Department have been entrusted with the operation of Nostro accounts (i.e., signing drafts or issuing TTs, etc.) or passing of entries in mirror accounts.

(xxii) Whether statements of accounts are received at least once in a month, and the Reconciliation Department is (a) watching receipt of the statements and (b) ensuring that there are no alterations, erasures, etc., which are unauthenticated or unverified in the foreign bank statements and mirror accounts, before the work of reconciliation is taken up.

(xxiii) Whether the reconciliation work is undertaken expeditiously and is up-to-date.

(xxiv) Whether half-yearly statements of unreconciled items (c.f. paragraph A.14 of Chapter 31 of the Exchange Control Manual) have been forwarded to the Reserve Bank promptly and the particulars reported therein are in accordance with the bank's records.

(xxv) Whether the unreconciled items are promptly and effectively followed up.

(xxvi) Whether any unreconciled items, other than those indicated in paragraph 6.3 of ECD's Guidelines, have been written off without prior approval of the Reserve Bank. If so, the details thereof should be given.

(xxvii) Whether the Reconciliation Department is submitting a report once a month to the higher authorities indicating the progress made in reconciliation of Nostro account balances and the special features, such as large unreconciled items, age-wise grouping of items, etc., and if so, what action has been taken on such reports by the bank's Management.

(xxviii) Whether there are any instances of (a) set-off of debit and credit items; and (b) entries in rupee columns of mirror accounts without corresponding foreign currency amounts. If so, these should be thoroughly checked.

(xxix) Whether any frauds have been detected through the reconciliation process and if so, these should be looked into in detail.

CHAPTER 4RATES OF EXCHANGEWhat is meant by rate of exchange

Profitability of any foreign exchange transaction, to a great extent, depends on the application of correct exchange rate. If a rate is wrongly quoted, the bank may be put to a substantial loss, as the transaction has to be covered in the market. It will amount to buying an article at a high price and disposing it of at a lower price. Hence, the application of rates plays a vital part in foreign exchange business.

4.2 A rate of exchange is the price of a unit of one currency expressed in terms of another currency. There are two methods of quoting rates. When the price of a given unit of home currency is quoted in foreign currency, it is called an indirect rate or currency rate. In this method, the foreign currency is shown as the variable factor. When the price of a given unit of foreign currency is quoted in terms of home currency, it is called a direct rate or pence rate. In this method, the home currency is shown as the variable factor. With the exception of the pound sterling, in most of the world's money centres, exchange rates are quoted in "dollar terms", that is, the number of units of a particular currency which equal one U.S. dollar. Because of the importance of the pound in the nineteenth century and its being a relatively large purchasing unit, it is the exception,

and all currencies tend to be quoted as so many units equal to one pound. The United Kingdom is one of the few places applying the indirect quotation system. In the United States, it is more normal for rates to be quoted as one foreign unit equalling so many dollars or cents, although lately there has been a tendency among professional traders in the United States foreign exchange market to deal on an indirect basis with the outside world and among themselves. In India, the indirect method of quoting exchange rates is followed, that is, rates are quoted for a fixed amount of Rs. 100. However, the rates for purchase and sale of foreign currency notes are quoted on the basis of direct quotation.

4.3 In foreign exchange parlance, the buying rate is referred to as the "bid rate" and the selling rate is referred to as the "offer rate" or "ask rate". In international foreign exchange markets, a professional operator or market-maker will nearly always quote a selling and a buying price for a currency. Such quotations are known as "two-way" quotes or "quotes in pairs". For instance, a dealer in London may quote U.S. dollars against pound sterling as follows:

<u>offer</u>	<u>Bid</u>
\$1.4955	\$1.4965

In other words, the dealer expresses a willingness to sell (or offer) U.S. dollars at \$1.4955 per pound

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sterling, and to buy (or bid) U.S. dollars at \$1.4965 per pound in sterling.

4.4. There are two business principles applied by banks while quoting rates of exchange, viz., 'Buy high, sell low' when quoting an indirect rate and 'Sell high, buy low' when quoting a direct rate. In India, the principle applied is 'Buy high, sell low' since exchange rates are quoted as indirect rates. For example, when U.S. dollars are quoted by a bank at 10.350 - 10.455, it means that the bank will sell US \$ 10.350 against receipt of Rs. 100 and it will buy US \$ 10.455 against payment of Rs. 100. When rates are quoted according to the indirect method, the buying rate will be higher than the selling rate for the bank will part with (sell) less foreign currency per Rs. 100 than the amount of foreign currency it will accept (buy) per Rs. 100.

#### Different types of rates

4.5 The basic rates quoted by banks are for T.T. (Telegraphic Transfer), i.e., remittances outward (T.T. selling rate) and inward (T.T. buying rate). Telegraphic transfers are the ideal form for remittance of funds as there is no loss of interest, risk or stamp duty. "In every exchange, the T.T. Rate is the basic rate of exchange since the funds are usually paid over in each centre on the same day - so that no loss of interest is involved. All variations shown by other quoted rates from the basic T.T. Rate are due either to a loss of

interest, extra costs of collection or increased risk of capital loss" (Evitt). For outward remittances, different rates may be quoted, according to whether they are clean remittances or are in payment of import bills. Different buying rates may be quoted for inward remittances according to whether they are clean remittances or are in payment of bills. The different rates quoted are as follows :-

(i) T.T. (Telegraphic Transfer) selling rate

This rate is applicable to a transaction in foreign exchange which does not involve handling of documents.

The transactions to which T.T. selling rate is applied are,

- Outward remittances in foreign currency (TT, MT, DD)
- Cancellation of a purchase made earlier when purchased bills are returned unpaid
- When foreign clean/documentary sight/usance bills purchased/discounted are transferred to foreign outward bills for collection
- When an inward remittance converted to rupees is to be refunded to the remitting bank
- When a forward purchase contract is cancelled.

(ii) B.C. (Bills for Collection) selling rate

It is a rate involving remittance in cover of documents handled by a bank and is always worse than a T.T. selling rate as it includes service charges

for handling documents. This is in addition to the collection commission recovered separately on import bills. The rate is applied to remittances in foreign currencies by way of DD, MT or TT being proceeds of import bills received for collection or under letters of credit.

(iii) T.T. (Telegraphic Transfer) Clean Buying rate

This is the basic buying rate involving no loss of interest and is applied to transactions where foreign currency funds are received by the bank either on the date of payment in rupees or prior to it. Examples are,

- Clean inward remittances (MT, TT, DD) where cover has already been credited to the bank's Nostro account
- Payment of proceeds of foreign outward bills for collection
- Cancelling outward TT, MT or DD when the prevailing TT buying rate of the day on which cancellation takes place must be applied
- When a forward sale contract is cancelled.

(iv) T.T. (Telegraphic Transfer) Documentary buying rate

The rate quoted for a documentary export bill negotiated under a letter of credit in which the negotiating bank obtains reimbursement from the opening bank by T.T., at the time of negotiation of the bill, is called T.T. (Documentary) rate. In such a case,

interest for a few days, say five days, is charged to the customer.

(v) O.D. (On Demand) buying rate

This is a rate at which on demand (sight) bills are purchased/negotiated. Interest for the transit period involved in the realisation of bills is recovered from the customer. The other transactions to which the rate is applied are,

- Purchase of cheques, travellers cheques, etc.
- Payment of DD, MT or TT where the bank has to claim cover after payment

Forward rates

4.6 Forward rates of exchange are quoted as a margin or difference against the spot rate of the currency concerned, or as a premium or discount on the spot rate, or they may be quoted outright, i.e., an actual forward rate of exchange in the currency, obtained by allowing for the forward margin over or under the current spot rate. Quotations are stated to be at premium when the forward exchange is costlier than spot exchange or at discount when the forward exchange is cheaper than spot exchange. The margins are expressed in terms of the subsidiary unit of the currency concerned or in fractions thereof. For instance, in the case of U.S. dollars and Deutsche Marks, the margins will be in cents and pfennings respectively or in fractions thereof. The

market quotations for the forward margins are usually expressed as under :

U.S. dollars

One month	0.15-0.10 c.pm.
Three months	0.40-0.35 c.pm.
Six months	0.75-0.70 c.pm.
One month	0.50-0.08 c.dis.
Three months	0.10-0.15 c.dis.
six months	0.25-0.30 c.dis.

It may be noted that as the margins are quoted in terms of subsidiary units or in fractions thereof, while computing forward rates of exchange care should be taken that the margins are correctly placed in decimal places. For example, 0.05-0.08 c.dis., means a discount of 0.0005-0.0008 of a U.S. dollar, and if the spot rates are \$1.4955-\$1.4965 per pound sterling, the forward rates will be -

	<u>U.S. dollars</u>
Spot rates	1.4955 - 1.4965
One month forward	<u>0.0005 - 0.0008</u>
One month forward rates	<u>1.4960 - 1.4973</u>

4.7 The guidelines for the application of forward margins to spot rates are given below :-

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(a) Selling rates

(i) Premium

- Quote maximum premium
- Deduct higher premium from spot rate
- Sell low to make it very dear for the customer
- For option forwards, deduct maximum premium for longest period

(ii) Discount

- Quote minimum discount
- Add lower discount to spot rate
- Sell low to make it less cheap for customer
- For option forward, add minimum discount for shortest period

(b) Buying Rates

(i) Premium

- Quote minimum premium
- Deduct lower premium from spot rate
- Buy high to make it less dear for the bank
- For option forward, deduct minimum premium for shortest period

(ii) Discount

- Quote maximum discount
- Add higher discount to spot rate
- Buy high to make it very cheap for the bank
- For option forward, add maximum discount for longest period.

4.8 It should be carefully noted that the above

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guidelines are for indirect rates only. The guidelines for direct rates will be exactly the opposite. In the case of indirect rates, premium is always to be deducted from spot rates both for selling and buying rates, and discount is always to be added to spot rates both for selling and buying rates.

### Cross Rate

4.9 In the present day foreign exchange operations, it becomes very often necessary for banks to deal in overseas markets for acquiring or disposing of a currency at a better rate or to deal in a currency, which is not traded or is not available in the domestic market. The rates quoted in overseas markets are in terms of one foreign currency against another foreign currency, e.g., £/U.S.\$ or U.S.\$/D.M. The bank in India has to equate such rates with rupees for its quotations in India. For example, if the rate quoted in the London or Singapore market for £/U.S.\$ (known as 'Cable') is £1 = U.S.\$ 1.8510 - 8530 and the prevailing rate in Bombay inter-bank market for pound sterling is Rs. 100 = £ 5,9500 - 9510, the bank can find out the Rs./U.S.\$ selling and buying rates by crossing the pound sterling rate against rupees with the U.S. dollars rate against pound sterling. The exchange rate so computed is called the Cross Rate. The arithmetical formula used to arrive at the Cross Rate is popularly known as the

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Chain Rule and consists of set of interconnected equations. Taking the above market data, for instance, the equations may be set up as under:-

How many U.S. \$ ?	=	Rs. 100
If Rs. 100	=	£ 5.9500
and £ 1	=	U.S. \$ 1.8510

Thus, the chain of equations begins with U.S. dollars and ends with U.S. dollars. The other feature is that every succeeding chain begins with the currency with which the preceding chain ends. When the factors on the right hand side are multiplied and the product is divided by the factors on the left hand side, the quotient provides the answer to the question.

Guidelines for calculation of exchange rates for merchant transactions

4.10 Till 31st December 1983, the Foreign Exchange Dealers' Association of India (FEDAI) used to fix, with the approval of the Reserve Bank, rates for pound sterling to be quoted by authorised dealers for their merchant transactions. In order to enable authorised dealers to quote competitive and finer exchange rates to merchants, both exporters and importers, and bring the rates in alignment with the on-going market rates, it has been decided to abolish the Sterling Rates Schedule prepared by FEDAI and also to

delink the interest element which was included in the exchange rates quoted for the negotiation, purchase or discount of export bills. FEDAI has issued guidelines to authorised dealers for the calculation of exchange rates for merchant transactions in all currencies which came into force with effect from the 1st January 1984. The guidelines are described in the following paragraphs.

4.11 The Exchange rates quoted for merchant transactions in all currencies will be based by authorised dealers on the 'Base rates' which shall be derived from the on-going spot market rates for various currencies.

#### Purchases

##### 4.12 Merchant spot T T. purchase rates

- (a) Arrive at the base rate.
- (b) To the above base rate add the appropriate exchange margin. The margin should be between 0.025% and 0.080% of the base rate.

##### 4.13 Merchant spot bill buying rates

- (a) Arrive at the base rate.
- (b) To the above base rate :
  - (i) Add/deduct the on-going forward discount/premium depending upon the transit period, tenor of the bill and grace period if applicable.

- (ii) Add appropriate exchange margin between 0.125% and 0.150% of the base rate.

4.14 Merchant forward T.T. buying rates

- (a) Arrive at the base rate.
- (b) To the above base rate :
  - (i) Add/deduct the on-going forward discount/premium depending upon the delivery period
  - (ii) Add appropriate exchange margin between 0.025% and 0.080% of the base rate.

4.15 Merchant forward bill buying rates

- (a) Arrive at the base rate.
- (b) To the above base rate :
  - (i) Add/deduct the on-going forward discount/premium depending upon the delivery period of the bill, transit period, tenor of the bill and grace period if applicable.
  - (ii) Add appropriate exchange margin between 0.125% and 0.150% of the base rate.

Sales

4.16 Merchant spot T.T. selling rates

- (a) Arrive at the base rate.
- (b) From the above base rate deduct appropriate exchange margin between 0.125% and 0.150% of the base rate.

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4.17 Merchant spot bill selling rates

From the merchant spot T.T. selling rate, as determined above, deduct appropriate exchange margin between 0.175% and 0.200% of the spot T.T. selling rate.

4.18 Merchant forward selling rates

For quoting the merchant forward selling rates for import T.T. and B.C. transactions, authorised dealers should base their quotations on the appropriate cover rates from which appropriate exchange margins for T.T. and bill transactions, as mentioned above should be deducted.

Important points to be noted regarding calculation of exchange rates for merchant transactions

4.19 Authorised dealers should ensure that the maximum spread between the merchant spot clean T.T. purchase and selling rates is within the spread limits prescribed by the Reserve Bank, which presently are as under :

<u>Name of currency</u>	<u>Maximum spread between customers rates for ready clean T.T. business from the mean T.T. rate (taking both sides together)</u>
1.	2.
Pound sterling	(To be fixed)
U.S. dollar	1.00%
Deutsche Marks	2.50%
Japanese Yen	2.50%

... .

<u>1.</u>	<u>2.</u>
French Francs	2.50%
Swiss Francs	2.50%
Dutch Guilders	2.50%
Australian Dollars	2.50%
Other currencies	No limit for the present but authorised dealers should keep the rate spreads to the minimum.

Authorised dealers are, however, free to quote rates to merchants which are better than those warranted by the above spread limits.

4.20 The merchant purchase rates should not be worse than the rates derived from the FBI buying rates in respect of the currencies in which FBI provides spot and forward cover.

4.21 The merchant spot selling rates for T.T. and bill transactions should not be worse for the customer than those derived from FBI spot selling rate for pound sterling as the basis.

4.22 The exchange rates for merchant quotes should be rounded off as follows:

<u>Currency</u>	<u>Fineness of rates to be quoted</u>
(a) Pound Sterling	Upto 4th place of decimal ending with 0 or 5. Rounding Off will be done to the nearest 5 or 0.
(b) U.S. Dollars	Upto 3rd place of decimal ending with 0 or 5. Rounding off will be done to the nearest 5 or 0.

<u>Currency</u>	<u>Fineness of rates to be Quoted</u>
(c) Belgian Francs	Rounded off to $\frac{1}{2}$ Franc.
(d) For all other currencies	

Currency Range

(Rs. 100 = currency units)

(i) Upto 20	.005
(ii) Above 20 but not exceeding 40	.01
(iii) Above 40 but not exceeding 100	.05
(iv) Above 100 but not exceeding 400	.1
(v) 400 and above	1.0

4.23 Authorised dealers should keep a record of (i) the base rates for the purpose of arriving at the merchant spot T.T. buying and selling rates and (ii) any changes made in the base rates during the day. Such record should be made available for audit.

4.24 The time of executing all merchant transactions should be recorded so as to establish the application of the correct prevalent rates and to prevent disputes regarding merchant rates consequent upon changes in the base rates during the day.

4.25 In the case of forward contracts for export bills the contract rate should be worked out without loading the interest element and the interest for the transit

period, usance of the bill and grace period, if applicable, should be recovered separately at the time of negotiation, purchase or discount of the export bill.

4.26 Authorised dealers are not permitted to quote forward buying rates for pound sterling bills of usance longer than nine months.

#### Forward margin

4.27 The rates for transactions where foreign currencies will be delivered by merchants on a future date take into consideration the forward margins. Since August 1978, the Reserve Bank has been charging a fixed forward margin (discount always) of 60 points (£0.0060) per month for its forward purchases of pound sterling from authorised dealers. The forward margin to be included in rates is determined by the transit period, usance period of export bill and forward period. In the case of purchase of 'on demand' bill, the relevant foreign exchange will not be available to the bank for sale on spot basis since even an 'on demand' bill involves a minimum transit period which is normally taken as 15 days. Accordingly, for fixing the buying rate for sight bill in pound sterling, a forward margin for one month is included in the rate as the relative cover transaction with the Reserve Bank will carry a minimum forward margin of 60 points because the

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Reserve Bank does not quote for forward purchases for periods of less than one month. Similarly, for a two months usance bill (60 days D/A) purchased two months forward, the forward margin (discount) for five months or 300 points is included. In this case, 60 days is the usance, 15 days is the transit period and two months is the forward period, which together comes to 135 days or 4 months and 15 days, and since the Reserve Bank applies the forward margin for each month or part of a month at 60 points, the total forward margin is 300 points.

Interest element

4.28 Foreign exchange transactions which are put through by means of credit instruments other than telegraphic transfers, e.g., drafts, mail transfers, bills of exchange and travellers cheques, involve loss of interest either to the seller or buyer of foreign currency. In a sale transaction, normally the customer pays the rupee funds first but in exchange, the bank gives out the foreign currency through its Nostro account only when the credit instrument, say demand draft, is presented for payment at the foreign centre. Strictly speaking, the customer should be entitled to receive from the bank interest on the funds for the intervening period. However, banks do not pay any interest because, in theory at least, a sale of foreign currency is immediately covered by the bank by a

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corresponding purchase against rupee paid by the customer. This purchase results in a credit to the bank's Nostro account on which it does not earn any interest. Even if it is assumed that the sale of foreign currency is not covered by a corresponding purchase by the bank, the payment in rupee made by the customer is in the nature of a demand deposit on which banks do not pay interest. The sale transactions, therefore, do not involve interest factor, regardless of the fact that they are put through by means of telegraphic transfers, mail transfers or demand drafts.

4.29 In the case of purchase transactions, the interest factor involved depends on the transit period, ~~usage~~ use of bills and/or the method of reimbursement. The theoretical assumption is that a purchase transaction is covered by the bank by a corresponding sale which results in a debit to its Nostro account. If, therefore, a credit to the bank's Nostro account arising out of purchase and the corresponding debit thereto on account of cover sale do not coincide, there will be either an overdraft or a credit balance in foreign currency depending on whether the debit precedes or follows the credit, in Nostro account. Banks do not earn any interest on credit balances in their Nostro accounts whereas they have to pay interest on overdrafts therein which, in turn, is

charged to customers. Export bills sent for collection also result in purchase transactions. However, the arrangement is that only when the bills are realised and foreign currency proceeds are credited to its Nostro account, the bank will effect payment in rupees to the customer. There is always a time-gap between the date on which foreign currency proceeds are received by the bank in its Nostro account and the date on which payment in rupees is made by it to the customer, unless credit advice is called for by cable/telex from foreign correspondent and rupee payment is made immediately on receipt thereof. For this intervening period, strictly speaking, the customer should receive compensation by way of payment of interest. However, as indicated above, foreign currency funds received by the bank in its Nostro account do not earn for it any interest and, therefore, no interest is allowed to the customer. Hence, purchase transactions arising out of export bills sent for collection do not involve any interest factor irrespective of usance of bills collected. In the case of purchase transactions arising out of inward foreign currency remittances received by the bank from its foreign correspondents, the interest factor is determined by

the manner in which the bank receive reimbursement. If the reimbursement arrangement is that the bank's Nostro account is credited either prior to or at the time of <sup>its</sup> effecting rupee payment to the beneficiary of the remittance, there will not be any loss of interest to the bank. But if the arrangement is that the bank should make rupee payment first and it will receive reimbursement in foreign currency thereafter from the remitting bank, the bank will be out of funds and, therefore, entitled to claim interest for the intervening period. Exception to this rule will be a remittance, the reimbursement for which can be claimed by the bank on a T T. basis from the remitting bank.

Delinking of interest element from exchange rates fro bills buying transactions

4.30 As indicated in paragraph 4.10 above, it has been decided to delink the interest element from exchange rates for the negotiation, purchase or discount of export bills in order to fall in line with international practice.

FFDAI has issued guidelines in this regard which have been brought into force with effect from the 1st January 1984. According to the guidelines, authorised dealers should quote the merchant spot and forward bill buying rates as indicated in paragraphs 4.13 and 4.15 above, and the interest fro the notional transit period, usance of the bill and grace period (where applicable) should be recovered at the time of negotiation, purchase or

discount of the export bill at the appropriate rate of interest on the rupee amount of the bill. The procedure to be followed will be (i) arrive at the rupee equivalent of the foreign currency amount of the bill at the appropriate buying rate (ii) credit the rupee amount to the customer's account and (iii) simultaneously recover the interest amount and credit it to "Interest on Export Bills Account." Overdue interest, if any, should also be recovered separately. When export bills drawn in rupees are negotiated, purchased or discounted, the entire amount of the bill should be paid to the customer and simultaneously the interest should be recovered on the rupee amount from the customer at the appropriate rate of interest. In the case of payment to a party not being a customer of the paying bank, only the net amount shall be payable. Full details of the interest and other deductions should be advised by authorised dealers to the concerned customers/parties.

4.31 The rates of interest to be charged would be the concessive rates for export finance prescribed by the Reserve Bank. FEDAI has laid down, in consultation with the Reserve Bank, the transit periods applicable to various countries for which banks may charge interest. As indicated above, no interest element is involved in T.T. and B.C. selling as also T.T. clean buying transactions. However, an interest element is involved in T.T. Documentary buying transaction. A minimum of

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3 to 5 days are required to get reimbursement of foreign currency in the case of T.T. Documentary purchase transaction and, therefore, banks cannot sell spot. In order to compensate themselves for handling documents, interest loss and forward margin, banks may charge interest for a few days, say five days, to the customer.

Certain other important aspects  
relating to rates for pound sterling

4.32 The pound sterling bills drawn on and payable in the United Kingdom are known as direct bills. The bills drawn in pound sterling payable outside the U.K., are regarded as indirect bills. For example, a bill in pound sterling drawn on Dubai or Japan is an indirect bill. However, a bill in pound sterling drawn on Dubai or Japan where the negotiating bank claims reimbursement directly from the U.K., is a direct bill. When purchasing/ discounting indirect bills, banks are required to charge the 'minimum differences' which represent the interest for the additional transit period involved in realising and remitting the proceeds of bills to London. The 'minimum differences' are calculated and advised to banks by FEDAI under Rule 7 of FEDAI Rules.

4.33 A few examples on the calculation of exchange rates for merchant transactions are given in the annexure to this Chapter.

Exchange Control Regulations

4.3+ While quoting rates to public for both spot as well as forward transactions, authorised dealers should be guided by certain well-established foreign exchange considerations such as their own position in the concerned currency and volume of foreign exchange business given by the client, apart from the prevailing cover rates in the inter-bank or overseas markets. They should not quote to their constituents rates which are better than those dictated by these genuine foreign exchange considerations on the ground that the constituents are keeping or have offered to keep fixed or other deposits with the authorised dealers. Conceding better exchange rates to merchants in this manner is against the spirit of the provisions of the directives issued by the Reserve Bank regarding interest rates on deposits as these practices in effect amount to giving a higher rate of interest indirectly on the fixed deposits than permitted by the directives. Further, such practices lead to unhealthy competition among authorised dealers and serious distortions in the spot and forward exchange markets in India and hamper their orderly functioning. Should, however, occasions arise for offering to their customers rates which are not based on the prevailing cover rates in the inter-bank or overseas market on grounds that may appear to the

authorised dealer to be genuine foreign exchange considerations, the reasons or considerations that weighed with the authorised dealer for conceding the rates must be kept on record for production to the Reserve Bank for scrutiny as and when required (A.D. circular No.44 of 1977).

4.35 While quoting rates for selling the rupee to their overseas branches/Head Offices/correspondent banks, authorised dealers should ensure that the rate is in no circumstances better for the overseas bank than the RBI ready selling rate (only ready selling rate for pound sterling is quoted by RBI) prevailing on that day in the case of pound sterling and in case the quote is made against any other currency, the rate arrived at by coupling the RBI ready selling rate for pound sterling with the corresponding rate for the foreign currency against pound sterling (being the direct cross rate or the effective cross rate through the medium of U.S. dollar) being quoted at the point of time in any active overseas market such as London or Singapore. This rule will apply to both 'Ready' as well as 'Value next day' and 'Spot' (i.e., value two business days after contract) transactions. Since the quotes for 'Ready', 'Value next day' and 'Spot' transactions are normally different, authorised dealers should ensure, while quoting rates for any one of these deliveries, that the rule can be complied

with if a quote has to be made for any other delivery at the same time. This rule will also apply if on any day the FBI buying rate for the foreign currency (being other than pound sterling) is better than the rate so arrived at. Symmetrically, while quoting rates for conversion of surplus rupee balances held by overseas banks/Head Offices/correspondent banks into foreign currency, authorised dealers should ensure that the rate quoted is not better for the overseas bank than the FBI ready buying rate for pound sterling in the case of pound sterling and in case the quote is made against any other currency, the rate arrived at by coupling the FBI ready buying rate for pound sterling with the corresponding rate for the foreign currency against pound sterling as explained above. For enabling snap checks being conducted by the Reserve Bank at any time, authorised dealers should maintain a continuing record of the rates quoted to overseas banks indicating the time at which the transaction was done, the cross rate for the foreign currency (if other than pound sterling) against pound sterling on which the rate was based and the bank's margin. This record together with supporting evidence should be available readily for production to the Reserve Bank whenever called for (A.D. - G.P. Series - circular No.50 of 1979).

4.36 Authorised dealers, whether Indian or foreign, should deal with their overseas branches at 'arm's length' and no preferences should be shown in regard to rates. In other words, they should not offer the prevailing inter-bank rate or RBI cover rate for selling rupees against U.S. dollars, Deutsche Marks and Japanese Yen to their overseas branches without adding any cushion/loading margin whatsoever on grounds such as that the transactions with overseas branches were covered from their position or that the rupee funds generated by such transactions could be lent in the call money market, etc. Also, authorised dealers should not offer to overseas branches rates on the basis of rates offered to their importer customers for large value business by building up small-enough cushion/loading margin thus making the rates better than even the prevailing inter-bank rates (A.D.- G.P. Series - circular No. 31 of 1980).

4.37 The spread limits given in paragraph 4.19 above do not govern rates quoted for ready business (other than clean TT) or for forward business. The rates for ready business (other than clean TT) should, as usual, be subject to considerations of interest rate (normal or concessional as appropriate) and transit period, if any,

laid down by FEDAI with the approval of the Reserve Bank from time to time. The forward rates may be quoted on the basis of normal factors of supply and demand and the cover rates available for such business. Authorised dealers must ensure that the rates quoted for ready clean TT business at all their operative branches at any point of time conform to the spread limits. Further, they should also readily furnish to the members of the public who enquire, their rates for both sides of business without insisting on the nature of interest (i.e. purchase or sale) being revealed (A.D. - G.P. Series - circular No. 68 of 1980).

4.38 Authorised dealers have been permitted to promote 'two-way' dealings in foreign currencies only in the Indian inter-bank market, i.e., dealings between authorised dealers themselves. They are not permitted to offer two-way quotes for Indian rupees in international markets, i.e., as between the authorised dealers in India on the one hand and overseas banks on the other. Authorised dealers can, however, quote a rate for either a sale or a purchase of rupees, and conclude the transaction at the agreed rate (A.D.-G.P. Series - circular No.5 of 1983).

#### Guidelines for Inspecting Officers

4.39 The Inspecting Officer should verify, by sample

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Checking, whether the rates of exchange quoted by the bank are in accordance with the Exchange Control Regulations and the Rules of the Foreign Exchange Dealers' Association of India. He should bear in mind the Exchange Control Regulations given in paragraphs 4.35 to 4.39 above and verify, by test check, whether the rates quoted by the bank to its constituents and overseas branches/Head Offices correspondents are in accordance with the regulations as also whether any preferences have been shown in this regard. In case any special rates of exchange have been quoted by the bank, the Inspecting Officer should ascertain whether a proper record of the reasons therefor is maintained as also whether the approval of the appropriate authority in the bank has been obtained. He may also examine whether the reasons which weighed with the bank can be regarded as genuine foreign exchange considerations

ANNEXURE TO CHAPTER 4Examples on calculation of exchange rates for merchant transactions

For the purpose of these illustrations, RBI selling and buying rates for pound sterling and buying rate for U.S. dollars as on the 10th November 1983 have been taken as follows :

- (i) RBI selling rate: Rs. 100 = £ 6.4977
- (ii) RBI buying rate: Rs. 100 = £ 6.5317
- (iii) RBI buying rate: Rs. 100 = \$ 9.70

2. Banks should adopt the going market rates for deriving their base rates for the calculation of merchant rates, when such going rates are better than the RBI rates.

I. POUND STERLING RATES1. Spot T.T. buying rate

	<u>With exchange margin of 0.025%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate</u> <u>(assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add exchange margin of 0.025% of the base rate	£ 0.0016	£ 0.0016
	<u>£ 6,5333</u>	<u>£ 6.5216</u>
Spot T.T. buying rate	£ 6.5335	£ 6.5215

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	<u>With exchange margin of 0.050%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add exchange margin of 0.050% of the base rate	£ 0.0033	£ 0.0033
	<u>£ 6.5350</u>	<u>£ 6.5233</u>
Spot T.T. buying rate	£ 6.5350	£ 6.5235

	<u>With exchange margin of 0.080%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add exchange margin of 0.080% of the base rate	£ 0.0052	£ 0.0052
	<u>£ 6.5369</u>	<u>£ 6.5252</u>
Spot T.T. buying rate	£ 6.5370	£ 6.5250

## 2. Spot sight bill buying rate

	<u>With exchange margin of 0.125%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for the transit period (usually for one month)	£ 0.0060	£ 0.0075
(iii) Add exchange margin of 0.125% of the base rate	£ 0.0082	£ 0.0082
	<u>£ 6.5459</u>	<u>£ 6.5357</u>
Spot sight bill buying rate	£ 6.5460	£ 6.5355

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	<u>With exchange margin of 0.140%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for the transit period (usually for one month)	£ 0.0060	£ 0.0075
(iii) Add exchange margin of 0.140% of the base rate	<u>£ 0.0091</u>	<u>£ 0.0091</u>
	<u>£ 6.5468</u>	<u>£ 6.5366</u>
Spot sight bill buying rate	£ 6.5470	£ 6.5365

	<u>With exchange margin of 0.150%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for the transit period (usually for one month)	£ 0.0060	£ 0.0075
(iii) Add exchange margin of 0.150% of the base rate	<u>£ 0.0098</u>	<u>£ 0.0098</u>
	<u>£ 6.5475</u>	<u>£ 6.5373</u>
Spot sight bill buying rate	£ 6.5475	£ 6.5375

3. Spot 90 days sight bill buying  
rate (Bill on France)

	<u>With exchange margin of 0.125%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200

(ii) Add forward margin for 4 months (3 months usance plus 20 days transit period for indirect bill)	£ 0.0240	£ 0.0300
(iii) Add exchange margin of 0.125% of the base rate	£ 0.0082	£ 0.0082
	<u>£ 6.5639</u>	<u>£ 6.5582</u>
Spot 90 days sight bill buying rate	£ 6.5640	£ 6.5580
	<u>With exchange margin of 0.140%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for 4 months (3 months usance plus 20 days transit period for indirect bill)	£ 0.0240	£ 0.0300
(iii) Add exchange margin of 0.140% of the base rate	£ 0.0091	£ 0.0091
	<u>£ 6.5648</u>	<u>£ 6.5591</u>
Spot 90 days sight bill buying rate	£ 6.5650	£ 6.5590
	<u>With exchange margin of 0.150%</u>	
	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for 4 months (3 months usance plus 20 days transit period for indirect bill)	£ 0.0240	£ 0.0300

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(iii) Add exchange margin of 0.150% of the base rate	£ 0.0098	£ 0.0098
	£ 6.5655	£ 6.5598

Spot 90 days sight bill buying rate	£ 6.5655	£ 6.5600
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4. Forward (say five months)  
T.T. buying rate

	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for five months	£ 0.0300	£ 0.0375
(iii) Add exchange margin (say 0.050%) of the base rate	£ 0.0033	£ 0.0033
	£ 6.5650	£ 6.5608

Five months forward T.T. buying rate	£ 6.5650	£ 6.5610
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5. Forward (say one month) 30 days  
sight bill buying rate (Bill on U.K.)

	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.5317	£ 6.5200
(ii) Add forward margin for three months (delivery period one month, usance 30 days and transit period 15 days, i.e. 2 months 15 days or 3 months)	£ 0.0180	£ 0.0225
(iii) Add exchange margin of, say, 0.125% of the base rate	£ 0.0082	£ 0.0082
	£ 6.5579	£ 6.5507

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One month forward 30 days sight bill buying rate	£ 6.5580	£ 6.5505
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6. Spot T.T. selling rate

	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.4977	£ 6.5100
(ii) Deduct exchange margin of, say, 0.140% of the base rate	£ 0.0091	£ 0.0091
	<u>£ 6.4886</u>	<u>£ 6.5009</u>
 Spot T.T. selling rate	 £ 6.4885	 £ 6.5010

7. Spot bill selling rate

	<u>RBI rate</u>	<u>Inter-bank rate (assumed)</u>
(i) Base rate	£ 6.4977	£ 6.5100
(ii) Deduct exchange margin of 0.125% (Minimum)	£ 0.0081	£ 0.0081
	<u>£ 6.4896</u>	<u>£ 6.5019</u>
	(£ 6.4895)	(£ 6.5020)
 Spot T.T. selling rate	 £ 6.4896	 £ 6.5019
(iii) Deduct exchange margin of, say, 0.190% of the spot T.T. selling rate	£ 0.0123	£ 0.0124
	<u>£ 6.4772</u>	<u>£ 6.4896</u>
 Spot bill selling rate (hitherto called B.C. selli rate)	 6.4770	 £ 6.4895

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8. Forward (say two months)  
bill selling rate

	RBI rate	Inter-bank rate (assumed)
(i) Spot T.T. selling rate (vide 7 above)	£ 6.4895	£ 6.5020
(ii) Add forward margin for two months (forwards for pound sterling in the inter-bank market in India are quoted at discount)	£ 0.0130	£ 0.0150
	£ 6.5045	£ 6.5170
(iii) Deduct exchange margin of, say, 0.200%, of the above	£ 0.0130	£ 0.0130
	£ 6.4915	£ 6.5040
Forward bill selling rate	£ 6.4915	£ 6.5040

II. U.S. DOLLAR RATES

1. Spot T.T. buying rate

	RBI rate	Inter-bank rate (assumed)
(i) Base rate	\$ 9.7000	\$ 9.6850
(ii) Add exchange margin of, say, 0.060%, of the base rate	\$ 0.0058	\$ 0.0058
	\$ 9.7058	\$ 9.6908
Spot T.T. buying rate	\$ 9.7050	\$ 9.6900

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2. Spot T.T. selling rate

	<u>Inter-bank rate(assumed)</u>
(i) Base rate	\$ 9.6850
(ii) Deduct exchange margin of, say, 0.135%, of the base rate	\$ 0.0131
	\$ 9.6719
Spot T.T. selling rate	\$ 9.6700

III. SWISS FRANC RATES

Assumed quotations

- (i) Sw.Fc. 2.1770/1805 per one U.S. dollar
- (ii) £1 = \$ 1.4833/4842
- (iii) RBI rates for pound sterling - Rs. 100 =  
£ 6.4977/6.5317
- (iv) Cross rate Rs. 100 = Swiss Francs 20.9820/  
21.1385

1. Spot T.T. buying rate.

	REI rate	Inter-bank rate (assumed)
(i) Base rate	Sw.Fcs.21.1385	Sw.Fcs.21.1000
(ii) Add exchange margin of, say, 0.05% of the base rate	Sw.Fcs. 0.0106	Sw.Fcs. 0.0106
	Sw.Fcs.21.1491	Sw.Fcs.21.1106
Spot T.T. buying rate	Sw.Fcs.21.15	Sw.Fcs.21.11

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2. Spot T.T. selling rate

Cover rate in inter-bank  
market (assumed)

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(i) Base rate	Sw. Fcs. 21.0000
(ii) Deduct exchange margin of, say, .125% of the base rate	Sw. Fcs. 0.0263
	<hr/>
	Sw. Fcs. 20.9737
	<hr/>

Spot T.T. selling  
rate.

Sw. Fcs. 20.97

CHAPTER - 5.FINANCING OF EXPORTS

In the context of the persistently high level of imports necessary to sustain the economy, the increasing external debt service payments and the near stability in the inflow of private remittances from abroad, promotion of exports is of paramount importance. The following agencies are, primarily, involved in the promotion of exports.

(i) Commercial banks, who advise/confirm letters of credit opened by importers' banks abroad; give pre-shipment credit, short-term post-shipment credit, medium/long-term post-shipment credit on deferred payment terms; and issue bid bonds, performance and other guarantees.

(ii) Reserve Bank of India, who issues directives to banks for granting export finance at concessive rates of interest; provides refinance to banks against their pre-shipment and short-term post-shipment advances; and disburses interest subsidy to banks on behalf of the Government of India

(iii) Export-Import Bank of India(Exim Bank), which rediscounts export bills of banks with a usance not exceeding 180 days and unexpired usance of a maximum of 90 days; gives 100 per cent refinance in respect of post-shipment credit extended by banks for export of capital goods covered by contracts upto Rs.One crore; participates with banks in providing term loans to exporters, in respect of contracts above Rs.One crore, for

financing export of plants, equipment, machinery and related services on deferred payment terms, turnkey projects and construction contracts; finances the equity investment by Indian promoters in joint ventures abroad in Indian rupees in the form of long-term credit with or without participation from the Indian promoter's bankers; provides pre-shipment credit, by way of term loans for periods beyond six months, in participation with banks to exporters for executing large value export contracts involving supply of high value capital equipment having long manufacturing cycles; gives term loans to Indian consultancy firms for export of technology and consultancy services with or without participation of banks or through refinance; participates with banks in the guarantees issued in foreign currencies on behalf of Indian exporters/contractors in favour of overseas importers/employers; offers directly to foreign buyers Buyers' Credit for import of capital goods and turnkey projects from India; and extends lines of credit to foreign governments and overseas financial institutions to enable them to provide long-term finance to borrowers in the respective countries for import from India of machinery, capital equipment and services for their projects.

(iv) Export Credit and Guarantee Corporation Ltd.(ECCG), which issues policies and provides guarantees covering risks, commercial as well as political, faced by exporters and export-financing banks.

(v) The Commerce Ministry of the Government of India, who make available from their Marketing Development Assistance, incentives and duty drawbacks to exporters and interest subsidy to the export financing banks.

### 5.2 Functions of Exports Section in a bank

The Exports Section in a bank is mainly concerned with the following items of work:

- (i) Advising and confirming export letters of credit;
- (ii) Grant of packing credit facilities;
- (iii) Negotiation of export bills drawn under letters of credit;
- (iv) Purchase and discount of export bills without letters of credit;
- (v) Handling export bills for collection and making advances against them;
- (vi) Grant of medium/long-term post-shipment credit on deferred payment terms;
- (vii) Providing forward exchange cover;
- (viii) Issue of bank guarantees towards fulfilment of export quota and export performance, as also bid bonds, performance and other guarantees on behalf of exporters of engineering goods on deferred payment terms and turnkey projects and undertaking overseas civil engineering construction contracts.

### 5.3 Forms of export credit

Export credit may be given/availed of in the following forms;

- (a) Pre-shipment credit  
(Packing credit)
- (b) Short-term post-shipment credit, and
- (c) Medium and long-term post-shipment credit  
on deferred payment terms.

5.4 While pre-shipment credit and short-term post-shipment credit are given by commercial banks, post-shipment credit on deferred payment terms is given by banks as also by Exim Bank in participation with banks.

### 5.5 Relaxation in rates of interest for pre-shipment and post-shipment credit.

Since August 1967, commercial banks, by virtue of directives issued by the Reserve Bank have been charging concessive rates of interest in respect of all pre-shipment and post-shipment credits granted by them. The details of the concessive rates of interest in force with effect from April 1, 1983, are given in the following paragraphs.

### 5.6 Rates of interest for pre-shipment credit

The rates of interest would depend on the purpose for which the credit is extended as detailed below:

- (a) Pre-shipment credit for export of specified medium and heavy engineering goods and financing working capital requirements, for execution of construction contracts abroad,

for incurring preliminary expenses, e.g., to transport necessary technical staff and purchase of consumable articles either in India or in the country where the contract is to be executed (vide circular DBOD.No.ECC.BC.90/C.297P-75 dated October 23,1975).

Rate of Interest

- |   |                         |
|---|-------------------------|
| (i) upto 180 days   | 12.0%                   |
| (ii) Beyond 180 days and upto 270 days (extension with the approval of Reserve Bank of India)   | 14.50%                  |
| (iii) Beyond 270 days   | Not exceeding<br>16.50% |
| <br>(b) Other specified goods, viz., hand knotted carpets, leather manufactures and finished leather, coir products, cashew, tobacco, sports goods and engineering goods as indicated in circular DBOD.No.ECC.BC.144/C.297 P-80 dated December 9, 1980. |                         |
| (i) upto 180 days   | 12.0%                   |
| (ii) Beyond 180 days  | Net exceeding<br>16.50% |
| <br>(c) Other goods and consultancy services.   |                         |
| (i) upto 90 days  | 12.0%                   |
| (ii) Beyond 90 days and upto 135 days (extension of 45 days may be granted by the bank itself)  | 14.50%                  |
| (iii) Beyond 135 days   | Not exceeding<br>16.50% |

Rate of interest for post-shipment credit

5.7 At the post-shipment stage, banks are required to charge interest at a rate of 12.0% per annum on export bills purchased discounted/negotiated, whether under letters of credit or otherwise, and on advances granted against export bills received for collection, for a maximum period of 180 days, as indicated below:

- (i) Demand bills for the transit period as specified by FEDAI,
- (ii) Usance bills upto 180 days comprising usance period of export bills, transit period as specified by FEDAI and grace period wherever applicable. In cases where export bills are realised before the expiry of the full usance period, banks are eligible for the interest subsidy and are required to charge the concessive rate of interest only for the actual period for which the usance has run plus the permitted transit period and days of grace wherever applicable. If, however, the bills are realised after the notional due date, the interest subsidy can be claimed only upto the notional due date. The date of realisation of usance bills for this purpose would be the date on which the proceeds are credited to the bank's Nostro account abroad,

Rate of interest for advances against claims for export incentives,

5.8 In respect of advances granted against export incentives receivable in the form of cash assistance and duty drawbacks, covered by Export Production Finance Guarantee of ECGC, at the pre-shipment stage and also at the post-shipment stage, the

rate of interest of 12.0% per annum is applicable for a maximum period of 90 days.

Rate of interest for deferred payment exports

5.9 In the case of exports on deferred payment terms for periods over one year, the Reserve Bank has fixed a rate of interest of 8.65% per annum. This facility is, however, available only in respect of export of specified capital and producer goods approved by the Reserve Bank from time to time.

Rate of interest for periods for which concessive rates of interest are not applicable

5.10 Banks have been advised that where pre-shipment credits or post-shipment credits are extended beyond the periods stipulated for concessive rates of interest, they should charge a reasonable rate of interest, as low as possible, for the extended period, taking into account the priority character of export credit. The scheme of penal rate is not applicable during such extended periods, vide circular DBOD, No.Dir.BC.70/C.96.76 dated 26th June 1976. In those cases where packing credits are availed of but exports do not materialise whatever may be the reason for exports not materialising banks are required to charge a suitable rate higher than their normal rate of interest from the date of advance. The penal rate in such cases may be on the scales indicated in paragraph 2(ii)(a) of the aforesaid circular.

5.11 At the post-shipment stage, interest subsidy is available to banks only when export bills are realised within a period of 180 days from the end of the transit period in the case of a demand bill and from the due date in the case of a usance bill. Where an export bill is realised beyond such period, the financing bank becomes ineligible for interest subsidy and would, therefore, be entitled to charge in respect of such overdue export bill interest at a rate not exceeding the ceiling rate (16.5 per cent with effect from April 1, 1983) for the entire period of the post-shipment credit. At the same time, the interest subsidy claimed and received in respect of such ineligible bills will have to be refunded to the Reserve Bank. In such cases, it will be not in order for banks to recover from the exporters the interest subsidy of 1.5 per cent refunded to the Reserve Bank. It may be emphasised that it is only where the credit does not actually result in an export transaction, in which case the credit ceases to be export credit, that banks can levy a penal rate of interest as indicated above.

#### Credit Authorisation Scheme

5.12 In regard to the financing of exports, the following relaxations have been allowed in the Credit Authorisation Scheme.

- (i) In the case of a major export-oriented manufacturing unit whose annual average export turnover during the preceding three calendar years is more than 25 per cent of the total

turnover of the goods manufactured by it and whose export turnover in the following year would not fall below 25 per cent of the total turnover, the cut-off point for working capital limits is Rs.5 crores (as against Rs.4 crores for other borrowers in the public or private sector). Further, the cut-off point in respect of such an export-oriented manufacturing unit in the private sector for individual term loans repayable over more than three years is Rs.1 crore (as against Rs.50 lakhs for other private sector borrowers and Rs.1 crore for public sector borrowers, whether or not the public sector borrowers are export-oriented manufacturing units).

(ii) Prior authorisation of the Reserve Bank is not required for the grant of post-shipment working capital limits relating to exports, but such credit facilities are to be counted for the purpose of the cut-off point.

(iii) The export packing credit working capital limits aggregating Rs.5 lakhs to a single borrower from one bank may be granted without obtaining the prior authorisation of the Reserve Bank. Besides, without prior authorisation, banks may allow additional packing credit limits upto 25 per cent of the existing export packing credit limits or Rs.50 lakhs, whichever is less, for periods not exceeding three months. This discretion is, however, available only where the packing credit limits are clearly defined and segregated, and not for combined/interchangeable cash credit and packing credit limits,

and should be exercised in banks at a level not below that of a Committee of Executives. The aforesaid credit facilities are to be counted for the cut-off point.

5.13 The export post-shipment and packing credit limits as at (ii) and (iii) above sanctioned to a non-CAS borrower which would take the total credit limits enjoyed by it from the banking system to Rs.1 crore and above or to a CAS borrower are required to be promptly reported by banks after sanction to the Reserve Bank along with the relevant data and a brief self-contained note or a copy of the note put up to the sanctioning authority explaining the reasonableness of the assessment of working capital needs and justification for the additional limits sought.

Pre-shipment credit(Packing credit)

5.14 Pre-shipment loan or packing credit facility is allowed to meet the working capital requirements of an exporter for the specific purpose of purchasing, processing, manufacturing, assembling and / or packing of goods meant for export against the lodgment of irrevocable export letters of credit or on the strength of confirmed firm export orders or sale contracts. Packing credits are also granted to finance receivables such as cash incentives and duty drawbacks. Raw materials, stores and components, goods-in-process and finished stocks, processed/acquired with the pre-shipment finance provided by the bank, should be pledged or

hypothecated to it, depending upon the stage at which they are. Packing credit facilities are usually extended by way of loans and the outstandings in the loan accounts should be extinguished by negotiation of the relative export bills and claims on Government departments in connection with cash assistance and duty drawbacks. Such advances are usually covered by packing credit guarantees issued by ECGC.

5.15 The period for which a packing credit advance may be given by a bank depends upon the circumstances of each case, such as the time required for procuring, manufacturing or processing and shipping the relative goods. It is primarily for the bank to decide the period for which a packing credit advance may be given having regard to the relevant factors, but it should be sufficient to enable the exporter to ship the goods. However, concessive rates of interest are applicable and interest subsidy is payable only for the periods stipulated by the Reserve Bank.

5.16 A close watch must be kept by banks on the end - use of packing credits and also on the timely fulfilment of export orders. It should also be ensured by them that neither the amount nor the period of the packing credit advance exceeds the actual requirement in each case, as follows:

(i) Whether the entire amount of the packing credit is needed in one lump sum for fulfilling the export order or it could be released in stages;

- (ii) Whether an import licence has been obtained in case a particular component or raw material is required to be imported for executing the export order;
- (iii) Whether a letter of credit has been received where the export contract provides therefore;
- (iv) Whether the reasons for the delay in receiving the letter of credit are justified;
- (v) Whether the progress made by the exporter from time to time towards fulfilment of the contract is satisfactory and funds drawn under the packing credit advance have been actually utilised for the purpose for which they have been made available;
- (vi) Whether the contracts cover all essential particulars such as the quality and quantity of goods to be exported, price at which the goods are to be supplied and the date of shipment, etc. in the case of packing credits being made available on the basis of export orders without the stipulation of opening letters of credit.

Packing credits without lodgment of firm orders/  
letters of credit and on running account basis.

5.17 To satisfy the financing banker that the accommodation required is export credit, the exporter has to produce a firm export order or a letter of credit and lodge the same with the bank. In the case of certain commodities which are processed exclusively for export, compliance with such requirements may not always be possible. Banks, have, therefore, been

permitted to extend pre-shipment finance to regular exporters on the strength of their past performance and capacity for undertaking the exports for which the finance is sought, even if they are unable to produce letters of credit on firm export orders. Commodities entitled to this relaxation include tea, jute goods, cashewnuts, coffee, hides and skins, finished leather, tobacco, diamonds, precious and semi-precious stones, pearls, synthetic stones, mineral ores, marine products, sea foods, carpets and silver ornaments/ware. In addition, pre-shipment finance for these commodities is permitted to be given on a running account basis and banks can mark off individual export bills as they are received for negotiation against the earliest packing credit advance.

Packing credits in excess of FOB value of contract/order

5.18 Banks have been advised that packing credits granted to exporters should be sufficient to cover the value of export orders, except for costs, if any, to be incurred after the stage of shipment and/or negotiation of bills. Normally, packing credits should not exceed the FOB value of the contract/order or the domestic cost of such goods, whichever is less. However, relaxations have been made as indicated below:

(i) Advances may be granted upto the domestic cost of goods to be exported even though such cost is higher than the FOB value of the contract/order, provided the excess advance is covered by export incentives receivable from the Government of India and Export Production Finance Guarantee of ECGC is obtained.

After the goods are shipped, the amount of the relative export bills should be adjusted towards the pre-shipment advance and any balance outstanding should be treated as a post-shipment advance against export incentives receivable. The advances against export incentives at the pre-shipment stage (on the amount in excess of FOB value) and at the post-shipment stage (on the balance outstanding in the account after shipment) are eligible for the concessive rate of interest upto a maximum period of 90 days. Where post-shipment advances are granted against provisional entitlements for duty drawbacks as certified by the Customs authorities under the Duty Drawback Credit Scheme, 1976, they may be used for adjusting any pre-shipment advances granted in excess of FOB value.

(ii) Banks are permitted to provide packing credits to exporters of HPS groundnut, deoiled and defatted cakes and rice bran extraction against the security of the relative raw materials (e.g., groundnut, cottonseed and rice bran) to the extent of the value of raw material required even though the amount so advanced exceeds the value of the export order. This facility is, however, subject to the condition that the amount of packing credit in excess of the export value should be adjusted either in cash or by sale of the residual groundnut or by-product oil as soon as the selection of HPS groundnut/extraction of oil is completed, but within a period of 15 days in the case of packing credits granted to exporters of HPS groundnut and 30 days in the case of packing credits provided to exporters of deoiled and defatted cakes and rice bran extraction, from the date of

advance. The balance in the packing credits has to be adjusted by the proceeds of the relative export bills. The excess packing credits would also be eligible for the concessional rate of interest and interest subsidy upto a maximum period of 15 days or 30 days as specified above. Banks should extend the benefit of the aforesaid relaxation judiciously for the genuine credit requirements of exporters, after making a careful assessment of the additional credit required over and above the value of the export order, taking into account the genuine raw material needs for executing the export order and the production schedules, etc. They should also ensure strict monitoring of the borrowers' accounts and devise appropriate safeguards to prevent misutilisation of the facility.

#### Substitution of export contracts

5.19 Where, for any reason, exporters who have availed of pre-shipment finance against export orders are unable to adjust the packing credit, it is in order for banks to allow the exporters to adjust the outstandings from the proceeds of export bills drawn on other importers either in the same country or in any other country, provided the relative bills are in respect of the same goods for which the pre-shipment credit was originally given and the export under the substituted contract takes place within a reasonable time.

#### Exports on consignment basis.

5.20 Precious and semi-precious stones, pearls and synthetic stones are exported mostly on a consignment basis. Banks may

adjust the pre-shipment advances in the case of exports on consignment basis, as soon as the export takes place, by transfer of the outstanding balance to a special (post shipment) account which, in turn, should be adjusted from the relative sale proceeds received from abroad. Such post-shipment advances are eligible for the concessive rate of interest as also interest subsidy upto a maximum period of 180 days from the date of advance,

5.21 The authorised dealers are required to comply with the regulations regarding consignment exports laid down in paragraph 11C-15 of the Exchange Control Manual.

Packing credits for exports through  
Export Houses/Agencies.

5.22 Packing credits may be granted at a concessive rate of interest to suppliers who do not have letters of credit or export orders in their own name and are exporting through Export Houses, State Trading Corporation and other agencies provided that, apart from usual stipulations, the following requirements are complied with:

(i) The bank should obtain from the Export House a letter setting out the details of the export order and the portion thereof to be executed by the supplier and also indicating the period, if any, upto which the Export House would like to avail itself of packing credit in respect of such portion of the order as is to be executed by the supplier.

(ii) The Export House should open inland letter of credit in favour of the supplier giving relevant particulars of the export letter of credit/order, and the outstandings in the packing credit account should be extinguished by negotiation of bills under such inland letter of credit.

(iii) If (ii) is inconvenient for the Export House, the supplier should draw bills on the Export House in respect of the goods supplied for export and adjust packing credits from the proceeds of such bills. In case the bills are not accompanied by bills of lading or other export documents, the bank should obtain through the supplier a certificate from the Export House at the end of every quarter that the goods supplied under this arrangement have in fact been exported. The certificate should give particulars of the relative bills such as date, amount and the name of the bank through which the bills have been negotiated.

(iv) The bank should obtain an undertaking from the supplier that the advance payment, if any, received from the Export House against the export order would be credited to the packing credit account.

5.23 Where goods are to be manufactured by the supplier and processed by the Export House, pre-shipment finance at a concessive rate of interest may be availed of by both the parties for the required period, so, however, that the total period does not exceed the relevant maximum period permitted for pre-shipment finance at the concessive rate of interest.

5.24 Banks should ensure that there is no double financing of the same export order. It is desirable that an inland letter of credit is established so as to bring about a clear and proper relationship between the banker to the Export House and the banker to the supplier/ manufacturer.

Packing credit facilities against supplies to IBRD/IDA/UNICEF aided projects/programmes in India.

5.25 Advances granted to parties against orders for supplies to **IBRD/IDA/UNICEF** aided projects/programmes in India are considered as packing credits if they satisfy the following conditions:

(i) The advances should be adjusted from free foreign exchange, representing payments for supplies of goods made under the **IBRD/IDA/UNICEF** orders, However, in those cases where free foreign exchange is placed at the disposal of a Central Agency of the Government of India and the supplier of goods is not directly concerned with the receipt of foreign exchange, packing credit facilities may be provided by banks on the basis of an authenticated copy of the contract between the project authorities and the supplier, together with a certificate issued by the concerned Central Agency to the supplier to the effect that he has won a particular tender under international competitive bidding for supplies to such aided project in India.

(ii) The supplies made by the Indian suppliers are used by the IBRD/IDA/UNICEF only for its aid projects/programmes in India and are eligible for the grant of normal export benefits by the Government of India.

Packing credits for export of consultancy services.

5.26 Banks may grant pre-shipment credit facilities against consultancy agreements to consultancy firms for meeting expenses of technical and other staff employed for projects set up in foreign countries and for purchase of any materials required for the purpose, after taking into account advance payments received against the contracts. Such advances are to be granted at the concessive rates of interest for a maximum period of 135 days, i.e., 90 days at the rate of 12.0% per annum and further 45 days at the rate of 14.50% per annum.

5.27. The regulations regarding the undertaking of consultancy/<sup>are</sup> technical services abroad ~~are~~ laid down in Part F of Chapter 11 of the Exchange Control Manual.

Packing credits to construction contractors

5.28 In order to assist construction contractors to meet their initial working capital requirements for execution of contracts abroad, banks may grant packing credits to bonafide contractors at the concessive rates of interest for a maximum period of 270 days, i.e. 180 days at the rate of 12.0% per annum and further 90 days at the rate of 14.50% per annum, subject to the following conditions:

(i) The advances may be made on the basis of a firm contract secured from abroad, in a separate account, on an undertaking obtained from contractors 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.

(ii) The advances should be adjusted by negotiation of bills relating to the contract or by remittances received from abroad in respect of the contract executed abroad.

5.29 Where the contractor is also exporting supplies like cement, steel and building materials, pre-shipment credit, as available to other exporters of such goods, may be availed of by the contractor at the concessive rates of interest of 12.0% per annum for 90 days and 14.50% per annum for further 45 days.

5.30 In case the pre-shipment credit availed of for export of materials and other expenses is to be repaid in part or in full out of progress payments and no bills are drawn at the post-shipment stage, the balance outstanding in the packing credit account may be treated as post-shipment credit from the date of shipment of goods and as such, it will be eligible for the concessive rate of interest of 12.0% per annum upto 180 days.

5.31 The regulations regarding the undertaking abroad of construction contracts are laid down in Part E of Chapter 11 of the Exchange Control Manual.

Packing credits to units in Free Trade/  
Export Promotion Zones.

5.32 Banks may make available working capital to units in Free Trade/Export Promotion Zones by granting them packing credits subject to the guidelines indicated below:

(i) At the time of granting packing credits banks may not insist upon production of letters of credit/firm orders; these may be produced later.

(ii) Packing credits may be granted from the stage of procuring raw materials, whether imported or purchased locally, for the purpose of processing, manufacturing, packing, etc.

(iii) If the bank maintains different accounts at various stages of processing/ manufacturing, etc., e.g., hypothecation and pledge, the outstanding balance may be adjusted by transfer from one account to the other and finally by negotiation of the relative export bills or remittances received from abroad in respect of the exports.

(iv) Banks should mark off individual export bills as they are received for negotiation against the earliest packing credit and thus ensure that no packing credit remains outstanding for more than the stipulated period(s).

Short-term post-shipment credit.

5.33 Any advance granted by a bank to an exporter after the goods have been shipped is a post-shipment credit. An exporter can avail himself of short-term export credit at the post-shipment stage from any commercial bank authorised to deal

in foreign exchange. The following are the principal methods of financing exporters at the post-shipment stage :

- (i) Negotiation of export bills under letters of credit established by foreign branches/correspondents;
- (ii) Purchase and discount of export bills or documents against payment (DP) and acceptance (DA) respectively;
- (iii) Grant of advances against bills on collection basis; and
- (iv) Grant of advances against claims for export incentives.

5.34 Banks should maintain up-to-date credit reports both on the drawers as also drawees of the bills. Export bills purchased/discounted without letters of credit are generally covered by export risks policies/guarantees issued by ECGC, besides usual marine/air insurance cover.

Accounting procedure for overdue foreign currency export bills negotiated, purchased or discounted

5.35 Presently, there is no uniformity in the accounting procedure followed by authorised dealers in respect of export bills negotiated, purchased or discounted by them which become overdue. Such bills are generally included in exchange positions till they are realised which not only disturbs the maturity pattern of foreign exchange commitments of banks but also involves swap transactions. The following guidelines have been issued by FEDAI, with the approval of the Reserve Bank, which will be effective from 1st January 1984.

- (i) Where bills remain unpaid for a period of 30 days after

the transit period in case of demand bills ~~and the due date in~~  
case of demand bills and the due date in case of usance bills,  
the foreign currency amount shall be reversed by the authorised  
dealer from the "export bills purchased portfolio" on the 30th  
day. In case 30th day happens to be holiday, or Saturday, it  
shall be reversed on the next following working day. The rate  
applicable to such reversal shall be the ready T.T. selling  
rate of exchange on that day and shall be reported as 'Notional  
sale' of foreign currency. The rupee equivalent of the foreign  
currency thus reversed, shall be held in the advances portfolio  
of the bank under the head "Advances against overdue export  
bills realisable account". The unpaid bill shall be treated as  
outstanding under the limit sanctioned to the exporter with  
the exchange risk open against him. Interest for the overdue  
period shall be recovered at the appropriate rate upto the  
date of realisation of the bill. The appropriate rate of  
interest shall mean the maximum rate of interest permitted by  
the Reserve Bank for overdue export bills or the penal rate if  
the bill amount is recovered in rupees from the customer due to  
dishonour thereof by the drawee.

(ii) As and when the bill is realised and the advice of  
realisation either by cable or by mail is received, the autho-  
rised dealer shall apply the T.T. buying rate on that day and  
adjust the advance created in its books against the bills as  
explained above. Any shortfall/excess shall be recovered from/  
paid to the exporter. Authorised dealer shall report the

'Purchase' of foreign currency.

(iii) Authorised dealers shall not charge or pay any swap cost for the period of 30 days, i.e., the period between the relevant due date and the transfer of the bill to advances portfolio as explained in (i) above.

(iv) In the case of highly volatile currencies, it is up to the authorised dealer to negotiate the bill at the risk and responsibility of the customer.

(v) For the purpose of reporting the reversals of bills purchased earlier - (i) above - and subsequent purchase of currency against realisation of bills - (ii) above - in the relative R>Returns, authorised dealers should be guided by the instructions issued by the Reserve Bank from time to time

Advances against retention money.

5.36 In the case of turn-key projects/construction contracts, overseas employers normally retain a small percentage of the progressive payments as retention money which is payable after the expiry of the stipulated period from the date of the completion of the contract, subject to the obtaining of certificate/s from the specified authority. Banks have been advised that

(i) no advances may be granted against retention money relating to services portion of the contract;

(ii) exporters should, as far as possible, provide suitable guarantees to overseas employers, instead of retention money;

(iii) banks may grant, on a selective basis, advances against retention money relating to supplies portion of the contract taking into account, among others, size of the retention money accumulated, its impact on liquid funds position of the exporter and past performance regarding timely receipt of retention money;

(iv) in view of contingent nature of payment of retention money, banks may like to stipulate a margin which may, however, be reasonable;

(v) The payment of retention money may be secured by letters of credit or bank guarantees, wherever possible.

5.37 In those cases where advances are granted against retention money which according to the terms of the contract, will be payable within a period of one year from the date of shipment, banks are required to charge interest on such advances at the rate of 12.0% per annum upto a maximum period of 90 days. If the retention money, according to the terms of the contract, is payable after a period of one year from the date of shipment and corresponding advance is extended for a period exceeding one year, it is to be treated as post-shipment credit given on deferred payment terms exceeding one year and eligible for interest at the rate of 8.65% per annum. Advances against retention money are eligible for the concessive rates of interest and interest subsidy only to the extent the advances are actually repaid by remittances received from

abroad relating to the retention money and provided such payments are received within 180 days from the due date on which the retention money is payable according to the terms of the contract.

Advances against undrawn balances

5.38 In certain lines of exports, it is the practice of the exporter not to draw a bill for the full invoice value of the goods but to leave a small portion thereof undrawn, for payment after adjustments due to differences in weight, quality, etc. These adjustments are made after inspection, weighment or analysis of the goods by the foreign buyer on their reaching the destination. If these undrawn balances are not realised within six months (or three months in the case of Afghanistan and Pakistan) from the date of shipment of the goods, the matter should be pursued by the bank with the concerned exporter. It should maintain a special register for the purpose of keeping a watch on the realisation of the undrawn balances within the prescribed period.

5.39 In cases where advances are granted against undrawn balances, banks are required to charge interest at the rate of 12.0% per annum on such advances till the receipt of the remittances from abroad, subject to the maximum period of 90 days. Advances against undrawn balances are eligible for the concessive rate of interest and interest subsidy only to the extent they are repaid by remittances from abroad towards

such undrawn balances and provided such remittances are received within 180 days after the date of expiry of the normal transit period in the case of demand bills and the due date in the case of usance bills(bills relating to which the undrawn balances have arisen).

Export of goods for exhibition and sale.

5.40 Any bank finance given against goods sent abroad for exhibition before sale does not strictly fall within the category of either pre-shipment or post-shipment credit. Banks may, however, provide finance for export of goods for exhibition and sale abroad in the normal course in the first instance and after the sale is completed, allow the benefit of the concessive rates of interest on such advances, both at pre-shipment stage and at post-shipment stage, upto the stipulated periods, by way of a rebate. Banks are eligible for interest subsidy on such advances given at the concessive rates of interest.

Maintenance of Dollar accounts  
abroad by diamond exporters

5.41 To facilitate the financing of import-export transactions of diamond exporters, the Reserve Bank has evolved a scheme for maintenance of foreign currency accounts abroad. Applications from eligible exporters of diamonds are required to be submitted to the Reserve Bank through the concerned authorised dealer for opening dollar accounts abroad subject to the conditions indicated in ECD's circular No,EC.COX/195/P&C.107 dated the 10th December 1982.

Exports of engineering goods on deferred payment terms and turnkey projects, and overseas civil engineering construction contracts.

5.42 Contracts for export of goods against payments to be received partly or fully after the statutory time limit of six months (three months in the case of exports to Afghanistan and Pakistan) are treated as deferred payment export contracts. Turnkey projects are those projects which involve the rendering of services like design, civil construction, erection and commissioning of plant or supervision thereof, along with the supply of equipment. Deferred payment exports are financed out of Suppliers' Credit or Buyers' Credit. Under Suppliers' Credits, the exporter extends credit directly to the overseas buyer. Buyers' Credits are credits afforded to the foreign buyer by an authorised dealer or a financial institution (including consortium of authorised dealers/ financial institutions) and the exporter realises the export value from the institution(s) concerned straight-away.

