EXTRACT OF ADVANCES

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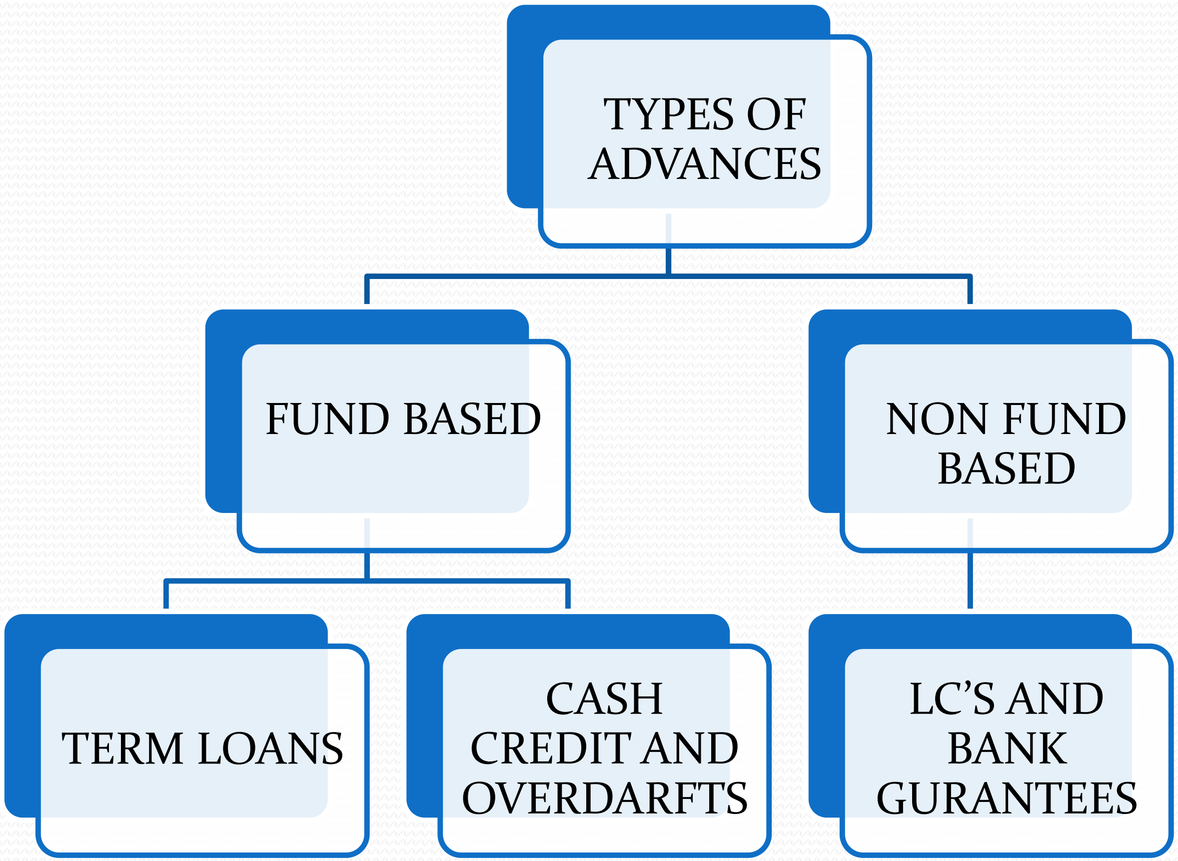
TYPES OF ADVANCES
FUND BASED
NON FUND BASED
TERM LOANS
CASH CREDIT AND OVERDARFTS
LC'S AND BANK GURANTEES

FUND BASED

- Cash credit facility is provided usually to entities(borrowers) engaged in manufacturing and / or trading activities to enable them to meet the gap in their working capital requirements.
- This facility is repayable on demand.
- The cash credit facility is generally granted against the security of stocks of goods (net of
- trade creditors), standing crops, bills / book debts representing genuine sales(restricted to pre-defined age of such book debts).

FUND BASED

- Cheque book is issued to the borrower for withdrawal of money against the limit sanctioned.
- The withdrawals are permitted within the drawing power balance available against facility amount approved. This is a revolving facility and is, generally, reviewed and renewed annually.

