



Bank Financial Management – CAIIB

– New Syllabus- Important Points

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Bank FINANCIAL Management

MODULE – A

INTERNATIONAL BANKING:

UNIT – 1: EXCHANGE RATES AND FOREX BUSINESS

1. Foreign Exchange: Conversion of currencies from the currency of invoice to the home currency of the exporters is called as **Foreign Exchange**.
2. Foreign Exchange Management Act (**FEMA**), 1999 defines Foreign Exchange as
 - “ All deposits, credits and balances payable in foreign currency and any drafts, traveler’s Cheques, LCs and Bills of Exchange, expressed or drawn in Indian Currency and payable in any foreign currency.”
 - Any instrument payable at the option of the drawee or holder, thereof or any other party thereto, either in Indian Currency or in foreign currency, or partly in one and partly in the other.
3. A **Foreign Exchange transaction** is a contract to exchange funds in one currency for funds in another currency at an agreed rate and arranged basis.
4. **Exchange Rate** means the price or the ratio or the value at which one currency is exchanged for another currency.
5. **Foreign Exchange markets participants** are
 - Central Banks
 - Commercial Banks
 - Investment Funds/Banks
 - Forex Brokers
 - Corporations
 - Individuals
6. The Forex Markets are highly dynamic, that on an average the exchange rates of major currencies fluctuate **every 4 Seconds**, which effectively means it registers **21,600 changes** in a day (15X60X24)
7. Forex markets usually operate from **“Monday to Friday”** globally, except for the Middle East or other Islamic Countries which function on Saturday and Sunday with restrictions, to cater to the local needs, but are closed on Friday.
8. The bulk of the Forex markets are **OTC (Over the Counter)**.
9. Factors Determining Exchange Rates:
 - a) **Fundamental Reasons**
 - Balance of Payment
 - Economic Growth rate
 - Fiscal policy
 - Monetary Policy

- Interest Rates
- Political Issues

b) Technical Reasons

- Government Control can lead to unrealistic value.
- Free flow of Capital from lower interest rate to higher interest rates

c) Speculative - higher the speculation higher the volatility in rates

- Due to vastness of the market, operating in different time zones, most of the Forex deals in general are done on **SPOT basis**.
- The delivery of **FX deals can be settled** in one or more of the following ways:
 - Ready or Cash
 - TOM
 - Spot
 - Forward
 - Spot and Forward
- Ready or Cash**: Settlement of funds takes place on the same day (date of Deal)
- TOM**: Settlement of funds takes place on the next working day of the deal. If the settlement day is holiday in any of the 2 countries, the settlement date will be next working day in both the countries.
- Spot**: Settlement of funds takes place on the second working day after/following the date of Contract/deal. If the settlement day is holiday in any of the 2 countries, the settlement date will be next working day in both the countries.
- Forward**: Delivery of funds takes place on any day after SPOT date.
- Spot and Forward Rates**: On the other hand, when the delivery of the currencies is to take place at a date beyond the Spot date, it is Forward Transaction and rate applied is called Forward Rate.
- Forward Rates are **derived from Spot Rates** and are function of the spot rates and forward premium or discount of the currency, being quoted.
- Forward Rate = **Spot Rte + Premium or – Discount**
- If the value of the currency is more than being quoted for Spot, then it is said to be **at a premium**.
- If the currency is cheaper at a later date than Spot, then it is called **at a Discount**.
- The forward premium and discount are generally based on the **interest rate differentials** of the two currencies involved.
- In a perfect market, with no restriction on finance and trade, the **interest factor** is the basic factor in arriving at the forward rate.
- The Forward price of a currency against another can be worked out with the following **factors**:
 - Spot price of the currencies involved
 - The Interest rate differentials for the currencies.
 - The term i.e. the future period for which the price is worked out.

24. The price of currency can be expressed in two ways i.e. **Direct Quote, Indirect Quote.**
25. Under **Direct Quote, the local currency is variable** E.g.: 1 USD = ` 48.10
26. Direct Quote rates are also called **Home Currency or Price Quotations.**
27. Under **indirect Quote, the local currency remains fixed**, while the number of units of foreign currency varies. E.g. ` 100 = 2.05 USD
28. Globally all currencies (Except a few) are quoted **as Direct Quotes**, in terms of USD = So many units of another currency)
29. Only in case of **GBP (Great Britain Pound) £, €, AU\$ and NZ\$, the currencies are quoted as indirect rates.**
30. Japanese Yen being quoted **per 100 Units.**
(To type GBP symbol £ in key board :

Pressing and holding the ALT with the left hand while a short code 1, 5, 6 is typed in on the keypad with the right hand. The ALT key is then released and the £ symbol appears.

To type Euro symbol in Key board:

Pressing and holding the ALT with the left hand while a short code 0,1,2,8 is typed in on the keypad with the right hand. The ALT key is then released and the € symbol appears.)

31. **Cross Currency Rates:** When dealing in a market where rates for a particular currency pair are not directly available, the price for the said currency pair is then obtained indirectly with the help of Cross rate mechanism.
32. **How to calculate Cross Rate?:**

The math is simple algebra: $[a/b] \times [b/c] = a/c$

Substitute currency pairs for the fractions shown above, and you get, for instance, GBP/AUD x AUD/JPY = GBP/JPY.

This is the **implied** (or theoretical) value of the GBP/JPY, based on the value of the other two pairs. The actual value of the GBP/JPY will vary around this implied value, as the following calculation shows.