5.43 The regulations governing exports against deferred payment arrangements and turnkey projects are given in Part D of Chapter 11 of the Exchange Control Manual and those in respect of overseas civil engineering construction

Contracts are contained in Part E thereof. The Reserve Bank has issued two booklets titled "Broad Guidelines to Exporters of Engineering Goods on Deferred Payment Basis and Turnkey Projects" and "Guidelines regarding Overseas Civil Engineering Construction Contracts" for the benefit of exporters and banks.

5.44 All banks authorised to deal in foreign exchange are permitted to approve applications for deferred payment exports and turnkey projects under Suppliers' Credits as also overseas civil engineering construction contracts upto Rs. one crore subject to certain minimum conditions as prescribed in the Exchange Control Manual. Applications which do not conform to the stipulated conditions and applications of a value in excess of Rs. one crore as well as all applications for deferred payment exports or turnkey projects under Buyers' Credits, irrespective of the value of contract, require the approval of the Working Group comprising the Reserve Bank (Exchange Control Department and Industrial and Export Credit Department), ECGC and Exim Bank, with the Exim Bank functioning as the focal point.

#### Quasi-credit facilities

5.45 Quasi-credit facilities, such as, bonds and guarantees on behalf of Indian exporters who want to set up projects abroad or who are involved in overseas civil engineering construction contracts, are extended by commercial banks and

Exim Bank. These are:

(i) Bid bonds and performance guarantees

Exporters who wish to tender for the supply of plant and machinery, engineering/capital goods or for construction works, are required to furnish bid bonds in lieu of earnest money along with their tenders in favour of the overseas body/project authorities who have invited global tenders. The bid bonds become effective if the exporter is awarded the tender but refuses to sign or proceed with the execution of the contract. In the ordinary course, bid bonds are substituted by performance guarantees at the time of signing the contract by the exporter. The bid bonds/performance guarantees may be issued by banks in India directly in favour of the overseas beneficiary or may be furnished by them through their foreign correspondents in the country concerned. It is important to note firstly that, the bank's liability under bid bonds comes into operation only if the exporter is awarded the contract for which he had tendered and secondly that, the issuance of bid bonds would enjoin the bank to furnish performance guarantees at the time of signing of the contract. While bid bonds are generally for 5% of the contract amount, performance bonds are for about 10% of the contract value. In other words, unless the bank is prepared to undertake the liability for twice the amount of the bid bond, it should not issue the bid bond on behalf of the exporter. Further, the bank should carefully examine

the capacity of the exporter to carry out the terms of the contract and his technical competence for undertaking the work or for supply of quality goods as per the specifications. It may sometimes happen that an Export House may tender for the supply of machinery overseas and, in turn, award the sub-contract to the supporting local manufacturer of the machinery. In such a case, the reputation and capacity of the supporting local manufacturer for the supply of quality goods as per the overseas buyer's specifications should also be ascertained. Although the issuing of bid bonds and performance guarantees is a "non-borrowing" facility extended to the exporter, the possibility of his approaching the bank for pre-shipment finance and/or post-shipment/medium-term export credit for a substantial amount of the overseas contract cannot be overlooked. These borrowing facilities, if required by the exporter, may amount to 15-16 times the bid bond amount or 7-8 times the amount of the performance guarantee. It is, therefore, necessary to enquire of the exporter and ascertain what financial arrangements he has made/is contemplating to make to serve the overseas contract. In the alternative, the bank must be satisfied that the exporter has at his disposal/command adequate financial resources for undertaking the overseas contract. If the answer to the foregoing enquiries is in the negative, the bank should take into account the possibility of granting financial accommodation as aforesaid and examine

the proposals for issuance of bid bonds/performance guarantees from that angle as well.

(ii) Guarantees in respect of advance payments

Bank guarantees are issued in favour of overseas buyers in respect of advance payments to be made by them. Such advance payments are a common feature in contracts pertaining to export of capital goods or turnkey jobs.

(iii) Guarantees for realise of retention money

In cases of turnkey projects, overseas buyers normally retain a certain percentage of the contract value for a specified period. It is desirable that exporters should try to secure the release of such retention money by furnishing a suitable bank guarantee in favour of the buyer. The bank issuing the guarantee should monitor the use of retention money so released until cancellation of the guarantee.

(iv) Guarantees for bridging finance in foreign exchange.

All turnkey projects and overseas civil engineering construction contracts should normally be self-financing in regard to the foreign exchange component. In case any temporary shortfall in the cash-flow is anticipated, the gap may be bridged by making necessary borrowing arrangements in the country of work or in a third country against an appropriate guarantee from the exporter's bank. While

arranging such bridging finance abroad, preference should be given to an overseas branch of an Indian bank, where possible.

5.46 The regulations governing furnishing of export guarantees by authorised dealers are given in part G of Chapter 11 of the Exchange Control Manual.

5.47 Banks have been advised by the Reserve Bank to adopt a flexible approach in the matter of obtaining security or earmarking of assets or cash credit limits or the drawing power available in the relative accounts as cover against bid bonds or performance and other guarantees issued by them for export purposes, and that they may not ask for any cash margin in respect of bid bonds and guarantees counter-guaranteed by ECGC. In other cases where such counter guarantees of ECGC are not available, for whatever reasons, the banks may stipulate a reasonable cash margin only where it is considered absolutely necessary. The bid bonds and guarantees executed by banks in respect of contracts secured by Indian exporters in foreign countries and guarantees relating to exports are excluded for the purpose of the norm stipulated by the Reserve Bank in terms of which scheduled commercial banks are required to limit their commitments by way of unsecured guarantees in such manner that 20 per cent of a bank's outstanding unsecured guarantees plus the total of its outstanding unsecured advances should not exceed 15 per cent of its total outstanding advances.

Pre-shipment Credit Scheme and  
Export Bills Credit Scheme.

5.48 The pre-shipment credit scheme was introduced with effect from February 1, 1969, Under the Scheme, refinance can be availed of by scheduled banks, under section 17(3A) of the Reserve Bank of India Act, 1934, against their pre-shipment advances in respect of shipments expected to be made within a period not exceeding 180 days from the date of advance.

However, where an exporter is for reasons beyond his control unable to ship the goods within the maximum period of 180 days and the goods are ultimately shipped within a reasonable time there-after, the advances will be eligible for refinance during the extended period, provided such extended period is approved by the Reserve Bank. It should be ensured that the total outstanding borrowings from the Reserve Bank under the scheme, at any time, are fully covered by the amount of pre-shipment advances drawn and outstanding.

5.49 The Export Bills Credit Scheme was introduced in March 1963 and refinance is made available to scheduled banks authorised to deal in foreign exchange, under section 17(3A) of the Reserve Bank of India Act, 1934, against holding of eligible usance export bills having a usance not exceeding 180 days purchased/negotiated/discounted by them. It is to be ensured that the outstanding borrowings from the Reserve Bank under the scheme are at all times, fully covered by the borrowing bank's holdings of eligible export bills.

5.50 The quantum of refinance to be provided by the Reserve Bank under the Schemes and the rate of interest to be charged thereon are laid down from time to time in consonance with credit policy of the Reserve Bank. (With effect from November 25, 1983, banks are entitled to export refinance upto 125 per cent of the increase in export credit over the monthly average level for 1982. The rate of interest charged on the refinance by the Reserve Bank is 10 per cent per annum).

Duty Drawback Credit Scheme, 1976.

5.51 Drawback is refund of customs and/or central excise duty already paid on the raw material and/or components which have gone into the production of the exported goods. It is an incentive given by the Government of India to exporters in cases where goods to be exported are not competitive in foreign markets. As an export promotion measure, the Duty Drawback Credit Scheme, 1976 was introduced with effect from February 1, 1976 to provide exporters with interest-free advances from banks upto a period of 90 days against their Duty Drawback entitlements as provisionally certified by the Customs authorities pending final sanction and payment. Banks in turn, are eligible to obtain refinance from the Reserve Bank under section 17(3B) of the Reserve Bank of India Act, 1947 free of interest, for a period not exceeding 90 days. Presently, the facility is available in respect of exports made from Bombay, Calcutta, Cochin, Delhi and Madras; refinance is

at Bombay, Delhi,

Calcutta and Madras.

5.52 Banks may stipulate a margin between the amount of duty drawback provisionally certified by the Customs authorities and the advance to be granted. However, the margin should not exceed 10 per cent. They may charge a reasonable amount towards the administrative expenses or costs relating to the transmission of funds between the centres where refinance is obtained from the Reserve Bank and the centres where advances are made to exporters. According to Rule ~~13~~-XI of FEDAI, such a service charge shall be at  $\frac{1}{2}$ % subject to a minimum of Rs.10. In the event of the borrower not being found eligible to the drawback amount claimed by him and against which an advance was granted to him or as being entitled to a lesser amount, the bank may charge from the date of advance, interest on the said amount or the difference, as the case may be, at the rate normally charged by it on its cash credits/ advances, and the bank shall pay to the Reserve Bank on the corresponding amount refinance obtained, for the period for which such an advance was included in the declarations submitted to the Reserve Bank, interest at a rate equal to the rate charged to the borrower less 1.5 per cent. The advances granted to exporters under the Scheme are not eligible for the interest subsidy.

Export Credit (Interest Subsidy) Scheme, 1968

5.53 Granting of export finance at concessive rates of interest results in loss of income for banks. In order to ensure that the reduction of profit margin does not discourage them from providing the necessary finance to exporters, banks are eligible for an interest subsidy of 1.50 per cent per annum under the captioned Scheme, effective from March 1968. The amount of interest subsidy is drawn from the Marketing Development Assistance of the Ministry of Commerce, Government of India, and disbursed to banks by the Reserve Bank. The subsidy is payable in respect of all types of export credit except that refinanced by the Exim Bank.

5.54 Buyers' Credit granted by banks on or after the 15th September 1980 to a buyer in a foreign country is also eligible for the interest subsidy at such rates not exceeding 1.5 per cent per annum and for the period as may be approved by the Reserve Bank. The Buyers' Credit has been defined in the captioned Scheme as any loan or advance granted or any other credit provided by an institution to an importer in a foreign country importing machinery or equipment from India on deferred payment terms approved by the Reserve Bank. The rate of interest to be charged by banks on the Buyers' Credit will depend on the merits of each case, the objective being to ensure that the terms offered are attractive enough to the foreign buyers. Hence, for the purpose of eligibility for the interest subsidy the rate of interest that may be charged on the Buyers' Credit is approved by the Reserve Bank on a case-to-case basis.

Export Credit and Guarantee Corporation Limited

5.55 The main functions of the Export Credit and Guarantee Corporation Limited (ECGC) are to assist exporters to sell in international markets with confidence and help banks to export more liberally and with less risk. Exporters are protected against credit risks, commercial as well as political, and ECGC bears the major part of their losses if payments for goods and services get blocked or delayed. ECGC issues standard policies to protect exporters against the risk of not receiving payment while trading with overseas buyers on short-term credit and specific policies to protect exporters against the risk of not receiving payment for exports on deferred payment terms, services rendered to foreign parties and construction works including turnkey projects undertaken abroad. Banks are given financial guarantees against the risks involved in extending credit or guarantee facilities to exporters. In addition, transfer guarantee is issued to protect banks which add confirmation to letters of credit, while insurance cover is provided for buyers credit, lines of credit, joint ventures and overseas investment.

Standard Policies

5.56 Four types of standard policies are issued to exporters : Shipments (Comprehensive Risks) Policy covering

both commercial and political risks from the date of shipment, <sup>Shipments</sup> (Political Risks) Policy covering only political risks from the date of shipment, Contracts (Comprehensive Risks) Policy covering both commercial and political risks from the date of contract, and Contracts (Political Risks) Policy covering only political risks from the date of contract. Under the contracts policy, in addition to the risks covered under the shipments policy, the risk of loss due to governmental ban on export of goods after the date of contract is also covered. ECGC normally pays 90 per cent of the losses on account of political or commercial risks. Commercial risks are covered by ECGC subject to approval of credit limit on each buyer. Credit limit is the limit upto which claim can be paid under the policy for losses on account of commercial risks. If no credit limit on a buyer has been approved, ECGC accepts liability for commercial risks subject to certain conditions. When payment risks become too high in a country, ECGC provides cover on a restricted basis.

#### Specific Policies

5.52 Contracts for export of capital goods or turnkey projects or construction works or rendering services abroad

are insured by ECGC on a case-to-case basis under specific policies. Specific policies may take any of the following four forms: Specific Shipments (Comprehensive Risks) Policy covering both commercial and political risks at the post-shipment stage, Specific Shipments (Political Risks) Policy covering only political risks 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, Specific Contracts (Comprehensive Risks) Policy and Specific Contracts (Political Risks) Policy. A contracts policy provides cover from the date of contract.

#### Guarantees to banks

5.58 ECGC provides five types of guarantees to banks, namely, Packing Credit Guarantee, Export Production Finance Guarantee, Post-shipment Export Credit Guarantee, Export Finance Guarantee and Export Performance Guarantee. These guarantees give protection to banks against losses due to non-payment by exporters on account of their insolvency or default. The Export Production Finance Guarantee enables banks to sanction advances at the pre-shipment stage to the full extent of cost of production when it exceeds the FOB value of the contract/order, the difference representing incentives receivable. The Export Finance Guarantee covers post-shipment advances granted by banks to exporters against.

export incentives receivable in the form of cash assistance, duty drawback, etc. The Export Performance Guarantee, which is in the nature of a counter-guarantee to the bank, is issued to protect the bank against losses that it may suffer on account of guarantees given by it on behalf of exporters.

#### Transfer Guarantee

5.59 The Transfer Guarantee safeguards a bank in India, which has added its confirmation to a foreign letter of credit, against losses suffered by it due to the failure of the opening bank to reimburse it with the amount paid to the exporter. It is issued at the option of the bank either to cover political risks alone or for covering both political and commercial risks.

#### Insurance Cover for Buyers' Credit and Lines of Credit

5.60 Insurance cover is provided to financial institutions in India for direct lending to buyers or financial institutions in developing countries for importing machinery and equipment from India. This kind of financing facilitates immediate payment to exporters and frees them from the problems of credit management as well as from the fear of loss on account of overseas credit risks.

#### Overseas Investment Insurance

5.61 Any investment made by way of equity capital or untied loan for the purpose of setting up or expansion of

overseas projects is eligible for cover under investment insurance. Investments may be by way of cash or exports of capital goods and services. The cover is available for the original investment together with annual dividends and interest payable. Risks of war, expropriation, and restriction on remittances are covered under this insurance.

#### Exchange Fluctuation Risk Cover Schemes

5.62 The Exchange Fluctuation Risk (Bid) Cover Scheme and Exchange Fluctuation Risk (Contract) Cover Scheme help the exporters engaged in exports involving deferred payment terms. The exchange fluctuation risk is protected from the date of bid. Where the contract is won, the exporter-contractor is given option to have the exchange rate as on the date of bid or as on the date of contract, whichever is more advantageous to him, as the reference rate for the purpose of indemnification by ECGC. The bid cover is provided for a maximum period of 12 months, but it can be extended. The contract cover is available for contracts with payments going beyond 12 months, with a maximum period of 15 years. Any instalment payable during the first 12 months is also covered in such cases. The cover is available in respect of all amounts receivable in India in foreign currency under the contract. Besides supply

contracts, construction contracts, turnkey projects and service contracts are covered under the schemes. While pound sterling, US dollar, Deutsche mark, Japanese yen, French franc and Swiss franc are specified, cover can be considered for any other convertible currencies approved by the Government. Contracts coming under buyers' credit and lines of credit arrangements are also covered. Losses exceeding 2 per cent and upto 35 per cent with reference to the agreed rate are reimbursed by ECGC. Profit between 2 per cent and 35 per cent of the agreed rate is payable to ECGC.

#### Guidelines for Inspecting Officers

5.63 During the financial inspection of a bank, the Reserve Bank, as the supervisory authority, is basically concerned with the quality of credit appraisal and effectiveness of the supervision exercised by the bank over export finance extended by it, as part of the assessment of the bank's advances portfolio. Apart from these general considerations, the special aspects regarding financing of exports are as follows:

(1) The export finance is granted at the concessive rates of interest prescribed by the Reserve Bank and it is, therefore, necessary that a close watch should be kept by the bank on the end-use of the finance and on the timely

fulfilment of export orders besides ensuring that neither the amount nor the period of export finance exceeds the actual requirement in each case.

(ii) All possible efforts should be made towards the prompt repatriation of export proceeds within the prescribed period and in accordance with the permitted methods.

(iii) The regulations governing export of goods and services given in Chapter II of the Exchange Control Manual should be strictly complied with.

5.64 The Inspecting Officer should bear in mind the aforesaid general considerations and special aspects regarding financing of exports and, particularly during branch inspections, should carry out a test check of selected transactions in order to verify:

(i) Whether packing credits have been granted, negotiation of export bills has been done and advances against bills sent for collection have been allowed under proper sanction of the appropriate authority or is within the discretionary powers vested in the Manager and, in the latter case, whether the facilities have been given to deserving parties only.

(ii) Whether, while granting pre-shipment credit facilities, the usual safeguards, such as, lodgment of

irrevocable export letters of credit and / or firm export orders by exporters, competence and capacity of the exporter to execute the orders within the stipulated delivery schedules, financial viability of the export deals, and relating amounts and periods of packing credit advances to export turnover and actual requirements, have been observed as also whether a watch is kept over the end-use of pre-shipment finance and packing credits are liquidated by negotiation of relative export bills within a reasonable time;

(iii) Whether bills negotiated have generally been under letters of credit established by approved banks or against firm orders from creditworthy parties abroad;

(iv) Whether there is a proper procedure for thorough scrutiny of the bills received for negotiation; in the case of bills negotiated under letters of credit, the instructions of the banks opening the letters of credit have been complied with; where bills have been drawn on the basis of firm orders, the documents have been drawn in accordance with the terms of the relative order;

(v) Whether bills, including those which have been negotiated against indemnity or under reserve (on account of the documents not being entirely in conformity with the terms of the relative letters of credit), have been

realised without undue delay (the Inspecting Officer should satisfy himself that negotiation against indemnity/under reserve has been allowed to deserving parties only; he should also go through the particulars of bills, if any, remaining unrealised beyond the prescribed period - including those held in 'Past Due and Dishonoured Bills' account - and ascertain the reasons for delay in realisation as also whether the position of overdue bills is reviewed periodically and appropriate steps taken for their realisation; he should further verify whether overdue interest has been collected wherever necessary

(vi) Whether appropriate export risks cover has been obtained from the Export Credit and Guarantee Corporation Ltd., and if not, the reason therefor may be ascertained;

(vii) Whether the Reserve Bank's directives relating to the rates of interest to be charged on export finance and stipulations regarding eligibility of packing credit and export bills for interest subsidy and refinance from the Reserve Bank, have been complied with;

(viii) Whether there is a satisfactory procedure for collection and recording of up-to-date credit information on the parties;

(ix) Whether the Export Bills Registers have separate columns for recording (a) the date on which the period

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prescribed for realisation of an export bill will expire

(b) the dates on which copies of GR/PP forms have been submitted to the Reserve Bank and

(c) the amount of commission and/or discount declared by exporters on GR/PP forms and accepted by Customs;

(x) Whether the bank is maintaining (a) special register to keep a watch on the realisation of the undrawn balances, if any, within the prescribed period and

(b) special register for recording full details of exports on consignment basis indicating under a separate column, the date on which the period prescribed for realisation of the export proceeds expires;

(xi) Whether any bills discounted by the bank have been rediscounted by it with its overseas branches/ Head Office / correspondents ; if so, the matter may be looked into in detail as banks are not permitted to rediscount or avail themselves of advances abroad against bills negotiated, purchased or discounted by them.

CHAPTER 6FINANCING OF IMPORTSImport Trade Control

Primary control over import of goods into India is exercised by the Import Trade Control organisation (ITC) which functions under the Ministry of Commerce of Government of India. The import policy of the Government of India is embodied in the 'Import Policy Book'. Rules and procedures observed by ITC are contained in the 'Hand Book of Import-Export Procedures' brought out from time to time by the Chief Controller of Imports and Exports. Changes in policies, rules and procedures are notified by ITC by issue of Public Notices. Authorised dealers should make arrangements for obtaining these publications and be conversant with provisions thereof having a bearing on their operations, viz., opening of letters of credit, remittances, etc. towards imports into India.

6.2 Import of goods from outside India is subject to licence except where it is covered by Open General Licences (O.G.L.) in terms of prevailing import licensing policy. An O.G.L. is a general permission to import certain goods during a specified period. No individual licences are necessary in the case of O.G.L. Items, eligible importers, value, quantity covered and the period for which the items will be under O.G.L., are

announced by the Chief Controller of Imports and Exports from time to time. The import licences issued by ITC authorities can broadly be classified into two categories, viz., cash licences and deferred payment licences. In respect of imports made into India against cash licences, importers are required to make remittances relating to cost of goods within a period of six months from the date of shipment. In the case of licences issued on deferred payment basis, the terms of deferred payment are indicated in the licence and the remittances are allowed by the Reserve Bank in accordance with these terms.

Functions of Imports  
Section in a bank

6.3 The tasks generally performed by the Imports Section in a bank are :

- (i) Opening import letters of credit and obtaining payments against documents received thereunder;
- (ii) Grant of credit facilities for the retirement of bills received under import letters of credit;
- (iii) Handling import bills received for collection;
- (iv) Issuing guarantees in respect of imports on deferred payment basis;
- (v) Providing forward exchange cover to importers

Letters of Credit

6.4 International trade takes place between sellers and buyers located in different countries and the parties to a trade transaction are not always known to each other. Even if they are known to each other, the seller may not have full confidence in the creditworthiness of the buyer or the buyer may not like to pay before he actually received the goods. A letter of credit is a device which enables the seller to safeguard himself by obtaining payment against shipping documents and also protects the buyer in that he does not part with his money until the shipping documents are in the possession of his bankers or their correspondents.

6.5 Documentary credit is defined in the Uniform Customs and Practice for Documentary Credits (1974 Revision - The International Chamber of Commerce Publication No.290). In simple terms, it is an instrument issued by a bank in which the bank furnishes its credit, which is both good and well known, in place of the buyer's credit, which may be good but is not so well known. Expressed more fully, it is a written undertaking by a bank (issuing bank) given to the seller (beneficiary) at the request, and in accordance with the instructions, of the buyer (applicant) to effect payment (that is, by making a payment, or by accepting or negotiating bills of exchange)

up to a stated sum of money, within a prescribed time limit and against stipulated documents. It is laid down in the Uniform Customs and Practice that credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts, that credit instructions and the credits themselves must be complete and precise, and that in order to guard against confusion and misunderstanding, issuing banks should discourage any attempt by the applicant for the credit to include excessive detail.

#### Revocable credit

6.6 A revocable credit is a credit which may be amended or cancelled at any moment without prior notice to the beneficiary. When, however, a revocable credit has been transmitted to and made available at a branch or other bank, its modification or cancellation shall become effective only upon receipt of notice thereof by such branch or other bank and shall not affect the right of that branch or other bank to be reimbursed for any payment, acceptance or negotiation made by it prior to receipt of such notice.

#### Irrevocable credit

6.7 An irrevocable credit is one which cannot be amended or cancelled by the issuing bank without the

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consent of the beneficiary or any other interested party including the confirming bank. It is a definite undertaking on the part of the issuing bank and involves an added credit risk for it since the issuing bank cannot cancel its commitment should the credit standing of its customer change, even before any shipment has taken place. The undertaking of the issuing bank is, however, conditional, that is, it is contingent on the fulfilment of the terms and conditions stipulated in the credit, which, generally, relate to the presentation of stipulated documents within a prescribed time limit by the beneficiary. Until and unless the terms and conditions of the credit are complied with, the issuing bank has no liability. Thus, a letter of credit by itself does not constitute a security. All credits should clearly indicate whether they are revocable or irrevocable. In the absence of such indication, the credit shall be deemed to be revocable, even though an expiry date may be stipulated in the credit.

Confirmed credit

6.8 When a letter of credit is opened by a bank in favour of an exporter in another country, the correspondent bank which advises the credit may or may not confirm the

credit. If the issuing bank asks the correspondent bank simply to transmit the credit to the beneficiary, then the credit is not confirmed and, in such a case, the correspondent bank is only an advising bank. The advising bank, merely by advising an irrevocable letter of credit, does not bind itself to negotiate the documents drawn thereunder even if the documents submitted are a perfect tender. It is the discretion of the bank to negotiate documents or refuse to do so. This position applies even in respect of the letters of credit restricted for negotiation to the advising bank as mere restriction of negotiation does not constitute a promise on the part of the advising bank to negotiate documents. When the issuing bank authorises or requests the correspondent bank to confirm its credit and the latter does so, then it is a confirmed credit. Such confirmation constitutes a definite undertaking of the confirming bank and it cannot be amended or cancelled without agreement of all parties concerned. Banks add confirmation only to irrevocable credits. The beneficiary of a confirmed credit has a double assurance of getting his money, the undertaking of the confirming bank in his own country which he knows in addition to the undertaking from the overseas issuing bank about which he may know nothing. For the importer,

the confirmation represents an additional requirement on the part of the exporter and is costly. When the exporter presents documents strictly in compliance with the credit terms and if the confirming bank accepts the documents as being complete correct and a valid tender, any subsequent rejection of the documents by the issuing bank will be a matter of dispute between the two banks and the exporter is free from any liability to the confirming bank.

#### Red Clause credit

6.9 A 'red clause' letter of credit is a credit containing a clause, usually printed in red, authorising the advising bank to grant advances to the beneficiary up to a specified amount to enable him to meet his expenses before shipment. The advances made are granted on the sole responsibility of the issuing bank, and are customarily repayable when the shipping documents are eventually submitted to the advising bank for negotiation under the credit. The amount advanced to the beneficiary with interest is recovered from the proceeds of the bill drawn under the credit and the balance, if any, is paid to the beneficiary. If no shipping documents are presented in due course, the advising bank is entitled to immediate reimbursement by the issuing bank. In order to have an

effective control, red clause credit must necessarily be restricted for negotiation to the advising bank so that the beneficiary is prevented from negotiating the stipulated shipping documents through another bank and thereby obtaining payment for the second time for the same shipment. The red clause credits are also called 'packing house credits' or 'anticipatory credits'. Opening of such letters of credit for imports into India requires prior permission of the Reserve Bank.

#### Transferable credit

6.10 A letter of credit is not a negotiable instrument. What is negotiable under it is the bill of exchange. In other words, the right to draw a bill and obtain payment under the credit conferred by the issuing bank on the beneficiary cannot be transferred by him unless the issuing bank specifically indicates that the credit is a 'transferable credit'. The transferable credit is usually established when the first beneficiary is not supplying the goods himself but wishes to transfer part or all of his rights under the credit to one or more second beneficiaries who will supply the goods. Article 46 of the Uniform Customs and Practice for Documentary Credits provides, inter alia, that a credit can be

transferred only if it is expressly designated as 'transferable' by the issuing bank and that under such a credit, the beneficiary has the right to give instructions to the bank called upon to effect payment or acceptance or to any bank entitled to effect negotiation to make the credit available in whole or in part to one or more third parties (second beneficiaries). A transferable credit can be transferred once only, that is, the second beneficiary cannot transfer to a third beneficiary unless transfer without restriction is specifically authorised.

#### Back-to-Back Credit

6.11 A back-to-back credit is the term given to an ancillary letter of credit, which arises where the beneficiary (seller) uses the letter of credit opened in his favour by the issuing <sup>bank</sup> to support another (the ancillary) letter of credit opened by the seller's bank favouring his supplier. As both the letters of credit are intended to cover the same goods, it is important that they contain virtually identical terms, except for such variations in price, amount and validity period as are required to meet the slightly different circumstances of the supplier and the seller.

Restricted credit

6.12 When the negotiation of documents under a letter of credit is restricted to the advising bank or to a specified bank, it is called restricted letter of credit. The documents under such a letter of credit can be negotiated only by the advising bank or the specified bank and it is not open to the beneficiary to negotiate documents through a third bank. Letters of credit are restricted by the issuing bank either under instructions from the opener or to retain the business within the same group or with a favoured correspondent bank. If the beneficiary wishes, however, to negotiate documents through a third bank, he should seek an amendment of the letter of credit.

Liabilities and responsibilities  
under letters of credit

6.13 The liabilities and responsibilities of the issuing and negotiating banks are governed by Articles 7 to 13 of the Uniform Customs and Practice for Documentary Credits. Broadly, the banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. In documentary credit operations, all parties

concerned deal in documents and not in goods. If, upon receipt of the documents, the issuing bank considers that they appear on their face not to be in accordance with the terms and conditions of the credit, that bank must decide as such on the basis of the documents alone, and not on any extraneous circumstances such as bankruptcy of the buyer, falling market, etc. The issuing bank is allowed reasonable time to examine the documents, but if it decides not to take up the documents as tendered, it must notify the negotiating bank without delay, stating the reasons, by cable or other expeditious means, such as telex or telephone, and must also state that the documents are being held at the disposal of the negotiating bank or are being returned. If the issuing bank fails to do so, it shall be precluded from making any claim. Thus, time<sup>is</sup> of essence in such matters. When the negotiating bank draws the attention of the issuing bank to any irregularities in the documents or advises that it has paid, accepted or negotiated under reserve or against a guarantee, even in such cases, the issuing bank is not relieved from any of its aforesaid obligations, as such guarantee or reserve concerns only the relations between the negotiating bank and the beneficiary and the guarantee or reserve cannot be transferred or extended to the issuing

bank without the consent of the beneficiary. Any delay or failure on the part of the issuing bank would amount to ratification of the discrepancies.

Appraisal of applications for opening letters of credit

6.14 The opening of a letter of credit amounts to granting a temporary advance to an importer. The following factors determine the extent of risk involved in a letter of credit transaction.

- (i) Means and standing of the applicant
- (ii) The standing of the beneficiary
- (iii) Nature of the shipment and whether it consists of merchandise which is readily marketable. The risk of being saddled with security of an undesirable nature should be avoided and care should be taken to ensure that the goods are being imported for the genuine business requirements of the applicant.
- (iv) In the case of imports of items of working capital, whether the working capital funds at the disposal of the applicant are sufficient to take care of the cost of the imported material.
- (v) If the import is an item of fixed asset, whether suitable financing arrangements by way of term loan/equity have been lined up, where necessary.

(vi) Whether the landed cost of the commodity to be imported is the approximate current market value and whether the price is liable to wide fluctuations in the local market.

Retirement of import bills

6.15 The documents negotiated under letters of credit opened by the bank should be scrutinised by a supervising official immediately on receipt in order to ensure that the documents have been made out in strict conformity with the terms and conditions of the letters of credit. Any discrepancies noticed by the bank but not disclosed by the negotiating bank in the relative forwarding schedule should be advised to the latter immediately by cable/telex. Documents which are free from discrepancies may be delivered to the applicants against payment of the drafts or against acceptance thereof subject to ensuring in the latter case that D/A facilities have been sanctioned to the applicants by an appropriate authority. Where the documents have not been made out in strict conformity with the terms of the relative letters of credit, the discrepancies should be advised to the applicants immediately and their confirmation that the documents are acceptable to them despite the discrepancies should be obtained before the release of the relative documents.

It is important that the applicants' instructions are obtained with the utmost expedition as any delay is likely to prejudice the bank's claim against the negotiating bank. In respect of all bills in which the bank has an interest, it should take all necessary steps to protect the goods on arrival. The expected date of arrival of the carrying vessel should be ascertained and diarised. The bank should take particular care to see that the goods are fully covered by insurance until they are finally delivered. If the bill is not retired even on arrival of the relative goods, steps should be taken to have the goods cleared, stored and insured in the bank's name.

6.16. Where necessary, importers may be granted credit facilities to enable them to retire the bills, clear the goods from the Customs and hold them under pledge/hypothecation to the bank. In such cases, it should be ensured by the bank that the goods are taken delivery of by the parties within a reasonable time against full payment. Further, in those cases where importers are allowed to take delivery of shipping documents or goods against a letter of trust, the proceeds should be realised and paid into the bank within a reasonable period which normally should not exceed a month or two.

6.17. Sight/demand bills under import letters of credit should normally be paid on presentation or latest on the arrival of the steamer carrying the relative shipment. Usance bills on D/P (Documents against payment) terms should be paid on due dates or immediately after the arrival of the carrying steamer, whichever is earlier. In the case of usance bills on D/A (Documents against acceptance) terms, documents are delivered against acceptance and payment obtained on due date. Unpaid/overdue bills are generally transferred to 'Unpaid Bills Receivable/Protested Bills Account'.

Guidelines issued by FEDAI regarding  
accounting procedure for import bills  
received under letters of credits

6.18 With the approval of the Reserve Bank, FEDAI has issued the following guidelines, effective from January 1, 1984, regarding the accounting procedure to be followed by banks for import bills received under letters of credit.

(i) Sight import bills received under letters of credit and conforming to the terms and conditions of the credits may be held in foreign currency for a maximum period of 10 days from the date of receipt of documents by the bank.

(ii) In case of non-payment by the drawee within 10 days as above, the importer's liability on the foreign currency bill should be crystallised by converting the foreign currency amount into rupees at the B.C. selling rate prevailing on the 10th day or the forward exchange contract rate where applicable. The liability of the importer in rupees should be reflected in an advance account as 'Import Loans', etc. (The nomenclature used by banks should be such that the advances are easily identified).

(iii) Authorised dealers should keep a proper record of the date of receipt of documents (in the bank and not by the concerned department/branch).

(iv) Authorised dealers should suitably make changes in their letters of credit agreement/applications to give effect to the above.

(v) In case the 10th day is a holiday or a Saturday, the importer's liability in rupees should be crystallised on the next following working day.

(vi) Authorised dealers should carry the swap costs upto the 10th day on their own account and should not recover such costs from the customer.

(vii) Authorised dealers should charge interest at the rate prescribed by the Reserve Bank, from time to time, for advances to non-priority sectors, on the rupee

advances made against import bills pending retirement by customers. Such interest should be recovered from the date of negotiation to the date of crystallisation of the rupee liability, and thereafter penal interest should be recovered.

(viii) If the date when the rupee liability on an import bill is crystallised at the forward exchange contract rate results in early/late delivery under a forward exchange contract, the charges as per FEDAI Rule 9 should be levied.

(ix) Authorised dealers should charge commission/handling charges at the rate of 0.15% on the bill amount at the time of converting foreign currency into Indian rupees irrespective of the fact whether the bill is retired within 10 days or later.

(x) All import bills under letters of credit should be reported as 'Sales', when the rupee liability is crystallised, in the relative 'R' returns along with forms 'A'. The instructions issued by the Reserve Bank in this regard should be scrupulously followed.

(xi) If an import bill received has discrepancies, the matter should be immediately taken up with the negotiating bank holding documents at the risk and responsibility of that bank and the bill should be treated

as an import bill for the purpose of crystallisation after the discrepancies are removed. Otherwise, the bill should be treated as a collection item.

#### Exchange Control Regulations.

6.19. The regulations governing import of goods from outside India are contained in Chapter 13 of the Exchange Control Manual (1978 edition). Authorised dealers have been delegated wide powers to effect remittances against imports, whether against O.G.L. or specific import licences issued by ITC authorities, and only a few types of cases, e.g., imports on deferred payment terms, advance payments against imports, remittances in excess of the value of import licences, imports into bond, etc., are required to be referred to the Reserve Bank through authorised dealer for specific approval. The Inspecting Officer should familiarise himself with the regulations before commencing a scrutiny of import letters of credit and advances granted by the bank for financing of imports.

#### Guidelines for Inspecting Officers.

6.20 As already indicated in Chapter 5 on Financing of Exports, the Reserve Bank, as the supervisory authority, is basically concerned with the quality of credit appraisal

and effectiveness of the supervision exercised by the bank over import finance extended by it, as part of the assessment of the bank's advances portfolio. Bearing this in mind, the Inspecting Officer should test check selected transactions, which should include some items of remittances of Rs.50,000 and above effected by the bank against import licences/O.G.L., in order to verify :

Letters of credit.

(i) Whether letters of credit limits are sanctioned by the bank after taking into consideration all the relevant factors including marketability and price stability of goods to be imported as also a critical appraisal of the ability of importers to retire bills from their own resources or of the adequacy of arrangements made by them to raise necessary resources in time;

(ii) Whether letters of credit have been opened under proper sanction of the appropriate higher authorities or within the discretionary powers of the Manager, and where letters of credit have been opened under the discretionary powers of the Manager, whether the facility has been allowed to deserving parties only;

(iii) Whether the bank maintains credit reports on overseas suppliers in whose favour import letters of credit are established;

(iv) Whether the Exchange Control requirements that letters of credit should be opened by authorised dealers only on behalf of their own customers who maintain accounts with them and are known to be participating in the trade, that credits should be established only after verification of the Exchange Control copies of import licences (except in cases where imports are under valid O.G.L) as also documentary evidence to the effect that firm orders for the goods to be imported have been placed and accepted, and after making endorsements on import licences at the time of opening letters of credit, that the date of expiry of the credit should not be later than 75 days after the final date for shipment permitted under the relative (specific) import licence, that letters of credit should not be opened during the grace period of 60 days for effecting shipments allowed by ITC authorities and that in cases where letters of credit have been opened on F.O.B. terms, suitable provision should be made to cover freight and insurance charges, have been complied with;

(v) Whether in the case of letter of credit with provision for deferred payment facility, the constituent has been remitting instalments according to the terms of the credit and is in a position to meet future commitments, as and when they accrue;

(vi) Whether the bank has implemented the suggestions of FEDAI (made at the instance of the Reserve Bank) that letters of credit should stipulate that shipments should be made only by Conference vessels which are on the Lloyds approved list and which are sea-worthy, that letters of credit should call for a certificate of inspection by a well-known International Inspection Agency, that in case of large value import contracts, banks should obtain credit reports on the suppliers before issuing letters of credit, that letters of credit should call for a certificate of origin from an independent third party like a Chamber of Commerce and that banks should see whether, taking into account the volume of consumption/demand in India for the goods ordered, the import contract on the basis of which letters of credit are issued, was reasonable; the underlying intention in the last suggestion being that banks should discourage speculation in commodities either on the basis of artificial scarcity or on the basis of expectations of changes in the Import Policy;

(vii) Whether there is any indication that importers have entered into contracts with overseas suppliers and/or back-dated the contracts or the relative letters of credit in order to circumvent restrictions imposed by the Import Policy (imposing a ban on or canalisation of Import of the commodity involved). If so, the matter should be looked into in detail by the Inspecting Officer;

Import bills received under  
letters of credit

(viii) Whether discrepancies, if any, in documents in relation to the terms and conditions of the letters of credit, are promptly taken up with the foreign branch/correspondent; whether in case, due to such discrepancies, the foreign branch/correspondent has negotiated the bill against indemnity or under reserve, the acceptance/payment of the bill has been promptly advised to the foreign branch/correspondent and in the event of dishonour of such a bill, notice of dishonour has been promptly sent to the foreign branch/correspondent by cable/telex, demanding refund of the amount, if any, obtained by it in reimbursement, as required;

(ix) Whether (a) usance bills are adequately stamped on their receipt by the bank (b) due dates are correctly arrived at and recorded in a diary maintained for the purpose and (c) acceptance is properly recorded on the bill and there is a procedure of verification of the acceptor's signature (the Inspecting Officer should check this by selecting a few bills at random);

(x) Whether in case of non-payment of documentary bills, prompt steps are taken to protect the goods covered by the bills (bills not retired even after the arrival of the carrying vessels should receive special scrutiny and the reasons therefor ascertained);

(xi) Whether in cases where import loan/trust receipt facilities have been granted, the advances have been allowed only for a reasonable period and sanction of the appropriate authority has been obtained, where necessary;

(xii) Whether the guidelines issued by FEDAI regarding the accounting procedure in respect of import bills received under letters of credit have been followed by the bank;

(xiii) Whether interest and other charges, where necessary, are collected from the drawees at the time of realisation of the bills in accordance with the directives issued by the Reserve Bank and the rules of FEDAI;

(xiv) Whether the Foreign Parcel Register is maintained for foreign inward bills and parcels, the particulars of parcels/bills are properly recorded therein, and necessary safeguards for the custody of bills and parcels are observed;

Exchange Control aspects

(xv) Whether the various formalities relating to import transactions prescribed in Chapter 13 of the Exchange Control Manual such as (a) submission of the Exchange Control copy of the import licence to the Reserve Bank after its utilisation to the maximum extent

(b) payment for imports in the prescribed/approved currency and in accordance with permitted methods (c) obtaining prior approval of the Reserve Bank for remittance of proceeds of bills relating to imports under 'cash' import licences where remittance has been delayed beyond the prescribed period, viz., six months from the last date for shipment authorised under the import licence (including grace period) or under the O.G.L., as the case may be (d) obtaining approval of the Reserve Bank for opening letters of credit against import licences on 'deferred payment' basis or for furnishing guarantees in the case of such imports to cover due payment of instalments by the importers (e) marking off the amount of freight on the relative import licence before issuing to the consignee a certificate (in the prescribed form) in support of application for payment of freight in rupees in cases where goods are shipped to India (other than under O.G.L.) on 'freight payable at destination' basis, etc., have been complied with by the bank;

(xvi) Whether payments in retirement of import bills are received by the bank, irrespective of amount, by debit to the account of the importer or by means of a crossed cheque drawn by him on his other bankers;

(xvii) Whether in the case of import by post parcel the precautions envisaged under the Exchange Control regulations have been observed;

(xviii) Whether in the case of imports under foreign loans/credits, the terms and conditions of the relevant Public Notice issued by the Import Trade Control have been complied with and the prescribed documents as required have been duly obtained and forwarded to the concerned authorities promptly.

## CHAPTER 7

### FORWARD EXCHANGE CONTRACTS

A forward exchange contract may be defined as an operation in exchange whereby a rate is fixed at once for a purchase or sale of one currency for another which is to be completed at some future date. In other words, a forward exchange contract is a firm and binding contract between a customer and his banker, or between two banks, for purchase or sale of a specified quantity of a foreign currency, at a rate of exchange fixed at the time of making the contract, for performance by delivery and payment at a future time agreed upon when making the contract. The purpose of the forward exchange contract is to fix the exchange rate in advance for a future commitment in a foreign currency in order to eliminate the risk of an adverse movement in the rate of exchange prior to the maturity of the commitment. For instance, an exporter who has to receive payment for goods in a foreign currency at a future date or an importer who has to discharge his debt at a future date in a foreign currency can enter into a forward exchange contract in order to fix the value of the debt receivable or payable in terms of rupees. The ingredients of a forward exchange contract are the parties (buyer and seller) to the contract, the amount expressed in foreign currency, the rate of exchange at which the purchase or sale is made, the date on or the

period during which the foreign exchange will be delivered and the mode of delivery. No money passes between the parties to a forward exchange contract until the agreed time arrives when the transaction is completed at the rate of exchange fixed in advance on the date of the contract.

Forward exchange contracts may be classified as under :

(i) Merchant contracts between banks and their exporter/importer customers.

(ii) Inter-bank contracts between banks in India usually through the medium of exchange brokers. These are normally entered into for covering operations.

(iii) Contracts between banks in India and their overseas branches/correspondents for covering operations.

(iv) Contracts for sale of certain specified foreign currencies by banks to the Reserve Bank. These are entered into by banks as a last resort since the rates of the Reserve Bank are least favourable to them. The banks need not approach brokers for fixing contracts with the Reserve Bank.

7.2 When a bank enters into forward exchange contracts with customers or banks, it takes credit risk. For instance, if a customer or a counter-party bank which has to deliver foreign currency fails to deliver it on maturity date, the bank must meet its off-setting customer or inter-bank

obligation by purchasing the currency which it had expected to receive (but did not receive) and had, in turn, contracted to deliver to the third party (customer or bank). The actual gain or loss will depend on the then-prevailing spot rate of the desired foreign currency relative to the contracted rate for the defaulted contract. The difference is deemed to arise from credit risk. The bank must, therefore, be confident at the time of concluding a forward contract that the counter-party possesses the financial soundness and liquidity required to meet at maturity, the obligations being undertaken by it. As the standing of the counter-parties may change during the interregnum of such contracts, the outstanding contracts against each counter -party should be monitored periodically by the bank.

### Merchant contracts

7.3 The regulations relating to forward dealings with merchants are contained in Chapter 7 of the Exchange Control Manual (1978 edition) and the Inspecting Officer should carefully study the regulations before commencing a scrutiny of forward exchange contracts entered into by a bank with its exporter/importer customers. The more important regulations are summarised below for ready reference.

7.4 Forward contracts cannot be undertaken with persons, firms, companies, etc., resident outside India.

7.5 Authorised dealers must satisfy themselves that exchange risk cover is required in respect of a genuine trade transaction.

7.6 Contracts for forward purchases and sales may be entered into only in permitted currencies.

7.7 Authorised dealers must ensure before entering into forward contracts that their exporter/importer customers are in fact exposed to an exchange risk in respect of the underlying transaction and the risk is in the currency in which the forward cover facility is desired. For instance, if the sale contract between exporter and overseas buyer is entered in pounds sterling, a forward cover can be provided only in pounds sterling and not in any other currency. Doubtful cases and cases where the parties are exposed to exchange risks in more than one currency in respect of the same underlying transaction should be referred to the Exchange Control Department.

#### Forward facilities for exports

7.8 The amount of forward purchase contract should not exceed the expected proceeds of a shipment already made/ to be made. Where shipment has already been effected,

the amount of forward purchase should not exceed the value of the bill presented by the exporter for negotiation/ collection. In cases where agency commission in respect of an export bill is desired to be deducted from the bill and paid to the agent abroad, the amount of forward purchase should not exceed the net amount expected to be received in India.

7.9 In the case of exports on consignment basis, forward purchase may be made only after the shipment has been effected and to the extent of the relative bill drawn in respect of the shipment.

7.10 The exporter customer must apply to the bank either in the bank's specified application form or by letter requesting for a forward purchase contract. Along with the application/letter, the customer must submit the following documents as evidence of the genuineness of the transaction.

(i) The original sale contract between exporter and overseas buyer and/or firm order from overseas buyer showing description and quantity of goods to be supplied, agreed price, approximate date of shipment, etc.

(ii) A valid irrevocable letter of credit in favour of the exporter and a declaration from the exporter concerned that he has not entered into any other forward exchange

contract against the same letter of credit or the underlying sale contract in respect of the shipment in question.

Where letters of credit are incomplete in any material respect such as unit price or description or quantity, forward contract may be booked only after verifying the underlying firm order or contract.

(iii) In cases where a contract is entered into on the basis of cables/telex messages, the cables/telex messages, etc., in original, between the exporter and the overseas buyer showing definite offer and acceptance and indicating quantity, price/value of goods to be shipped and approximate date of shipment, should be produced to the authorised dealer. In such cases, a written undertaking should be obtained from the customer that he will produce the original sale contract and/or letter of credit within a month from the date of booking of contract and the bank should ensure that the contract/letter of credit is so produced.

(iv) The verification of sale contract may be dispensed with while booking contracts against export documents already sent for collection through the bank.

#### Forward facilities for imports

7.11 Authorised dealers may sell forward exchange to their constituents against import of goods into India after satisfying themselves that the foreign exchange

to be sold does not exceed the value of the goods contracted by the importer with overseas seller of goods or the value for which letter of credit has been opened through their medium, provided the proposed imports are covered either by valid import licence or by Open General Licence. In the case of imports contracted on f.o.b./c.& f., etc., basis, forward sales may be made for the firm value on f.o.b./c. & f., etc., basis or if so desired by the importer for estimated c.i.f. value inclusive of reasonable estimates for freight/insurance/escalation charges if latter charges will be paid by supplier and recovered from importer on the invoice. Any commission payable in rupees to local agents should be excluded before concluding the forward sale contracts.

7.12 Before entering into forward sale contracts against import of goods into India, authorised dealers should verify that the importer wishing to purchase forward exchange is in possession of valid import licence with Exchange Control copy covering the proposed import. Authorised dealers should not book forward contracts either in anticipation of issue of licence (even where the importer has received "Letter of Intent") or on the strength of the importer's statement that he has valid import licence. In all cases, original Exchange Control copy of licence should be called for and inspected. Additionally, authorised

dealer must verify either that letter of credit has been opened through his medium covering the proposed import or that firm order has been placed by the constituent and accepted by overseas supplier, for the proposed import. An appropriate remark about the booking of contract should be made on the licence over stamp and initials of authorised dealer before it is returned to the importer. Full particulars of the licence should also be recorded with the authorised dealer. Where import is proposed to be made under Open General Licence, authorised dealers should verify that the proposed import is in fact covered by a current Open General Licence.

7.13 While entering into forward sale contracts or extending delivery period of forward sale contracts already fixed, authorised dealers must ensure that the last date of delivery under the contract or the extended contract, as the case may be, does not fall beyond six months from the date of shipment if goods are already shipped and expected date of shipment according to underlying sale contract if goods are yet to be shipped. These rules are applicable for import of goods into India covered by 'cash' import licences (i.e., licences not stipulating deferred payment terms) or under Open General Licences. Fixation of forward sale contracts or extension of forward

contracts already fixed so as to provide for delivery beyond six months from the date of shipment is not permissible.

Verification of documents,  
utilisation of cover,  
cancellation of contracts, etc.

7.14 Authorised dealers must mark documents verified while booking forward purchase or sale contracts with remarks indicating date and amount of forward contract under their stamp and initials. A record of documentary evidence so verified should be kept contract-wise in a systematic manner.

7.15 The last date of delivery under forward purchase contract with extensions, if any, should not fall beyond three months in the case of exports to Pakistan and Afghanistan and six months in other cases, from the date of shipment if goods are already shipped and expected date of shipment according to underlying sale contract if goods are yet to be shipped. However, where the Exchange Control Department has relaxed the time limit for realisation of proceeds of exports, the corresponding forward purchase contracts may be extended to cover the extended period approved by the Exchange Control Department.

7.16 It is in order for authorised dealers to book a single contract against different firm export orders provided payments against all the orders are to be received through themselves subject to the conditions stipulated in paragraph A.4 of Chapter 7 of the Exchange Control Manual. In terms of A.D.(G.P.Series) circular No.55 of 1979, authorised dealers are also permitted to fix a single contract covering several bills sent through their medium for collection covering shipments already made by the exporters. If, however, a forward contract has to be fixed for a round sum representing part of the total value of the bills, without identifying the amount covered against each bill, the authorised dealer should insist on the exporter furnishing a list of all the bills sent through the authorised dealer's medium against which the cover is required. The authorised dealer should verify the correctness of the information furnished by the exporter and thereafter fix a single contract on condition that the exporter will not be eligible for covering at any subsequent stage the uncovered balance of the listed collection items. Additionally, in such cases, the full value of the bills should be first adjusted against the contract as and when they are realised and the value of the remaining bills adjusted on ready **basis**.

7.17 Forward purchase and sale contracts must be utilised for fulfilment of the same transactions in respect of which they were originally fixed. In no circumstances, should contracts be utilised even partially against any other foreign exchange commitments or risks of a constituent. In case of forward sale contracts against imports, this prohibition applies even where the order in respect of which the contract is desired to be utilised and the order against which the contract was originally booked are covered by the same import licence or Open General Licence. Authorised dealers are, however, permitted to accept from exporters delivery of foreign exchange derived from part shipment(s) in part utilisation of forward purchase contracts and to allow utilisation of a forward purchase contract against shipment of goods of a quality/grade, etc., different from that mentioned in the original order from the foreign buyer provided that the foreign buyer has agreed to accept those goods under the same order and suitable documentary evidence in support thereof is produced to the authorised dealer. Further, in terms of A.D.(G.P. Series) Circular No.55 of 1979, where after fixing forward purchase contracts, exporters obtain unit price rises for the products to be exported on grounds of rise in raw material prices, hike in export duty/

freight charges, etc., or as a result of operation of escalation clauses, authorised dealers may accept deliveries after satisfying themselves that the goods to be shipped are the same (even if of a different quality or grade, etc.) and the price rise has been negotiated in respect of part or whole of the same order against which the forward cover was fixed. Documentary evidence submitted by constituents in this connection should be marked by the authorised dealer in the manner indicated in paragraph 7.13 above. In the event of a balance being left unutilised out of a forward purchase or sale contract after completion of the original transaction, such balance must be cancelled. No fresh ready purchases from or sales to a constituent should be made in respect of a transaction for which forward purchase or sale contract had been previously fixed. Authorised dealers should maintain records in a systematic manner so that this can be ensured.

7.18 Authorised dealers may cancel unutilised portion of forward purchase or sale contracts, without reference to the Reserve Bank, irrespective of amounts involved. In cases, however, where unutilised portion of the contract exceeds U.S. \$ 500 or its equivalent, authorised dealers should obtain applications from their constituents (on form FCC1 or FCC2 given in Exchange Control Manual -

Volume II) for cancellation of the contract. Authorised dealers should satisfy themselves about the genuineness of the reasons for cancellation stated therein. Reports of such cancellations should be furnished immediately to the Reserve Bank enclosing copy of application with their certificate appended thereto together with supporting documentary evidence.

7.19 Authorised dealers should not keep forward purchase or sale contracts open for unreasonable length of time merely on the ground that application for cancellation has not been received from the customer. In such cases, unutilised portions of contracts may be cancelled if authorised dealers are otherwise satisfied that their customers are not in a position to fulfil the contracts. A separate report of such cases should be submitted to the Reserve Bank. Rule 9 IV of FEDAI Rules provides that if an expired forward exchange contract is not taken up, extended or cancelled within a maximum period of 2 months from the date of its expiry, authorised dealer should treat it as cancelled on the expiry of the said period of 2 months after serving a 15 days ' notice to the contracting party in respect of the cancellation, provided the authorised dealer is satisfied that no further delivery will be made/ taken up by the contracting party.

7.20 Authorised dealers should not cancel a forward purchase contract entered into with a customer against a firm export order on the ground that the letter of credit opened by the buyer is restricted to another authorised dealer. In all such cases, exporters should arrange through their bankers for obtaining payments in foreign currency from the bank to which the letter of credit is restricted so that delivery of foreign exchange may be made under forward purchase contract.

7.21 While cancelling forward sale contract entered into against import of goods into India, amount cancelled must be endorsed on Exchange Control copy of the relative import licence, except in undernoted cases :

- (a) where contract has been entered into with an indenting agent under a valid Letter of Authority and the original holder of import licence decides subsequently to import either directly or through another indenting agent;
- (b) where original overseas supplier may not be in a position to supply the relative goods and importer desires to transfer the order to another supplier;
- (c) where cancellation has arisen because of freight and/or insurance having been settled locally and the amounts having already been endorsed on the licence.

In all cases where amount cancelled has not been endorsed on the licence, suitable explanatory note should be given in the report required to be submitted to the Reserve Bank. If any requests are received from constituents for cancelling endorsement on import licence (relating to undelivered portion of the forward sale contract), reference should be made to the Reserve Bank stating reasons why the endorsement is required to be cancelled.

7.22 Forward purchase/sale contracts covering exports/imports on deferred payment basis should not be cancelled without the prior approval of the Exchange Control Department.

Deferred payment export/imports,  
export of services and foreign  
currency notes and surplus  
freight/passage collection

7.23 Authorised dealers are permitted to provide long-term/roll-over forward cover for deferred payment exports/imports as well as forward facilities against export of services, export of foreign currency notes and surplus freight/passage collections subject to stipulations in paragraphs 7A.5, 7A.10, 7A.11, 7B.4 and 7B.5 of the Exchange Control Manual.

Inter-bank contracts and  
contracts with overseas  
branches/correspondents

7.24 Subject to compliance with the provisions in paragraphs 2 and 3 of Chapter 8 of the Exchange Control

Manual regarding exchange position and cash balances, authorised dealers may freely enter into forward purchase or sale contracts in any permitted currency, against rupees, or any other permitted currency, with other authorised dealers in India. They may also freely correct imbalances in their own exchange position such as ~~over~~bought in spot position and oversold in forward position or overbought at one forward position and oversold at another, by making appropriate swap operations in the currency with other authorised dealers in India. However, authorised dealers should, as far as possible, avoid outright forward or swap transactions which will result at the close of business on any day in unreasonably 'mismatched' maturities.

7.25 Subject to compliance with the provisions in paragraphs 8.2, 8.3, 8.8 and 8.9 of the Exchange Control Manual, authorised dealers may buy and sell for forward deliveries any permitted currency against any other permitted currency from and to banks (including overseas branches of authorised dealers) in the External Group of countries or make swap operations in permitted currencies with them. However, authorised dealers are required to put the broker network or inter-bank communication channels in India to maximum use before undertaking the operations with overseas banks and explore whether necessary cover for merchant business

or for rectification of exchange position imbalances cannot be secured in inter-bank market in India itself.

7.26 Operations for forward purchase or sale of foreign currencies against rupees with overseas banks (including overseas branches of authorised dealers) are prohibited.

7.27 In case of forward purchases and sales made with overseas banks (including overseas branches of authorised dealers) involving amounts individually exceeding U.S.\$ 500,000 or its equivalent, particulars thereof are required to be intimated on a daily basis by letter to the office of the Reserve Bank to which R Returns are submitted by authorised dealers in the manner indicated in paragraph 8.7(iii) of the Exchange Control Manual.

7.28 Authorised dealers must not do any transactions with their overseas branches/correspondents which would enable them to grant to persons, firms or companies in India forward exchange facilities which are contrary to Exchange Control regulations in force in India.

Rules of Foreign Exchange  
Dealers' Association of India

Contract amounts

7.29 Forward exchange contracts should be for definite amounts, i.e., there should be no provision for excess or shortage. For instance, a forward contract for purchase of say \$ 10,475 with a provision xxxxxxxxxxxxxxxxxxxxxxx

of say 10% more or less is not permitted by Rule 4 I of FEDAI Rules. When more than one rate for bills with different deliveries are mentioned, the contract must state the amount and delivery against each rate.

Option of delivery

7.30 Forward contracts may be fixed or option forwards. A fixed forward is a forward contract where one specific date is agreed upon for performance to take place, for example, 14th of August. An option forward contract is one where a specific period of time is agreed upon and performance must take place during such a period, for example, 15th of January to 14th of February. The word 'option' does not mean the customer has a choice as to whether or not to take or give delivery of foreign currency. The party to whom the option is given is bound to complete the deal and his option applies only to the date, within the specified option period, on which he may choose to complete it.

7.31 Rule 4 I(b) of FEDAI Rules lays down that the option of delivery should in no case extend over a total period of more than one calendar month, for example :

15th January to 14th February

30th January to 28th (29th) February

28th February to 27th March

31st March to 30th April

7.32 The first and the last dates of delivery must be stated in the contracts. It is not permissible to use general expressions such as 'delivery one week', or 'delivery one month' or 'delivery two months forward', etc. Unless it is specifically stated in the contract to the contrary, the option of delivery lies with customers or parties, other than authorised dealers, irrespective of whether it is a sale or purchase contract. Between two banks (authorised dealers), the option of delivery lies with the buyer, unless otherwise stated. Delivery can be taken/given by the customer on any day during the option period as determined by the first and last dates of delivery. In case the last day of the delivery period of a contract falls on a Saturday or a holiday, the contract should be deemed to fall due on the preceding working day.

Substitution of bills for T.Ts.  
and vice versa (Rule 8I)

7.33 If a forward contract is made for the purchase of an export bill, the bank should not accept delivery of a clean T.T. or documentary T.T. in substitution thereof. This is because, it is argued, the substitution would upset the rediscounting arrangements the bank might have made in the foreign centre for usance bills, when the forward contract was originally fixed. However, since there is no question of rediscounting sight (O.D.) bills

in a foreign centre, banks may accept delivery of a documentary T.T. in substitution for O.D. bills subject to recovery of the cost, if any, of budleeing the relative cover contract. Further, a bank may accept delivery of bills under a contract made for the purchase of T.T. provided the interest at the current rate of interest applicable to the purchase of the bills in question and the cost, if any, of budleeing the relative cover contract, are recovered.

Changes in contract usance  
prior to or at the time of  
contract delivery (Rule 8 II)

7.34 It is within the option of a bank whether to accept or to agree to accept bills drawn at usance other than that stated in the contract. For instance, it may accept 90 days bill instead of 60 days bill stated in the contract or vice versa. When the bank permits such a change, a difference in rates will either be allowed or collected, as the case may be, from the original rate quoted to the merchant. The difference should be calculated on the basis of any change in the rate of **interest** applicable to the purchase of the bills in question between the date of the contract and the date of substitution, and the cost, if any, or budleeing the relative cover.

Changes in usance of bills  
subsequent to purchase

7.35 If the usance of a bill purchased is altered to a longer period, it is not enough to collect, from the drawer or the drawee, only the additional interest but the bank should also recover interest on the basis of any change in the rate of interest applicable to the purchase of the bill in question between the date of purchase and the date of alteration in the usance, and the cost, if any, of budleeing the relative cover.

Alteration of a D/P  
bill to D/A subsequent  
to purchase

7.36 When a D/P bill (which attracts a higher rate) is altered to D/A after purchase, the purchasing bank should not make a refund of the difference between the D/P and D/A rates.

Early delivery under  
forward exchange contracts

7.37 Rule 9I of FEDAI Rules provides that it is optional for a bank to accept or give earlier delivery under a forward contract than that originally contracted for and that in all such cases, the cost if any, of budleeing the relative cover including interest on any outlay of funds by the bank for the purpose of arranging the budlee, at the time of accepting or giving early delivery, irrespective of whether an actual budlee is made or not, should be recovered from the merchant.

Example

A bank entered into a forward contract with its exporter customer for three months for US \$ 50,000 at \$ 10.75 for the purchase of a sight (demand) bill. The bank's cover sale for three months forward was fixed at \$ 10.60. Before the end of the second month, the customer approaches the bank with the bill for negotiation. The bank agrees to accept early delivery. On the date of negotiation, the inter-bank rates are as under :

1 month forward (Buying)	\$ 10.60
2 months forward (Selling)	\$ 10.45

Assuming that the bill will take 20 days for realisation, the bank will sell one month forward at the inter-bank buying rate of \$ 10.60. As the original cover sale contract will mature in about two months time, the bank will buy two months forward at the inter-bank selling rate of \$ 10.45. Hence, the budlee (swap) transaction will be as follows :

Sell one month forward \$ 50,000 at \$ 10.60	Rs.471,698.11
Buy two months forward \$ 50,000 at \$ 10.45	Rs.478,468.89
	-----
Cost of budlee	Rs. 6,770.78
	-----

The brokerage on the above two inter-bank contracts aggregating Rs.950,167 at, say, 0.01 per cent, amounts to Rs.95.02. The bank will recover the cost of budlee and brokerage from the customer while negotiating the export bill at the rate originally fixed under the contract as under :

Demand export bill for \$ 50,000 at \$ 10.75	Rs.465,116.27
<u>Less :</u>	
Cost of budlee	Rs. 6,770.78
Brokerage	Rs. 95.02
	-----
Net amount payable to customer	Rs.458,250.47
	-----

There is no outlay of funds by the bank under the swap transaction and, therefore, no interest in this regard is to be recovered from the customer.

Extension of forward  
exchange contracts

7.38 It is laid down in Rule 9 II (A) of FEDAI Rules that the extension of a forward exchange contract is at the contracting bank's option. At the time of extension, the bank has an opportunity to reassess the risk and the option to determine the contract or impose other conditions such as a cash margin, etc., as may appear necessary. A forward exchange contract may be extended at any time

prior to, during or after the delivery period stipulated in the contract. The cost of extension to the customer would be the cost of budleeing the relative cover including interest on any outlay of funds by the bank for the purpose of arranging the budlee at the time of extension irrespective of whether an actual budlee is made or not. In case, however, the contract is extended after the last delivery date specified therein, the bank would charge for such an extension overdue interest or exchange difference (cost of budlee), whichever is more favourable to the bank (but not both), for the overdue period, i.e., the period for which the contract remains unextended beyond the last date of delivery. The overdue interest or exchange difference should be collected from the customer at the time of extending the contract which continues to run at the same rate. The above rules are applicable to extensions of forward exchange contracts in all currencies.

#### Cost of budlee (Swap)

7.39 The cost of budlee (swap) to be collected from the customer consists of the following :

- (i) The difference between the selling and buying rates, whenever such difference is against the bank.
- (ii) Brokerage on inter-bank sale and/or purchase depending whether it is a short swap or a long swap.

(iii) The interest on any funds invested by the bank (outlay of funds) on behalf of the customer as a result of extension of the contract.

#### Overdue interest

7.40 In the case of a contract extended after the last delivery date specified therein, the overdue interest is to be charged by the bank on the rupee equivalent of the foreign currency at the contract rate as follows :

(i) For purchase contracts, interest at not less than 2 per cent per annum over the ruling discount rate of the Central Banking Institution of the country on which exchange was fixed, with a minimum of 7 per cent per annum, from the date of expiry to the date on which extension of the delivery period is arranged.

(ii) For sale contracts, interest at not less than 2 per cent per annum over the Reserve Bank of India Rate, with a minimum of 7 per cent per annum from the date of expiry to the date on which extension of the delivery period is arranged.

#### Example

A bank entered into a two months forward contract for the purchase of an export bill sent for collection amounting to U.S. \$ 100,000 at Rs.100 = \$ 9.84 and covered itself in inter-bank market at \$ 9.75. Ten days after

the expiry of the contract, the exporter requested the bank to extend the contract by two months when inter-bank rates were as under :

Spot	\$ 9.7800
1 month forward	\$ 9.7950
2 months forward	\$ 9.8100

The bank's cover sale will have to be met by spot purchase and simultaneously it will have to sell forward for two months to match the extended delivery period.

Buy spot	\$ 9.78
Sell forward - 2 months	\$ 9.81
Swap difference	<u>\$ 0.03</u>

The swap difference is against the bank and it will, therefore, be recovered from the customer along with brokerage.

However, as the spot purchase is at a rate (Rs.100 = \$ 9.78) higher than the bank's cover sale (Rs.100 = \$ 9.75), there is no outlay of funds.

Adjusted Rate

Original contract rate	\$ 9.8400
<u>Add</u>	
Swap difference	\$ 0.0300
Brokerage	\$ 0.0040
	<u>\$ 9.8740</u>
Rounded to	- \$ 9.875

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Rupee equivalent

\$ 100,000 at	
\$ 9.84 (Contract rate)	Rs.10,16,260.10
\$ 100,000 at	
\$ 9.875 (adjusted rate)	Rs.10,12,658.20
Exchange difference	Rs. 3,601.90

The interest for the overdue period of 10 days on the rupee equivalent of the foreign currency at the contract rate (Rs.10,16,260) at 10.5% per annum (U.S. interest rate of 8.5% plus 2%) works out to Rs.2,923.48. As the exchange difference is more favourable to the bank than the overdue interest, it will be recovered from the customer and the contract will be extended at the original rate of \$ 9.84 for two months.

