

REPORT NO.

146



सत्यमेव जयते

PARLIAMENT OF INDIA

RAJYA SABHA

DEPARTMENT RELATED PARLIAMENTARY STANDING COMMITTEE

ON COMMERCE

ONE HUNDRED AND FORTY SIXTH REPORT

**IMPACT OF BANKING MISAPPROPRIATION ON TRADE
AND INDUSTRY**

*(Presented to the Rajya Sabha on 6th August, 2018)
(Laid on the Table of Lok Sabha on 6th August, 2018)*



**Rajya Sabha Secretariat, New Delhi
August, 2018/ Shravana, 1940 (Saka)**

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COMPOSITION OF THE COMMITTEE

(Constituted w.e.f. 1st September, 2017)

1. Shri Naresh Gujral — *Chairman*

RAJYA SABHA

2. Shrimati Roopa Ganguly
3. Shri Ram Kumar Kashyap
4. Shrimati Thota Seetharama Lakshmi
5. Shri Vayalar Ravi
6. Shri Kapil Sibal
7. Dr. Kanwar Deep Singh
- \$ 8. Shri Sushil Kumar Gupta
- % 9. Shri M.P. Veerendra Kumar
- & 10. Vacancy

LOK SABHA

11. Shri Dibyendu Adhikari
12. Shri Subhash Chandra Baheria
13. Shri Abhishek Banerjee
14. Shri Bodhsingh Bhagat
15. Shrimati Bijoya Chakravarty
16. Shri Jitendra Chaudhury
17. Shri Dushyant Chautala
18. Shri Chhotelal
19. Dr. Kambhampati Haribabu
20. Shrimati Kavitha Kalvakuntla
21. Shri Saumitra Khan
22. Shri Dhananjay Mahadik
23. Shri Thota Narasimham
24. Shri Kamal Nath
25. Shri Kamlesh Paswan
26. Shri K.R.P. Prabhakaran
27. Shri T. Radhakrishnan
28. Shri Janak Ram
29. Shri D. S. Rathod
30. Adv. Narendra Keshav Sawaikar
31. Shri Vinod Kumar Sonkar

SECRETARIAT

Shri Jagdish Kumar, Joint Secretary
Shri A.K. Gandhi, Director
Shri Narendra Kumar, Additional Director
Shri Amit Kumar, Deputy Secretary

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- \$ Nominated w.e.f. 2nd June, 2018.
% Nominated w.e.f. 2nd June, 2018.
& Shri Joy Abraham retired w.e.f. 1st July, 2018.

INTRODUCTION

I, the Chairman of the Department Related Parliamentary Standing Committee on Commerce, having been authorised by the Committee, present this One Hundred and Forty-Sixth Report on 'Impact of Banking Misappropriation on Trade and Industry'.

2. The Committee took up the subject for detailed examination on 26th April, 2018 and the same was notified *vide* Parliamentary Bulletin Part-II dated 11th May, 2018. As a part of examination of the subject, the Committee considered the subject in detail in the two meetings wherein it heard the views of Secretaries of Department of Commerce and Department of Industrial Policy and Promotion, Ministry of Commerce and Industry and the views of representatives of Federation of Indian Chambers of Commerce and Industry (FICCI); Associated Chambers of Commerce and Industry of India (ASSOCHAM); Confederation of Indian Industry (CII); Federation of Indian Export Organisation (FIEO) and Indian Banks' Association (IBA).

3. The Committee also undertook one study visit to Mumbai from 9th to 11th July, 2018. The Committee, during the study visit, had interactions with various stakeholders wherein it heard the views of the representatives of Export Promotion Councils of industries like Gems and Jewellery, Cotton Textiles, Apparel, Pharmaceuticals, Engineering, Leather, Chemicals and Plastic; representatives of DGFT, Customs, ECGC Limited, Reserve Bank of India and public and private sector banks, namely, Punjab National Bank, EXIM Bank, State Bank of India, Bank of India, Central Bank of India, Union Bank of India, Bank of Maharashtra, Indian Bank, Indian Overseas Bank, Canara Bank, HDFC, IDBI, ICICI Bank, Kotak Mahindra Bank, Bank of Baroda, Dena Bank, Allahabad Bank, Andhra Bank, Corporation Bank, Oriental Bank of Commerce, Punjab & Sind Bank, UCO Bank, United Bank of India, Vijaya Bank and Syndicate Bank.

4. The Committee considered the draft Report and adopted the same at its meeting held on 2nd August, 2018.

5. The Committee expresses its sincere gratitude to the representatives of both the Departments and all the representatives of various organizations for placing before it their valuable suggestions, materials and information required in connection with the examination of the subject.

New Delhi;
August 02, 2018
11 Shrawana, 1940

NARESH GUJRAL
Chairman,
Department Related Parliamentary
Standing Committee on Commerce
Rajya Sabha

ACRONYMS

AEPC	Apparel Export Promotion Council
API	Active Pharmaceutical Ingredient
ASSOCHAM	The Associated Chambers of Commerce & Industry of India
AD	Authorized Dealer
BLR	Bank Lending Rate
BRC	Bank Realisation Certificate
CARE	Credit Analysis and Research Limited
Chemexcil	Chemical Exports Promotion Council
CII	Confederation of Indian Industry
CIS	Commonwealth of Independent States
CTEPC	Cotton Textile Export Promotion Council
CLE	Council for Leather Exports
DA	Documents against Acceptance
DGFT	Directorate General of Foreign Trade
DP	Documents against Payments
CRISIL	Credit Rating Information Services of India Limited
EEPC	Engineering Export Promotion Council
ECGC	Export Credit Guarantee Corporation
EDPMS	Export Data Processing and Monitoring Systems
EPC	Export Promotion Council
FICCI	Federation of Indian Chambers of Commerce & Industry
FIEO	Federation of Indian Export Organisation
FEDAI	Foreign Exchange Dealers Association of India
FLC	Fireigh Letter of Credit
GJEPC	Gems and Jewellery Export Promotion Council
GJD	Gems, Jewellery and Diamond
ICC	International Chamber of Commerce
INR	Indian Rupee
INSTC	International North-South Transport Corridor
LC	Letter of Credit
LIBOR	London Interbank Offered Rate
LoC	Letter of Comfort
LoU	Letter of Undertaking
MSMEs	Micro, Small and Medium Enterprises
NEIA	National Export Insurance Account
NPAs	Non Performing Assets
OFAC	Office of Foreign Assets Control
Plexcouncil	Plastics Export Promotion Council

PSL	Priority Sector Lending
PCA	Prompt Corrective Action
RBI	Reserve Bank of India
RECL	Rupee Export Credit Loan
SBLC	Standby letter of Credit
SBI	State Bank of India
SMEs	Small and Medium Enterprises
UCPDC	Uniform Customs and Practice for Documentary Credits
USD	US Dollars
WTP	Whole Turnover Policy

REPORT

INTRODUCTION

1.1 Finance is the lifeblood of a robust trade and industrial framework of a nation. Banks play a vital role in facilitating access to finance to trade and industry in an economy. They largely provide debt finance to enable their smooth functioning and growth. The need for availability of debt finance on 'time' and at a 'reasonable cost' for the smooth performance of trade and industry cannot be overemphasised.

1.2 The country is still significantly dependent on imports. The industries carry out lots of imports of quality inputs for their manufacturing processes as well as to cater to the requirement of capital goods. A major portion of such imports are meant for exports in the form of finished goods. There are also imports of consumer goods for direct sale in domestic market. Traditionally, industries have been using different borrowing instruments for their import requirements. These borrowing instruments have been refined over the years to remove the apparent loopholes and customer inconveniences. These instruments, for example, include Letter of Credit (LC), revolving LCs, Letter of Undertaking, Letter of Comfort, etc.