Here are Friday's actual closing BID prices for the 3 currency pairs in this example (taken from FXCM's Trading Station platform): GBP/AUD = 1.73449, AUD/JPY = 0.85535 and GBP/JPY = **1.48417**. Now, let's do the math:

GBP/AUD x AUD/JPY = GBP/JPY

1.73449 x 0.85535 = **1.4836**, which is not exactly the same as the actual market price

Here's why. During market hours (Sunday afternoon to Friday afternoon, EST), all prices are LIVE, and small departures from the mathematical relationships can exist momentarily.

33. **Fixed Vs Floating Rates:**

- The fixed exchange rate is the official rate set by the monetary authorities for one or more currencies. It is usually pegged to one or more currencies.
- Under floating exchange rate, the value of the currency is decided by supply and demand factors for a particular currency.

34. Since **1973**, the world economies have adopted **floating exchange** rate system.

35. India switched to a **floating exchange rate regime** in **1993**.

36. **Bid & Offered Rates:** The buying rates and selling rates are referred to as Bid & Offered rate.

37. **Exchange Arithmetic** – Theoretical Overview:

- **Chain Rule:** It is used in attaining a comparison or ratio between two quantities linked together through another or other quantities and consists of a series of equations.
- **Per Cent or Per mille:** A percentage (%) is a proportion per hundred. Per Mille means per thousand.

38. **Value Date:** The date on which a payment of funds or an entry to an account becomes actually effective and/or subjected to interest, if any. In the case of TT, the value date is usually the same in both centers.

39. The payments made in same day, so that no gain or loss of interest accrues to either party is called as **Valuer Compense**, or simply here and there.

40. **Arbitrage in Exchange:** Arbitrage consist in the simultaneous buying and selling of a commodity in two or more markets to take advantage of temporary discrepancies in prices.

41. A transaction conducted between two centers only is known as **simple or direct arbitrage**.

42. Where additional centers are involved, the operation is known as **compound or Three (or more) point arbitrage**.

43. Forex Operations are divided into 3:

- 1) Forex Dealer
- 2) Back Office
- 3) Mid Office

44. The **Forex dealing room** operation functions:

- a service branch to meet the requirement of customers of other branches/divisions to buy or sell foreign currency,
- Manage foreign currency assets and liabilities,
- Fund and manger Nostro Accounts as also undertake proprietary trading in currencies.
- It is a separate profit center for the Bank/FI

45. A Forex Dealer has to maintain two positions – **Funds position and Currency Position**

46. Funds position reflects the **inflow and out flow of funds**.

47. Back office takes care of processing of **Deals, Account, reconciliation etc.** It has both a **supportive as well as a checking role over the dealers**.

48. Mid Office deals with **risk management and parameterization of risks for forex dealing operations**. Mid Office is also supposed to look after the compliance of various guidelines/instructions and is an independent function.
49. The major **risks associated with the dealing operations** are :
- Operational Risk
 - Exchange Risk
 - Credit Risk
 - Settlement Risk
 - Liquidity Risk
 - Gap Risk/ Interest/ Rate Risk
 - Market Risk
 - Legal Risk
 - Systemic Risk
 - Country Risk
 - Sovereign Risk
50. The **Operation Risk** is arising on account of human errors, technical faults, infrastructure breakdown, faulty systems and procedures or lack of internal controls.
51. The **Exchange Risk** is the most common and obvious risk in foreign exchange dealing operations and arise mainly on account of fluctuations in exchange rates and/ or when mismatches occur in assets/ liabilities and receivables/ payables.
52. **Credit risk** arises due to inability or unwillingness of the counterpart to meet the obligations at maturity of the underlying transactions.
53. Credit Risk is classified into
- **Pre- Settlement Risk**
 - **Settlement Risk**
54. **Pre Settlement Risk** is the risk of failure of the counter party before maturity of the contract thereby exposing the other party to cover the transaction at the ongoing market rates.
55. **Settlement Risk** is Failure of the counter party during the course of settlement, due to the time zone differences, between the two currencies to be exchanged.
56. **Liquidity Risk** is the potential for liabilities to drain from the bank at a faster rate than assets. The mismatches in the maturity patterns of assets and liabilities give rise to liquidity risk.
57. **Gap Risk/ Interest Rate Risk** are the risk arising out of adverse movements in implied interest rates or actual interest rate differentials.
58. **Market Risk**: This is arises out of adverse movement of market variables when the players are unable to exit the positions quickly.
59. **Legal Risk** is arising on account of non-enforceability of contract against a counter party.
60. **Systemic Risk** is the possibility of a major bank failing and the resultant losses to counter parties reverberating into a banking crisis.

61. **Country Risk** is risk of counter party situated in a different country unable to perform its part of the contractual obligations despite its willingness to do so due to local government regularizations or political or economic instability in that country.
62. **Sovereign Risk** is over all country risk
63. **RBI** has prescribed guidelines for authorized dealers, permitted by it, to deal in foreign exchange and handle foreign currency transactions.
64. **FEMA 1999** also prescribes rules for persons, corporate etc in handling foreign currencies, as also transactions denominated therein.
65. The **RBI** is issued **licenses** to Authorized Dealers to undertake foreign exchange transactions in India.
66. The RBI has also issued **Money Changer License** to a large number of established firms, companies, hotels, shops etc. to deal in foreign currency notes, coins and TCs
67. **Full Fledged Money Changers (FFMC)** : Entities authorized to buy and sell foreign currency notes, coins and TCs
68. **Restricted Money Changers (RMCs)**: Entities authorized to buy foreign currency.
69. Categories of Authorized Dealers; in the year 2005, the categorization of dealers authorized to deal in foreign exchange has been changed.