Cancellation of forward contracts

7.41 Forward exchange contracts may be cancelled at any time during the currency of the contract, on the date of expiry of the contract or after the expiry of the contract. On cancellation, the penalty or the cost of cancellation to be collected from the customer should consist of

(i) exchange difference, plus

(ii) if the contract is cancelled before the option period of delivery, the cost of budleeing the relative cover including interest on any outlay of funds by the bank for the purpose of arranging the budlee, at the time of cancellation, irrespective of whether an actual budlee is made or not, and

(iii) if at the time of cancellation, the contract has already expired, then overdue interest on the rupee equivalent of the foreign currency at the contract rate from the date of expiry of the contract to the date of its cancellation.

7.42 The exchange difference referred to in paragraph 7.40(i) above means the difference between the forward rate fixed under the contract and the opposite spot rate obtaining on the date of cancellation. Thus, a forward sale contract is to be cancelled at the bank's T.T. buying rate on the date of cancellation and the exchange difference, if any, should be collected from the customer or paid to the customer by the bank, as the case may be. Similarly, a forward purchase contract is to be cancelled at the bank's T.T. selling rate on the date of cancellation. The exchange difference not exceeding Rs.10 may be waived at the option of the contracting bank.

7.43 Rule 9III(B) of FEDAI Rules lays down the rates of overdue interest that should be charged by banks while cancelling overdue forward contracts, vide paragraph 7.39 above. However, overdue interest not exceeding Rs.10 may be waived at the option of the contracting bank and it may also be waived if a bill purchase contract becomes overdue due to the bank's refusal to accept the bills tendered as approved bills (vide Rule 10 of FEDAI Rules) and the exporter takes up the contract by tendering other approved bills or cancels the contract within a reasonable time.

Example

On 25th June, a bank entered into a forward sale contract for 2 months for DM 25,000 at the B.C. selling rate DM 25.20. On the 24th August, the importer requests for the cancellation of the contract, when the spot rates for DM quoted by the bank are as follows :

	<u>Selling rates</u>		<u>Buying rates</u>	
	<u>T.T.</u>	<u>B.C</u>	<u>T.T.</u>	<u>O.D.</u>
Rs.100 = DM	25.30	25.20	25.80	26.10

The forward sale contract will be cancelled by the bank at its spot T.T. buying rate, even though the forward sale was a B.C. sale. Thus, on the forward sale of DM 25,000, the customer would have paid to the bank

at the rate of DM 25.20 (i.e., the B.C. ~~selling~~ rate fixed under the contract) : Rs.99,206.35

Less : By purchasing back

DM 25,000 from the customer,

the bank would pay at the spot

T.T. buying rate of DM 25.80 : Rs.96,899.22

-----  
Rs. 2,307.13  
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The bank would, therefore, recover from the customer Rs.2,307.13 as the cost of cancellation. If, for instance, the contract could not be cancelled until the 3rd September, the bank would recover the cost of cancellation as under :

(i) Exchange difference as calculated above :	Rs.2,307.13
(ii) Overdue interest for 10 days (i.e., from 25th August to 3rd September) at 12% p.a. (i.e., 2% over RBI Rate) on Rs.99,206.35	Rs. 326.16
	----- Rs.2,633.29 -----

The cost of cancellation of the overdue contract to the importer would, therefore, be Rs.2,633.29. If, however, the exchange difference is in favour of the customer, the bank would pay the exchange difference to the customer but collect the overdue interest from him. It is important to note that in the case of a forward sale contract, the bank would cancel the contract at

the T.T. clean buying rate irrespective of whether the forward sale is a clean sale or a B.C. sale.

Guidelines for Inspecting Officers

7.44 While examining forward exchange contracts entered into by the bank, the following points should be seen by the Inspecting Officer.

Inter-bank and customer limits

(i) The Inspecting Officer should ascertain whether the guidelines given in paragraphs 3.2.3 and 3.2.4 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank, regarding setting up and monitoring of limits for forward contracts for its larger customers and individual banks, both overseas banks as well as authorised dealers in India, have been implemented by the bank.

Documents and procedure

(ii) It may be seen whether before entering into forward contracts with merchants, the bank has verified that there is adequate documentary evidence in respect of the relevant transaction of the constituent and a record has been kept of such evidence which shows that the exchange risk covered has been in respect of genuine trade transactions and the method of remittance is a permitted one. It may

be verified whether in cases where forward purchase contracts were booked against letters of credit, the requisite declaration of the exporter as required in paragraph 7A.2 of the Exchange Control Manual had been obtained.

(iii) Where in any case, the forward purchase contract had been booked on the strength of cable/telex message, it should be verified that the original signed contract has been submitted to the bank within a period of one month from the date of booking of the contract.

(iv) A few cases of forward purchase and sale contracts may be verified with the available case papers to see whether they have been booked in conformity with the Exchange Control regulations.

#### Delivery period

(v) The Inspecting Officer should ascertain whether the bank has ensured that the period of delivery (as extended from time to time) is such that the last date of delivery does not fall beyond 6 months (3 months in case of Afghanistan and Pakistan) from the actual date of shipment or expected date of shipment or beyond the extended period approved by the Reserve Bank.

#### Utilisation of cover

(vi) It should be verified whether the bank has a satisfactory procedure/system for watching the delivery

dates of forward contracts and ensuring that the contracts are taken up/extended by the due dates. It may be noted that authorised dealers are permitted to cancel outstanding contracts unilaterally, i.e., even if the application in Form FCC 2 has not been completed by the customer, after giving due notice to their customers, at the expiry of two months from the last date of delivery of the contracts, if they are satisfied that the contracts will not be performed by the customers. In the case of overdue contracts, the comments of the authorised dealer should be obtained as to why they have remained outstanding. Opportunities for speculation in the exchange rate can be provided to customers if contracts are not cancelled as quickly as possible.

(vii) It should be verified whether the bank has inbuilt procedures to ensure at the time of purchasing foreign currency proceeds of exports from their customers or purchasing their export bills, that a forward contract has not been fixed already in respect of the underlying export order and is outstanding against which the purchases are to be adjusted. Any cases coming to notice where such purchases have been treated as ready purchases when the forward contracts were outstanding should be properly enquired into as such shortcomings in procedure can provide opportunities for speculation in the exchange rate.

(viii) Where forward contracts have been booked after export bills were sent on collection basis, it should be verified whether the bank takes care and ensures that the proceeds of such bills when realised are adjusted against the contracts and are not treated as fresh (i.e. ready) purchases. The aim should be to see whether proper coordination exists between the department handling forward contracts and that handling documents for negotiation/purchase/collection.

(ix) If the bank had booked any contracts against bills sent for collection after they were sent for collection in terms of the relaxation permitted in AD (GP Series) Circular No.55 of 1979, it should be verified whether the conditions laid down therein have been fulfilled.

(x) It may be verified whether the bank had any cases where the forward contracts had been booked with it by the exporter and the letters of credit opened subsequently was restricted for negotiation through another authorised dealer and if so, whether the bank arranged to obtain a foreign currency draft against negotiation of documents from the other authorised dealer for settlement of the forward contract.

(xi) It should be verified whether the bank is allowing exporters to substitute contracts, i.e., deliver proceeds of an export contract other than the one against which

the forward contract was booked, without prior permission of the Reserve Bank.

Cover Operations

(xi) The bank's cover operations in inter-bank and overseas markets should be verified to see whether there is any speculative tendency in fixing forward contracts.

Cancellation

(xiii) It should be checked that wherever unutilised portions of cancelled contracts were more than U.S. \$ 500 or its equivalent, they have been reported to the Reserve Bank promptly.

Compliance with FEDAI Rules

(xiv) It should be verified, by a test check, whether the charges prescribed under FEDAI Rules have been recovered from customers while accepting or giving early deliveries, granting extensions and/or cancelling forward exchange contracts as there is scope for leakage of the bank's income.

NON-RESIDENT (EXTERNAL) RUPEE ACCOUNTS  
AND FOREIGN CURRENCY (NON-RESIDENT)  
ACCOUNTSIntroduction

The accounts opened and maintained with authorised dealers in the names of persons of Indian nationality/origin residing abroad, in pursuance of the Non-resident (External) Accounts Rules, 1970, are known as "Non-resident (External) Accounts". The scheme was introduced by the Reserve Bank as a measure of incentive to encourage persons of Indian nationality/origin to remit their savings to India. Initially, the accounts were allowed to be maintained only in Indian rupees. Since 1st November 1975, Non-resident (External) accounts have been permitted to be opened in designated foreign currencies. These accounts are known as "Foreign Currency (Non-resident) accounts (FCNR accounts)". Presently, the FCNR accounts are permitted to be opened in Pounds Sterling and U.S. Dollars. The Exchange Control provisions relating to Non-resident (External) Rupee accounts and FCNR accounts are contained in Chapter 28 of the Exchange Control Manual. The Inspecting Officers should familiarise themselves with the provisions of the Manual before undertaking scrutiny of Non-resident (External) Rupee accounts and FCNR accounts.

## 8.2 Special Features

- (i) Interest accruing on balances held in the Non-resident (External) accounts is free of income-tax and balances held in these accounts are exempt from wealth-tax. Gifts made from the accounts are also exempt from gift-tax. The balances are, however, not exempt from estate duty.
- (ii) The rates of interest payable by banks on deposits of maturity of one year and above held in Non-resident (External) Rupee accounts and FCNR accounts are 2% higher than the rates permissible on domestic deposits of comparable maturity.
- (iii) Balances held in these accounts alongwith interest thereon are freely repatriable outside India at any time at the request of the account holder without obtaining prior approval of the Reserve Bank.
- (iv) The exchange risk involved in maintaining FCNR accounts in the designated foreign currencies and the interest accrued thereon is borne by the Reserve Bank.
- (v) Transfer of Non-resident (External) accounts from one branch of authorised dealer to another branch of the same authorised dealer is freely allowed.

(vi) Transfer of funds from Non-resident (External) accounts held with one authorised dealer to another authorised dealer at the same centre or at another centre for opening new Non-resident (External) accounts is allowed by authorised dealers on fulfilment of certain conditions.

(vii) Transfer of funds from Non-resident (External) account of one person to the Non-resident (External) account of another person may be considered by the Reserve Bank on fulfilment of certain conditions.

### 8.3 Opening of Accounts

(i) Non-resident (External) accounts are allowed to be opened in the form of savings, current, recurring or fixed deposits in the names of persons of Indian nationality or origin, resident outside India provided the funds are received from the countries of residence of the prospective account holders or from any other country provided the country of residence of the account holder and the country from which remittance is received are both in External Group.

(ii) Overseas companies, partnership firms, societies and other corporate bodies which are owned to the extent of at least 60% by non-residents of Indian nationality/

origin and overseas trusts in which at least 60% of the beneficial interest is irrevocably held by such persons are also eligible to open Non-resident (External) Rupee accounts and FCNR accounts with authorised dealers in India, provided the funds for the purpose are transferred to India in an approved manner from the country where the company/firm/society/trust is registered or situated or from any other country if the country where such entity is registered/situated and the country from which the remittances are received are both in External Group.

(iii) Designation of existing ordinary non-resident accounts as Non-resident (External) Rupee accounts and opening of new Non-resident (External) accounts in rupees by transfer of funds from ordinary non-resident accounts require prior approval of the Reserve Bank.

(iv) Opening of Non-resident (External) Rupee accounts and FCNR accounts in the names of individuals other than those of Indian nationality or origin and in the names of overseas companies, partnership firms, societies and overseas trusts, otherwise than in the manner explained at item 8.3(ii) above, are not normally permitted.

8.4 Facilities available to Non-resident (External) Rupee and FCNR accounts holders

(i) Debits for local disbursements are freely allowed.

(ii) Balances held in Non-resident (External) Rupee and FCNR accounts are freely allowed to be invested, without prior approval of the Reserve Bank, in Units of Unit Trust of India, National Plan/Savings Certificates and Government Securities (investment in bearer securities is not permitted).

(iii) Interest/dividend on the aforesaid securities is freely allowed to be credited to the Non-resident (External) Rupee and FCNR accounts.

(iv) Sale/maturity proceeds/repurchase price of Units/Government Securities can be freely credited to these accounts provided the original purchases were made by debit to the same account.

(v) Balances in these accounts are allowed to be utilised towards payment of passage fare of the account holders as well as of the dependents for travel to/from India without prior approval of the Reserve Bank.

(vi) Balances in Non-resident (External) Rupee and FCNR accounts are eligible to all benefits that are generally available to foreign exchange remittances (i.e., investments in shares with and without repatriation benefits, investments in debentures/bonds, investments in new issues of Indian companies under 40% scheme and investment in priority industries under 74% scheme, etc.)

(vii) Balances in Non-resident (External) Rupee and FCNR accounts are freely allowed to be invested in the new issues of 12% 6-year National Savings Certificates. Such investments are free from wealth-tax, income-tax and gift-tax.

(viii) Shares/debentures purchased on repatriation basis, with the approval of the Reserve Bank, by non-residents of Indian nationality/origin residing abroad, by utilising the funds in these accounts, are eligible to be offered as collateral security for obtaining loans/overdrafts from overseas correspondents/branches of authorised dealers abroad.

#### Guidelines for Inspecting Officers

8.5 Since the balances held in Non-resident (External) Rupee and FCNR accounts are repatriable by authorised dealers at the request of the account holders, without obtaining prior

approval of the Reserve Bank, and also these funds are eligible for investment in various schemes, including schemes with repatriation benefits, much responsibility is devolved on Inspecting Officers to ensure that the operations allowed by authorised dealers in these accounts are strictly in accordance with the provisions of Exchange Control regulations. The Inspecting Officer should, inter alia, satisfy himself about the following :

(i) that the Non-resident (External) Rupee and FCNR accounts have been opened by authorised dealers only in the names of persons of Indian nationality/origin after obtaining necessary application/account opening form containing essential information (i.e., nationality, country of origin, permanent overseas address, purpose of stay abroad, etc.). An undertaking (in the account opening form itself) that the account holder would promptly intimate the authorised dealer about his return to India on his coming to India for permanent residence, is also obtained.

(ii) that in case of accounts opened in the names of overseas company/firm/society/trust, a certificate, along with account opening form, from an overseas Auditor/Chartered Accountant/Certified Public Accountant is obtained to ensure that the ownership/interest in the overseas company/firm/society or the

irrevocable beneficial interest in the trust held by persons of Indian nationality/origin is not less than 60%. Also, an undertaking from the institutional account holders is obtained to the effect that in case such interest falls below the level of 60% at any time in future, they would immediately intimate the change to the authorised dealer.

(iii) that the Non-resident (External) Rupee and FCNR accounts are maintained in separate ledger/binders or in separate block of the same ledger/binder to distinguish these accounts while allowing operations, from other accounts.

(iv) that foreign currency instruments (i.e., FCs, drafts, cheques) drawn in favour of residents of India/third party which are subsequently endorsed in favour of the account holders are not accepted for affording credit to these accounts.

(v) that funds held in ordinary non-resident accounts are not transferred to Non-resident (External) Rupee and FCNR accounts without obtaining prior approval of the Reserve Bank.

(vi) that the directives issued by Department of Banking Operations and Development regarding rates of interest on

deposits and directions regarding re-investment of deposits, etc., are strictly adhered to by authorised dealers.

(vii) that encashment/bank certificates are not issued by authorised dealers in respect of remittances received/foreign currency tendered to the credit of these accounts.

(viii) that applications for grant of loans and overdrafts to resident individuals/firms/companies in India against the collateral of fixed deposits held in Non-resident (External) Rupee and FCNR accounts are promptly forwarded by authorised dealers to the Reserve Bank (Exchange Control Department and Department of Banking Operations and Development) for their approval and such loans and overdrafts are granted only after obtaining their approval.

(ix) that Rupee loans granted to holders of Non-resident (External) Rupee and FCNR accounts are credited, if necessary, to ordinary resident accounts of the respective account holders but not to Non-resident (External) Rupee accounts .

(x) that Non-resident (External) accounts are not opened with Indian rupees derived from local sources.

(xi) that all transactions in Non-resident (External) Rupee and FCNR accounts are promptly reported to the Reserve Bank

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every month in STAT-4 and STAT-6 respectively (if the authorised dealer under inspection is a link office, i.e., which undertakes sale and purchase transactions with the Reserve Bank, it should be ensured that STAT-5 received from its offices/branches, is promptly forwarded to the Reserve Bank after scrutiny).

(xii) that all transactions in Non-resident (External) Rupee and FCNR accounts required to be reported to the Reserve Bank on Form A4/A2 are correctly reported and all transactions requiring specific approval of the Reserve Bank are handled only after obtaining such approval.

8.6 The Inspecting Officers may select a few Non-resident (External) Rupee and FCNR accounts, at random, and verify the credits afforded to these accounts with the original credit advices (i.e., T.T., M.T., D.D.) received from overseas branches/ correspondents/other authorised dealers to ensure the external origin of the credits and that no rupee credits from local sources are afforded to these accounts. Similarly, the debit entries for large amounts may be checked to ensure that these debits are allowed strictly as per Exchange Control regulations

Note : While persons resident in Bilateral Group of countries (U.S.S.R., Poland Zechoslovakia, Romania and German Democratic

open FCNR accounts, the Inspecting Officers should familiarise themselves with the specific provisions of the Exchange Control Manual relating to Non-Resident (External) accounts in rupees maintained by persons resident in any country included in Bilateral Group.

#### Recommendations

8.7 It is observed that certain Exchange Control regulations governing FCNR deposits are at variance with the relative directives issued by the Reserve Bank (DBOD), which are detailed in the Annexure to this Chapter. The Group recommends that early action should be taken to bring about a uniformity between the Exchange Control regulations and the directives issued by the Reserve Bank (DBOD) so that the Inspecting Officers are clear about the various provisions governing Non-resident (External) and FCNR accounts.

ANNEXURE TO CHAPTER 8Rate of interest payable on FCNR deposits converted into rupee deposits on change of status from non-resident to resident

(i) According to the note to paragraph A.14 of Chapter 28 of the Exchange Control Manual, in cases where FCNR deposits are converted into rupee deposits upon the return of the account holder to India for taking up employment or for carrying on a business or vocation or for any other purpose with the intention of residing in India and the deposits will be kept for the full term, interest will be payable on the rupee deposits at the rate applicable for such deposits for the full term originally fixed, as on the date of conversion. However, authorised dealers have been advised, in circular DBOD No. Dir.BC.41/C.347(I)-83 dated the 9th May 1983, that notwithstanding any change that might take place in the status of a depositor before the date of the ~~maturity~~ of a Non-resident (External) (NRE) deposit or FCNR deposit, it will be incumbent on the bank to allow on the relative deposit the rate of interest originally contracted for until the date of its maturity. In other words, even after the change in the status of depositors from non-resident to resident, NRE deposits and FCNR deposits (converted into rupee deposits) of terms of one year and above will continue to be entitled to the additional interest of 2 per cent per annum over the rates permissible on local currency deposits of comparable maturities.

Permitted types of FCNR deposits

(ii) According to paragraph C.3 of Chapter 28 of the Exchange Control Manual, effective from 1st March 1978, FCNR deposits can be made only for a minimum period of one year and a maximum period of five years and opening of accounts of any other kind including recurring deposits is not permitted. However, paragraph C.11 of Chapter 28 of the Manual states, inter alia, that where amounts in FCNR accounts are held in term deposits for periods less than twelve months, interest should be paid only on maturity of the deposits which implies that FCNR deposits can be accepted for periods less than twelve months. In terms of A.D. (M.A.Series) circular No.16 of 1979, paragraph 28 C.3 of the Manual has been amended by stating that the period for which deposits under the Scheme can be accepted by authorised dealers will be notified by DBOD from time to time and they should be guided by the circulars issued by DBOD and that the nature and period of deposits should conform strictly to the provisions contained in such circulars. In this connection, it was observed that the earlier instructions contained in paragraph 28 C.3 of the Manual that 'opening of accounts of any other kind including recurring deposits is not permitted under the Scheme' have been deleted by the Exchange Control Department and not clarified by DBOD. On the other hand, in terms of circular DBOD No.Dir.BC.80/C.

347-79 dated the 5th June 1979, the stipulation about the minimum period of one year and maximum period of five years applicable to FCNR deposits has been discontinued, with effect from 5th June 1979, bringing such deposits on par with all other deposits accepted by banks. In other words, authorised dealers may open FCNR accounts in any form, e.g., savings, current, recurring and fixed deposit, like NRE accounts.

Periodicity for calculation of interest

(iii) The note to paragraph 28 C.3 of the Exchange Control Manual states that authorised dealers may accept deposits under FCNR accounts with the facility of automatic reinvestment of interest as and when it accrues provided the plans involve compounding of interest on the deposits at half-yearly rests (and not at shorter intervals), period of deposit is 12 months or more and the plans are otherwise in conformity with the directive DBOD.No.Dir.BC.95/C.347-75 dated the 27th October 1975, as amended from time to time. Further, paragraph 28C.11 of the Manual provides that interest on balances held in FCNR accounts should be paid half-yearly, but authorised dealers may also pay interest on an annual basis if so desired by the depositor. As indicated at (ii) above, FCNR deposits have been brought on par with NRE deposits on which

interest can be calculated at quarterly or longer rests, vide DBOD No.Dir.BC.25/C.347-78 dated 28th February 1978 as amended vide directive DBOD No.Dir.BC.30/C.347-78 dated 2nd March 1978.

Premature withdrawal of deposits

(iv) In terms of paragraph 28 B.5 of the Exchange Control Manual, where a term deposit in Non-resident (External) account is withdrawn before maturity, the penalty in terms of directions issued by DBOD from time to time should be levied. In regard to FCNR accounts, the regulations governing premature withdrawal of deposits given in paragraph 28 C.12 of the Manual are based on the directive DBOD.No.Dir.BC.95/C.347-75 dated the 27th October 1975. However, as per the directive DBOD.No.Dir.BC.20/C.347-82 dated the 27th February 1982, the provisions relating to premature withdrawal of NRE and FCNR deposits shall be determined in accordance with the directive DBOD.No.Sch.BC.4/C.347-75 dated the 14th January 1975. Broadly, in terms of this directive(a) where a NRE or FCNR deposit is repaid before the expiry of the period of deposit agreed upon at the time of the deposit, the interest payable on such deposit shall be, for the entire period of the deposit, at least two per cent less than the rate of interest applicable to the period for which the deposit has remained with the bank and (b) a renewal of a deposit

before the date of its maturity shall not be regarded as involving premature repayment of the deposit, provided the deposit is held by the bank after the date of renewal for a period longer than the remaining period of the original contract whereas according to paragraph 28 C.12 of the Exchange Control Manual, (i) no interest will be payable if a FCNR term deposit for any period up to one year is withdrawn before the expiry of one year from the date of deposit and (ii) in cases where FCNR deposits are converted into Non-resident (External) account deposits before maturity at the request of account holder, the FCNR deposits will be treated as if they have been withdrawn prematurely and new deposits made in Non-resident (External) accounts in rupees. Further, as per the directive DBOD.No.Dir.BC.38/C.347-83 dated the 30th April 1983, the rate of penalty for premature repayment of term deposits has been reduced from two per cent to one per cent and in the event of premature closure or withdrawal of a deposit under reinvestment plan, which provides for reinvestment of the interest, interest as permissible is to be paid on a compounded basis with quarterly rests for the period during which the deposit has remained with the bank. It is not very clear whether this directive is also applicable to NRE and FCNR deposits.

CHAPTER 9RUPEE ACCOUNTS OF NON-RESIDENT  
EXCHANGE HOUSES

The immigration of skilled and semi-skilled labour for gainful employment in the West Asian countries after the oil price rise in the early 70s brought to the fore the question of handling their remittances to families and dependants in home countries. The West Asian countries do not generally have a network of banks with well-spread out branches and, in any case, the existing network is not adequate to handle the large volume of remittances made by expatriates. Most of the West Asian countries follow a restrictive policy in regard to the opening of branches by foreign banks. For example, Kuwait, Saudi Arabia and Iraq do not allow entry of any foreign bank. It was against this background that private local firms generically known as "Exchange Houses" found an opportunity to act as intermediaries in making remittances outside the West Asian countries. These Exchange Houses are, for the most part, partnership firms traditionally engaged in carrying out a number of informal banking services besides trading in silver and gold bullion as well as other commodities. They, with their local ownership and intimate knowledge of the administrative systems, are in a position to provide facilities at the sites of industrial and other projects for the issue of drafts to expatriates to enable them to remit their savings to home countries. Further, the Exchange Houses, because of their low administrative cost and informal approach to customers, are

able to offer to immigrants rates of exchange finer than those which they could obtain from banks operating in these countries. However, this requires an "account relationship" with banks in India as, according to Exchange Control regulations, transfer of funds to beneficiaries in India can take place only through the medium of authorised dealers.

9.2 During the years 1975-78, a number of Exchange Houses sought relationship with Indian banks so as to facilitate the transfer of savings of expatriates. The Indian banks were also keen on establishing such relationship because they saw in the arrangements three main advantages, namely, use of float funds, earning of exchange profits on sale of rupees to the Exchange Houses against convertible currencies and a boost to deposit mobilisation in India as beneficiaries of remittances could be expected to save a part of their receipts. The requests received from Indian banks to open non-resident rupee accounts in the names of Exchange Houses were initially considered by the Reserve Bank on a case-by-case basis and permission was granted on the condition that such accounts would be operated only for channelling inward remittances on personal account and no overdraft facilities would be allowed by banks for conducting the operations. In 1979, considering the fact that Indian banks were not represented in the West Asian region adequately, it was decided to permit Exchange Houses more liberally, on a general basis, to have account relationships with Indian banks

in order to facilitate the transfer of savings by expatriates. It was also felt at that time that enquiry into the means and standing of Exchange Houses could better be done by authorised dealers themselves and that guidelines could be framed to ensure that the non-resident rupee accounts were conducted satisfactorily from the Exchange Control angle. Accordingly, in terms of A.D. (G.P. Series) Circular No.8 of 1980, authorised dealers were granted general permission for establishing account relationships with Exchange Houses subject to a proper assessment of their means and standing and scrupulous observance of the rules specified in the circular for opening and allowing operations on the rupee accounts. Subsequently, in July 1981, the Reserve Bank issued to authorised dealers Guidelines for Internal Control over Foreign Exchange Business which also contained instructions regarding the management of risks arising in rupee accounts of Exchange Houses.

9.3 In the light of the failure of an Exchange House in Qatar and on the basis of the findings of the Reserve Bank's Study Team which visited some West Asian countries, it was decided in July 1982 to withdraw the general permission granted to authorised dealers for opening/maintaining rupee accounts of non-resident Exchange Houses, and the authorised dealers have been advised that all such fresh accounts can be opened only with the prior permission of the Reserve Bank. Authorised dealers have also been advised that the maintenance of the existing rupee accounts as also of new accounts (that

may be permitted by the Reserve Bank) of non-resident Exchange Houses will be governed by the revised guidelines laid down by the Reserve Bank. These guidelines are given in the following paragraphs.

Guidelines issued by Exchange Control Department in July 1982

9.4 All the existing accounts should be brought within the framework of the revised guidelines effective 1st October 1982.

9.5 An agreement as envisaged in the revised guidelines may be entered into with the Exchange House before 1st October 1982.

9.6 In order to ensure that operations as per the revised guidelines are closely observed, authorised dealers should open fresh accounts of Exchange Houses to put through the transactions relating to drafts issued from 1st October 1982.

9.7 The number of accounts an Exchange House will be allowed to maintain with banks in India will be restricted in accordance with the guidelines given by Exchange Control Department.

9.8 While considering the request of an Exchange House for opening an account, the authorised dealer concerned should make all necessary enquiries about the financial standing of the Exchange House in accordance with the normal banking practices and satisfy himself fully in all respects. More specifically, authorised dealers should satisfy themselves that the Exchange Houses hold valid licences issued by the Local Monetary Authority concerned and have necessary authority/licence to

transact currency exchange business. A resume of the authorised dealer's own assessment - the creditworthiness and standing of the Exchange House - should be submitted to the Reserve Bank while seeking permission for opening the account. Requests received from Exchange Houses which are not registered/licensed, as indicated above, should not be entertained by authorised dealers.

9.9 It is the intention of the Reserve Bank that the arrangement which an authorised dealer enters into with an Exchange House should be subject to comprehensive legal documentation duly registered. It should be ensured that all the partners of the Exchange House are jointly and severally bound to honour the obligations devolving on the Exchange House under the agreement.

9.10 The normal banking requirements of registration of Power of Attorney/Solecimen signatures of signing officials of Exchange Houses should be observed.

9.11 The accounts should be used for channelling inward remittances to India only on private account. The remitter in most cases and the beneficiary invariably should be an individual. No operations for trade transactions of any kind should be permitted in such accounts nor should the accounts be used for remittances from India.

9.12 The accounts should run on a credit basis after taking into account, if need be, the funds lying abroad at the disposal

of the bank, vide paragraph 9.19 below. No overdraft should be granted to the account holders. It is the intention of the Reserve Bank that the Exchange Houses may enjoy the benefit of a float up to 7 days and in this background, the banks need not, if they so decide, insist on payment of interest in the event of an occasional overdraft arising accidentally in the operation of these arrangements.

9.13 The accounts should be funded by sale of permitted foreign currency to the authorised dealer maintaining the account. Rupee funds transferred from another authorised dealer will not be eligible for credit to the accounts. Authorised dealers may permit credit of rupees derived by sale of rupees by their overseas branch/Head Office of the same authorised dealer to the account of the Exchange House provided both the transferor and the transferee are situated in the External Group of countries. (Also refer to paragraph 9.14 below regarding transfers).

9.14 Debits of permitted types (vide paragraph 9.11 above) may be made freely and given the same status as remittances made in foreign exchange in an approved manner to India. Thus, such payments will be eligible for credit to Non-Resident (External) Accounts maintained by non-resident Indians or for acceptance under priority allotment, etc., schemes. In order that tourists (whether Indian or not) receiving remittances through such accounts may prove the external sources of the funds where

required (such as for payment of passages in India or for reconversion of unutilised balances), authorised dealers may issue certificates in the same form as for inward remittances received through rupee accounts of overseas banks.

9.15 Funds in such accounts will not be convertible, nor will they be transferable to other authorised dealers or to non-resident accounts of other such institutions or banks with the same authorised dealer.

9.16 Balances in the rupee accounts will not qualify for payment of interest.

9.17 The office maintaining the funding account should not credit to the account of the Exchange House rupee purchased by the latter unless written confirmation is received to the effect that the Nostro account of the authorised dealers has been credited with the counter value of foreign currency (vide paragraph 3.1.3 of the Guidelines for Internal Control over Foreign Exchange Business).

9.18 Authorised dealers may like to obtain suitable and adequate collateral either in the form of a cash deposit with a foreign bank and with an appropriate lien thereon and/or a guarantee of a well-known international bank.

9.19 The Exchange House will be required to open a bank account in U.S. Dollars or Pound Sterling in the name of the drawee bank (a/c. - Exchange House) with an international bank - Designated Depository Agency (D.D.A.) - acceptable to the drawee bank at a centre mutually agreed.

9.20 The Exchange House will, at the end of each day, arrive at the total drawings in Indian rupees for the day and will convert the same into U.S. Dollars/Pound Sterling which sum shall be deposited into the account of the drawee bank (as described at 9.19 above). Exchange Houses may deposit their daily collections on the next working day before noon in local currency if the same is a freely convertible currency. Where the collections are converted into U.S. Dollars/Pound Sterling, the deposits of such collections may be made within two working days.

9.21 The Exchange House will send to the drawee bank on each Monday morning a telex containing information about the total number and the aggregate value of drafts drawn on each day of the preceding week ended previous Sunday and daily deposits in and transfers from the U.S.Dollars/Pound Sterling account during the week. The information about the total number of drafts drawn need not be insisted upon. However, the information could be obtained on monthly basis for reconciliation purposes.

9.22 The Designated Depository Agency abroad will hold the U.S.Dollar/Pound Sterling funds under lien to the drawee bank

and will allow debits only on account of transfer to the U.S. Dollar/Pound Sterling account of the drawee bank.

9.23 It will be the responsibility of the Exchange House to arrange for the transfer of the sum deposited on any particular day to the U.S. Dollar/Pound Sterling accounts in the U.S.A./U.K. of the drawee bank not later than seven days from the date of deposit. The Exchange House may, if it so desires, transfer the U.S. Dollar/Pound Sterling funds to the accounts of the drawee bank any day prior to the stipulated 7-day period.

9.24 The interest earned on the U.S. Dollar/Pound Sterling funds deposited by the Exchange House with the D.D.A. abroad as provided for at 9.20 above upto the date of transfer to the U.S. Dollar/Pound Sterling account in the U.S.A./U.K. of the drawee bank will accrue to the Exchange House. Where the Exchange House transfers to the Nostro account deposits made in the D.D.A. any day prior to the stipulated 7-day period, authorised dealers may compensate the Exchange House (for loss of interest) for the full 7 days at the rate of interest applicable to U.S. Dollar irrespective of the currency in which the deposit has been made. In other words, authorised dealers should compensate the Exchange House to the extent of 7 days' interest applicable to the U.S. Dollar on daily collections.

9.25 To ensure compliance with the above, the drawee bank in India will appoint a firm of practising Chartered Accountants/

Auditors operating in the country concerned to examine the daily drawings and deposits in the accounts with the D.D.A. abroad as well as transfers to the U.S. Dollar/Pound Sterling accounts of the drawee banks. For this purpose, the Exchange House will undertake to allow the auditors to inspect the books pay-in-vouchers, etc., of the Exchange House in so far as they pertain to the rupee drawings. Such inspection will be done at least once or twice in every week by the auditors. In case the Auditors of Exchange House are entrusted with the work, authorised dealers should issue a mandate to such Auditors specifically for overseeing the compliance with the provisions of the guidelines.

9.26 As an alternative to the appointment of auditors as mentioned in paragraph 9.25 above, the authorised dealer may depute a suitable official as his representative to the Exchange House to take up such functions so as to safeguard the interests of the authorised dealer.

9.27 The auditors/representative will promptly report the findings by telex to the drawee bank. In case of default on the part of the Exchange House, the drawee bank will, as per terms and conditions of agreement, terminate the agency arrangement under notice to the Exchange House by telex. The termination will also be promptly reported to the Reserve Bank by telex.

9.28 The Exchange Houses managed by Indian/Foreign banks and

a few others having good track record are allowed to follow alternative procedure to D.D.A. procedure outlined above which is as under:-

(a) All the Exchange Houses who are maintaining accounts under the alternative procedure should keep deposits in India or abroad equal to minimum 15 days' drawings on a moving average basis as security. The deposits should be in the name of the bank maintaining the account with interest thereon payable to the Exchange House if the deposits are placed abroad. The amount of deposits should be periodically reviewed and properly monitored by the bank to ensure that these deposits adequately cover the drawings effected.

(b) In addition to what is stated at (a) above, guarantees (actual amount to be decided by the bank maintaining the account but which should not be less than 15 days drawings on a moving average basis) from international banks of repute should be obtained as collateral to cover the drawings effected. As in the case of (a) above, the amount of guarantee should be periodically reviewed to ensure adequate cover for the drawings effected.

9.29 So long the Exchange House complies with these guidelines, the drawee bank will ensure that the drafts issued are honoured at the branches mutually agreed to.

9.30 The remuneration payable to the auditors will be borne by the drawee banks who will obtain the necessary prior approval from the Exchange Control at the time of appointment of auditors.

9.31 Drafts drawn by the Exchange House should have a validity of only three months from the date of issue thereof.

9.32 In all respects other than those specifically covered in the above paragraphs (including reporting of the transactions to the Reserve Bank), the accounts of Exchange Houses will be treated as bank accounts. Thus, the guidelines contained in paragraph 2 of A.D. (G.P. Series) Circular No.50 of 1979 will be applicable for the rates to be quoted for funding remittances from the Exchange Houses also. Further, the transactions in the accounts should be reported on R5 Returns, these accounts being listed separately under Part 'C' immediately after accounts of banks in Bilateral Group countries. Funding remittances received in foreign currency from the Exchange Houses should be reported in the corresponding R1, R2, etc., Returns against the item 'Purchases from Overseas Banks and Branches'. Likewise, the corresponding rupee credits should be reported in the R5 Returns under column (5).

9.33 The above guidelines authorise only the opening of rupee accounts for the Exchange Houses in the local books of authorised dealers. Authorised dealers should not open any foreign currency accounts with the Exchange Houses abroad.

9.34 Authorised dealers should satisfy themselves that the books of account of the Exchange Houses are regularly audited by auditors approved by the local monetary authorities.

9.35 Authorised dealers should call for periodical credit

reports, audited balance sheet and profit and loss account of the Exchange Houses and other relevant information so as to take a decision regarding continuance of the accounts in their books.

9.36 Since the books of account of Exchange Houses cannot be inspected, authorised dealers should periodically review the arrangements by paying visits to Exchange Houses and/or by periodical reviews of opinion reports. The visits of officials from authorised dealers should be at a sufficiently senior level, fully conversant with the conduct of the non-resident rupee accounts of the Exchange Houses.

Guidelines for  
Inspecting Officers

9.37 The Inspecting Officer should ascertain whether the rupee accounts of non-resident Exchange Houses are maintained and operations thereon are allowed by the bank in accordance with the guidelines issued by the Exchange Control Department (vide paragraphs 9.4 to 9.36 above and/or that may be issued in future) as also whether it has implemented the instructions contained in Part 7 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank. In particular, the Inspecting Officer should verify the following :

(i) Whether the accounts are maintained by the Foreign Exchange Department of the bank and if not, where are they located, how are they supervised as also whether the arrangements

for supervision over the accounts are satisfactory;

(ii) Whether the bank is following one of the three alternatives provided in paragraph 2 of A.D. (G.P. Series) Circular No.23 of 1978 regarding drawings in rupees by the Exchange Houses or whether any exceptions have been made;

(iii) Whether accounts of the Exchange Houses in India have been utilised for channelling inward remittances other than on private account and, in particular, whether the bank has appointed any Exchange House as its agent for selling rupee travellers cheques (RTCs) and transactions in respect thereof are mixed with other business of the Exchange House and settled through its rupee accounts maintained in India. If so, the names of such Exchange Houses, whether the Exchange Houses concerned are managed by the bank or any other bank in India or abroad, the details of arrangements for the sale of RTCs and the manner of reimbursement, why the encashment/reimbursement of RTCs is not done through the account operated for the bank's RTCs, etc., should be ascertained by the Inspecting Officer;

(iv) Whether the time-lag between payment of drawings at the drawee office and debits raised at the account-maintaining office is reasonable and if not, whether the bank has taken measures as suggested in A.D.(G.P.Series) Circular No.75 of 1979;

(v) Whether the bank has made sufficient enquiries about the means and standing of the Exchange Houses through reliable

sources abroad including the Indian Missions in the territory/  
country concerned and likewise satisfied itself periodically  
that they continue to be well reported upon;

(vi) Whether the bank while quoting rates for selling  
rupees to the Exchange Houses ensures that the rates quoted are  
strictly in accordance with the instructions contained in A.D.  
(G.P.Series) Circular No.50 of 1979.

C H A P T E R 10

FOREIGN EXCHANGE DEALINGS, COVER  
OPERATIONS, SWAP TRANSACTIONS,  
DEALINGS WITH OVERSEAS BANKS/  
BRANCHES AND RUPEE (VOSTRO) ACCOUNTS -  
RISKS AND CONTROL

International trade in goods and services is worth some 10 billion for every working day. Direct investment flows account for another few hundred millions. Yet trading volume in the world's foreign exchange markets is estimated at over \$ 200 billion a day. Thus, about 95 per cent of foreign exchange is not direct commercial business but trading between market bankers - the foreign exchange dealers of the world's international banks. The foreign exchange turnover of authorised dealers in India has been increasing at an annual rate of over 45 per cent; the foreign exchange turnover rose from Rs.31,843 crores in 1977 to Rs.139,869 crores in 1981. (In 1981, export receipts amounted to Rs.7,178 crores and import payments amounted to Rs.13,338 crores. Thus, Rs.20,516 crores accounted for foreign exchange transactions arising out of foreign trade. The total foreign exchange turnover includes transactions arising out of foreign trade, purchase and sale of foreign currencies for travel and other purposes and inter-bank transactions with their multiplier effect.) The increase in foreign exchange operations has been essentially due to opportunities provided by the regime of floating exchange rates, which

has enabled foreign exchange dealings to become more remunerative but at the same time more risky. There is, therefore, a need for better internal controls by banks over their foreign exchange operations.

10.2 The world's foreign exchange markets span the globe. The more important exchange markets are found in London, New York, San Francisco, Paris, Frankfurt, Amsterdam, Milan, Zurich, Toronto, Brussels, Bahrain, Tokyo, Hong Kong and Singapore. However, the foreign exchange market does not exist in one physical place like, for example, the Stock Exchange. The 'market place' for foreign exchange is a communication system through which participants remain in continuous contact with one another. The communication system is so continuous that, despite time and space differences, there exists a single world market and, for at least 23 hours a day, currencies are being bought and sold and prices are moving somewhere. Banks in the Far East begin trading in Hong Kong, Singapore and Tokyo at about the time most traders in San Francisco are going home. As the Far East closes, trading in Middle Eastern financial centres has been going on for two hours, and the trading day in Europe is just beginning. Because of the United Kingdom's geographical position, banks in London can deal with the Far East, Middle East and North America, as well as with the rest of Europe, in the course of the working

day. This has resulted in London having a pre-eminent position in the market.

10.3 The Indian Foreign Exchange Market may be broadly described as a three-tiered market. The first tier consists of foreign exchange transactions between authorised dealers and their customers, mainly importers and exporters. Secondly, there is the inter-bank market wherein there are foreign exchange dealings between authorised dealers themselves, conducted through exchange brokers, and supplemented by transactions with the Reserve Bank. The third tier consists of foreign exchange dealings between banks in India and their counterparts and branches in foreign countries. All the three are inter-connected; this is so because, after all, customers are the ultimate suppliers and consumers (sellers and buyers) of foreign currencies and their needs are met by banks either by operating in the inter-bank market locally or in international foreign exchange markets. Until a few years ago, banks in India were heavily depending on London foreign exchange market for their cover operations this was because of our historical links with the United Kingdom. Presently, apart from London, banks in India also operate in foreign exchange markets such as New York, Frankfurt, Hong Kong and Singapore, to cover their foreign exchange transactions. The overseas branches of Indian banks are now functioning in all time zones and banks in India are

able to have access to **international** markets through their offices instead of depending on foreign banks, as in the past. Many authorised dealers in Bombay have gone in for Reuter Monitor screen and such facilities are being extended to other centres as well.

#### Inter-bank markets in India

10.4 The inter-bank markets are established mainly in Bombay, Calcutta, Cochin, Madras and New Delhi, the Bombay and Calcutta markets being fairly large. Foreign exchange dealings are also undertaken at some other centres like Ahmedabad and Bangalore in a limited way. Bombay is traditionally an import centre and, therefore, to cover merchant sales, banks would be predominantly buyers in the inter-bank market. Calcutta and Madras are export centres and, to cover merchant purchases, there would be more sellers than buyers in these inter-bank markets. With the increased role assigned to public sector undertakings, which mostly have head offices in New Delhi, in India's foreign trade, the inter-bank market in New Delhi has grown up rapidly. With the growth of telex communications and STD facilities, the inter-bank markets in these centres are more closely knit than previously.

10.5 The hours during which foreign exchange business may be conducted, during which inter-bank business may be

concluded and brokers may call and transact business, are laid down for each centre by the Local Committees of the Foreign Exchange Dealers' Association of India. For instance, the hours of business in Bombay are 11.00 A.M. to 3.00 P.M. On Saturdays, however, no inter-bank business may be concluded.

10.6 The Reserve Bank has been taking steps from time to time to develop an active inter-bank foreign exchange market in India. Prior to 1978, the market was comparatively narrow and there used to be at any point of time three types of banks when confronted with a merchant offer or bid for foreign currency, viz.,

- (a) Banks having an open position in the currency which would get reduced by acceptance of the merchant business.
- (b) Banks maintaining square or near square position in the currency who were not eager to expose themselves to currency exposures by running open positions.
- (c) Banks having an open position in the opposite direction which would get further worsened by acceptance of the merchant business.

The first category of banks would quote fine rates, while the other two would quote unattractive rates if quoting at all. The exchange market was, therefore, not a homogeneous and competitive one as the merchant would be finding a large part of the market unwilling to quote for business,

or even if quoting, to quote a competitive rate. As a result, there was no uniformity in rates and some of the banks used to exploit the narrowness of the market to the detriment of the exporter or importer. There were two alternatives for remedying this type of situation for the purpose of quoting fine rates to customers, one was that the Reserve Bank should lay down daily rates for all important currencies or it should liberalise Exchange Control constraints and trading so as to permit a freer market in foreign currencies in India. The former was not a feasible proposition in the context of the highly volatile and fluctuating exchanges world over where rate changes occurred every few seconds. It was, therefore, decided to liberalise the Exchange Control regulations relating to exchange trading so as to develop and activate inter-bank market in India. In the 1978 edition of the Exchange Control Manual, rules relating to inter-bank dealings have been revised. Prior to 1978, authorised dealers were required to keep square or near square position at all times. They are now required to avoid only overnight open positions, the rule of square or near square position applies only to the end-of-the-day position and not to daylight positions. The implication of the new regulation is that banks can undertake trading/dealing operations without necessarily relating them to merchant transactions during the day, while the overnight position should be kept at square or near square. Before

undertaking transactions in overseas markets, authorised dealers are required to explore the possibilities of securing the necessary cover in the inter-bank in India itself. Authorised dealers have been advised to avoid covering merchant purchases in currencies in which the Reserve Bank is dealing by selling the currencies in overseas markets. A set of fineness guidelines for rate quotations in the inter-bank market has been recommended by the Reserve Bank to the authorised dealers in order to improve upon the fineness of rates quoted in the market for various currencies. The Reserve Bank has also suggested the fineness of rates for customer quotations in the various currencies. These guidelines have been circulated to authorised dealers by FEDAI. The Reserve Bank has advised the authorised dealers to develop 'two-way' dealings in the Indian inter-bank market in the principal trading currencies, so that the inter-bank market acquires necessary depth and customers are enabled to get finer rates.

10.7 Efforts have been made by the Reserve Bank to persuade authorised dealers to decentralise foreign exchange dealings. There are several advantages in decentralising foreign exchange dealings:

- (a) Customers will be able to get finer rates quickly because banks will be able to arrange cover locally.
- (b) Dissemination of expertise in foreign exchange dealings will be possible only with decentralisation.

- (c) In the decentralised system, the communication difficulties will be less.
- (d) Prompt covering of transactions in the inter-bank market will be possible and the risk of uncovered items remaining in the pipeline will be considerably reduced.
- (e) Since each dealing office will keep its own accounts at foreign centres, reconciliation problems will be reduced.

10.8 In order to ensure that the foreign exchange operations are conducted by authorised dealers on sound lines, the Reserve Bank has issued a set of " Guidelines for Internal Control over Foreign Exchange Business" to all authorised dealers, and they have been advised to gear up their machinery to ensure that the Guidelines are implemented in letter and spirit. The Guidelines have been issued not because banks are operating in India under Exchange Control regime. Even in countries like the United Kingdom and Singapore, which do not operate Exchange Controls, there are similar guidelines issued by Monetary Authorities.

10.9 Inter-bank dealings are put through by means of exchange contracts which may be on 'Cash', 'Value next day', 'Spot' or 'Forward' basis. The terms 'Cash', 'Value next day' and 'Spot' are defined in Rule 4II(B) of FEDAI Rules. In the case of all inter-bank T.T. contracts, the option to take delivery is with the purchasing bank, unless otherwise agreed upon. An inter-bank contract may specify

the payment of rupee amount at another centre in India even though the contract may be between two banks in the same city. The centre at which rupee funds are to be paid is specified in exchange contracts by using phrases like 'Bombay Funds', 'Calcutta Funds' or 'Madras Funds'. In the event of late payment abroad, regardless of the cause of the delay, overdue interest is payable by the selling bank as laid down in Rule 5 of FEDAI Rules. The Rules do not provide for any payment of overdue interest to the seller bank by the buyer bank for the delay in payment of the counterpart rupee funds as there is no reason why the buyer bank should delay the payment of rupee funds.

10 10 The Reserve Bank buys and sells Pounds, Sterling, which is the intervention currency. The Reserve Bank also buys U.S. Dollars (since October 1972), Deutsche Marks (since March 1974) and Japanese Yen (since end - May 1974). Although it is not customary for central banks to be in the forward market on a regular basis, the Reserve Bank has undertaken to purchase forward the major foreign currencies in which exports are generally invoiced, viz., Pounds, Sterling, U.S. Dollars, Deutsche Marks and Japanese Yen, to enable authorised dealers to extend forward cover at reasonable rates to exporters invoicing their exports in foreign currencies. The regulations governing purchase and sale of foreign currencies by the Reserve Bank from/to authorised dealers are contained in Chapter 9 of the Exchange Control

Manual and the procedure for transactions with the Reserve Bank is outlined in the memorandum F.B.M given at the end of that Chapter.

### Cover Operations

10.11 Authorised dealers put through sale as well as purchase transactions in various foreign currencies with their import and export customers. The transactions may be for spot or forward deliveries. In normal times, authorised dealers quote to customers firm rates of exchange for various transactions and it is up to banks to ensure that transactions are covered at a profit. The fundamental principle in foreign exchange dealings is that sales should be offset by corresponding purchases and vice versa, if the bank is not to run the risk of exchange fluctuation or indulge in speculation. While it would be an ideal situation in which sales to customers are offset fully by corresponding purchases from them, in practice, however, the bank would find that such a situation would be an exception rather than a rule. It is, therefore, necessary for the bank to undertake cover operations with a view to ensuring that it does not run any exchange risk due to adverse fluctuations in rates of exchange.

10.12 Foreign exchange dealings involve judicious judgement of the position in various foreign currencies at all

times and conducting cover operations in a manner to minimise exchange risk and maximise profit. A dealer who wants to play perfectly safe would have to match his purchases to sales and vice versa, having regard not only to the point of time (delay may result in fluctuation in exchange rate) and amount (more or less may leave him exposed to the extent of surplus or shortfall) but also maturity (interval between deliveries may expose him to risk in respect of one part of the deal). However, it is difficult to achieve perfect matching in respect of all aspects due to the following reasons:

(a) Cover operations with other banks are almost always for certain minimum amounts and in round sums whereas purchases from or sales to customers may be for lesser and odd amounts. This creates time and amount discrepancies. During the interval between transactions with customers and cover operations in the inter-bank market, the exchange rate may move against the bank.

(b) In option contracts, it is the merchant who has the option to give or take delivery of foreign currencies during the option period and in the inter-bank contracts, it is the buying bank which has the option. This creates maturity discrepancy. For instance, when a merchant contract is covered in the inter-bank market, the merchant may offer delivery at a time which does not coincide with

the requirement of the bank with whom the deal is covered or the latter may seek delivery before the merchant chooses to give delivery.

(c) Pipeline transactions, that is, delay in receipt of intimations from branches regarding transactions put through at firm rates.

10.13 In actual practice, authorised dealers make a number of sale and purchase transactions and each transaction is not covered individually but overall cover operations are entered into keeping the exchange risk to the minimum and maturities matched.

#### Organisation of the Dealing Department

10.14 The instructions regarding segregation of dealing and accounting functions, selection and training of dealers, infrastructure of the Dealing Department, duties of dealers, dealing procedure, duties of Accounting Department, etc., are laid down in Part 1 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank.

#### Inter-bank dealings through Exchange Brokers

10.15 Exchange brokers perform the function of bringing together buyers and sellers of foreign exchange in the inter-bank foreign exchange market. Rule 3 of FEDAI Rules

governs the inter-bank business through exchange brokers. It provides, mainly, that when authorised dealers make contracts through brokers, such contracts should be made through only exchange brokers recognised by FEDAI, that no brokerage or other form of remuneration is paid by banks to their employees on contracts made in respect of any business, that the recognised exchange foreign exchange/brokers are permitted to contract exchange business on behalf of authorised dealers only upon the understanding that they will conform to the rates, rules and conditions laid down by FEDAI, and that all dealings between banks in centres which are serviced by recognised exchange brokers are to be conducted through them. Thus, direct dealings between banks in such centres is not permitted. Dealings between banks and the Reserve Bank are, however, conducted directly without the intervention of brokers. The brokers' contracts attract stamp duty.

10.16 With effect from August 1, 1980, the rates of exchange brokerage payable by banks on the inter-bank transactions, as fixed by FEDAI, with the approval of the Reserve Bank, are as under:

Type of business <hr/> 1.	Rate of brokerage (payable both by selling and buying banks) <hr/> 2.
I. Spot and outright forward business against the rupee	
(a) US dollars and pound sterling	1 paise per Rs.100/-
(b) Other foreign currencies	1.15 paise per Rs.100/-
II. Swap transactions in foreign currencies against the rupee :	
(i) 'Short' swaps i.e., where the delivery of the further leg is due on the 7th day after contract or earlier :	
(a) US dollars and pound sterling	1.20 paise per Rs.100/-
(b) Other foreign currencies	1.40 paise per Rs.100/-
(ii) 'Long' swaps (i.e., other than 'short' swaps)	
(a) US dollars and pound sterling	1.50 paise per Rs.100/-
(b) Other foreign currencies	1.75 paise per Rs.100/-

1.	2.
III. Switches (i.e., sales of foreign currencies against foreign currencies, spot or outright forward)	12 paise per US \$ 100/- or equivalent
IV. Swaps in foreign currencies against foreign currencies (irrespective of period)	18 paise per US \$ 100/- or equivalent

No brokerage should be paid by banks on merchant contracts arranged through brokers and on the inter-bank sale and purchase contracts of value of less than £ 500 (and/or the equivalent in other currencies). It has been clarified by FEDAI, with the approval of the Reserve Bank, that in case a bank exercises its option of delivery within 7 days from the date of the contract, the swap should be treated as 'short' and that in case a bank exercises the option of delivery on a date beyond 7 days from the date of the contract, the swap should be treated as 'long'.

10.17 Authorised dealers should maintain all necessary records to indicate the exact nature of business done through brokers in order that the brokerage payments are made at the approved rates. As the rates for swaps are less than double the rates for outright transactions, banks should be watchful to ensure that there is no tendency on the part of brokers to split swap requirements into outright transactions.

### Swap Transactions

10.18 The textbook rule is that whenever a bank buys or sells forward, the forward position should be covered at once by a spot transaction in the opposite direction so as to establish the rate of exchange and thereafter, at a convenient moment, the resulting spot and forward commitments may be offset by a swap transaction. The term 'swap' literally means exchange or barter. It may be defined as the simultaneous buying and selling of a foreign currency in approximately equal amounts for different maturity (settlement) dates. In other words, an exchange transaction in which there is a simultaneous sale of spot currency against forward purchase of the same currency or purchase of spot currency against forward sale of the same currency, is known as 'swap' or 'budlee' or 'double deal' transaction. A swap transaction is usually taken to mean swap of spot with forward, but with the widening of forward markets and sophistication acquired by dealers, a considerable business has also developed in forward to forward swap. Thus, the term 'swap' also refers to purchase or sale of short forward exchange against long forward exchange.

10.19 A swap transaction does not affect the net exchange position. Swaps are undertaken mainly for adjustment of

funds position or better cash management and for correcting gaps in maturities of foreign exchange transactions entered into by authorised dealers. A dealer must bear in mind his exchange position, funds position and interest rates ruling in India and at foreign centres. For instance, a dealer may sell spot £ 20,000 by way of a T.T. remittance on London and on the same day, he may purchase 90 days sight export bill for £ 20,000. Having bought and sold same amounts, his exchange position is square but maturities of transactions differ and, as a result, in view of T.T. sale, his Nostro account may become overdrawn whereas the export bill purchased will be realised only after, say, 105 days, that is, 90 days tenor plus 15 days transit period. The dealer may consider effecting a swap deal of spot purchase and forward sale to match with maturities of T.T. sale and purchase of export bill respectively. In the case of import bills drawn under letters of credit, overseas negotiating banks reimburse themselves by debit to Nostro accounts of opening banks whereas importers usually pay on presentation of documents, and the interval may be about 10 days or more. The opening bank has an option to allow its Nostro account to remain overdrawn until import bills are paid, but this may not be practical in view of the Exchange Control regulations and/or rates of interest on overdrafts being more than rates of interest

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payable by importers. For instance, a telex received by the bank from its correspondent in New York says that its account is overdrawn to the extent of US \$ 80,000 as a result of a debit raised for negotiating a bill under the bank's import letter of credit. The bank's exchange position was overbought US \$ 25,000 at the start of the day. If the bank decides to purchase, say US \$ 80,000 to adjust the overdraft, its exchange position in US \$ will become overbought US \$ 105,000 and it would run the exchange risk until the import bill is received and paid, that is, until the sale of US dollars is effected to the importer. On the other hand, overdraft in New York may be expensive and the bank may like to avoid it as far as possible. The bank may, therefore, enter into a swap transaction, that is purchase spot US dollars in order to liquidate the overdraft and sell the same forward for a suitable future delivery corresponding with the estimated date of payment of the import bill. When the importer makes payment, the bank will purchase spot to meet its forward sale under the swap transaction. Thus, while remaining as square as possible, a dealer should endeavour to keep minimum working balances in his Nostro accounts, and the more accurately he can synchronise the delivery dates of his purchases and sales, the more profitable will be his operations.

Exchange Control Regulations

10.20 As already stated in paragraph 7.24 of Chapter 7, subject to compliance with the provisions in paragraphs 8.2 and 8.3 of the Exchange Control Manual regarding exchange position and cash balances, authorised dealers may freely correct imbalances in their own exchange position such as overbought in spot position and oversold in forward position or overbought at one forward position and oversold at another, by making appropriate swap operations in the currency with other authorised dealers in India. However, authorised dealers should, as far as possible, avoid outright forward or swap transactions which will result at the close of business on any day in unreasonably 'mismatched' maturities.

10.21 Authorised dealers should not resort to the practice of set-off of foreign exchange deliveries indiscriminately. There is, however, no objection to authorised dealers agreeing to set-offs in genuine circumstances where mutual pick-ups between authorised dealers arise unintentionally due to the cumulative effect of transactions undertaken between banks over a time and in the normal course of exchange business. Even in such cases, the relative entries should be passed at the contracted rates in the foreign currency mirror account as if deliveries have been made and taken, albeit the fact

that no actual deliveries will be taking place at the foreign centre. Such set-offs should also be reflected in the Returns as deliveries made and taken. The object of this procedure is to ensure that the effect of the set-off gets reflected in the profit and loss account only through the mirror accounts and not directly. A separate record of such set-offs should also be maintained in order to facilitate reconciliation of Nostro accounts with mirror accounts as well as scrutiny by the Inspecting Officers of the Reserve Bank and by the internal auditors of banks. Set-offs are not permitted in dealings with overseas branches, correspondents, etc., of authorised dealers in any circumstances.

10.22 Swaps involving 'Ready' (i.e., delivery on the same day) and 'Spot' (i.e., delivery on the second business day succeeding the date of the contract) transactions in foreign currency against rupees with overseas banks (including their branches/Head Offices) are ordinarily speculative in nature if made for the purpose of closing out by opposite swaps on 'Ready' against 'Value next day' basis on the ensuing business day or for postponing funding of overdrafts arising in rupee accounts maintained by them. Besides, paragraph 10.9 of the Exchange Control Manual clearly lays down that rupee funds acquired by overseas banks should be for meeting

genuine business needs. Authorised dealers should not, therefore, permit swap operations being made by overseas banks in the rupee.

Foreign Exchange Operations -  
Risks and Control

10.23 Foreign exchange operations can expose banks to more than usual business risks. The special features that have a great bearing on the risk potential of foreign exchange operations include the following:

(a) Dealing decisions are generally made in highly volatile market conditions and since the decision to clinch a deal has to be made within a split second, the dealers hardly have the time or the opportunity to evaluate fully the pros and cons of alternative courses of action or the opportunities available from the emerging developments.

(b) Many complex factors influence exchange rates in foreign exchange markets operating at different centres. As foreign exchange dealers operating in Indian markets are far removed from the major scenes of action, they may not be able always to get all the relevant information.

(c) Dealing operations in Indian banks are handled by

relatively junior level officers to whom the authority to commit the banks for such large amounts normally would not have been delegated in other areas of a bank's business. On the other hand, by its very nature, dealing transactions cannot be conducted through a process of on-going consultations with and authorisations from the higher supervisory or top management levels of the bank. By the very exigencies of the market situation and market practices, the dealers have to be given sufficient freedom to operate in the market at rates and in amounts they deem prudent in the context of the prevailing and expected market conditions.

10.24 It is, therefore, necessary for banks to institute adequate controls, accounting, monitoring and profit evaluation systems and procedures in respect of their foreign exchange business. The main objectives of such a system should be to reduce the risk exposure of the bank and to establish a process of on-going evaluation of the quality of dealing decisions which will enable the bank to take appropriate corrective measures to cut losses, if any, in time.

Risks in Foreign Exchange  
Business.....

10.25 There are a number of risks associated with foreign exchange transactions. These could be grouped under the following heads :

- (a) Net open position risk or rate risk
- (b) Mismatched maturity risk
- (c) Credit risk
- (d) Fraud risk
- (e) Operational risk
- (f) Country risk

Net open position risk  
or rate risk.....

10.26 The nature of this risk has been explained in Part 3 of the Guidelines for Internal Control over Foreign Exchange Business. As indicated therein, the risk arises from unexpected changes in the exchange rates. With a high degree of volatility witnessed in recent years in the foreign exchange markets, the risk attached to carrying open positions in any foreign currency has increased. The rate risk is controlled by fixing daylight and overnight limits in each currency, maximum contract value limits in each currency, limit on aggregate net open position for all currencies together and limit on total daily transactions value for all currencies together (turnover limit). The instructions regarding fixing and monitoring of daylight and overnight limits are given in paragraphs 3.2.1 and 3.2.2 of

the Guidelines. The limits laid down by banks should be advised to the Reserve Bank (Exchange Control Department).

#### Mismatched maturity risk

10.27 Mismatched maturity risk is also called liquidity risk and is closely associated with rate risk. Gaps occur when liabilities and contracts to sell in a given currency mature earlier than assets and contracts to purchase in that currency and vice versa. The maturity mismatching is basically a problem of excess or shortage of funds on any given day or period. Paragraphs 3.1.2 and 3.3 of the Guidelines contain detailed instructions regarding maturity mismatching and control over mismatchings in maturities.

#### Credit risk

10.28 In entering into any foreign exchange transaction, the bank must be confident that the counterparty, a customer or another bank, possesses the financial soundness and liquidity required to meet its obligations at maturity. All foreign exchange transactions necessarily mean delivery of one currency against another. If one of the parties to a transaction fails to fulfil its part of the contract in delivering or taking up delivery of the currency, the other party will be exposed to the risks of exchange rate fluctuations or interest rate costs due to the necessity of purchasing or disposing of the currency for readjusting its own currency or funds position or both.

The credit risk is controlled by fixing customer limits and limits for dealing with individual banks, and instructions in this regard are contained in paragraphs 3.1.3, 3.2.3 and 3.2.4 of the Guidelines. Limits should be fixed for all counterparty banks including nationalised banks.

#### Fraud risk

10.29 The chances of fraudulent deals are significant in foreign exchange business. This is partly due to the technical nature of the business and hence the difficulty in detecting the malpractices. Frauds which have recently come to light include instances of dealings for one's own benefit without putting them through the mirror accounts, undertaking unnecessary deals to pass on brokerage for earning kick back, sharing benefits by quoting better rates to some banks and customers, unauthorised speculative deals, etc. While there is no easy solution to the problem, effective controls and monitoring, separation of back-up procedures from dealing, prompt reconciliation of accounts, proper selection and training of dealers, etc., are the means available to a bank to manage the risks arising from fraud and malpractices.

#### Operational risks

10.30 These risks include inadvertent mistakes in the rates, amounts and counterparties of deals, misdirection of funds, etc. The scope for such mistakes arises partly because of

the speed with which the foreign exchange transactions are normally effected and partly due to the fact that the deals are effected over telephone or telexes and the mistakes can be detected only when the follow-up confirmations/advice are received subsequently. The reversing of such mistakes may, however, involve the bank in losses due to exchange rate changes, interest costs and also loss of goodwill of the counterparty banks. These risks could be reduced by strict adherence to the procedures, particularly those procedures relating to the verification of the details included in the deal slips with the counterparty confirmation advice/contracts and broker slips, prompt reconciliation of Nostro and Vostro accounts, etc.

### Country risk

10.31 Country risk, in contrast to the credit risks of a borrower, relates to the ability and willingness of a country to service its external liabilities, including those incurred by its public and private entities. In other words, it is the possibility that the sovereign as well as other borrowers of a particular country may be unable to fulfil their foreign debt obligations for reasons which are beyond the usual credit risks. The inability of a country to meet its obligations can be due to economic, social or political reasons but such an inability ultimately manifests itself in the form of moratorium or default or rescheduling or just protracted delay in remitting

the interest payment or principal or both. It is not correct to assume that country risk is involved only in cross-border medium-term lending portfolios and not in respect of short-term finance, including inter-bank market deals, trade financing and foreign exchange transactions. The foreign exchange business involves maintenance of balances abroad with correspondent banks and also contracts for sale and purchase of currencies with foreign counterparty banks. The liabilities arising from these balances and forward transactions are in no way different from the liabilities arising from the medium-term lending portfolios.

Dealings with overseas banks/  
branches and Rupee (Vostro)  
accounts.

10.32 The instructions governing the conduct of Rupee accounts of non-resident banks (which expression includes overseas branches/Head Offices of authorised dealers and correspondent banks) in the External Group of countries are contained in Chapter 10 of the Exchange Control Manual. These should be read with the provisions regarding the permitted methods of receipts and payments as laid down in paragraphs 4.6 and 4.7 of the Manual. According to paragraph 10.9 of the Manual, authorised dealers are permitted to freely purchase T.Is and other remittances in any permitted currency from their overseas branches and correspondents to enable the latter to lay down funds in their rupee accounts in India for meeting bonafide.

needs of the overseas banks for payments against exports and other commitments in India, but acquiring of spot rupees by overseas banks for building open positions in the currency or for holding as cover against their forward commitments is not permitted. Thus, the rupee funding operations of overseas banks should be commensurate with their normal requirements for meeting their payment obligations in India. Paragraph 10.12(i) of the Manual allows that rupee balances of overseas banks situate in any country of the External Group may be converted into any permitted currency freely. However, whenever such conversion takes place for a significant amount, authorised dealers are required to make an instantaneous check of the operations in the overseas banks' rupee accounts in the immediate past to ascertain whether any transactions with a speculative intent so as to benefit from a change in the external value of the rupee had been undertaken by the overseas bank and if so, to make a detailed report to the Reserve Bank immediately. Authorised dealers have sometimes to undertake sales and purchases of rupees with overseas banks where the rupees are required to be delivered to an account maintained by the latter with another authorised dealer or where the rupees are being provided from an account maintained with another authorised dealer, as the case may be. In such cases, the other authorised dealer should invariably be requested to scrutinise the funds position in the overseas bank's rupee account without any delay and ensure that the operations

are being conducted in conformity with the Exchange Control regulations. The obligation of reporting any unusual features to the Reserve Bank will then rest on the other authorised dealer. In order to ensure that all large transactions have been properly examined, authorised dealers are required to report to the Reserve Bank (Exchange Control Department, Central Office) purchase of rupees from overseas banks for Rs.5 lakhs and above and sale of rupees to overseas banks for Rs.100 lakhs and above on any day, whether the funding is undertaken through an account maintained with another authorised dealer or not. All transactions involving an aggregate amount of Rs.5 lakhs or Rs.100 lakhs and above, as the case may be, on any day with the same overseas bank (all branches abroad being taken together) should be reported to the Reserve Bank. This report should also cover transactions concluded with overseas branches/Head Office of authorised dealers. The following reporting format should be used.