1.3 The Committee notes that the banking sector recently has been victim of misappropriation through fraud of unprecedented magnitude. The Reserve Bank of India (RBI) being the regulator of banking sector has taken a slew of measures which has deep ramifications for trade and industry. These measures have affected trade finance which is likely to impinge on the competitiveness of trade and industry. It is learnt that the impact has been quite acute on labour intensive industries. These industries also happen to hold a significant share in country's merchandise export and they have been major foreign exchange earners. There are fears that tepid business on account of measures taken by the RBI shall have a spill-over on the jobs and employment opportunities for the people. In view of the above, the Committee decided to examine the impact of such measures/regulations on trade and industry in the country.

DISCONTINUATION OF LETTERS OF UNDERTAKING/LETTERS OF COMFORT

2.1 The banks assign both fund based and non fund based credit limits for the purpose of trade finance. The traditional and the most commonly used methods of non-fund based trade finance is a Bank Guarantee or a Letter of Credit. The importers have also been availing Buyers Credit against Letters of Undertaking (LoUs) issued by their banker. Inasmuch as fund based trade finance is concerned, credit instruments like working capital loan/Rupee Export Credit Loans have been

in vogue. Another way of financing the trade is through assignment of receivables i.e. factoring, which is in infancy in the country.

2.2 The RBI being mindful of the need to simplify the procedures related to trade finance to bolster trade and to liberalise the foreign exchange regime has progressively delegated more powers to Authorised Dealers (banks) for undertaking foreign exchange related transactions. Accordingly, one of the measures adopted on November 1, 2004 in order to promote investment activity and to further liberalise the procedures related to trade credit for imports, was to grant general permission to Authorised dealers to issue Guarantees/Letter of Undertaking (LoU)/ Letter of Comfort (LoC) in favour of overseas suppliers, banks and financial institutions up to an amount of USD 20 million per transaction.

2.3 The RBI has, however, discontinued the practice of issuance of Letters of Undertaking (LoUs)/ Letters of Comfort (LoCs) for Trade Credits for imports vide Para 2 of RBI Circular No 20 dated March 13, 2018. Para 2 reads as under:

*“On a review of the extant guidelines, it has been decided to discontinue the practice of issuance of **Letters of Undertaking (LoUs) and Letters of Comfort (LoCs) for Trade Credits for imports into India by AD Category –I banks with immediate effect. Letters of Credit and Bank Guarantees for Trade Credits for imports into India may continue to be issued subject to compliance with the provisions contained in Department of Banking Regulation Master Circular No. DBR. No. Dir. BC.11/13.03.00/2015-16 dated July 1, 2015 on “Guarantees and Co-acceptances”, as amended from time to time.”***

2.4 The Committee was informed that the Buyer’s Credit has been disrupted on account of the RBI Circular dated 13th march, 2018. Buyer’s credit is a short term credit available to an importer (buyer) from overseas lenders such as banks and other such financial institution enabling the importers to make good of the payments in due dates against goods they have imported. Buyer's credit helps local importers gain access to cheaper foreign funds that may be closer to LIBOR rates as against local sources of funding which are more costly due to higher rates of interest and suffers with uncertainty in terms of availability. Buyer's credit has several advantages for the importer. On the one hand the overseas exporter gets payment on due dates, on the other hand, the importer gets extended date for making an import payment as per the cash flows. The importer can negotiate a better discount and use the buyer’s credit route to avail financing.

2.5 As per a study of India Ratings published in Hindu Business Line (Apr 23, 2018), the total outstanding buyer’s credit of the top 160 importers as of 31st March 2017 was over INR 330 billion of which INR 312 billion of credit was availed by large importers and remaining (INR 19 billion) by SME importers. It

also stated that unlike large corporate, the level of dependence on buyer's credit in total debt of SMEs is very high.

2.6 The Committee was informed that there is a decline in export credit to the tune of 24.4% ending fiscal 17-18 and as a percentage of priority sector lending (PSL) it was only 1.74%. The Year-On-Year decline in export credit was 29.6% in 2018. The Committee felt that such a sharp decline in exports credit along with discontinuance of the issuance of LoU/LoC might not augur well for the future and will impact exports adversely. It is a matter of deep concern and deserves immediate attention in order to avert likely disruption to trade and industry.

2.7 In response to the Committee's concern over the likely disruption to trade and industry on account of discontinuation of issuance of LoUs/LoCs, the Department of Financial Services has stated that discontinuation of issuance of Letters of Undertaking (LoUs)/ Letters of Comfort (LoCs) does not mean discontinuation of trade credit as a means of Trade Finance. Trade Credits, including Buyer's credit can be availed of as a form of clean credit, apart from availing Bank Guarantee for Trade Credit, subject to extant trade credit guidelines and RBI circulars. It has been further stated that as before, Letters of Credit (LC) and Bank Guarantee continue as forms of Trade Finance. Existing LoUs/LoCs (Letters of Understanding / Letters of Comfort), issued prior to the RBI Circular dated 13.03.2018, discontinuing LoUs/LoCs, may also continue till their original validity, although no roll-over is permitted.

2.8 The Committee held interactions with FIEO, Chambers of Commerce, Export Promotion Councils, Industry Associations, etc. to understand the disruption, if any, caused to the trade and industry in the context of the ban imposed by the RBI on issuance of LoUs/LoCs. A summary of submissions made by some of these bodies are given hereunder:

Federation of Indian Export Organisation (FIEO)

2.9 FIEO has submitted that the LoU/ LoC facility provided foreign currency loans at LIBOR + 1% and 3% forward premium. For one year it works out to around 5.6% to 6% (LIBOR 1 year being 2.6% as on date) for a borrower whereas with L/C the cost will range from 8.5% to 9% (with interest equalization) and without equalization 11 to 12 %; a differential of 2.5% to 3% which could impact an SME adversely. Besides this, LoC /LoU was granted from non-fund based facility which was 50% of lending whereas the facility being provided now will be under fund limits reducing availability of funds /liquidity further .

Confederation of Indian Industry (CII)

2.10 CII has stated that currently importers can only use Letters of Credit and bank guarantees for imports. The ban on LoUs and LoCs has dried up the cheaper foreign currency loans which were available at LIBOR + 2.0 %. The cost of alternate rupee loan is in double digits. This has increased the cost of funding imports.

2.11 It has been submitted that LoUs & LoCs were practically the only route to access cheap foreign credit for SMEs as other mechanisms are more complex that would need a highly professional fund management team, which they cannot afford.

2.12 CII has suggested that LoU or similar instruments for import of Machinery & Equipment should be allowed so that the expansion of Indian Industry is not hampered.

The Federation of Indian Chambers of Commerce & Industry (FICCI)

2.13 FICCI has submitted that there has been a direct impact on trade finance, especially for SMEs on account of the RBI's decision to discontinue Letters of Undertaking (LoUs) and Letter of Comfort (LoCs) for trade credits for imports into India. It has been stated that the ban has created liquidity pressure and higher funding cost for SMEs. The impact has been largely felt by SMEs dependent on import of inputs, including sectors like gems & jewellery, electronic equipment, auto ancillaries, etc.

2.14 Data on bank credit also shows that MSMEs particularly in manufacturing sector are feeling constrained on account of limited availability of credit. FICCI has pointed out that several companies had been in fact utilizing LoU to access cheap foreign financing. The foreign funds that were earlier accessible at 2.5% per annum under LoU mechanism can now be availed only at upwards of 10% post the curbs on LoUs.

The Associated Chambers of Commerce (ASSOCHAM)

2.15 ASSOCHAM has submitted that the measure to terminate these instruments is harsh on honest borrowers, who have been following the system ardently through the years. It has further stated that in case of complete termination of such instruments, the industry along with bankers may have to devise new methods to borrow. Apart from that, the termination of such instruments shall also impact the industry in terms of capital inadequacy and increase in turn-around time.