Category	Entities	No. of Entities as on 31/08/2010
AD – Category I	Banks, FIs and other entities allowed to handle all types of Forex	87
AD – Category II	Money Changers (FFMCs)	39
AD- Category III	Money Changers (RMCs)	07

70. **Foreign Exchange Dealers Association of India, FEDAI (ESTD 1958)** prescribes guidelines and rules of the game for market operations, merchant rates, quotations, delivery dates, holiday, interest on defaults , Handling of export – Import Bills, Transit period, crystallization of Bills and other related issues.
71. Export bills drawn in foreign currency, purchased/ Discounted/ negotiated, must be crystallized into rupee liability. The same would be done at **TT selling rate**.
72. The crystallization period can vary from Bank to bank, (For Export Bills Generally on **the 30th Day**) customers to customer but **cannot exceed 60 days**.
73. Sight Bills drawn under ILC would be crystallized on the **10th day after the due date of receipt** if not yet paid.
74. All forward contracts must be for a **definite amount with specified delivery dates**.
75. All contracts, which have matured and have not been picked up, shall be automatically cancelled on the **7th working day, after the maturity date**.
76. All cancellations shall be at **Bank's opposite TT rates. TT Selling = purchase contracts; TT buying = Sale contracts**.
77. All currencies to be quoted per unit Foreign **Currency = `**, JPY, Indonesian Rupiah, Kenyan Schilling quoted as **100 Units of Foreign currency = `**.

UNIT –2: Basics of Forex Derivates

1. **Derivatives** are the instruments to the exposure for neutralize or alter to acceptable levels, the uncertainty profile of the exposure. E.g: Forward contracts, options, swaps, forward rate agreements and futures.
2. A **risk** can be defined as an unplanned event with financial consequences resulting in loss or reduced earnings.
3. Some of the very **common risks** faced in forex operations
 - i. Exchange Risk
 - ii. Settlement Risk/ Temporal Risk/ Herstatt Risk (Named after the 1974 failure of the Bankhaus Herstatt in Germany)
 - iii. Liquidity Risk
 - iv. Country Risk
 - v. Sovereign risk
 - vi. Interest Rate Risk
 - vii. Operational Risk
4. Movement in exchange rates may result in **loss** for the dealer's **open position**.
5. In case of **excess of assets over the liabilities**, the dealer will have **long position**
6. **Country risk** is a **dynamic risk** and can be **controlled by fixing country limit**.
7. Sovereign risk can be managed by suitable disclaimer clauses in the documentation and also by subjecting such sovereign entities to third jurisdiction.
8. Operational risk can be controlled by putting in place state of art system, specified contingencies.
9. RBI has issued Internal Control Guidelines (ICG) for Foreign Exchange Business.
10. Various Dealing Limits are as follows:
 - a. **Overnight Limit**: Maximum amount of open position or exposure, a bank can keep overnight, when markets in its time zone are closed.
 - b. **Daylight Limit**: Maximum amount of open position or exposure, the bank can expose itself at any time during the day, to meet customers' needs or for its trading operations
 - c. **Gap Limits**: Maximum inter period/month exposures which a bank can keep, are called gap limits
 - d. **Counter Party Limit**: Maximum amount that a bank can expose itself to a particular counter party.
 - e. **Country Risk**: Maximum exposure on a single country
 - f. **Dealer Limits**: Maximum amount a dealer can keep exposure during the operating hours.
 - g. **Stop-Loss Limit**: Maximum movement of rate against the position held, so as to trigger the limit or say maximum loss limit for adverse movement of rates.

- h. **Settlement Loss Limit:** Maximum amount of exposure to any entity, maturing on a single day.
 - i. **Deal Size Limit:** Highest amount for which a deal can be entered. The limits are fixed to restrict the operational risk on large deals.
11. **CCIL** (Clearing Corporation of India Ltd) **takes over the Settlement Risk**, for which it creates a large pool of resources, called settlement Guarantee Fund, which is used to cover outstanding of any participant.
 12. **The Clearing Corporation of India Ltd. (CCIL) was set up in April, 2001** for providing exclusive clearing and settlement for transactions in Money, GSecs and Foreign Exchange.

February 15, 2002	Negotiated Dealing System (NDS)
November 2002	settlement of Forex transactions
January 2003	Collateralized Borrowing and Lending Obligation (CBLO), a money market product based on Gilts as collaterals
August 7, 2003.	Forex trading platform "FX-CLEAR"
April 6, 2005.	settlement of cross-currency deals through the CLS Bank

13. **Six 'core promoters' for CCIL** - State Bank of India (SBI), Industrial Development Bank of India (IDBI), ICICI Ltd., LIC (Life Insurance Corporation of India), Bank of Baroda, and HDFC Bank.

Derivatives:

14. A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage.
15. **In early 1970s, the Chicago Mercantile Exchange introduced** world's first Exchange traded currency future contract.

UNIT 3 – Correspondent Banking and NRI Accounts

1. **Corresponding Banking** is the relationship between two banks which have mutual accounts with each other, r one of them having account with the other.
2. **Functions** of Corresponding Banks:
 - A. Account Services
 - i. Clearing House Functions
 - ii. Collections
 - iii. Payments
 - iv. Overdraft and loan facility
 - v. Investment Services
 - B. Other Services
 - i. Letter of Credit Advising
 - ii. LC confirmation
 - iii. Bankers Acceptance
 - iv. Issuance of Guarantees – Bid-bond, Performance
 - v. Foreign Exchange services, including derivative products
 - vi. Custodial Services etc.
3. **Types of Bank Accounts:** The foreign account maintained by a Bank, with another bank is classified as Nostro, Vostro, and Loro Accounts.
4. **Nostro Account:** “Our Account with you”. DLB maintains an US \$ account with Bank of Wachovia, New York is Nostro Account in the books of DLB, Mumbai.
5. **Vostro Account:** “Your account with us”. Say American Express Bank maintain a Indian Rupee account with SBI is Vostro Account in the books of American Express bank
6. **Loro Account:** It refers to accounts of other banks i.e. His account with them. E.g. Citi Bank referring to Rupee account of American Express Bank, with SBI Mumbai or some other bank referring to the USD account of SBI, Mumbai with Citi Bank, New York.
7. **Mirror Account:** While a Bank maintains Nostro Account with a foreign Bank, (Mostly in foreign currency), it has to keep an account of the same in its books. The mirror account is maintained in two currencies, one in foreign currency and one in Home currency.
8. **Electronic Modes of transmission/ payment gateways**