- (a) Date of transaction
- (b) Amount of sale/purchase of Indian rupees
- (c) Name of overseas bank (indicating name of branch)
- (d) Date of delivery of the rupee
- (e) Currency against which sale/purchase of rupee was made
- (f) Rate
- (g) Underlying cross rate on which the above rate was based
- (h) Name of authorised dealer (indicating name of branch) at

which the rupees will be credited/debited as the case may be.

The report should be made as at the close of the day on which the transactions are undertaken by letter or telex so as to reach the Reserve Bank by the next working day. It is to be noted that this reporting system is meant to supplement the check by authorised dealers and does not in any way obviate the necessity of authorised dealers exercising the checks envisaged in the Manual and in A.D.(G.P.Series) circular No.50 of 1979, which should continue to be made whether the rupee accounts are maintained by overseas banks with other authorised dealers or the same authorised dealer's branch or at a different branch (whether in the same centre or another centre in India) of the same authorised dealer.

10.33 In terms of paragraph 8.12 of the Manual, when the limit of Rs.20 lakhs for granting loans, overdrafts or other types of credit facilities to overseas banks is exceeded because of unforeseen negotiations under letters of credit, etc., approval of the Reserve Bank need not be sought provided the excess is adjusted within five days. This relaxation is intended for meeting the needs of overseas banks' normal exchange business and large unforeseen negotiations, and should not be used by overseas banks (including branches/Head Offices of authorised dealers) to postpone funding in anticipation of rate changes or to convert rupees into foreign currency or to transfer

funds to other authorised dealers.

10.34 Authorised dealers are not permitted to offer two-way quotes for Indian rupees in international markets, i.e., as between the authorised dealers in India on the one hand and overseas banks on the other. Authorised dealers can, however, quote a rate for either a sale or a purchase of rupees, and conclude the transaction at the agreed rate.

10.35 Detailed instructions regarding management of risks arising in rupee (Vostro) accounts are contained in Part 7 of the Guidelines for Internal Control over Foreign Exchange Business.

#### Guidelines for Inspecting Officers.

#### Foreign Exchange Dealing Operations.

10.36 The Inspecting Officer should bear in mind the instructions contained in Parts 1 and 8 of the Guidelines for Internal Control over Foreign Exchange Business and ascertain whether these have been complied with by the bank. In particular, he should verify -

(i) Whether the dealing function has been separated from the accounting, funding and other back-up functions ;

(ii) Whether the bank's system for the selection, training and rotation of its dealers is satisfactory;

(iii) Whether the infrastructure facilities provided to the Dealing Department are adequate ;

(iv) Whether, before the work starts, the dealers confer on the trend in the overnight markets as also markets still operating in the same time zone and keep the higher authorities informed of the conclusions, and there are adequate communication channels to facilitate quick consultations between the dealers and the higher authorities, as indicated in paragraph 1.5 of the Guidelines ;

(v) Deal slips in respect of transactions for amounts of £500,000 or its equivalent and above (all deal slips in the case of small banks) during the last one month should be verified to ascertain whether (a) the deals made by the dealers have been recorded on appropriate printed deal slips in duplicate ; (b) the deal slips are serially numbered and in different colours to identify sales and purchases ; (c) all required particulars are furnished therein particularly the time at which the deal was put through; and (d) the deal slips have been signed/authenticated by the dealer ;

(vi) Whether the Accounting Department prepares bank-wise summaries of all outstanding forward exchange contracts with banks for which confirmations from counterparty banks have not been received as at the last working day of each month and the outstandings are followed up expeditiously to have them confirmed by the counterparty banks ;

(vii) Whether the bank is maintaining any record showing the movement of rates in the Indian/overseas inter-bank markets ;

(viii) Whether the Accounting Department prepares the Rate Scan Report and the action thereon is taken as indicated in paragraph 1.11 of the Guidelines. A few such reports may be verified with the relative deal slips and in case aberrations are wide and/or quite frequent, the explanations given by the dealers/bank may be examined to determine whether they can be considered as acceptable;

(ix) Whether the bank has fixed limits for dealing with individual banks, both overseas banks as well as authorised dealers in India, and if so, the setting up and monitoring of the limits are in accordance with the instructions contained in paragraph 3.2.3 of the Guidelines. In those cases where the limits have been exceeded, whether the approval of appropriate higher authorities has been obtained ;

(x) Whether, while making purchases and sales of foreign currencies with overseas banks( including overseas branches of authorised dealers), the bank has observed the conditions/ restrictions contained in paragraphs 8.8 and 8.9 of the Exchange Control Manual.

Dealings through Exchange  
Brokers

10.37 The Inspecting Officer should bear in mind the instructions

contained in Part 2 of the Guidelines and ascertain whether these have been complied with by the bank. He should be on the alert in case there are indications of an excessive concentration of business with any one exchange broker, excessive swaps, exchange rates that appear out of line with those for similar transactions on the same day or other unusual terms, late receipt of exchange brokers' notes, nomination of brokers, and substitutions of names of banks. In particular, the Inspecting Officer should verify -

(i) Whether the Accounting Department ensures that

(a) all exchange brokers' notes for inter-bank deals concluded through their medium are received before the close of business on the day on which the deals were concluded or before the opening hours of the succeeding day; (b) the dates and other particulars given in the notes agree with the relative deal slips; (c) the discrepancies, if any, are brought to the notice of the dealers immediately and clarifications/rectification of errors are called for promptly and directly from the brokers by the Accounting Department and not by the dealers; and (d) in case of deals with authorised dealers at outside centres, telex confirmations are attached to the deal slips and if concluded through brokers, their notes are received expeditiously;

(ii) Whether the Accounting Department is maintaining up-to-date broker-wise daily record (separate folio for each broker) of brokerage paid/committed in the form prescribed

by the Exchange Control Department in its letter No.EC.S.95/86 (Spl.)-82/83 dated 31st July 1982, all brokerage claims are being verified from this record and the brokerage has been paid at the rates prescribed by FEDAI ;

(iii) Whether the Accounting Department is preparing a monthly statement showing a summary of brokerage payments to each broker together with a comparative statement showing payments during previous two years and the changes in the panel of brokers, if any, made during the month, and the statement is put up to the Chief of the Accounting Department as also higher authorities ;

(iv) Whether the bank is maintaining a panel of brokers approved by appropriate higher authorities and if so, the number of brokers on the panel, how often and by whom it is revised as also the procedure followed by the bank in this regard, should be indicated ;

(v) Whether there have been any complaints against the dealers and/or relating to malpractices indulged in by brokers and if so, whether the action as indicated in paragraphs 2.6 and 2.9 of the Guidelines has been taken by the bank.

### Swap Transactions

10.38 The Inspecting Officer should verify whether (a) the swap deals undertaken by the bank in international markets (cross currency deals) were for meeting genuine merchant

transactions; and (b) the full amounts of purchases and sales under the swap deals have been recorded in the transactions sheets (to be ultimately incorporated in exchange position records) or only the differences thereof have been entered in the sheets as net purchases or sales in counter-currencies. (The latter will show a lower volume of dealings compared with merchant transactions and will not also give a correct picture of purchases and sales of the bank for the purpose of weekly POS statements).

10.39 The Inspecting Officer should verify all swap deals undertaken by small banks during the last one month and in the case of larger banks, each of the deals for amounts of £ 500,000 or its equivalent and more may be scrutinised to see :

(a) Whether the base rates at which the deals were concluded and the swap differences were realistic and reflected the prevailing conditions in the inter-bank market. (These may be verified from the rate chart maintained by the bank and brokers' daily reports, if available);

(b) Whether any swap deal has been undertaken at a level rate and if so, the reasons therefor should be ascertained;

(c) Whether swap deals were done for trading in forward and/or for raising rupees;

(d) Whether any foreign currency deliveries have been set off with other authorised dealers and if so, the circumstances

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in which the set-offs become necessary should be ascertained, and it should also be verified whether the instructions as indicated in paragraph 10.21 above have been complied with. An irregular swap is illustrated below :

Bank A entered into two swap deals for US \$ 25 million each in, say, April with Bank B as under :

<u>Purchaser</u>	<u>Seller</u>	<u>Rate</u>	<u>Delivery</u>	<u>Rupce payment by</u> <u>(in lakhs of rupees)</u>	
				<u>Bank</u> <u>A</u>	<u>Bank</u> <u>B</u>
A	B	12.06	21-30 April	2072.97	
B	A	12.35	21-30 April		2024.29
B	A	12.00	24-30 June		2083.33
A	B	12.33	24-30 June	2027.57	

On due dates, foreign currency amounts were set off without any deliveries of foreign currencies and transactions were settled by making rupee payments. The effect of the above swap deals was that Bank A paid a net amount of Rs.48.68 lakhs when the first leg of the transactions was put through and received Rs.55.76 lakhs at the conclusion of the second leg, yielding a profit of Rs.7.08 lakhs for lending rupee funds to the extent of Rs.48.68 lakhs to Bank B for two months (return on an annual basis 87%). The irregularities in the above deals are :

(i) Neither the base rates at which near forwards of the transactions were concluded nor the swap differences reflected the prevailing rates in the inter-bank market. This is also obvious from the fact that for the same delivery, viz., 21-30 April, the rates were as widely divergent as \$12.06 and \$ 12.35. The rates for the other delivery were also widely divergent.

(ii) The transactions were not genuine foreign exchange transactions as no deliveries were given or taken on due dates through correspondent banks at foreign centre and the foreign currency purchases and sales were set off and net amounts were settled in rupees locally.

Dealings with overseas  
banks/branches and  
Rupee (Vostro) accounts

10.40 The Inspecting Officer should bear in mind the instructions contained in Part 7 of the Guidelines and ascertain whether these have been implemented by the bank. In particular, he should verify -

(i) Whether the arrangements for supervision and monitoring of Rupee (Vostro) accounts by the bank are satisfactory ;

(ii) Whether funds held in any Rupee (Vostro) accounts of overseas banks (including overseas branches/Head Office of the bank and correspondent banks) are abnormal or

disproportionate to meet their normal business requirements in India ;

(iii) Whether the rupee trading with overseas banks has been disproportionate to their normal trade-related and need-based funding requirements for meeting bonafide payment obligations in India and whether there was a speculative intent in putting through the transactions in as much as purchases of overseas banks were much in excess of their requirements and consequently sales back to the same or some other authorised dealer were also for large amounts ;

(iv) Whether, while quoting rates for selling or buying rupees to/from overseas banks, the bank ensures that the rates quoted are strictly in accordance with the directions contained in A.D.(G.P.Series) circular No.50 of 1979 and A.D.(G.P.Series) circular No.5 of 1983 ;

(v) Whether the bank is maintaining properly a continuing record of the rates quoted to overseas banks indicating the time at which the transaction was done, the cross rate for the foreign currency (if other than pound sterling) against pound sterling (or other currency) on which the rate was based, the bank's margin and the relative supporting evidence ;

(vi) Whether the bank has submitted daily reports to the Reserve Bank in respect of its purchases of rupees from overseas banks for Rs.5 lakhs and above and its sales of rupees to overseas banks for Rs.100 lakhs and above, as prescribed in A.D.(G.P.Series) circular No.5 of 1983, and the particulars

so reported are correct as per the bank's records.

(vii) Whether there were any instances where the bank had quoted to overseas banks cover rates without adding any cushion/loading margin in contravention of the directions contained in A.D.(G.P.Series) circular No.31 of 1980.

(viii) Whether the Rupee (Vostro) accounts of any overseas bank were overdrawn beyond the limit of Rs.20 lakhs continuously for more than 5 days and if so, the extent and period of the overdraft, the rate of interest charged thereon, if any, as also whether the matter was reported to the Reserve Bank, may be indicated - Paragraph 8.12 of the Exchange Control Manual ;

(ix) Whether the bank is following one of the three alternatives indicated in A.D.(G.P.Series) circular No.23 of 1978 read with A.D.(G.P.Series) circular No.75 of 1979, regarding drawings in rupees by overseas banks or whether any exceptions have been made;

(x) Whether the time-lag between payment of drawings at the drawee offices and debits raised at the account-maintaining office is reasonable and if not, whether the bank has taken the measures as suggested in A.D.(G.P.Series) circular No.75 of 1979 ;

(xi) Whether the adequacy of balances in Rupee(Vostro) accounts of overseas banks is established by applying the test prescribed in ECD's circular No.ECA.424/29-83 dated 5th

April 1983 ;

(xii) Whether the secrecy of inward messages is maintained by ensuring the adequacy of arrangements regarding the custody of secret documents, decoding and coding of messages, etc., as indicated in paragraph 7.5 of the Guidelines;

(xiii) Whether in case of forward purchases and sales with overseas banks involving amounts individually exceeding U.S.\$ 500,000 or its equivalent, particulars thereof have been intimated by the bank, on a daily basis, to the Reserve Bank as per paragraph 8.7(iii) of the Exchange Control Manual.

CHAPTER 11EVALUATION OF FOREIGN EXCHANGE  
PROFITS AND LOSSES

Foreign exchange transactions are entered into by banks at rates of exchange which include their profit margin. Besides, till the end of December 1983, in the case of purchase or discount of export bills, ready or forward, interest for the transit period, usance period as well as grace period, if any, was built in the rates of exchange quoted by banks. (It has been decided to delink the interest element from exchange rates. Details in this regard are given in Chapter 4). It is generally a practice with banks to pass entries in foreign currency accounts at the rates of exchange at which transactions are put through. The foreign currency balances as reflected in the bank's books (mirror accounts) are revalued as on a particular date in order to arrive at exchange profit or loss. Depending on whether the item revalued is an asset or a liability and whether the rupee value arrived at on revaluation is higher or lower than the corresponding book value, exchange profit or loss is determined. In essence, the assumption is that if the bank were to stop trading in foreign exchange on that day and close all its exchange positions at the foreign exchange rates which then prevailed, what

would be its resultant profit or loss? In other words, if it were long (overbought) in a currency, would a profit or loss be made on the sale, and vice versa?

Periodicity of revaluation and booking of exchange profit or loss

11.2 The revaluation exercise and booking of exchange profit or loss are undertaken by many banks on a half-yearly basis, i.e., in the months of June and December, while by some banks, these are carried out on a quarterly or even monthly basis.

Basis of revaluation

11.3 Banks generally determine the exchange profit or loss arising out of foreign exchange operations in respect of each currency in which a currency position is maintained. However, there is no uniformity among banks in regard to the components of the currency position to be evaluated. The different methods of evaluation are as follows:

(i) Balances in Nostro (Mirror) accounts

All banks revalue the balance in each account in a particular currency individually or the balances in different accounts in the same currency are netted and the consolidated balance is revalued. All items in transit are first adjusted to arrive at the true balance.

(ii) Net currency position

The net ready and forward positions comprising various items of assets and liabilities, such as Nostro (Mirror) accounts, foreign bills purchased or discounted, advance bills purchased, demand drafts payable, forward purchase and sale contracts, are first computed. The net position in a particular currency is composed of two segments, viz., net ready position and net forward position. Each segment is independently evaluated for the purpose of arriving at the profit or loss. The net ready position is taken care of while evaluating balances in Nostro accounts. Some banks do not evaluate the forward position at all. Among those which evaluate the forward position, while a few banks take into consideration both profit and loss arising out of evaluation of forward positions, some banks, as a prudent measure, do not take into consideration the profit but provide for the loss.

(iii) Rates of exchange applied

The practices also differ in regard to the rates of exchange applied for the purpose of evaluation of foreign currency balances in the spot and forward positions. However, there is some measure of uniformity among banks in the matter of evaluation of pound sterling because of

the ready availability of the Reserve Bank of India rates

(a) Evaluation of net ready position

Many banks value the pound sterling balance at the appropriate Reserve Bank spot rate and other currencies on the basis of London closing rates. A few banks adopt the Reserve Bank spot buying rates for US dollars, Deutsche Marks and Japanese yen because of the ready availability of these rates while a few others apply the middle of the T.T. buying and selling rates in the inter-bank market or notional rates arrived at from London middle rates for the currency. The object is to use a rate which can be readily established (such as published rates) to satisfy the auditors and other authorities, if any when necessary

(b) Evaluation of net forward position

The rates made use of by banks for the notional liquidation of the overbought or oversold forward position also differ. If the net forward position is overbought, it is notionally liquidated at the 'average rate', i.e., the rate applicable to the estimated average unexpired period of forward contracts at which the currency can be sold. Where the currency is pound sterling, appropriate Reserve Bank's forward buying rate is applied and in other cases, the forward buying rate is arrived at on the basis

of London market quotations for the respective currency crossed with the Reserve Bank's forward buying rate. If, however, the net forward position is oversold, the position is notionally liquidated at the 'average rate' adopted on the basis of London closing quotation for forward selling of the concerned currency crossed with the Reserve Bank's ready selling rate for pound sterling. Some banks adopt inter-bank rates for forward deals instead of the Reserve Bank rates while others revalue the forward position also on the basis of spot rates without making any allowance for forward margins. Many banks do not have a proper system for realistically assessing the gaps in the forward positions so as to estimate the cost of closing the mismatches while evaluating the profit or loss. This can result in a bank showing artificial profits in one year and artificial losses in the subsequent year (s) and ulterior motives, such as, evasion or postponement of tax payments cannot be ruled out.

11.5 The diversity of procedures followed by banks poses problems in the proper analysis and study of the foreign exchange operations of banks. It is also possible for unscrupulous officials in banks to project a wrong picture of the working results of the foreign exchange operations of their banks, for example, by showing profits whereas in fact they had incurred losses, by manipulating the rates, etc. Besides, there are possibilities of collusion between dealers of different banks, one of whom is valuing forward positions whereas the other is not, as a result of which the dealers may conclude suitable deals between themselves so that the profits of one bank may be shown at artificially high or low level, the real position of which may surface only later, i.e., in the subsequent accounting year.

11.6 The forward transactions may be matching transactions as it happens when a bank covers a forward contract entered into with a customer in the inter-bank market or with the Reserve Bank for the same currency, amount and delivery. The general principle here is that the profit or loss on such transactions accrues in the year in which the actual

deliveries take place, i.e., on a 'consummated' basis. The banks which undertake spot transactions and also forward transactions which are of a purely covering nature may use the method of evaluating their true Nostro balances and account for the profit or loss on forward transactions on a 'consummated' basis in the year in which actual deliveries are taken or given. However, this method cannot be valid if banks undertake forward transactions which are not of a covering nature. Banks do not cover merchant transactions on a 1:1 basis as they wish to match customer business of opposite kinds to the maximum extent possible and cover only the resultant differences. Besides, banks may undertake pure trading transactions of buying and selling foreign currencies, both spot and forward, against rupee or against another foreign currency, both in Indian inter-bank as well as abroad, within the various constraints imposed by Exchange Control, for the purpose of generating profits, immediate or prospective. It will be imprudent on the part of such banks not to evaluate the effect of the outstanding forward transactions as on the valuation date as their complete exclusion will result in the correct level of profits or losses remaining undisclosed.

11.7 A crucial question is whether only losses in forwards should be provided for and profits ignored or whether both profits and losses should be reckoned and accounted for. There are serious lacunae in the former procedure apart from the difficulties in isolating or identifying losses alone. In the case of a bank making cover operations only, where customer transactions can be readily related to the inter-bank transactions, it is no doubt true that the former procedure can be followed and it will also be prudent. This is not the case with the banks which have other operations as well. The first question is whether the profit or loss of each forward month has to be separately evaluated and profit ignored. This is irrational since the break-up of forward position into months is itself somewhat arbitrary because of forward options. Secondly, a pure trading operation in the forward might have resulted in a profit while another operation might have resulted in a loss. Evaluation of trading has to be on a net basis and hence both profits and losses must be reckoned. Besides, the provision for losses alone implies deferment of payment of taxes arising on profits or payment of less taxes. Also, separation of loss transactions from profit transactions bristles with practical difficulties if a large number

of forward transactions, whether of a covering nature or a trading nature, are made by a bank and a variety of currencies and positions are involved.

11.8 Banks in the U.K., U.S.A. and the Continent have adopted a method of computation whereby the exchange profit or loss on the Nostro balances based on market rates and on forward operations on a month-to-month basis, is arrived at. In this method, the spot positions (Nostro balances) are valued separately and forward positions are valued on a month-to-month basis arriving at eventually the total profit or loss. In the U.K., banks still do not take into account profit on forward operations until the exchange contracts mature whereas in the Continent and the U.S.A., both profit and loss on forward operations are taken into account.

Guidelines for Internal Control  
over Foreign Exchange Business  
issued by the Reserve Bank

11.9 It is desirable that banks having sizeable forward business or sizeable inter-bank trading evaluate the forward contracts also, whether in inter-bank or in customer business, outstanding as on the valuation date. A conservative method is to ignore the profits, if any, on the forwards and provide

for the losses, if any. While evaluating Nostro balances, the opposite rates for closing out the balances notionally, i.e., the Reserve Bank spot rate for pound sterling and the rates for other currencies arrived at by coupling the day's closing cross rates in London market with the corresponding spot rate of the Reserve Bank for pound sterling, may be used. If there is an established closing rate for a currency in the Indian inter-bank market, banks may use it as an alternative method of evaluation. For evaluating the effect of outstanding forward contracts, the corresponding forward rates or spot rates coupled with swap rates arrived at in a similar manner may be used. Whatever be the method of evaluation followed, it is necessary to adopt a uniform method from period to period and from year to year so that the profits or losses revealed are realistic and assessments can be comparable and meaningful.

Workshop on Revaluation of Foreign  
Currency Position and Booking of  
Exchange Profits/Losses held in  
Bankers Training College - January  
5 to 7, 1984

11.9 Some of the conclusions reached at the captioned Workshop are given in the annexure to this Chapter.

#### Guidelines for Inspecting Officers

11.10 The Inspecting Officer should verify whether the bank is taking into account foreign currency bills purchased or discounted (Export suspense), import bills under

letters of credit (Import suspense), foreign currency notes in hand and foreign currency drafts payable, and making adjustments for items in transit while evaluating exchange positions or it is reckoning only the balances in Nostro (mirror) accounts for the purpose of adjustment of profit or loss. It should also be verified whether the forward purchase and sale contracts outstanding as on the date of evaluation are taken into consideration. The procedure followed in this regard should be examined and any special features, particularly the rates used for the purpose of liquidating monthwise positions and the departures, if any, made from the procedure followed during the previous evaluation period, should be commented upon. It should be ascertained whether the work regarding evaluation of foreign exchange profit or loss is handled by persons other than dealers and the results of the evaluation reported to the top management. A statement showing the profit or loss on the bank's foreign exchange business during the last three calendar years may be furnished.

#### Recommendation

11.11. The Group recommends that a uniform procedure for the evaluation of foreign exchange profits and losses may be evolved by FEDAI with the approval of the Reserve Bank.

Annexure to Chapter 11

Some of the conclusions reached at the Workshop on Revaluation of Foreign Currency Position and Booking of Exchange Profits/Losses held in Bankers Training College - January 5 to 7, 1984

Valuation Base

1. Each foreign currency position should be revalued separately.
2. All components of currency (exchange) position, viz.,
  - i) Mirror Account,
  - ii) Foreign Currency Notes held,
  - iii) Import Suspense Account,
  - iv) Value to-morrow and value spot positions,
  - v) Forward position including Export Bills (both sight and usance), and
  - vi) Pipeline transactions\*

should be revalued.

\* Transactions which are reported to the position desk but are not adjusted in the accounts.

Mirror Account

3. The balance outstanding in each of the Mirror Accounts should be revalued independently. Where an assessment of individual account is not required, the balances in various accounts in the same currency could be netted out for the purpose of valuation.

Import Suspense Account

4. Import Suspense Account should be treated as a separate foreign currency asset account for valuation purpose and revalued on spot basis; exchange profit/loss arising out of valuation of the Import Suspense Account should be booked through an Exchange Adjustment Account.

Export Bills Purchased/Discounted

5. Balance outstanding in Export Bills Purchased and Export Bills Discounted Accounts should be grouped under appropriate monthwise time band according to expected dates of realisation of proceeds and considered maturity-wise along with the forward commitments of the bank for the purpose of valuation.

Overdue Export Bills

6. In view of the recent guidelines issued by the Foreign Exchange Dealers' Association of India, effective from January 1, 1984, no export bill will remain overdue from the exchange position angle.

Forwards

7. Forward contracts due for execution during the next two working days from the date of valuation should be segregated and grouped under spot for the purpose of valuation.

8. Forward maturities should include outstanding export bills purchased and discounted as well as forward purchase/sale contracts, merchants and inter-bank, including those concluded with the Reserve Bank of India.

9. Forward purchase/sale contracts and export bills purchased and discounted should be grouped monthwise and netted out monthwise. Such netted monthly gaps should be evaluated at the appropriate forward rates.

10. Option forward contracts should be grouped at the beginning or at the end of the option period, whichever is most disadvantageous from the bank's point of view taking into consideration the premium or discount on the currency and whether the transaction is a purchase or sale.

#### Recognition of Exchange Profits/Losses in the Books.

11. Exchange profit/loss in respect of balance sheet items should be brought into books by updating the rupee equivalent of the individual accounts on the valuation date and reversed on the opening day of the subsequent accounting period through an Exchange Adjustment Account **excepting** the Mirror Account.

12. Book value of the bills portfolio should not be altered as the netted forward position is evaluated at the appropriate forward rates.

13. Both exchange profits and losses arising out of valuation of forwards should be brought into the books, as on valuation date.

#### Periodicity of Valuation

14. Exchange profit/loss arising out of revaluation should be brought into the books at least half-yearly; monitoring could be done monthly.

#### Valuation Date

15. Valuation date should be the last working day of each month.

16. The year-end valuation date should, as far as possible, synchronise with the balance sheet date.

#### Valuation Rate

17. The net forward maturities should be valued at the forward rates and the other components (accounts) of the exchange position, be valued at spot rates.

18. Where unmatured forward contracts include contracts in one foreign currency against another foreign currency (cross-currency deals), such contracts in the respective foreign currency should be valued separately.

(cross-currency deals), such contracts in the respective foreign currency should be valued separately.

19. As regards the rate to be applied for valuation purposes there were two views. One view was to apply the rates obtained in the Indian inter-bank market for valuing spot as well as forward position for pounds sterling and U.S. dollars. Where such rates are not available, the rates against rupees can be arrived at by crossing with the overseas cross-rates against U.S. dollars prevailing as at the close of business in India on the valuation date, i.e., say, 5.00 p.m., to fall in line with international market practice. The rates can be ascertained from approved brokers. The second view was to apply the Reserve Bank rates for pounds sterling crossed with cross-rates quoted in an international market against U.S. dollars, closing after us. The rates should not be ascertained from the brokers.

20. As in the case of item 19, there were two views in regard to the applicable forward rates. One view was that if inter-bank rates are applied, the discount/premium quoted in that market is to be taken into account. The second view was that if the Reserve Bank rates are applied, appropriate discount of the Reserve Bank should be applied, for valuation of long or overbought position whereas for valuation of short or oversold position, spot rate should be applied.

21. While arriving at the appropriate forward rates, the least beneficial rates on both sides has to be applied.

22. While valuing foreign currency notes, costs such as transportation, insurance, etc., should be provided for and it is desirable to apply one month forward rate to arrive at a reasonable value of this asset.

CHAPTER 12RETURNS AND STATEMENTS SUBMITTED TO EXCHANGE CONTROL DEPARTMENT BY AUTHORISED DEALERS

Returns and statements prescribed in the Exchange Control Manual are the principal source for compilation of the balance of payments data of the country. These are simultaneously used as an important channel for exercising strict supervision over the operations of authorised dealers and to ensure that the powers delegated to them are properly exercised. Unless specifically indicated otherwise, all returns and/or statements are required to be submitted to the office of the Reserve Bank, under whose jurisdiction the concerned office/branch of authorised dealer is situated. If <sup>in</sup> any period, there are no transactions to report a 'Nil' return and/or statement has to be submitted within the prescribed period. In view of the importance attached to the returns and statements, authorised dealers are expected to maintain a proper internal organisation both in their controlling offices and operating branches so that they are prepared in a systematic manner accurately and submitted to the Reserve Bank within the prescribed time schedule.

12.2 The Exchange Control provisions relating to R>Returns and Statements are contained in Chapter 31 of the Exchange Control Manual. "Hand Book on compilation of R>Returns" has been brought out to serve as a guide to all members of staff engaged in compilation of R>Returns in the offices of authorised dealers. The Inspecting Officers should familiarise themselves with the provisions of the Exchange Control Manual and the Hand Book on compilation of R>Returns.

## R-Returns

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12.3 All foreign currency transactions made by an authorised dealer and all transactions passed through the rupee accounts of non-resident banks are required to be reported to the Reserve Bank on appropriate R-Returns thrice a month at the close of business as on the 10th, 20th and the last day of the month. If the 10th, 20th or the last day of the month is a holiday, the return should be submitted as at the close of business on the preceding working day, so as to reach the Reserve Bank within five days from the close of reporting period to which they relate. The transactions are required to be reported in R-Returns (appropriate to the currency concerned) as under:-

<u>Return</u>	<u>Description</u>
R1	Return of transactions in Pounds Sterling
R2	Return of transactions in U.S. Dollars
R3	Return of transactions in Deutsche Marks
R4	Return of transactions in Japanese Yen
R5	Return of operations on rupee accounts of non-resident banks
R6	Return of transactions in foreign currencies other than Pounds Sterling U.S.Dollars, Deutsche Marks and Japanese Yen.

### Note:

Asian Clearing Union(ACU) transactions undertaken in the participating countries' currencies by authorised dealers are reported in R6 Return; ACU transactions in rupee are reported in R5 Returns.

Guidelines for Inspecting Officers

12.4 While undertaking the scrutiny of R>Returns of authorised dealers, the Inspecting Officers should, prima facie, satisfy about the following:-

- (i) That all the concerned branches of the bank have been submitting R>Returns to Exchange Control Department Offices within the prescribed period.
- (ii) That the branches are adequately staffed with experienced personnel to compile R>Returns.
- (iii) That the system adopted by the Head Office to watch prompt submission of R>Returns by branches to Exchange Control Department Offices is satisfactory.
- (iv) That the R>Returns are seen and signed invariably by the officials holding charge of the branches.
- (v) That the Head Office ensures, through appropriate reporting system, that all the transactions handled by the branches during the ten-day period are reported by them in the R>Returns pertaining to that period.
- (vi) That the classification of transactions into 'Ready' and 'Forward' by authorised dealer for reporting in R>Returns, is correct.
- (vii) That reconciliation of the balances in foreign currency accounts as appearing in the local books with the balances advised by the overseas banks is attempted regularly.
- (viii) That certificates of balances in respect of rupee accounts of overseas banks are sent periodically and confirmation obtained.

12.5 The Inspecting Officer should pick up F>Returns submitted to Exchange Control Department, on a random basis, and scrutinise the sale/purchase transactions reported therein with reference to the relevant books and registers maintained by the authorised dealer to ensure:-

(i) Whether all sale transactions undertaken during the ten-day period have been reported in the F-return.

(ii) Whether remittance forms A1 and A2 are duly completed in respect of all sale transactions.

(iii) Whether the sale transactions are either clearly covered under the powers delegated to authorised dealers or covered by specific approval of Exchange Control Department

(iv) Whether the branches in Category 'A' (i.e. branches maintaining independent foreign currency accounts in their names) ensure, periodically, that the aggregate sales and purchases of branches in Category 'B' (i.e. branches not maintaining independent foreign currency accounts but having powers of operating on the accounts maintained by Head Office/ Principal Office or any other link office) reported in their F>Returns tally with the sales and purchases actually reported to Exchange Control Department in the R>Returns submitted directly by branches in Category 'B'.

(v) Whether all purchases made during the ten-day period have been properly classified and correctly reported in the F>Returns.

(vi) Whether purchases from public are properly classified under purchases against exports and purchases other than against exports.

(vii) That in case of purchases from public for purposes other than exports individually for the equivalent of Rs.10,000/- and above, a supplementary statement showing details of such purchases is attached in the format given in the F-Return.

(viii) That all forward sales and forward purchases undertaken by the authorised dealer during the ten-day period have been reported in the F>Returns.

(ix) Whether the figures of cash balance and exchange position reported in the F-Return correctly reflect the balance and position as per the books maintained by the authorised dealer.

(x) Whether all the supporting documents (e.g. remittance forms A1 and A2, duplicates/triplicates of GF/EP/PP forms, fully utilised Exchange Control copies of import licences, fully utilised F.BI exchange permits, Exchange Control copies of Customs Bills of Entry) are invariably submitted alongwith the F>Returns.

### Statements

12.6 Particulars of various statements required to be submitted by authorised dealers to Exchange Control Department Offices are given in Chapter 31 of the Exchange Control Manual. For ready reference, a chart : showing the details of the statements is given in the Annexure to this chapter.

### Guidelines for Inspecting Officers

12.7 The Inspecting Officers should satisfy themselves about the following:-

(i) Whether the staff attending to the work relating to compilation of statements have full knowledge of the regulations to compile the figures correctly.

(ii) Whether Head Office/Controlling Office ensures submission of various statements by the branch to the Reserve Bank in time; whether any calendar of statements is maintained by the former to monitor timely submission of statements.

(iii) Whether any reminders have been received by the branch, regarding delay in submission of statements, from the Reserve Bank in the past; if so, what measures have been initiated to avoid such delays in future.

12.8 One or two statements may be selected, at random, from each category and the figures reported therein may be checked with reference to the relative books and registers to ensure that all the figures reported in the statements correctly reflect the position as per books and registers.

ANNEXURE TO CHAPTER 12

Particulars of various statements required to be  
submitted by Authorised Dealers to Exchange  
Control Department

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<u>Sr. No.</u> <u>(1)</u>	<u>Nature of statement</u> <u>(2)</u>	<u>Periodicity</u> <u>(3)</u>	<u>To whom submitted</u> <u>(4)</u>
1.	<u>POS</u> Statements of Positions	Weekly	Central Office
2.	<u>BAL</u> Statement of foreign currencies held abroad by authorised dealers and balances held in non-resident rupee accounts of overseas branches and correspondents.	Monthly	ECD Offices
3.	<u>STAT-1</u> Statement of balances held in non-resident rupee accounts of banks in Bilateral Group.	Monthly	ECD Offices
4.	<u>STAT-2</u> Statement of Non-Resident Government Accounts.	Monthly	ECD Offices
5.	<u>STAT-3</u> Statement of Ordinary Non-resident Accounts	Monthly	ECD Offices
6.	<u>STAT-4</u> Statement of Non-resident (External) Accounts.	Monthly	FCD Offices
7.	<u>STAT-5</u> Statement of deposits under the Foreign Currency (Non-resident) Accounts Scheme.	Monthly	ECD Offices (Link Offices of authorised dealers are required to forward this statement to RBI after scrutiny)
8.	<u>STAT-6</u> Statement of operations on Foreign Currency (Non-resident) Accounts	Monthly	ECD Offices

<u>(1)</u>	<u>(2)</u>	<u>(3)</u>	<u>(4)</u>
9.	<u>STAT-7</u> Statement of Blocked Accounts	Monthly	ECD Offices
	<u>Note:</u> STAT-8 relating to NDES Accounts discontinued.		
10.	<u>STAT-9</u> Statement of Export Letters of Credit advised.	Monthly	ECD Offices
11	Statement of bidbonds, tender guarantees, performance, etc, guarantees issued on behalf of Indian exporters in favour of overseas buyers.	Monthly	ECD Offices
12.	Guarantees for Non-resident Firms/Companies	Monthly	ECD Offices
13.	Statement of operations on Diplomatic Bond Store Accounts	Monthly	ECD Offices
14.	<u>STAT-10</u> Statement showing purchases of exchange in the form of travellers cheques, currency notes and coins and drawings under inward travellers letters of credit.	Quarterly	ECD Offices
15.	<u>XOS Statement</u> Statement of export bills outstanding beyond the prescribed period of realisation.	Quarterly	ECD Offices
16.	Statement showing details of certificates regarding export of gift parcels issued.	Quarterly	ECD Offices
17.	<u>(a) STAT-11</u> Statement of remittances made under Deferred Credit Arrangements for imports.	} Half-yearly	ECD Offices
	<u>(b) STAT-12</u> Proforma of Schedule of Principal Payments and Interest Payments under Deferred Credit Arrangements for imports		
18.	<u>FXT</u> Statement showing the details of turnover of foreign exchange business done on all India basis by authorised dealers.	Annual	Central Office

SYSTEMS OF CONTROL IN HEAD OFFICES  
OF INDIAN BANKS OVER THE WORKING  
OF THEIR FOREIGN BRANCHES.

One of the terms of reference of the Group is to examine the control systems in the Head Offices of Indian banks over the working of their foreign branches including general supervision, control over foreign exchange transactions, guarantee and other contingent liabilities, fixing of limits for various currencies, country-wise risk exposure, control over the advances portfolio of the foreign branches, etc., and suggest modifications, if any, necessary in such control systems. The group feels that this term of reference is too wide for it to examine in depth unless the Group visits the Head Offices of Indian banks, which have branches outside India, and studies in detail the systems of supervision and control exercised by them in regard to the items covered by the term of reference, in order to be able to find out the deficiencies, if any, and suggest necessary modifications. Such a job would be very time-consuming as it involves a detailed study of the various control systems including examination of the coverage and periodicity of internal audits/ inspections as also of the returns and statements called for by the Head Offices of banks from their overseas branches. However, as indicated in Chapter 1, with a

view to knowing the existing control systems a questionnaire, vide Appendix V, was addressed to nine Indian banks having branches outside India and the issue has been examined in the light of replies received from eight banks which have been summarised in Appendix VII. It will be observed therefrom that the banks have established certain control systems to oversee and supervise the working of their foreign branches. Broadly, the supervision and control is exercised by the banks' Head Offices through periodical returns and progress reports submitted by overseas branches, audit/inspection by internal auditors/inspectors, annual performance budgeting, periodical review of performance and visits by senior executives from Head Offices. The foreign branches are inspected/audited by internal inspectors/auditors generally once in three years. Most of the banks have, however, not laid down written policies/guidelines for assessing country risks and with regard to their borrowings in Euro-currency markets, participation in Euro-currency loans/bonds, operating budgets and goals, funds management and maintenance and evaluation of foreign currency positions.

13.2. The Group considered the question whether the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank (Exchange Control

Department) in July 1981 may be implemented, to the extent appropriate, by the foreign branches of Indian banks. The Group feels that as the Guidelines are based on well-established controls adopted by international banks, the Indian banks should treat the Guidelines as a model or base for devising their own internal control guidelines in respect of foreign branches, subject to local regulations and conditions. The Guidelines, inter alia, require banks to fix daylight, overnight, inter-bank and customer limits as also individual and aggregate gap limits. The Group is of the view that in so far as the overseas branches are concerned, it may be left to the management of individual banks to fix the limits after taking into consideration the local regulations and conditions as well as other relevant factors. In other words, the banks need not be asked to furnish to the Reserve Bank details regarding the limits laid down by them for their overseas branches because in case they are not advised about the appropriateness or otherwise of the limits, the banks may take it that the limits have been approved by the Reserve Bank. In any case, considering the volatile nature of overseas foreign exchange markets, it may be difficult for the Reserve Bank to continuously monitor the limits and it would, therefore, be desirable that the managements of

banks are made responsible therefor. The Inspecting Officers of the Reserve Bank need only verify whether the appropriate authorities in the banks have prescribed the limits and the business undertaken by the overseas branches is within the limits. These observations have already been conveyed by the Group to the Department of Banking Operations and Development and the Group is happy to note that DBOD has issued a circular on these lines to Indian banks having overseas offices - DBCD.No.IBD.382/C.469(91)-82 dated the 12th November 1982.

13.3. In August 1982, the Reserve Bank (DBOD) reviewed the Policy of Indian banks in regard to personnel placement at foreign branches and their systems of control and supervision of the affairs of overseas branches and with a view to streamlining and strengthening the administration of the overseas operations has urged the banks to implement certain guidelines in this regard as early as possible - DBCD.No.BL.7242/C.212-82 dated the 16th August 1982. At the instance of the Group that in addition to these guidelines, the banks should take action to strengthen their lines of communication with the overseas branches by establishing an effective Management Information System and through occasional visits by senior executives from Head Offices, that the discussions to be held by the

visiting executives should be based on pre-planned agenda and important issues emanating from such visits must be recorded and reported to higher management, that banks should reinforce the machinery in the International Divisions for the appraisal of credit proposals and scrutiny of control returns as well as for taking necessary follow-up action thereon, that they should formulate written guidelines/checklists for internal inspection/audit of foreign branches, lay down written policies/guidelines in regard to assets and liabilities management, including maturity mismatchings, and devise a mechanism to monitor country exposures, and that it would be helpful to the foreign branches if the banks' Head Offices issue policy guidelines indicating the overall objectives they would expect the branches to achieve during a certain period, the Department of Banking Operations & Development has advised the concerned banks to take necessary steps to implement these measures, as per circular DBCD.No.1BS.260/C.212-83 dated the 2nd March 1983.

13.4 The Group also considered the question whether there could be a Local Board for the overseas branches of Indian banks - one Local Board for the branches of each Indian bank if the number is significant or one common Local Board for the branches of all the Indian banks

taken together in a particular country. The Group is of the view that local advisory boards may be established wherever it is compulsory under the local regulations or justified by the operations of a branch or branches of an Indian bank in a particular country and not elsewhere. It is not desirable to constitute one common local board for the branches of all the Indian banks taken together in a particular country because it would lead to disclosure of affairs of customers of one bank to another. The Group understands that the Reserve Bank has agreed, in principle, to the proposal of the Central Bank of Kenya that local advisory committees may be set up by the Indian banks in Kenya, but the then Governor had observed that the Reserve Bank should see to it that this principle is adopted generally and not just with reference to the Indian banks. The Group feels that generally there is a danger that local members of the advisory boards may influence the independent commercial judgement of the Indian Managers and this factor should also be kept in view while considering the question of setting up of local advisory boards by the Indian banks at foreign centres.

INSPECTION OF FOREIGN  
BRANCHES OF INDIAN BANKS

The policy in regard to expansion of Indian banks abroad was explained briefly in the Reserve Bank of India Annual Report 1980-81 (Paragraph 105). "The expansion of Indian banks overseas is guided principally by economic considerations such as the furtherance of India's trade, assistance to Indian entrepreneurs in the setting up of joint ventures abroad and the earning of foreign exchange. Priority is given to the opening of branches in countries where good potential is seen for closer economic ties with India." In his speech delivered at the Seminar on International Banking organised by the Indian Bank in January 1982, Dr. I.G. Patel observed "And I would suggest that for our bankers the first responsibility is to develop better understanding of the changing nature of the international capital market so that in turn they can be good advisers to the Indian Government, to Indian investors, to Indian borrowers about what is going on. It is this primary function of understanding which is more important than the retail business which you may do in some centres and earn some money .....

Therefore, when our banks compete with each other in wanting to have a presence abroad, it is not in order to make some retail chips to make the profit and loss account look better - that is important perhaps - but the much more important consideration should be how

do we facilitate the task of a country, which in the nature of it cannot be a very large part of the world capital market but whose stake in the world capital market will be much greater than its presence in the world capital market. And since our stake in the world capital market is much greater than our presence can be, our presence must be used as an antenna through which we get the right information at the right time and sometimes to develop the antenna also which means to develop the right **contacts** and do the right things."

14.2. The overseas branch expansion by Indian banks makes demands on the foreign exchange resources of the country since under the banking laws of several countries, foreign banks are required to bring in by way of working funds or otherwise, specified minimum quantum of foreign exchange resources for their business in the host country. The draft on the scarce foreign exchange resources will be justified only when the bank puts the funds to profitable use in overseas business so as to generate surplus over a period of years and it is repatriated. The overseas branches of Indian banks should not take up non-viable proposals or undertake transactions much beyond their resources and needed expertise since in the ultimate analysis, any losses suffered by them will have to be made good by remittances from India.

14.3. The Reserve Bank had no statutory powers, until 1959, to carry out the inspection of overseas branches

of Indian banks. The Banking Regulation Act, 1949 was amended in 1959 empowering the Reserve Bank to inspect at any time the branches of Indian banks operating in foreign countries. In terms of these provisions, the Reserve Bank can inspect not only any branch of an Indian bank situated outside India but also any subsidiary formed by an Indian bank for the purpose of carrying on the business of banking exclusively outside India. Even after the assumption of powers to inspect, such inspections used to be taken up on an ad-hoc basis, there being no fixed periodicity. It was, however, decided in July 1980 that all the overseas branches of Indian banks should be inspected once in five years. In the light of certain adverse developments in Kenya, it was felt that, in order to ensure the healthy and proper functioning of overseas branches of Indian banks, it was necessary that the control and supervision over these branches should be adequately strengthened. It was accordingly decided that inspections of all overseas branches of Indian banks should be carried out by the Reserve Bank at least once in two years. Between July 1980 and December 1983, inspections of 38 branches were carried out or taken up.

14.4. There are at present 141 branches of Indian banks (including eight off-shore banking units but excluding representative offices) operating in foreign countries.

Unlike in the case of branches of banks in India, there is no element of surprise in the case of inspection

of branches in foreign countries. A special set of inspection forms is sent to the bank's Head Office for being filled in by each branch to be inspected. In terms of the instructions in the Inspection Manual, on completion of the inspection, the Inspecting Officer has to prepare a separate inspection report for each bank in respect of all its branches in the country visited. A copy of the report, after it is approved, is forwarded to the Head Office of the bank with a request to advise the Reserve Bank of the steps taken or proposed to be taken to rectify the irregularities. Apart from the usual instructions laid down for the inspection of Indian branches, the Inspecting Officer has to bear the following aspects in mind :-

(i) The practices obtaining in other banks in the foreign country should be the main guiding factors in deciding policies and procedures for granting advances by the branches of Indian banks;

(ii) The Inspecting Officer should be extra careful so as not to create any situation which might directly or indirectly cause any apprehension in the minds of the Indian or foreign clientele abroad;

(iii) How the working of the foreign branches could be improved so as to secure higher foreign exchange earning for India ;

(iv) The extent of import/export trade of the foreign country as also third country trade, if any, financed by the Indian banks, the relations between these banks and the respective foreign Government and, in particular, the Central Banking Institution;

(v) The political climate, various laws relating to banking, immigration, trade, etc., which are in force or are anticipated and whether thereby the future prospects of Indian banks are likely to be adversely affected or endangered;

(vi) Whether there have been attempts to violate/circumvent the Exchange Control regulations of India and/or foreign country concerned. The modus operandi of frauds, if any, committed by members of the staff and/or constituents which might have already been investigated by the concerned bank or come to light during the course of inspection should be studied and measures suggested to plug the loopholes in the procedures so as to prevent recurrence of similar frauds or at least to minimise them to the extent possible;

(vii) The Inspecting Officer should see whether the discretionary powers delegated to the Officers-in-Charge of foreign branches are adequate in relation to the business they have to do and also whether the powers vested in them are judiciously exercised.

14.5. The primary objective of inspection of the foreign branches is to find out whether they are working on sound lines and on a profitable basis and whether the pace of development of their business is satisfactory. In addition to the usual scrutiny of assets, liabilities and the internal control systems, the Inspecting Officer is required to pay special attention to certain developmental and other aspects in respect of branch management, staffing pattern, Head Office supervision and control, resource mobilisation, advances, non-deposit and non-credit services, working results and promotion of exports from India and inflow of foreign capital in India, elaborated in Supplement 'C' to the Inspection Manual.

14.6. Besides the periodical internal inspections that may be carried out by the bank itself, it is necessary that the Reserve Bank also inspects the overseas branches, apart from monitoring their working through a reporting system, to gain a first-hand knowledge of the manner in which they are functioning and to ensure that their operations are sound and profitable and also effectively subserve the objectives for which they were opened. In fact, having regard to the types and scale of operations of a foreign branch, any shortcomings, if not corrected in time, may have a larger impact on the profitability of the bank, as compared to a domestic branch, and also result in an outflow of foreign exchange and, moreover,

tarnish the image of the Indian banking system. The losses likely to be suffered by some of the Indian banks in regard to their overseas operations in the U.K., Bahrain, Hongkong and Singapore would underline the need for such inspections for an assessment of their risk exposure. It may not be out of place to mention here that while supervisory authorities in each foreign country have evolved their own systems of supervision over the operations of banks functioning in the country, including the domestic and foreign banks, they are essentially concerned with the soundness of the operations consistent with the local regulations, whether formal or informal, relating to capital and liquidity adequacy, permissible business activities, foreign currency exposure, loan concentrations and quality of loans. On the other hand, the Reserve Bank as the supervisory authority of the parent country, is more concerned with an assessment of the risk exposure and the likely impact of the working of the foreign branches on the overall position of the bank. In fact, the effectiveness of the supervision exercised by the monetary authority of the parent country is increasingly being recognised as a criterion for international presence. The guidelines approved by the Central Bank Governors of the Group of Ten in December 1975, known as the 'Basle Concordat', have recognised that while the supervision of liquidity should be the primary responsibility of the host authorities, the supervision of

solvency is essentially a matter for the parent authority in the case of foreign banks. The guidelines visualise that practical co-operation should be promoted, inter alia, by the authorisation of bank inspections by or on behalf of the parent authorities on the territory of the host authority. Such inspections are allowed in the United Kingdom, U.S.A., Belgium, Hongkong, Japan, Sri Lanka and South Korea, while a few countries like France and Singapore do not permit inspections by parent authorities. Although it was decided in 1982 that the foreign branches of Indian banks should be inspected once in two years, the inspection system is yet to stabilise itself. The Working Group is, therefore, of the view that the inspections should be carried out on an ongoing and regular basis and each branch should be inspected at least once in three years. Some of the banks have more than one branch in a country and it is gathered that the inspection teams which have recently taken up inspections in foreign countries have covered only some of the branches of a bank excluding its other branches and even its main branch in that country. In order to have an overall picture regarding the operations of a bank in a country, it is desirable that all the branches including its main branch are inspected with reference to the same date.

14.7. As regards the coverage of inspections, the Group is of the view that the guidelines given in

Supplement 'C' to the Inspection Manual are relevant and may continue to be followed. There are, however, certain aspects like Head Office supervision and control which require elaboration. Besides, a special feature of international banking business is the unusual dependence on money market funds and an essential aspect to be seen during inspection is how effective is the assets and liabilities management by the bank to avoid any undue liquidity and interest rate risks and mis-matching of assets with liabilities. Certain international developments which have brought into bold relief the risks involved in unduly large exposure to certain countries by the overseas branches of Indian banks, have also underlined the need for a country risk analysis. The additional aspects to be seen during the inspection are explained in detail in the next chapter.

CHAPTER 15

WORKING OF OVERSEAS BRANCHES OF  
INDIAN BANKS - SPECIAL ASPECTS

Range of Operations  
of Various Types of  
Foreign Offices

Full Service Branches

These are regular branch units of banks offering comprehensive banking services, their operations being restricted, if at all, only by local regulations. Services normally rendered by these branches are :-

- (i) Agency functions for India business including confirmation and advising of letters of credit, collection of bills, issue and encashment of remittances, issue of guarantees, purchase and sale of exchange, borrowing and placement of funds.
- (ii) Acceptance of domestic deposits.
- (iii) Lending to domestic borrowers.
- (iv) Issue and confirmation of letters of credit.
- (v) Issue and confirmation of guarantees.
- (vi) Remittances business.
- (vii) Purchase/negotiation of bills of exchange, both inland and foreign.
- (viii) Functioning as correspondent for other banks including Indian banks.

15.2 Foreign branches are not obliged, except by compulsion

of local regulations, to engage in developmental banking activities such as lending to small scale industries, export finance and financing retail business unless such business is acceptable on strictly business considerations including safety, liquidity, profitability and control. American banks have generally been following the policy of avoiding retail banking in their overseas operations in order to maximise profits; retail business is high cost operation particularly at overseas centres where services are highly priced. But Indian banks cannot obviously approach this problem from the angle of American banks as two elements of overseas operations of Indian banks, viz., agency functions for India business and servicing of the banking business for expatriates, are inextricably involved with retail banking. Besides, retail banking has its own merits; it is more profitable in the lower brackets of funds deployment and this factor is relevant for Indian banks; it is more of a short-term and self-liquidating nature; and it provides a wider risk exposure.

#### Representative Offices

15.3 These are not operational offices. They are set up at centres where a full service branch cannot be established due to restrictive local regulations, or a sufficient business base at the centre itself (as distinct from the dispersal of business contacts over a large region comprising a few countries), is not available, or the bank is desirous of establishing a

foothold on an experimental basis before venturing into full scale operations. The normal set up is one Representative assisted by a secretary and an office-boy. The Representative generally has a wide area comprising a number of countries under his jurisdiction. The required mobility would be available for the functional role assigned to him as no operational responsibilities are vested in him. Broadly speaking, the functions of a representative office are as follows :-

(i) Study and report on the foreign trade opportunities for India, particularly with respect to exports, in the region covered by the representative office.

(ii) Provide, on an on-going basis, commercial information with regard to tenders and other export orders arising in the area for being fed back to the bank's customers in India.

(iii) Provide information on Indian capabilities for supply of goods and services to interested parties in the countries covered by the representative office.

(iv) To look out for investment opportunities for deploying the surplus resources of the bank's foreign offices.

(v) To look out for investible resources available in the area served by the office for investment in India or for placement with the bank's customers in India as loans or with the bank's foreign offices.

(vi) Make correspondent calls and service correspondent

relations in the area covered by the representative office.

(vii) Provide credit information on parties in India and in the area served by the office, required in connection with business transactions.

(viii) Resolve serious business problems arising between the bank's Indian and foreign offices and correspondents/customers in the area served by the representative office.

(ix) Assist expatriate Indians in their banking problems.

#### Offshore Branches

15.4 Offshore banking refers to banking that generally covers only non-residents and does not mix into the main stream of domestic banking. Offshore banking centres have developed either in tax-havens, e.g., Bahamas, Cayman Islands, New Hebrides; Luxembourg, Channel Islands, Isle of Man and Bermuda, or in areas which are consciously developed as international money markets through tax concessions and other incentives provided by the local monetary and government authorities, e.g., Switzerland, Bahrain, Singapore and Manila; the basic precondition for the latter category of offshore markets is that international money and investment activity at these centres is sufficient to induce foreign banks to go to such centres. Offshore banking operations generally involve generation of tax-free profits or profits subject to concessional tax rates. In the second category of offshore markets, the local monetary

authorities take all the necessary care and regulate the offshore operations in order that the operations of the offshore banking units do not cause upheavals or distortions in the internal monetary system. Subject to this precondition, regulated business with local residents is also occasionally permitted, e.g., Singapore and Manila. Generally, lending to residents subject to approval by the monetary authority is permitted and occasionally residents are also permitted to deposit moneys with the offshore banking units. The essential characteristic of an offshore branch of an international bank is its capacity to participate effectively in the international money and exchange markets both as borrower and lender. To have this capacity, the bank concerned should have a sufficiently high international stature and size. This is the reason why licensing conditions are rather strict. In tax-havens (the first category mentioned above), of course, there is no regulation of any kind. In fact, this category of offshore banking is known as "brassplate" presence with an office registered only for the sake of form in the tax-haven, transactions being booked in the books of one of the operating branches elsewhere. The token presence is looked after by local corporations which generally extend such services for a small fee. The business operations of an offshore branch would fall within the undernoted range and conditions, from centre to centre depending on the local regulations :

(i) Acceptance of deposits from non-residents in currencies other than the local currency.

(ii) Acceptance of deposits from non-residents in the local currency.

(iii) Lending of foreign currency funds to non-residents.

(iv) Lending of foreign currency funds to residents.

(v) Issuance and confirmation of letters of credit and guarantees on behalf of non-resident customers.

(vi) Issuance and confirmation of letters of credit and guarantees on behalf of residents.

(vii) Borrowing and placing of foreign currency funds in the local inter-bank market for such funds.

(viii) Borrowing and lending of funds in other international money markets.

(ix) Purchase and sale of foreign currencies either against the local currency or against the other foreign currencies for non-residents (for residents also if permitted by the local regulations).

(x) Purchase/negotiation of export/import bills.

(xi) Operating in the local and other international exchange markets for purchase and sale of foreign currencies.

15.5 From the Indian banks' point of view, an offshore branch provides facilities for the undernoted objectives :

- (i) Raising of international funds for financing India's exports, Indian joint ventures abroad, India sponsored projects abroad and high value imports by India (purchase of ships, aircraft, petroleum, etc.)
- (ii) Access to international exchange markets.
- (iii) Provision of performance and other financial guarantees and opening of letters of credit in connection with Indian joint ventures and India sponsored projects abroad.
- (iv) Opportunity for placing of surplus investible funds in areas with attractive yields.
- (v) Operations with high profitability due to tax exemption or tax concession.

#### Head Office Supervision and Control

15.6 As overseas branches are far away from Head Offices, the lines of control tend to be long and weak. It is, therefore, essential to have an effective and efficient system of supervision and control. A few banks have set up territorial/regional offices to control overseas branches and delegated to them adequate authority and responsibility in order to decentralise decision making and control. However, there are several gaps in the existing control systems of Indian banks which need to be suitably restructured. An important point which should be borne in mind by the Inspecting Officers is that each territory has its own

peculiar environmental factors relevant to the business of a bank and the conditions in all territories not being identical, it will not be a correct approach to evaluate the functioning of a branch in one territory on the basis of what is observed about a branch in a different territory. The main instruments of supervision and control are -

- (a) Management Information System:
  - (i) Control through returns;
  - (ii) Progress Reports.
- (b) Audit/Inspection.
- (c) Periodical visit reports.
- (d) Performance Budgeting.

#### Management Information System

15.7 It connotes the mechanism for processing and providing of accurate information to the top management at the right time and in the right form. MIS is built up with a view to supporting decision making at various management levels. The essential attributes of a good MIS are format, relevance, accuracy and timeliness. In other words, MIS is a facilitating system that helps managers in improving the quality of their decisions in planning, operational and control functions. Decisions are of two types, programmed and non-programmed. Programmed decisions are of routine operational nature and of predetermined periodicity. Such decisions are facilitated by giving discretionary powers

at various levels and laying down operational guidelines by the top management for personnel in operational field. Non-programmed decisions are on issues which are not repetitive, call for creative intervention by higher executives and involve implications of large magnitude and ramifications. Such decisions are facilitated by regular flow of information from base level to higher management. It is primarily for the non-programmed decisions that an information system is devised through control returns and progress reports.

#### Control Returns

15.8 Areas of control through returns generally are credit and other facilities, foreign exchange business, investments, administration and house keeping, and other statistical information. Periodicity of returns would depend on the jurisdiction of control at Head Office and territorial/regional offices, if any, at overseas centres. In other words, frequency should be higher for the returns flowing from branches to territorial/regional office since the responsibility of operational control over day-to-day business aspects and routine administrative matters is that of the territorial/regional office. The returns flowing from the territorial/regional office to Head Office may be at lesser frequency for the perspective is overall control on policy issues and individual decisions of greater magnitude and implications. Periodicity of returns should take care of the time-gap required for initiating corrective steps. The

effectiveness of the method of control through returns would depend on :

- Promptness and accuracy with which the return is submitted ;
- Understanding or knowledge of the rationale/purpose of each return ;
- Interpretation and analysis of the data flowing from each return;
- Utilisation of the analysis for control purposes and to initiate corrective measures ;
- Reporting to higher authorities for information and guidance.

15.9 In the matter of exercise of control, the top management should have a watchful eye on expenses and cost-benefit approach to all decisions. The bank should have a system of periodical review of the efficacy of returns in order to bring about suitable modification, merger, discontinuance, changes in periodicity, etc., of the returns.

#### Progress Reports.

15.10 These are meant to provide a birds eye view of the operations and progress of overseas branches/territory. On the basis of progress reports received from overseas branches/territorial/regional offices, a consolidated report of the bank's entire overseas operations should be submitted to the Board with a view to informing trends of operations and seeking

guidance. The items that may be covered in a progress report are :

Business statistics

- Deposits
- Advances
- Other facilities like letters of credit, bid bonds, guarantees, etc.
- Investments
- Trends in earnings, expenses and profits ;
- Reasons for sharp rise/decline in any of the above with brief comments.

Identify branches

- that substantially contribute to profits,
- that are loss making,
- that have heavy incidence of operating costs,
- that contribute other remunerative business.

Currency positions

- Interest structure in different countries/currencies and variations thereof ;
- Important changes in monetary policy and exchange regulations.

House-keeping function

- Balancing of books ;

- Reconciliation and defaulting/problem branches ;
- Rectification of irregularities ;
- Compliance regarding submission of returns and defaulting branches ;
- Frauds.

Any other developments, favourable and unfavourable, either in the overseas branches or in the territory of operations, say political or economic or in banking field which would affect the bank's operations in the territory, adversely or otherwise.

#### Audit/Inspection

15.11 The important aspects which audit/inspection should cover are :

- Whether discretionary powers, lending and administrative, have been judiciously exercised;
- Compliance by branches in taking proper documents and following terms and conditions stipulated by the sanctioning authority ;
- Early detection of warning signals of incipient sickness/problems in respect of parties enjoying credit facilities ;
- Scrutiny of foreign currency positions ;
- Irregularities in house-keeping functions of branches ;
- Whether branches are following prescribed procedures ;
- Audit of expenses incurred and control over expenditure ;

- Handling of frauds ;
- Scrutiny of investment portfolio with a view to ensuring proper mix to achieve optimum return on investments.

#### Periodical visit reports

15.12 The discussions held with visiting executives should be based on pre-planned agenda so that maximum advantage can be taken of the presence of the visiting executive. This will provide an opportunity to appreciate practical problems and constraints, if any, and consider important issues on the spot, exchange of information, etc. Important issues emanating from such visits and/or decisions taken/instructions given must be recorded by the visiting executive and reported to higher management.

#### Performance Budgeting

15.13 Planned performance is always better than unplanned performance. Performance budgeting is a method to manage affairs with optimum efficiency. An important feature of performance budgeting is to perform better than what would come about automatically in the normal course. The starting point is the enunciation of goals desired to be achieved during the budget period, in quantified terms. The goals enunciated should, however, be within the bounds of feasibility. Employee participation is vital for the success of performance budgeting.

The participation of employees in budgeting leads to motivation and motivation leads to better performance in comparison with the performance which is merely dictated by authority. The budget settlement process should be an across-the-table dialogue, largely, if not entirely, on the basis of hard data in an open, free and frank manner and with a clear awareness and appreciation of mutuality of overall goals. The performance of branches should be reviewed and the results of the review should be promptly communicated to the branches. The reasons for any shortfall in performance in relation to the budgets and variances should be analysed. The branches must be made to feel that their performance is being carefully watched. Good performance should be recorded and recognised by the concerned authorities.

Instructions issued by  
the Reserve Bank .....

15.14 The Indian banks having overseas branches have been advised, in circulars DBOD.No.BL.7242/C.212-82 dated August 16, 1982 and DBOD.No.IBS.260/C.212-83 dated March 2, 1983, to take necessary steps to implement the following measures/guidelines as early as possible.

Personnel placement  
policies

(a) Having regard to the complexities of carrying on banking business in highly competitive markets and in different political, economic and legal environments, it is essential

that only personnel who have been properly trained and are considered to have the necessary job competence and maturity should be deputed to overseas branches. Banks should, therefore, lay down proper criteria for selecting candidates for overseas assignments. Deputations should be for specific periods and a system of rotation of staff should be strictly enforced. It should also be ensured that deputationists are not continued on overseas assignments for unduly long periods and brought back to the home country after a specific period of, say, five years.

Reporting and control systems

(b) Banks should review the reporting systems, if any, that are presently operative in regard to the overseas branches and make a judgement whether adequate and timely feed back about the functioning of these offices is being received. If not, steps may be taken to introduce/tone up the reporting systems. It would be necessary to make in-depth and detailed 'reviews' of the working of these branches in each country at reasonable intervals, of not more than a year, and put up such reviews for the consideration of the top management and the Board. Copies of such reviews may also be sent to the Reserve Bank ( DBOD, Central Office).

(c) Banks should ensure that all important developments connected with or affecting their overseas branches, including

changes in policy environment as well as relationships with local authorities and public, are promptly reported by their branches to the Head Offices which, in turn, should report such major developments to the Reserve Bank promptly. Similarly, frauds/defalcations/losses, etc., involving significant amounts should also be reported to the Reserve Bank.

(d) The internal audit and inspection system relating to overseas branches should be reviewed and strengthened. A system of placing before the Board of Directors 'summary' reports, at periodical intervals, of the audit/inspection reports highlighting problem areas, strengths and weaknesses in the functioning of the overseas branches may be introduced, if such practice is already not in vogue. Copies of the 'summary' reports should also be forwarded to the Reserve Bank (DBOD, Central Office).

Supervision machinery  
at Head Offices

(e) It has been found that the supervision exercised by the International Divisions or equivalent functional set-up at the Head Offices of banks leaves scope for improvement. This machinery should immediately be reinforced. It would be also necessary to evolve a system whereby responsibility for negligent administration at the executive levels, leading to avoidable large losses at overseas branches, is fixed and necessary action taken so that a sense of accountability is

felt by the management overseas as well as at the Head Office.

Management Information System

(f) Banks should take action to strengthen their lines of communication with the overseas branches by establishing an effective Management Information System and through occasional visits by senior executives from Head Offices. The discussions to be held by visiting executives should be based on pre-planned agenda and important issues emanating from such visits must be recorded and reported to higher management.

Machinery for appraisal of credit proposals, scrutiny of control returns, etc.

(g) The banks should reinforce the machinery in their International Divisions for appraisal of credit proposals and scrutiny of control returns as well as for taking necessary follow-up action thereon. Further, they should formulate written guidelines/checklists for internal inspection/audit of foreign branches, lay down written policies/guidelines in regard to assets and liability management, including maturity mismatches and devise a mechanism to monitor country exposures. It will be helpful to the foreign branches if the banks' Head Offices issue policy guidelines indicating the overall objectives they would expect the branches to achieve during a certain period.

