Trade Finance in India - Recent Trends

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Pratish Kumar (Partner, Juris Corp)

Saurabh Sharma (Principal Associate)

Dhwani Bansdawala (Trainee)

Trade Finance is not a novel concept. In fact, since the time businesses have started growing globally, different modes of trade finance have evolved.

Traditionally, Indian corporates have been offered with trade finance in the form of:

1. facilities for pre-sales and post sales requirement;
2. packing credit advances;
3. bill discounting facilities; and
4. letter of credit / BG facility.

The traditional forms of trade finance were generally part of working capital limits. Even though bill discounting may include assignment of receivables on non-recourse basis, this generally forms part of the working capital limits. This is mainly because the legal framework was not so evolved in relation to trade finance transactions. These were mainly governed by customary practices.

Post 2010, there were many developments in the trade finance space. Some of them are:

(a) Factoring Act was passed in 2011;

(b) NBFC factors (specific factoring companies) were introduced in 2011-12;

(c) Major changes were made in export and import related laws (including allowing third party payments); and

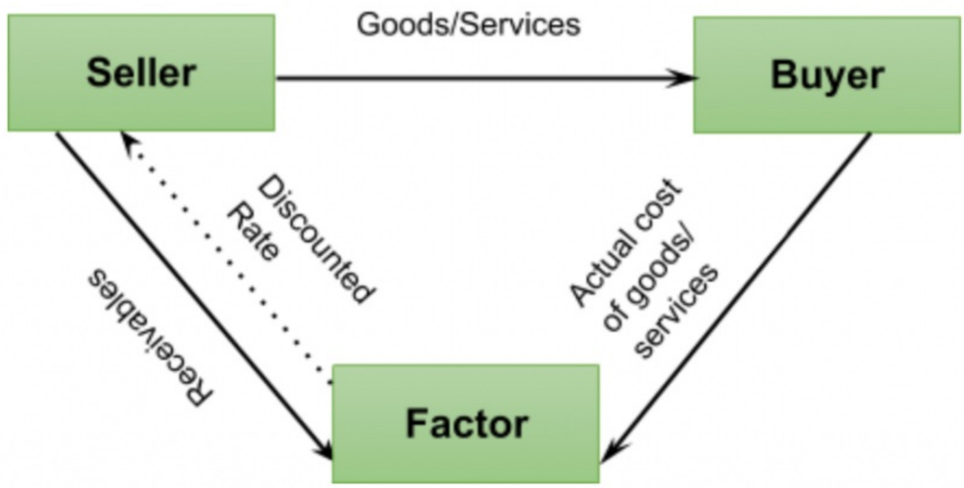
(d) Insolvency and Bankruptcy Code was passed in 2016 which included ‘receivables sold or discounted other than any receivables sold on non-recourse basis’ and ‘any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing’, as financial debt.

Based on the above legal changes and need of the market participants, evolution in modes of trade finance in India have been observed. Recent trends show that Indian business houses have shown indentation towards trade finance by way of:

1. Factoring and
2. Export Advances.

Some plain vanilla transaction structures have been captured below under the aforementioned heads. Many structures are possible under these transactions within the ambit of regulatory framework.

1) Factoring



It is one of the most flourishing modes of trade finance. A seller assigns its receivables under the invoices to a factor at a discounted rate. The factor in turn receives the payment under the invoices from the buyer.

In a nutshell, the factor is getting premium for timely payment to the seller. Factoring is currently fulfilling the working capital requirement of various businesses. In India, factoring is regulated and has specific statutory requirements. Some of the commonly raised queries have been set out below:

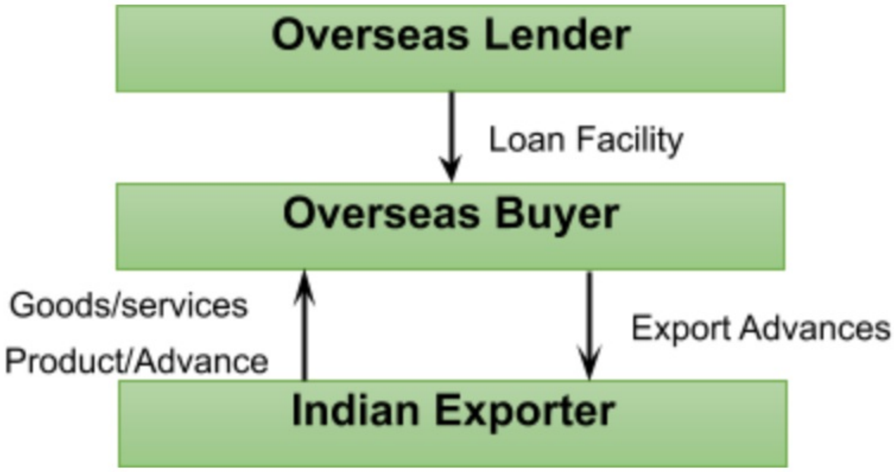
Sr. No.	FAQs	Responses
1)	Any specific law to regulate factoring in India?	The applicable act is Factoring Regulation Act, 2011 (**"Factoring Act"**).
2)	Who can provide factoring services?	Any entity having a certificate of registration under the Factoring Act. Banks can provide services of factoring without getting registered under the Factoring Act.
3)	What can be factored?	All or part of interest in any right of any person under a contract can be factored.
4)	Whether factoring can be done on cross border basis?	(a) Authorised dealer banks are authorised to factor the export receivables on a non-recourse basis; (b) Offshore entities cannot act as the factor in relation to the receivables arising out of the contract between two Indian parties; and (c) Offshore factoring entities may be permitted to provide factoring to Indian exporters directly.
5)	What is the status of the factor in an insolvency scenario?	Treatment of factor as 'financial creditor' or 'operational creditor' will depend on the terms and conditions of each transaction. Some of the basic principles are: (a) Factor will be treated as operational creditor *vis a vis* buyer/debtor; (b) Factor will be treated as operational creditor *vis a vis* seller (if the factoring is on non-recourse basis); and (c) Factor will be treated as financial creditor *vis a vis* seller (if the factoring is on non-recourse basis).