Chemical Exports Promotion Council (Chemexcil)

2.16 Chemexcil has stated that the move by RBI to discontinue issuance of LoUs/LoCs has created an adverse impact on the working capital requirements of MSMEs. It has started affecting exports as a result of lack of affordable funds and reduced working capital cycle. It was informed that industry, particularly MSMEs, whose working capital is based as per their trade cycle will now require higher working capital or else they will suffer irreparable losses. The Committee notes that the manufacturers, particularly MSMEs used to get total credit of more than 270 days under LoUs/LoCs which helped them to ease their working capital cycle. It is noted that the funds under LoU/LoC were available at 3-4 per cent interest. Instead of low interest funds, now MSMEs have to utilize Bank funds which are available at 11-14 per cent interest. It has been emphasised that the discontinuation of LoUs/LoCs is a double whammy since the industry has already been facing a huge stress on the working capital requirement on account of delay in IGST refunds.

Council for Leather Exports (CLE)

2.17 Council for Leather Exports (CLE) has submitted that the exporters in the leather sector import capital goods, raw materials and other critical inputs required for making value added products, as per the demands and specifications of the overseas buyer. Many such exporters had been availing the facility of Letters of Undertaking (LoUs)/ Letters of Comfort (LoCs) for Trade Credits for imports into India. Sudden stoppage of this facility has not only affected their working capital but will jeopardize their production schedule in future, leading to cancellation of export orders.

2.18 CLE has requested for postponement of the decision to discontinue the practice of issuance of Letter of Undertaking (LoUs)/ Letter of Comfort (LoCs) for Trade Credits for imports into India, for a period of at least 6-7 months, so as to give time to the exporters/importers to make adjustments in their business plan accordingly. It will help the sector immensely in consolidating and further expanding the export growth from Indian leather sector in the coming years.

Engineering Export Promotion Council (EEPC INDIA)

2.19 Engineering Export Promotion Council (EEPC INDIA) has submitted that businesses which availed LoUs/LoCs against import documents are facing difficulty due to this sudden change. The cost of finance under LoUs/LoCs is very low as it comprises of LIBOR plus one to two basis points. Due to the restriction on issue of LoUs/LoCs, the cost of funds is going up substantially at minimum

bank lending rate (BLR), making it unviable to carry out trade due to thin operating margins.

2.20 It has been further stated that the businesses will have to shift to instruments like letters of credit or bank guarantees, which could increase their borrowing costs by about 0.5 to 1 per cent, thus impacting margins. This will be particularly detrimental for MSMEs as there will be an increase in the cost of production since imports will now become expensive and in turn the cost of inputs will go up. It was pointed out that MSME units are already struggling hard to become globally competitive and are facing stiff competition from their global counter parts. Any increase in cost of production and cost of capital will definitely impact them adversely affecting their competitiveness.

2.21 EEPC INDIA has further submitted that this move initiated by Government and RBI would have adverse impact on employment too as most of the engineering SMEs are labour intensive and operate on low margin. Not only are exports of these industries in the doldrums, industrial production data also shows tepid growth in these sectors. Most of them are already in trouble due to delay in GST refund and blockage of working capital. The move to discontinue LoUs will have cascading impact on their revenue growth.

Pharmaceuticals Export Promotion Council (Pharmexcil)

2.22 Pharmexcil has stated that banning of buyer's credit by the RBI has led to choking of working capital of many of the genuine and compliant business houses. The issue is so serious in some of the small business and merchant exporters that they are forced to go for either unviable funding option at high cost or let go the business for want of fund though they may have credit limits which cannot be used in the wake of above restrictions.

2.23 It was further submitted that while Pharmexcil support that the regulator should take strict action against defaulter and those who do not comply with policy/ guidelines, but any restrictive action to curb such practices should not have an adverse effect on genuine business houses.

The Plastics Export Promotion Council (Plexcouncil)

2.24 Plexcouncil has averred that the industry is facing cash crunch due to non-availability of buyer's credit from bank. The ban has resulted in increase in cost of finance while short-term and stand-by finance has vanished. The Council has further insisted that buyers' credit is an important tool of evaluation of commercial/pricing negotiations for the exporters. Absence of such tool is making

the commercial negotiations with the foreign as well domestic clients unfavourable. It has been requested to resume the policy of buyers' credit for better standing of the company in the competitive market.

Gems and Jewellery Export Promotion Council (GJEPC)

2.25 GJEPC has submitted that LoUs/LoCs have not been part of the working capital component for procuring raw material in the Gems, Jewellery and Diamond (GJD) sector. Non funded limits by way of Standby letter of Credit (SBLC) are being used for purchase of gold from nominated Agencies and authorized dealers.

2.26 It was submitted that the banks have started implementing tighter credit norms for the GJD industry and have also made the process for sanctioning loans quite rigid as they demote exposures to the industry. There has been a huge increase in Finance costs either by way of withdrawing concessions or increase in interest rates. These concessions were provided by the banks to the customers for many years. It was also pointed out that Banks are insisting for higher collateral now which is a big hindrance for an industry predominated by small and medium enterprises. Earlier, the demand for collateral was quite low and the stock & receivables were considered adequate for getting Finances.

2.27 It was regretted that though the entire sector provides direct and indirect jobs to more than 30 million people yet they are now looked down as bandits for the fraud committed by one particular branch of one particular Bank by flouting the laid guidelines of the RBI and Government of India.

Apparel Export Promotion Council (AEPC)

2.28 AEPC has submitted that the apparel industry imports lot of things and buyer's credit facility is being used by importers. Their fund planning is done accordingly. However, the sudden decision to withdraw that facility, due to banking misappropriations, puts everything to a standstill. It was informed that the working capital limits are at stake as these are either not getting renewed or if renewed, then, it is being done with a lot of conditionality by the banks. The demand for collateral has gone up very high.

2.29 The Council has stated that banking charges for exporters has been increasing which is an additional burden of cost for exporters. These new banking charges are an attempt by the Banks to make good their losses. Exporters have to pay charges for nearly every services offered by the banks. This is causing undue hardships to the sector which already competes on thin margin with their competitors in the world market.

Cotton Textile Export Promotion Council

2.30 The Council has informed that due to tightening of foreign exchange transaction, exporters are facing problems in terms of exports. Import and export transaction have to go through centralized clearance system which takes two days for clearance. The delay causes loss of interest and loses the advantage of exchange rate. It was submitted that the centralized system should be made faster and documents should be cleared at the bank branch level itself.

2.31 In view of the above submissions, it is amply clear that after the discontinuation of issuance of LoUs/LoCs, there has been a decline in trade finance as well as rise in the cost of credit. It is feared that such a development will hobble the performance of our trade and industry. The Committee notes that though the exports figure as of now does not show a downward slide as a result of the ban on LoUs/LoCs yet it is not too far in time when the effect of the ban on LoUs/LoCs will reflect in terms of decline in exports. The Committee, however, has been informed that there has been a slight dip in diamond trade.

2.32 The Committee finds that the immediate casualty on account of the ban on LoUs/LoCs has been the ability of importers to secure a low interest short term credit in foreign currency. The curb on LoUs severely impacts their liquidity and raises the funding costs. The Department of Commerce has shared an analysis carried out by FIEO which shows that the cost of credit for industry has increased:

For industry: *Commercial paper April 2018

Commercial Paper Issued by Companies (At face value)

Fortnight Ended	Amount outstanding (Rs. Billion)	During the Fortnight	
		Amount issued (Rs. Billion)	Rate of Interest (Per Cent)
April 15, 2018	4,331.8	729.9	6.04-11.88
April 30, 2018	4,476.9	567.7	6.35-12.31

Source: RBI

*Commercial paper is an unsecured form of promissory note that pays a fixed rate of interest. It is typically issued by large banks or corporations to cover short-term receivables and meet short-term financial obligations, such as funding for a new project

2.33 Even the banks during interaction with the Committee have unanimously agreed that the impact of discontinuation of LoU/LoC on the cost of credit is to the extent of 2 to 2^{1/2} per cent which is substantial in absolute terms and is much costlier than the LC products or the funded limits made available by the Indian banks as a substitute to the LoUs and LoCs.

