TRADE & COMMODITY FINANCING IN INDIA - AN OVERVIEW!

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Trade finance is the financing of international trade flows. It exists to mitigate, or reduce, the risks involved in an international trade transaction. There are primarily two players in a trade transaction:

1. an exporter, who requires payment for their goods or services; and
2. an importer who wants to make sure they are paying for the correct quality and quantity of goods.

Given that such trade and commodity finance transactions take place on a cross border basis, there are various risks that need to be examined and mitigated while structuring such deals and finalizing the commercials of the transactions. These include timely payments to the exporter as well as ensuring that the importer derives adequate comfort that they will receive goods as per the agreed quality and quantity. Additionally, there are others risks associated to such trade and commodity transactions viz., exchange rate risk, political risk and sovereign risk. To reduce these risks, banks and other financiers play a pivotal role in providing finance for such trade products.

Trade & commodity finance products are unlike conventional financing products. We elucidate hereinbelow, the applicable laws and product offerings from an Indian standpoint.

1) Trade Credits ("TCs")

TCs refer to credits extended by the overseas supplier, bank, financial institution and other permitted recognized lenders for maturity, as prescribed under Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 read together with the Master Direction – External Commercial Borrowings, Trade Credits and Structured Obligations dated 26th March 2019 (as amended) (collectively the **"ECB/TC Regulations"**), for import of capital / non-capital goods permissible under the Foreign Trade Policy of the Government of India. Depending on the source of finance, such TCs include suppliers' credit and buyers' credit from recognized lenders. Suppliers' credit relates to the credit for imports into India extended by the overseas supplier, while buyers' credit refers to loans for payment of imports into India arranged by the importer from overseas bank or financial institution. The key features of the framework for raising TCs (ECB/TC Regulations) are as follows:

1. **Eligible Borrower**: Person resident in India acting as an importer.
2. **Recognized lender**:
    1. For suppliers' credit: Supplier of goods located outside India; and
    2. For buyers' credit: Banks, financial institutions, foreign equity holder(s) located outside India and financial institutions in International Financial Services Centers located in India.
3. **Period of TC**: The period of TC, reckoned from the date of shipment, shall be up to 3 years for import of capital goods. For non-capital goods, this period shall be up to 1 year or the operating cycle whichever is less. For shipyards / shipbuilders, the period of TC for import of non-capital goods can be up to 3 years.
4. **All-in-cost ceiling per annum**:
    1. For Foreign Currency (**"FCY"**) denominated TC: the all-in-cost ceiling per annum for existing TCs linked to LIBOR whose benchmarks are changed to an alternative reference rate (**"ARR"**) is 'benchmark rate plus 350 bps spread' and in case of new TCs it is 'benchmark rate plus 300 bps spread'; and
    2. Indian Rupees (**"INR"**) denominated TC: the all-in-cost ceiling is 'benchmark rate plus 250 bps spread'.

2) Export Transactions

1. Export collection transactions for certain types of scenarios involving onshore pre-shipment and post-shipment credit are regulated under the Master Circular – Rupee / Foreign Currency Export Credit and Customer Service to Exporters dated 1st July 2015 (as amended). The credit can be extended by licensed banks in India in Rupees or in foreign currency. The period of advance for a pre-shipment credit is flexible and depends on the circumstances of the individual cases. Such pre-shipment credit can also be converted into a post-shipment credit if the proceeds from the bills drawn for the exported goods / services are used. Post-shipment credit can be availed in the form of: discounting / purchase / negotiation of export bills; advances against bills for collection; and advances against duty drawback receivable from Government. For transactions involving letters of credit (**"LCs"**), banks are required to obtain, among others, original sale contract / confirmed order / proforma invoice countersigned by overseas buyer / indent from authorized agent of overseas buyer for handling the export documents as per the Foreign Exchange Management Act, 1999 read together with the relevant rules and regulations issued / framed thereunder (collectively **"FEMA"**).
2. An Indian exporter is permitted to receive export advances against export of goods from India to an overseas buyer. Such export advance arrangements enable exporters to reduce interest cost, widen fund raising options and elongate the debt maturity profile of the exporter.
3. Types of Export Advances
    1. **Short-term:** In such export advance arrangements, the exporter is under an obligation to ensure that the shipment of goods is made within 1 year from the date of receipt of advance payment. The rate of interest, if any, payable on such advance payments cannot exceed ARR + 100 basis points.
    2. **Long-term:** Exporters having a minimum of 3 years' satisfactory track record have been permitted to receive long-term export advances up to a maximum tenor of 10 years subject to fulfilment of certain conditions. The rate of interest, if any, payable on such advance payments cannot exceed ARR + 200 basis points.