FUND BASED

- The cash credit advances are generally on 'floating' interest rate basis.
- The rate is reset periodically, depending upon any changes in the bank's base rate (MCLR – Marginal Cost of fund based Lending Rate) / spread in relation to the class of borrower / risk perception about the borrower.

MCLR

- **MCLR** is the new benchmark lending rate at which banks will now lend to new borrowers. Till 31 March 2016, banks used the base rate as the benchmark rate to lend. **MCLR** is built on four components—marginal cost of funds, negative carry on account of cash reserve ratio (CRR), operating costs and tenor premium.

MCLR

- MCLR is built on four components:
- **Marginal Cost of Funds** is the marginal cost of borrowing and return on net worth for banks.
- Negative Carry on account of Cash Reserve Ratio(CRR)
- **Operating Cost** include cost of providing the loan product including the cost of raising funds by the bank.
- **Tenor Premium** due to long term loan commitments

MARGINAL COST OF FUNDS

- **Marginal cost of funds**
- It depends on 3 factors
- **I: Interest given by banks to its customers**
- **2: REPO rate decided by RBI**
- **3: Return on capital invested**
- Weights are assigned in a ratio of 92:8 that is first two as a combination will hold a weight of 92 with the 3rd one.
- So basically it is the cost incurred by bank in order to arrange fund.
- And banks arrange funds from 3 sources. One is from RBI through REPO. second is from public as deposits and third is from the returns of investment made.

- For example I am depositing 100 rupees with bank in my savings account. And bank have to give me at 4% per annum. Like that banks will give certain interest to its fixed, recurring and bulk account holder like 7%,8%,10% And for current account there is no interest. So cost of fund average of all interests. That is total interest given by total fund deposited expressed in percentage.
- Like wise banks are paying interest to RBI for funds under REPO. And same for investment made.

Negative carry on account of CRR.

- There is a long debate going over CRR because banks terms this as the biggest Non performing asset(NPA) which yields nothing. Where SLR does yield at least the minimum. So the term negative carry on account of CRR arised
- There are certain technicalities while deriving that rate and on the explanation of why this is negative. In simple words when a depositer deposits 100 rupees bank gives him 4% on 100 rupees. But bank gets nothing on CRR which is 4% and gets very less percentage on SLR which is 21.5% l. That means banks are at a loss on 25.5% of the amount deposited. So while leading they have to recover that much. So this term is included

Operating cost

- This is the cost incurred by bank in order to perform day to day operations.

Tenure of loan:

- RBI have asked banks to derive 5 lending rates that is on overnight basis, one day basis, one month, six month and one year
- This is because RBI wants the real cost to arrange fund for 1 year must be included while giving loan for 1 year. For example If a person is taking loan in February for one year term then he will pay little more interest than the interest rate what banks pays to a depositor in February. Not before and not after.
- And MCLR will be revised in monthly basis as a result true cost to banks to arrange funds will be reflected.
- How a borrower are going to affected ?
- The impact will be on home loan borrowers mostly. Because they will be on floating rate of interest regime where they will have a new interest every year. Once someone avail a home loan then he will be sticking to that rate for a year until new MCLR takes over. In case new MCLR becomes less than the previous one than then the borrower will have to pay for less tenure say 14 years instead of 15 years. Because in EMI system one have to pay exactly same amount. As servicing amount can't be reduced then tenure will be reduced.

Term Loans

- Term loans are repayable in installments spread over a period of time
- excluding the moratorium period, if granted. The moratorium period is
- assessed by the lender based on future cash flows and requirements of borrower.
- The interest rate for loans may be either on ‘fixed’ terms’ in which
- event the rate contracted originally holds good during the entire currency of the
- loan, or it may be on ‘variable’ terms

TERM LOANS

The term loans are generally extended for the following purposes:

- For setting up of plants, acquisition of fixed assets like land and building, plant and machinery, furniture, vehicles, implements, houses, consumer durables, etc.
- For meeting expenses on education / medical treatment of self/dependants.
- For meeting other personal expenses.
- For meeting deficit in the net working capital requirements as assessed by the bank.(WCTL)
- For Marketing / Launching / Branding etc.