Asset and Liability Management

13.15 The special features of international banking business are the unusual dependence on money market funds for a large portion of the bank's liabilities and the absence of an international lender of last resort. The raising of funds at a maturity different from that at which the funds are lent gives rise to two types of risks. One is the commitment to provide funds, that is, the liquidity risk, and the other is the commitment to a particular interest rate. The liquidity risk stems from the possibility that the bank may be unable to repay its depositors on time because funds may not be available and the interest rate risk flows from the fact that the cost of liabilities may rise faster or exceed the earnings on assets. Losses may result if the bank finances its loans with relatively short-term funds and market rates rise or if relatively long-term funds are used and lending rates fall. Correspondingly, profits can be earned if interest rates move in the other direction. In practice, much of this risk is reduced by tying the lending rate to the cost of funds. The international banks have taken a variety of steps to minimise liquidity risk. The most obvious is to maintain close personal relationships with major depositors - other banks and non-bank depositors. Efforts are also made to avoid over-dependence on one or a group of depositors. Secondly, international banks maintain liquidity reserves in the form of negotiable instruments and other assets

which can be mobilised in the event of difficulties in renewing deposits as well as establish standby facilities from friendly or related institutions which are utilised to supplement these reserves. The international banks also issue negotiable certificates of deposit and floating rate notes with a contractual maturity approaching or equivalent to that of their loan portfolio.

15.16 The management of individual components of assets and liabilities such as loans, investments and deposits within a certain framework is known as the asset and liability management. The goal of asset and liability management is to maintain adequate levels of bank profitability while at the same time avoiding sharp fluctuations in profitability rate, but attaining a steady rise, from period to period. A detailed analysis of all assets and liabilities on the bank's balance sheet is the first step in the application of any asset and liability management system. The purpose of this examination is to identify the interest rate characteristics of various balance sheet items so that they may be classified into one of the following three categories -

- (a) Assets and liabilities with matched maturity and cost characteristics.
- (b) Those with variable rates.
- (c) Assets and liabilities with relatively

fixed rates and costs.

The matched liabilities and assets represent sources and uses of funds in equal amounts which have identical pre-determined maturity and a negotiated rate spread. In other words, the spreads are constant and the maturities are coterminous. Such transactions include Eurodollar deposits redeposited in other banks (placements), Eurodollars supporting matched loan agreements and acceptance transactions. The margin contribution on these matched categories is stable even in times of volatile interest rates. In contrast to the matched group, the fixed rate category includes assets and liabilities with rates that are relatively free from fluctuation over long periods of time. Examples are instalment loans, long-term investments, mortgage loans, long-term debt, bank's capital and reserves or net usable time and demand deposits. The costs or returns of each of these are relatively stable over time. A key issue in any asset and liability management system involves the definition and analysis of the variable rate category. In general, this group represents interest bearing assets and liabilities where the rates tend to fluctuate with money market conditions, such as floating rate loans, negotiable Certificates of Deposit, short-term investments, Eurodollar deposits (unmatched) or short-term borrowings. Such items are also referred to as "interest-rate sensitive" assets and liabilities. However, the degree of sensitivity to changing conditions in the markets is

not universal and there is no widely accepted definition that precisely dictates what items should be so classified. For example, some argue that an asset or liability belongs to the variable rate category if it can be repriced within one year; others argue that the relevant period should be shorter. Essentially, the choice of a definition of "variable" should probably rely on the planning horizon of the bank and the frequency with which its management requires changes in sources and uses of funds. Profitability of this interest differential business is determined by the ability of management to control the rate spread between variable rate funds and variable rate assets.

#### Gap Management

15.17 The imbalance between the variable rate assets and variable rate liabilities is referred to as the Gap. The changes in the size of the Gap at various money market rate levels can have a significant impact on the earnings performance. This is because the cost of funds in the Gap is relatively fixed while the income generated by the asset side will rise or fall with the level of money market rates. A perfect Gap is difficult or impossible to attain. However, there are some widely accepted principles of Gap management. There should almost always be a Gap. Fixed rate liabilities (or funds) must exceed the fixed rate assets. If this does not occur, a portion of fixed rate assets would be supported by

variable rate funds with attendant risks in liquidity and profitability. At high rate phases of the cycle, variable market sensitive funds are in short supply and variable cost rates could cause narrow or negative spreads on previously existing fixed rate investments and loans. Gap must be managed to expand and contract with rate cycle phases. The relationships to various phases of the rate cycle are as follows :

- Rising rates - Widening Gap
- High rates - Widest Gap
- Falling rates - Narrowing Gap
- Low rates - Narrowest Gap

The asset and liability management strategy should be oriented towards optimising Gap relationships throughout a complete cycle and not maximising at any one phase. The Gap size can only be controlled by changes in the level of either fixed rate assets or fixed rate funds since, by definition, the Gap is the amount of difference between fixed rate assets and fixed rate funds. Management action relative to fixed rate funds (particularly deposits) is somewhat limited and subject to all the usual competitive pressures. Hence, the primary management control over the size of the Gap must come from the strategy and tactics employed in relation to fixed rate loans and investments.

15.18 There is no asset and liability management system that can be universally applied successfully to all banks nor will

any combination of approaches eliminate the necessity for the exercise of good business judgement. The cornerstone of a system for an individual bank is a thorough understanding of its customer behaviour, economic and market environment, and the relationship of its assets and liabilities. The objectives of asset and liability management must be realistic in relation to the bank's capital base and its access to funds sources of the type needed to reasonably assure liquidity and profitability. A few examples on the asset and liability management are given in Annexure I to this Chapter.

#### Country Risk Analysis and Country Exposure Measurement and Control

15.19 The evaluation of country risk is a key aspect of international lending. The problem with country risk for bankers is not simply that it exists, since the business of banking necessarily involves risk taking, but rather that it is difficult to quantify the risk and hence determine whether the level of risk is acceptable to a lender. Most of the indicators and checklists describe conditions as they were a year or two ago. Even when current, they describe the situation only as it now is; they do not tell how the picture will change in the future. And predicting debt-servicing difficulties is essentially peeking into the future. Nevertheless, these indicators serve as warning signals that a prospective foreign borrower ought to be examined more closely. Thus, the lender has to decide how much information he needs to negotiate a loan with a prospective borrower, and then he

has to go out and get it. If the information simply is not available, or if it indicates too high a risk for the expected rate of return, the loan applicant may be turned down. But even if the decision is made to go ahead with the loan, the prudent banker will want to reduce the risk of loss. Bankers have several ways to cut risk. They can seek third-party support in the form of loan guarantees or management assistance for borrowers; they can share risk exposure with several lenders; or, most important, they can diversify their loans among several borrowers or areas.

15.20 The replies to a questionnaire received from certain Indian banks having overseas branches revealed that the banks did not have well defined systems for assessing, monitoring and reviewing of country exposure limits. The Working Group appreciates that the concept of country risk involves a substantial measure of judgement and that country risks are taken not always on pure commercial considerations. At the same time, the Working Group feels that it is important to inculcate greater country risk consciousness among Indian banks and continuously monitor country exposures not only bankwise but also for the Indian banking system as a whole so that necessary corrective steps may be taken.

15.21 A copy of a note prepared by the Committee on Banking Regulations and Supervisory Practices of the Bank for International

Settlements, Basle, on "Management of banks' international lending : country risk analysis and country exposure measurement and control" is given in Annexure II to this Chapter.

Issue of Floating Rate  
Certificates of Deposits  
(FRCDs) and Floating  
Rate Notes (FRNs)

15.22 The Reserve Bank (Exchange Control Department) has advised, in May 1982, the Indian banks having overseas branches that they may undertake a careful review, on an annual basis, of the composition of loan assets in relation to the funds base of each of their overseas branches in order to bring about a suitable balance from the liquidity considerations in the term loans exposure and that should the bank consider it necessary, on the basis of such review, that it should arrange to issue FRCDs or FRNs for raising finance abroad, the bank may submit to the Reserve Bank annually a review together with its specific proposals. On the basis of the bank's proposals, the Reserve Bank will consider granting approval for issue of FRCDs/FRNs for a certain limit over the year. The Reserve Bank will, while granting such approval, also indicate the broad parameters which it considers reasonable for such issues over that year. Once the annual limit for issue of FRCDs/FRNs has been approved by the Reserve Bank, it will not be necessary for the bank to approach the Reserve Bank again at the time of each issue, except when the terms of issue are significantly different

from the ones indicated by the Reserve Bank. It will, however, be necessary for the bank to advise the Reserve Bank the full details of the issue after each issue has been completed. As regards FRNs, such issues involve compliance with the listing requirements of the security exchanges at foreign centres and the documentation formalities are extensive requiring the Head Offices of the banks to assume liabilities to disclose full information of their status and finance pertinent to qualifying for listing. It will be thus necessary for the bank concerned to obtain clearance from the Government of India, Ministry of Finance (Department of Economic Affairs), New Delhi, for issue of FRNs, besides the approval of the Reserve Bank. Any other form of term borrowings by the bank to support the liquidity of the overseas branches should also be referred to the Reserve Bank for approval so that it may, if need be, indicate whether additionally the Government of India approval should also be obtained by the bank.

Foreign exchange business undertaken by overseas branches of Indian banks - Internal control.

15.23 The Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank are also applicable to overseas branches of Indian banks. The observance of the Guidelines by the overseas branches has of course to be consistent with the local laws and instructions of the monetary

authority of the country concerned. In this regard, the Indian banks having overseas branches have been advised, in circular DBOD.No.IBD.382/C.469(91)-82 dated the 12th November 1982, to treat the Guidelines as a model or base for devising suitable guidelines for the overseas branches subject to such modifications as may be considered necessary in the light of local conditions and regulations.

Guidelines for  
Inspecting Officers

15.24 The instructions contained in circulars DBOD.No.BL.7242/C.212-82 dated August 16, 1982 and DBOD.No.IBS.260/C.212-83 dated March 2, 1983, vide paragraph 15.14 above, have been reiterated and amplified in circular letter D.O.No.DBOD.IBS.123/C.212-84 dated February 14, 1984. Broadly, the banks have been further advised as follows :

(i) Informative and analytical reviews should be prepared by the banks on the working of overseas branches - not only in the aggregate but separately for each operation - at half-yearly intervals and placed before their Board of Directors. (Copies thereof should be furnished to the Reserve Bank for information.)

(ii) Only suitable officers of proven integrity and expertise should be posted to foreign centres. Banks should establish proper screening procedures for selection of officers to be posted abroad and they should be given adequate training

before they are entrusted the management of foreign branches. It has also to be ensured that overseas placements are not allowed to run beyond three years.

(iii) At overseas centres where more than one Indian bank have branches, the Indian banks should set up inter-bank consultative forums with a view to alerting the banks to the risks of assuming large commitments on a few borrower groups involving also multiple financing, the intention being that the Indian banks' managers could have, inter alia, mutual exchange of views as well as information and assessments on credit exposures on borrowers and borrower groups. Further, the executives from any of the public sector banks visiting such centres could prepare country assessment reports and make them available to the other banks for the common benefit of all.

(iv) It is absolutely essential that the Head Offices ensure that credit operations undertaken by managers of overseas branches are within the agreed parameters of delegation and home authorisations. The accountability of the senior executives at the Head Offices (International Divisions) for properly overseeing the working of overseas offices and ensuring their healthy functioning should be clearly established.

(v) It is necessary that the critical comments/observations of statutory auditors as well as the central banking authorities are used as part of the bank's management information and

control systems on overseas branches and corrective action taken promptly in this behalf and reported to the Boards.

(vi) It is imperative that effective systems of internal/concurrent audits of overseas branches on a regular basis are established and such auditors be enabled to function independently and objectively with direct accountability to Head Office management.

(vii) It is important to enjoin upon senior executives to look into important aspects of working of the overseas offices during their visits and report systematically to the higher authorities for proper follow up. Further, besides usual reporting, it will be useful if the overseas executives are required to specifically bring to the notice of the Chairman by telex or demi-official letter any important developments in the working of overseas branches, like frauds noticed, liquidity problems, important instructions of local central banking authority and any large over-limits granted, with reasons therefor.

15.25 Besides the guidelines given in the various Chapters for the scrutiny of foreign exchange business and the instructions contained in Supplement C to the Inspection Manual, the following points may be examined by the Inspecting Officers during the course of inspection of overseas branches of Indian banks.

(i) Whether the measures/guidelines/instructions as

indicated in paragraphs 15.14 and 15.24 above, have been implemented/complied with by the bank;

(ii) Whether the branch has implemented the Guidelines for Internal Control over Foreign Exchange Business regarding dealing room operations ;

(iii) Whether the branch has remitted every year its profits to the Head Office in India ;

(iv) Whether the Head Office of the bank has laid down any specific guidelines (including daylight, overnight, etc., limits) for the overseas branch's exchange dealings and other foreign exchange operations, and if so, to what extent the branch has been complying with the guidelines ;

(v) Whether in respect of project exports from India, the branch has granted any overdraft, letters of credit, forward cover, etc., facilities to Indian Companies (i.e., those registered in India) and if so, whether the facilities have been approved by the Head Office of the bank and that confirmation is available at the branch regarding completion of the Exchange Control formalities by the borrower/obligant company. In case the branch has granted any such facilities without the Indian company having obtained proper Exchange Control approvals for entering into the commitments abroad, full details thereof should be ascertained by the Inspecting Officer and indicated in the inspection report. Similarly, in respect of any loan

arrangement in the name of companies registered in India such as shipping companies, etc., the branch should be asked to furnish full details of the Exchange Control and Head Office approvals in support of the arrangement. Such cases may be suitably commented upon in the inspection report.

(vi) Deposit accounts of companies registered in India may be listed and commented upon with reference to the Exchange Control approvals for maintaining such accounts.

Annexure I to Chapter 15Example . . 1

A bank with total assets of 50 million identifies categories of assets and liabilities as shown below :-

	(Period of rising rates)	(In million)
	<u>Liabilities</u>	<u>Assets</u>
Matched	10 (@ 12%)	10 (@ 13%)
Variable	10 (@ 12%)	20 (@ 13%)
Fixed	30 (@ 6%)	20 (@ 9%)
TOTAL ... ..	<u>50</u>	<u>50</u>

Variable assets minus variable liabilities = Gap

20 million - 10 million = 10 million

Another common method of measuring the Gap is through the ratio of rate sensitive assets to rate sensitive liabilities, that is, rate sensitive assets divided by rate sensitive liabilities.

Whenever the ratio exceeds 1, a Gap exists. The larger the ratio, the larger the Gap. In the above example, the Gap is 10 million, the amount of variable rate assets that is financed by fixed rate funds or the amount by which variable rate assets exceeds variable rate liabilities. The resulting level of profitability can be calculated based on the spread occurring between various sources and uses of funds.

Profitability Analysis

(i)	Spread on matched assets and liabilities	1%
(ii)	Spread on variable assets and liabilities	1%
(iii)	Spread on fixed assets and liabilities	3%
(iv)	Spread on the Gap (Return on variable assets less cost of fixed funds)	7%

Estimated (Annual) pre-tax profits

(i)	10 million (0.01)	100,000
(ii)	10 million (0.01)	100,000
(iii)	20 million (0.03)	600,000
(iv)	10 million (0.07)	700,000
		1,500,000

The Contribution of the Gap is 700,000. The spread on the Gap is quite favourable since the bank is earning 13% on variable assets, and 10 million of these are financed through fixed rate funds costing only 6%. Suppose this analysis took place during the rising phase of the interest rate cycle. Once rates have peaked and begun to fall, changes will be apparent in the liability categories, as shown below :

( Period of falling rates)  
(In million)

	<u>Liabilities</u>	<u>Assets</u>
Matched	10 (@ 8%)	10 (@ 9%)
Variable	8 (@ 7%)	20 (@ 8%)
Fixed	32 (@ 6%)	20 (@ 9%)
TOTAL	50	50

Gap = Variable rate assets - variable rate liabilities = 12 million

The Gap has increased to 12 million. Changes have also occurred in the spreads available on the three rate mix categories. The rate of return on variable rate assets has dropped significantly, and so has the spread on the Gap. The resulting profit projection has fallen to 1.02 million (annually) as shown below :

Profitability Analysis

(Revised)

(i) Spread on matched rate category	1%
(ii) Spread on variable rate category	1%
(iii) Spread on fixed rate category	3%
(iv) Spread on the Gap	2%

Estimated (Annual) pre-tax Profits

(i) 10 million (0.01)	100,000
(ii) 8 million (0.01)	80,000
(iii) 20 million (0.03)	600,000
(iv) 12 million (0.02)	240,000
	1,020,000

The declining profitability is a result of a failure to apply appropriate management principles for controlling the size of the Gap. Because the contribution of the Gap has fallen to 2% and was lower than the spread in the fixed rate asset and liability category (3%), action should have been taken to reduce the size of the Gap. The general goal is to narrow the Gap in times of falling rates so that it will be at its lowest level when interest rates hit the bottom of the cycle.

Example 2

( in million)

<u>Sources of funds</u>	Due within one year	Over one year but less than two years	Over two years but less than three years	Over three years	Total
	-----	-----	-----	-----	-----
(i) Capital	-	-	-	5	5
(ii) Customer deposits	555	2	-	-	557
(iii) Inter-bank	1562	11	4	21	1598
(iv) Inter-office	372	-	-	2	374
(v) FRGDs and FRNs	-	35	20	60	115
(vi) Other floating funds	99	-	-	-	99
	-----	-----	-----	-----	-----
	2588	48	24	88	2748
	=====	=====	=====	=====	=====

Utilisation of funds

	Due within one year	Over one year but less than two years	Over two years but less than three years	Over three years	Total
(i) Statutory investments	2	-	-	10	12
(ii) Fixed Assets	-	-	-	3	3
(iii) Money market operations	1047	-	3	1	1051
(iv) Inter-office placements	421	1	1	1	424
(v) Cash credits, overdrafts, trust receipts and bills discounted	337	10	-	-	347
(vi) Participation loans	78	41	16	186	321
(vii) Term Loans	168	47	41	119	375
(viii) Demand Loans	142	1	1	6	150
(ix) Others	52	5	1	7	65
	<u>2247</u>	<u>105</u>	<u>63</u>	<u>333</u>	<u>2748</u>

Loans  
sanctioned  
but not  
disbursed

2                      7                      20                      30                      59

Based on the foregoing, the bank's mismatch position at the end of a year computed as follows :

	(In million)
Funds deployed with more than one year's maturity	501 (105+63+333)
<u>Add</u> : Term Loans sanctioned but not disbursed	57 ( 7+20+30 )
	-----
	558
	=====

These were covered by :

(i) Hard core customer funds (25% of customer deposits)	139
(ii) FRCDs and FRNs	115
(iii) Inter-bank funds	36
(iv) Other funds including capital	9
(v) Standby lines of credit	73
	-----
	372
	-----

The mismatch was 558 minus 372 = 186 or 186 as percentage of 558 is 33.33%

332

Annexure II to Chapter 15

COMMITTEE ON BANKING REGULATIONS  
AND  
SUPERVISORY PRACTICES

Management of banks' international lending : country risk  
analysis and country exposure measurement and control

The Basle Committee of Banking Supervisors has recently reviewed how banks manage country risk in their international lending business. The information has been derived from observation of the banks' practices during the process of supervision. As a result of this review, the Committee considers that it may be helpful to banks to set out some general considerations relating to country risk assessment. It is not the Committee's intention to lay down a preferred method of setting about what is generally acknowledged to be a complex exercise. The Committee recognises that some banks have very sophisticated systems and that all banks need to tailor their country risk management systems to meet their individual circumstances and exposure. The paper sets out a number of considerations which banks should bear in mind when establishing or reviewing their control systems and which auditors or supervisors should have before them in assessing the adequacy and efficiency of those control systems. Its concluding section sets out the Committee's views on the role of supervisors in monitoring banks' management of their country risk. This section is included so that banks may be aware not only of the kind of questions which their supervisors are likely to ask and of the thinking behind any requirements which they might set, but also of the advice or practical assistance which supervisors may be able to provide.

The Committee would welcome comments on this paper, recognising as it does that methods of country risk assessment are still evolving. Recipients are invited to channel any remarks they may have through their own supervisory authorities.

Basle,  
March, 1982

Management of banks' international lending : country risk analysis and country exposure measurement and control

Introduction

Lending involves a number of risks. In addition to risk related to the creditworthiness of the borrower, there are others including funding risk, interest rate risk, clearing risk, and foreign exchange risk. International lending also involves country risk.

This paper deals solely with the country risk of international lending. It does not deal with the related risk to which banks may be exposed when they lend domestically in the knowledge that the borrower may be exposed to the risk of default by a foreign customer, or to other foreign impediments that might endanger repayment of the banks' loans. The presence of country risk in international lending, however, does not mean that international lending necessarily entails more aggregate risk than domestic lending.

Part I of the paper deals with banks' assessment of country risk; Part II with the measurement of country exposure; and Part III with the control of banks' country exposure. Part IV sets out the Committee's views about the role of supervisors in monitoring banks' country risk assessment systems and their country exposure. Finally, as misunderstandings can easily arise from the use of different terminology in relation to country risk, an Annex to the paper contains suggested definitions of certain terms that are in frequent use.

I. Banks' assessment of country risk

Country risk is taken to refer to the possibility that sovereign borrowers of a particular country may be unable or unwilling, and other borrowers unable, to fulfil their foreign obligations for reasons beyond the usual risks which arise in relation to all lending. A very wide variety of factors may prevent borrowers of a given country from fulfilling their

foreign obligations, which makes country risk a difficult concept to define with precision. The risks range from the consequences of official actions or important socio-political changes in the borrowing country to largely unpredictable events such as natural disasters or external shocks arising from global phenomena like world depression or the consequences of an oil price rise. A major complication is that the same events will affect borrowers in some countries more than in others and also have varying effects on different borrowers in the same country. Their impact will, moreover, tend to vary over time. Country risk assessment cannot, therefore, be an exact science, but an art in which a significant degree of unpredictability must be acknowledged.

All banks are aware of the existence of country risk and of the need for a system for assessing that risk as part of the process of managing their international lending portfolio. For most major banks the starting point is statistical information available from both national and international sources. For the more industrialised **countries**, banks may find domestic statistics more useful since they are often the most up-to-date. For developing countries, data produced by international organisations such as the IMF/IBRD the OECD and the EIS may be more frequently resorted to. The analyst will of course wish to look at a wide range of macro-economic numbers and at the relationships between them that he believes are significant. Many banks operate sophisticated mechanical scoring systems, with certain risks being weighted numerically to produce country scores or ratings. Such systems can be useful, but should not be relied on too much since economic ratios based on past performance have quite limited predictive ability over the wide range of possible country risks.

Since the key question is whether there will be impediments to the repayment of external indebtedness, the size, nature and maturity pattern of a country's current external indebtedness are particularly significant. Unfortunately, these data can be

the most difficult to establish, because of some countries' reluctance to undertake the collection of all necessary data or to reveal the true extent of their indebtedness.\* The analyst will nonetheless wish to project a path for countries' external debt and to forecast their ability to service and repay, which means looking at the outlook for official reserves and other balance-of-payments items, terms of trade, exchange rates, inflation, the country's record in servicing and repaying external debt and other relevant factors.

Given the complexities, it is no surprise that banks, particularly large banks with diversified portfolios, recognise that forecasting risks over the life of a bank's credit exposure entails a substantial measure of judgement. Thus, managerial assessments, if possible, based on direct experience of local conditions about, for example, a given country's economic policy stance, its possibilities for development and in particular its social and political stability, have justifiably been given greater emphasis in recent years by many banks in assessing their country risk. At the same time, banks need to be careful in interpreting intelligence received from local representatives or other persons whose judgement may be coloured by marketing factors, in order that their analysis can set forth the risk without a sales bias.

Larger banks with greater analytical resources and access to better information through their branch networks, more frequent foreign visits and a larger number of business and government contacts tend to be better equipped than smaller banks to assess country risk. Smaller banks too, however, should have a capacity to make independent analyses of the country risks they incur and where possible to build up representation or reliable contacts in countries where their main exposure lies. Where a bank's exposure is in the form of syndicated lending and where the lead bank may be known to have

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\*In this connection the analyst may find helpful the Manual on Statistics compiled by International Organisations on Countries' External Indebtedness (BIS, Basle, March 1979).

a first class risk assessment system, such independent analysis is still needed since a lead bank will probably face a different set of credit risks and may well find a particular credit attractive for reasons which may not apply to other participating banks. There is, furthermore, no inherent guarantee that a syndicated credit is less risky than other forms of lending.

## II. Banks' measurement of country exposure

Systems for measuring country exposure need to be tailored according to the size and complexity of an individual bank's international lending operations. There is thus no single method of calculating exposure which will be appropriate for all banks. For the individual bank, the objective is to maintain a system comprehensive enough to capture all significant exposure and detailed enough to permit adequate analysis of different types of risk.

At the same time, a number of general problems arise in measuring country exposure which are common to all banks, whatever their size or nature of business. It seems sensible for banks to approach these problems in a broadly similar manner for three main reasons :

- to give banks some assurance that their system of measurement conforms at least to some minimum standard
- to allow aggregation in summary form for banking group nationally and globally for the statistical reference of all participants in the market;
- and thus to enable individual banks to assess their own exposure in comparison with others, information which will be of value to both senior management and supervisors.

With these benefits in mind the Committee would commend to banks a framework in which banks' measurement systems should be set. The following suggested guidelines are, of course, in no way inconsistent with a more detailed analysis by individual

banks, which can build varying degrees of sophistication into the overall framework as is appropriate to them.

(a) Allowance for risk reallocation

One difficulty in measuring country exposure is to determine where the final risk lies. The initial task is to allocate each claim according to the residence of the borrower, but it is then necessary to consider how to take into account additional factors which in practice may give the lending bank a claim on a resident of a different country. Country exposure may arise in either case in certain circumstances and, in view of the number of borderline situations in this regard, the Committee recommends that banks' systems should be capable of making two separate calculations of their country exposure, one of which is a straightforward breakdown by country of the borrower and the other of which makes allowance for risk transfers of various kinds.

In the case of funds placed with a foreign branch of another bank, for example, exposure may in practice be regarded as applying both in respect of the country in which the branch is situated and also in the country of the branch's parent. In order to take this into account, banks can usefully make a dual calculation. The second calculation would bring into the country exposure measurement credits to branches of foreign banks located in the lending bank's own country.

Dual exposure measurement is also in order in the case of loans covered by legally binding guarantees from a resident of a country other than that of the borrower. Collateral that is liquid and available in a country other than that of the borrower may be considered in the same manner as guarantees for this purpose. The dual calculation should bring into the country exposure analysis loans to domestic borrowers which are guaranteed by foreign entities, and equally remove from the exposure foreign lending which is guaranteed by domestic entities, a common example of which will be credits guaranteed by a bank's

own domestic export credit agency.

(b) Consolidation

The best way for management to obtain a picture of an international bank's overall exposure to foreign borrowers outside the bank's own organisation is by measuring country exposure on a consolidated basis. To be complete, such consolidation can usefully embrace the operations of the bank's branches, subsidiaries and significant participations.

While such consolidation is an essential aid to the management of the country exposure of the overall operation, it remains true that banks' internal transactions, where they are cross-border, will themselves give rise to country exposure. But, as well as measuring its exposure on a consolidated basis, a bank will need to be aware of the gross country exposure arising from the funding of its individual overseas branches and subsidiaries. In the same way, a bank will be wise to consider the country exposure of each of its foreign branches and subsidiaries, and of the head office itself, individually, and to draw the appropriate conclusions.

(c) Breakdown and analysis of claims by borrowing country

Country exposure consists of all balance-sheet assets (including loans, acceptances, placements, securities, etc.) which represent claims on residents of another country. A breakdown by residual maturity of claim should also be available to provide a comprehensive maturity profile of indebtedness. Additional breakdowns may also be desirable in order to enable, at a detailed level, analysts and, at a more general level, banks' managements (and the supervisory authorities) to assess the bank's exposure in a number of different ways. For instance, it might be desirable to be able to distinguish between claims on sovereign borrowers, banks and others.

Claims should be recorded irrespective of currency. For banks which conduct retail business in other countries through local offices, however, intra-country loans denominated

in the local currency will be subject to country risk in a somewhat different sense since their repayment does not represent a call on the foreign exchange reserves of that country. Such loans may usefully be identified separately in a summary exposure total.

Offsets of deposits against credits may be possible, but probably quite limited in practice. Deposits from a country should not ordinarily be offset against credits to that country unless the bank has established a legal right of set-off vis-a-vis the same customer. Even then, it should be borne in mind that legal actions by third parties may prevent the bank from enforcing its right of set-off.

Certain potential claims that do not appear on the balance sheet can also involve country risk and banks should seek to identify their true exposure in this regard. For example, letters of credit and legally binding commitments to lend to foreign clients may expose the bank in much the same way as a loan that has actually been drawn down. Banks should monitor all commitments to provide funds whatever their precise nature may be. Such commitments may arise from loans with draw-down according to a schedule and even from market lines whose total may not have been advised to the potential borrower. The bank should also take into account any guarantees it may have issued in favour of borrowers abroad and any "buying risk" it may have taken on in the form of acceptances or "a forfait" paper. Certain banks also include some proportion of their forward foreign exchange contracts in their measurement of country exposure. Fiduciary operations, where the bank acts only as an agent, need not be regarded as country exposure, although a bank should be aware that operations of this sort can, in certain circumstances, expose the bank.

### III. The control of country exposure

Having assessed the nature of country risk for individual countries and measured the individual country exposures, a bank then needs to reach a view on the appropriate weighting

or actual limits to be applied to its individual country exposures. This process should take account of the size and nature of the bank itself, the perceived economic strength and stability of the borrowing country and the bank's spread of risk or existing portfolio diversification.

An individual bank, even though it may engage in the most sophisticated and informed country risk analyses, can have little direct influence on the country risks which may confront it in its international credit operations. A bank is, however, able to spread its risks by diversifying its country exposure in the same way as it tries to avoid excessive concentrations of risk in any of its areas of business. In recommending diversification, however, the Committee recognises that many banks have particular expertise in a given area and it accepts that such expertise may justify extra concentration of risk in that area. Furthermore, diversification pursued for its own sake may also add to rather than reduce risk. A somewhat similar qualification can be made in the case of a consortium bank with first-class shareholders that wish to use it as a vehicle to channel lending to a particular country or region. But in such cases the exposure of a consortium bank should be taken into account by its shareholders in assessing their own exposure and the special risks attaching to such exposures recognised by the shareholders in the context of their overall commitment to that consortium bank.

Any system for control of country exposure should be based on the setting and monitoring of country exposure limits. All banks should have a system for establishing, maintaining and reviewing country limits. Overall exposure limits for each country to which the bank extends or is considering extending credit should be set on prudential grounds and not on marketing grounds. To achieve the necessary objectivity, it is important that banks maintain a correct division of responsibility by separating the marketing function from the limit-setting function. In any case, limits should be set in a formal process that

culminates at a very senior level in the bank (for example, with the bank's directors or with a senior policy committee) which enables the process to be integrated at the highest level with the direction of the bank's international credit operations.

Banks should set limits on their country exposure in relation to degrees of perceived risk. The limits banks set should be related to their capital and reserves, i.e. to their capacity to sustain losses in their business and should apply both with and without risk reallocation as referred to in section II(a) of this paper. As one check on its degree of concentration, a bank will wish to relate its country exposure pattern to the total foreign indebtedness of countries and to the overall exposure of international banks. A help in this exercise is the BIS's semi-annual report on the maturity distribution of international bank lending.

In recognition of the differences in country risk that may be present in different types of lending, it may often be sensible for banks to set out to diversify their exposure within major borrowing countries by placing sub-limits on certain types of credit (i.e. trade-related credits, self-liquidating loans, project loans, co-financed loans, etc.), by type of borrower (banks, sovereign borrowers, etc.) or by maturity (short-term and long-term). Also, although not directly related to country risk, there are single borrower limits in most countries, either statutory or self-imposed, and similar limits should of course apply to international borrowers.

Once limits have been set, they should not be breached without going through procedural safeguards, such as referral to the board or the policymaking group which originally approved them, even if this means abstaining from making loans which promise a good return or which fulfil other marketing objectives. At the same time, limits set on prudential grounds ought not to be considered as targets by the marketing divisions of the bank. In practice, this may be difficult to avoid unless lending officers themselves have a perception of country risk and of

their bank's policy in that respect.

Bank's procedures must provide for the regular review of country limits so that these may be raised or lowered in response to changing risks. Since essential support to the limit-setting process comes from the bank's country exposure reporting and country risk assessment systems, regular reviews must entail updates on country risk perceptions and the systematic comparison of exposure and limits. This will help banks to anticipate problems that may arise in countries where they have substantial exposure and enable them to take a cautious attitude to new high-risk countries.

Should problems arise with existing credits, banks will need to reconsider the nature and extent of their exposure, which might include working out new arrangements with borrowers. Such action will always need to be considered with due regard for the overall circumstances. Provisions should be made against expected losses and losses should be written off as appropriate. Where an interruption of interest or principal payments is due to country risk factors, the borrowing country may apply to its creditors for a rescheduling of its debts. In such cases, even when arrangements satisfactory to both sides have been worked out, the bank should not assume that losses may not ultimately result. Indeed, the fact of rescheduling may frequently be thought to indicate a deterioration of credit-worthiness and banks should be ready to make appropriate provisions to capital against probable losses.

#### IV. The role of the banking supervisor

In the same way that the supervisor would not expect to dictate to banks what specific domestic loans should be granted, he does not set out to dictate to banks decisions about specific international loans. Bank managements are responsible for the risks involved in the credits that they grant, whether to domestic or international customers. At the same time, however, the supervisor has a responsibility to review risks, particularly country risks, and needs, therefore, to ensure that

banks have adequate methods of assessing, measuring and controlling their country exposure.

In the first place, the supervisor will wish to see that banks operate at least some form of country risk assessment system, that that system has sufficient resources devoted to it and that it is competently managed. He should be ready to suggest improvements in banks' systems where he believes that his advice would be of benefit.

Secondly, the supervisor will take an interest in banks' country exposure management. Not only will he wish to see that banks have systems that capture the totality of their country exposures in a manner sufficiently detailed to permit adequate control, but he will wish to see adequate diversification of each bank's exposure. He will therefore need to know about individual country exposures and may comment on them in the light of the bank's capacity to sustain losses. One of the main difficulties facing the supervisor is to judge the true extent of a bank's country exposure, since large differences among banks' measurement systems may make comparisons difficult or impossible. Partly for this reason, standard reporting for at least summary country exposure data has been introduced in several countries. Such reporting allows the supervisor (as well as the banks themselves, when these reports are aggregated and publicised) to compare in a standard way country concentration of lending and lending in relation to capital.

Thirdly, the supervisor will be concerned to see that banks use their country risk assessments to set and maintain continuous controls on their own exposure. He may also wish to ensure that banks have some form of self-imposed limits on their exposure and that those limits function effectively to contain and to diversify their exposure.

Finally, the supervisor will wish to satisfy himself that banks for their guidance have access to the best possible macro-economic statistics. The Committee is well aware of the

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deficiencies in international debt statistics and is currently pressing for improvements in their consistency, coverage and timeliness. Banks can significantly contribute to the value of international statistics by making their own returns as promptly and as accurately as possible.

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Definitions and concepts

Country risk is taken to refer to the possibility that sovereign borrowers of a particular country may be unable or unwilling, and other borrowers unable, to fulfil their foreign obligations for reasons beyond the usual risks which arise in relation to all lending.

Country risk assessment, following on from the above, refers to the methods used (by lending banks in particular) to evaluate the risk of an interruption in the servicing or repayment of obligations by borrowers of a particular country.

Country exposure is taken to refer to an individual bank's or banking group's exposure in its total claims on borrowers in individual foreign countries. Measures of exposure to a particular country may take account of guarantees or other factors that could shift risk to a different country from that of the borrower.

Country indebtedness is taken to refer, in an international context, to the sum total of external borrowing by a particular country from all sources.

Sovereign risk arises from the special risk associated with a sovereign loan, which is a loan to, or guaranteed by, a government (and some government-guaranteed bodies). The special significance of such lending lies in the risk that it might prove impossible to secure redress through legal action, i.e. the borrower might claim immunity from process or might not abide by a judgement.

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CHAPTER 16

SUMMARY OF RECOMMENDATIONS OF THE  
WORKING GROUP AND GUIDELINES FOR  
INSPECTING OFFICERS

Recommendations

1. The various aspects pertaining to the foreign exchange business of a bank are scrutinised during its financial inspection by DBOD. While in the case of annual appraisal inspection of public sector banks, the systems and procedures are broadly seen, no separate note on foreign exchange business is prepared. Thus, the annual appraisals do not effectively serve the purpose of scrutiny of the foreign exchange business of authorised dealers. Even in regard to financial inspections, having regard to the time-lag between successive inspections which is as much as five years in the case of public sector banks, the scrutiny which is confined to only a test check of a few transactions in each category, as indicated in the Inspection Manual, cannot be considered adequate. As regards the inspections and scrutinies carried out by ECD, they are only selective, covering specific aspects and that too not of all authorised dealers on a regular basis. Having regard to certain adverse features in respect of foreign exchange operations of banks which have of late come to surface, there is a need for a separate periodical inspection of certain aspects of

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foreign exchange business so that the general inspection is not burdened with detailed examination of these aspects. The introduction of such a system will make the scrutiny of the foreign exchange operations more incisive and meaningful and follow-up action will also be more effective. It is understood that the Working Group under the Chairmanship of Shri V.G. Pendharkar to review the existing system of inspection by DBOD has recommended that general inspections should be annual so that there can be a system of rating of a bank's performance in each of the key areas. It has further observed in its report that there is a need for other types of scrutinies limited in scope and it has suggested that short inspections may be undertaken, among other things, to ensure that the Exchange Control regulations and the Reserve Bank's Guidelines for Internal Control over Foreign Exchange Business are complied with. This Group endorses the view of the Pendharkar Working Group and recommends further that such portfolio inspections of foreign exchange operations of banks actively engaged in foreign exchange dealing operations (presently about a dozen) may be conducted once a year and in the case of other authorised dealers once in two years. While aspects relating to import and export finance are relevant for an assessment of the quality of advances and the method of booking foreign exchange profit in regard to the scrutiny

of the profit and loss account and examination of the profitability of the bank, other aspects pertaining to the organisation of Dealing Department, cover and dealing operations, management of risks through dealers' limits, forward exchange contracts, Non-resident (External) and FOM accounts, Rupee (Vostro) accounts of Exchange Houses and overseas correspondents/Head Offices/branches, reconciliation of Nostro balances and returns submitted to ECD, can be covered during the short inspections so that regular inspections are not burdened with a probe into these aspects except to the extent necessary to make an evaluation of the efficacy of internal controls over the foreign exchange operations. Such short inspection of foreign exchange business can be carried out jointly by DBOD and ECD. In case this recommendation is accepted, the formats of the branch inspection note and the consolidated note on the foreign exchange business as also the Annexures thereto given in the Inspection Manual, will require to be suitably amended. (Chapter 2- Paragraph 2.9)

2. The Group feels that there is a dearth of experienced and well trained officers at all levels in DBOD and FCD to scrutinise the foreign exchange transactions of banks and operations of foreign branches of Indian banks and, therefore, recommends that a pool of officers conversant with the Exchange Control regulations and having the necessary expertise should be built up to facilitate the portfolio inspections. It is

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necessary that the officers (in Grade 'C' and above ) undertaking such inspections should have undergone training (say for two months) in a commercial bank authorised to deal in foreign exchange and attended the advanced foreign exchange course of the Bankers Training College as also the Bourse programme conducted by the College or authorised dealers (like Citibank and Grindlays Bank p.l.c.). On a selective basis, officers (in Grade 'D' and above) should also be sent abroad for a month or so to study and have insight into the working of the active overseas money and foreign exchange markets. DBOD and ECD should also arrange for in-house training programmes for Officers (in grades 'A' and 'B'). The officers so trained should be retained in DBOD/ECD for a period of at least five years if not more for being deployed for the purpose for which they have been trained (Chapter 2 - Paragraph 2.10).

3. It is observed that certain Exchange Control regulations governing FCNR deposits are at variance with the relative directives issued by the Reserve Bank (DBOD), which are detailed in the Annexure to Chapter 8. The Group recommends that early action should be taken to bring about a uniformity between the Exchange Control regulations and the directives issued by the Reserve Bank (DBOD) so that the Inspecting Officers are clear about the various provisions governing Non-resident (External) and FCNR accounts. (Chapter 8 - Paragraph 8.7).

4. The Group recommends that a uniform procedure for the evaluation of foreign exchange profits and losses may be evolved by FEDAI with the approval of the Reserve Bank (Chapter 11 - Paragraph 11.11)

5. The Group considered the question whether the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank (Exchange Control Department) in July 1981 may be implemented, to the extent appropriate, by the foreign branches of Indian banks. The Group feels that as the Guidelines are based on well-established controls adopted by international banks, the Indian banks should treat the Guidelines as a model or base for devising their own internal control guidelines in respect of foreign branches, subject to local regulations and conditions. The Guidelines, inter alia, require banks to fix daylight, overnight, inter-bank and customer limits as also individual and aggregate gap limits. The Group is of the view that in so far as the overseas branches are concerned, it may be left to the management of individual banks to fix the limits after taking into consideration the local regulations and conditions as well as other relevant factors. In other words, the banks need not be asked to furnish to the Reserve Bank details regarding

the limits laid down by them for their overseas branches because in case they are not advised about the appropriateness or otherwise of the limits, the banks may take it that the limits have been approved by the Reserve Bank. In any case, considering the volatile nature of overseas foreign exchange markets, it may be difficult for the Reserve Bank to continuously monitor the limits and it would, therefore, be desirable that the managements of banks are made responsible therefor. The Inspecting Officers of the Reserve Bank need only verify whether the appropriate authorities in the banks have prescribed the limits and the business undertaken by the overseas branches is within the limits. These observations have already been conveyed by the Group to the Department of Banking Operations and Development and the Group is happy to note that DBOD has issued a circular on these lines to Indian banks having overseas offices - DBOD.No.IBD.382/C. 469(91)-82 dated the 12th November 1982. (Chapter 13 - Paragraph 13.2)

6. In August 1982, the Reserve Bank (DBOD) reviewed the policy of Indian banks in regard to personnel placement at foreign branches and their systems of control and supervision of the affairs of overseas branches and, with a view to streamlining and strengthening the administration of the overseas operations, has urged the banks to implement

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certain guidelines in this regard as early as possible - DBOD.No.BL.7242/C.212-82 dated the 16th August 1982. At the instance of the Group that in addition to these guidelines, the banks should take action to strengthen their lines of communication with the overseas branches by establishing an effective Management Information System and through occasional visits by senior executives from Head Offices, that the discussions to be held by the visiting executives should be based on pre-planned agenda and important issues emanating from such visits must be recorded and reported to higher management, that banks should reinforce the machinery in their International Divisions for the appraisal of credit proposals and scrutiny of control returns as well as for taking necessary follow-up action thereon, that they should formulate written guidelines/checklists for internal inspection/audit of foreign branches, lay down written policies/guidelines in regard to assets and liabilities management, including maturity mismatchings, and devise a mechanism to monitor country exposures, and that it would be helpful to the foreign branches if the banks' Head Offices issue policy guidelines indicating the overall objectives they would expect the branches to achieve during a certain period, the Department of Banking Operations & Development

has advised the concerned banks to take necessary steps to implement these measures, as per circular DBOD.No.IBS. 260/C.212-83 dated the 2nd March 1983. (Chapter 13 - Paragraph 13.3)

7. The Group also considered the question whether there could be a Local Board for the overseas branches of Indian banks - one Local Board for the branches of each Indian bank if the number is significant or one common Local Board for the branches of all the Indian banks taken together in a particular country. The Group is of the view that local advisory boards may be established wherever it is compulsory under the local regulations or justified by the operations of a branch or branches of an Indian bank in a particular country and not elsewhere. It is not desirable to constitute one common local board for the branches of all the Indian banks taken together in a particular country because it would lead to disclosure of affairs of customers of one bank to another. The Group understands that the Reserve Bank has agreed, in principle, to the proposal of the Central Bank of Kenya that local advisory committees may be set up by the Indian banks in Kenya, but the then Governor had observed that the Reserve Bank should see to it that this principle is adopted generally and not just with reference to the Indian banks. The Group feels that generally there is a danger that local

members of the advisory boards may influence the independent commercial judgement of the Indian Managers and this factor should also be kept in view while considering the question of setting up of local advisory boards by the Indian banks at foreign centres. (Chapter 13 - Paragraph 13.4)

8. Although it was decided in 1982 that the foreign branches of Indian banks should be inspected once in two years, the inspection system is yet to ~~stabilise~~ itself. The Working Group is of the view that the inspections should be carried out on an ongoing and regular basis and each branch should be inspected at least once in three years. Some of the banks have more than one branch in a country and it is gathered that the inspection teams which have recently taken up inspections in foreign countries have covered only some of the branches of a bank excluding its other branches and even its main branch in that country. In order to have an overall picture regarding the operations of a bank in a country, it is desirable that all the branches including its main branch are inspected with reference to the same date. (Chapter 14 - Paragraph 14.6)

Guidelines for Inspecting Officers

Foreign exchange position, foreign currency accounts and control over reconciliation of Nostro balances (Chapter 3 - Paragraphs 3.16, 3.17 and 3.18)

1. The Inspecting Officers should familiarise themselves with the relevant Exchange Control regulations and instructions given in the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank and verify whether these have been complied with by the bank. Broadly, the regulations and rules to be observed by authorised dealers are as follows:

(a) The basic rule governing exchange position is that authorised dealers should maintain at close of business each day square or near-square position in each foreign currency after taking into account all their purchases and sales, spot and forward. Maintenance of overnight open positions in foreign currencies should be avoided.

(b) Authorised dealers should devise appropriate control systems to ensure that exchange positions in various currencies are maintained in accordance with the above rule.

(c) The banks management should lay down the maximum position limits in each currency that may remain uncovered during the day (daylight limits) and the limits should be

periodically reviewed. Any temporary excesses over the approved daylight limits should require approval of the top management.

(d) Managements should keep a close watch on the dealers' positions at the close of business each day (overnight limits).

(e) Authorised dealers should ensure that at the close of business each day, the maturities of forward contracts are not unreasonably mismatched.

(f) Management in each bank should lay down Individual Gap Limit (IGL) and Aggregate Gap Limit (AGL) in accordance with the Guidelines for Internal Control over Foreign Exchange Business.

(g) Accounting Department should prepare a statement of true exchange positions as on the last Friday of each month after reckoning the effect of all transactions in the pipeline as on that Friday and coming to notice subsequently.

2. The following records will generally be available in the Accounts Department.

(i) Position Book, Register and/or card-sheets in each foreign currency, consolidated position sheets and daily currency position reports indicating maximum exchange positions held during the day and overnight positions submitted to higher authorities.

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- (ii) Inter-bank spot and forward contracts register
- (iii) Inter-bank liability ledger.
- (iv) Monthwise forward contracts maturity register.
- (v) Ledgers showing mirror transactions in Nostro accounts
- (vi) Records indicating analysis of forward maturities and Gap statements submitted to higher authorities.
- (vii) Office copies of weekly statements of positions (POS) submitted to Exchange Control Department.
- (viii) Statements of Nostro accounts received from correspondent banks/branches abroad.

3. The Inspecting Officer should verify from the Position Book, Register and/or other relevant records whether the bank has been keeping unduly large overnight open positions (either oversold or overbought). To ascertain this, exchange positions on certain selected dates may be examined. He should also verify whether (a) the spot and forward contracts concluded on each day are accounted for in exchange position on the same day; (b) there are any alterations/corrections in the dates of contracts in order to manipulate exchange position so as to show it at a level different from what it actually is; and (c) all items in the position records of the day are genuine purchases and sales (i.e., there are no 'planted' items in order to manipulate exchange position). It should also be verified :

(i) Whether any limit has been fixed for transactions to be reported by telex/telegram by 'B' category branches (i e , offices and branches not maintaining independent foreign currency accounts but having powers of operating on the accounts maintained abroad by their head/principal offices or any other link offices) and if so, whether such transactions are promptly reported for taking into exchange position and explanation for non-reporting of the transactions is sought from the concerned branches. Further, whether the records maintained for the purpose of registering the reports from **up-country centres are adequate** and the reporting instructions to them need any modification;

(ii) Whether the statement of daily closing positions (Daily Currency Position Report), as indicated in paragraph 3.2.2. of the Guidelines for Internal Control over Foreign Exchange Business, is regularly submitted to the **higher** authorities at the close of business daily and the bank's management has ensured that the dealers do not hold a position which can be considered as not being near square;

(iii) Whether the statement of true currency positions as on the last Friday of each month after reckoning the effect of all transactions in the pipeline as on that Friday and coming to notice subsequently, as indicated in paragraph 3.4.1 of the aforesaid Guidelines, is regularly submitted

within a period of three weeks to the higher authorities indicating the steps taken/proposed to be taken for reducing the distortion, if any, and a copy of such statement has been furnished to the Reserve Bank. The particulars reported in the last statement of true currency positions so prepared and submitted to the management/ Reserve Bank may be checked to ascertain whether they are correct as per the bank's records;

(iv) Whether foreign currency notes held by the various offices of the bank are taken into account while computing exchange position; if not, the reasons therefor may be ascertained;

(v) Whether the consolidated foreign exchange position sheets, as indicated in paragraph 3.1.1 of the aforesaid Guidelines, are regularly submitted to the higher authorities;

(vi) Whether the particulars in POS statements submitted to the Exchange Control Department during the last one month were correctly reported as per the bank's records;

(vii) Whether the bank has fixed daylight and overnight open position limits in each currency and the limits are periodically reviewed. In those cases where the limits have been exceeded, the reasons for exceeding the limits, action

taken by the bank and whether the excesses have been approved in writing by the higher authorities should be ascertained. The Inspecting Officer may give his observations on the excessiveness, if any, of the daylight and overnight position limits in the light of the volume of the bank's business, volume of its transactions always in the pipeline, trading expertise available in the bank and its capital plus reserves position;

(viii) whether the bank has fixed individual gap limits (IGL) and aggregate gap limits (AGL) and they conform to the formula laid down in the aforesaid Guidelines; if not, in what respects do they differ. Further, whether (a) the limits fixed are adhered to and if not, the details thereof as also steps taken by the bank to rectify the position may be indicated; (b) statements of maturities (Form IC.6 of the Guidelines) are being submitted to higher authorities/Reserve Bank and if so, at what interval. Particulars reported in a few statements may be checked to see whether they are correct as per the bank's records;

(ix) The need for maintaining the various foreign currency accounts by the bank may be examined;

(x) Whether balances held abroad are commensurate with the needs of the bank to meet its immediate commitments;

- (xi) Whether any large balance has been held in an inoperative account for a long period and if so, the reasons therefor may be ascertained;
- (xii) The arrangements, if any, made by the bank for automatic transfer of funds, as per A.D. (G.P. Series) circular No.62 of 1978, in order to secure the benefit of interest on overnight idle funds, may be looked into;
- (xiii) Whether the bank is lending in foreign currencies to its overseas branches/correspondents or investing funds abroad in treasury bills, call, fixed deposits, etc., without RBI's prior approval;
- (xiv) Whether there are overdrawn balances of Rs.20 lakhs and above for continuous period of more than 5 days and if so, the details thereof may be given indicating whether the matter has been reported to the Reserve Bank for post-facto approval as required in terms of paragraph 14 of Chapter 8 of the Exchange Control Manual;
- (xv) Whether the bank has maintained an account with a bank in a country other than the country of the currency concerned and if so, when the account was opened and whether the Reserve Bank's prior approval has been obtained for opening the account, as required as per paragraph 5(ii) of Chapter 4 of the Exchange Control Manual;

- (xvi) Whether there is an accumulation of foreign currency notes in branches and the system for the disposal of the notes needs improvement to shorten the time-lag for realising the value thereof;
- (xvii) Whether the bank has introduced special weekly report in order to obtain information on the value of currency-wise accumulations of foreign currency notes at various branches and taken steps towards their prompt disposal (Paragraph 3.4.2 of the Guidelines);
- (xviii) Whether the bank has been submitting BAL statements promptly and regularly to the Reserve Bank and the particulars reported in the last BAL statement furnished to the Reserve Bank are correct as per the bank's records (Paragraph B 2 of Chapter 31 of the Exchange Control Manual);
- (xix) Whether the reconciliation work in the bank is being attended to by a separate Department/Section (in larger banks) headed by an officer of sufficient rank; in case of smaller banks, whether the work has been entrusted to the Accounting Department under the charge of a separate official;
- (xx) The procedure/policy followed by the bank for posting/rotation of staff in the Reconciliation Department may be looked into and it may be ascertained whether considerations of knowledge and experience of the foreign exchange department are taken into account while posting the staff;
- (xxi) Whether the officials attached to the Reconciliation

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Department have been entrusted with the operation of Nostro accounts (i.e., signing drafts or issuing TTs, etc.) or passing of entries in mirror accounts;

(xxii) Whether statements of accounts are received at least once in a month and the Reconciliation Department is (a) watching receipt of the statements and (b) ensuring that there are no alterations, erasures, etc., which are unauthenticated or unverified in the foreign bank statements and mirror accounts, before the work of reconciliation is taken up;

(xxiii) Whether the reconciliation work is undertaken expeditiously and is up-to-date;

(xxiv) Whether half-yearly statements of unreconciled items (c.f. paragraph A.14 of Chapter 31 of the Exchange Control Manual) have been forwarded to the Reserve Bank promptly and the particulars reported therein are in accordance with the bank's records;

(xxv) Whether the unreconciled items are promptly and effectively followed up;

(xxvi) Whether any unreconciled items, other than those indicated in paragraph 6.3 of the Guidelines, have been written off without prior approval of the Reserve Bank. If so, the details thereof should be given;

(xxvii) Whether the Reconciliation Department is submitting a report once a month to the higher authorities indicating the progress made in reconciliation of Nostro account balances and the special features, such as large unreconciled items, age-wise grouping of items, etc., and if so, what action has been taken on such reports by the bank's Management;

(xxviii) Whether there are any instances of (a) set-off of debit and credit items; and (b) entries in rupee columns of mirror accounts without corresponding foreign currency amounts. If so, these should be thoroughly checked;

(xxix) Whether any frauds have been detected through the reconciliation process and if so, these should be looked into in detail.

#### Rates of Exchange

(Chapter 4 - Paragraph 4.39)

4. The Inspecting Officer should verify, by sample checking, whether the rates of exchange quoted by the bank are in accordance with the Exchange Control regulations and the Rules of the Foreign Exchange Dealers' Association of India. He should bear in mind the Exchange Control regulations given in paragraphs 4.34 to 4.38 of Chapter 4 and verify, by test check, whether the rates quoted by the bank to its constituents and overseas branches/Head Offices/correspondents are in accordance with the regulations as also whether any preferences have been shown in this regard. In case any special rates of exchange have been quoted by the bank, the Inspecting Officer should ascertain whether a proper record of the reasons therefor is maintained as also whether the approval of the appropriate authority in the bank has been obtained. He may also examine whether the reasons which weighed with the bank can be regarded as genuine foreign exchange considerations.

Financing of Exports  
(Chapter 5 - Paragraphs 5.63  
and 5.64)

5. During the financial inspection of a bank, the Reserve Bank, as the supervisory authority, is basically concerned with the quality of credit appraisal and effectiveness of the supervision exercised by the bank over export finance extended by it, as part of the assessment of the bank's advances portfolio. Apart from these general considerations, the special aspects regarding financing of exports are as follows :

(i) The export finance is granted at the concessive rates of interest prescribed by the Reserve Bank and it is, therefore, necessary that a close **watch** should be kept by the bank on the end-use of the finance and on the timely fulfilment of export orders besides ensuring that neither the amount nor the period of export finance exceeds the actual requirement in each case.

(ii) All possible efforts should be made towards prompt repatriation of export proceeds within the prescribed period and in accordance with the permitted methods.

(iii) The regulations governing export of goods and services given in Chapter II of the Exchange Control Manual should be strictly complied with.

6. The Inspecting Officer should bear in mind the aforesaid general considerations and special aspects regarding financing of exports and, particularly during branch inspections, should carry out a test check of selected transactions in order

to verify :

(i) Whether packing credits have been granted, negotiation of export bills has been done and advances against bills sent for collection have been allowed under proper sanction of the appropriate authority or is within the discretionary powers vested in the Manager and, in the latter case, whether the facilities have been given to deserving parties only ;

(ii) Whether, while granting pre-shipment credit facilities, the usual safeguards, such as lodgment of irrevocable export letters of credit and/or firm export orders by exporters, competence and capacity of the exporter to execute the orders within the stipulated delivery schedules, financial viability of the export deals, and relating amounts and periods of packing credit advances to export turnover and actual requirements, have been observed as also whether a watch is kept over the end-use of pre-shipment finance and packing credits are liquidated by negotiation of relative export bills within a reasonable time ;

(iii) Whether bills negotiated have generally been under letters of credit established by approved banks or against firm orders from creditworthy parties abroad;

(iv) Whether there is a proper procedure for thorough scrutiny of the bills received for negotiation; in the case of bills negotiated under letters of credit, the instructions of the banks opening the letters of credit have been complied

with; where bills have been drawn on the basis of firm orders, the documents have been drawn in accordance with the terms of the relative order;

(v) Whether bills, including those which have been negotiated against indemnity or under reserve (on account of the documents not being entirely in conformity with the terms of the relative letters of credit), have been realised without undue delay (the Inspecting Officer should satisfy himself that negotiation against indemnity/under reserve has been allowed to deserving parties only; he should also go through the particulars of bills, if any, remaining unrealised beyond the prescribed period - including those held in 'Past Due and Dishonoured Bills' account - and ascertain the reasons for delay in realisation as also whether the position of overdue bills is reviewed periodically and appropriate steps taken for their realisation; he should further verify whether overdue interest has been collected wherever necessary);

(vi) Whether appropriate export risks cover has been obtained from the Export Credit and Guarantee Corporation Ltd., and if not, the reasons therefor may be ascertained;

(vii) Whether the Reserve Bank's directives relating to the rates of interest to be charged on export finance and stipulations regarding eligibility of packing credits and export bills for interest subsidy and refinance from the Reserve Bank, have been complied with;

(viii) Whether there is a satisfactory procedure for collection and recording of up-to-date credit information on the parties;

(ix) Whether the Export Bills Registers have separate columns for recording (a) the date on which the period prescribed for realisation of an export bill will expire (b) the dates on which copies of GR/PP forms have been submitted to the Reserve Bank and (c) the amount of commission and/or discount declared by exporters on GR/PP forms and accepted by Customs;

(x) Whether the bank is maintaining (a) special register to keep a watch on the realisation of the undrawn balances, if any, within the prescribed period and (b) special register for recording full details of exports on consignment basis indicating under a separate column, the date on which the period prescribed for realisation of the export proceeds expires;

(xi) Whether any bills discounted by the bank have been rediscounted by it with its overseas branches/Head Office/correspondents; if so, the matter may be looked into in detail as banks are not permitted to rediscount or avail themselves of advances abroad against bills negotiated, purchased or discounted by them.

Financing of Imports  
(Chapter 6 - Paragraph 6.20).

7. As indicated in paragraph 5 above, the Reserve Bank, as the supervisory authority, is basically concerned with the

quality of credit appraisal and effectiveness of the supervision exercised by the bank over import finance extended by it, as part of the assessment of the bank's advances portfolio. Bearing this in mind, the Inspecting Officer should test check selected transactions, which should include some items of remittances of Rs.50,000 and above effected by the bank against import licences/O.G.L., in order to verify :

(i) Whether letters of credit limits are sanctioned by the bank after taking into consideration all the relevant factors including marketability and price stability of goods to be imported as also a critical appraisal of the ability of importers to retire bills from their own resources or of the adequacy of arrangements made by them to raise necessary resources in time;

(ii) Whether letters of credit have been opened under proper sanction of the appropriate higher authorities or within the discretionary powers of the Manager, and where letters of credit have been opened under the discretionary powers of the Manager, whether the facility has been allowed to deserving parties only;

(iii) Whether the bank maintains credit reports on overseas suppliers in whose favour import letters of credit are established;

(iv) Whether the Exchange Control requirements that letters of credit should be opened by authorised dealers only on behalf

of their own customers who maintain accounts with them and are known to be participating in the trade, that credits should be established only after verification of the Exchange Control copies of import licences (except in cases where imports are under valid O.G.L.) as also documentary evidence to the effect that firm orders for the goods to be imported have been placed and accepted, and after making endorsements on import licences at the time of opening letters of credit, that the date of expiry of the credit should not be later than 75 days after the final date for shipment permitted under the relative (specific) import licence, that letters of credit should not be opened during the grace period of 60 days for effecting shipments allowed by ITC authorities and that in cases where letters of credit have been opened on F.O.B. terms, suitable provision should be made to cover freight and insurance charges, have been complied with;

(v) Whether in the case of letter of credit with provision for deferred payment facility, the constituent has been remitting instalments according to the terms of the credit and is in a position to meet future commitments, as and when they accrue;

(vi) Whether the bank has implemented the suggestions of FEDAI (made at the instance of the Reserve Bank) that letters of credit should stipulate that shipments should be made only by Conference vessels which are on the Lloyds approved list and which are sea-worthy, that letters of credit should call for a

certificate of inspection by a well-known International Inspection Agency, that in case of large value import contracts, banks should obtain credit reports on the suppliers before issuing letters of credit, that letters of credit should call for a certificate of origin from an independent third party like a Chamber of Commerce and that banks should see whether, taking into account the volume of consumption/demand in India for the goods ordered, the import contract on the basis of which letters of credit are issued, was reasonable; the underlying intention in the last suggestion being that banks should discourage speculation in commodities either on the basis of artificial scarcity or on the basis of expectations of changes in the Import Policy;

(vii) Whether there is any indication that importers have entered into contracts with overseas suppliers and/or back-dated the contracts or the relative letters of credit in order to circumvent restrictions imposed by the Import Policy (imposing a ban on or canalisation of import of the commodity involved). If so, the matter should be looked into in detail by the Inspecting Officer;

(viii) Whether discrepancies, if any, in documents in relation to the terms and conditions of the letters of credit are promptly taken up with the foreign branch/correspondent; whether in case, due to such discrepancies, the foreign branch/correspondent has negotiated the bill against indemnity or under reserve, the

acceptance/payment of the bill has been promptly advised to the foreign branch/correspondent and in the event of dishonour of such a bill, notice of dishonour has been promptly sent to the foreign branch/correspondent by cable/telex, demanding refund of the amount, if any, obtained by it in reimbursement, as required;

(ix) Whether (a) usance bills are adequately stamped on their receipt by the bank (b) due dates are correctly arrived at and recorded in a diary maintained for the purpose and (c) acceptance is properly recorded on the bill and there is a procedure of verification of the acceptor's signature (the Inspecting Officer should check this by selecting a few bills at random);

(x) Whether in case of non-payment of documentary bills, prompt steps are taken to protect the goods covered by the bills (bills not retired even after the arrival of the carrying vessels should receive special scrutiny and the reasons therefor ascertained);

(xi) Whether in cases where import loan/trust receipt facilities have been granted, the advances have been allowed only for a reasonable period and sanction of the appropriate authority has been obtained, where necessary;

(xii) Whether the guidelines issued by FEDAI regarding the accounting procedure in respect of import bills received under letters of credit have been followed by the bank;

(xiii) Whether interest and other charges, where necessary, are collected from the drawees at the time of realisation of the bills in accordance with the directives issued by the Reserve Bank and the rules of FEDAI;

(xiv) Whether the Foreign Parcel Register is maintained for foreign inward bills and parcels, the particulars of parcels/bills are properly recorded therein, and necessary safeguards for the custody of bills and parcels are observed;

(xv) Whether the various formalities relating to import transactions prescribed in Chapter 13 of the Exchange Control Manual such as (a) submission of the Exchange Control copy of the import licence to the Reserve Bank after its utilisation to the maximum extent (b) payment for imports in the prescribed/ approved currency and in accordance with permitted methods (c) obtaining prior approval of the Reserve Bank for remittance of proceeds of bills relating to imports under 'cash' import licences where remittance has been delayed beyond the prescribed period, viz., six months from the last date for shipment authorised under the import licence (including grace period) or under the O.G.L., as the case may be (d) obtaining approval of the Reserve Bank for opening letters of credit against import licences on 'deferred payment' basis or for furnishing guarantees in the case of such imports to cover due payment of instalments by the importers (e) marking off the amount of freight on the relative import licence before issuing to the

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consignee a certificate (in the prescribed form) in support of application for payment of freight in rupees in cases where goods are shipped to India (other than under O.G.L.) on 'freight payable at destination' basis, etc., have been complied with by the bank;

(xvi) Whether payments in retirement of import bills are received by the bank, irrespective of amount, by debit to the account of the importer or by means of a crossed cheque drawn by him on his other bankers;

(xvii) Whether in the case of import by post parcel, the precautions envisaged under the Exchange Control regulations have been observed;

(xviii) Whether in the case of imports under foreign loans/credits, the terms and conditions of the relevant Public Notice issued by the Import Trade Control have been complied with and the prescribed documents as required have been duly obtained and forwarded to the concerned authorities promptly.

Forward Exchange Contracts  
(Chapter 7 - Paragraph 7.44)

8. While examining forward exchange contracts entered into by the bank, the following points should be seen by the Inspecting Officer.