SWIFT, CHIPS, CHAPPS, RTGS, NEFT
9. **SWIFT:** Society for Worldwide Interbank Financial Telecommunications. There are 8300 Member FIs spread over 209 countries.
10. **SWIFT** has introduced new system of authentication of messages between banks by use of Relationship Management Application (RMA) also called as **SWIFT BIC i.e. Bank Identification Code.**

11. **CHIPS: (Clearing House Interbank Payment System)** is a major payment system in USA since 1970. It is established by New York Clearing House. Present membership is 48. CHIPS are operative only in New York.
12. **FEDWIRE:** This is payment system of Federal Reserve Bank, operated all over the US since 1918. Used for domestic payments.
13. All US banks maintain accounts with **Federal Reserve Bank** and are allotted an **“ABA number”** to identify senders and receivers of payment

What Does ABA Transit Number Mean?

A unique number assigned by the American Bankers Association (ABA) that identifies a specific federal or state chartered bank or savings institution. In order to qualify for an ABA transit number, the financial institution must be eligible to hold an account at a Federal Reserve Bank. ABA transit numbers are also known as ABA routing numbers, and are used to identify which bank will facilitate the payment of the check.

14. **CHAPS:** Clearing House Automated Payments system is British Equivalent to CHIPS, handling receipts and payments in LONDON
15. **TARGET:** Trans-European Automated Real Time Gross Settlement Express Transfer System is a EURO payment system working in Europe. And facilitates fund transfers in Euro Zone.
16. **RTGS + and EBA:** RTGS+ is Euro German Based hybrid Clearing System. RTGS+ has 60 participants.
17. **EBA-Euro 1** is a cross Border Euro Payments
18. **RTGS/NEFT in India:** The RTGS system is managed by IDRBT- Hyderabad. Real Time Gross Settlement takes place in RTGS. NEFT settlement takes place in batches.
19. **NRI: (Non- resident Indian) definition: As per FEMA 1999**
A person resident outside India who is a citizen of India i.e.
 - a) Indian Citizen who proceed abroad for employment or for carrying on any business or vocation or for any other purpose in circumstances indicating indefinite period of stay outside India.
 - b) Indian Citizens working abroad on assignment with Foreign government, government agencies or International MNC
 - c) Officials of Central and State Governments and Public Sector Undertaking deputed abroad on assignments with Foreign Govt Agencies/ organization or posted to their own offices including Indian Diplomatic Missions abroad.
20. **NRI** is a Person of Indian **Nationality or Origin**, who resides abroad for business or vocation or employment, or intention of employment or vocation, and the period of stay abroad is indefinite. And a person is of Indian origin if he has held an Indian passport, or he/she or any of his/hers parents or grandparents was a citizen of India.
21. **A spouse , who is a foreign citizen**, of an India citizen or PIO, is also treated **at a PIO**, for the purpose of opening of Bank Account, and other facilities granted for investments into India, provided such accounts or investments are in the joint names of spouse.
22. NRE Accounts – Rupee and Foreign Currency Accounts

23. NRI has provided with various schemes to open Bank A/cs an invest in India.

1) Non Resident (External) Rupee Account (NRE); 2.) Non- Resident (Ordinary) Rupee Account (NRO); 3).Foreign Currency (Non-Resident) Account (Banks) {FCNR(B)}

Salient features of NRE (Rupee), NRO (Rupee), and FCNR (B) A/cs:-

	NRE	NRO	FCNR (B)
Opened and Maintained personally by NRI remittance from abroad by way of TT, Cheques, drafts or trf from another Non Resident account	✓	✓	✓ (In Designated Currencies US\$,€,CA\$,AU\$,£)
Tendering FC/TC or Notes by the NRI during his temporary visit to India	✓	X	X
Opened and maintained by Foreign Tourists	X	✓	X
Rupee Account	✓	✓	X (Forex A/c)
SB/CA/RD/TD with a minimum period of 1 year	✓	✓	✓ (Only TD >=12 m<=60m)
Joint Accounts in the name of 2 or more NRI, PIO	✓	✓	✓
Joint account with a person resident in India	X	✓	X
Lien permission in Balances in SB	X		
TDS is applicable	X	✓	X
POA in India can open a/c, make gift, transfer funds to another NRE Account or remit abroad *	X	✓	X
POA in India can maintain the a/c	✓	✓	X
Principal and Interest - both Fully Repatriable.	✓		✓
Nomination Permissible	✓	✓	✓
Permitted Credits	Remittance to India in any permitted Currency	✓	✓
	Personal Cheques drawn on foreign Currency account of the account holder	✓	✓
	TC & DD in any permitted currency	✓	✓