2.34 Besides the considerable increase in the cost of funds for domestic exporters/importers, the Committee notes with concern that as for the LoUs already issued, a "risk premium" has already been set in for any Indian paper. The Committee was informed that foreign lenders have reduced credit exposures for short term dollar loans to local counterparts. Accordingly, foreign lenders have become reluctant to accept the guarantees from their local counterparts. Banks such as, Citigroup Inc., Deutsche Bank AG, Standard Chartered Plc and HSBC Holdings Plc are declining/reducing exposure to these transactions, used by smaller companies to access short-term dollar funding. It was informed that the premium on Indian paper has shot up by 10-50 bps. LoU-based short-term loans are coming in at a premium of 10-30 basis points, and in some cases it has gone up to even 50 bps. Similarly in case of Supplier's credit, there is a marginal hike in the interest loaded by the Supplier. But since the LoUs were issued against all types of imports such as Import Bills under Collection, Direct Imports done by the Importer apart from the FLC bills, its prohibition has led to decrease of finance for such imports. It has also put the competitiveness of the local businesses vis-à-vis traders from other countries under strain. Further in the aftermath of the fraud, the overseas financial lenders are keenly monitoring the aspects such as Regulatory Compliances, KYC details and detailed verification of underlying transactions.

2.35 The embargo on issuance of LoUs has caused imports bills getting pending for payments and clearance of import consignments have got stalled. It has been submitted that companies have already started considering cutting down on their raw material sourcing due to increased costs and this will have an impact on their overall turnover.

2.36 Moreover, after the discontinuation of LoU/LoC, the importers will have to convert their rupee loans into foreign currency to make payments to their foreign suppliers. This will cause a spurt on the spot demand of the dollar in currency market. There is all likelihood that the spurt will lead to high conversion cost causing hardship to the importers. On the other hand, the Banks have the ability to raise foreign currency from overseas at a very reasonable rate due to their credit worthiness and capital adequacy. The banks could pass on the benefit of low interest rate raised by them through LoUs/LoCs. Now, the importers are left to fend themselves. **The Committee expresses its deep concern on the present situation when the rupee is weak, the rise in spot demand will prove to be onerous on importers. It recommends that RBI may take measures to enter into bilateral currency swap agreements with major trade partners to meet spot demand and buy back exporters' receivables. This will enable the smooth currency movement in the market and further it will not impact the forex reserves.**

2.37 The Committee enquired about the accessibility of other trade finance instruments and it was informed that getting letters of credit (LC) is a time-consuming process as various rules need to be complied by the beneficiary and verified by the bank. A lot of documentation is required which results in consumption of huge resources of the applicant. These instruments involve a commission fee along with a so called acceptance charge which is not the case with LoUs as they only involve a guarantee fee. **The Committee recommends that necessary interventions may be made to streamline and simplify the procedure in processing of LCs. The Committee also desires that maximum concessions may be offered on LC charges especially to MSMEs.**

2.38 The Committee further notes that no banks except State Bank of India (SBI) have come up with an alternate instrument which could be as cost effective and accessible to the importers as LoUs/LoCs. **The Committee welcomes that State Bank of India has developed a new reimbursement product with systemic and compensatory controls which is being extended presently to the AAA and AA rated large corporate customers and will gradually over a period of 6 months be extended to the SME borrowers as well. The Committee recommends that SBI must ensure that SME borrowers are not left out for want of desired credit ratings and hopes that other banks shall also come up products which can provide convenience similar to LoUs/LoCs.**

2.39 The Committee enquired about the reasons/basis for the RBI to discontinue issuance of LoU/LoC and the likely impact of such a measure on the trade and industry of the country. The RBI has informed that subsequent to their interaction on 5th March, 2018 with the Foreign Exchange Dealers Association of India (FEDAI) it was advised to the RBI that there was neither a standard format for LoUs/LoCs nor a standard protocol like the one prescribed by the ICC in respect of LCs/Documentary Credit (viz., Uniform Customs and Practices for Documentary Credits). In the interest of the stability of the banking system and to strengthen the existing mechanisms, it was decided to discontinue issuance of LoUs/LoCs for trade credit with effect from March 13, 2018. The RBI has stated that since LCs and Bank Guarantees, which are standardized and internationally used instrument of trade credit, are readily available to the trading community through the banking system and are also subject to well-recognised norms of the ICC, it is expected that the needs of the industry would be catered to adequately.

2.40 The RBI has further stated that due to the sizable fraud recently reported by the Punjab National Bank, related to misuse of LoUs, the Department of Financial Services, Ministry of Finance requested on March 6, 2018 the RBI to consider the need to continue LoUs, especially since an option like Letter of Credit (LC),

governed by a set of rules issued by International Chamber of Commerce (ICC), Paris was already available for supporting international trade.

2.41 The Committee is not convinced with the justification proffered by the RBI for discontinuing issuance of LoUs/LoCs. The Committee notes that the RBI has stated that it was advised by FEDAI to discontinue LoUs/LoCs as there was neither a standard format for LoUs/LoCs nor a standard protocol like the one prescribed by the ICC in respect of LCs/Documentary Credit (viz., Uniform Customs and Practices for Documentary Credits).

2.42 During its interaction with the representatives of both public and private sector banks, many of whom being FEDAI members, the Committee was told that LoUs/ LoCs has been an effective instrument for raising short term credit in foreign currency. All the banks, including FEDAI PSB members, have unanimously accepted that the LoUs/ LoCs were not flawed instruments. Instead, these were means of raising cheaper finance for trade. They informed that LoUs and LoCs which were made available were within the sanctioned LC limits of the various borrowers. These were unique to India though the same is not approved under the UCPDC. The fraud was localized to only one bank, one branch and was committed and perpetuated by one family. It is significant that the other bankers have not suffered any loss under the LOUs and LOCs issued by them. The Committee notes that in line with the RBI instructions most of the banks have reduced their exposures under the LOUs and LOCs by more than 75 per cent.

2.43 The Committee strongly feels that the RBI has perhaps not held enough consultations before deciding to discontinue issuance of LoU/ LoC. The Committee notes that the RBI has in a response to the comments sought by the Department of Financial Services about the impact of discontinuation of LoUs/ LoCs on credit cost for short term foreign currency loan has stated that there is no comparative reporting to RBI of quantum or cost of trade finance through LoUs/ LoCs *vis-à-vis* other available avenues of raising short-term foreign currency finance. If this be the case, then the Committee is constrained to say that the RBI should have done more scrutiny before proceeding with the decision to ban LoUs/ LoCs. The Committee is of the view that the discontinuation of issuance of LoUs/ LoCs is a knee-jerk reaction by the RBI to the recent frauds. It is a typical case of throwing baby along with the bath water and it must be stopped. The Committee, therefore, recommends that LoU/ LoC should be restored at the earliest albeit with proper safeguards.

BANKING MISAPPROPRIATION AND NON PERFORMING ASSETS (NPAs)

3.1 The Committee notes that the frauds and misappropriation in the banking sector has impinged on the capital base of the banks and it has contributed to rising Non Performing Assets (NPAs). The regulations/measures taken by the RBI and the Government of India to tackle the problem of NPAs have made the banks act with extra caution. The Committee notices that while discontinuation of issuance of LoUs/LoCs is the immediate fall-out of banking misappropriation having adverse impact on the cost competitiveness of India's trade and industry, the larger effect is noticed in the shift by banks towards adoption of stringent measures while offering its credit products. The Committee notes that the extra cautionary approach of the banks is proving burdensome for trade and industry, especially MSME sector.

3.2 The Reserve Bank of India has informed the Committee that NPAs arising in the banking system on account of frauds and wilful default, as reported by the banks, as on March 31, 2018 was Rs.29,734 crore involving 277 borrowers and Rs.11,914 crore involving 445 borrowers respectively. These amounts include defaults in the accounts with exposures of only Rs. 5 crore and above.