(i) The Inspecting Officer should ascertain whether the guidelines given in paragraphs 3.2.3 and 3.2.4 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank, regarding setting up and monitoring of limits for forward contracts for its larger customers and individual banks, both overseas banks as well as authorised dealers in India, have been implemented by the bank;

(ii) It may be seen whether before entering into forward contracts with merchants, the bank has verified that there is adequate documentary evidence in respect of the relevant transaction of the constituent and a record has been kept of such evidence which shows that the exchange risk covered has been in respect of genuine trade transactions and the method of remittance is a permitted one. It may be verified whether in cases where forward purchase contracts were booked against letters of credit, the requisite declaration of the exporter as required in paragraph 7A.2 of the Exchange Control Manual had been obtained ;

(iii) Where in any case, the forward purchase contract had been booked on the strength of cable/telex message, it should be verified whether the original signed contract has been submitted to the bank within a period of one month from the date of booking of the contract;

(iv) A few cases of forward purchase and sale contracts may be verified with the available case papers to see whether they have been booked in conformity with the Exchange Control regulations;

(v) The Inspecting Officer should ascertain whether the bank has ensured that the period of delivery (as extended from time to time) is such that the last date of delivery does not fall beyond 6 months (3 months in case of Afghanistan and Pakistan) from the actual date of shipment or expected date of shipment or beyond the extended period approved by the Reserve Bank;

(vi) It should be verified whether the bank has a satisfactory procedure/system for watching the delivery dates of forward contracts and ensuring that the contracts are taken up/extended by the due dates. It may be noted that authorised dealers are permitted to cancel outstanding contracts unilaterally, i.e., even if the application in Form FCC 2 has not been completed by the customer, after giving due notice to their customers, at the expiry of two months from the last date of delivery of the contracts, if

they are satisfied that the contracts will not be performed by the customers. In the case of overdue contracts, the comments of the authorised dealer should be obtained as to why they have remained outstanding. Opportunities for speculation in the exchange rate can be provided to customers if contracts are not cancelled as quickly as possible;

(vii) It should be verified whether the bank has inbuilt procedures to ensure at the time of purchasing foreign currency proceeds of exports from their customers or purchasing their export bills, that a forward contract has not been fixed already in respect of the underlying export order and is outstanding against which the purchases are to be adjusted. Any cases coming to notice where such purchases have been treated as ready purchases when the forward contracts were outstanding, should be properly enquired into as such shortcomings in procedure can provide opportunities for speculation in the exchange rate;

(viii) Where forward contracts have been booked after export bills were sent on collection basis, it should be verified whether the bank takes care and ensures that the proceeds of such bills when realised are adjusted against the contracts and are not treated as fresh (i.e. ready) purchases. The aim should be to see whether proper

coordination exists between the department handling forward contracts and that handling documents for negotiation/purchase/collection;

(ix) If the bank had booked any contracts against bills sent for collection after they were sent for collection in terms of the relaxation permitted in AD (GP Series) Circular No.55 of 1979, it should be verified whether the conditions laid down therein have been fulfilled;

(x) It may be verified whether the bank had any cases where the forward contracts had been booked with it by the exporter and the letters of credit opened subsequently were restricted for negotiation through another authorised dealer and if so, whether the bank arranged to obtain a foreign currency draft against negotiation of documents from the other authorised dealer for settlement of the forward contract;

(xi) It should be verified whether the bank is allowing exporters to substitute contracts, i.e., deliver proceeds of an export contract other than the one against which the forward contract was booked, without prior permission of the Reserve Bank;

(xii) The bank's cover operations in inter-bank and overseas markets should be verified to see whether there is any speculative tendency in fixing forward contracts;

(xiii) It should be checked that wherever unutilised portions of cancelled contracts were more than U.S. \$ 500 or its equivalent, they have been reported to the Reserve Bank promptly;

(xiv) It should be verified, by a test check, whether the charges prescribed under FEDAI Rules have been recovered from customers while accepting or giving early deliveries, granting extensions and/or cancelling forward exchange contracts as there is scope for leakage of the bank's income.

Non-resident (External) Rupee accounts and Foreign Currency (Non-resident) accounts (Chapter 8 - Paragraphs 8.5 and 8.6)

9. Since the balances held in Non-resident (External) and FCNR accounts are repatriable by authorised dealers at the request of the account holders, without obtaining prior approval of the Reserve Bank, and also these funds are eligible for investment in various schemes, including schemes with repatriation benefits, much responsibility is devolved on Inspecting Officers to ensure that the operations allowed by authorised dealers in these accounts are strictly in accordance with the provisions of Exchange Control regulations. The Inspecting Officer should, inter alia, satisfy himself about the following :

(i) that the Non-resident (External) and FCNF accounts have been opened by authorised dealers only in the names of persons of Indian nationality/origin after obtaining necessary application/account opening form containing essential information (i.e. nationality, country of origin, permanent overseas address, purpose of stay abroad, etc.). An undertaking (in the account opening form itself) that the account holder would promptly intimate the authorised dealer about his return to India on his coming to India for permanent residence, is also obtained;

(ii) that in case of accounts opened in the names of overseas company/firm/society/trust, a certificate, along with account opening form, from an overseas Auditor/Chartered Accountant/Certified Public Accountant is obtained to ensure that the ownership/interest in the overseas company/firm/society or the irrevocable beneficial interest in the trust held by persons of Indian nationality/origin is not less than 60 . Also, an undertaking from the institutional account holders is obtained to the effect that in case such interest falls below the level of 60 at any time in future, they would immediately intimate the change to the authorised dealer;

(iii) that the Non-resident (External) and FCNF accounts are maintained in separate ledger/binders or in separate

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block of the same ledger/binder to distinguish these accounts from other accounts;

(iv) that foreign currency instruments (i.e., FCs, drafts, cheques) drawn in favour of residents of India/third party which are subsequently endorsed in favour of the account holders are not accepted for affording credit to these accounts;

(v) that funds held in ordinary non-resident accounts are not transferred to Non-resident (External) and FCNR accounts without obtaining prior approval of the Reserve Bank;

(vi) that the directives issued by the Department of Banking Operations and Development regarding rates of interest on deposits and directions regarding re-investment of deposits, etc., are strictly adhered to by authorised dealers;

(vii) that encashment/bank certificates are not issued by authorised dealers in respect of remittances received/foreign currency tendered to the credit of these accounts;

(viii) that applications for grant of loans and overdrafts to resident individuals/firms/companies in India against the collateral of fixed deposits held in Non-resident (External) and FCNR accounts are promptly forwarded by authorised dealers to the Reserve Bank (Exchange Control Department and Department of Banking Operations and Development) for their approval and such loans and overdrafts are granted only after obtaining the approval;

(ix) that Rupee loans granted to holders of Non-resident (External) and FCNR accounts are credited, if necessary, to ordinary non-resident accounts of the respective account holders but not to Non-resident (External) accounts;

(x) that Non-resident (External) accounts are not opened with Indian rupees derived from local sources;

(xi) that all transactions in Non-resident (External) and FCNR accounts are promptly reported to the Reserve Bank every month in STAT-4 and STAT-6 respectively; if the authorised dealer under inspection is a link office, i.e., which undertakes sale and purchase transactions with the Reserve Bank, it should be ensured that STAT-5 received from its offices/branches is promptly forwarded to the Reserve Bank after scrutiny;

(xii) that all transactions in Non-resident (External) and FCNR accounts required to be reported to the Reserve Bank on Form A4/A2 are correctly reported and all transactions requiring specific approval of the Reserve Bank are handled only after obtaining such approval.

10. The Inspecting Officers may select a few Non-resident (External) and FCNR accounts, at random, and verify the credits afforded to these accounts with the original credit advices (i.e., T.T., M.T., D.D.) received from overseas

branches/correspondents/other authorised dealers to ensure the external origin of the credits and that no rupee credits from local sources are afforded to these accounts. Similarly, the debit entries for large amounts may be checked to ensure that these debits are allowed strictly as per Exchange Control regulations.

Note: While persons resident in Bilateral Group of countries (U.S.S.F., Poland, Czechoslovakia, Romania and German Democratic Republic, i.e. East Germany) are not eligible to open FCNF accounts, the Inspecting Officers should familiarise themselves with the specific provisions of the Exchange Control Manual relating to Non-Resident (External) accounts in rupees maintained by persons resident in any country included in Bilateral Group.

Rupee accounts of non-resident  
Exchange Houses (Chapter 9 -  
Paragraph 9.37)

11. The Inspecting Officer should ascertain whether the rupee accounts of non-resident Exchange Houses are maintained and operations thereon are allowed by the bank in accordance with the guidelines issued by the Exchange Control Department (vide paragraphs 9.4 to 9.36 of Chapter 9 and/or that may be issued in future) as also whether it has implemented the

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instructions contained in Part 7 of the Guidelines for Internal Control over Foreign Exchange Business issued by the Reserve Bank. In particular, the Inspecting Officer should verify the following:

(i) Whether the accounts are maintained by the Foreign Exchange Department of the bank and if not, where are they located, how are they supervised as also whether the arrangements for supervision over the accounts are satisfactory:

(ii) Whether the bank is following one of the three alternatives provided in paragraph 2 of A.D. (G.P.Series) Circular No.23 of 1978 regarding drawings in rupees by the Exchange Houses or whether any exceptions have been made;

(iii) Whether accounts of the Exchange Houses in India have been utilised for channelling inward remittances other than on private account and, in particular, whether the bank has appointed any Exchange House as its agent for selling rupee travellers cheques (FTCs). In those cases where the bank's FTCs are sold outside India through the Exchange Houses, the Inspecting Officer should ascertain whether the instructions contained in ECD's letter No.EC.CO.TD SAS 514/54-(5)-(FTC)-83 dated 28th November 1983 have been complied with;

(iv) Whether the time-lag between payment of drawings at the drawee office and debits raised at the account-maintaining office is reasonable and if not, whether the bank has taken measures as suggested in A.D. (G.P.Series) Circular No.75 of 1979;

(v) Whether the bank has made sufficient enquiries about the means and standing of the Exchange Houses through reliable sources abroad including the Indian Missions in the territory/ country concerned and likewise satisfied itself periodically that they continue to be well reported upon;

(vi) Whether the bank while quoting rates for selling rupees to the Exchange Houses ensures that the rates quoted are strictly in accordance with the instructions contained in A.D. (G.P. Series) circular No.50 of 1979.

Foreign Exchange Dealings, Cover Operations, Swap Transactions, Dealings with overseas banks/branches and Rupee (Vostro) accounts-Risks and Control

(Chapter 10 - Paragraphs 10.36, 10.37, 10.38, 10.39 and 10.40)

Foreign Exchange Dealings

12. The Inspecting Officer should bear in mind the instructions contained in Parts 1 and 8 of the Guidelines for Internal Control over Foreign Exchange Business and ascertain whether these have been complied with by the bank. In particular, he should verify -

(i) Whether the dealing function has been separated from the accounting, funding and other back-up functions;

(ii) Whether the bank's system for the selection, training and rotation of its dealers is satisfactory;

(iii) Whether the infrastructure facilities provided to the Dealing Department are adequate;

(iv) Whether, before the work starts, the dealers confer on the trend in the overnight markets as also markets still operating in the same time zone and keep the higher authorities informed of the conclusions, and there are adequate communication channels to facilitate quick consultations between the dealers and the higher authorities, as indicated in paragraph 1.5 of the Guidelines;

(v) Deal slips in respect of transactions for amounts of £ 500,000 or its equivalent and above (all deal slips in the case of small banks) during the last one month should be verified to ascertain whether (a) the deals made by the dealers have been recorded on appropriate printed deal slips in duplicate; (b) the deal slips are serially numbered and in different colours to identify sales and purchases; (c) all required particulars are furnished therein particularly the time at which the deal was put through; and (d) the deal slips have been signed/authenticated by the dealer;

(vi) Whether the Accounting Department prepares bank-wise summaries of all outstanding forward exchange contracts with banks for which confirmations from counterparty banks have not been received as at the last working day of each month and the outstandings are followed up expeditiously to have them confirmed by the counterparty banks;

(vii) Whether the bank is maintaining any record showing the movement of rates in the Indian/overseas inter-bank markets;

(viii) Whether the Accounting Department prepares the Rate Scan Report and the action thereon is taken as indicated in paragraph 1.11 of the Guidelines. A few such reports may be verified with the relative deal slips and in case aberrations are wide and/or quite frequent, the explanations given by the dealers/bank may be examined to determine whether they can be considered as acceptable;

(ix) Whether the bank has fixed limits for dealing with individual banks, both overseas banks as well as authorised dealers in India, and if so, the setting up and monitoring of the limits are in accordance with the instructions contained in paragraph 3.2.3 of the Guidelines. In those cases where the limits have been exceeded, whether the approval of appropriate higher authorities has been obtained;

(x) Whether, while making purchases and sales of foreign currencies with overseas banks (including overseas branches of authorised dealers), the bank has observed the conditions/restrictions contained in paragraphs 8.8 and 8.9 of the Exchange Control Manual.

Dealings through Exchange  
Brokers

13. The Inspecting Officer should bear in mind the instructions contained in Part 2 of the Guidelines and ascertain whether these have been complied with by the bank. He should be on the alert in case there are indications of an excessive concentration of business with any one exchange broker, excessive swaps, exchange rates that appear out of line with those for similar transactions on the same day or other unusual terms, late receipt of exchange brokers' notes, nomination of brokers, and substitutions of names of banks. In particular, the Inspecting Officer should verify -

(1) Whether the Accounting Department ensures that  
(a) all exchange brokers' notes for inter-bank deals concluded through their medium are received before the close of business on the day on which the deals were concluded or before the opening hours of the succeeding day; (b) the dates and other particulars given in the notes agree with the relative deal slips; (c) the discrepancies, if any, are brought to the notice

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of the dealers immediately and clarifications/rectification of errors are called for promptly and directly from the brokers by the Accounting Department and not by the dealers; and (d) in case of deals with authorised dealers at outside centres, telex confirmations are attached to the deal slips and if concluded through brokers, their notes are received expeditiously;

(ii) Whether the Accounting Department is maintaining up-to-date broker-wise daily record (separate folio for each broker) of brokerage paid/committed in the form prescribed by the Exchange Control Department in its letter No.EC.S.95/86 (Spl.)-82/83 dated 31st July 1982, all brokerage claims are being verified from this record and the brokerage has been paid at the rates prescribed by FEDAI;

(iii) Whether the Accounting Department is preparing a monthly statement showing a summary of brokerage payments to each broker together with a comparative statement showing payments during previous two years and the changes in the panel of brokers, if any, made during the month, and the statement is put up to the Chief of the Accounting Department as also higher authorities ;

(iv) Whether the bank is maintaining a panel of brokers approved by appropriate higher authorities and if

so, the number of brokers on the panel, how often and by whom it is revised as also the procedure followed by the bank in this regard, should be indicated;

(v) Whether there have been any complaints against the dealers and/or relating to malpractices indulged in by brokers and if so, whether the action as indicated in paragraphs 2.6 and 2.9 of the Guidelines has been taken by the bank.

Swap Transactions

14. The Inspecting Officer should verify whether (a) the swap deals undertaken by the bank in international markets (cross currency deals) were for meeting genuine merchant transactions; and (b) the full amounts of purchases and sales under the swap deals have been recorded in the transactions sheets (to be ultimately incorporated in exchange position records) and not merely the differences thereof as net purchases or sales in counter-currencies. (The latter will show a lower volume of dealings compared with merchant transactions and will not also give a correct picture of purchases and sales of the bank for the purpose of weekly POS statements).

15. The Inspecting Officer should verify all swap deals undertaken by small banks during the last one month and in the case of larger banks, each of the deals for amounts of £ 500,000 or its equivalent and more may be scrutinised to see:

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(a) Whether the base rates at which the deals were concluded and the swap differences were realistic and reflected the prevailing conditions in the inter-bank market. (These may be verified from the rate chart maintained by the bank and brokers' daily reports, if available);

(b) Whether any swap deal has been undertaken at a level rate and if so, the reasons therefor should be ascertained;

(c) Whether swap deals were done for trading in forward and/or for raising rupees;

(d) Whether any foreign currency deliveries have been set off with other authorised dealers and if so, the circumstances in which the set-offs became necessary should be ascertained, and it should also be verified whether the instructions as indicated in paragraph 10.21 of Chapter 10 have been complied with. An irregular swap is illustrated below :

Bank A entered into two swap deals for US \$ 25 million each in, say, April with Bank B as under :

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Purchaser	Seller	Rate	Delivery	Rupee payment by (in lakhs of rupees)	
				Bank <u>A</u>	Bank <u>B</u>
A	B	12.06	21-30 April	2072.97	
B	A	12.35	21-30 April		2024.29
B	A	12.00	24-30 June		2083.33
A	B	12.33	24-30 June	2027.57	

On due dates, foreign currency amounts were set off without any deliveries of foreign currencies and transactions were settled by making rupee payments. The effect of the above swap deals was that Bank A paid a net amount of Rs.48.68 lakhs when the first leg of the transactions was put through and received Rs.55.76 lakhs at the conclusion of the second leg, yielding a profit of Rs.7.08 lakhs for lending rupee funds to the extent of Rs.48.68 lakhs to Bank B for two months (return on an annual basis 87%). The irregularities in the above deals are:

- (i) Neither the base rates at which near forwards of the transactions were concluded nor the swap differences reflected the prevailing rates in the inter-bank market. This is also obvious from the fact that for the same delivery, viz., 21-30 April, the rates were as widely divergent as \$12.06 and \$ 12.35. The rates for the other delivery were also widely divergent.

(ii) The transactions were not genuine foreign exchange transactions as no deliveries were given or taken on due dates through correspondent banks at foreign centre and the foreign currency purchases and sales were set off and net amounts were settled in rupees locally.

Dealings with overseas banks/branches  
and Rupee (Vostro) Accounts

16. The Inspecting Officer should bear in mind the instructions contained in Part 7 of the Guidelines and ascertain whether these have been implemented by the bank. In particular, he should verify -

(i) Whether the arrangements for supervision and monitoring of Rupee (Vostro) accounts by the bank are satisfactory ;

(ii) Whether funds held in any Rupee (Vostro) accounts of overseas banks (including overseas branches/Head Office of the bank and correspondent banks) are abnormal or disproportionate to meet their normal business requirements in India ;

(iii) Whether the rupee trading with overseas banks has been disproportionate to their normal trade-related and need-based funding requirements for meeting bonafide payment obligations in India and whether there was a speculative intent in putting through the transactions in as much as

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purchases of overseas banks were much in excess of their requirements and consequently sales back to the same or some other authorised dealer were also for large amounts

(iv) Whether, while quoting rates for selling or buying rupees to/from overseas banks, the bank ensures that the rates quoted are strictly in accordance with the directions contained in A.D. (G.P. Series) circular No.50 of 1979 and A.D. (G.P. Series) Circular No.5 of 1983;

(v) Whether the bank is maintaining properly a continuing record of the rates quoted to overseas banks indicating the time at which the transaction was done, the cross rate for the foreign currency (if other than pound sterling) against pound sterling (or other currency) on which the rate was based, the bank's margin and the relative supporting evidence ;

(vi) Whether the bank has submitted daily reports to the Reserve Bank in respect of its purchases of rupees from overseas banks for Rs.5 lakhs and above and its sales of rupees to overseas banks for Rs.100.lakhs and above, as prescribed in A.D. (G.P. Series) Circular No.5 of 1983, and the particulars so reported are correct as per the bank's records ;

(vii) Whether there were any instances where the bank had quoted to overseas banks cover rates without adding any cushion/loading margin in contravention of the directions contained in A.D. (G.P.Series) Circular No.31 of 1980;

(viii) Whether the Rupee (Vostro) accounts of any overseas bank were overdrawn beyond the limit of Rs.20 lakhs continuously for more than 5 days and if so, the extent and period of the overdraft, the rate of interest charged thereon, if any, as also whether the matter was reported to the Reserve Bank, may be indicated - Paragraph 8.12 of the Exchange Control Manual;

(ix) Whether the bank is following one of the three alternatives indicated in A.D. (G.P. Series) Circular No.23 of 1978 read with A.D. (G.P.Series) Circular No.75 of 1979, regarding drawings in rupees by overseas banks or whether any exceptions have been made;

(x) Whether the time-lag between payment of drawings at the drawee offices and debits raised at the account-maintaining office is reasonable and if not, whether the bank has taken the measures as suggested in A.P. (G.P Series) Circular No.75 of 1979;

(xi) Whether the adequacy of balances in Rupee (Vostro) accounts of overseas banks is established by applying the test prescribed in ECD's circular No.ECA.424/29-83 dated 5th April 1983;

(xii) Whether the secrecy of inward messages is maintained by ensuring the adequacy of arrangements regarding the custody of secret documents, decoding and coding of messages, etc , as indicated in paragraph 7.5 of the Guidelines;

(xiii) Whether in case of forward purchases and sales with overseas banks involving amounts individually exceeding U.S. \$ 500,000 or its equivalent, particulars thereof have been intimated by the bank, on a daily basis, to the Reserve Bank as per paragraph 8.7 (iii) of the Exchange Control Manual.

Evaluation of Foreign Exchange Profits and Losses (Chapter 11 - Paragraph 11.10)

17. The Inspecting Officer should verify whether the bank is taking into account foreign currency bills purchased or discounted (Export suspense), import bills under letters of credit (Import suspense), foreign currency notes in hand and foreign currency drafts payable, and making adjustments for items in transit while evaluating exchange positions or it is reckoning only the balances in Nostro (mirror) accounts for the purpose of adjustment of profit or loss. It should also be verified whether the forward purchase and sale contracts outstanding as on the date of evaluation are taken into consideration. The procedure followed in this regard should be examined and any special features, particularly the rates used for the purpose of liquidating monthwise positions and the departures, if any, made from

the procedure followed during the previous evaluation period, should be commented upon. It should be ascertained whether the work regarding evaluation of foreign exchange profit or loss is handled by persons other than dealers and the results of the evaluation reported to the top management. A statement showing the profit or loss on the bank's foreign exchange business during the last three calendar years may be furnished.

Returns and statements submitted to Exchange Control Department by Authorised Dealers (Chapter 12 - Paragraphs 12.4, 12.5, 12.6, 12.7 and 12.8 )

#### R- Returns

18. While undertaking the scrutiny of R>Returns of authorised dealers, the Inspecting Officers should, prima facie, satisfy about the following:-

- (i) That all the concerned branches of the bank have been submitting R>Returns to Exchange Control Department Offices within the prescribed period;
- (ii) That the branches are adequately staffed with experienced personnel to compile R>Returns;
- (iii) That the system adopted by the Head Office to watch prompt submission of R>Returns by branches to Exchange Control Department Offices is satisfactory ;

(iv) That the F>Returns are seen and signed invariably by the officials holding charge of the branches;

(v) That the Head Office ensures, through appropriate reporting system, that all the transactions handled by the branches during the ten-day period are reported by them in the F>Returns pertaining to that period;

(vi) That the classification of transactions into 'Ready' and 'Forward' by authorised dealer for reporting in R>Returns, is correct;

(vii) That reconciliation of the balances in foreign currency accounts as appearing in the local books with the balances advised by the overseas banks is attempted regularly;

(viii) That certificates of balances in respect of rupee accounts of overseas banks are sent periodically and confirmation obtained.

19. The Inspecting Officer should pick up R>Returns submitted to Exchange Control Department, on a random basis, and scrutinise the sale/purchase transactions reported therein with reference to the relevant books and registers maintained by the authorised dealer to ascertain

(i) Whether all sale transactions undertaken during the ten-day period have been reported in the R-Return;

(ii) Whether remittance forms A1 and A2 are duly completed in respect of all sale transactions;

(iii) Whether the sale transactions are either clearly covered under the powers delegated to authorised dealers or covered by specific approval of Exchange Control Department;

(iv) Whether the branches in Category 'A' (i.e., branches maintaining independent foreign currency accounts in their names) ensure, periodically, that the aggregate sales and purchases of branches in Category 'B' (i.e., branches not maintaining independent foreign currency accounts but having powers of operating on the accounts maintained by Head Office/ Principal Office or any other link office) reported in their F>Returns tally with the sales and purchases actually reported to Exchange Control Department in the R>Returns submitted directly by branches in Category 'B';

(v) Whether all purchases made during the ten-day period have been properly classified and correctly reported in the F>Returns;

(vi) Whether purchases from public are properly classified under purchases against exports and purchases other than against exports;

(vii) That in case of purchases from public for purposes other than exports individually for the equivalent of

Rs.10,000/- and above, a supplementary statement showing details of such purchases is attached in the format given in the R-Return ;

(viii) That all forward sales and forward purchases undertaken by the authorised dealer during the ten-day period have been reported in the R>Returns;

(ix) Whether the figures of cash balance and exchange position reported in the R-Return correctly reflect the balance and position as per the books maintained by the authorised dealer;

(x) Whether all the supporting documents (e.g. remittance forms A1 and A2, <sup>statements, duplicates</sup> ENC- / of GR/PP forms, fully utilised Exchange Control copies of import licences, fully utilised FBI exchange permits, Exchange Control copies of Customs Bills of Entry) are invariably submitted alongwith the R>Returns.

### Statements

20. Particulars of various statements required to be submitted by authorised dealers to Exchange Control Department Offices are given in Chapter 31 of the Exchange Control Manual. For ready reference, a chart showing the details of the statements is given in the Annexure to Chapter 12.

21. The Inspecting Officers should satisfy themselves about the following:-

(i) Whether the staff attending to the work relating to compilation of statements have full knowledge of the regulations to compile the figures correctly;

(ii) Whether Head Office/Controlling Office ensures submission of various statements by the branch to the Reserve Bank in time; whether any calendar of statements is maintained by the former to monitor timely submission of statements;

(iii) Whether any reminders have been received by the branch, regarding delay in submission of statements, from the Reserve Bank in the past; if so, what measures have been initiated to avoid such delays in future.

22. One or two statements may be selected, at random from each category and the figures reported therein may be checked with reference to the relative books and registers to ensure that all the figures reported in the statements correctly reflect the position as per books and registers.

Working of overseas branches of Indian banks - Special aspects (Chapter 15 - Paragraphs 15.24 and 15.25)

23. The instructions contained in circulars DBOD.No,BL. 7242/C.212-82 dated 16th August 1982 and DBOD No.IBS 260/C.212-83 dated 2nd March 1983, vide paragraph 15.14 above, have been reiterated and amplified in circular letter D.O.No. DBOD.IBS.123/C.212-84 dated 14th February 1984. Broadly, the banks have been further advised as follows :

(i) Informative and analytical reviews should be prepared by the banks on the working of overseas branches - not only in the aggregate but separately for each operation - at half-yearly intervals and placed before their Board of Directors. (Copies thereof should be furnished to the Reserve Bank for information.)

(ii) Only suitable officers of proven integrity and expertise should be posted to foreign centres. Banks should establish proper screening procedures for selection of officers to be posted abroad and they should be given adequate training before they are entrusted the management of foreign branches. It has also to be ensured that overseas placements are not allowed to run beyond three years.

(iii) At overseas centres where more than one Indian bank have branches, the Indian banks should set up inter-bank consultative forums with a view to alerting the banks to the risks of assuming large commitments on a few borrower groups involving also multiple financing, the intention being that the Indian banks' managers could have, inter alia, mutual exchange of views as well as information and assessments on credit exposures on borrowers and borrower groups. Further, the executives from any of the public sector banks visiting such centres could prepare country assessment reports and make them available to the other banks for the common benefit of all.

(iv) It is absolutely essential that the Head Offices ensure that credit operations undertaken by managers of overseas branches are within the agreed parameters of delegation and home authorisations. The accountability of the senior executives at the Head Offices (International Divisions) for properly overseeing the working of overseas offices and ensuring their healthy functioning should be clearly established.

(v) It is necessary that the critical comments/<sup>o</sup> observations of statutory auditors as well as the central banking authorities are used as part of the bank's management information and control systems on overseas branches and

corrective action taken promptly in this behalf and reported to the Boards.

(vi) It is imperative that effective systems of internal/concurrent audits of overseas branches on a regular basis are established and such auditors be enabled to function independently and objectively with direct accountability to Head Office management.

(vii) It is important to enjoin upon senior executives to look into important aspects of working of the overseas offices during their visits and report systematically to the higher authorities for proper follow up. Further, besides usual reporting, it will be useful if the overseas executives are required to specifically bring to the notice of the Chairman by telex or demi-official letter any important developments in the working of overseas branches, like frauds noticed, liquidity problems, important instructions of local central banking authority and any large over-limits granted, with reasons therefor.

24. Besides the guidelines given in the various Chapters for the scrutiny of foreign exchange business and the instructions contained in Supplement C to the Inspection Manual, the following points may be examined by the Inspecting Officers during the course of inspection of overseas branches of Indian banks.

(i) Whether the measures/guidelines/instructions as indicated in paragraphs 15.14 and 15.24 above, have been implemented/complied with by the bank;

(ii) Whether the branch has implemented the Guidelines for Internal Control over Foreign Exchange Business regarding dealing room operations ;

(iii) Whether the branch has remitted every year its profits to the Head Office in India;

(iv) Whether the Head Office of the bank has laid down any specific guidelines (including daylight, overnight, etc., limits) for the overseas branch's exchange dealings and other foreign exchange operations, and if so, to what extent the branch has been complying with the guidelines;

(v) Whether in respect of project exports from India, the branch has granted any overdraft, letters of credit, forward cover, etc., facilities to Indian companies (i.e , registered in India) and if so, whether the facilities have been those/approved by the Head Office of the bank and that confirmation is available at the branch regarding completion of the Exchange Control formalities by the borrower/obligant company. In case the branch has granted any such facilities without the Indian company having obtained proper Exchange Control approvals for entering into the commitments abroad, full details thereof should be ascertained by the Inspecting

Officer and indicated in the inspection report. Similarly, in respect of any loan arrangement in the name of companies registered in India such as shipping companies, etc., the branch should be asked to furnish full details of the Exchange Control and Head Office approvals in support of the arrangement. Such cases may be suitably commented upon in the inspection report.

(vi) Deposit accounts of companies registered in India may be listed and commented upon with reference to the Exchange Control approvals for maintaining such accounts.

A P P E N D I X - I

RESERVE BANK OF INDIA  
CENTRAL OFFICE,  
DEPARTMENT OF BANKING OPERATIONS & DEVELOPMENT  
"The Arcade", World Trade Centre, Cuffe Parade,  
Colaba, BOMBAY-400 005.

DATE: 27th August, 1981  
5th Bhadra, 1903  
(Saka)

M E M O R A N D U M

It has been decided to set up a Working Group to evolve guidelines for the scrutiny of foreign exchange transactions of banks and operations of foreign branches of Indian banks. The Group will consist of :

1. Shri R.C. Mody, Chairman  
Addl. Chief Officer,  
Industrial Credit Department,  
Reserve Bank of India,  
Central Office.
2. Shri S.S. Thakur, Member  
Jt. Controller,  
Exchange Control Department,  
Reserve Bank of India,  
Central Office.

A l t e r n a t e :

3. Shri V. Subrahmanyam,  
Dy. Controller,  
Exchange Control Department,  
Reserve Bank of India,  
Central Office.
4. Shri V.M. Sunder Raj, Member  
Director,  
Banking Division,  
Economic Department,  
Reserve Bank of India,
5. Shri S.S.H. Jhurani, Member-  
Dy. Chief Officer, Secretary  
Department of Banking  
Operations & Development,  
Reserve Bank of India,  
Central Office.

It will more specifically -

- (i) examine the important aspects to be covered while scrutinising the foreign exchange transactions of banks in the course of their inspection by the Reserve Bank of India;
- (ii) review the system of internal control on various aspects of foreign exchange business, viz., inter-bank dealings, banker-broker relationship, rupee account of foreign banks, verification of balances, mode of currency valuation, method of booking profit/loss and suggest suitable guidelines for the use of the inspecting officers of both DBOD and ECD;
- (iii) examine the control system in the Head Offices of banks over the working of the foreign branches including general supervision, control over foreign exchange transactions, guarantee and other contingent liabilities, fixing of limits for various currencies, country-wise risk exposure, control over the advances portfolio of the foreign branches, etc., and suggest modifications, if any, necessary in such control systems;
- (iv) examine the system of inspection of foreign branches of Indian banks by the RBI and suggest a suitable policy for such inspections in

regard to periodicity, coverage, etc.; and

- (v) any other related matter which the Group may like to go into.

In their deliberations, the Group may keep in view the guidelines already issued by the Reserve Bank for internal control over foreign exchange business. They may also keep in view the need for the Indian banks operating abroad to conform to the norms evolved by the monetary authorities of the countries in which the Indian banks operate.

The Group may furnish its report within a period of 3 months. The Secretariat for the Group will be provided by DBOD.

( W. S. Tambe )  
Executive Director.

A P P E N D I X -II

RESERVE BANK OF INDIA  
CENTRAL OFFICE  
DEPARTMENT OF BANKING OPERATIONS  
AND DEVELOPMENT  
"THE ARCADE", World Trade Centre, Cuffe Parade,  
Colaba, BOMBAY-400 005.

9th December 1981  
18th Agrahayana 1983 (Saka)

M E M O R A N D U M

In partial modification of the Memorandum dated the 27th August 1981, the composition of the Working Group to evolve guidelines for the scrutiny of foreign foreign exchange transactions of banks and operations of foreign branches of Indian banks will stand modified, with immediate effect, as under :

1. Shri V. Subramanian (Vice Shri R.C., Mody) Chairman  
Additional Chief Officer,  
Department of Banking Operations  
and Development,  
Reserve Bank of India,  
Central Office,  
Bombay.
2. Shri S.S. Thakur, Member  
Additional Controller,  
Exchange Control Department,  
Reserve Bank of India,  
Central Office,  
Bombay.

A l t e r n a t e :

Shri V. Subrahmanyam,  
Deputy Controller,  
Exchange Control Department,  
Reserve Bank of India,  
Central Office,  
Bombay.

3. Shri V. M. Sundar Raj, Member  
Director,  
Banking Division,  
Economic Department,  
Reserve Bank of India,  
Bombay.
  
4. Shri S.S.H. Jhurani, Member-Secretary  
Deputy Chief Officer,  
Department of Banking  
Operations & Development,  
Reserve Bank of India,  
Central Office,  
Bombay.

The terms of reference will, remain unchanged.

( W. S. Tambe )  
Executive Director.

### APPENDIX - III

Summary of suggestions received from  
Regional Offices of the Department  
of Banking Operations and Development  
and Exchange Control Department and  
the Bankers Training College

Department of Banking Operations  
and Development

Bombay Regional Office (DBOD)

Considering that officers from DBOD have more background and those from ECD would be comparatively more conversant with Exchange Control regulations, it may be desirable to associate officers of both Departments for the purpose of scrutinising the foreign exchange transactions of banks. Detailed plans for synthesising the expertise of both Departments should be worked out.

2. There is generally a long time-lag of 3 to 6 years between two consecutive inspections of at least major banks. It would be hardly possible for the Inspecting Officer to scrutinise transactions spread over such a long period. It would, therefore, be necessary for the Inspecting Officer to concentrate on the scrutiny of transactions during the specified periods where certain aspects acquire significance because of trends in exchange rate fluctuations/other factors affecting international trade, etc. As ECD would be scrutinising/

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examining a host of returns and other information in this context, and carries out its own inspections too, it would be normally in a better position to give this background information to DBOD. While ECD has been giving such information to DBOD, it appears to be at present on an ad-hoc basis and there is need for a continuous flow of such information. Further, it would also be useful if DBOD is kept apprised of, in detail, regarding the action taken by ECD on the issues raised by DBOD officers in the notes on the foreign exchange business on banks.

3. Inspecting Officers of DBOD at present scrutinise only a limited number of transactions in respect of the foreign exchange business of banks. Constraints of time and trained staff make it difficult to have a wider coverage or to scrutinise the operations in greater depth.

4. The 'Guidelines for Internal Control over Foreign Exchange Business' issued by ECD could serve as a useful basis for scrutiny of internal controls in banks. The guidelines may have to be brought up-to-date after receipt of comments of foreign banks on the prevalent systems of internal control observed by them. The aspects of scrutiny on the basis of the guidelines would depend on the level of foreign exchange business development in individual banks.

5. The aspects of scrutiny of foreign exchange transactions would undergo changes due to new trends and practices in international trade and finance. The Inspecting Officers should be promptly informed of new developments which have a bearing on our scrutiny of foreign exchange business.

6. As far as the returns prescribed by ECD are concerned, it would be better for the Department to follow-up more closely the non-submission or delays in submission of the returns. Any information having an important bearing on the conduct of foreign exchange business or any relevant policy matters of importance should be communicated to DBOD so that the aspects could be looked into during inspections.

7. As banks are required to submit returns to ECD covering various aspects of foreign exchange, the work relating to returns and non-residents accounts, which requires considerable time but does not require experience or training in foreign exchange, may be left to ECD.

8. The information about the working of Foreign Exchange Departments of banks is not made available to officers of DBOD. Some information in this regard, on the basis of returns received by FCD, may be made available to DBOD officers,

9. During inspection of foreign exchange business, DBOD officers should be asked to cover foreign currency

accounts, operations in rupee accounts maintained in India by overseas banks/exchange houses, inter-bank transactions including cover operations, position, forward contracts and any other aspect which the Inspecting Officer desired to cover.

10. As regards method of booking of profits, F.B.I has not yet evolved a uniform procedure for booking profits in foreign exchange by banks. Laying down a uniform procedure in this regard by F.B.I would be helpful both to the banking system as also to RBI officers in scrutinising this aspect.

11. Inspection of foreign banks may normally be synchronised with the financial inspection/annual appraisal of the banks and their periodicity should be at least once in 2 to 3 years.

12. Books/literature on the banking practices/systems of laws and other customs which might affect banking in foreign countries where the branches of Indian banks are situated, should readily be available with DBOD and its Regional Offices for pre-study. RBI and Head Offices of banks should function as repositories of such information.

13. At present, the instructions are to scrutinise a few selected transactions under exports, imports, forward contracts, foreign currency accounts, cover operations, etc.

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The interpretation of the word 'few' is left to the Inspecting Officer. The work load on the inspection team is such that it is not possible to scrutinise all aspects. The Inspecting Officer will cover exports and imports as the scrutiny of advances is taken up. Except the exchange rate which is advised by the Central Foreign Exchange Department of a bank, inadequacy of experienced staff will not be a constraint as an officer will understand the transactions by a perusal of a few transactions and the instruction manual of a bank. No Inspecting Officer is likely to detect frauds except by accident. Inspection is not an audit. This is not appreciated.

14. As regards inspections of foreign branches of banks, it is observed that no officer of the Bombay Regional Office of DBOD has been associated in any such inspections so far although it has not only the largest compliment perhaps of inspecting officers but also banks doing large foreign exchange business.

Madras Regional Office (DBOD)

15. Qualitative study of foreign exchange transactions is suggested to find out the quantum of arbitrage transactions and whether such transactions are commensurate with the financial strength/capacity of the bank. It would be necessary, in the first instance, to determine the outer

limits for exchange turnover and whether the limit should be based on the volume of merchant transactions or the owned funds of the bank or a combination of both.

16. A scrutiny of the terms of arrangements, entered into by the banks on behalf of their overseas branches, be made to arrive at the advantages or disadvantages accruing to the bank. It should also be ensured that in appointing agents/correspondents, a proper appraisal of their resources, standing and credit rating is undertaken.

17. A special study is suggested in areas of inter-bank transactions, funding operations and arbitrage transactions with overseas branches and banks.

18. To ensure that no (cover) entries are made to cover the heavy trading transactions in a week, a detailed study of the statement of position be made as also the individual entries. The study must pertain to all currencies.

19. Fupee accounts of private bankers must be checked for concealed overdrafts specially to see whether value-dating of payments against drawings by overseas correspondents is adhered to.

20. The Inspecting Officer will have to see whether the dealer is educationally qualified to appreciate the intricacies of economic and political developments which have a bearing on foreign exchange rates. He must find out

whether the dealer is mentally alert and of high integrity warranting the particular assignment. Adherence to prescribed rules by him be ascertained. Complaints received must receive proper attention.

21. The Inspecting Officer must look into exchange functioning to find out whether any target oriented approach is made by the bank to increase exchange profits. This is stressed because such approach may result in heavy speculation in deals.

22. The Inspecting Officer must look for any substitution of banks in inter-bank contracts with a view to discourage it.

23. There are a number of irregularities in the day-to-day operations of foreign exchange business like delay in taking swap deals into position, non-submission of correct statement of position, unwarranted inter-bank transactions, mismatched position maintenance on the higher side and violation of Exchange Control regulations. Some amount of inter-bank transactions have necessarily to be allowed for developing a domestic exchange market. All that is necessary is to prescribe the outer limits for such transactions either with reference to the merchant base or equity base of the dealing bank.

24. In order to ensure the effectiveness of inspection of foreign exchange business, it is suggested that the Inspecting Officers be given adequate training in a commercial bank in foreign exchange transactions.

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New Delhi Regional Office (DBOD)

25. There should be clear cut demarcation of important aspects to be covered for scrutinising the foreign exchange transactions of banks in the course of inspection by DBOD and ECD Officers at branch and Head Office levels. This bifurcation should be done on the basis of inspections carried out during the last three years and, at least their utility to the bank/country may be looked into before demarcation. DBOD should only examine financial risk exposure subjects such as financing of exports, imports, forward exchange contracts, income and method of booking exchange profits, conduct of non-resident deposit accounts and working of the branches abroad. The detailed scrutiny of returns and submission thereof and the violation of Exchange Control regulations should be looked into by ECD only. ECD should provide DBOD Regional Offices copies of their inspection reports for information and guidance immediately, after the completion of inspections. DBOD Officers should devote more attention to the undernoted aspects:

- (i) Inter-bank dealings should be scrutinised with a view to know the speculative activities of the bank atleast for 2 to 3 months period.
- (ii) The commission paid to brokers for last few years may be examined with a view to see that no favour has been

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shown to a particular broker. Several brokers have taken undue advantage from banks' officials due to laxity on their part in the past for consideration other than normal business transactions. The middleman role of brokers may be dispensed with provided the role is taken up by dealing banks. It is suggested that a study in this respect may be taken up.

(iii) Larger payments and receipts in rupee accounts of foreign banks for last one year may be carefully scrutinised.

(iv) The follow-up action by branches in respect of outstanding export bills should be prompt and Head Office control in respect of large outstandings should be effective. Head Office should monitor effectively prompt submission of quarterly statements with complete particulars to ECD offices and take follow-up action promptly on larger transactions of exports (i.e., according to the size of banks and risk involved therein).

(v) Head Offices/International Divisions who monitor exchange position of branches should take appropriate action immediately in case where they notice large open positions. It will be better if some limits are fixed for each currency for open position for each position maintaining branch.

(vi) The foreign currency accounts should be reconciled periodically with the balances advised by the overseas correspondents at a shorter interval (i.e., monthly or

fortnightly, if transactions are more) and prompt follow-up action in respect of items for large amounts should be taken up by branches and this position should also be watched constantly by Head Office through monthly certificates/returns.

(vii) Head Office/International Banking Division should arrange inspection of branches handling major portion of bank's foreign exchange business on a yearly basis by competent staff who are conversant with the Exchange Control regulations.

(viii) The staff attached to foreign exchange departments of authorised dealers should be experienced and equipped with technical knowledge. Adequate number of copies of ECD Manual (or relevant extracts) or other important publications should be made available to staff working in such departments.

(ix) The Dealing Department should be equipped with well trained personnel with academic background, mental ability and of integrity. There should be independent on-going check on the activities of the dealers through the medium of back-up staff. System of reporting larger transactions to senior officers for approval should be brought in for control on dealers. All large deals should be carefully scrutinised by Accounts Department independently and approval taken from senior experienced local Heads.

(x) The method adopted by the bank for evaluation of profit/loss should be uniform from period to period and year to year. As far as possible, the balances in Nostro mirror accounts should be valued at realistic rates uniformly. The forward business transactions should be excluded for this purpose, as far as possible, unless they represent a sizable business. However, for losses expected on account of forward transactions, provision should be made for such losses. The rates and methods adopted by banks for evaluation of profit and loss should be studied for last few years or from the period when changes have been made in the method. This item requires close scrutiny by our officers as manipulations/adjustments are made to show better results.

(xi) For effective supervision and control, Head Office should obtain periodical controlling statements such as, foreign bills purchased/discounted which are overdue for more than 30 days, irregular advances statement (including bills), weekly statement of affairs, statement of guarantee and other contingent liabilities (with larger outstandings) Limits should be fixed for dealing in various currencies and close watch should be kept by controlling offices. Country-wise/currency-wise exposure of risk in foreign bills negotiation should be called for at periodical intervals. Control over the advances portfolio of foreign branches

is very necessary. All unauthorised advances should be discouraged and constant watch should be kept on branch Managers who indulge in unauthorised business on large scale. Such officers/Managers should be called back or transferred if they do not adhere to Head Office discipline for some time, keeping in view the risk involved.

(xii) During the course of inspection of banks/controlling offices of foreign branches of Indian banks, Principal Inspecting Officer should first study the state of affairs and position of business conducted by the foreign branches and Head Office control thereon as available from Head Office records. After seeing the country-wise risk exposure of foreign branches and control over the advances portfolio of the foreign branches, he may suggest the names of the foreign branches for inspection to Central Office for their approval. Where risk exposure/quantum of advances is more according to Head Office, the inspection should be carried out immediately or on completion of the inspection of Head Office (Foreign Exchange Division), by such competent staff who have got sufficient experience of inspection of foreign exchange business and preferably by persons who have seen the records of such branches at Head Office and have got the necessary background idea about the working of the foreign branches.

Bangalore Regional Office (DBOD)

26. The guidelines contained in Chapter 5 of the Inspection Manual are adequate. The guidelines issued

by Exchange Control Department to banks dealing in foreign exchange are also quite exhaustive and the Inspecting Officers may indicate the progress made by the banks in implementing the guidelines. The broad guidelines issued by the Central Office of Exchange Control Department to their Regional Offices may be borne in mind while conducting an inspection of the foreign exchange business portfolio. The attention of the Inspecting Officer should be focussed on inter-bank dealings. In particular, it should be seen whether banks having low customer base which have recently been licensed are embarking on free exchange trading on a large scale. The Inspecting Officer should verify whether the operations undertaken by the dealer in inter-bank market are justifiable. It should be ensured whether transactions with overseas banks are necessitated by the existence of a currency position. Inter-bank dealings have assumed importance in recent times as fund problems are sometimes resolved by seeking recourse to the inter-bank market. The other areas to be covered are the currency position, control over reconciliation of Nostro balances, control over Vostro accounts, internal control and reporting system and the system of booking exchange profit. The present format of the note on foreign exchange business is considered adequate. However, it

needs to be modified so as to include an assessment of the bank's activities in international banking such as raising funds through issue of Floating Rate Notes, current deposits, etc., and participating in syndication loans.

27. In many banks, credit proposals involving one or more lines of credit pertaining to foreign exchange business are processed by the Foreign Exchange Department or International Banking Division. As this Department is essentially concerned with the task of compliance with Exchange Control requirements, the proposals are seldom analysed from the credit analyst's points of view - capacity of the borrower, assessment of credit needs, etc. It should be ensured during inspections that credit proposals are properly analysed and whether qualified credit analysts are posted to the Department.

28. In certain banks, Head Offices are located outside Bombay, but the centralised Foreign Exchange Department is situated in Bombay. In such cases, because of geographical distance, lack of control by Head Office over the Central Foreign Exchange Department is observed. It may be seen during inspections whether the Management Information System returns devised by the bank are adequate to enable the Head Office to get a feed-back regarding the important aspects of the working of the

Central Foreign Exchange Department.

29. Inspecting Officers may be required to examine whether banks, while quoting rates for foreign currency deposits, quote higher rates in lieu of concessional interest rates offered for deposits. Where finer rates are quoted to customers, the loss in income in this regard may be made good by collecting from them (customers) other incidental charges such as postage, service charges, etc. The Inspecting Officer may examine this aspect to ensure whether customers get a fair deal.

30. While opening letters of credit on behalf of an importer, his ability to honour the bills should be taken into account. A total overall limit should be fixed so as to include all his credit requirements, viz., pledge/hypothecation, bills limits, etc. The Inspecting Officers may ensure this aspect during inspections. In certain cases, it is observed that the documents negotiated are not promptly despatched to the respective centres. This results in delay in accrual of foreign currency funds to the bank. The Inspecting Officer may ensure that there is no undue delay in despatch of documents by making a sample verification in this regard.

31. The Head Office supervision and control over the working of foreign branches has to be exercised through an effective reporting system, periodical internal audit/

inspection and occasional fact-finding visits by senior officers from Head Office. The system of reporting should cover all the facets of the working of the foreign branches. The key areas, relating to which returns may be called for, should cover outstanding export bills, revaluation of net currency positions, interest and exchange rates information on daily basis, and exchange cover arrangements adopted by the branch for the foreign currency liabilities and assets. The statements received from foreign branches should be subjected to detailed scrutiny at the Head Office. As regards fixing of limits for various currencies, country-wise risks and contingent liabilities, suitable guidelines may be framed in the light of the deliberations of the International Conference of Banking Supervisors and comments received from banks in this regard.

32. The guidelines regarding inspection of foreign branches of Indian banks laid down in the Inspection Manual are comprehensive. In addition, the following main areas should receive the attention of the Inspecting Officers.

(i) The Inspecting Officer's observations have to be focussed particularly on the composition of funds, relative factors, composite cost, switched assets, tenor/maturity pattern, and any obligation to keep any part of the funds in specific reserve assets.

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(ii) The prime factor in the study of assets is their disbursal in terms of risk element and the choice of assets in a manner harmonising with the pattern of funding. The Inspecting Officers would also do well to check up the turnover of assets in the previous period and particularly examine whether on account of any mismatching of the maturities of assets and liabilities, the bank had to incur any additional cost.

(iii) The factors that go into the profitability of an overseas branch are mainly the net differential between the income on advances and funding cost, and exchange and commission earned on services including gainful accruals from foreign exchange transactions. The maturity pattern of advances has a decisive bearing upon the net differential between the cost of funding and operational income as in case the two maturities are not well matched, there is every possibility of the bank being put to additional cost.

(iv) The control mechanism should be such that it would be adequate to ensure prevention of income erosion and, at the same time, be able to answer the fundamental requirements of correct monitoring of data and their proper interpretation. The areas which are most vulnerable and need to be carefully examined are those mentioned in paragraph 31 above.

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(v) The special aspects relating to funding techniques, loaning avenues and operational profitability are worth mentioning. Taking the funding aspect, there is a possibility of the branch taking finance from other banks through discounting of acceptances. In the Euro-market especially, the discount rate for acceptances is a shade lower than the interest for a deposit of the same tenor. Thus, it is advantageous if the branch resorts to discounting of bills to provide itself with funds as a cheaper alternative to taking deposits. Moreover, there is also the profitability of entering into participation arrangements with other banks to fund advances portfolio in the event the period of participation and the terms thereof match with the corresponding aspects of the advances. Taking up a foreign currency asset further brings with it the question of exchange risk management for the bank as well as the borrower. In the case of commercial advances in foreign currencies (bills particularly), the bank has to be guarded in taking up positions without there being a prospect of availability of cover for the full period and amount of the asset. There is also the overall question of lengthening of the period of particular types of assets (such as overdue instalments in Euro-loans and delays in the realisation of purchased bills) which may

cause dislocation in the cash flow pattern and also may lead to a situation of unforeseen erosion of income and asset value. The periodicity of inspections of branches by RBI would depend upon the system and periodicity of inspections by the bank's own internal inspection machinery. It is, however, suggested that the foreign branches may be inspected once in three years.

33. In the light of the recent sophisticated developments in international banking arena, the need to impart intensive practical training to the officers of DBOD and ECD cannot be overemphasised. The workshop on International Banking recently organised at BTC is a healthy development and more officers should be exposed to such training programmes.

34. The guidelines for internal control recently brought out by the Exchange Control Department are exhaustive and it may be ensured during inspections whether banks have implemented the guidelines.

35. It is desirable that a uniform procedure is followed by all banks as regards booking of profit, and efforts in this regard with the good offices of RBI and FFDAI should be speeded up.

36. At present, the inspection of foreign exchange business of banks is conducted by DBOD during their inspections while ECD is also independently carrying out

inspections of inter-bank, cover and funding operations of banks. It is suggested that the latter inspections may be done jointly by DBOD and FCD during the regular inspections of banks except in circumstances where separate and ad-hoc inspections are warranted.

37. Copies of the booklet 'Guidelines for Internal Control over Foreign Exchange Business' should be made available to all Inspecting Officers.

Calcutta Regional Office (DBOD)

38. When import bills are received in branches, the Inspecting Officers should examine the accounting system followed by them in respect of those bills.

39. Whether deferred instalments in respect of import deferred payment guarantees are paid on due dates and a proper record is maintained in respect of guarantees issued, dates of payment of deferred instalments, etc.

40. Deferred payment guarantees - Exports

Whether the conditions stipulated in approval of ECD and undertaking given by the exporters have been fulfilled.

41. Cover transactions and position

(i) The Inspecting Officer should examine the turnover in foreign exchange business and ensure that the bank's transactions with overseas correspondents and inter-bank are not disproportionately high in relation to its merchant transactions.

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(ii) The Inspecting Officer should examine that the position is matched at least month-wise as far as possible.

(iii) The Inspecting Officer should ascertain the limits of uncovered position the bank is allowed to keep. In this connection, the instructions issued by the bank's Head Office may be looked into. Inspecting Officer should see that such instructions are strictly adhered to.

(iv) Inspecting Officer should see that forward contracts are not extended without any valid reasons. It should be ensured that necessary steps are being taken by the bank for cancellation of the overdue contracts, where necessary.

(v) Inspecting Officer should verify that the dealer has calculated the position after taking into consideration the transactions in the pipeline.

(vi) As the inter-bank transactions are booked through brokers, Inspecting Officer should see that these transactions are usually spread over a number of brokers by periodical rotation instead of concentrating on one broker.

(vii) It is understood that Exchange Control Department has, in September 1981, fixed limits for open positions in four major currencies, viz., Pound Sterling, U.S. Dollars, Deutsche Mark and Japanese Yen, as well as for the netted rupee position for the individual banks. It is also understood that the said limits are kept secret for

Exchange Control Department's use and have not been advised to concerned authorised dealers. The desirability of keeping DBOD Inspecting Officers aware of the said limits may be considered.

42. Exchange Rates

Inspecting Officer should ensure that the rates for purchase and sale of non-sterling currencies by the bank are based on the principle of acquisition or disposal of foreign exchange and uneconomic rates are not quoted to merchants.

43. Overdrafts to foreign correspondents

Inspecting Officer should examine and ensure that the relaxation in para 8.12 of the Exchange Control Manual permitting excess over the limits of Rs.20 lakhs for overdrafts in the rupee accounts of overseas branches/ correspondents is not intended to be used by the overseas banks to postpone funding in anticipation of rate changes or to transfer funds to other authorised dealer.

44. Inward remittances

Inspecting Officer should verify that all inward remittances are promptly credited to the party's account or remitted according to the remitter's instructions.

Exchange Control Department

Calcutta Regional Office (ECD)

45. Though the position in a currency may be near square, an authorised dealer may be carrying an element of risk if the maturities are not properly matched. In the absence of a properly matched position, the authorised dealer is often forced to go in for swap transactions to provide immediate funds. Though market transactions can be easily matched and the gap is eliminated, authorised dealers experience great difficulty in respect of merchant forward transactions as in many cases, the merchants do not take contracts in time. This necessitates a number of swap transactions. Though the swap loss is recovered from the merchant, there is a definite loss of foreign exchange if these swap deals are put through in the overseas markets. This aspect may require some detailed study.

46. Authorised dealers purchase foreign currencies from their correspondents and credit their rupee accounts with the equivalent whenever the correspondents desire to have additional rupee funds. These funds should be for meeting their rupee requirements and should not, in the normal course, be repatriated. Repatriation of funds regularly means that the overseas correspondents are either trying to invest their surplus funds (which may not be advantageous under the present interest structure

prevailing in the overseas markets) or trying to make profit in the rate difference between the two dates. These types of transactions are not desirable and the Inspecting Officer should keep this in mind while scrutinising the accounts. It was observed during the inspection of an authorised dealer that its overseas branches purchased large amounts of rupees by sale of foreign currencies (mainly pound sterling and U.S. dollars) which were badly needed by the authorised dealer to meet merchant transactions. However, it was informally understood that the rupee funds credited to the Vostro accounts were not fully required to meet the requirements but part of the amount was sold by the overseas branches of the authorised dealer to the overseas branches of other Indian banks. Though there was no repatriation, it may amount to trading in rupees.

47. The Head Office should prescribe the maximum daylight limit for position to ensure minimum exposure to the exchange risk. While fixing the daylight limit, the Head Office should take into account the normal trend of the bank's merchant transactions and may have to fix different limits for overbought and oversold position. For instance, Bank 'A' having generally an oversold position in its day-to-day merchant transactions, say about 10 m in U.S. dollars, need not have to worry much about an overbought position of U.S. \$ 12m at 11.30 A.M. but a sale

report of U.S. \$ 5m right in the morning may necessitate covering the same immediately, i.e., bank having predominantly import transactions to handle should keep its oversold limit lower than the overbought limit for the daylight position and vice-versa. The Inspecting Officer will have to examine whether the limits are being followed by the office maintaining the position. All information between the dealing room and the department should be through slips which should indicate also the time of the transactions/ receipt of advice from branches. This will be necessary to verify whether the office had tried to maintain the daylight position within the limits.

48. Inspecting Officer has to verify whether all the deal slips issued by the dealer as entered in the respective contract registers and the contracts are advised and confirmation obtained from the other banks. The system followed by authorised dealer should be examined to see whether it is fool-proof and eliminate any irregular transactions. Forward merchant contract registers should be seen to verify whether proper follow-up action is taken to ensure taking up of the contracts/ its extension/cancellation.

49. At places where recognised Association of Brokers is available, all inter-bank transactions are to be put through a broker (FEDAI rule 3I). The Inspecting Officer

will verify this aspect and also cross-check the broker's notes with the contracts. Broker-wise register will also have to be scrutinised to see whether any special favour is being shown to any particular firm of brokers and payment of brokerage in respect of the contracts may be cross-checked from the brokerage register.

50. The mechanism of reporting the daily merchant transactions by branches to the office maintaining the position should be examined to see whether the time gap between the date of original transactions in the branches and the receipt of advices in the office maintaining the position is the minimum. Any delay in the receipt of advices of transactions from branches will keep the transactions in the pipeline and the same will remain uncovered and the position arrived at by the office will be far from the actual position. Larger transactions should at least be, therefore, reported on the same day and taken in position. The limit for the purpose has to be fixed by the Head Office of the bank and may vary from bank to bank depending on its total merchant transactions. The other transaction should not remain in pipeline for more than a day or two. During the inspection of one of the authorised dealers, it was observed that advices sent by mail took, on an average, one week. This is not desirable and can be eliminated if some link offices are established at convenient places with

the branches near around reporting to these link offices their day-to-day transactions; it will be possible for the link offices to advise the position maintaining office the total purchases/sales of the branches under its jurisdiction. This advice can reach by the day following the date of transaction and reduce the transactions in the pipeline to the minimum.

51. The inter-bank transactions can be mainly for cover of authorised dealers' merchant transactions and the overseas transactions for converting one currency into another which is not freely available in the inter-bank. These transactions may also be in the nature of trading or for closing the gap in the maturity dates. Whereas the first and the last purposes are necessary, the second one is mainly to make a small profit and too much indulgence in this activity may become dangerous. One aspect which is important is that a transaction which is purely of trading nature will generally be against the genuine needs of the other banks and the loss, if any, incurred by the other bank will ultimately be to the account of its customers. Therefore, it is necessary to ensure that trading is not allowed to become highly speculative but is limited to a level which will be healthy by providing free mobility of funds to the required place and ensuring finer rates to the merchants.

52. Some authorised dealers pass entries through Suspense Account when full details of transactions are not received from branches reporting the transactions. The Inspecting Officer should examine whether the transactions are retained in these accounts for long periods. The follow-up action taken by the authorised dealer to clear the outstanding items in these accounts should also be seen.

New Delhi Regional Office (ECD)

53. Exchange Control Department inspections are segmental - restricted to particular aspects of the foreign exchange transactions handled by the authorised dealers. The scrutiny of the transactions is, therefore, confined to examining the compliance or otherwise by the authorised dealers with the relevant statutory requirements and the various instructions/directives issued by us from time to time. None of the Inspecting Officers at the Regional Office had the opportunity of examining the foreign exchange transactions of an authorised dealer in their totality. The Inspecting Officers do not also have adequate field experience for a reasonably adequate time span as there had been many changes - frequently too - due to movements under Inter-mobility Scheme, promotions, transfers, etc. By the time an officer is equipped to take up independent inspection, he is shifted, which causes considerable dislocation and all our energies

wasted in grooming him. To make our inspection an effective tool to oversee the operations/functioning of the authorised dealers and ensure that they do not transgress the powers delegated to them or undertake any transactions, in violation of Exchange Control regulations, we should first, address ourselves for placing the inspection machinery on a sound and proper footing. This calls for planning, selection and intensive training before an Inspecting Officer is assigned duty - not to be disturbed for a period of at least two years.

54. Presently, there is no co-ordination between inspections carried out by DBOD and ECD. In the earlier years, whenever an inspection of an authorised dealer was taken up by DBOD, a member of the staff of ECD used to be attached with the inspection team; his scrutiny, however, used to be confined to 'F' returns only. During the course of inspections carried out by DBOD, the Inspecting Officer no doubt, examines the foreign exchange portfolio also, but he normally devotes his attention to examining whether the transactions undertaken by the authorised dealer conform to sound banking practices; exchange control aspects thereof involved, if any, are not deeply looked into, because of various constraints like time, expertise, etc. To achieve the full benefit of FBI inspections, it is worthwhile constituting a team including an experienced officer from ECD

(Inspection Wing) whenever a financial inspection is taken up by DBOD, to specifically look into exchange control aspects and report to the Principal Inspecting Officer, for incorporation in the report.

55. The present approach to inspection of the foreign branches of a single bank at a time, could be replaced with advantage by the centre-wise approach. In the earlier years, DBOD used to carry out centre-wise inspections which gave a complete picture of the potentialities offered by <sup>the centre under inspections the scope offered by</sup> it for bankable propositions, the success and failure of the branches of various banks operating there; it also led to freer communication and exchange of views and experiences among the various units operating in the centre. On a similar pattern, we may consider the desirability of sending three or four teams under the leadership of a Principal Inspecting Officer, not below the rank of an Additional Chief Officer or Additional Controller, to simultaneously carry out the inspections of all the branches of Indian banks operating at a centre.

56. The composition of each team may be one or more each from DBOD and ECD and they should carry out the inspection by proper allocation of work between/among themselves and submit their report to the Principal

Inspecting Officer immediately on completion of the inspections to enable him to meet all the executives in a group and thus facilitate exchange of views and experience among them.

57. A small cell could be set up at Bombay in DBOD to collect data pertaining to country profiles in which our banks are operating, the commercial links between India and these countries, the banking laws and regulations, the Exchange Control regulations, etc. By correspondence with appropriate agencies, these data may be kept up-to-date. Information should also be collected regarding the practices and procedures followed at each of the centres besides the information system developed and followed.

58. The entire team before departure should be given an opportunity to go through the data collected and also study the previous inspection reports. This would facilitate reducing the time taken by the members of the inspection team abroad to familiarise themselves with the local laws, regulations, practices, etc., and commencing the actual inspection at the shortest possible time.

59. The inspections should be development oriented and the audit element should be minimal. Since overseas branches are subject to various inspections by the local statutory authorities and the internal inspections of the bank concerned, we may give greater attention to the

policies followed by the branches, their exposure to risks, currency-wise, country-wise, etc., as also the Information System followed internally and with the Head Office and the effectiveness thereof. The Principal Inspecting Officer should be responsible for co-ordinating the inspections, engage himself in assessing the potentialities of the centre, avenues for expansion of trade between India and the country concerned, scope for opening more offices, services rendered to ethnic community and the scope for further improving them through his meetings with the banks and authorities.

Bangalore Regional Office (ECD)

60. Greater emphasis may be given on follow-up of overdue export bills, submission of extension applications and preparation of quarterly statements of outstanding export bills. Time has also come when we may attempt to standardise the format for export bills register.

61. We cover this aspect partly, i.e, purchases only, during inspection of export transactions. In view of the importance of these returns for proper compilation of balance of payments statistics, we may broaden our scrutiny so as to cover all the transactions, i.e , purchases as well as sales. For proper assessment of the quality of reporting, it may be necessary to cover at least 6 to 8 ten day periods as against the present 2 to 3 ten day periods.

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62. Our inspections may aim at scrutiny of records of letters of credit opened so as to ensure that no back-dated letters of credit are opened to circumvent regulations of import trade control authorities. Further, we may examine the procedure obtaining with authorised dealers regarding submission of evidence of import by its importer clients. We may also take up percentage check of endorsements made by authorised dealers on exchange control copies of import licences so as to ensure that sales against imports have properly been marked off against import licences.

63. The transactions relating to sales of foreign exchange under delegated powers are scrutinised by us at the time of detailed audit of F-returns. It is, however, suggested that individual sales above a certain value may be scrutinised independently with reference to records available with authorised dealers.

64. Holders of QA.22 accounts are afforded facility to maintain bank accounts, operations on which are allowed freely. They also have facility in certain circumstances to repatriate the balances available in their QA.22 accounts. A random scrutiny of transactions in these accounts, therefore, appears necessary to ensure that funds credited to these accounts have come from sources declared to the Control, and that the account is not being used to repatriate unauthorised funds.

Exchange Control Department -  
Central Office

65. Among other things, the Inspection Team should devote some time to study the developments of foreign exchange markets, particularly Euro-dollar currency operations in overseas markets as also off-shore banking and its causes and effects on the economic development of the country concerned. In the light of the current thinking on the subject that we should also go in for off-shore banking, the above study is essential. Such studies will be helpful not only in making preliminary arrangements but also in assessing the possibility of introducing off-shore banking in India.

66. Branches of Indian banks abroad are also using sophisticated machines, computers, etc. In foreign countries, most of the registers and other systems of keeping records, etc., has been done away with. Inspecting Officers may also like to get familiarised with this and submit a report on their suggestions to the extent of introducing these things as suitable to the Indian conditions.

67. As far as foreign exchange dealing operations are concerned, the banks have some control systems but generally these control systems are on papers and physically neither they are adhered to nor anybody bothers about it,

including the internal auditors of the banks. Therefore, the inspecting officers should compare the system of internal controls in the banks/branches abroad as formulated by the Head Office, to what is factually existing and point out the deficiencies, suggestions for improvement, if any. It should be carefully seen to what extent the dealers go beyond the delegated powers and at the same time their higher-ups in the Head Office overlook it.

68. Before proceeding for inspection of overseas branches, it would be worthwhile if the inspection team visits the bank's Head Office and study the control system laid down by the Head Office, compare it with what is factually existing. More attention may be given as to whether the guidelines are issued and if so, the same are implemented in letter and spirit.

69. Whenever the inspections of the Indian branches abroad are carried out, they are supposed to be carried out with utmost secrecy. This is not possible as the inspection team is required to call on the Indian Ambassador, Consulate General and other important officials in the Indian business community, besides calling on the officials of the Head Office of the bank. Somehow or the other, there is a feeling that the information collected during the course of the inspection may probably be used against Indian community

there. The fear arises presumably as these inspections are not carried out with defined frequency. Therefore, Indian community outside gathers a feeling that the inspections are carried out only when some particular information about them is required. To avoid this, either the inspections should be carried out under the garb of some nature of study or alternatively, the periodicity of inspections should be maintained which may remove their fear.

70. It will also be worthwhile to set up some small study cells which will keep in touch with market developments, investment pattern and development of banking at specified overseas countries and changes, if any, in exchange control regulations, and such studies would be very much useful to the inspection teams.

71. Under the Control regulations, authorised dealers can allow overdrafts to their overseas correspondents/branches abroad to the extent of Rs.20 lacs. This limit was fixed quite a long ago and needs revision. A suitable system may also be devised to ensure that these limits are strictly adhered to.