4. In addition to the above, authorised dealer category – banks (**“AD Banks”**) may also allow exporters to receive advance payment for export of goods which would take more than 1 year to manufacture and ship. In such instances, the export agreement should provide for shipment of goods extending beyond the period of 1 year from the date of receipt of advance payment and shall remain subject to fulfilment of certain additional conditions. The rate of interest, if any, payable on such advance payments cannot exceed ARR + 100 basis points.
5. Long-term export advances can be backed by:
    1. Guarantee: Bank guarantee issued by an AD Bank in India for a liability owed by an overseas entity to an Indian exporter, is required to be counter-guaranteed by a bank of international repute located overseas; and
    2. Letter of credit: In addition to advance payment, an irrevocable letter of credit is a pre-requisite for direct dispatch of shipping documents to the overseas buyer / agent.
6. An exporter who has not been able to realize the outstanding export dues despite best efforts, may either self-write off or approach the AD Category – I banks, who had handled the relevant shipping documents, with appropriate supporting documentary evidence.
7. Third party payments are allowed in respect of export transactions, upon satisfaction of certain domestic compliance requirements by the exporter and verified by the AD Bank. Such payments are required to be made via the banking channel only. Third party payments are not allowed for merchanting trade transactions.

3) Import Transactions

1. Import Advances: An AD Bank may permit import advances to an importer, payable within 6 months from the date of shipment. Upon satisfaction of certain conditions, extensions are allowed, 6 months at a time, for a maximum of 3 years. It is important to note the following:
    1. Suppliers’ and buyers’ credit, including the usance period of LCs opened for import of other precious metals, should not exceed 90 days from the date of shipment; and
    2. For merchanting trade import transactions where an import advance of USD 500,000 or above has been extended, it is required to be backed by a guarantee or an irrevocable standby letter of credit issued by a bank of international repute.
2. Import advances can also be made against deferred payment arrangements (including suppliers’ and buyers’ credit) entered into, for up to 3 years in case of import of capital goods and up to 1 year or the operating cycle whichever is less, in case of import of non-capital goods, shall be treated as trade credits for which the procedural guidelines as laid down in the ECB/TC Regulations may be followed.
3. Import advances can also be extended in the nature of TCs. In this regard, please refer to paragraph 1 hereinabove.
4. For import advances exceeding USD 200,000 or its equivalent, issuance of the following instruments is required and is allowed to be issued by an international bank of repute: (i) an irrevocable standby letter of credit or (ii) a guarantee or (iii) counter-guarantee against a guarantee issued by an AD Bank. However, this requirement has been relaxed in the following situations:
    1. Advance remittances up to USD 50,000,000 for import of aircrafts/helicopters and other aviation related purchases;

    2. Advance payments to be made to an overseas mining entity by an Indian importer (other than Public Sector Company or Department / Undertaking of Government of India / State Government), at the discretion of the AD Bank; and
    3. For advances up to USD 5,000,000 or equivalent, if the AD Bank is satisfied about the track record and *bona fides* of the Indian importer.
5. Further, an AD Bank may, subject to the directions issued by the Reserve Bank of India (**"RBI"**) in this behalf, permit a person resident in India to issue corporate guarantee in favour of an overseas lessor for financing import through operating lease effected in conformity with the Foreign Trade Policy in force and under the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000 framed by the Government of India vide Notification No. G. S. R. 381 (E) dated 3rd May 2000 and the directions issued by RBI under FEMA from time to time.