3.3 The banks are required to maintain adequate provisions, as per the RBI norms, in their balance sheet to cover the expected losses arising from Non-Performing Assets (NPAs) in their books. The banks also need to bolster their lending capacity by raising adequate risk capital, and robust risk management systems should also be put in place to identify measure, monitor and control the range of risks involved in each loan transaction. This, coupled with capacity building within the banks, through necessary skill up-gradation for proper risk assessment, pricing of loans, formulation of loan covenants and follow through when an agreed covenant is being violated, adequate sector-specific knowledge and understanding of business models, etc., will lead to a robust banking system that would be able to adequately support the real economy.

3.4 The Committee noted the results of the successive FICCI-IBA bi-annual Survey of Bankers where it has been stated that banks are turning risk averse to corporate sector credit. Almost in all rounds of survey, the respondent banks have reported tightening of credit standards for large corporations. There is greater insistence on collaterals and various documents for credit. An analysis of survey findings also shows that banks are increasingly shifting their credit portfolio towards retail sector. Earlier, the average corporate to retail ratio in total credit of banks stood at 62:38 in early 2016, which currently stands at around 56:44 as per latest rounds of survey.

3.5 The Committee was also informed during its deliberations with various stakeholders of trade and industry that there is a fear psychosis amongst bankers, who have turned wary of taking loan decisions as easily as in the past. The Committee notes that loan approvals are getting delayed and even release of funds to approved loans take more time than usual. It has been submitted that the risk appetite of banks have lowered significantly, which in turn has had an impact on the overall credit disbursements and fresh investments by the private sector.

3.6 The Committee found that new credit norms have been introduced where credit limit will not be increased further for borrowers as business expands perforce making them to plough back their profits back into business and be self sustaining rather than borrow more from the Banks through increasing credit limits. The Committee finds such a situation is a cause of concern for trade and industry.

3.7 During its deliberations with industry and trade bodies, the Committee noticed that difficulty in availing of loans by MSMEs has been a general refrain. The Committee was informed that banks have become stringent in their lending policies to MSMEs. Banks ask for credit report from third party agencies like CRISIL, ICRA, CARE, etc. when a firm applies for credit of Rs. 5 crore and more. This requirement of obtaining ratings report has resulted in incurring of additional costs to the industry. Further, the rating has a validity of only one year. Generally proprietorship firms are rated low and if the company has suffered from any fire or an accident then their rating is even poorer. It has been submitted that most of these credit agencies go by Archaic Rules and have little understanding of the day-to-day functioning of a business. Further, the rating agencies upload the credit rating report on their website which can be viewed publicly by exporter's buyer as well as importers.

3.8 The Committee notes that bank finance is coming to the 'AAA' or 'AA' rated firms. The banks also extend concession to these firms. The Committee is of the view that introduction of credit rating system has deprived a large part of MSME sector from easy access to bank finance. Moreover, the credit rating agencies assess every firm with the same scale without taking into account the characteristic, nature and size of the unit. The Committee notes that instead of strengthening their internal risk appraisal mechanism, the banks have assigned their responsibility to third party agencies. The Committee is of the considered view that the banks must be alive to their responsibility. The prudence expected of the banks should not be used as an alibi to kill entrepreneurship. Moreover, the industry has already been reeling under the burden of high interest loan, drying up of finances on account of failure to secure 'AAA' or 'AA' ratings will prove disastrous for trade and

industry. The Committee recommends that due weightage to local vagaries specific to the industry must be taken into consideration by the credit rating agencies while awarding ratings to the firms. The Committee desires that SEBI must be engaged to take necessary action in this regard. Further, the banks must also strengthen their credit appraisal frameworks so that they can undertake in-house risk appraisals of a project in a professional manner.

3.9 The Committee further notes that apart from credit ratings, banks are also insisting for higher collateral and the companies with collateral levels of 15-25% are now being asked to cough up security of 35-50% which is almost a 100% increase. **The Committee finds the situation worrisome. Apart from the increase in the cost of credit, the trade and industry has also been burdened with the demand for higher collateral by the banks. The Committee strongly feels that such a situation will adversely impact the competitiveness of our trade and industry. While the industry world over are getting low interest loan, Indian trade and industry is saddled with expensive bank finance. This will result in lower revenue growth and lower profit margins. The Committee feels that meeting very high stringent and unrealistic requirement of collateral security will not be possible for many companies and may lead to diversion of funds to build collaterals. The Committee is of the considered opinion that margin and/or collateral requirements for issuance of LCs or Bank guarantees by the banks must be prescribed by the RBI, especially for MSME sector. The requirement of higher collaterals is a big hurdle for the industry. Higher margin money and collateral requirements are not the solution. It will be better if credit appraisal is based on track record of the exporter. Status Holder Certification of the DGFT and the credit covers taken by the exporters (such as, say, from ECGC) are also better ways to assess credit risk.**

3.10 The Committee notes that ECGC's capital base has increased to Rs.2000 crore to enable it for better underwriting of risks covered so they have more leverage to extend the credit facilities. **The Committee notes that though the bankers are insisting on ECGC policy, yet they are not reducing the value of the collateral. The Committee is of the view that the collateral requirement must be reduced in cases where the credit cover has been taken from ECGC. It desires that the Government must take necessary action in this regard as high collateral requirement stymie the expansion and growth of trade and industry.**

3.11 The Committee was also informed that the new RBI guidelines (Circular dated February 12, 2018) define even 1 day default as sign of incipient stress. The Committee finds the guideline to be too taxing. Presently, businesses, especially MSME sector as well as engineering and construction sector are finding it difficult

to get payments on time. In these circumstances, defining 1-day default as a sign of incipient stress is too onerous a condition for Indian industry. **The Committee recommends that such guideline must be reviewed on an urgent basis. This is entirely misleading in case of E&C companies, since over 75 per cent of their turnover comes from Government Contracts where payments are prone to delays. It is therefore recommended that Governments honour the payment terms of contracts and ensure timely payments.**

OTHER ISSUES

i. Closure of open items under Export Data Processing Management System

4.1 During the deliberations with the EPCs and Industry associations, the Committee was apprised about the problems being faced by exporters on account of Export Data Processing and Monitoring Systems (EDPMS). The Committee notes that the RBI, in order to automate the process of regularisation of exporter has provided AD (Authorized Dealers) banks access to updated list of caution listed exporters through EDPMS. The criteria laid down for cautioning/de-cautioning of exporters in EDPMS are as under:

1. Any shipping bill open for more than 2 years puts exporters in caution list. Date of shipment will be considered for the estimation of the realisation period.
2. Once associated bills are realised, extension for realisation is granted, and Exporter will be put in caution list even before the termination of two years, based on AD bank process and recommendations. Any adverse notice of ED/CBI/DRI or any adverse media news can result in inclusion of name in caution list.
3. Reserve Bank might caution/ de-caution the exporters under the guidance of AD banks.

4.2 The Committee notes that exporters are often penalized even where export proceeds have been received and banks have not updated the EDPMS or in cases of Sanctioned country payments under OFAC, where the banks are reluctant to handle documents. The Committee is quite concerned to note that there are more than 4 lakh exporters whose accounts have not been updated despite receipt of export proceeds. The timeline set for updating the EDPMS has been extended till 30th September, 2018. **The Committee understands that the banks are making best efforts to settle/ close the export accounts where export proceeds have been realized. However, there is likelihood that the timeline fixed for the purpose may not be adequate. The Committee recommends that the RBI take**

stock of the situation and extend the timeline beyond 30th September, 2018 if needed, so that the exporters are not put to any disadvantage.

