

Watchdog scraps PNB scam tool

OUR SPECIAL
CORRESPONDENT

Mumbai: The RBI on Tuesday barred banks from issuing guarantees in the form of letters of undertaking (LoUs) as it clamped down on the import financing route used by fugitive jeweller Nirav Modi and his uncle Mehul Choksi for allegedly committing India's biggest bank fraud.

The Reserve Bank of India also banned with immediate effect issuance of letters of comfort which, like LoUs, are used by importers to fund their overseas purchases.

"On a review of the extant guidelines, it has been decided to discontinue the practice of issuance of LoUs/LoCs for trade credits for imports into India by authorised dealer (AD) Category-I banks with immediate effect," the central bank said in a notification.

However, letters of credit and bank guarantees for trade credit will continue upon meeting certain conditions, the central bank said.

PROMPT ACTION

■ **Barred:** Letter of undertaking (LoU) and letter of comfort for trade credit

■ **Allowed:** Letter of credit and bank guarantees, subject to conditions

■ **What is buyer's credit:** A loan an importer gets from foreign banks which may be subsidiaries of Indian banks. This credit is provided on the basis of an

A letter of credit is an assurance from the bank that if the importer defaults, the bank will pay on his behalf.

The RBI's action comes nearly a month after PNB announced that it had detected fraudulent and unauthorised transactions at its Brady House branch in Mumbai.

LoUs were allegedly used by diamondaires Nirav Modi and his uncle Mehul Choksi to defraud the state-owned bank in connivance with its officials. The CBI has in its two

LoU, which is like a guarantee and is issued by the importer's local bank against a margin or a collateral such as a fixed deposit

Letter of comfort: Is similar to an LoU, except that it is an intra-bank transaction

Letter of credit: An assurance from the bank that if the importer defaults, the bank will pay on his behalf

FIRs filed on the PNB scam accused that fake LoUs were issued without keeping any margin money as security. Moreover, the buyer's credit raised was not used for specific purposes in many cases. They did not have any pre-approved credit limit either.

Buyer's credit is a loan an importer (from India) gets from foreign banks which may be subsidiaries of Indian banks. It is used (by the importer) to pay for the imports into the country. This buyer's

credit is provided on the basis of an LoU, which is akin to a guarantee and is issued by the importer's local bank.

An LoU is provided against a margin or a collateral which could be in the form of a fixed deposit. Banks charge a fee from the importer for the LoU. On the other hand, a LoC is an instrument which is similar to an LoU, except that it is an intra-bank transaction.

The buyer's credit usually goes to an overseas nostro account from where the payment to the importer's bank is made. The payment can also be made directly to the importer. A nostro account is an account held by an Indian lender in a foreign bank in their currency.

Experts said the RBI's move to bar LoUs could affect genuine importers. "The instrument (LoU/LoC) is being blamed, taking the focus away from the system failure in PNB," Sanjay Mandavia, an expert on trade finance who arranges buyers credit for SMEs, told **The Telegraph**.

JAYANTA ROY
CHOWDHURY

New Delhi: Industry associations are worried that a fear psychosis within state-run banks, who account for 70 per cent of all banking operations in the country, could affect loans sanctioned to industry.

"We have written to the government and the RBI on this ... a fear psychosis should not impact lending," said Rashesh Shah, president of the Federation of Indian Chambers of Commerce & Industry (Ficci) and chairman of the Edelweiss Group.

While Shah does not believe lending has been impacted yet, he said: "Our fear is that it will lead to a fear psychosis and impact lending and thus the economy."

Shah also believes the high levels of bad loans in key sectors could make "project finance difficult" to access. To overcome this, he has suggested that the State bank of India, the country's largest lender, set up a separate arm dedicat-

Loan worries for industry

ed to large project finance.

A circular by the RBI asking banks to tighten checks on bank loans as well as questioning of top bankers in the Nirav Modi case is believed to have impacted credit flows.

Usually bank credit disbursal in March is the highest as yearly targets have to be met by banks. However, in the current situation, officials, especially at PSU banks, are going slow on loans.

After several months of negative credit growth last year, bank credit had picked up from last November. In January, credit to industry increased 1.1 per cent compared with a contraction of 5.1 per cent in January 2017.

Among others, a requirement that bankers certify that

borrowers have not been involved in any frauds is also making bankers cautious as it is virtually impossible for them to check on this without a forensic audit of a borrowing firm's balance sheet, say top bankers.

The Reserve Bank of India (RBI) has also tightened its leash on banks, with new norms for recognising bad loans, which may force lenders to recognise bad loans sooner than later. This has come after some of the country's largest banks, including the SBI, juggled soured loans citing technicalities in the past.

Shah said new big ticket private sector investments were currently "not happening" as "potential investment is going into purchase of stressed assets put up for sale by the NCLT".

The National Company Law Tribunal has taken up for resolution through auctions some 12 cases of megabad loans worth Rs 2.21 lakh crore.