	FC/Bank Notes tendered during his temporary visit to India.	✓	✓	✓
	Trf from any other NRE/FCNR(B) a/cs	✓	✓ (TRF from other Rupee Accounts of NRI)	✓
	Any other credit if covered under General permission or specific permission from RBI	✓	✓	✓
	Legitimate Dues in India of the A/c Holder (Rent, Interest, Dividend, Maturity proceeds of Units of UTI,LIC etc)	X	✓	X
Permitted Debits	Local Disbursements/Payments	✓	✓ (In Indian Rupees)	✓
	Remittance Outside India	✓	✓ (But up to 1 US\$ out of funds held in A/c permissible Txns after TDS)	✓
	Trf to any NRE/FCNR(B) account	✓		✓
	Investments in Shares/Securities	✓		✓
	Remittance outside India of current income like rent, dividend, pension, interest etc. in India of the account holder net off TDS	X	✓	X
	Any other transaction if covered under general or specific permission granted by RBI	✓	✓	✓
	Full Repatriation in Foreign currency	✓	✓ (But up to 1 US\$ out of funds held in A/c permissible Txns after TDS)	✓

- 2) When resident becomes NRI, **his/her domestic rupee account, has to be re-designated as an NRO account.**
- 3) For NRE – Rupee A/cs , w.e.f 15-3-2005 an attorney can withdraw for **local payments or remittance to the account holder himself through normal banking channels.**

Term Deposits:

	NRE	NRO	FCNR(B)
Term Deposit Min Period	12 months	15 days	12 months
Term Deposit Max Period	5 years	10 years	5 years
Interest calculation	Maximum of LIBOR + 175 bps	As per bank's interest rates @ Domestic rates	Interest is compounded on half yearly basis under the reinvestment plan if opened for 366 days or more.

Unit 4. Documentary Letters of Credit

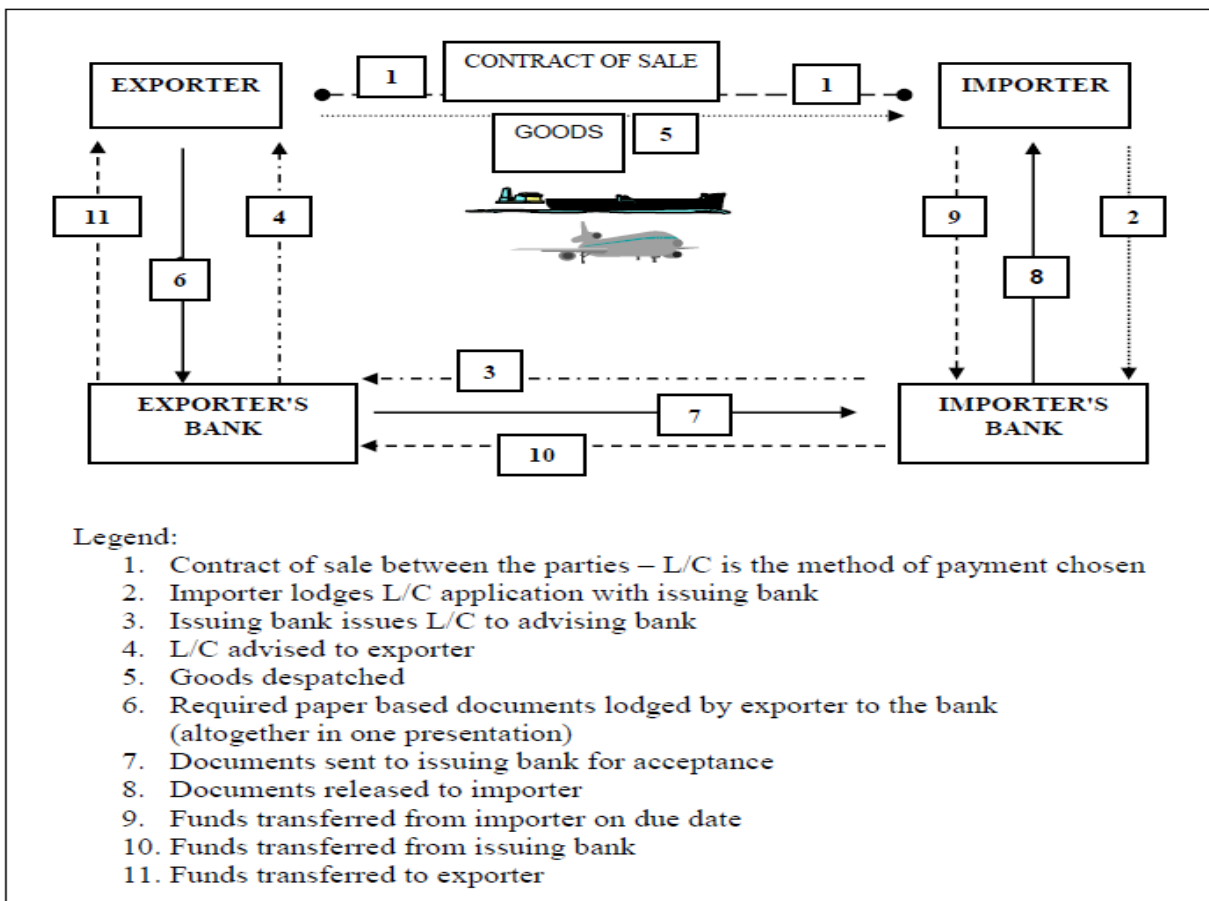
1. In international trade, where buyers and sellers are far apart in two different countries, or even continents, the **Letter of Credit acts** as a most convenient instrument, giving assurance to the sellers of goods for payment and to the buyers for shipping documents, as called for under the Credit.
2. In order to bring an uniformity in matters pertaining to LC Documents and Transactions, International Chamber of Commerce formed rules and procedures. Those are called as **Uniform Customs and Practices for Documentary Credits (UCPDC)**.
3. The **International Chamber of Commerce (ICC)** was established in **1919 headquartered at Paris**.
4. The first UCPDC published in **1933** and has been revised from time to time in 1951, 1962, 1974, 1983, 1993 and **recently in 2007**.
5. The updated UCPDC in 2007 is called as **UCPDC 600**. And it has been implemented **w.e.f 1-7-2007**.
6. **Documentary Credit/Letter of Credit**: LC/DC can be defined as a signed or an authenticated instrument issued by the buyer's Banker, embodying an undertaking to pay to the seller a certain amount of money, upon presentation of documents, evidencing shipment of goods, as specified, and compliance of other terms and conditions..
7. **IN an LC Parties are as follows:**
 - a. **The buyers/Importers** or the applicant – on whose behalf LC is opened.
 - b. The Sellers/Exporters or the **Beneficiary** of the LC
 - c. The **opening Bank (Buyer's Bank)**, who establishes the LC
 - d. The advising **bank (Bank in sellers country)**, who acts as an agent of the issuing bank and authenticates the LC.