4.3 The Committee was also informed that majority of the items which are not settled/ closed are those of promotional supplies with no commercial value. However, since the EDPMS open items are taken from shipping bill data from custom's records where all shipping bills appear under the same i.e. commercial as well as promotional supplies. This has led to lot of confusion and banks have taken extreme steps (though as per RBI's directive) to stop handing export documents even when the pendency in EDPMS was only on account of promotional supplies. **The Committee recommends that Customs should bring about necessary modification in the Shipping bill so as to avoid such difficulty being faced by the exporters for their promotional supplies with no commercial value.**

4.4 **The Committee is also of the view that the banks should be empowered to take judicious decision and handle documents of their genuine client after due care and verification of pendency. The Committee also recommends that RBI must exempt those delay in payments which have arisen on account of non-availability of currency (US Dollar) in the importing countries while preparing the Caution List. There have been experiences when the exporters have failed to realise their exports from countries like Nigeria and Angola due to shortage of USD in those countries a few years ago.**

ii Business with embargo countries

4.5 The Committee notes that many banks are not handling business transactions pertaining to countries like Iran, Syria, North Korea, Sudan, etc. which have been put under sanctions by the USA or UN.

4.6 It was informed that sanctions that the embargo does not apply to exports of pharmaceuticals and food products to such countries. However, many banks refuses to handle such transactions and only a few public sector banks handle such transactions as per their policy and compliance guidelines. However, the process of compliance clearance is so long that it creates lot of disruption in business. Often there is delay in clearance which leads to LC expiry. Also, there is a long delay in lodgement of documents leading to consignment reaching destination before documents reaching to customer's bank which results in incurring of substantial amount of demurrage by the customer. Many times foreign exchange remittance is received in advance against export orders into the exporters' account with a FIRC issued by the banks and thereafter exports have taken place. However, eBRC are not issued by banks stating that these are embargo countries.

4.7 The Committee was also informed that subsequent to the advocacy of the Government of India to promote exports through INSTC route (i.e. via Bandar Abbas sea port in Iran), many of the Pharmaceutical exporters have exported to CIS countries like Tajikistan, Azerbaijan, Kazakhstan etc. via Iran by sea and thereafter by road. Despite the fact that the CIS countries do not fall within the purview of US/UN Sanctions but since the exports have taken place via Iran, the Banks refuse to handle their documents.

4.8 The Committee expresses its concern over the difficulties being faced by pharma exporters to embargo countries. It was informed that banks are bound by international agreements while dealing with such transactions. The Committee is of the view that there needs to be a clear policy for exports to sanctioned/ embargo countries. It is surprising that the exporters were never stopped while exporting to these countries nor were they advised to the contrary by any Public Notice or Circular, then why are the banks refusing to handle such transactions and issue eBRC. The Committee feels that there is big potential for Indian pharmaceutical industry to grow their business in embargo countries and therefore, banks should be given clear guideline to enable smooth handling of business with such countries. Further, the refusal to handle export transaction carried through Iran to CIS countries is also disconcerting. The Committee recommends the Department to take immediate action to address the concerns.

iii. Insistence of Banks to take ECGC insurance policy mandatorily.

4.9 The Committee was informed by Pharmexcil that after the present episode of fraud/ misappropriation, ECGC has asked all the PSU banks to ascertain with their clients that in-case the exporters which have been / to be exported under DA/DP terms to take mandatory ECGC policy. It has been submitted by them that exporters of API used in Pharma Industry are working on thin margins of around 2% margin. The banks already seek collateral to tune of 50% to 150% on the credit extended. It was stated that imposition of compulsory export cover by ECGC in the absence of cheap credit instruments like LoU/ LoC shall prove onerous for the industry. **The Committee desires that insistence on ECGC cover in spite of heavy collateral taken by the banks may be revisited and necessary relief may be provided to the exporters.**

iv. Substantial delay in issue of e-BRCs leading to delay in export incentive realisation

4.10 This is a serious issue particularly in case of public sector banks where it is observed that the Committee was informed that after realisation of export proceeds, the public sector banks takes lot of time to close the invoice and issue e-

BRC. Many a time the delay is more than 12 months which in turn delays realisation of export incentives. It was submitted that in the normal course, after receipt of fund, the e-BRC should be issued in 3 to 4 days' time. However, it is observed that due to either shortage of staff and / or technical reasons, the issue of e-BRCs are held up. **The Committee recommends that the glitches being faced in issue of e-BRC may be addressed urgently.**

v. Credibility Report of international Suppliers

4.11 The Committee was informed that banks insist for credibility report of international suppliers before extending credit. It has been submitted that obtaining the credibility report of international suppliers is a major hindrance in the free flow of the business. Also, obtaining report seems impractical when the amount involved in the business is small. It takes a minimum of 5 to 7 days to obtain the credibility report and in a competitive environment it is difficult to retain supplier for such duration.

4.12 In view of the above, the Committee feels that there is a need to simplify the process of obtaining credibility report and reduce the amount of time involved in the process for better functioning of the business. Further, the need to call for credibility report of international supplier if shipment is not under advance payment basis may be revisited.

vi. Constraints for MSMEs under Prompt Corrective Action

4.13 The Committee observes that a set of rules have been put in place by the RBI under Prompt Corrective Action (PCA) framework to assess, monitor and take corrective action on banks which are weak and troubled. These are necessary steps to resolve the mounting NPAs and are primarily aimed at improving the overall health of the banking sector. In April 2017, Reserve Bank of India tightened the rules under the PCA framework and the revised framework came into effect on 1st April 2017. Subsequently, RBI has put 11 public sector banks under Prompt Corrective Action (PCA) which has significantly affected the lending process in these banks. The Committee notes that for industries, who were customers of these banks are now moving to new banks, and the process of moving is painful and time consuming. More importantly, since a significant part of the financing needs of MSME were serviced through the Public sector banks, MSME are caught in this churn and struggling to meet their financial needs. **The Committee is of the opinion that RBI may consider exempting bank credit to MSMEs from the purview of PCA restrictions. Similar arrangement for differential treatment for MSMEs has also been envisaged in the recent amendment of the Insolvency & Bankruptcy Code as the sector was put to disproportionate pressure.**

vii. Export Credit cover by Export Credit Guarantee Corporation (ECGC)

4.14 The issue of delays in deciding claims by ECGC has been flagged before the Committee. It has been stated that while the banks declare an account as NPA on the 90th day, the ECGC takes years to decide claims. It has been pointed that apart from delay, ECGC also dithers in paying claim. This approach is affecting the exporters, especially small exporters.

4.15 The Gems and Jewellery EPC have stated that exposure under Whole Turnover Policy (WTP) of the ECGC is no more available to their industry since 2014. It was submitted that there is a need to reinstate the same since premium of the individual policy is many times greater than WTP. Moreover the directive is unclear as to which party has to bear the premium for individual policy unlike WTP which clearly mentions that premium for pre-shipment is to borne by the customer and post shipment is to be borne by the banks.

4.16 The Committee appreciates the constraints of the ECGC which has stopped extending WTP to the Gems and Jewellery sector since claim to premium ratio of this sector is adverse. The Committee, nonetheless, notes that the banks seek higher collateral from the gems and jewellery sector which is predominantly comprises of SMEs since they are not getting cover from ECGC. In view of the hardships faced by the gems and jewellery sector which otherwise is one of the largest foreign exchange earners and employer, the Committee feels that the ECGC must find some way to reinstate WTP for this sector. The Committee learnt that the ECGC have proposed to the Government of India to extend cover for Gems, Jewellery and Diamond sector under NEIA Trust. The Committee recommends the Government to give sympathetic consideration to the proposal of the ECGC.

4.17 The Committee also notes that 294 claims of value of Rs.219 crores are pending with the ECGC. It recommends the ECGC to settle the claims expeditiously. Further, the ECGC must also frame timeline for settlement of claims. It must ensure that industry does not suffer on account of delays by the ECGC.

CONCLUSION

5.1 In the absence of deep domestic bond market, Indian industry is primarily dependent on bank credit for its financial needs. This dependence increases more for smaller enterprise as they are short on resources and expertise in tapping the alternative sources of funding such as equity issues, bond issuance and overseas borrowing. Thus, a robust banking sector is *sine qua non* for vibrant trade and industry. However, the banking sector has suffered a setback on account of frauds and misappropriation by some unscrupulous elements.