Foreign Currency Loans

- Banks are authorized to lend in foreign currency. These loans are
- sanctioned as per the EXIM Policy and guidelines issued by Reserve Bank of India from time to time. Foreign Currency Loans may be in nature of Term
- loans or Working Capital loans.

Overdrafts

- The overdraft facility may be either secured or clean (i.e., without security) and does not generally carry a fix repayment schedule.
- The most common form of security for an overdraft arrangement is term deposit receipts.
- In such cases, care is taken to ensure that lien marking is done in the system and also on physical fixed deposit receipt (and not on fixed deposit advice).
- Overdrafts may also be granted against other securities like immovable properties, life insurance policies, shares, bonds, NSCs, Kisan Vikas Patra, Indira Vikas Patra, etc.

LETTER OF CREDIT

- An LC is a promise by a financial institution to honor the financial obligations of the buyer due to the risk of the buyers failure to pay the seller. It is often used in a transaction to mitigate the risk of not being paid post-delivery of the products. An LC is issued to the buyer after carrying out the necessary due diligence and collecting sufficient collateral. The letter is then presented to the seller as a proof of the buyer’s credit quality.

BANK GUARANTEES

- Financial institutions issue bank guarantees to assist in facilitating transactions and these products help companies to mitigate credit risks that may arise. The agreed amount is referred to as the guaranteed amount. Bank guarantees play a vital role in the **forfaiting** market and also in high value transactions. A bank guarantee is issued to the applicant for carrying out a transaction after necessary due diligence and is always given in favour of a **beneficiary** who would be affected in a case where the applicant fails to honour obligations.

TYPES OF LC AND GUARANTEES

- As tailored financial instruments, bank guarantees come in different forms such as an Advance Payment Guarantee, Loan Guarantee, Performance Guarantee, Deferred payment Guarantee, Shipping Guarantee and Trade Credit Guarantee. Similarly, Lending institutions issue LCs in forms such as Import LCs, Export LCs, Revocable LCs, Irrevocable LCs, Confirmed LCs and Unconfirmed LCs.

OTHER ADVANCES

- EXPORT CREDIT
- IMPORT TRADE CREDIT

EXPORT CREDIT

- Exporters are granted facilities in the form of cash credit and bills only but, being of a special nature, require a separate mention here.
- These facilities extended to exporters are in the form of ‘pre-shipment credit’ and ‘post shipment credit’.
- All type of advances sanctioned to finance the production cycle – i.e. from procurement of raw materials to bringing them to the port for dispatch fall under ‘pre-shipment credit’ category.
- It also includes financing of working capital expenses towards rendering of services.
- The advance is given either on the basis of individual order obtained, or the customer is sanctioned

  an export packing credit (EPC) limit and the advances are disbursed on production of individual orders; in the latter case, EPC becomes a running account.
- The exporter usually adjusts the account by drawing bills of exchange on the foreign buyer, which are discounted by the bank under the letter of credit and the proceeds collected from the foreign bank.
- The post-shipment credit relates to financing of bills raised on the overseas buyer upon shipment of goods/ services.

Continued

- Another feature of export credit is that the advance may be granted in Indian Rupees or a designated foreign currency.
- In the latter case, the loan is disbursed in a foreign currency but, for the purpose of accounting,
- converted into rupees.
- The export credit is granted at concessional rates of interest.
- The pre-shipment credit has to be liquidated out of the export proceeds only and cannot be adjusted out of rupee funds (except where the raw materials required for processing exceed the FOB value of the contract, in which the excess advance has to be repaid within a maximum of 30 days from the date of advance).
- The export proceeds have normally to be received within 9 months from the date of shipment.
- The period can be extended in genuine cases, with the approval of the bank (within the discretion available to it under the regulations in force at the relevant time) or of the RBI, as permitted by the Exchange Control Manual and the operating instructions issued by the Reserve Bank from time to time.
- The bills representing the export proceeds can be handled only by branches permitted to act as authorized foreign exchange dealers as they involve handling transactions in a foreign currency and reporting to Reserve Bank.