- e. The **confirming Bank**- Who undertakes to pay on behalf of the issuing bank.
- f. The **negotiating Bank (Seller's bank** or Bank nominated by the opening Bank)
- g. **Reimbursing Bank** – Who reimburses the negotiating or confirming bank.

(A hypothetical Situation:

Mr Ram, (Banking with Dhanlaxmi Bank) an agriculture entrepreneur growing vegetables in green house technology in Khammam wants to update his farm house with modern machinery. He is importing the same from a Chinese manufacturer M/s Zuanch LLC, Beijing who are banking with China Development Bank for total cost of US\$ 4500. M/s Zaunch LLC has issued an invoice stating the sale transaction must be backed by LC. As such, Mr Ram approaches Dhanlaxmi Bank for opening of Letter of Credit (Foreign) in FCY USD. Dhanlaxmi Bank's China Foreign Correspondent Bank is Bank of China, Beijing.

Applicant of LC	Mr Ram, Khammam
Beneficiary of LC	M/s Zaunch LLC
LC Opening/ Issuing Bank	Dhanlaxmi Bank
Advising Bank /Confirming Bank	Bank of China
Negotiating bank	China Development Bank
Reimbursing Bank	Bank of China in China



8. **Types of Letters of Credit**

- a. Revocable LC
- b. Irrevocable LC
- c. Irrevocable Confirmed LC
- d. Transferable LC
- e. Red Clause LC
- f. Sight/Acceptance, Deferred Payment, or Negotiation LC
- g. Back to Back LC

9. **Revocable LC** can be amended or cancelled at any moment by the issuing bank without the consent of any other party, as long as the LC has not been drawn or documents taken up.
10. In case the Negotiating Bank has taken up the documents under revocable LC, prior to receipt of cancellation notice, the issuing bank is liable to compensate/reimburse the same to the negotiating bank.
11. **Irrevocable LC** which holds a commitment by the issuing bank to pay or reimburse the negotiating bank, provided conditions of the LC are complied with.
12. **Irrevocable LC** cannot be amended or cancelled without the consent of all parties concerned.
13. The **irrevocable LC** is an unconditional undertaking by the issuing bank to make payment on submission of documents conforming to the terms and conditions of the LC
14. All LCs issued, unless and otherwise specified, are **irrevocable Letter of Credits**.

15. **Irrevocable confirmed LC** is an L/c which has been confirmed by a bank, other than the issuing a bank, usually situated in the country of the exporter, thereby taking an additional undertaking to pay on receipt of documents conforming to the terms & conditions of the LC
16. The **Conforming Bank** can be **advising Bank**, which on receipt of request from the issuing bank takes this additional responsibility.
17. The conforming bank steps into the shoes of **the issuing bank** and performs all functions of the issuing bank.
18. **Transferrable LC** is available for transfer in full or in part, in favour of any party other than beneficiary, by the advising bank at the request of the issuing bank.
19. **Red Clause LC** enables the beneficiary to avail pre-shipment credit from the nominated/advising bank. The LC bears a clause in "RED Letter" authorizing the nominated bank to grant advance to the beneficiary, prior to shipment of goods, payment of which is guaranteed by the Opening Bank, in case of nay default or failure of the beneficiary to submit shipment documents.
20. **Under a Sight LC**, the beneficiary is able to get the payment on presentation of documents conforming to the terms and conditions of the LC at the nominated bank's countries.
21. **Under the Acceptance Credit**, the bill of exchange or drafts are drawn with certain Usance period and are payable upon acceptance, at a future date, subject to receipt of documents conforming to the terms and condition of the LC.
22. **A Deferred Payment Credit** is similar to Acceptance Credit, except that there is no bill of exchange or draft drawn and is payable on certain future date, subject to submission of credit confirmed documents. The due date is generally mentioned in the LC
23. A **Negotiation Credit**, the issuing Bank undertakes to make payment to the Bank, which has negotiated the documents.
24. **In a Negotiation LC**, LC may be freely negotiable or may be restricted to any bank nominated by the LC issuing Bank.
25. **Back to Back LC**: when an exporter arranges to issue an LC in favour of Local supplier to procure goods on the strength of export LC received in his favour, it is known as Back to Back LC.
26. UCP 600 come into **force w.e.f. 01/07/2007**.
27. Main features of **UCP 500 Vs UCP 600**:

Article No	UCP 500 (Abandoned)	UCP 600 (Latest)
1	Application of UCP	Application of UCP
2	Meaning of Credit	Definitions of various Terms
3	Credits Vs. Contracts	Interpretations of various terms
4	Documents/Goods/Services/Performances	Credits v. Contracts
5	Instructions to Issue/Amend Credits	Documents v. Goods, Services or