The RBI also introduced the concept of setting up of TReDS platform taking que from the fact that factoring allows real time financing of the genuine businesses. TReDS platform is an online platform where an invoice is uploaded by one party (either seller or buyer) and is consented by the other party. Thereafter, the financiers on the platform start bidding on the consented invoice. The seller accepts the bid, and the discounted amount is credited in its account in T+1 day, where T is the day of acceptance. TReDs Platform has revolutionized the working capital availability for cash crunched Micro, Small & Medium Enterprises sector.

Improvement Prospect

Offshore banks may provide external commercial borrowings where the money raised will be used for onshore end use. Why not allow offshore factors to participate for the domestic receivables? It will open opportunities for Indian traders to have liquidity at competitive pricing.

2) Export Advances



Another type of trade finance which has picked up in the last few years is export advance transactions. An overseas buyer disburses advances to the onshore exporter prior to receipt of the goods or services. Generally overseas buyers also take back to back finance from its lenders to arrange funds for export advances. The said lender draws comfort from the past performance of the Indian exporter. Export advances are regulated transactions. Some of the commonly raised queries have been set out below:

Sr. No.	FAQs	Responses
1)	Any specific law to regulate export advances in India?	Circulars relating to export of goods and services.
2)	Who can avail export advances?	Indian exporters. There are other specific conditions that need to be fulfilled by the Indian exporters based on nature and tenure of the export advances.
3)	What is the tenor of export advances?	Tenor may vary between 1 year to 10 or more years.
4)	What is the upper limit on interest rate?	(a) For export advances tenor up to 1 Year: London inter-bank offered rate (LIBOR) + 100 basis points; and (b) For other export advances: London inter-bank offered rate (LIBOR) + 200 basis points.

Treatment of offshore buyer

Any bank secures internal approval easily for a lending transaction when they get treated as a financial debtor. So, the status of the overseas buyer in an insolvency scenario is one of the key factor for export advances. Treatment of lender / offshore buyer as 'financial creditor' or 'operational creditor' will depend on the terms and conditions of each transaction. Some of the basic parameters are:

1. Whether the contract for export advances has a ‘commercial effect of borrowing’?
2. Whether there is any time value of money?
3. What is the end use?

In one of the recent cases, the offshore lender who provided loan for advance payments had been classified as a ‘financial creditor’. In this case, the Mumbai Bench of the National Company Law Tribunal (“NCLT”), after hearing the arguments put forth by counsels to both parties held that the loan extended by ANZ on behalf of Avanti (overseas buyer) to Ruchi Soya (Indian Exporter) was a financial debt. While arriving at this conclusion, the NCLT, inter alia observed that the loan had been extended as a prepayment to enable Ruchi Soya in turn to utilize the same for its working capital requirements so as to generate production of the goods to be exported and had not been given for the immediate supply of goods by Ruchi Soya. In other words, the loan was advanced as a finance to cater to the needs of Ruchi Soya.

In light of above, it can be comfortably stated that structuring of transaction by overseas buyer will decide whether the status of the debt is operation or financial.

Conclusion

As we are looking towards making India an Atmanirbhar Bharat, the Indian manufacturer and exporter will require consistent working capital to build a strong supply chain. Trade Finance in various forms may prove to be one of the most important modes of sufficient funding to the Indian business houses. Unlike loan facility the rate of default in trade finance is very less as it is purely dependent on the business strength and past record of the debtor and the need of the hour is to have a level playing field for all the onshore and global financiers. In this regard, the Government should consider liberalizing trade finance modes like factoring and export advances by which Indian business houses can tap foreign funding at competitive rates and giving the status of financial debtor to trade financiers not depending on the mode of trade finance structures.

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