4) Factoring and Receivables Financing

1. Under the Factoring Regulation Act, 2011 (as amended by the Factoring Regulation (Amendment) Act 2021) (**"Factoring Act"**) only a registered factor[1] can undertake factoring business[2] in India. However, an AD Bank already having a banking license in India is not required to be registered as a factor under the Factoring Act. In case a debtor liable to pay the receivable or the business of factor is situated or established outside India, assignment of foreign currency receivables shall also be subject to the provisions of FEMA. Any assignment of receivables arising under or from foreign exchange transactions shall not trigger the Factoring Act. The Factoring Act requires every factor to register the particulars of every transaction of assignment of receivables in its favour with the Central Registry set-up under section 20 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (**"Central Registry"**), within such time from the date of such assignment, in such manner and subject to payment of such fee, as may be prescribed;
2. The Government of India *vide* the Factoring Regulation (Amendment) Act 2021 has introduced the trade receivables discounting system (**"TReDs"**). TReDs is an electronic platform introduced to widen the scope of factoring transactions by facilitating the financing / discounting of trade receivables of micro, small and medium enterprises (MSMEs) through multiple financiers. Guidelines for setting up of and operating the TReDs released by the RBI on 3rd December 2014 were issued under Section 10(2) read with Section 18 of Payment & Settlement Systems Act, 2007. The Registration of Assignment of Receivables (Reserve Bank) Regulations, 2022 dated 14th January 2022 provides filing of the particulars of the assignment of receivables with the Central Registry, within a period of ten days, from the date of such assignment or satisfaction thereof, as the case may be;
3. Under the Master Direction – Import of Goods and Services dated 1st January 2016 (as amended) (**"Import Regulations"**), an AD Bank in India can enter into arrangements with international factoring companies of repute, preferably members of Factors Chain International. No specific RBI approval is required in this regard. The onus of ensuring compliance with the stipulations under the Import Regulations and any other applicable regulations issued by the RBI shall lie on the relevant AD Bank; and
4. Under the Foreign Exchange Management (Export of Goods and Services) Regulations, 2015 dated 12th January 2016 read together with the Master Direction – Export of Goods and Services dated 1st January 2016 (as amended), an AD Bank can

enter into export receivables factoring arrangement on a non-recourse basis and should have credit evaluation and collection of payment arrangements with an import factor located overseas. In cases where there is no import factor, the AD Bank (as the export factor) can obtain credit evaluation details from a correspondent bank located overseas.

5) Conclusion

The recent past has witnessed significant developments in trade finance. Introduction of TReDs has given an inimitable platform to MSMEs for converting the trade receivables into liquid funds thereby contributing to the economic fabric of the country. The disruptions on account of COVID-19, global sanction on Russia has had a macroeconomic impact on imports in India. To foster growth of global trade with emphasis on exports from India and to support the increasing interest of global trading community in INR, invoicing, payment, and settlement of exports / imports in INR has been put in place. AD banks may now open Rupee Vostro Accounts of correspondent banks of the partner trading country. These measures have gone a long way to boost confidence and push the boundaries for the stakeholders.

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[1] A factor is defined under the Factoring Act in the following manner:

"factor" means a non-banking financial company as defined in clause (f) of section 45-I of the Reserve Bank of India Act, 1934 (2 of 1934) which has been granted a certificate of registration under sub-section (1) of section 3 or any body-corporate established under an Act of Parliament or any State Legislature or any Bank or any company registered under the Companies Act, 1956 (1 of 1956) engaged in the factoring business.

[2] Factoring business has the following definition under the Factoring Act:

"factoring business" means the business of acquisition by way of assignment of receivables of assignor for a consideration for the purpose of collection of such receivables or for financing, whether by way of making loans or advances or otherwise, against such assignment, but does not include—(i) credit facilities provided by a bank in its ordinary course of business against security of receivables; (ii) any activity as commission agent or otherwise for sale of agricultural produce or goods of any kind whatsoever or any activity relating to the production, storage, supply, distribution, acquisition or control of such produce or goods or provision of any services.

Explanation.—For the purposes of this clause—(i) the expression "agricultural produce" shall have the meaning assigned to it under clause (a) of section 2 of the Agricultural Produce (Grading and Marking) Act, 1937 (1 of 1937); and(ii) the expressions "goods" and "commission agent" shall have the meanings assigned to them respectively under clause (d) and Explanation(ii) of clause (i) of section 2 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952).