Notes on

International Lending Operations, Policies and Practices

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Paper Title: Foreign Exchange,Foreign Trade and International Finance (DSE 4)

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Module Name: International Lending Operations, Policies and Practices

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Meaning of International Finance

- When an importer buys goods from a foreign country, or an exporter sells goods, no movement of currencies from one country to another need be generated.
- Instead, transactions are settled through the banking system, which involves offsetting one debt against another.
- An importer of goods can make payments in variety of ways through the banking system.
- But whatever method is used, the net effect will be to reduce the foreign currency balances of a domestic bank or to increase the rupee balances of an overseas (foreign) bank.
- Interest earned from lending to foreign borrowers, both internationally and domestically, remains a major source of profit for banks that conduct international activities.

- International Finance is an important part of financial economics. It mainly discusses the issues related with monetary interactions of at least two or more countries.
- International finance is concerned with subjects such as exchange rates of currencies, monetary systems of the world, foreign direct investment (FDI), and other important issues associated with international financial management.
- International finance exists due to the fact that economic activities of businesses, governments, and organizations get affected by the existence of nations.
- It is a known fact that countries often borrow and lend from each other. In such trades, many countries use their own currencies.
- The World Bank, the International Finance Corporation (IFC), the International Monetary Fund (IMF) are some of the notable international finance organizations.

International Lending Risks

- All loans involve some degree of default risk, and credit agencies must effectively assess the degree of risk in each credit extension.
- Credit and currency risks are also key risks associated with international lending.
- Credit Risk refers to the potential inability of a borrower to comply with contractual credit terms.
- Evaluation of foreign credit risk is similar to domestic credit analysis and requires the review of appropriate information, including the amount of credit requested, loan

purpose, collateral, anticipated terms, and repayment source.

- Currency Risk reflects the possibility that variations in value of a currency will adversely affect the value of Currency conversion exposure exists in every international transaction.
- For borrowers, rapid depreciation in the home currency relative to the borrowing currency can significantly increase debt service requirements.
- For lenders, rapid appreciation or depreciation in currencies can substantially affect profit or loss depending on how the institution finances the assets.
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Policies and Practices in International lending Operations

- Every bank engaged in international lending should be guided by a formal, written, board-approved policy.
- These include basic credit standards for international lending, a statement of the bank's international lending objectives, a description of its system for credit approval, and the establishment of committee and officer lending authorities.
- In addition, the policy should define procedures that ensure the board of directors is regularly apprised of the size, performance, and risk profile of the international loan portfolio.
- Defining geographic loan limits is one of the most significant components of an adequate international lending policy. Limits should be set according to estimates of where the bank can profitably lend.
- When evaluating international credit risk, special consideration must be given to reviewing foreign financial statements, types of borrowers, and the forms of indirect support provided by parent companies, banks, and financial institutions
- Because financial information from foreign countries is not always reliable, the bank's policies should enable it to determine borrower capacity and reputation by other means.
- One of the most effective methods is a program of regular visits to borrowers' countries by bank account officers and by obtaining credit references, followed by preparation of candid reports that become significant parts of credit files.
- Banks can also consider the Financial Sector Assessment Program, jointly established by the World Bank and the International Monetary Fund, which analyzes a country's adherence to sound financial sector principles such as the Core Principles of Banking Supervision prescribed by the Basel Committee on Banking Supervision.