5.2 Misappropriation manifested in frauds and wilful defaults have a significant share in building up of the non-performing assets of the banks. The RBI has pushed for better prudence and regulations in the banking sector in view of the misappropriation committed on banks. **The Committee welcomes such interventions. However, it has been noticed that the prudence has often been interpreted as overwhelming caution by the banks and regulations sometimes borders on stifling of trade and industry.**

5.3 The Committee notes that RBI has responded to the banking misappropriation committed through fraud related to LoU at one branch of the Punjab National Bank by discontinuing the practice of issuance of Letters of Undertaking (LoUs) and Letters of Comfort (LoCs) for Trade Credits for imports into India. **The Committee is of the considered opinion that discontinuation of the practice of issuance of LoU/LoC for trade credit by the RBI was a knee-jerk reaction. The Committee feels that the RBI got unnerved with the PNB fraud and it hastened the decision to ban LoU/LoC without much thought and consideration. It is significant to note that none of the stakeholders representing trade and industry including banks with whom the Committee held deliberations have suggested that LOU/LoC was a flawed trade document. Everyone has been unanimous that LoU/LoC was a widely accepted bank instrument globally. Its efficacy as a source of cost-effective short term credit of foreign currency for importers was unmatched. Its preference by the foreign supplier in comparison to LC is also well-recorded. Moreover, RBI has itself promoted it after thorough verification more than a decade ago. The Committee notes that there is also a unanimity that the ban of LoU/LoC has resulted in rise in the cost of credit by 2 to 2^{1/2}%. This will certainly affect the cost competitiveness of country's trade and industry and have a cascading effect on jobs. The loss of jobs is something the country can ill-afford.**

5.4 **The Committee strongly feels that the RBI should have engaged more in consultations with stakeholders on the matter before resorting to discontinuation of LoU/LoC. It is of the considered opinion that LoU/LoC should be restored at the earliest albeit with proper safeguards. Its restoration assumes more significance in the face of the fact that the content of imports is over 20% of India's total exports. In present times when the currency is witnessing high depreciation, it is imperative that the cost of credit for imports must be minimal. The ban on LoU/LoC takes away the benefit of cheap source of funds availed by the importers. Costly imports shall lead to higher costs of production and erode the competitiveness of the domestically**

produced goods. The loss of competitiveness takes away the gains that might have accrued to export on account of rupee depreciation.

5.5 The Committee also feels that discontinuation of LoU/LoC as a response to the fraud and misappropriation has set in a contagion of conservatism in banking sector. The banks have become very stringent in their operation and credit exposures. The caution has inadvertently made banks becoming inaccessible to MSME sector. The Committee is concerned that such an approach has the dangers of making banking services elitist and subservient to a few large corporates leaving out the vast majority of MSME units which are not able to measure to the standards and parameters laid down by external credit rating agencies for getting 'AAA' or 'AA' ratings. The MSME units are getting burdened with high cost of loan which is further accompanied with the demand of unreasonably high collateral by the banks. The Committee is constrained to state that such an approach also crowds out innovative, high risk, growth segments, which is not good for the economy in the long run. It recommends the Government to set things right and take necessary measures in all earnest for the purpose.

RECOMMENDATIONS/ OBSERVATIONS - AT A GLANCE

DISCONTINUATION OF LETTERS OF UNDERTAKING/LETTERS OF COMFORT

- 1. The Committee expresses its deep concern on the present situation when the rupee is weak, the rise in spot demand will prove to be onerous on importers. It recommends that RBI may take measures to enter into bilateral currency swap agreements with major trade partners to meet spot demand and buy back exporters' receivables. This will enable the smooth currency movement in the market and further it will not impact the forex reserves. (Para 2.36)**
- 2. The Committee recommends that necessary interventions may be made to streamline and simplify the procedure in processing of LCs. The Committee also desires that maximum concessions may be offered on LC charges especially to MSMEs. (Para 2.37)**
- 3. The Committee welcomes that State Bank of India has developed a new reimbursement product with systemic and compensatory controls which is being extended presently to the AAA and AA rated large corporate customers and will gradually over a period of 6 months be extended to the SME borrowers as well. The Committee recommends that SBI must ensure that SME borrowers are not left out for want of desired credit ratings and hopes that other banks shall also come up products which can provide convenience similar to LoUs/LoCs. (Para 2.38)**
- 4. The Committee is not convinced with the justification proffered by the RBI for discontinuing issuance of LoUs/LoCs. The Committee notes that the RBI has stated that it was advised by FEDAI to discontinue LoUs/LoCs as there was neither a standard format for LoUs/LoCs nor a standard protocol like the one prescribed by the ICC in respect of LCs/Documentary Credit (viz., Uniform Customs and Practices for Documentary Credits). (Para 2.41)**
- 5. During its interaction with the representatives of both public and private sector banks, many of whom being FEDAI members, the Committee was told that LoUs/ LoCs has been an effective instrument for raising short term credit in foreign currency. All the banks, including FEDAI PSB members, have unanimously accepted that the LoUs/ LoCs were not flawed instruments. Instead, these were means of raising cheaper finance for trade. They informed that LoUs and LoCs**

which were made available were within the sanctioned LC limits of the various borrowers. These were unique to India though the same is not approved under the UCPDC. The fraud was localized to only one bank, one branch and was committed and perpetuated by one family. It is significant that the other bankers have not suffered any loss under the LOUs and LOCs issued by them. The Committee notes that in line with the RBI instructions most of the banks have reduced their exposures under the LOUs and LOCs by more than 75 per cent. (Para 2.42)

6. The Committee strongly feels that the RBI has perhaps not held enough consultations before deciding to discontinue issuance of LoU/ LoC. The Committee notes that the RBI has in a response to the comments sought by the Department of Financial Services about the impact of discontinuation of LoUs/ LoCs on credit cost for short term foreign currency loan has stated that there is no comparative reporting to RBI of quantum or cost of trade finance through LoUs/ LoCs *vis-à-vis* other available avenues of raising short-term foreign currency finance. If this be the case, then the Committee is constrained to say that the RBI should have done more scrutiny before proceeding with the decision to ban LoUs/ LoCs. The Committee is of the view that the discontinuation of issuance of LoUs/ LoCs is a knee-jerk reaction by the RBI to the recent frauds. It is a typical case of throwing baby along with the bath water and it must be stopped. The Committee, therefore, recommends that LoU/ LoC should be restored at the earliest albeit with proper safeguards. (Para 2.43)

BANKING MISAPPROPRIATION AND NON PERFORMING ASSETS (NPAs)

7. The Committee notes that bank finance is coming to the 'AAA' or 'AA' rated firms. The banks also extend concession to these firms. The Committee is of the view that introduction of credit rating system has deprived a large part of MSME sector from easy access to bank finance. Moreover, the credit rating agencies assess every firm with the same scale without taking into account the characteristic, nature and size of the unit. The Committee notes that instead of strengthening their internal risk appraisal mechanism, the banks have assigned their responsibility to third party agencies. The Committee is of the considered view that the banks must be alive to their responsibility. The prudence expected of the banks should not be used as an alibi to kill entrepreneurship. Moreover, the industry has already been reeling under the burden of high interest loan, drying up of finances on account

of failure to secure 'AAA' or 'AA' ratings will prove disastrous for trade and industry. The Committee recommends that due weightage to local vagaries specific to the industry must be taken into consideration by the credit rating agencies while awarding ratings to the firms. The Committee desires that SEBI must be engaged to take necessary action in this regard. Further, the banks must also strengthen their credit appraisal frameworks so that they can undertake in-house risk appraisals of a project in a professional manner. (Para 3.8)