		Performance
6	Revocable v. Irrevocable Credits	Availability, Expiry Date and Place for Presentation
7	Advising Bank's Liability	Issuing Bank Undertaking
8	Revocation of a Credit	Confirming Bank Undertaking
9	Liability of Issuing and Confirming Banks	Advising of Credits and Amendments
10	Types of Credit	Amendments
11	Teletransmitted and Pre-Advised Credits	Teletransmitted and Pre-Advised Credits and Amendments
12	Incomplete or Unclear Instructions	Nomination
13	Standard for Examination Documents	Bank-to-Bank Reimbursement Arrangements
14	Discrepant Documents and Notice	Standard for Examination of Documents
15	Disclaimer on Effectiveness of Documents	Complying Presentation
16	Disclaimer on the Transmission of Messages	Discrepant Documents, Waiver and Notice
17	Force Majeure	Original Documents and Copies
18	Disclaimer for Acts of an Instructed Party	Commercial Invoice
19	Bank-to-Bank Reimbursement Arrangements	Transport Document Covering at Least Two Different Modes of Transport
20	Ambiguity as the Issuers of Documents	Bill of Lading
21	Unspecified Issuers or Contents of Documents	Non-Negotiable Sea Waybill
22	Issuance Date of Documents Vs. Credit Date	Charter Party Bill of Lading
23	Marine/Ocean Bill of Lading	Air Transport Document
24	Non-Negotiable Sea Waybill	Road, Rail or Inland Waterway Transport Documents
25	Charter Party Bill of Lading	Courier Receipt, Post Receipt or Certificate of Posting

26	Multimodal Transport Documents	On Deck", "Shipper's Load and Count", "Said by Shipper to Contain" and Charges Additional to Freight
27	Air Transport Document	Clean Transport Document
28	Road, Rail or Inland Waterway Transport Docs.	Insurance Document and Coverage
29	Courier and Post Receipts	Extension, Expiry
30	Transport Documents issued by Freight Forwarders	Tolerance in Credit Amount, Quantity and Unit Prices
31	"On Deck, Shipper's Load ..., Name of Consignor	Partial Drawings or Shipments
32	Clean Transport Documents	Installment Drawings or Shipments
33	Freight Payable/Prepaid Transport Documents	Hours of Presentation
34	Insurance Documents	Disclaimer on Effectiveness of Documents
35	Type of Insurance Cover	Disclaimer on Transmission and Translation
36	All Risks Insurance Cover	Force Majeure
37	Commercial Invoices	Disclaimer for Acts of an Instructed Party
38	Other Documents	Transferable Credits
39	Allowances in Credit Am., Quantity and Unit Price	Assignment of Proceeds
40	Partial Shipments/Drawings	*
41	Installment Shipments/Drawings	
42	Expiry Date and Place for Presentation of Docs.	
43	Limitation on the Expiry Date	
44	Extension of Expiry Date	
45	Hours of Presentation	
46	General Expressions as to Dates for Shipment	

47	Date Terminology for Periods of Shipment	
48	Transferable Credit	
49	Assignment of Proceeds	

28. Important Changes in the Articles of UCP 600 and their implication for the Banks:-

- A reduction in the number of articles from **49 to 39**
- New articles **on "Definitions" and "Interpretations"** providing more clarity and precision in the rules
- A definitive description of negotiation as "purchase" of drafts of documents
- The replacement of the **phrase "reasonable time" for acceptance or refusal of documents** by a maximum **period of five banking days**
- New provisions allow for the discounting of deferred payment credits
- Banks can now accept an insurance document that contains **reference to any exclusion clause**

29. **UCP 600 does not apply by default** to letters of credit issued after July 1st 2007. **A statement needs to be incorporated** into the credit (LC), and preferably also into the sales contract that expressly states it is subject to these rules.

30. **Revocable Credits (Article 2):** One of the most important changes in UCP 600 is the exclusion of any verbiage regarding revocable letters of credit, which can be amended or canceled at any time without notice to the seller. .Actually, **Article 2** explicitly defines a credit as "any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation."

31. **Article 3** states that "**A credit is irrevocable even if there is no indication to that effect.**" and **Article 10** makes it clear that "**a credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary**" (seller).Therefore, it is prudent for the seller to stipulate in the sales contract that the "buyer will open an irrevocable letter of credit", and to check that the buyer's credit does, in fact, either describe itself as "irrevocable" or state that it incorporates UCP 600 (without exclusion).

32. **Definitions and Interpretations (Articles 2 and 3):** A new section of Definitions and Interpretations has been introduced in the UCP 600. This includes definitions of "Advising bank", "Applicant", "Banking day", "Beneficiary", "Complying presentation", "Confirmation", "Confirming bank", "Credit", "Honour", "Issuing bank", "Negotiation", "Nominated bank", "Presentation", "Presenter". In addition to that, the following terms are now clearly defined : "singular/plural", "irrevocable", "signatures", "legalizations", "Branches of a bank", "Terms describing issuer of a document", "Prompt etc", "on or about", "to", "until", "till", "from", "between", "before", "from", "after", "first half", "second half", "beginning", "middle", "end".

