Quadrant II – Transcript and Related Materials

Programme: Bachelor of Commerce (Third Year)

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Course Title: Banking DSE4

Unit: Unit 3- Financing of International trade

Module Name: Export /Import Guarantees, Export promotion Incentives, Role of ECGC

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Notes:

Export/ Import Guarantees

A bank guarantee is a written contract given by a bank on the behalf of a customer.
By issuing this guarantee, a bank takes responsibility for payment of a sum of money in case, if it is not paid by the customer on whose behalf the guarantee has been issued.
In return, a bank gets some commission for issuing the guarantee.
bank guarantee remains valid until the customer dully releases the bank from its liability
A bank guarantee is frequently confused with letter of credit (LC), which is similar in many ways but not the same thing.
The basic difference between the two is that of the parties involved.
In a bank guarantee, three parties are involved; the bank, the person to whom the guarantee is given and the person on whose behalf the bank is giving guarantee.
In case of a letter of credit, there are normally four parties involved; issuing bank, advising bank, the applicant (importer) and the beneficiary (exporter).
Benefits of Bank Guarantees *for Governments*
Increases the rate of private financing for key sectors such as infrastructure.
Provides access to capital markets as well as commercial banks.
Reduces cost of private financing to affordable levels.
Facilitates privatizations and public private partnerships.
Reduces government risk exposure by passing commercial risk to the private sector.
Benefits of Bank Guarantees *for Private Sector*
Reduces risk of private transactions in emerging countries.
Mitigates risks that the private sector does not control.
Opens new markets.
Improves project sustainability.

1. **Types of Bank Guarantees**
   Direct Bank Guarantee - It is issued by the applicant's bank (issuing bank) directly to the guarantee's beneficiary without concerning a correspondent bank. This type of

guarantee is less expensive and is also subject to the law of the country in which the guarantee is issued unless otherwise it is mentioned in the guarantee documents.
Indirect Bank Guarantee - With an indirect guarantee, a second bank is involved, which is basically a representative of the issuing bank in the country to which beneficiary belongs. This involvement of a second bank is done on the demand of the beneficiary. This type of bank guarantee is more time consuming and expensive too.
Confirmed Guarantee - It is cross between direct and indirect types of bank guarantee. This type of bank guarantee is issued directly by a bank after which it is send to a foreign bank for confirmations. The foreign banks confirm the original documents and thereby assume the responsibility.
Tender Bond - This is also called bid bonds and is normally issued in support of a tender in international trade. It provides the beneficiary with a financial remedy, if the applicant fails to fulfil any of the tender conditions
Performance Bonds - This is one of the most common types of bank guarantee which is used to secure the completion of the contractual responsibilities of delivery of goods and act as security of penalty payment by the Supplier in case of non-delivery of goods.
Advance Payment Guarantees - This mode of guarantee is used where the applicant calls for the provision of a sum of money at an early stage of the contract and can recover the amount paid in advance, or a part thereof, if the applicant fails to fulfil the agreement.
Payment Guarantees - This type of bank guarantee is used to secure the responsibilities to pay goods and services. If the beneficiary has fulfilled his contractual obligations after delivering the goods or services but the debtor fails to make the payment, then after written declaration the beneficiary can easily obtain his money from the guaranteeing bank.
Loan Repayment Guarantees - This type of guarantee is given by a bank to the creditor to pay the amount of loan body and interests in case of non-fulfilment by the borrower.
B/L Letter of Indemnity - This is also called a letter of indemnity and is a type of guarantee from the bank making sure that any kind of loss of goods will not be suffered by the carrier.
Rental Guarantee - This type of bank guarantee is given under a rental contract. Rental guarantee is either limited to rental payments only or includes all payments due under the rental contract including cost of repair on termination of the rental contract.
Credit Card Guarantee - Credit card guarantee is issued by the credit card companies to its customer as a guarantee that the merchant will be paid on transactions

ECGC Policies

Exporter faces two major risk in international trade
First: Risk of loss due to damage of goods
Second: Risk of loss due to non-realisation of sales proceeds
Risk of loss due to damage of goods is covered by insurance