8. The Committee finds the situation worrisome. Apart from the increase in the cost of credit, the trade and industry has also been burdened with the demand for higher collateral by the banks. The Committee strongly feels that such a situation will adversely impact the competitiveness of our trade and industry. While the industry world over are getting low interest loan, Indian trade and industry is saddled with expensive bank finance. This will result in lower revenue growth and lower profit margins. The Committee feels that meeting very high stringent and unrealistic requirement of collateral security will not be possible for many companies and may lead to diversion of funds to build collaterals. The Committee is of the considered opinion that margin and/or collateral requirements for issuance of LCs or Bank guarantees by the banks must be prescribed by the RBI, especially for MSME sector. The requirement of higher collaterals is a big hurdle for the industry. Higher margin money and collateral requirements are not the solution. It will be better if credit appraisal is based on track record of the exporter. Status Holder Certification of the DGFT and the credit covers taken by the exporters (such as, say, from ECGC) are also better ways to assess credit risk. (Para 3.9)
9. The Committee notes that though the bankers are insisting on ECGC policy, yet they are not reducing the value of the collateral. The Committee is of the view that the collateral requirement must be reduced in cases where the credit cover has been taken from ECGC. It desires that the Government must take necessary action in this regard as high collateral requirement stymie the expansion and growth of trade and industry. (Para 3.10)
10. The Committee recommends that such guideline must be reviewed on an urgent basis. This is entirely misleading in case of E&C companies, since over 75 per cent of their turnover comes from Government Contracts where payments are prone to delays. It is therefore

recommended that Governments honour the payment terms of contracts and ensure timely payments. (Para 3.11)

OTHER ISSUES

ii. Closure of open items under Export Data Processing Management System

11. The Committee understands that the banks are making best efforts to settle/ close the export accounts where export proceeds have been realized. However, there is likelihood that the timeline fixed for the purpose may not be adequate. The Committee recommends that the RBI take stock of the situation and extend the timeline beyond 30th September, 2018 if needed, so that the exporters are not put to any disadvantage. (Para 4.2)

12. The Committee recommends that Customs should bring about necessary modification in the Shipping bill so as to avoid such difficulty being faced by the exporters for their promotional supplies with no commercial value. (Para 4.3)

13. The Committee is also of the view that the banks should be empowered to take judicious decision and handle documents of their genuine client after due care and verification of pendency. The Committee also recommends that RBI must exempt those delay in payments which have arisen on account of non-availability of currency (US Dollar) in the importing countries while preparing the Caution List. There have been experiences when the exporters have failed to realise their exports from countries like Nigeria and Angola due to shortage of USD in those countries a few years ago. (Para 4.4)

ii Business with embargo countries

14. The Committee expresses its concern over the difficulties being faced by pharma exporters to embargo countries. It was informed that banks are bound by international agreements while dealing with such transactions. The Committee is of the view that there needs to be a clear policy for exports to sanctioned/ embargo countries. It is surprising that the exporters were never stopped while exporting to these countries nor were they advised to the contrary by any Public Notice or Circular, then why are the banks refusing to handle such transactions and issue eBRC. The Committee feels that there is big potential for Indian pharmaceutical industry to grow their business in embargo countries and therefore, banks should be given clear guideline to enable smooth handling of business with such countries. Further, the

refusal to handle export transaction carried through Iran to CIS countries is also disconcerting. The Committee recommends the Department to take immediate action to address the concerns. (Para 4.8)

iii. Insistence of Banks to take ECGC insurance policy mandatorily.

15. The Committee desires that insistence on ECGC cover in spite of heavy collateral taken by the banks may be revisited and necessary relief may be provided to the exporters. (Para 4.9)

iv. Substantial delay in issue of e-BRCs leading to delay in export incentive realisation

16. The Committee recommends that the glitches being faced in issue of e-BRC may be addressed urgently. (Para 4.10)

v. Credibility Report of international Suppliers

17. In view of the above, the Committee feels that there is a need to simplify the process of obtaining credibility report and reduce the amount of time involved in the process for better functioning of the business. Further, the need to call for credibility report of international supplier if shipment is not under advance payment basis may be revisited. (Para 4.12)

vi. Constraints for MSMEs under Prompt Corrective Action

18. The Committee is of the opinion that RBI may consider exempting bank credit to MSMEs from the purview of PCA restrictions. Similar arrangement for differential treatment for MSMEs has also been envisaged in the recent amendment of the Insolvency & Bankruptcy Code as the sector was put to disproportionate pressure. (Para 4.13)

vii. Export Credit cover by Export Credit Guarantee Corporation (ECGC)

19. The Committee appreciates the constraints of the ECGC which has stopped extending WTP to the Gems and Jewellery sector since claim to premium ratio of this sector is adverse. The Committee, nonetheless, notes that the banks seek higher collateral from the gems and jewellery sector which is predominantly comprises of SMEs since they are not getting cover from ECGC. In view of the hardships faced by the gems and jewellery sector which otherwise is one of the largest foreign exchange earners and employer, the Committee feels that the ECGC must find some way to reinstate WTP for this sector. The Committee learnt that the ECGC have proposed to the Government of India to

extend cover for Gems, Jewellery and Diamond sector under NEIA Trust. The Committee recommends the Government to give sympathetic consideration to the proposal of the ECGC. (Para 4.16)

20. The Committee also notes that 294 claims of value of Rs.219 crores are pending with the ECGC. It recommends the ECGC to settle the claims expeditiously. Further, the ECGC must also frame timeline for settlement of claims. It must ensure that industry does not suffer on account of delays by the ECGC. (Para 4.17)

CONCLUSION

21. The Committee welcomes such interventions. However, it has been noticed that the prudence has often been interpreted as overwhelming caution by the banks and regulations sometimes borders on stifling of trade and industry. (Para 5.2)
22. The Committee is of the considered opinion that discontinuation of the practice of issuance of LoU/LoC for trade credit by the RBI was a knee-jerk reaction. The Committee feels that the RBI got unnerved with the PNB fraud and it hastened the decision to ban LoU/LoC without much thought and consideration. It is significant to note that none of the stakeholders representing trade and industry including banks with whom the Committee held deliberations have suggested that LOU/LoC was a flawed trade document. Everyone has been unanimous that LoU/LoC was a widely accepted bank instrument globally. Its efficacy as a source of cost-effective short term credit of foreign currency for importers was unmatched. Its preference by the foreign supplier in comparison to LC is also well-recorded. Moreover, RBI has itself promoted it after thorough verification more than a decade ago. The Committee notes that there is also a unanimity that the ban of LoU/LoC has resulted in rise in the cost of credit by 2 to 2^{1/2}%. This will certainly affect the cost competitiveness of country's trade and industry and have a cascading effect on jobs. The loss of jobs is something the country can ill-afford. (Para 5.3)
23. The Committee strongly feels that the RBI should have engaged more in consultations with stakeholders on the matter before resorting to discontinuation of LoU/LoC. It is of the considered opinion that LoU/LoC should be restored at the earliest albeit with proper safeguards. Its restoration assumes more significance in the face of the fact that the content of imports is over 20% of India's total exports. In present times when the currency is witnessing high depreciation, it is

imperative that the cost of credit for imports must be minimal. The ban on LoU/LoC takes away the benefit of cheap source of funds availed by the importers. Costly imports shall lead to higher costs of production and erode the competitiveness of the domestically produced goods. The loss of competitiveness takes away the gains that might have accrued to export on account of rupee depreciation. (Para 5.4)

24. **The Committee also feels that discontinuation of LoU/LoC as a response to the fraud and misappropriation has set in a contagion of conservatism in banking sector. The banks have become very stringent in their operation and credit exposures. The caution has inadvertently made banks becoming inaccessible to MSME sector. The Committee is concerned that such an approach has the dangers of making banking services elitist and subservient to a few large corporates leaving out the vast majority of MSME units which are not able to measure to the standards and parameters laid down by external credit rating agencies for getting 'AAA' or 'AA' ratings. The MSME units are getting burdened with high cost of loan which is further accompanied with the demand of unreasonably high collateral by the banks. The Committee is constrained to state that such an approach also crowds out innovative, high risk, growth segments, which is not good for the economy in the long run. It recommends the Government to set things right and take necessary measures in all earnest for the purpose. (Para 5.5)**