33. **Deferred payment undertakings - Articles 7 and 8** :: Articles 7 and 8 establish a definite undertaking by issuing and confirming banks to reimburse on maturity whether or not the nominated bank prepaid or purchased its own acceptance or deferred payment undertaking before maturity. Article 12(b) expressly provides authority from an issuing bank to a nominated bank to discount (prepay or purchase) a draft that it has accepted or a deferred payment undertaking that it has given.
34. **Advising of credits - Article 9**: At present an advising bank only has to verify the apparent authenticity of the credit that it has advised. Under art 9(b) it has to certify that the document that it advises to the beneficiary is the same document that it received. **The obligation is also extended to any second advising bank.**
35. **Amendments - Article 10**:- The position under article 9(d)(iii) of UCP 500 has been maintained in Article 10 under UCP 600. Article 10 now deals exclusively with amendments and article 10(c) provides: '... **The beneficiary should give notification of acceptance or rejection of an amendment.** If the beneficiary fails to give such notification, a presentation that complies with the credit and to any not yet accepted amendment will be deemed **to be notification of acceptance by the beneficiary of such amendment.**
36. **Time Allowed Banks for Document Review (Article 14)** :- Under UCP 500, banks have a **"reasonable time ... not to exceed seven banking days"** in which to honor or dishonor documents. **UCP 600** shortens the period to a **maximum of five "banking days"**.
37. Article 2 defines a **banking day as** "a day on which a bank is regularly open at the place at **which an act subject to these rules is to be performed.**"
38. **Non-Matching Documents (Article 14)**:- Article 14(d) provides the standard for examination of documents generally. It seeks to resolve the problem of inconsistency in data by clarifying that there is no need for a mirror image but rather
39. **Regarding addresses on the various documents, Article 14** indicates that they do not have to exactly match as long as the country is the same. The only exception is when addresses appear as part of the consignee or notify party details on a transport document, in which case they must be the same as stated in the credit.
40. **Examination of documents**: The standard for examining documents is reflected in article 14. **Banks now only have 5 banking days to accept or refuse documents.** This replaces the "Reasonable time not exceeding 7 banking days".
41. **The period for presentation (usually 21 days) only applies to original transport documents.**
42. Addresses of beneficiaries and applicants need no longer be as mentioned in the documentary credit. They must however be within the same country. .
43. **Non-Documentary Requirements**: - Under UCP 600, Banks should disregard all non-documentary requirements. This means that any requirement in the credit that is not specifically part of a required document will be ignored by the bank in determining conformity.
44. **Complying presentation - article 15**:- Under UCP 600 it is clear that this begins when the bank determines that a presentation is compliant.
45. **Discrepant documents, waiver and notice - Article 16**:- Under UCP 500 a bank which refuses documents has the option of holding them at the presenter's disposal or handling them in

accordance with the presenter's prior instructions, such as to return them.. Article 16 now encompasses additional options designed to avoid banks sitting on discrepant documents and issues relating to forced waivers.

The options (which are alternatives) are as follows:

- Hold documents pending further instructions from the presenter; or
 - Hold documents until it receives a waiver from the applicant and agrees to accept it, or receives further instructions from the presenter prior to agreeing to accept a waiver; or return the documents; or act in accordance with instructions previously received from the presenter. There is no provision for payment under reserve or indemnity.
46. **Original Documents (Article 17):-** Article 17 of the new rules attempts to define original documents with more precision.
47. **Transport documents: Articles 19-24:-** The transport articles have been redrafted under advice of a group of "transport experts". The requirement that a bill of lading must show that goods are shipped on board a named vessel has been made much simpler which will hopefully lead to less confusion.
48. It is now acceptable that a **"Charterer"** (or a named agent on behalf of the charterer) can sign a **Charter Party Bill of Lading**. If an agent signs on behalf of a **"Master" on a Charter Party Bill of Lading** then the name of **the master need not appear from the document**.
49. Under UCP 600 a generic set of rules generally applies to all transport documents (other than charter party bills of lading). These include the following:
- The document must indicate the name of the carrier and be signed by: (a) the carrier or named agent for or on behalf of the carrier; or (b) the master or named agent for or on behalf of the master.
 - Any signature by the carrier, master or agent must be identified as that of the carrier, master or agent.
 - Any signature of an agent must indicate whether the agent has signed for or on behalf of the carrier for or on behalf of the master.
 - There is no need to name the master.
 - In the case of charter party bills of lading :
 - These no longer need to indicate the name of the carrier.
 - They may now also be signed by the charterer, although it is difficult to envisage a situation where an FOB buyer/ applicant would wish to rely on a bill of lading signed by the seller/beneficiary and vice versa in the case of a CIF sale.
 - Transport documents also no longer need to bear the clause 'clean' in order to comply with any credits that require a document to be 'clean on board'.

50. **Insurance documents - article 28**:- Documents providing for wider coverage than stipulated in a credit will be acceptable. Banks will also be able to accept an insurance document that **contains reference to any exclusion clause**.
51. For the insurance documents the following has been changed: "**Proxies**" can now sign on behalf of the **insurance company** or **underwriter**.
52. **Force majeure - Article 36**:-Despite suggestions for an option to allow a grace period of five banking days after a bank reopens for the presentation of documents, the position remains as it was under UCP 500 -i.e. **banks will not honour or negotiate under a credit that expired during the force majeure event**.
53. It is the responsibility of the **Negotiating bank** to examine the documents, before making payment.
54. In case the advising bank does not advise the LC, it must inform of its decision to the **Opening Bank** immediately.
55. The **advising bank** must ensure the authenticity of LC before advising the same to the beneficiary.
56. In case the reimbursing bank does not pay to the negotiating bank, the ultimate **liability** lies with the **opening bank**.
57. **Important documents** called for under the **Letter of Credit** :
- a. Bill of Exchange
 - b. Invoice
 - c. Bill of Lading
 - d. Insurance Policy/Certificate
 - e. Certificate of Origin
 - f. Packing List, Weight List and other Documents
58. **Bill of exchange** is drawn by the Beneficiary on the LC issuing Bank.
59. **Invoice** is a commercial Document and is a basic necessity of trade documents. It is being prepared by the Beneficiary
60. If invoice is issued for an amount in excess of the amount permitted by credit (when not specifically prohibited by the terms of LC), as per Article 18 B of UCPDC, **the drawing should not exceed the amount of credit**.
61. **Bill of Lading** is a transport document evidencing movement of goods from the port of acceptance to port of destination. It is a receipt issued by the ship owner or its authorized agent.