Pre-shipment credit

- Pre-shipment credit granted in a foreign currency is called ‘Packing Credit in Foreign Currency’ (PCFC) advance and has to be repaid out of the export bills discounted under the Export Bills Rediscounting (EBR) scheme or out of export proceeds.
- Each bank designates a few select branches to handle PCFC and EBR transactions.
- The Rupee Export credit is also allowed to be shared between export order holders and manufacturer of the goods to be exported.
- Similarly, bank may extend PCFC also to the manufacturer on the basis of disclaimer from the export order holder through his bank.
- PCFC granted to the manufacturer can be repaid by transfer of foreign currency from the export order holder by availing of PCFC or by discounting of bills.
- It should be ensured that no double financing is involved in the transaction and total period of packing credit is limited to the actual cycle of production of theexported goods.

Import
Trade Credit – Buyer's Credit

- In Indian context, this facility is provided by overseas banks / foreign branches of Indian banks to the importers of capital goods and raw material through Indian Banks to its customers (importers) towards payment of imports in India.
- The overseas bank either

  (i) credits the amount of Buyer's credit in theNOSTRO account of the Indian bank and the Indian bank remits the funds to theoverseas supplier of the importer for payment of import bill or

  (ii) remits the funds to the overseas supplier of the importer for payment of import bill of the importer.

FLOW OF TRANSACTIONS OF BUYER'S CREDIT

The typical flow of transaction of Buyer's Credit (with underlying import through LC transaction) is as follows:

1) The borrower imports goods from foreign supplier against Foreign Letter of Credit (FLC) drawn in favor of foreign supplier;

2) The borrower either through its Indian bank or on its own approaches foreign

bank (or overseas / foreign branches / offices of Indian banks) for availing Buyer's Credit for payment to be made to the foreign supplier;

3) The Letter of Comfort is issued by Indian bank to the foreign bank on approval of terms and conditions through SWIFT message for the proposed Buyers Credit;

4) The foreign Bank remits funds to the NOSTRO Account of Indian bank which is handling import transaction, on the strength of the Letter of Comfort (LoC)/ Letter of Undertaking (LoU) which is issued by the Indian bank in its favor;

5) The Indian bank remits the funds to foreign supplier through its NOSTRO Accounts.

FLOW CONTINUED

6) The Indian bank subsequently retires and reverses the Letter of Credit in its book and passes another entry for creation of a non-fund based (contingent) liability of Letter of Comfort;

7) On the due date of Buyer's Credit, the Indian bank remits the funds (inclusive of interest) to the overseas bank and recovers the similar amount from its customer;

8) With respect to liability towards Letter of Comfort, the Indian banks accounts for the same as a "Contingent Liability".

- The entries of the inward and outward remittances (specified in steps 3 and 4) are to be recorded in the books of accounts (NOSTRO Mirror Account) of the Indian bank.

Following documents are required to be verified by the statutory auditors during review of Buyers' Credit Transaction and its accounting treatment in the Indian Bank's books.

1) (Loan) Agreement, if any, entered between the Indian importer (borrower),overseas bank (lender), the Indian bank (facilitator);

2) SWIFT messages originated by overseas bank specifying the terms of Buyer's Credit;

3) The calculation of contingent liability towards LoC/ LoU is inclusive of interest accrued on the Buyer's Credit as on financial statement date;

4) Documentation / Agreement between overseas bank and Indian bank, and, any further confirmatory documents exchanged between overseas bank and Indian bank;

5) Review of documents specifying right of recovery against borrower, in case if the borrower defaults in repayment of Buyer's Credit;

6) Balance confirmations obtained from the overseas bank;

7) Charge created in records of RoC related to the security offered for Buyer's Credit vis-à-vis disclosure of Buyer's Credit in the financials of borrowers as secured / unsecured loan;

8) Acknowledgement of debt, if any, obtained from the borrower;

9) The calculation of drawing power for working capital finance availed by the borrower is net of the Buyer's Credit;

10) Form 15CA / Form 15CB compliance made by the borrower.

THANK YOU