72. It was observed that although there are branches of Indian banks at overseas centres, most of the other Indian banks prefer to maintain their foreign currency accounts

with banks other than the Indian banks' branches/abroad. Efforts may be made to take up the matter with the banks so that they may open their accounts, to the extent possible, with the Indian banks' branches abroad.

Bombay Regional Office (ECD)

73. Our inspections today are more of a procedural audit or a post-mortem of some specific transaction(s). They do not cover any developmental aspects, e.g., general comments/suggestions regarding customer service, existing/scope for export promotion measures, existing/proposed steps for attracting non-resident funds, feed-back from customers regarding the efficacy of existing Control measures and the areas of improvement for making them more useful, etc.

The scope of inspections may be suitably expanded to cover these, so that inspections serve a positive purpose also.

74. The Inspecting Officer should be required to have detailed discussions with the officials of the inspected banks about their handicaps/difficulties, if any, in complying with the various requirements of the Control including timely submission of returns, follow-up of export outstandings, suggestions for procedural improvements, etc. The Inspections should also function as the eyes and ears of the Control.

75. The purpose of the Inspection should be educating the authorised dealers about the purpose and mechanics of various Control stipulations and not mere fault-finding. This also yields better co-operation from the banks concerned and makes the Control functions easy. We have been trying this particularly with the outside Bombay branches in respect of inspection of non-resident accounts and exports follow-up and it has been paying good dividends.

76. Our greatest handicap today is the evaporation of trained and experienced staff who may have the appropriate and critical appreciation of the various aspects of the foreign exchange transactions. Most <sup>of</sup> our Inspecting Officers today have only a superficial knowledge of their job and they can hardly go beyond the beaten track. Well planned and concerted efforts are necessary to rectify this situation and cultivate this expertise. The following measures, inter-alia, may be considered in this respect.

- (a) A critical choice of personnel while deciding postings to the Inspection Wing.
- (b) Periodical exposures to institutional and on-the-job training to the staff.
- (c) Concerted efforts to ensure that the officers posted to the Inspection Wing are retained there for a reasonably good period - say 3 to 5 years.

(d) Preparation of a comprehensive Inspection Manual for foreign exchange inspections.

(e) Provision of prescribed formats for the inspection reports on various aspects (say, on the lines of existing proformae for inspection of non-resident accounts and export transactions). Besides, these formats serve as a good check-list for the Inspecting Officers in ensuring that no important point is missed.

77. While taking up the inspection of big branches, we may try the team method, i.e., instead of one Inspecting Officer, we may have 3- 4 officers, each adept in areas, e.g., exchange transactions, trade transactions and documentation, non-resident accounts, etc.

78. In the case of foreign branches of Indian banks, compliance with the local laws in regard to the maintenance of books of accounts, audit, submission of returns, etc., to the local authorities as also compliance with the provisions of Exchange Control Manual, to the extent applicable, may be seen.

79. In the case of Indian banks and branches of foreign banks, the Inspecting Officer should see the compliance with the provisions of Exchange Control Manual, etc, in regard to documents to be obtained in respect of exports,

opening and maintenance of non-resident accounts, formalities to be observed while booking forward purchase and sale contracts as also extension and cancellation thereof, methods of payments, keeping <sup>in</sup> view the regulations about the countries to which the payments were effected, sale to and purchase of currency from the public, banks and the Reserve Bank, safe custody and release of shares, securities, etc , of non-residents, opening and maintenance of rupee accounts of foreign branches/Head Office, correspondents and non-resident private Exchange Houses, opening and maintaining of foreign currency accounts abroad and funds management, submission of returns to the Reserve Bank, etc., promptness, regularity, proper compilation, ensuring that the necessary documents are enclosed, training of staff handling foreign exchange operations, and keeping the Exchange Control Manual up-to-date.

80. The Inspecting Officer should see whether the bank has implemented the guidelines advised by the Reserve Bank and if so, to what extent, in regard to inter-bank dealings, banker-broker relationship, whether the bank has made arrangements for the periodical obtention of statements of accounts from foreign branches/banks, their reconciliation and follow-up of the old items, and the procedure in vogue for the valuation of balances in foreign currency and the evaluation of profit/loss.

Madras Regional Office (ECD)

81. Regarding the exposure limits to be fixed for banks, it is rather difficult as most of the banks in India are nationalised and hence limits for dealings with them, the State Bank of India and its subsidiaries, as well as foreign banks, who have a much larger capital base may not be necessary as failure to meet commitments in inter-bank dealings by these banks is unheard of. Limits could be fixed for dealing with small non-nationalised banks, but even these may not be realistic, in the absence of information relating to the extent to which such a bank has entered into commitments with other banks in India and abroad.

82. At present, the open position limits for the dealer are fixed by the relative managements. Central Office has also prescribed certain limits in the guidelines for conducting inspections supplied to offices. The limits fixed by some banks are very low as compared to limits fixed by Central Office. As we are required to advise authorised dealers suitably whenever they exceed the limits prescribed by Central Office, it is not understood why limits fixed by us should not be intimated to authorised dealers. Where the limit fixed by the management is very low, the dealer who wants to show a better result by having a larger turnover, not finding enough elbow room to operate within the narrow

limit fixed by the management, may be tempted to conceal the real position. Hence, we are of the opinion that we should prescribe realistic limits for open position taking into account the merchant base of the authorised dealer and the number of 'B' category branches whose pipeline transactions will be reflected in his position.

83. In respect of cash/ready transactions, <sup>some</sup> authorised dealers prepare only deal slips and contract notes are not sent as funds are delivered/received on the same day. It is, therefore, essential that serially numbered deal slips are used and exact accounting and comprehensive explanation for any form not used, obtained by the Accounting Department completely unconnected with the trading room. It is pertinent to point out that in most banks, generally, no one higher in rank than the dealer is fully conversant with the day-to-day dealing operations. This has emboldened <sup>certain unscrupulous</sup> dealers to put through deals which are not based on sound business principles. Therefore, we should insist that the official above the level of dealer should have a thorough knowledge about dealing operations.

84. Accounting Department should maintain the daily rate sheets on an hour to hour basis. The exchange rates, interest rates and key forward rates ( 1,3,6 months), the rates at which business was done (time of the deal to be

indicated by the dealer on the deal slips/contracts) which should be compared retro-actively to ensure the deals are not being put through at off-market rates with co-operating parties with a view to sharing profits or getting other forms of kick-backs.

85. The area of dealer-broker relationship is prone to corrupting influence. At present, brokers are to be accorded recognition by the local FEDAI. No norms have been evolved for this purpose with the result outstation brokers have started operating in other centres and in their bid to secure a share of business enjoyed by local brokers, they may offer inducements to the dealers. It is high time we evolve ~~some~~ procedure norms to fix the number of brokers required at each centre depending on the volume of business transacted there. At present, many brokers are not in a position to service efficiently for want of telex/telephone facilities with the result banks have necessarily to resort to the broker who is able to put through the deal, which may give the appearance of the dealer having favoured a particular broker. The Reserve Bank should assist the various brokers to get the necessary infrastructure facilities and we should insist upon certain minimum facilities such as certain number of telephone connections, telex, etc., available with each broker.

86. In terms of Chapter 8.12 of the Exchange Control Manual, authorised dealers have been given general permission for granting to overseas branches/correspondents loans, overdrafts, etc., upto Rs.20 lacs. This limit applies to the aggregate amount that may remain outstanding at any time against all overseas branches/correspondents in the books of all offices of the authorised dealer in India. It is difficult during inspections to verify whether the limit has been exceeded without adjustment in 5 days as we cannot know the balances in the accounts maintained by the various offices of the authorised dealer in India. Some procedure to monitor this limit should be evolved. This limit was fixed years back and in the present context of increased trading by banks it requires upward revision, say, atleast upto Rs. 1 crore.

87. At present, banks are not following a uniform practice for evaluating profits. Some banks value profit/loss on the basis of revaluating ~~mirror~~ account balances at the RBI buying rates for sterling pounds, U.S. dollars, D.M., and Japanese Yen and for other currencies, sterling rates of RBI crossed with London closing rates for the currency on the last working day. The system is, however, not perfect as it only envisages the liquidation of assets/liabilities only and not its contingent accounts including unliquidated foreign exchange contracts outstanding. A

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system of completely squaring of all exchange positions whereby for every value date which the bank has purchased foreign exchange, it will sell a like amount and vice versa, is called for. In other words, foreign exchange positions should be valued at market prices at the time of closing the books. This should be done by first valuing everything at the spot market rate and then to adjust the forward transactions to reflect the appropriate market premium or discount. The more conservative approach is to ignore the forward discount when arriving at forward rates to liquidate the oversold positions and vice-versa. Again, segregation of interest element loaded in the rates quoted for export bills purchased in respect of which contracts are outstanding on the date of computing profits and excluding the interest element from the gross forward profits. This is a more scientific method and is recommended to be adopted uniformly by all banks. In this context, it is worthwhile considering whether it would not be better specially for the dealing banks to evaluate Nostro balances and forward contracts on the basis of market rates rather than the FBI rates as the practice of adopting FBI rates for the purpose tends to underestimate the profits and overestimate the losses at the given point of time.

88. Once the AGL and IGL are fixed by the management, the dealer should be allowed to have inter-changeability

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between IGL limits as long as the overall AGL is not exceeded. In order to reduce mismatches created due to buyers' option permitted in the inter-bank market in India, it would be desirable to make banks in India to fall in line with international practice of operating only on the basis of fixed dates.

89. At present, the practice with most authorised dealers is to maintain the position at their international division. Such centralisation while it has its advantages like enabling the authorised dealer to marry its own purchases and sales without seeking cover outside, however, creates distortion in currency position due to pipeline transactions. The remedy for this is not reduction of the number of operative branches as the emphasis is now more on decentralisation of customer service. The distortion to some extent can be minimised by improving communication links between the branches and the dealing room. However, the real solution to the problem lies in decentralisation of dealing operations to various centres. This would also fulfil our objective of activating the market at various centres. At present, the market is influenced, to a great extent, by State Bank of India, whenever it steps in to purchase. Unless and until the bank is made to decentralise its operations from Calcutta atleast to other metropolitan

centres, the market operations would continue to be uneven and lopsided. It is high time some steps in this direction are taken.

Bankers Training College

90. Letters of credit clearly specify that they are subject to the provisions of UCPDC. Letters of credit should generally have two authorised signatories. The letters of credit opening bank verifies the credit status of the proposed beneficiary, the shipping company and the insurer. Letters of credit should invariably call for a certificate of origin of the goods covered by shipment from an independent source as Chamber of Commerce. Payments made under letters of credit should conform to the approved methods of payment laid down in the Exchange Control Manual. Before extinguishing the liability under a letter of credit, it should be ensured that the relative bills have been retired by the importer customer or that there is a satisfactory procedure which will take into account bills which are not retired under letters of credit. Importer customer to make a very careful credit review of the seller prior to opening of letter of credit. The standing of the confirming bank should be carefully assessed. There should be proper co-ordination between the working of the

forward contracts section and the letters of credit section. Where a letter of credit stipulates D/A terms, the relative credit limit sanctioned should specifically suggest such terms. Letter of credit opening commission is collected as per FEDAI Rules. The bank should evolve a system to keep necessary funds in its Nostro account to meet debits arising out of negotiation of bills under letters of credit. Letters of credit application form and blank letters of credit forms are serially numbered and kept under double lock.

91. Rupee liability is determined on the day the documents are received, at the prevailing rates of exchange, i.e., B.C. selling rate or at the contracted rate where a forward contract has been booked, where the arrangement is to treat the amount as an import loan in rupees. Where the documents are not acceptable, the negotiating bank should be intimated promptly (reasonable time) and the documents should be held at its disposal. Where there is delay in the retirement of documents or where the documents have not been accepted, the bank should take necessary action to protect the goods. Where the bank is called upon to fund its account, the bank should endeavour to minimise the swap costs when the currency is at a discount in the forward market. In case demand bills are not retired within a period of 7 days, usance commission as laid down under FEDAI Rules should be collected.

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92. That for transactions in non-sterling currencies, rates are based on quotations in the current international markets with reasonable profit margin. Rates for sale of rupees against foreign currencies are in conformity with the Exchange Control regulations. The spread between the T.T. ~~buying rates~~ and T.T. selling rates should not exceed the percentage prescribed by Exchange Control. Interest element loaded to the rates are as per the rates laid down by RBI from time to time. There should be a proper record of the movement in exchange rates daily. The Accounts Department (i.e. somebody other than the Dealer) should independently verify the rates with the brokers periodically during the course of the day.

93. It should be ensured that in all cases, confirmation of contracts are obtained from the counterparty. That confirmation of outstanding contracts are obtained periodically. Substitution of forward contracts is not allowed. Forward contracts should be serially numbered.

94. Whether there is a system of obtaining balances in Nostro accounts periodically and even daily where necessary. Whether there is any system for reconciling the currency position maintained by the dealer with the Accounts Section every day. Control over position limits and gaps is

maintained as per the guidelines issued by ECD in this regard. Whether there is any system to minimise the transactions in the pipeline between the position maintaining office and the designated branches. There should be an effective system of monitoring over inter-office accounting between designated branch-position maintaining office.

95. It should be ensured that while calculating profit on the forward positions, necessary adjustments are made for forward margins based on gaps in maturities.

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A P P E N D I X - IV

Questionnaire

Foreign Exchange Business -  
Internal Control, Information  
and Accounting Systems

I. SYSTEM OF CONTROL

1. Please furnish Organisation Chart of the Department at the Head/Controlling Office which supervises and controls the foreign exchange business of the bank. (In the case of banks incorporated abroad, this refers to their business in India).

2. (a) Please furnish specimens of the returns/statements which are required to be submitted by the branches/offices conducting foreign exchange business.

(b) What is their periodicity ?

(c) What action is taken thereon at the Head/Controlling Office ?

3. (a) How often are departments, branches and/or offices conducting foreign exchange business inspected/audited ?

(b) Has the bank prescribed any proforma inspection/audit report and/or check-points for the guidance of staff attached to the Internal Inspection/Audit Department ? If so, copies thereof may please be furnished.

4. (a) Are the foreign exchange operations of the bank reviewed periodically ?

(b) If so, by whom and how often ?

(c) To whom is the review submitted ?

(d) Please furnish a copy of the last review made by the bank ?

## II. DEALING IN FOREIGN EXCHANGE

5. (a) Please furnish the names of the branches/offices which are authorised to conduct foreign exchange dealing operations independently.

(b) Please give the Organisation Chart of the Dealing Department at each of the centres indicating the functions performed by the personnel attached to the Department.

6. What are the infrastructure facilities, such as telex machines, tickers, etc., provided to the Dealing Department ?

7. Please describe the policy and system of the bank regarding fixing of daylight, overnight, interbank and customer limits, control over mismatchings in maturities (gaps), pipeline transactions and operations in foreign currency notes.

## III. ACCOUNTING SYSTEM

8. What is the system of the bank regarding control over reconciliation of 'Nostro' balances and management of risks arising in Rupees (Vostro) accounts ?

9. What is the procedure for accounting import

bills received under letters of credit and when are they treated as 'sale' of foreign currency ?

10. (a) What accounting entries are passed when export bills are purchased/discounted or negotiated under letters of credit ?

(b) In case the bills are not accepted or remain outstanding for along time, what action is taken to ensure that the bank does not suffer a loss due to changes in rates of exchange ?

11. Please describe the follow-up action taken in regard to import and export bills under letters of credit which remain outstanding beyond due dates.

IV. EVALUATION OF FOREIGN EXCHANGE PROFITS AND LOSSES

12. How often do you evaluate foreign exchange profit/loss and when do you book the profit/loss ?

13. Please describe the manner of evaluation of profits/losses in foreign exchange business by the bank and furnish a copy of the latest evaluation showing the computation of profit/loss.

A P P E N D I X - V

Questionnaire

Operations of foreign branches  
of Indian banks.

1. Please describe the system of control and general supervision exercised by the Head Office/International Division over the operations of overseas branches/offices. A copy of the Organisation Chart of the International Division may please be furnished.
  
2. (a) Please furnish specimens of the returns/statements which you receive from overseas branches.  
(b) What is their periodicity ?  
(c) What action is taken thereon at the Head Office/International Division.
  
3. (a) How often are overseas branches inspected/audited ?  
(b) Has the bank prescribed any proforma inspection/audit report and/or check-points for the guidance of staff attached to the Internal Inspection/Audit Department ?  
If so, copies thereof may please be furnished.
  
4. (a) Are operations of overseas branches reviewed periodically ?  
(b) If so, by whom and how often ?  
(c) To whom is the review submitted ?  
(d) Please furnish a copy of the last review made by the bank.

5. (a) Do you have a system of maintaining country and customer profiles ?

(b) If so, what are the main aspects covered in this regard ?

(c) Have you issued guidelines to overseas branches for assessing country risks ? If so, a copy thereof may please be furnished.

6. (a) Do you obtain periodical information on Government/ Central Banking Authority policies and other environmental factors in the countries where the bank has branches/ offices ?

(b) If so, please indicate the countries in respect of which such information is available with you.

7. (a) Have you given guidelines to overseas branches regarding their (i) borrowings in Euro-currency markets, (ii) participation in Euro-currency loans/bonds, (iii) operating budgets and goals, (iv) funds management and (v) Maintenance and evaluation of foreign currency positions ?

(b) If so, a copy thereof may please be furnished.

8. (a) Have you implemented, to the extent appropriate in respect of overseas branches, the "Guidelines for Internal Control over Foreign Exchange Business" issued by the Exchange Control Department regarding fixing of daylight, overnight, interbank and customer limits and

control over mismatchings in maturities (gaps) ?

If so, a copy of the instructions issued in this regard may please be furnished.

(b) What is the system introduced at Head Office to ensure proper compliance of the instructions by the overseas branches on a continual basis ?

9. (a) Please indicate broadly the discretionary powers delegated to overseas branches.

(b) When were these revised last ?

(c) Have the foreign branches expressed any difficulty in operating within the delegated discretionary powers ?

10. Please describe the system of supervision and control exercised by the Head Office/International Division over the advances portfolios of overseas branches.

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## A P P E N D I X VI

### Summary of replies received from banks to questionnaire on Foreign Exchange Business - Internal Control, Information and Accounting Systems

#### Question 1

Please furnish Organisation Chart of the Department at the Head/Controlling Office which supervises and controls the foreign exchange business of the bank. (In the case of banks incorporated abroad, this refers to their business in India).

#### Replies

##### State Bank of India.

The bank's Foreign Department at Calcutta exercises overall control over the foreign exchange business of the bank. The local Head Offices exercise day-to-day control on foreign exchange business conducted by the bank. The Foreign Department, Calcutta, where the cover operations are centralised, is headed by General Manager. The International Division at Bombay is basically concerned with the policy matters in respect of foreign exchange business conducted by the bank's offices in India. However, in respect of overseas offices, it acts as the Local Head Office as well as Control Office.

##### Bank of Baroda.

Overall supervision and control over the foreign exchange business of the bank is exercised by its International Division

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at Central Office, Bombay. Certain branches have been authorised to maintain position and conduct foreign exchange dealing operations independently. The concerned branches are headed by Chief Manager/Senior Manager/Manager. The International Division is headed by General Manager and he is assisted by Chief Manager.

Bank of India

The International Department at Central Office, Bombay, supervises and control the foreign exchange business of the bank and is headed by General Manager. Certain branches of the bank are authorised to conduct foreign exchange dealing operations independently.

Central Bank of India.

At Central Office, Bombay, General Manager exercises overall control over the foreign exchange business of the bank and he is assisted by an Assistant General Manager and a Chief Manager. There are four Divisions in Central Office (i) Foreign Division, which deals with correspondent arrangements, development of foreign exchange business, matters relating to imports/exports, liaison with the Reserve Bank, ECGC, etc. (ii) Accounts Division which has Dealing Operations and Accounting departments and each department is under Deputy Chief Officer (iii) Reconciliation Division and (iv) London Section.

United Commercial Bank

The International Division at the Head Office of the

bank, which controls the foreign exchange business of the bank, is headed by General Manager, who is assisted by Assistant General Manager and Chief Officer.

Union Bank of India.

The Foreign Operations and Export Development Department (FOEDD) at the Head Office supervises and controls the foreign exchange business of the bank, and it is headed by Deputy General Manager. The Department has four wings each under the charge of Superintendent. They attend to (i) 1st Wing - Agency arrangements, branch inspection reports and statements, RBI returns, etc. (ii) IIInd Wing - Condification of inspection circulars, book of instructions, staff matters, training and business statistics (iii) IIIrd Wing - Overseas construction projects, monitoring foreign currency position and foreign branches and (iv) IV Wing - ECGC matters, export development, credit information, interest subsidy, etc.

Corporation Bank.

Dealings, maintenance of position, accounts of correspondents and forward transactions are centralised at **Central Foreign Exchange Department** at Bombay. The bulk of foreign exchange (merchant) transactions is conducted at Bombay (Nariman Point) branch. The Central Foreign Exchange Department is headed by Assistant General Manager who is also Controller of Foreign Exchange. It has got three main departments - General

Administration, Dealing and Accounting, and Advances. The Manager of the Dealing and Accounting Department is the main dealer and he is assisted by three assistant dealers.

Bank of Maharashtra

At the bank's Central Office at Pune, the foreign exchange business is controlled by Divisional Manager under the supervision of General Manager. All policy matters are looked after in that office. The Foreign Exchange Department at Bombay which is headed by Divisional Manager, is the only office where foreign exchange dealing operations of the bank are carried out at present. Fifteen branches/offices have been authorised to conduct foreign exchange business, where Foreign Exchange Cells have been created. Under the Divisional Manager at Bombay, there are two dealers, Chief Dealer and Assistant Dealer. The Chief Dealer works under the day-to-day supervision of the Divisional Manager, Bombay, and reports daily to the Divisional Manager, Foreign Exchange, Pune, and the top management.

Indian Bank

The International Banking Division at the bank's Central Office, Madras, supervises and controls the foreign exchange business of the bank, including the operations of foreign branches. The bank has established Regional Foreign Exchange Cells through which the foreign exchange business of the branches is routed. The entire cover operations, at present,

are centralised at the International Banking Division at Madras.

Syndicate Bank

The International Banking and Investment Wing at Bombay, headed by General Manager, is having overall control over the foreign exchange business handled by the bank. There are five divisions each under the charge of Divisional Manager (i) Business Development Division (ii) Overseas Operations and Merchant Banking, Economic Intelligence and Systems (iii) Administration and Accounts (iv) Exchange Dealings and (v) Investment and Resources Management.

Canara Bank

The foreign exchange business of the bank is under the overall control of the General Manager, Credit Wing, Head Office, Bangalore. However, the day-to-day operations, systems and procedures are controlled and supervised by the International Division at Bombay, which is headed by Deputy General Manager. The Dealing Section at the International Division is in charge of Manager, who is assisted by two officers. The Back-up Section is also in charge of Manager. The foreign exchange business is handled by various Foreign Departments located in metropolitan centres and port towns having jurisdiction over branches in their command area. Certain branches have also been designated for handling export bills directly. At other dealing centres, viz., Bangalore, Calcutta and New Delhi, since operations are mainly in U.S. dollars and pound sterling,

which are not very large in volume, only staff sufficient to take care of the various activities and submission of statements, etc., is maintained.

#### Grindleys Bank

The foreign exchange business of the bank in India is controlled by its Bombay Main Office. The Manager, Operations, in Bombay Office is assisted in this regard by Sub-Manager and two officers in charge of Contracts Department and Reconciliation Department.

#### Chartered Bank

The foreign exchange business of the bank in India is controlled by a senior executive of Manager's rank at Bombay.

#### Question 2

(a) Please furnish specimens of the returns/statements which are required to be submitted by the branches/offices conducting foreign exchange business.

(b) What is their periodicity ?

(c) What action is taken thereon at the Head/Controlling Office ?

#### Replies

##### State Bank of India

The following returns are required to be submitted by branches to the Local Head Offices/International Division.

(i) Monthly statement of exchange contracts outstanding as on the last working day of the month.

- (ii) Weekly statement of foreign exchange transactions (Purchases).

The returns are scrutinised to see whether the business is being conducted by offices on the lines prescribed. This also serves as the information for the management.

Bank of Baroda.

Authorised branches submit the following statements to the concerned Regional Offices.

- (i) Copies of weekly Statement of Positions.
- (ii) The dates when their trimonthly 'R' returns are submitted to RBI.
- (iii) Copies of their monthly/quarterly and half-yearly statements sent to RBI.
- (iv) Monthly statements of outstanding advance bills and foreign bills purchased.

The Regional Offices follow up all important matters in respect of these statements.

Bank of India

The Bombay (Main) branch submits the following statements on daily basis to the Management.

- (i) Consolidated daily position statement.
- (ii) Daily currency-wise position of Bombay (Main) Branch.
- (iii) Brief report of daily turnover and rate movement of major currencies.

The concerned Deputy General Manager scans through these statements and in case of large overbought/oversold positions, he institutes necessary enquiries and after ascertaining the

reasons therefor, takes necessary action.

Central Bank of India

(a) Branches conducting foreign exchange business submit to the bank's Foreign Division at Bombay, weekly telex advices of foreign exchange positions as at the close of business every Friday, statements of profitability of operations on monthly basis (operative branches) and quarterly basis (other branches), copies of reconciliation statements of all foreign currency accounts (monthly) and copies of all returns submitted to the Reserve Bank.

(b) At centres where branches are authorised to deal in foreign exchange and maintain direct foreign currency accounts, the relative daily foreign exchange positions prepared by Foreign Exchange Department is independently overseen/supervised by the branch Managers. All contracts prepared by the Department are also supervised by him. At main centres such as Calcutta, Madras, New Delhi, etc., the Regional Office exercises a degree of direct control and the Chief Manager oversees the transactions which are also periodically locked into at the level of Assistant General Manager at the time of surprise inspections.

(c) At present, the bank's Calcutta and Madras branches are allowed to deal and operate directly in Foreign exchange markets. All other branches cover their positions through Bombay (Main) Office or nearest Main Office maintaining foreign

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currency accounts.

(d) At Central Office, Bombay, the returns received are in the nature of statistical data and they are made use of to exercise supervisory control and to initiate guidance.

United Commercial Bank

The branches conducting foreign exchange business are required to send the following statements to the bank's International Division at Calcutta.

- (i) Currency purchases and sales (weekly).
- (ii) Weekly foreign currency position statement.
- (iii) Foreign Exchange purchase and sales statement (weekly).
- (iv) Statement of overdue bills (monthly).
- (v) Statement of gap-limits (quarterly).
- (vi) Profit and loss statement on currency evaluation (quarterly).
- (vii) Half-yearly statement of statistics of foreign exchange business.
- (viii) Statement of foreign exchange turnover (annually).

The statements received in the International Division are scrutinised and follow-up action taken wherever necessary besides using them for internal control. The branches are sending the copies of the important returns/statements to the Divisional Manager/Assistant General Manager also to enable them to supplement supervision by the Head Office.

Union Bank of India

The following returns/statements are submitted by the

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branches conducting foreign exchange business.

- (i) Statement of position furnished by branches maintaining position to Bombay (Samachar Marg) branch who after scrutiny forward the same to FOEDD daily.
- (ii) Statement of position of Bombay (Samachar Marg) branch to FOEDD daily.
- (iii) Statement of maturities forwarded to FOEDD by Bombay (Samachar Marg), Calcutta and Cochin - branches who are authorised to deal independently in inter-bank market (monthly).
- (iv) Statement of report on foreign exchange business (quarterly/monthly).
- (v) Statement regarding particulars of foreign business-bank-wise (quarterly).
- (vi) Return of sale/purchase of foreign currency (monthly).
- (vii) Statement of Export Credit (Interest Subsidy) Scheme (quarterly).
- (viii) ECGC declaration of packing credits/shipping loan advances.

The returns/statements received in the FOEDD are scrutinised and irregularities/abnormalities observed therein, are taken up with the respective branches.

#### Corporation Bank

The branches which are authorised to deal in foreign exchange are required to submit the following returns/statements to the Central Foreign Exchange Department, at Bombay.

#### Monthly

- (i) Statement of foreign import letters of credit and foreign bank guarantees outstanding.
- (ii) Statement of overdue export bills purchased (not under letters of credit) outstanding.

- (iii) Statement of overdue foreign cheques/drafts purchased and outstanding beyond one month.
- (iv) Statement of overdue export bills **discounted** (not under letters of credit) outstanding beyond a fortnight from the due date and those dishonoured by non-acceptance.
- (v) Statement of overdue export bills negotiated under letters of credit and outstanding.
- (vi) Statement of overdue merchant forward contracts outstanding.
- (vii) Foreign exchange turnover statement, etc.

Quarterly

- (viii) Statements of interest subsidy claimed.

Half-yearly

- (ix) Statement showing statistical data relating to export finance.

In addition, the branches are required to submit copies of all returns submitted to the Reserve Bank. The **central** Foreign Exchange Department, which is the controlling department reviews these statements.

Bank of Maharashtra.

The branches submit to the Foreign Exchange Division at Head Office and/or Foreign Exchange Division, Bombay, the undernoted returns/statements relating to their foreign exchange business.

Daily

- (i) Statement of exchange position.
- (ii) Statement of acceptance and payment of FCNR deposits.

- (iii) Statement of purchase and sale of foreign currencies (spot and forward).
- (iv) Exchange position (weekly).
- (v) Nostro accounts reconciliation statement (bi-monthly).

Monthly

- (vi) Statement of outstanding forward purchase and sale contracts.
- (vii) Statement of foreign currency notes and coins held.
- (viii) Statement of business statistics.
- (ix) Statement of profit and loss account.

Quarterly

- (x) Overdue export bills.
- (xi) Statement of overdue bills purchased/negotiated.
- (xii) Statement of exchange profit booked.

Yearly

- (xiii) Turnover of foreign exchange business.

Systematic and regular follow up of information contained in the returns received is done at Central Office from time to time. Various guidelines are issued in the form of circulars, information booklets, etc. Besides, where centres or branches have been found lacking, the concerned officer or the branch Manager is deputed for training courses on foreign exchange.

Indian Bank

The periodical returns/statements as prescribed in the Manual of Instructions are submitted by the branches to the

Head Office, Foreign Department. Besides, ready and forward purchases and sales against forward contracts or ad-hoc are reported on the same day by express telegram before 1 P.M.

Syndicate Bank

The branches are required to submit the following returns/statements to FEDCO/Zonal Office FED/Head Office.

Daily

- (i) Purchase notes for export bills and sale notes for import bills to FEDCO where the foreign currency position and Nostro accounts are maintained, on the same day.
- (ii) Purchase notes for clean cheques/travellers cheques/inward remittances and sale notes for outward remittances to FEDCO, Bombay.

Weekly

- (iii) Statement of foreign exchange business advances outstanding to FEDCO/Zonal FED.
- (iv) Statement of balances outstanding in Duty Drawback loan accounts to FEDCO , Bombay.

Monthly

- (v) Statement of overdue foreign bills purchased/discounted to Zonal Office FED.
- (vi) Statement of irregular loans to Zonal Office FED.
- (vii) Statement of forward sale/purchase contracts outstanding to FEDCO.
- (viii) Statement of FX/MT/TT/DD paid account outstanding for more than 15 days, etc., to FEDCO.

Half-yearly

- (ix) Currency-wise statement of total turnover of foreign exchange business during the half-year to FEDCO.

The returns/statements received by the controlling office are studied in depth with a view to **assessing** the performance of the branch/region and for initiating corrective measures. On the basis of returns received, reporting is also done to appropriate authorities like Board or the ECGC.

Canara Bank

The Foreign Department at the dealing centre submits to the International Division at Bombay various returns/statements on daily, weekly, monthly and quarterly basis. They relate to foreign currency position, purchase and sales in miscellaneous currencies, currency notes holdings, confirmed import letters of credit, reconciliation of 'NOSTRO' accounts, overdue merchant forward contracts, overdue export/import bills, break-up of GRI outstandings, foreign business turnover and FCNR accounts. The Foreign Department is also required to submit periodically statements on interbank/ABI/overseas contracts, outstanding customer **contacts** and import/export bills, month-wise contracts liability and cash balances held in 'NOSTRO' account. The branches which have been **designated** for handling export bills are required to submit **the** relative statements to the Foreign Department **to** which they are attached. The various returns/statements received in the International Division at Bombay are made use of by it for exercising various checks and controls over the operations at the Foreign Departments and the branches, and for preparation of consolidated statements and reviews to

be put up to the Management. Checking whether exposures in foreign currencies are within limits, ensuring that holdings of foreign currency notes are within limit, follow up of outstanding entries in 'NOSTRO' accounts, follow up of overdue forward contracts and overdue export/import bills, ensuring that outstandings in GRI forms of earlier years are reduced, etc., are some of the actions taken on the returns.

Grindlays Bank

Branches are required to submit the following returns/statements to their controlling office.

Daily

- (i) Daily transactions by telex(outstation branches).
- (ii) Daily foreign exchange operation sheets (Bombay branches).

Tri-monthly

- (iii) Foreign Currency Control Ledger position by telex (outstation branches).
- (iv) Summary of exchange position(Bombay branches). Branches have to advise by telephone or telex transactions of large amounts to the controlling office. The controlling office checks whether the transactions advised have been taken into exchange position. The uncovered transactions are then taken into position from returns at (i) and (ii) above. Bi-monthly, the net Foreign Currency Control Ledger balances advised by all branches are reconciled with the dealers' exchange position by the controlling office.

Chartered Bank

Indian branches are required to advise Bombay Office at

the close of business daily their exchange positions as well as the estimated 'NOSTRO' account balances. On scrutiny of the returns, branches are instructed to take remedial measures by undertaking cover operations with Bombay Dealing Centre, if their position is unwarranted.

Question 3

(a) How often are departments, branches and/or offices conducting foreign exchange business inspected/audited ?

(b) Has the bank prescribed any proforma of inspection/audit report and/or check-points for the guidance of staff attached to the Internal Inspection/Audit Department ? If so, copies thereof may please be furnished.

Replies.

State Bank of India

A regular audit system exists in the bank. At large branches (present numbering 46), an internal auditor is posted to audit the transactions on <sup>an</sup> on-going basis. Further, there is a centralised Audit/Inspection Department at Central Office level which arranges for audit and inspection of branches on a regular basis. The Inspection Department has been decentralised into various geographical zones to enforce effective control. Generally, the branches are audited at an interval of two to three years. Management audit of Local Head Offices is conducted by senior Executives of the bank. No specific proforma has been.

prescribed for audit of foreign exchange transactions.

Bank of Baroda

Authorised branches are inspected by Regional Inspection Centres once in 18 months. Format has been prescribed for inspection report. Besides, the Inspecting Officers are provided with Audit Programme Sheets which contain the aspects to be seen/checked, under various types of bank's business including foreign exchange.

Bank of India

The branches/offices conducting foreign exchange business are audited once in 16/18 months. The bank has prescribed a worksheet listing out the items to be audited, and also a format for inspection note detailing the points on which the comments are required to be given. A background note on areas to be checked is also made available to the audit staff.

Central Bank of India

Foreign Exchange Department of a branch is audited by internal auditors when the branch as a whole is taken up for audit, except in the case of the Bombay Main Office, where audit is done departmentwise. The frequency of audit depends upon the audit categorisation of the branch, i.e., A, B, C, and ranges from six months to eighteen months. Audit Manual of the bank is under preparation. However, the bank has issued check-lists and guidelines to internal auditors.

United Commercial Bank

The foreign exchange departments of Indian branches are inspected by the bank's regular inspecting staff along with other departments in the branches visited by them. The proforma has been introduced for inspection report.

Union Bank of India

The branches conducting foreign exchange business are being audited almost every year. There is a daily audit system at the Bombay (Samachar Marg) branch. A check-list has been prescribed for the inspection of foreign exchange business for the guidance of the staff of audit department. This is in addition to the broad guidelines for examination of foreign exchange business given in the **Inspection** Manual.

Corporation Bank

The designated branches conducting foreign exchange business are normally inspected at a frequency of 15 to 18 months, whereas the Central Foreign Exchange Department at Bombay is normally inspected at an interval of three years. The internal inspectors are guided by the bank's Inspection Manual, the Guide to Internal Inspectors supplied by Bankers Training College and materials collected by internal inspectors at BTC during the training. A format has been fixed for the report on the inspection of branches. Preparation of comprehensive check-list has been taken on hand by the bank.

Bank of Maharashtra

Inspection of branches is undertaken generally once in a year. The Inspecting Officers have been provided with check-lists for their use.

Indian Bank

The branches/offices conducting foreign exchange business are inspected/audited once in two years. The bank has prescribed proforma for inspection/audit report which also contains check-points for the guidance of the auditstaff.

Syndicate Bank

Branches are inspected once in a year by internal auditors. In the case of large branches, auditors are appointed for conducting concurrent audit on a daily basis. A desk guide/ Inspection kit for the internal auditors has been prepared by the bank and it is under print.

Canara Bank

Guidelines have been issued by the Inspection Department to its officers for inspection of the bank's Foreign Departments and branches designated to handle export business directly. The guidelines cover checking/audit/inspection of all aspects. Inspection of the Foreign Departments by the Inspection Department, Head Office, is expected to be conducted once in a year. The export bills handling section of the designated branch is inspected by the nearest Foreign Department officials in the

initial period and thereafter once in six months by the Inspection Department.

Grindlays Bank

The departments and branches conducting foreign exchange business are inspected by the Internal Control Team once in two months. This Team reports to the respective Area General Manager. The Bank's internal auditors conduct audit of the departments/branches once a year. In addition, the external auditors conduct an audit once a year. The bank has a list of check-points to be used by the internal auditors.

Chartered Bank

In the Bombay Main Office where the dealing activities take place, the spot checks are carried out by a senior officer in various departments dealing in foreign exchange and also at the dealing centre, daily, weekly, fortnightly and monthly. The other Indian branches are inspected at least once a year by the branch inspectors. Audit report on Bombay dealing centre is submitted to the Manager at Bombay daily.

Question 4

- (a) Are the foreign exchange operations of the bank reviewed periodically ?
- (b) If so, by whom and how often ?
- (c) To whom is the review submitted ?

(d) Please furnish a copy of the last review made by bank.

Replies

State Bank of India

Reviews on foreign exchange operations are done periodically by the Foreign Department, Calcutta, and by the International Division, Bombay, and they are submitted to top management. (The bank has not furnished a copy of any review).

Bank of Baroda

The foreign exchange operations of the bank are reviewed by the International Division at Central Office, Bombay, once a year. The review is submitted to the Board of Directors. (The Review put up to the Board in December 1981 in respect of its domestic foreign exchange business for the years 1979 and 1980 deals with authorised branches, purchases and sales, training of staff and operational problems of the authorised branches).

Bank of India

The foreign exchange operations of the bank are reviewed periodically as under :-

- (i) Monthly report including turnover figures is submitted to the Management.
- (ii) Annual report of the Foreign Department of the Bombay (Main) branch (which is the main operations wing in Bombay) is submitted to the Management.
- (iii) A consolidated annual report of the foreign exchange business of the bank

is submitted to the Board of Directors.

(The annual report submitted to the Board of Directors for the year 1980 contains detailed information in respect of the bank's business under exports, imports, deferred payment guarantees, remittances, foreign currency non-resident accounts, exchange statistics, exchange profit and correspondent relationships. It also contains a study of international monetary developments and developments in Indian Exchange Control. Statistics furnished in the report are for the year under report as well as for the previous year to have a comparative view. The information is also given regionwise).

Central Bank of India

The foreign exchange business of the bank is reviewed periodically by the Chief Manager and Assistant General Manager alongwith Chief Dealer. The review of cover operations is done on daily basis. The position book prepared by the Dealing Department in connection with foreign exchange operations is submitted daily to Chief Manager who in turn refers to AGM, whenever necessary. The annual review of the working of foreign exchange business of the bank is prepared and submitted to the Board. (The review for 1980 submitted to the Board in July 1981 covers general developments in the world foreign exchange markets, performance of the branches, profits, export credit, cover operations, Rupee funding operations, Rupee accounts of foreign banks/Exchange Houses, Rupee travellers

Cheques, Non-resident(External) and FCNR accounts, training of staff, foreign tours, etc. It is stated in the review that during the period of review, main branches at Calcutta and Madras were permitted to conduct cover operations directly which had to some extent affected the profitability of operations. It is further stated that prior to decentralisation, the bank was able to absorb in its overall position major part of foreign exchange operations of various branches with the result that the bank's recourse to foreign exchange markets had been to the extent of spill over only, thus saving considerable amount of brokerage and out of pocket expenses, such as telex charges, for inter-bank sales and purchases).

United Commercial Bank

Foreign exchange operations are reviewed by the International Division on the basis of returns and statements and inspection reports. (The bank has not, however, sent any copy of the review nor has it indicated its periodicity).

Union Bank of India

FCEDD reviews the foreign exchange business of the bank once a year at the time of review of Annual Business Plan and, in some respects, monthly and quarterly reviews are made on receipt of statements from the branches. General business review is submitted once a year to the management. Currency position and outstanding contracts review is submitted to the Board of Directors every quarter. (The annual review for the

year 1981 submitted to the Board covers zone-wise turnover of foreign exchange business, need for diversification of export involvement, export prospects for various commodities, overseas operations, importance of foreign exchange business and about the branches conducting foreign exchange business).

#### Corporation Bank

Foreign exchange operations of the bank are reviewed periodically by the Central Foreign Exchange Department and the review submitted to the Board of Directors on a monthly basis. (A copy of such review has been furnished).

#### Bank of Maharashtra

Review of foreign exchange business is done at the Foreign Exchange Department at Pune, monthly and quarterly, and such reviews are put up to the top management. Note on the working of the foreign exchange business is put up to the Board of Directors, yearly. (Copy of the Review for 1981 has been furnished).

#### Indian Bank

The foreign exchange operations of the bank are reviewed periodically. (A copy of such a review for the year 1981 prepared by the International Division and put up to the Board in February 1982, has been furnished by the bank. On perusal, it is observed that the review contains the bank's sales and purchases during the last five years. It also covers region-

wise break-up of sales and purchases in 1980=1981. The progress made by the Regional Foreign Exchange Cells, training programme conducted for branch Managers and proposed strategies for achieving the targets set for 1982 have also been covered).

#### Syndicate Bank

Review of the bank's foreign exchange operations is done on a quarterly basis by the Economic Intelligence Division at Bombay and submitted to the Board. (On a perusal of the review for the quarter October-December 1981, it is observed that it contains information regarding agency arrangements, overseas expansion, merchant banking, exchange dealings, systems and Manual, Economic Intelligence, overseas projects and shipping finance, working results and staff position).

#### Canara Bank

International Division submits to the Credit Wing, Head Office, various statements and information for the latter to monitor/review the foreign exchange operations, including quarterly review of business turnover of Foreign Departments and International Division, and for putting up a note to the Board of Directors on a half-yearly basis on the working results of the International Division and Foreign Departments. (The note put up to the Board covers the growth of the bank's foreign business, world economic scene, global trade, Indian trade, targets in respect of foreign business and Non-resident(External) and FCNR deposits, profitability, travellers cheques, internal

control, manpower, training, etc.)

Grindlays Bank

The foreign exchange operations of the bank are reviewed monthly at the Bombay Main Office, where these operations are controlled. These are reviewed by the Officer-in-Charge of the Reconciliation Section with the assistance of his supporting staff, who are independent of the Processing Section. The review is submitted to the Unit Head, Manager Operations and Area General Manager. (A copy of the review for March 1982 has been furnished by the bank).

Chartered Bank

Review of foreign exchange business is done by the Chief Manager, India monthly, which is submitted to Head Office. (A copy of the review has not been furnished by the bank).

Question 5

(a) Please furnish the names of the branches/offices which are authorised to conduct foreign exchange dealing operations independently.

(b) Please give the Organisation Chart of the Dealing Department at each of the centres indicating the functions performed by the personnel attached to the Department.

Replies

State Bank of India

The cover operations are centralised at the Foreign

Department, Calcutta.

Bank of Baroda.

Five branches in category 'A' at Bombay, Calcutta, Madras, New Delhi and Ahmedabad are authorised to maintain position and conduct foreign exchange dealing operations independently. Dealing Rooms at all these centres have three officers, one dealer keeps track of developments over ticker, screen, etc., and concentrates on Rupee funding and overseas deals, another dealer handles all inter-bank transactions, and the third dealer attends to merchant business. The inter-bank dealer and merchant dealer inter-act and co-ordinate with each other. The Dealing Department has three sections, viz., Dealing, Back-up and Accounts Sections and their functions are segregated.

Bank of India

The bank's six branches, viz., Bombay (Overseas branch), Madras, New Delhi, Ahmedabad, Vasco-da-gama, and Calcutta, are authorised to conduct dealing operations independently. (The information regarding the organisational set up of the dealing departments at these centres has not been furnished by the bank).

Central Bank of India

At the Bombay(Main) Office, there is a Chief Dealer, assisted by two other dealers. At Calcutta and Madras Main branches, where dealing operations are done independently, there is one dealer who works under the supervision of the branch

Manager/Chief Manager or AGM of the Region concerned.

United Commercial Bank.

Nine branches of the bank in important cities are authorised to do dealing operations and maintain currency positions. The foreign exchange dealing department consists of a chief dealer, one assistant dealer and two officers, one to follow-up contracts and another to assist checking of Nostro and Vostro accounts and funds management.

Union Bank of India

Three branches, viz., Bombay(Samachar Marg), Cochin(Main) and Calcutta (India Exchange Place), are authorised to conduct foreign exchange dealing operations independently. New Delhi (Connaught Place) branch maintains currency positions in pound sterling and U.S.dollars. This branch, however, is not yet permitted to deal in inter-bank markets for cover operations, and the branch is required to enter into deals with Bombay (Samachar Marg) branch. Nine other branches have also been allowed to maintain mini-positions in pound sterling only in order to expeditiously transact export-import business in that currency. These branches are required to maintain a square or as near square position/as possible and, in any case, not exceeding £ 5,000 overbought or oversold. The dealing centre at Bombay (Samachar Marg) branch has two dealing officers, a funding officer and an accounting officer under the charge of superintendent who works under the guidance of Manager, Foreign Exchange Department,

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of the branch.

Corporation Bank

Dealing operations are solely conducted by the Central Foreign Exchange Department, Bombay.

Bank of Maharashtra

Dealing operations are centralised at the Foreign Exchange Department, Bombay. The foreign exchange business is conducted at 15 branches/offices. Due to the small volume of transactions, the dealer at Bombay performs both functions of accounting and dealing, including follow-up functions.

Indian Bank

Only the International Division at Central Office is authorised to conduct dealing operations for the whole bank. As regards the organisational set-up of the Dealing Department, it consists of one senior dealer and one junior dealer.

Syndicate Bank

International Wing at Bombay and Calcutta branch have been authorised to conduct foreign exchange dealing operations independently in India. At the Bombay Dealing Department, there are four dealers including a separate dealer for merchant business. Back-up Department is separate from Dealing Department and is provided with sufficient staff.

Canara Bank

The bank's offices at Bombay, Bangalore, Calcutta and

New Delhi have been authorised to conduct dealing operations independently.

Grindlays Bank

Bombay and Calcutta offices have been authorised to conduct foreign exchange dealing operations independently. The Dealing Department is headed by Funds Manager assisted by Chief Trader. There are three Traders under the Chief Trader, two in Bombay and one in Calcutta. The Funds Manager and the Chief Trader are based in Bombay. The Traders report to the Chief Trader who is in charge of the foreign exchange dealings in India. One of the two Traders in Bombay is involved in active dealings and the other maintains the position pad and also the rupee-pad for Bombay.

Chartered Bank

At Bombay(Main) office, the Assistant Manager is in charge of the Bombay Dealing Centre (Centralised). There are two dealers, two processing officers and one internal auditor in the Dealing Centre.

Question 6

What are the infrastructure facilities, such as telex machines, tickers, etc., provided to the Dealing Department ?

Replies

State Bank of India

Point to point teleprinter channel with Overseas Branch,

Bombay, and Madras, direct hot telephone connections with Singapore Office, direct telephone line between Foreign Department and Madras Overseas Branch and with brokers, etc., facilities are available at the Foreign Department, Calcutta. Usual Telex machines have also been provided.

Bank of Baroda.

Dealing rooms are provided with telex machines, tickers and direct telephones. At Bombay, the dealing room has a Reuter Money Screen.

Bank of India

The dealing Department at Bombay has been provided with a telex machine, Reuter Monitor, PTI teleprinter and direct telephone facilities. Hot lines with brokers and some of the main operating branches are available.

Central Bank of India

The bank has telex as also STD facilities at Bombay, Calcutta, Delhi, etc. However, at some centres, because of communication difficulties, arrangements for fixed time telephone calls in the afternoon between the branch and Bombay(Main) office have been made. This is in addition to the telex facility. There is a Reuter Monitor Service at Bombay(Main) Office and also a direct connection with London branch through Reuter Monitor Service.

United Commercial Bank

The Dealing Department has a telex machine, FTI rates service, account transcript service of foreign correspondents and telephones.

Union Bank of India

The Dealing Department at Bombay has been provided with separate direct line telephones, telex machines and Reuter Monitor Screen. The Department has also many hot line telephone connections with brokers. At Calcutta and Cochin branches, there are direct telephones and telex machines for the Dealing Department and direct telex link with Bombay branch.

Corporation Bank

Infrastructure facilities provided to the Dealing Department consist of two telex machines, telephone facilities and hot/direct lines with important brokers, Reuter Video Screen and teleprinter.

Bank of Maharashtra.

Dealing Department has been provided with independent telex machines and UNI Financial Service. No separate room is provided for dealing. The bank is studying the requirements of the Dealing Department in regard to infrastructure and organisation, in the light of the guidelines issued by ECD in 1981.

Indian Bank

It is stated in a note put up to the Board in September

1981 regarding Central Office control over foreign exchange transactions that the bank is now equipped with United News Service ticker for getting the information on currency movements, foreign exchange rates, market conditions in various international financial markets, etc. It will be going in for Reuter Money Service and other scanner equipments in due course. Besides, facilities of telexes and direct telephones are available.

#### Syndicate Bank

Dealing Department at Bombay has Spectrum-II, teleprinters with Calcutta, Delhi, Madras, Manipal and Bombay(Homji Street) Branch, Reuter Monitor Report(Ticker), PTI Ticker, Reuter-Monitor Screen, telexes, hot lines with local brokers and four direct telephone lines. At Calcutta Office, teleprinter with Bombay, telexes and telephones are available.

#### Canara Bank

The dealing centres are provided with telex and STD facilities. Hot lines with brokers are also provided in Bombay and other dealing centres where such facilities are available. There is a teleprinter connection between International Division, Bombay, and Foreign Department, Bangalore. Applications have been made for teleprinter connections for International Division and Foreign Departments at Calcutta and New Delhi. The bank also proposes to instal a video monitor screen.

Grindlays Bank

The Dealing Department in Bombay has two telephone lines, two telex machines, one ticker-tape and one Reuter Screen. In addition, it has a number of telephone hot lines with exchange brokers. The dealer in Calcutta has one telephone line and one telex machine.

Chartered Bank

There are a telex machine, Reuter Monitor Screen, Ticker and direct telephone lines with Brokers.

Question 7

Please describe the policy and system of the bank regarding fixing of daylight, overnight, inter-bank and customer limits, control over mismatchings in maturities(gaps), pipelines transactions and operations in foreign currency notes.

Replies

State Bank of India

The General Manager, who heads the Foreign Department, exercises day-to-day control on the activities of the Department, including reconciliation of 'Nostro' balances. Balances are regulated according to day-to-day requirements on the basis of the up-to-date information available including the information received from the principal correspondents throughout the world, who send cables and telex messages. Daylight limits and Inter-bank limits have not been fixed. Pipeline transactions

are kept to the minimum by introduction of special procedure for reporting transactions of high value, improvement in communication system and restriction of foreign exchange business to limited branches. Foreign currency notes(stock) are not taken into currency position. However, the accrual cost and disposal proceeds are taken into currency position as sale and purchase.

Bank of Baroda.

Separate limits for each of position maintaining branches have been fixed for daylight, overnight, inter-bank and customer open positions, mismatchings, etc., in accordance with the RBI guidelines.

Bank of India

Daylight, overnight and mismatchings (Gap) limits are fixed for each dealing centre by the Board of Directors, after taking into consideration the volume of business, both exports and imports. While granting credit facilities to customers, suitable limits for forward covers, where applicable, are also generally stipulated. Pipeline transactions have been reduced by decentralisation of exchange dealings and by instructing branches to report to the dealing centre all items above Rs.10,000/- on the same day by telephone or telex. The bank has suggested that the foreign currency notes position should be delinked from the exchange positions as inclusion thereof distorts funds management and the exchange position of the bank.

Central Bank of India

The bank has not yet fixed any daylight, overnight, inter-bank and customer limits. The matter is under its consideration. The branches have been instructed to maintain as near square position as possible and mismatchings should be adjusted as quickly as possible, but within five days. In case of pipeline transactions, the branches should report them to Bombay(Main) Office (Cover Department) when these exceed the prescribed limit of equivalent of Rs.7500/- either by telex or during fixed time telephones. In case of major transactions they should contact by STD or telex. The bank maintains very limited stock of foreign currency notes. In case of excess stock, it is sold to authorised money changers. Similarly, they are also bought from the money changers when required.

United Commercial Bank

The bank has recently evolved broad guidelines for observance by the dealing department. These guidelines have been modelled on the RBI instructions contained in the booklet 'Guidelines for Internal Control over Foreign Exchange Business'. The actual implementation will be known in due course. Foreign currency notes are despatched to the concerned centre for crediting to the Nostro account at convenient intervals.

Union Bank of India

The bank is putting up a note to the Board recommending

various, limits (Daylight, overnight, inter-bank and customer limits) to be fixed for exchange dealing branches.

Corporation Bank

At present, no daylight limits have been laid down. The matter is under consideration of the bank. However, a careful watch is kept to see that all transactions are as far as possible simultaneously covered. Overnight limits are set to ensure that the dealers do not hold a large open position. No limits have been fixed for dealing with individual banks, both overseas banks as well as authorised dealers in India. Most of the transactions are, however, with foreign banks and the nationalised banks only. Fixing of limits for the banks is also receiving attention of the bank. No customer limits have been fixed for forward exchange contracts at present. Forward exchange contract facility is being offered only to customers who enjoy credit limits with the bank. Fixing of limits for customers is also under consideration. IGL and AGL in respect of mismatchings in maturities have not been fixed. At present outstanding forward covers are gone through periodically and gaps are minimised. The volume of pipeline transactions is kept to the minimum by arrangement of reporting transactions above US\$ 10,000 and £ 5,000 or equivalent, by branches to the Central Foreign Exchange Department immediately over telex or telephone. Purchases/sales of currency notes are taken into position on the basis of telephone or telex messages or on receipt of

relevant purchase or sale notes at the Central Foreign Exchange Department. Branches send such currency notes to the correspondents in convenient lots. The bank is also reviewing the entire position in this regard.

Bank of Maharashtra

The bank has not yet prescribed daylight, overnight, inter-bank and gap limits. It has stated that the bank's dealers have been instructed to execute mainly cover operations backed by trade transactions and matching funding operations. It is contemplating laying down limits for dealers in respect of daylight open positions and overnight limits for major currencies. Limits have, however, been fixed for customers. In respect of pipeline transactions, efforts are made to monitor outstanding contracts and unadjusted entries periodically. Efforts are also made to improve communication between operating centres and dealing offices. It is stated that due to paucity of trained personnel, it is not feasible for the bank to arrange decentralisation of dealing operations. Detailed guidelines have been issued to branches/offices regarding ceilings and disposal of foreign currency notes. Any surplus over the ceilings is diverted to the Foreign Exchange Division, Bombay.

Indian Bank

The following control systems over the Dealing Section has been prescribed. (a) Deal limits - Single deals above the

specified amount will be put through only with the prior approval of Chief Officer/AGM of International Division. Single deal over a certain amount will be put through only after the prior approval of G.M. A day's turnover shall not exceed a certain specified amount.

(b) Credit limits - Deals with non-nationalised banks and other foreign banks with whom no experience is there will not be put through unless a foreign exchange deal limit is established. Limits have been prescribed for overnight position in various currencies. The bank proposes to introduce gap limits for various currencies and also inter-bank limits. (The information regarding pipeline transactions and operations in foreign currency notes has not been furnished by the bank).

#### Syndicate Bank

Daylight, overnight, inter-bank and customer limits are fixed taking into account the risk limits, volume of business, confidence in dealers, profit target, past experience, etc. Pipeline transactions are minimised by decentralisation of the dealings, by fixing amounts for the branch for daily purchase and sale and preparation of currency position statement on the last Friday of each month. A major portion of the foreign currency notes collected from branches is disposed of through money changers in Bombay.

#### Canara Bank

The limits for International Division and various

Foreign Departments for intra-day, overnight, gap position on account of mismatched maturities and for various types of trading risks, bank-wise limits for banks operating in India as also for banks outside India, **countrywise** limits (for developed countries and other countries) and customer-wise limits for forward contract booking, are fixed by the Board of Directors. The limits are recommended to the Board, taking into consideration the present Exchange Control regulations, guidelines issued by the Reserve Bank of India, past experience and expected market activities of the bank.

Grindlays Bank

The dealers' daylight and overnight positions are fixed by the top management in India. The main aim is to minimise exchange risk. Inter-bank and customer limits are fixed by the Corporate Banking Division after studying the financial status of the individual bank/customer. Gap report is prepared tri-monthly by the Reconciliation Department in Bombay showing the month-wise exchange gaps on an all-India basis. These reports are given to the **dealers** who then close the gaps by covering the transactions with a matched maturity as far as possible. The branches send a daily message to the Main Branch in Bombay, giving the total of the exchange transactions of the day. The difference between the total of exchange transactions advised during the day and the total of exchange transactions of the day represents pipeline transactions and it is taken in the

position, the next day. The purchase of foreign currency notes is restricted to pounds sterling and U.S. dollars; other foreign currency notes are accepted by the bank on collection basis only. It is ensured that the holding of foreign currency notes does not exceed the normal requirement. Surplus, if any, is disposed of through authorised dealers. Sales/purchases of foreign currency notes are advised to the dealer who takes them in his position pad.

#### Chartered Bank

The daylight, overnight and mismatched maturity limits are fixed by Head Office on the basis of the operations in Bombay inter-bank and customer limits are established on the basis of balance sheet considerations.

#### Question 8

What is the system of the bank regarding control over reconciliation of 'Nostro' balances and management of risks arising in Rupee (Vostro) accounts ?

#### Replies

##### State Bank of India

The reconciliation of the transactions reported by the offices with the entries appearing in the statements of accounts of the foreign banks is done on an on-going basis at Foreign Department, Calcutta. The work is stated to be in arrears and steps are being taken to regularise the position.

Bank of Baroda

All Nostro accounts are regularly reconciled by the Back-up Section in the Dealing Department.

Bank of India

Every effort is made to reconcile Nostro accounts promptly with a proper follow-up of outstanding/unreconciled entries. A quarterly statement is submitted to the management of the unreconciled entries. ( It is observed from the report of the bank on the working of the Foreign Department for the year 1980 that there were a large number of entries which were yet to be marked off and reconciled in major Nostro accounts). Weekly fortnightly/monthly statements as required by the foreign banks are furnished to them in respect of their Vostro accounts. The concerned department also monitors these accounts periodically with a view to ensuring that they are properly conducted. These accounts are generally in credit. Any occasional overdrawings are immediately conveyed to the bank concerned by telex and replenishment is made promptly by the foreign banks.

Central Bank of India

As regards foreign currency accounts, the balances are received from the foreign banks by telex daily; in the case of highly operative accounts, particularly U.S. dollars, bi-weekly or weekly, depending upon the turnover in accounts. Besides, some of the correspondent banks advise by telex major debits

and credits exceeding \$ 10,000. Reconciliation of foreign currency accounts is prepared on a monthly basis. This is submitted by the branches to the branch Manager or Divisional Office as the case may be. Divisional Office scrutinises the statements with a view to ascertaining if there are any old and large outstanding entries which have remained unreconciled and report them to the Foreign Division, Central Office. It is the practice of the bank to forward the statements of accounts in respect of Rupee accounts maintained by foreign banks to them according to the period required by them. If the account is overdrawn, the concerned bank is immediately contacted by telex for laying funds.

#### United Commercial Bank

Reconciliation of balances in Nostro accounts is required to be done every month and copies of such statements sent to the Head Office, International Division. Similarly statements of Vostro accounts are sent to the foreign correspondents/branches and their queries dealt with promptly.

#### Union Bank of India.

At the Foreign Exchange Department, Bombay Samachar Marg, where Nostro and Vostro accounts are maintained, there is a separate Reconciliation Department under the charge of a Superintendent. The reconciliation of Nostro accounts is done in that Department, which also follows-up old outstanding entries and submits monthly report to FOEDD and the Reserve Bank. The

same department keeps an effective control over the balances in Vostro accounts. In case of overdrafts in Vostro accounts on account of unforeseen genuine transactions, the department takes up the matter with respective banks asking them to replenish their accounts. A monthly statement of balances in the Vostro accounts is received in the FOEDD for scrutiny.

#### Corporation Bank

'Nostro' accounts wherein operations are continuous and heavy are reconciled at an interval of 15 days to one month; whereas periodicity of not exceeding 3 months is observed in the case of accounts which are operated sparingly. Efforts are made to ensure that reconciliation is done regularly to eliminate all outstanding items speedily. The Vostro accounts are maintained at the Nariman Point, Bombay, branch by the staff deputed by the Central Foreign Exchange Department, for the sake of convenience. The guidelines issued by RBI for internal control over foreign exchange business are taken note of and measures are being adopted to have control over various aspects.

#### Bank of Maharashtra.

A separate section attends to reconciliation of Nostro accounts and management of risks arising in Vostro accounts. Monthly statement of Nostro account balances alongwith remarks is submitted by the Divisional Manager, Foreign Exchange, Bombay to top management. Bi-monthly statement of reconciliation of Nostro accounts is also submitted to the Divisional Manager,

FEX, Pune. Vostro accounts are maintained at Bombay Office, separate from other Rupee accounts. Funds flow into these accounts is reviewed periodically.

Indian Bank

The Regional Foreign Exchange Cells have been allotted different correspondent banks for keeping Vostro accounts in U.S. dollars and sterling pounds. As major portion of transactions relates to U.S.\$ and sterling pounds only, the reconciliation work at the Regional Foreign Exchange Cells has been smooth and easy. International Division checks the outstandings in the reconciliation statements received from R.F.E.Cells periodically and initiates follow-up action, to keep the unreconciled entries to the barest minimum. However, backlog of a number of unreconciled entries for small charges, etc., is being carried and the bank expects that the recent decentralisation made at Regional Foreign Exchange Cells would help in clearing the backlog. It is also proposed to strengthen the Reconciliation Department by posting adequate senior level staff. The bank had encountered certain difficulties in conducting Vostro accounts of exchange companies and had taken certain measures for eliminating loopholes in the conduct of these accounts. Consequently, exchange companies who were annoyed at these measures shifted their accounts to other banks. As such, the bank has only a few non-resident Rupee accounts of banks and exchange companies now, which the bank closely monitors.

Syndicate Bank

Statements of Nostro accounts are obtained on a daily or weekly basis for scrutiny. Besides, particulars of debits and credits for larger amounts in active accounts are obtained in order to have control over major debits. Reconciliation work is entrusted to a separate department independent of Accounts Section. The officer does not have the powers to operate the Nostro accounts. The staff of the Reconciliation Department is rotated more frequently. The reconciliation statements are prepared every month and outstanding items are followed-up. The position of reconciliation is reported to Head Office every month. Control over Vostro accounts is exercised by taking immediate steps to advise the concerned correspondents about overdrawals, if any, and obtaining funds to clear the debt. A continuous track is kept of local changes, market information on the working of various banks, exchange companies, etc. Exchange companies have to maintain a fixed minimum balance in their accounts. For drawings of Rs.50,000/- and above, the concerned bank has to send telex or cable instructions to the paying branch. There is a system of value-dating all the transactions in Vostro accounts from time to time (by means of a computer) so as to find out hidden overdrawals, if any. Confirmation of balances is obtained on a quarterly basis.

Canara Bank

Limits for balances to be maintained in Nostro accounts,

in important currencies, are fixed by the Board. Separate limits for the International Division and Dealing Foreign Departments are stipulated. Occasional increases in balances over and above the limits allowed, are required to be reported to the executives of the International Division, giving reasons for such excess balances. The International Division follows up long outstanding items in Nostro accounts, from the monthly statement of reconciliation of such accounts received from Foreign Departments, to see that effective steps are taken for early elimination of such entries. No regular overdraft limits are permitted to banks maintaining Vostro accounts with the bank except with the approval of the Reserve Bank. Casual overdrafts allowed are got cleared within the normal period of five days. If not so cleared, the matter is reported to the International Division for post-facto approval.

#### Grindlays Bank

Reconciliation of Nostro accounts is done on monthly basis by a clerk who is independent of posting and processing transactions. The clerk is rotated every year. Reconciliation of each Nostro account is reviewed monthly by senior management. Unreconciled items are listed and branch Manager evaluates them monthly, taking into account the transit/processing time lag. Investigation and continuous follow-up action is initiated on all outstanding items. Generally Rupee (Vostro) accounts are maintained with credit balances. If they get overdrawn as a

result of large commercial transactions, a telex advice is sent to the concerned bank, requesting prompt adjustment. It is ensured that overdrafts in Vostro accounts do not exceed the limit prescribed by RBI.

#### Chartered Bank

All Nostro accounts are reconciled every month and prompt action is taken in respect of unreconciled items. Vostro accounts are scrutinised often by the Assistant Manager in charge of Funds and Foreign Exchange operations in Bombay.

#### Question 9

What is the procedure for accounting import bills received under letters of credit and when are they treated as 'sale' of foreign currency.

#### Replies

##### State Bank of India

Bills received under import letters of credit are treated as sale of foreign currency on the day they are retired by the importing customer, and entry is also passed in respect of import bills outstanding at the time of yearly closing.

##### Bank of Baroda.

Import bills received under letters of credit are debited to 'Advance Bills Account' at the B.C. selling rate ruling on the day of the entry and the corresponding credit

is given to the mirror account of the currency, Sale of the foreign currency is reported when the bills are retired by the drawees.

Bank of India

Import bills received under letters of credit are being converted into local currency and rupee liability fixed on the seventh day of presentation after reporting sale of the relative foreign currency.

Central Bank of India

The branch opening letter of credit extinguishes foreign exchange liability in respect of demand bills received under import letter of credit at the prevailing B.C. rates, on the day the bill is retired by the importer or on the 7th day from the day of its presentation advice, whichever is earlier. In the case of usance bills, the branch extinguishes foreign exchange liability on the due date or the date of retirement of documents by credit openers, whichever is earlier. If the bill is not retired before 7 days in the case of demand bills and before the due dates in case of usance bills, the foreign exchange liability is crystallised into rupee loan.