Risk of loss due to non-realisation of sales is taken care by ERIC (Export Risk Insurance Corporation)
Risk of loss due to non-realisation of sales may take place due to Economic Difficulties/ Balance of Payment problems/ Restriction by Countries
ERIC was set up in India on July 1957 to by the government to protect exporter
ERIC was transformed to ECGC in 1964
ECGC stands for Export Credit Guarantee Corporation in 1964
It helped exporters to get timely and liberal credit facilities from banks
ECGC comes under the ministry of commerce
ECGC is run by board of Directors
Schemes of ECGC are divided into two categories one **Exporters** and the second is **Banks**
For **Exporters** it is divided into **Whole Turnover Policy/ Specific Policy**/ **Factoring**
Whole Turnover Policy
The whole turnover policy is classified into **Standard Policy** and **Small Export Policy**
Standard Policy
Provides cover for shipment on short term credit or whole turnover Basis
The risk covered are classified into Commercial risk and Political risk
Commercial risk includes
Insolvency of buyer
Default to pay for goods expected by him
Failure to accept goods subject to certain conditions
Political risk would include
Restriction on remittance by government in buyers' country
Civil/ Revolution/ Disturbance in country
Cancellation of valid import licence
Additional handling / transport due to diversion of route
Any other cause of loss not covered by insurance
Small Exporters Policy
It's a standard policy with modifications in terms of cover
Issued to exporters whose anticipated export turnover for next twelve months does
Specific policy
Projects that are non-repetitive are considered under specific policy
Specific Policy are taken up on a case to case basis
Specific policies are catagorised as below
Specific Shipment Policies
Offers to cover one or more shipments only under a particular contract
Option to cover either or both that is commercial/ Political risk
Percentage covered is 80%
Can be availed by exporter who hold the standard policy
Specific Policy for Supplier Contracts
Covers export commodities for a period beyond 180 days
Specific Shipment (comprehensive Risk) Policy covers both political and commercial risk at post shipment stage
Specific Shipment (Political Risk) Policy covers political risk at post shipment stage
Specific Shipment (comprehensive Risk) Policy and Specific Shipment (Political Risk) Policy provides cover from date of contract

Export (Specific Buyers Policy)
Buyer wise (BP), short term (ST) provide cover to Indian exporters against commercial and political risk
All shipments to the buyer in respect of whom the policy is issued will be covered
Can be availed by exporters who have and do not have standard policy
Types of Export (Specific Buyers Policy)
Buyer wise (Commercial and Political Risk) policy – short term
Buyer wise (Political Risk) policy – short term
Buyer wise (Insolvency and default of L/C) policy – short term
Export Turnover
Policy is for large exporters who contribute not less than 10 lakhs towards premium
Policy constitutes projection of export turnover for the year
Policy provides for additional discounts in premium to promote exports
Issued with validity period of one year
Buyer Exposures Policy
Meant for large exporters
Un intentional omissions and commissions occur due to large shipment volume
This impacts settlement
Demand for simplification is made by exporters
ECGC has introduced two policies for such buyers
Exposure (Single Buyer) Policy – covers risk on specified buyer
Exposure (Multiple Buyer) Policy – covers risk on All buyer
Exporter can choose as per their requirement
Cover is against commercial and political risk
Period of cover is 12 months
Insurance Credit for Buyers Credit and Lines of Credit
Buyers credit – is loan extended by financial institutions/ group of institutions to buyer for financing export contract
Line of Credit – Loan extended to Government/ financial institution in the importing country for importing specified items
ECGC have come out with schemes to protect financial institutions in India which extend such type of credit
Service Policy
Indian firms that render services to foreign parties are exposed to risk
This policy offers protection to such firms
Two types of policies are introduced
Specific Service Contract (Comprehensive Risk) Policy – covers Insolvency of Buyer/ Default in Payment/ Restriction on Remittance between buyers' country and India/Government Restrictions/ Any other cause of Loss
Specific Service Contract (Political Risk) Policy – covers political risk

1. War between two countries (India and employer)
2. Civil war in employers' country
3. Cancellation of licence
4. Additional handling/ transport/ etc
5. Failure of employers to pay
6. Policy is issued on basis of estimated contract price and other payments under contract

Software Project Policy
Provided to exports of software and software related services
Payments will be received in foreign currency
Eligible software service under software project policy
Software project service – One Time/ Turnkey Basis/ Milestone Basis
Both offshore and onsite development
I-T Enabled Service (Specific Customer Policy)
It covers commercial and political risk involved in rendering IT enabled service to particular customer
Commercial risk involves
Insolvency of customer
Failure of customer to make payment within due date
Buyers failure to accept service rendered
Bank risk involved
Bankruptcy of L/C opening bank
Failure of L/C bank to make payment within specified period
Political Risk Involved
Imposition of restrictions by government in customers country
War/ Civil War/ Revolution
New import restrictions
Cancellation of import licence
Overseas Investment Insurance
Provides protection to exporter in capital participation in overseas project
Investment may be by equity or loan
Investment may be in cash/ capital goods/ service
Cover is available for original investment/ interest/ dividend
No cover for commercial risk is provided in this scheme
In order for investment to qualify for insurance there must exist bilateral agreement among both the countries to protect investment
If investment agreement is absent then investment protection code will be considered
Insurance cover is up to 15 years
Amount insured shall reduce progressively in the last five years of insurance period
Exchange Fluctuation Risk Cover Scheme
Protects exporters of Capital Goods/ Civil Engineering Contractors/ Consultants
They receive payment over a period for work/ service
If loss is greater than 2% then ECGC will make good the loss up to 35% of reference rate
If gain is greater than 2% then, ECGC will take the amount in excess of 2% up to 35%
Maturity factoring facility
New service provided by ECGC
It renders Credit Protection/ Sales Ledger Maintenance/ Collection for a period not exceeding 180 days
ECGC will pay the bank 10 days after that
Exporters with good track record can avail of the facility
Benefit to banks from this scheme are
Does not disturb existing system of banking arrangement