United Commercial Bank.

Import bills under letters of credit are first taken to Suspense Account (ABP) and the actual sale is considered to be effected when the importer customer pays for the

documents, However, when there is a forward sale contract already booked, the importer is required to take up the documents on or before the due date of the contract at the contracted rate, failing which the contract is adjusted and the rupee liability created.

#### Union Bank of India

Immediately upon receipt of documents drawn under letters of credit, a control entry is passed crediting correspondents mirror account and debiting suspense account styled as 'Payment against documents account' (PAD). It is only when the customer retires the documents, the transaction is treated as sale and taken into the exchange position. If customer wants rupee finance until arrival of steamer, the same is extended by conversion of foreign currency into rupee equivalent with proper mandate of the customer and when converted, it is reported as sale.

#### Corporation Bank

In the case of import bills received under letters of credit, the following entries are passed :

- Dr.            Advance Bills under letters of credit ( at B.C. selling rate or at forward contract rate.)
- Cr.            Central Foreign Exchange Department through Branch Accounts for passing on the relative credit to Bank account.

On retirement of the bill by the customer, the following entries

are passed at the branch :

Dr. - Customer

(a) for draft amount

(b) other charges (commission and interest from the date of negotiation abroad to the date of retirement at B.C. selling rate ruling on the date of retirement or at forward contract rate, if already booked.)

Cr. - Advance Bills under letters of credit

Cr. - Interest

Cr. - Commission

Cr. - Sundry assets - Stamp account

Dr./Cr.- Exchange difference

The transaction is treated as sale of foreign currency only on the retirement of the bill.

#### Bank of Maharashtra

Initially, Foreign Advance Bills Purchased Account is debited which is immediately adjusted to the client's account if the bills show no discrepancy. In case of any discrepancy, the amount remains in the FABP Account, till actual authorisation for accepting the documents is received. The amount is treated as sale only when it is adjusted with the clients' account.

#### Indian Bank

As soon as import bills are received and if no discrepancies are observed in the documents, they are immediately

debited to 'Advance Bills Account' and the amount is treated as sale.

Syndicate Bank

Import bills received under letters of credit are entered in the Register. The bill is converted into rupee liability on the 8th day at the prevailing B.C.selling rate in the case of sight bills. On the day of conversion, Foreign Import Bills Purchased account (FIIP) is debited and FEDCO is credited. Thus, the cover for Nostro debit is passed on to the International Division and the sale is reported to the Dealing Section. On the date of conversion, the sale of foreign currency is reported. In the case of usance bills, the following entries are passed immediately on receipt of bill at B.C.selling rate :

Credit - Usance Bill under Import Letters of Credit for Collection (UBILC)

Debit - Usance Bill under Letters of Credit Receivable

On the due dates, the cover is provided to International Division by effecting the sale and converting the foreign currency amount at the B.C.selling rate.

Canara Bank

Import bills under letters of credit are received at Foreign Departments who open letters of credit. The bill amounts are credited to the mirror accounts and debited to import suspense account which is called 'Advance Bills'

account. The documents are then forwarded to the concerned branches. On the dates of retirement of bills at the branches, they are treated as sale of foreign currency.

Grindlays Bank

On receipt of an import bill drawn in conformity with the terms of the letter of credit the following entries are passed:

Dr. - Import Bills Local Currency or  
Foreign Currency.

Cr. - Vostro/Nostrro account.

The balance in the I.B. account represents import bills outstanding and which cannot be readily debited to the customer's account. The sale of foreign currency in respect of an import bill under letter of credit is treated only on the date of retirement of the bill.

Chartered Bank

Bills received under letters of credit are initially debited to General Ledger account styled as 'Bills Receivable Account' and entries for sale of foreign currency are passed only when the bills are retired by the drawees.

Question 10

(a) What accounting entries are passed when export bills are purchased/discounted or negotiated under letters of credit?

(b) In case the bills are not accepted or remain outstanding for a long time, what action is taken to ensure that

the bank does not suffer a loss due to changes in rates of exchange ?

Replies

State Bank of India

In the case of demand export bills negotiated, the concerned currency account is debited and the proceeds paid to the exporter. The purchase of foreign currency is taken into account immediately by the Foreign Department to whom the transaction is reported by the branch concerned. In the case of usance bills discounted, offices debit the amounts to Bills of Exchange Account and release the amount to the party. The entries in the Bills of Exchange Account are reversed on receipt of relative payment advice at firm rates, in consultation with the Foreign Department who take the purchase in their position. If the bills remain outstanding, there is no exchange risk to the bank as the purchase of foreign currency is taken into position at the time of purchase/negotiation. The exporters pay overdue interest from the date of negotiation of the bill to the actual date of payment.

Bank of Baroda

When export bills are purchased or discounted or negotiated, Foreign Bills Purchase account is debited at O.D. buying rate and the corresponding credit is given to the drawer. On realisation, the F.B.P. account is reversed to the debit of the

mirror account. In cases where the export bills are not accepted or remain outstanding for a long time, swap costs are recovered from the drawers.

Bank of India

The following accounting entries are passed when export bill is purchased/discounted or negotiated.

Dr. - Export Bills Purchased at the applicable O.D. buying rate.

Cr. - Customer's account (for bills purchased and discounted)

Dr. - Export Bills Negotiated at the applicable O.D. buying rate

Cr. - Customer's account (for bills negotiated)

In case export bills are not accepted or remain outstanding for a long time, the bank recovers overdue interest either from expiry date of transit period till date of realisation of the bill or from the date of purchase (at the T.T. selling rates)/ negotiation till the date of refund obtained from the customer, as per the rates of interest stipulated by RBI from time to time.

Central Bank of India

When export bills are purchased/discounted or negotiated under letters of credit, 'Foreign Bills Purchased' or 'Foreign Bills Discounted' account is debited and Party's account is credited. When the bill is realised, the entry is reversed by

debiting the overseas bank's foreign currency account in the General Ledger, and crediting FBP or FBD, as the case may be. In case the bill purchased is not accepted or remains outstanding the customer is immediately informed and the entries in the aforesaid accounts are adjusted by debiting customer's account at current T.T. selling rates and the bill is taken on collection basis. When the collection is realised, the customer is paid at current T.T. buying rates.

United Commercial Bank

When export bills are purchased or discounted, the rate is inclusive of transit period interest. However, when the bills get realised, the reversal is done by passing credit to FBP, at the TT mean rate on the date of reversal. At the end of every half year, FBP foreign currency account is revalued at the TT mean rate at that time and profit and loss account adjusted accordingly. In the case of overdue bills, the bank charges interest at 2% more than the normal rate of interest and also covers through appropriate swaps to safeguard against exchange fluctuations.

Union Bank of India

At the time of purchasing/discounting/negotiating export bills under letters of credit in foreign currencies, the customer's account is credited and Suspense Account, i.e., Foreign Bills Purchased account, is debited. The entry in the F.B.P. account

is reversed to the debit of the correspondent's account upon receipt of the credit advice by the bank. In the event of bills being not accepted or remaining outstanding for a long time, the matter is taken up with the exporters asking them to chase the buyers for acceptance or payment of the bill. Simultaneously, the matter is taken up with the correspondents to ascertain the position of the goods which might have remained uncleared in the docks. The exporter customer is also asked to repay the advance and transfer the bill to the collection portfolio.

Corporation Bank

The following accounting entries are passed at the designated branches when export bills are purchased/discounted or negotiated under letters of credit.

Dr. - Foreign Documentary Bills negotiated/purchased/  
discounted at the appropriate buying rates  
ruling on the day or at contract rate.

Cr. -- Customer

Cr. - Postage, Commission, etc.

On the same day, the purchase is taken into exchange position. When export bills remain unpaid beyond due dates, no additional exchange loss is charged to the party except penal rate of interest as prescribed by RBI.

Bank of Maharashtra

When export bills are purchased/discounted or negotiated, a telex is sent to the Foreign Exchange Division, Bombay, for

incorporating it in currency position. In case any sight bill remains unpaid beyond transit period or 45 days from the date of despatch and the usance bill remains unpaid on due date, the bills are transferred to overdue FOBW account and removed from the exchange position by converting the liability into rupee liability. Simultaneously, action is initiated to protect the goods on arrival at destination and to extend the insurance cover. A registered notice is served on the client asking him to pay the amount of interest and loss of exchange.

#### Indian Bank

When export bills are purchased under letters of credit, they are debited to, 'Foreign Bills Negotiation Account' and if they are authorised branches they will send the bills directly to correspondent banks. If the bills are not under letters of credit, they are debited to 'Foreign Bills Purchased Account'. If a bill remains outstanding for a long time, normally, the entry is reversed and the bill is taken on collection basis. When the reversal is done, they are treated as sales as per the FEDAI rules.

#### Syndicate Bank

If the bill is drawn in foreign currency, the amount is converted into rupees at rates of exchange as obtained from FEDCO. In the case of bills which are not accepted or remain outstanding for a long time, the bank has stated that the matter is under consideration and suitable procedure is being worked out.

Canara Bank

Export bills purchased/discounted or negotiated under letters of credit are debited to 'Bills Purchased' account. In respect of bills which remain outstanding for more than two months, Foreign Departments instruct the concerned branches to recover the advance or delink the foreign currency and grant a rupee advance.

Grindlays Bank

Export bills that become overdue are transferred from 'Export Bills' account to overdue bills account. The purchase of foreign currency is treated at the time of negotiation of export bills. Therefore, the bank does not suffer any loss due to change in exchange rates. However, incurring of swap costs especially in respect of currencies which are at discount, cannot be ruled out. The bank recovers only overdue interest in terms of RBI directives which may or may not cover swap costs.

Chartered Bank

Export bills purchased or negotiated under letters of credit are debited to 'Credit Bills Negotiated' and the debits are reversed when payments are received from abroad. Where bills remain unaccepted or unpaid after representation, repayments are obtained from drawers and where the bills for large amounts are involved, swap operations are carried out.

Question 11

Please describe the follow-up action taken in regard to

import and export bills under letters of credit which remain outstanding beyond due dates.

Replies

State Bank of India

Close follow-up action is undertaken by the bank's offices in respect of import and export bills outstanding for which a proper diary note is kept. The Local Head Office also monitors the position in respect of overdue export bills.

Bank of Baroda

When import bills under letters of credit remain outstanding beyond due dates, possession of goods is taken and the bills are transferred to Past Due Bills Account. Thereafter, legal action against the concerned client is taken for recovery of advance. In the case of dishonoured export bills, the advance is recovered from drawers and the bill is kept in collection portfolio.

Bank of India

In case of unpaid export bills under letters of credit, the concerned branch/department generally takes the following action:

- (i) Reminders are sent to the bank's foreign branches/ correspondents for the fate of the bill.
- (ii) If the bill is outstanding for a very long time, refund is obtained from the drawers in India.
- (iii) If necessary, Reserve Bank's permission is obtained for extension of time limit for realisation of proceeds beyond 180 days.

- (iv) In case of bills unpaid for very long time, Reserve Bank's permission is sought for release of triplicate forms.
- (v) Necessary steps are taken to protect the goods by clearing/storing at the foreign centre and arrange for protesting/noting of the bill, if necessary.
- (vi) If all the efforts fail to realise the proceeds of the bills, arrangements are made for reshipment of goods to India after obtaining the necessary approval.

#### Central Bank of India

In case the bill under import letter of credit remains outstanding beyond its due date, notice is given to the importer for immediate payment failing which the bank will reserve the right to dispose of the goods and adjust the proceeds along with the margin amounts towards the amount due to the bank from the importer. In the case of export bills purchased by the bank and not paid on due dates, notice is given to the exporter in respect thereof. He may substitute the buyer or extend the period of the bill by substitution of another bill provided, in totality, the export proceeds are realised within 180 days. ECGC is also intimated in respect of these bills and of the possible claim which may arise if the bill is ultimately not paid. The exporter also has the right to ask E.C.D. permission to import the goods to India or for a reduction in price as may be permissible.

#### United Commercial Bank

Export bills are kept under close attention for follow-up and if not paid within normal settlement date, the exporter is

called upon to either reimburse or give satisfactory explanation for the delay. If the time limit of 180 days is exceeded, Exchange Control permission is applied for keeping the bill outstanding for a further period. In the meantime, necessary steps for protecting the bank's interests in the relative goods and/or preference of claims with ECGC are undertaken. Regarding import bills remaining unpaid on presentation even on arrival of the vessel, notice is given to the party to immediately retire the bill and if there is any delay in payment, the goods are cleared and stored in bonded warehouses and further follow-up action is taken.

#### Union Bank of India

As regards import and export bills under letters of credit which remain outstanding beyond due dates, the bank takes up the matter with its customers or credit opening banks to expedite the payment of the bills. In case of import bills under letters of credit which are not paid by the importers for a long time, the bank takes care to protect the goods, the matter being followed up simultaneously with the importer for payment of the bill. As regards export bills which remain outstanding beyond due dates, the matter is taken up with customers and correspondents as stated above.

#### Corporation Bank

In the case of import bills remaining outstanding beyond due dates, normally, the importer will be pressurised to make

the payment. Meanwhile, the goods will be cleared and stored with the bank's approved clearing agents, after giving due notice to the importer about the cost involved which ultimately will have to be reimbursed by him. Where justified, an advance will be given to the party after obtaining approval of the appropriate sanctioning authority. In case there is any default or fraudulent intention, immediate action including criminal action, where warranted, is taken. In the case of export bills outstanding beyond due dates, the following action is taken :

- (i) Recover the money from exporter and take the bill into collection.
- (ii) Arrange for clearance, storing and insurance of the goods.
- (iii) Pressurise the party to explore possibility of finding an alternative buyer by allowing concessions, discount, etc.
- (iv) If these do not result in realisation of proceeds, resort to legal proceedings including noting and protesting in the case of bills discounted.
- (v) Where it is necessary, seek the help of the Embassy.

Bank of Maharashtra

On receipt of debit advice at the branch where the opener is maintaining his account, if the branch is not able to adjust it due to want of funds, the amount is debited to a separate account styled 'Bills Receivable under letters of Credit' under advice to the concerned Divisional Manager and Foreign Exchange Office and the documents are held till the amount is actually paid. In case the amount is not paid before the arrival of the steamer, the branch gets the goods cleared by the approved

clearing agents. The goods when received are taken under pledge pending further instructions from the Divisional Office.

Indian Bank

The outstandings of bills are periodically taken and follow-up action with the drawees and the drawers is initiated. RBI is kept informed in respect of export bills which are overdue for more than six months from the date of shipment.

Syndicate Bank

If import bills are outstanding beyond due dates and if the goods arrive, the bank is obliged to bond the goods entirely at the importer's cost. If the importers fail to make payment to the bank and take delivery of the goods, the bank may sell the goods and the proceeds adjusted towards the bank's dues. If the bank's dues are not fully covered, legal action will be taken against the importer for recovery of shortfall. If the payment is not forthcoming in respect of export bills and they are remaining outstanding beyond due dates, the amounts are recovered from the customers, as a last resort.

Canara Bank

In the case of export bills, the bank looks to the exporter for repayment of the advance or branches are instructed to delink the foreign currency element and grant Rupee advances. The import bills under letters of credit are sent by Foreign Departments to the concerned branches for presentation to the

importers. The branches follow up the matter till retirement of bills. Where there is a delay in getting the documents retired by the importers in time, wherever possible, the foreign currency element is delinked from the advance by clearing the consignment and making a rupee advance against the pledge of consignment.

#### Grindlays Bank

Overdue import bills are subjected to weekly review to ensure that appropriate action is taken to protect the bank's interest. Particular attention is given to the arrival of carrying vessels, insurance, etc. Overdue export bills are subjected to tri-monthly review by a senior branch operations officer and credit sanctioning authorities to ensure that appropriate action is taken to protect the bank's interest.

#### Chartered Bank

Normally, bills under letters of credit are paid on due dates, but where this is not the case, the advance is transferred to the past-due bills portfolio and special attention is given in obtaining payment.

#### Questions 12 and 13

12. How often do you evaluate foreign exchange profit/loss and when do you book the profit/loss?

13. Please describe the manner of evaluation of profits/losses in foreign exchange business by the bank and furnish a copy of the latest evaluation showing the computation of

profit/loss.

Replies

State Bank of India

This is done by the<sup>bank</sup> annually, on the first Friday of December every year. The method followed is in line with that indicated in the RBI's Guidelines for Internal Control over Foreign Exchange Business'. Profit in the forward portfolio is also taken into account.

Bank of Baroda

At the time of half-yearly closing of accounts on 30th June and 31st December, foreign exchange profit/loss is evaluated and booked. Evaluation of profits/losses is done by applying the least profitable rate. The previous day's closing rates in London market are crossed with current FEDAI's merchant T.T. buying and T.B. selling rates for pound sterling and the T.T. buying rate so arrived at for ledger balances in debit (in funds) and T.T. selling rates for ledger balance in credit (overdrafts) are applied and the foreign currency balances in ledger are converted into Indian rupees. The difference between the rupee equivalent so arrived at and the rupee balance in the ledger represents the exchange profit/loss.

Bank of India

Evaluation of foreign exchange profit/loss is done on half-yearly basis on the last business day of June and December.

Evaluation is done on the Nostro balances as on those days, as appearing in the 'Mirror Accounts'. (However, the bank has not indicated the rates applied for evaluation purposes).

Central Bank of India

Evaluation of profit and loss of foreign exchange transactions is done on a notional basis every month. However, the book entries are passed through profit and loss account every half-year ending June and December. Balances in foreign currency accounts are evaluated on prevailing rates on the date of evaluation, which are advised by the Foreign Exchange Accounts Department, Central Office.

United Commercial Bank

The foreign exchange profit or loss is evaluated as and when there is a change in parity of pound sterling with the Indian rupees as also at the end of each calendar year. The booking, however, is done at half-yearly intervals. The working of profit or loss is done by recalculation of assets and liabilities at T.T. mean rates prevalent on the date of evaluation.

Union Bank of India

The foreign exchange profit or loss is evaluated and booked as at the end of every calendar half-year. For this purpose, the Nostro balances are evaluated. The rates applied are RBI selling/purchase spot rates for pounds sterling in case of sterling Nostro accounts, and in the case of other currencies,

the RBI selling/buying rates for spot sterling crossed with the concerned currency rates in the London market and the resultant rate is applied for evaluation. Regarding forward transactions, no profit is booked; the valuation of the contracts is done to ensure that unearned profits are not booked and losses in the forward transactions are not carried to the next accounting period. Foreign money on hand is valued at the buying rates advised by RBI, for the purpose of evaluation.

Corporation Bank

The evaluation and booking of exchange profit/loss is done every half-year. Only Nostro account balances are taken for evaluation. For arriving at the buying and selling rates to be applied for the purpose of calculation of exchange profit/loss, RBI rates with the overseas rates are applied.

Bank of Maharashtra

Evaluation of foreign exchange profit or loss is done quarterly by the Foreign Exchange Division, Bombay. However, booking of profits is done once in a year, i.e. at the end of December. Profits are calculated on the Nostro account balances by applying RBI rates and/or London closing rates.

Indian Bank

The bank books profit or loss on a monthly basis. The method adopted to calculate profit is the normal disposal theory.

Syndicate Bank

The bank evaluates foreign exchange profit/loss every month for internal information. However, profit/loss is booked every half-year, i.e., 30th June and 31st December. Every half-year end, the Nostro balances as revealed in the mirror accounts are valued for adjustment of profit or loss by applying the opposite rates for closing balances notionally; RBI spot rates for pound sterling are applied and the rates for other currencies are arrived at by crossing the day's closing rates in London market with the corresponding RBI's spot rates for sterling.

Canara Bank

Only balances in Nostro accounts are revealed in the mirror accounts are reckoned for adjustment of profits/losses. The Nostro balances are valued at RBI rates in the case of pound sterling, RBI rate crossed with Singapore market rate for U.S. dollars and the U.S.dollar rate so arrived at crossed with the rate prevailing in Singapore for other currencies. (The bank has, however, not furnished information regarding how often it evaluates foreign exchange profit/loss and when it books the profit/loss).

Grindlays Bank

The bank evaluates exchange profits on a monthly basis but books them on a quarterly basis. Evaluations is carried out by persons independent of dealings. Calculation of exchange profit

is done on the net positions by applying liquidation principle on a matched maturity basis to all foreign currency assets and liabilities.

Chartered Bank

All foreign currency balances including those in bills account are revalued at the end of each month and profit or loss transferred to profit and loss account. While all the foreign currency balances including Nostro accounts, bills accounts, etc., are revalued at the middle rates, the forward contracts (O.B/O.S) position in each currency month-wise is revalued at market rates prevailing on the last day of the month.

## APPENDIX VII

### Summary of replies received from banks to a questionnaire on operations of foreign branches of Indian banks

#### Question 1

Please describe the system of control and general supervision exercised by the Head Office/International Division over the operations of overseas branches/offices. A copy of the Organisation Chart of the International Division may please be furnished.

#### Replies

##### State Bank of India

All foreign offices of the bank are controlled by the International Division at Central Office. The International Division is headed by Chief General Manager, who is assisted by three General Managers, that is, General Manager (Overseas Operations), General Manager (Domestic Operations) and General Manager (Planning). In the evolution of a system of control and general supervision over the functioning of foreign offices, the bank has taken into account the practical experience it has gained over the past several years. The system of control designed by it is basically a balanced mix between optimum delegation of powers and centralised control through a

structured information system, the salient features of which are briefly outlined below :

(a) Management at foreign offices

Only officials with the requisite background, experience and seniority are posted as Managers/Representatives and other supporting staff at foreign offices.

(b) Discretionary powers of Managers and reporting system

Discretionary powers for sanction of loans and advances and for the conduct of the bank's business in general are delegated to the Managers/Representatives and all decisions taken by them under these discretionary powers are required to be reported to the International Division periodically through various control returns. Proposals for advances and other business which fall outside the purview of the discretionary powers have to be referred to Central Office for prior approval except in emergent situations when decisions taken by the Manager in excess of his discretionary powers are reported to Central Office immediately for post facto sanction and confirmation. Even in such cases, the Managers are expected to consult International Division over telex/telephone wherever

possible. The scheme of delegation of powers and other allied instructions have been suitably codified and circulated among all the bank's foreign offices. All foreign offices function directly under the International Division at Central Office, except in the case of a few smaller offices in the U.K. and U.S.A. which undertake limited banking activities. These offices function under the control of the Manager of the bank's London/New York Main Offices respectively. In the same way as other foreign offices do, these local offices in U.K./U.S.A. are expected to report decisions taken within their discretionary powers to the bank's London/New York Managers as the case may be and decisions in excess of their discretionary powers are taken by London/New York Manager. Matters which are beyond the London/New York Managers' discretionary powers are referred to Central Office. In addition to the foregoing, the following measures also assist the bank in exercising control over its foreign offices :

(i) Periodical inspection by the inspection teams deputed by it;

(ii) System of annual performance budgeting and periodical review of performance;

(iii) Scrutiny of audit/inspection reports submitted by statutory auditors, RBI inspection teams and local central banking/deposit insurance authorities, Exchange Control authorities, tax authorities, etc.;

(iv) On-going audit by India-based internal auditors positioned at large overseas branches;

(v) Visits to foreign offices by senior executives from Central Office.

#### Bank of Baroda

The bank has established Regional Offices (also known as Group Control Offices) at centres like Guyana, Fiji, London, New York, Abu Dhabi, Mauritius and Kenya, headed by senior executives. They supervise, control and guide the overseas branches under their jurisdiction, in their day-to-day operations. These Regional Offices and other branches which are not covered report to the International Division at Central Office. The International Division exercises overall control over the operations of overseas branches and Group Control Offices, as under :

(a) Appraisal and sanctioning of advances which are beyond the discretionary powers of Zonal Committees/Regional Executives and keeping a watch on the review of advances sanctioned by the Board or Committee of Executives at the Central Office.

- (b) Post-sanction scrutiny of all advances and other important administrative decisions taken by Committees/ Regional Executives.
- (c) Posting, repatriation and transfer of officers/ executives at overseas centres and determining their service conditions, etc.
- (d) Scrutinising inspection reports on overseas branches (of internal/external auditors, RBI and Central Monetary Authorities) and take follow-up action.
- (e) Keeping a close watch on advances which are considered substandard or doubtful of recovery.
- (f) Scrutinising the various control returns received from the above offices.

#### Bank of India

The bank has sent only the Organisational Chart of its International Department.

#### Central Bank of India

The bank has prescribed returns/forms to be submitted by its overseas branches to Central Office for the purpose of control and general supervision. They are on weekly, monthly, quarterly and half-yearly basis. The bank has only three overseas branches, i.e., London, East Ham and

Birmingham in the U.K. The statements and control returns are submitted by the branches to the Assistant General Manager in charge of the U.K. offices, who forwards them to Central Office along with his comments. At Central Office, the statements are attended to by the Foreign Division and submitted to Chief Manager who in turn forwards them to AGM/GM with his comments.

Indian Bank

The bank has sent only the Organisation Chart of its International Banking Division.

Syndicate Bank

International banking operations of the bank are handled by the International Banking Division and Investment Department. The day-to-day supervision over the routine operational and administrative areas and the implementation of policy decisions are carried out by the Chief Executive at the branch in London. The International Division exercises control over the branch by calling for various statements. Advances at the London branch are regularly reviewed by the International Division once in a quarter and deviations observed are followed up. Overdue accounts and overdue bills are also regularly followed up.

The balance sheet and profit and loss account of the branch prepared at the end of June and December every year are scrutinised to assess the performance of the branch and suitable instructions/guidance issued to the branch wherever necessary. Expenditure budget prepared by the branch is submitted to the International Division, which recommends suitable limits.

Union Bank of India

The system of control over the London branch is through the returns required to be submitted to the Foreign Operations and Export Development Department periodically. They relate to statement of affairs, statement of advances granted beyond sanctioned limit/drawing power/Chief Executive's discretionary powers, statement of bills purchased remaining outstanding, profit and loss statement, statement of exchange position and gaps, statement of country-wise commitment, etc.

United Commercial Bank

The foreign branches have been divided into three territorial divisions, viz., U.K., Singapore and Hong Kong. The branches in Singapore and Hong Kong are headed by Assistant General Managers while U.K. operations are

controlled by Chief Manager. The foreign branches have their second tier of controls at Head Office, International Division.

Question 2

(a) Please furnish specimens of the returns/statements which you receive from overseas branches.

(b) What is their periodicity?

(c) What action is taken thereon at the Head Office/International Division?

Replies

State Bank of India

Periodical returns are called for from all foreign offices in respect of resources, investments, advances, sticky accounts, positions maintained in various foreign currencies, charges, suspense and sundry deposit accounts, purchase and disposal of deadstock, monthly profit and loss, performance report, etc. These are scrutinised upon receipt at Central Office and appropriate follow-up action taken thereafter, as warranted.

Bank of Baroda

Two sets of returns have been evolved for submission to the Regional Offices (Group Control Offices) and to the International Division. The International Division at the Central Office scrutinises the statements and takes follow-up action wherever necessary. Internal inspection team is required to look into the proper submission of control returns and scrutiny by Group Control Offices.

Bank of India

The foreign branches are required to submit to Head Office, General Ledger balances statement (monthly), profit and loss statement (monthly), statement of staff salaries and reconciliation (monthly), reconciliation statement of accounts with other branches of bank, statement of temporary overdrafts and out-of-order accounts (monthly), report of overlimit/casual business undertaken by foreign branches (immediately), report of the progress made by the branch (bi-monthly), annual report of the branch performance, annual statistical returns, annual closing returns duly audited by the statutory auditors, statement of affairs of overseas offices which are in turn submitted to RBI (quarterly), proposals for advances sanctioned by overseas branches and proposals beyond their authority for sanction at Head Office. These returns, etc., are scrutinised by

the desk officers and letters of routine nature are issued by them. Any serious discrepancies noticed are immediately reported to the Chief Manager. Any serious irregularities noticed are then reported to the AGM/GM and, if necessary, to the Executive Director and Chairman also depending upon the seriousness of the matter.

Central Bank of India

The foreign branches are required to submit a copy of the General Ledger balances (monthly), statement of all types of advances (monthly), profit and loss account (monthly), statement of overdue and returned bills (monthly), statement of sundry debtors and creditors (monthly), statement of bills purchased and discounted (monthly), quarterly statement of bad and doubtful debts, and half-yearly statement of letters of credit and guarantees. Statements/returns when received are scrutinised by the concerned departments and forwarded to GM with the comments of the Department and where necessary, follow-up action is taken.

Indian Bank

(The bank has not furnished the required information.)

Syndicate Bank

The following returns are submitted by the London branch to the International Division :

Daily

Telex report of currency position.

Weekly

Trial balance, statement of foreign currency position as on Friday, review of currency position as on Friday and statement of mismatched forward contracts.

Monthly

Manager's certificate, newsletter to Chairman and Managing Director, statement of excesses permitted over sanctioned limits, interest rate-wise classification of funds generated and employed, report of foreign exchange trading, statement of deposits of £5 lakhs and above, and statement of ~~loans~~/placements of £5 lakhs and above.

Quarterly

Statement of advances, statement of limits sanctioned under Manager's discretionary powers, statement of overdue unpaid bills, statement of overdue bills locally paid, statement of irregular loans/ overdrafts and other advances and balance sheet and profit and loss account.

Half-yearly

Maturity-wise classification of deposits and classification of deposits by size.

International Division scrutinises and takes action wherever necessary. Irregular advances are reported to the Board on a quarterly basis.

Union Bank of India

The following returns/statements are submitted by the London branch :

Weekly

Statement of exchange position.

Monthly

Statement of affairs, statement of advances granted by the Chief Executive beyond sanctioned limit/drawing power/discretionary powers of the Chief Executive, statement of bills purchased and remaining outstanding for more than 60 days in case of documentary bills and 30 days from due date in case of usance bills, profit and loss statement and statement showing country-wise commitments.

Quarterly

Report on irregular accounts, statement on irregular accounts, certificate of balancing of books and reconciliation of accounts, statement of party-wise outstandings

under various trade facilities, particulars of foreign business (bank-wise), statement of outstanding letters of credit, and statement of outstanding guarantees.

On receipt of these statements, Foreign Operations and Export Development Department scrutinises the same keeping in mind the objective/rationale behind the prescribed statements and if any additional information is needed, it is called for from the London branch to complete the scrutiny.

United Commercial Bank

The foreign branches submit the following statements:

Weekly

Currency purchases/sales, foreign currency position statement, and statement of irregular accounts.

Fortnightly

Overdue trust receipts statement and statement of customers' acceptances.

Monthly

Past due and dishonoured bills statement.

Quarterly, half-yearly  
and annually

Profit and loss account statement on currency revaluation.

The AGM in the International Division is involved in the scrutiny of the above returns and follow-up action.

Question 3

(a) How often are overseas branches inspected/ audited?

(b) Has the bank prescribed any proforma inspection/ audit report and/or check-points for the guidance of staff attached to the Internal Inspection/Audit Department?

If so, copies thereof may please be furnished.

Replies

State Bank of India

Overseas branches are required to be inspected once in two years. The bank's standard format is used for compiling inspection reports on all the bank's domestic/ overseas offices, subject to such modifications as may be necessary to take care of the business operations conducted by the foreign offices. In addition, inspecting officials are advised to compile and submit a report on procedural and serious irregularities, general administration, premises, etc., on the branches they inspect.

Bank of Baroda

The overseas branches are normally inspected by the Head Office inspectors once in three years. Wherever

it is considered necessary due to special circumstances, inspections at shorter interval are also carried out. The bank has posted expatriate officers as internal auditors at a few overseas centres such as London, Nairobi and Suva (Fiji Islands). These internal auditors undertake periodical visits to branches and carry out audits. The bank has issued a letter to overseas territories detailing the job role of internal auditors. The format of inspection report prescribed for the Indian branches is adopted for foreign branch inspection also.

#### Bank of India

The operations of overseas branches are subjected to audits/inspections by the statutory auditors, inspectors of the local Monetary Authorities, internal auditors, and officers of RBI. Statutory auditors audit all the foreign branches once a year. In some cases, they also undertake an additional surprise audit during the year. The inspectors of the local Monetary Authority also audit the bank's foreign branches periodically. Reports of the above audits received at the Head Office are scrutinised and necessary remedial measures are taken to rectify the matters, if any. The bank's internal auditors audit the foreign branches normally once in 3 years. From experience, the bank has observed

that more frequent audits by internal auditors are not warranted, because of audits by the statutory auditors and inspectors of local Monetary Authorities, and in view of the cost and time involved. The bank has prescribed worksheet listing out the items to be audited, inspection note detailing the points on which the comments are required and a background note on areas to be checked.

#### Central Bank of India

The bank deputes at periodic intervals senior officers and executives from the Central Office to visit the U.K. for the purpose of audit and inspection. The statutory auditors, in addition to routine audits, also look into all types of business activities. The reports are received by the Central Office, Audit Department, and attended to by them. No specific proforma for audit and inspection has been prescribed.

#### Indian Bank

Overseas branches are inspected/audited once in three years. The proforma of the inspection report in respect of foreign branches is the same as that for Indian branches.

Syndicate Bank

Overseas branches are inspected/audited every year. The bank has prepared a Desk-Guide/Inspection-Kit for the overseas branches and circulated among the executives for their remarks and observations. The same is under print. It has been prepared on the basis of manuals of various international banks for conducting inspections.

Union Bank of India

The bank's branch in London was opened in February 1981 and was inspected by its internal auditors in August 1981. It has as yet not fixed any period for audit/inspection of the branch by the internal auditors. The statutory auditors would also conduct a surprise audit. The bank is yet to prescribe proforma inspection/audit report and/or check points for the guidance of the staff. This will be done in due course from the experience gained.

United Commercial Bank

The overseas branches are inspected by senior officers deputed by the top management once in a year. The branches are also audited by external auditors every year. The proforma inspection report for overseas branches is the same as that for Indian branches. The inspecting officers are required to supplement the information/details called for therein by furnishing their own observations as pertinent to the branch.

Question 4

(a) Are operations of overseas branches reviewed periodically?

(b) If so, by whom and how often?

(c) To whom is the review submitted?

(d) Please furnish a copy of the last review made by the bank.

Replies

State Bank of India

In order to ensure satisfactory growth in business and profits and to ensure that the performance of each foreign branch is closely reviewed and monitored in the light of its performance, vis-a-vis the budgeted levels, each foreign office submits an annual budget in respect of the various types of business handled by it and the earnings, expenses and net result profit for the next calendar year. The budget is presented to Central Office and is accepted, after suitable modification, wherever necessary, under advice to the concerned foreign offices. The accepted budgets thus form the basis for performance during the year. Foreign offices submit monthly performance reports in which the actual performance and the budgeted levels in respect of each sphere of activity are indicated

including earnings, expenses and net result profit. Variances are commented upon in the monthly performance reports submitted by the offices. These reports are examined at Central Office and put up to the top management for review. Suitable action, wherever warranted, is also initiated to bring the performance in line with the budgeted projections. A review of the performance of the foreign offices is also submitted to the bank's Central Board of Directors once in a quarter. Copies of these quarterly reviews are also forwarded regularly to RBI, Department of Banking Operations & Development, since June 1979 in conformity with the instructions contained in DBOD. D.O. letter No. BL/3502/C.212(A)3-79 of the 13th June 1979. The bank is examining the feasibility of issuing, towards the close of the year, policy guidelines (as in the case of its domestic offices) to its foreign offices also on a regional basis (say, Far East, Middle East, U.K. and Europe and the Americas) indicating the overall objectives it would expect its foreign offices to achieve during the following year in terms of business levels, promotional activities, net result profits, etc.

Bank of Baroda

The overall performance of overseas branches is being reported to the Committee of Executives/Board

periodically. The bank proposes to introduce country-wise performance review from the current year.

Bank of India

Operations of overseas branches are reviewed periodically as under :

- (a) Statement of total deposits and advances branch-wise and country-wise is submitted every month to the executives.
- (b) At the end of June, performance of the foreign branches as a whole for the first half-year is reported to the executives.
- (c) Annual performance review is made every year and reported to the Board of Directors.

Central Bank of India

The operations of overseas branches are reviewed periodically by the Chief Manager on the basis of statements and data received from the branches. The reviews are then submitted to AGM/GM for information and instructions, if any. Half-yearly reports are also submitted to the Board.

Indian Bank

The operations of overseas branches are reviewed once a year and the review is put up to the Board.

Syndicate Bank

Operations of overseas branch are reviewed on a half-yearly basis at the International Division. The review is submitted to the Board of Directors.

Union Bank of India

Operations of overseas branch are reviewed periodically by the Foreign Operations and Export Development Department. The review is submitted to the Executive Director/M.D. as also to the Board wherever required.

United Commercial Bank

The operations of overseas branches are reviewed every six months and at the conclusion of the full year, a review report of the branches is put up to the Board. Apart from this, a quarterly note is put up to the top management.

Question 5

(a) Do you have a system of maintaining country and customer profiles?

(b) If so, what are the main aspects covered in this regard?

(c) Have you issued guidelines to overseas branches for assessing country risks? If so, a copy thereof may please be furnished.

Replies

State Bank of India

Individual credit files are maintained in respect of all borrowers where credit limits have been sanctioned by the bank's Central Office. Where loans are sanctioned by its foreign Managers under their discretionary powers, the files are maintained at the foreign offices. However, relevant particulars of each such loan are furnished to the Central Office in control returns required to be sent by the foreign offices. Apart from these files of correspondence, a system of maintaining customer profiles has been introduced at the Central Office. While the individual credit files would contain all information on the customer, including the credit proposal, only the essential data are incorporated in the Customer Profile which is meant to serve as an 'aide memoire'. The profiles cover name of borrower and group, if any, index number of the file, names of principal promoters/directors, nature of business, facilities extended with terms and purpose thereof, key financial indicators and remarks to include special features/problems connected with the advance. Files have been built up at the Central Office on all countries to yield adequate data on basic data on the political system and economic infrastructure, GDP and population growth rate, inflation

rate, level of foreign exchange reserves and import coverage, total external debt and debt service as percentage of export earnings, current account and balance of payments position, and composition and growth of exports and imports. Country reports appearing in the international financial press and publications of large international banks, supplemented by information furnished by the bank's representatives stationed abroad, have helped in building up country files. In addition, the bank also depends on its foreign offices, from which the loan proposals emanate, to assess the country risk involved based on an evaluation of the latest developments relating to the particular country obtained through personal contacts (when the country is in its operational area) or through discussions with other local banks having close business links with the country concerned. The bank maintains a country-wise record of exposures taken up at its various offices abroad, and at the time of processing the loan proposal, due note is taken of its total exposure in the particular country in order to determine the acceptability of any further exposure.

#### Bank of Baroda

The bank has a system of maintaining country profiles. It has such profiles of 100 countries in respect of which

it has commitments. These profiles are up-dated from time to time. Besides, the bank does country risk rating before taking up a commitment. Customer profiles as such are not maintained but individual files on borrowers are maintained. Various economic, political, geographic, and social indicators (including attitude towards foreign investments) are taken into account. Certain weightage is given to each factor listed above and the total assessment in terms of points, out of possible 100, is attempted. The bank's results are compared with other sources before participation decisions are taken. The guidelines for assessing country risk have been orally conveyed to the overseas executives at the conference held in February 1981.

#### Bank of India

The bank has a separate Economists Cell in the Department. Country-wise files are kept in the Department in which clippings from various international newspapers containing important developments in these countries are kept. Any adverse developments which affect the bank's business in these countries are immediately reported to the executives in Head Office, and, if necessary, to H.O. Committee and Board of Directors. The customer profiles are kept essentially at the bank's concerned branches.

A separate dossier is kept for each customer in which balance sheets and other financial statements are kept. Important information contained in balance sheets/financial statements is culled out and incorporated in the proposal for advances to customers. In the H.O. International Department, the bank has a register containing names of all borrowers, names of main partners/directors/guarantors, etc., for all important customers. Separate files are kept in H.O. International Department.

#### Central Bank of India

There is no regular system for maintaining country profiles. The bank collects data from various sources including its overseas correspondent banks, Chambers of Commerce, Trade Counsels, etc. No guidelines have been issued to overseas branches for assessing country risks.

#### Indian Bank

As the bank has been dealing with only a few countries like Indonesia, Singapore, Sri Lanka and Hong Kong, it has collected information from various economic and financial journals like Economic Intelligence Unit Bulletins, IMF Reports, the report of the Central Bank of the country concerned and other prime banks' country profiles. The

bank also supplements this by the information available from 'London Times' reviews and 'Euro-Money' Service.

Syndicate Bank

The bank has a system of maintaining country and customer profiles. It has since advised its London office to maintain profiles of prospective clients. The main aspects covered in this regard are area, population, capital, principal towns, climate, language, time, foreign regulations, currency, exchange rate, GDP statistics, Government, agriculture, mineral resources, energy, industry, banking system, money and treasurers, foreign trade, exchange, foreign capital, links with India, business opportunities, embassy of India in that country, their embassy in India, our correspondent banks and comparative basic statistical data. The bank has also started publishing the country profiles for the benefit of its branches and prospective clients. As per the existing arrangements, all proposals are processed at the International Division, Bombay. While processing them, the bank assesses the country-risk, taking into account political, social, economic and cultural factors, which have the potency to prevent or delay the payments. The bank takes data preferably from the World Bank, IMF, Euro-money publications, etc. It takes factors such as

political stability, external debt, international reserves in relation to imports, export earnings, capacity to service the debt, dependence on imported energy and micro-economic indicators, into consideration while analysing the country-risk. To minimise the risk generally, the bank tries to lend within safe limits to the country, participate in syndicated loan proposals, obtain guarantee from commercial bank/Central Bank of the country in the case of private borrower, obtain guarantee from the third country, obtain, wherever available, risk coverage from credit-risk insurance companies or Government Organisation in the lending country, obtain collateral such as foreign currency deposits or external assets of the borrower.

#### Union Bank of India

The bank has a system of maintaining country profiles and customer profiles. Country profiles are being received by the bank from Midland Bank/Barclays Bank, Union Bank of Switzerland, Grindlays Bank, Hong Kong Shanghai Banking Corporation, etc. Customer profiles (credit reports on overseas buyers/sellers) are being regularly up-dated on a yearly basis. The aspects covered in relation to customer profile are by way of credit reports on them. Often, wherever so required, the credit worthiness of the customer

for particular sums are also called for. Since the bank's branch in London was recently opened, it has not issued any guidelines to it for assessing country risk. All credit proposals exposing the branch to a particular country are processed at the FOED Department, Bombay, and Management/Board approval obtained.

#### United Commercial Bank

The bank maintains separate files for each credit customer and files contain also credit reports on borrowers and their principal associates. As for country profiles, the bank maintains records of the intelligence supplied to it by its branches and correspondents abroad (i.e. ABECOR, Natwest Economic Report, Euromoney, Chase, etc.) The main points in customer evaluation are financial standing, previous experience, other bankers' report and the extent and nature of business operations. Regarding country aspects, the bank takes into account economic situation, market prospects, political factors and the country's track record of settlement in foreign exchange. From H.O. International Division, the bank transmits to overseas centres important intelligence reports that it receives regarding countries and keeps them alerted if there is any need for observance of caution. By themselves also, the branches get to know about the factors having bearing on the country risk and adopt precautions as suited to the occasion.

Question 6

(a) Do you obtain periodical information on Government/Central Banking Authority policies and other environmental factors in the countries where the bank has branches/offices?

(b) If so, please indicate the countries in respect of which such information is available with you.

Replies

State Bank of India

The foreign offices are managed by very senior officials of the bank and the information referred to are being monitored by them at their end. Necessary action, if required, is taken by them under advice to Central Office. In some regions, the bank does not have an operating office but has established representative offices to cover a group of countries in the region. The representatives have been instructed to collect the information on an ongoing basis on countries covered by them and the reports are kept in separate country-wise files at International Division. The paper cuttings on the relevant information are also filed in the country files for periodical reference. While the bank has up-to-date <sup>reports</sup> on South-East and Far East countries and also

on Egypt and Sudan, brief country files on economic environment of other countries are also maintained by it.

Bank of Baroda

The bank's Regional Offices at overseas territories furnish to it information on Government/Central Banking Authority policies and other environmental factors. Such particulars are informed to Board/Committee of Executives as and when deemed necessary. Such information is available with the bank in respect of the U.K., Kenya, Mauritius, Fiji, Seychelles, Brussels, U.A.E., etc.

Bank of India

Foreign branches are required to submit a bi-monthly report to International Department, reviewing their performance and containing important economic/political developments in the centre/country in which they operate. Besides the above information, the bank is also contributing regularly to the Economic Reviews of the Economist Intelligence Unit Ltd. The bank obtains reports on 64 countries in which it is interested.

Central Bank of India

The bank has at present 3 branches in the U.K. and its London Main Office advises it periodically about Government/Central Banking Authority policies, etc.

Indian Bank

The bank obtains periodical information on Government/Central Banking Authority policies, etc. Such information in respect of Singapore, Sri Lanka, Hong Kong and Indonesia is available with it.

Syndicate Bank

The bank obtains information on Government/Central Banking Authority policies and other environmental factors where it has overseas branch. Such information in respect of the U.K. is available with it.

Union Bank of India

The bank's London branch has instructions to advise Head Office periodically information on Government/Central Banking Authority policies etc., in the U.K. Although the branch by itself has not furnished any such information, the Head Office is in constant touch with the developments both in political, social and economic areas from various periodicals. The bank subscribes to papers such as London Economic Times and Financial Times.

United Commercial Bank

The bank receives from its overseas branches information pertaining to local government policies, etc.

Reports of the above nature are available in respect of the three territories where the bank is represented, viz., Singapore, Hongkong and U.K.

Question 7

(a) Have you given guidelines to overseas branches regarding their (i) borrowings in Euro-currency markets, (ii) participation in Euro-currency loans/bonds, (iii) operating budgets and goals, (iv) funds management and (v) maintenance and evaluation of foreign currency positions?

(b) If so, a copy thereof may please be furnished.

Replies

State Bank of India

Medium to long-term funds are periodically raised by the bank abroad through FRNs/FRCDs with a view to strengthening its foreign currency resources base. All such borrowings are subject to prior approval of Central Office. It has also arranged with international banks 5 year standby lines which ensure availability of funds to its foreign offices as and when necessary, during the currency of such lines. The terms on which such standby lines are arranged are approved by Central Office. The bank's foreign currency assets portfolio mainly comprises commercial loans and bills, participation in syndicated

Euro-currency loans, loans to Indian companies and Indian joint ventures, investments in securities and bonds and inter -bank placements. The maturity mismatch between liabilities and assets is monitored through periodical statements of assets and liabilities submitted by foreign offices. Such mismatch is controlled by Central Office on a global basis within the norms stipulated by the bank's corporate management. All participations in Euro-Currency loans are subject to prior approval of Central Office as the maturity and country risk aspects of such loans are monitored and controlled at the apex level. As it has not granted any discretion to foreign offices in regard to participation in loans, the need to issue general guidelines on this subject has not been felt. However, foreign offices are cautioned not to take risks in countries facing political or chronic economic problems. The need for them to exercise utmost selectivity is also being emphasised from time to time in response to proposals which foreign offices send to Central Office for approval. Country files are maintained at Central Office for monitoring the country risk aspect. As mentioned elsewhere, besides **collating** data on the basis of published reports, country reports are obtained from international banks through foreign offices; the information on country risk is further corroborated through

discussions with the representatives of international banks. Investments in FRNs/FRCs are permitted at select foreign offices. Such investments are made within the limit and norms stipulated by Central Office from time to time for each foreign office. The bank has not so far laid down detailed guidelines in regard to operating budgets and goals. This was one of the subjects considered at the Regional Conference of its foreign Managers held at Singapore in May 1982. Suitable follow-up action is being initiated in this regard. The funds management broadly covers two areas, viz., raising of resources and deployment of resources. These two functions give rise to the need to control mismatch between the maturities of liabilities and assets in a given currency. The bank's currency resources base mainly consists of customers' deposits, short-term inter-bank borrowings, medium to long-term funds raised through FRNs/FRCs and standby lines. Its foreign branches have freedom to accept deposits from their customers provided they are in a position to deploy such deposits profitably. Short term funds (normally upto 6 months) are raised by foreign offices in inter-bank market and these funds constitute a major source of liquidity for them. Such funds are made available to them by other banks under lines fixed by them for the bank on a global basis. As it is not the general practice for international banks

to disclose their lines to the borrowing banks, the exact quantum of such lines cannot be determined. While it has only limited control on the availability of inter-bank lines which is dependent on the internal norms adopted by every lending bank, the cost of funds made available under such lines is an important factor to be reckoned by the bank. As a rule, foreign offices do not pay more than LIBOR on funds borrowed in inter-bank market. While approving dealing limits for foreign offices, the bank issues suitable instructions on the control aspect of this business. This aspect was also one of the subjects for discussion at the conference in Singapore.

#### Bank of Baroda

The bank has not issued any specific guidelines regarding these aspects. It is, however, generally guided by the following :

(a) The bank's principal sources of funds are customer deposits, FRCs and the inter-bank borrowings. Customer deposits form the core of the bank's resources and they always grow, lessening its dependence on roll-over operations which has proved to be the bane of Euro-currency transactions and which is small in the bank's operations. Decisions on raising long-term paper such as FRCs are

taken at Central Office. Resort to FRCDs is made to reduce the imbalance between the term of resources and maturities of lending. Inter-bank borrowings are resorted to only when the bank has to lend in a currency in which it has not developed funding capability under the lines of credit made available by the correspondent banks.

(b) Main components of Euro-currency loans are

(i) participation in syndicated loans, (ii) participation in financing of joint ventures in third countries promoted by Indian entrepreneurs, and (iii) participation in financing of a private or public sector company in India for projects at home. There is no investment of the bank in Euro-bonds at present.

(c) The overseas territories are required to furnish to Central Office their operating budgets/goals at the beginning of the year in the prescribed format. The bank calls for figures of deposits and advances of overseas branches as at the end of every month and keeps a watch on their performance vis-a-vis the targets fixed.

(d) The bank's funds management is very conservative. It manages liabilities and creates assets within the framework of its policy. Medium-term lendings are not allowed to exceed a certain percentage of deposits, leaving the balance and other resources (mainly FRCDs)

for meeting trade bills and inter-bank lendings, which are for periods not exceeding six months. These lendings are made with the objective of profitability and maintaining the required liquidity. In respect of country risk, clearance is obtained from Central Office. Reference to Central Office is also made where global position is involved. As in the case of resources, deployment is also mainly in U.S. dollars and on floating rate basis.

#### Bank of India

At all the major foreign centres where the bank has branches, it has posted officers in the senior management level, i.e., AGMs (Scale V). Besides, major foreign branches are headed by Chief Managers (Scale IV). All the above officers are well qualified, experienced and competent. In view of the bank's limited exposure in the Euro-currency loans/bonds, etc., it has not given any routine guidelines to the foreign branches. However, Euro-currency borrowings/participation in Euro-currency loans/bonds are generally approved at Head Office level. For the bank's major foreign branches, inter-bank borrowing limits have been fixed. In view of the fact that the bank has in all major foreign centres officers in senior management level, aspects of operating budgets, funds management, maintenance of foreign currency positions are generally looked after by the AGMs posted abroad.

Central Bank of India

No regular guidelines have been issued. However, all transactions are required to be reported to Central Office, including those falling under the sanctioning powers of branch Manager and AGMs, for approval of Central Office wherever necessary.

Indian Bank

A copy of the approach paper prepared for the bank's recent Overseas Conference said to have been enclosed, was not received.

Syndicate Bank

The bank is developing its Euro-currency portfolio and has advised its London office about prospective areas for Euro-currency finance, such as finance to shipping companies, project exporters, Indian and overseas companies, against guarantees of other banks and participation in syndication. Currently, all proposals are routed through International Division, Bombay, where currency and country risk is taken into account. A corporate plan for overseas operations is prepared annually covering the targets in respect of deposits, advances, contingent liabilities, profit, etc. To support the corporate plan objectives,

credit plans are drawn up. Expenditure budget for the year is also drawn up separately. The bank tries to manage funds judiciously. It has substantial deposits in major currencies, viz., pounds sterling, U.S. dollars, Swiss francs, Japanese Yen and Deutsche Marks. The bank tries to match its deposits and loan terms. The London branch will also be funding the loans from one of the following sources:

(i) Using its dollar resources to purchase the relevant currency and simultaneously covering in the forward market.

(ii) Inter-bank borrowings in respective currencies. The inter-bank deposits may be procured at LIBOR. Substantial lines are set-up for this purpose with international banks.

(iii) Selectively floating of FRCDs.

The liquidity report and currency positions are looked into by DGM, London branch. The bank has fixed limits in respect of foreign exchange dealings, such as daylight, overnight, customer limits and deposit placement lines. The London branch submits to the Bank of England returns giving details of currencies, maturity analysis, analysis by country, territorial analysis and foreign currency exposure. The bank follows consistent method of evaluation of profit or loss in foreign exchange.

Union Bank of India

At present, as the bank's London branch is now, it operates in the market only for funding **its** commitments for import/export business. Proposals relating to participation in Euro-dollar syndication are always referred to Head Office for prior approval. They are considered by the Management or the Board. An Advisory Committee has been constituted to study and lay down policy guidelines regarding the business development and growth of London branch. As regards the funds management, the instructions to the branch are to avoid gaps in the maturities and to match them as far as possible. As to maintenance and evaluation of foreign currency positions, bank has permitted its London branch to carry out cover operations for trade related transactions. When the branch gains sufficient experience, it will be permitted to enter into trading operations. The Board will be approached for fixing limits in respect of daylight and overnight positions as also for gaps.

United Commercial Bank

The bank's foreign branches receive Euro-currency deposits from members of the public as also in inter-bank market. The funds so mobilised are used in lending and if there is any spillover, extra funds available are deployed

in shorter placements with banks of good standing, The bank has participated in Euro-currency loans syndicated in favour of the Republic of Nigeria, Bank Handlowy of Poland and ONGC and ICICI from India. These participations have been done after study of the relative proposals by the Head Office, International Division. The main considerations have been the borrowing country's risk-rating and the bank being in a position to have direct access to know about the soundness of the economy, foreign exchange situation, etc., of the borrowing country, from the view point of its capacity to repay. The branches have been instructed to see that the funds bring forth such levels of return as the bank shall have a good spread between the funding cost and available return. As regards the foreign currency balances with correspondents, the bank's instructions are that the idle balances should be avoided and funds should be put to optimum use. The branches have also been instructed to ensure that excessive long or short positions are avoided.

Question 8

(a) Have you implemented, to the extent appropriate in respect of overseas branches, the "Guidelines for Internal Control over Foreign Exchange Business" issued

by the Exchange Control Department regarding fixing of daylight, overnight, inter-bank and customer limits and control over mismatchings in maturities (gaps)? If so, a copy of the instructions issued in this regard may please be furnished.

(b) What is the system introduced at Head Office to ensure proper compliance of the instructions by the overseas branches on a continual basis?

Replies

State Bank of India

The bank has not so far issued detailed guidelines on the basis of the booklet referred to in the questionnaire. It has called for the opinions of the Managers of London, New York, Singapore, and Bahrain offices on the subject and a set of guidelines will be framed by the bank after taking into consideration all aspects of this business. The bank's branches are required to submit weekly statement of currency position indicating the opening position, the highest position during the week and the closing position. These are scrutinised with reference to the limits sanctioned for each branch and appropriate action initiated wherever necessary. In addition, branches active in forex trading are also required to submit weekly statements of profit and loss separately in respect of trading undertaken in

Indian rupee and other currencies. Another control measure to monitor forex operations is the submission of monthly statement of exchange earnings as an enclosure to the Profit and Loss Statement of each branch. In addition, as and when changes in Rupee-Sterling parity are announced by the Reserve Bank, the bank's branches are required to immediately advise Central Office the notional profit/loss on the rupee open position maintained by them. Based on the data thrown up by the statements/returns referred to in the foregoing, appropriate action is initiated, whenever necessary. The adequacy of the present monitoring and control systems will be reviewed by the bank when the new guidelines are framed.

Bank of Baroda

Copies of the Guidelines have been sent to overseas territories for their information and guidance. Since the Guidelines are essentially meant for the use of authorised dealers in India, no system has been introduced to ensure compliance by the bank's overseas branches.

Bank of India

The foreign exchange dealings and positions are looked after by well experienced and suitably trained dealers who are India based officers. General guidelines

for the branches are that they should have as near square a position as possible. However, separate limits for daylight and overnight positions are sanctioned at Head Office level and advised to concerned foreign branches. All the foreign branches are required to submit to H.O. a periodical report of the foreign exchange positions held by them. These are scrutinised at H.O. level to confirm that there is no undue overbrought or oversold position maintained at the branches.

#### Central Bank of India

The bank has not implemented the Guidelines as it has issued instructions that the foreign exchange position should be maintained as near a square position as possible and mismatched contracts, if any, should be regularised as soon as possible or within 5 working days, the compliance of which is ensured on the basis of various returns received from overseas branches.

#### Indian Bank

The bank has forwarded its letter dated the 1st October 1981 addressed to Deputy General Manager, Singapore, wherein it is stated "While we are ourselves anxious to ensure that proper systems exist for controlling the

foreign exchange and trading operations, I have been constantly reminded of this particular aspect both by Reserve Bank of India and the Government of India in the context of certain unfortunate happenings in other nationalised banks. I shall, therefore, be glad if you will please re-examine the system obtaining at your centre and revamp it, if found necessary. I wish to reiterate that while we approve of your recommendations for a day-time open limit and an overnight open position, the following control measures may also be strictly adhered to:

(a) Deal Limit - Single transaction to be fixed at US \$ 1 million (over and above this, the deal should be put through only with the concurrence of the Chief Officer/DGM - should you require any revision in this, based upon the business needs, please feel free to write to us).

(b) Open position - The open position of U.S.\$ 2 million in aggregate of all currencies should be maintained. Any excess thereof for genuine reasons should be brought to the notice of the Chief Officer/DGM who should record the reasons for the excess and it should be ensured that these excesses are off-loaded as soon as possible.

(c) Cash balance - You may fix limits for cash balances in the currencies with a view to ensure against any idle cash balance. (Please send your recommendations at your earliest.)

(d) Maturity gap - A monthly maturity gap statement should be prepared and submitted to the Chief Officer/DGM. The CO/DGM should discuss and implement measures to rectify and narrow the maturity gaps. The minutes of such discussions should be recorded.

(e) Checks and control - There should be a ceiling on the total turnover for the whole day. This shall be fixed by you based on your experience. Any large and unusual transactions should be brought to the notice of the Chief Officer/DGM, if possible then and there and in any case, definitely at the end of the day. Alternatively, at irregular intervals, the Chief Manager at Singapore branch/Chief Officer in DGM's office should check all the transactions for one day to ensure that the transactions put **through** are in order and within the stipulated checks and control. The surprise element in this regard can hardly be over-emphasised. Overnight open position statement and cash balance statement should be periodically scrutinised by the DGM. Regarding limits to various institutions to be fixed by the branch, the views of DGM of Singapore have been called for." Overseas branches have instructions to report to H.O. any deviations. Such reports are, however, submitted by Singapore branch to the DGM stationed there.

Syndicate Bank

The bank has forwarded a copy of the Guidelines, along with a copy of its report on the steps taken by it to implement the Guidelines, to its London branch and requested the branch to follow up. The bank is awaiting the views of London branch and it will formulate a system to ensure proper compliance of the instructions.

Union Bank of India

As to maintenance and evaluation of foreign currency position, the bank has permitted its London branch to carry out cover operations for trade related transactions and enter into exchange market operations for customer cover. When the branch gains sufficient experience, say in a few months time, it will be permitted to enter into trading operations within the framework of the guidelines to be issued by the bank. The Board will be approached shortly for fixing up limits for daylight position, overnight position and gaps. Similarly, limits for banks for money market operations and foreign exchange will be fixed. The compliance of the instructions will be ensured through periodical returns submitted to Head Office and inspections by the Audit & Inspection Department.

United Commercial Bank

The bank has broadly adopted the salient provisions of the Guidelines. Head Office, International Division, is overseeing the operational performance of overseas branches through statements and returns as well as reports of inspectors/auditors.

Question 9

(a) Please indicate broadly the discretionary powers delegated to overseas branches.

(b) When were these revised last?

(c) Have the foreign branches expressed any difficulty in operating within the delegated discretionary powers?

Replies

State Bank of India

A copy of circular issued by the bank to its foreign offices on the subject has been furnished. The discretionary powers were last revised in September 1981. The foreign offices have not expressed any difficulty in operating within the delegated discretionary powers.

Bank of Baroda

Copies of discretionary powers granted to various executives/managers at all overseas territories have been furnished by the bank. The territories are Bahrain, Brussels, Fiji, Guyana, Kenya, Mauritius, New York, Nassau, U.K. and West Asia. In respect of the U.K., different discretionary powers for lending have been given to U.K. Committee, DGM, and the Chief Manager, London. The powers of individual territories are revised as and when specific requests for such revision are received from the concerned territories. As the discretionary powers have been sanctioned at the specific requests of the territories, they have not expressed any difficulty in operating within such powers. Whenever they exceed the powers, they are reported to Central Office for obtaining confirmation.

Bank of India

The lending powers of overseas branches were last reviewed at the Board meeting held in March 1982. Delegation of powers given in 1978 were found to be inadequate and accordingly the powers were revised in March 1982.

Central Bank of India

The discretionary powers were revised in June 1980 and are again under revision. The foreign branches have expressed difficulty in operating within the delegated discretionary powers.

Indian Bank

(The minutes of the Overseas Offices Conference to which the bank has made a reference in this regard was not received).

Syndicate Bank

Revision of the delegated powers to the London branch is under consideration. However, the sanctioned powers in respect of Euro-currency finance were revised in February 1982. The branch has expressed difficulty to operate within the discretionary powers. To obviate the difficulty, the bank has posted DGM. to the branch with higher discretionary powers.

Union Bank of India

The bank proposes to review the discretionary powers delegated to its London branch. The powers were delegated to the branch in 1981. The bank is now in the process of collecting similar data from various Indian banks having branches in the U.K. with a view to ensure that the delegated authority is commensurate with the requirements of the branch. Though the London branch has not expressed any difficulty in operating within the delegated discretionary powers, it has desired the Head Office to constantly review the same.

United Commercial Bank

The operational heads at overseas branches have been granted discretionary powers for customer business under various facilities. The present discretionary powers were set up with the approval of the Board in 1980. By and large, the discretionary powers have been found to be adequate. However, in order to take care of any requests of the bank's important customers, it has introduced a committee system in each territory whereby decision upto 1.5 times the AGM's powers can be taken at the local level.

Question 10

Please describe the system of supervision and control exercised by the Head Office/International Division over the advances portfolios of overseas branches.

Replies

State Bank of India

The primary responsibility for proper appraisal of loans rests with the foreign offices. The quantum of discretionary powers vested in the Manager has been determined on the basis of his seniority and the business potential at his centre. Downstreaming of the financial powers delegated to the Manager is subject to prior and specific

approval of Central Office. Control being an essential and inextricable part of every scheme of delegation as mentioned above, the foreign offices are required to submit control reports relating to the exercise of discretionary powers at the level of the No.1 position at weekly intervals in respect of loans and advances. Apart from the control reports, foreign offices are also required to submit periodical follow-up reports in the case of project finance and the review/renewal exercise is done on a half-yearly or annual basis. While foreign offices have been permitted to exceed the prescribed powers by 10%, subject of course to the ceilings laid down in the Regulations of the bank, such excess drawings are to be reported on a monthly basis in the prescribed format. Besides the above control systems which provide for an on-going review, the foreign offices are required to re-evaluate the credit risk of all the borrowal accounts towards the end of each financial year and submit recommendations as regards provisions, if any, to be made and follow-up measures to be initiated for safeguarding the bank's interests. Considerable importance is also given to the aspect of documentation which is invariably vetted by the local solicitors so as to ensure conformity with the prevalent governing laws at the centre concerned. The foreign offices have also been asked to prepare a branch profile with details of the environment,

business potential, trade and lending practice, etc., and exchange credit information with other offices of the bank abroad, particularly in respect of customers having operating presence at more than one centre.

Bank of Baroda

The International Division exercises control over the advances portfolios of overseas branches as under :

(a) Appraisal and sanctioning of all advances which are beyond the discretionary powers of Regional Executives and keeping a watch on the review of advances as sanctioned by Board or Committee of Executives at Central Office.

(b) Post-sanction scrutiny of all advances.

(c) Keeping a close watch on the advances accounts which are considered sub-standard or doubtful of recovery.

(d) Scrutinising the various control returns and inspection reports and taking follow-up action.

Bank of India

The International Division exercises control and supervision over advances portfolios of overseas branches as under :

(a) The branches have to submit to International Division proposals for advances sanctioned by them and proposals for advances beyond their authority for sanction at H.O. level.

(b) Report of over-limit/casual business undertaken by them.

(c) Statements of temporary overdrafts, out-of-order accounts, etc.

These are scrutinised by the International Division and follow-up action taken. Any serious irregularities noticed are reported to AGM/GM and if necessary, to the E.D. and Chairman and even to the Board.

#### Central Bank of India

Various returns are received by Central Office, Foreign Division. The sanctions above the discretionary powers of AGM, London are ratified by Head Office.

#### Indian Bank

The International Division at Central Office, Madras, receives from overseas branches various returns/statements in respect of their advances portfolio. In respect of advances sanctioned by H.O., follow-up is initiated by periodical review of the accounts and renewal of advances.

#### Syndicate Bank

International Division calls for various control statements and scrutinises the same. Regarding advances of the London branch, the accounts are regularly reviewed by the International Division once in a quarter. The

quarterly statement of limits and liabilities of the customers is scrutinised and follow-up action is taken wherever limits are exceeded. The overdue statements are also scrutinised and appropriate action taken. Major irregular accounts are reported to the Board on quarterly basis. While renewing or sanctioning the facilities, operation experience of the account, market reports or credit investigator's report is taken into account. Auditors and inspectors check the advances portfolio and submit the reports. Rectification reports of the ~~branch~~ are duly scrutinised.

Union Bank of India

The system of supervision and control over the advances portfolio of overseas branch is exercised through the medium of monthly/quarterly statements. These include monthly statement of advances granted by the Chief Executive beyond sanctioned limits/drawing power/discretionary powers of the Chief Executive, statement of bills purchased remaining outstanding for more than stipulated number of days, report on irregular accounts, statement of irregular accounts and statement of party-wise outstandings under various credit facilities.

United Commercial Bank

The International Division supervises and controls sticky advances and problem accounts, takes follow-up action on correspondence regarding audit/inspection reports, does appraisal of all major credit proposals and post-sanction review and follow-up. It receives statements/returns from overseas branches in respect of credit limits sanctioned by local AGM/GM/Committee, provisions for bad and doubtful debts and past-due and dishonoured bills, overdue trust receipts and irregular accounts.