

**RBI/2004-05/168**

**DBS. CO.PP.BC. 6 /11.01.005 /2004-05**

**September 08, 2004**

To,

All Scheduled Commercial Banks (excluding RRBs)

Madam/Sirs

**Opening of LCs for Import/Export of Gold and other commodities**

We invite reference to our Foreign Exchange Department circular A.P. (DIR Series) Circular No. 2 dated July 09, 2004 in terms of which it has been advised interalia that banker's prudence should be strictly exercised for all transactions pertaining to import of gold. Further, any large or abnormal increase in volume of transactions of the importer should be closely examined to ensure that the transactions are bonafide trade transactions.

Recent scrutinies undertaken by our offices have disclosed similar large scale opening of Letters of Credit (LCs) in the import of diamonds and also other commodities like edible oil, copper etc. Two examples are given below:

- (i) Against LCs opened by the Indian banks for one year for import of commodities like oils, diamonds, the importer/exporter gets sale proceeds within a short period of time say 30-45 days. The proceeds are then deposited with banks as Fixed Deposits (FDs) for opening further LCs. This cycle of opening LCs had resulted in huge FDs and huge outstanding LCs. The turnover of the entity in some cases jumped more than ten times within a short period.
- (ii) A trading company abroad sent advance payments to an Indian counterparty. Each advance was supported by a contract in which the Indian counterparty was stated to be supplying agricultural commodities at the buyer's option during the period of one year from the date of advance. The advance so received was kept in the form of FDs with the banks in India and against these deposits, LCs were opened in favour of the same company that had sent the advance remittance. Payments were made under the LC on the due dates. The amount kept as security was rolled

over as security for another LC. The amount of LCs opened in this manner exceeded Rs. 2,000 crore in respect of the same entity within a short period.

It is needless to add that the safeguards advised vide FED A.P. (DIR Series) circular No. 2 dated July 09, 2004 are equally applicable for unusual increase in import/export transactions facilitated through LCs opened by banks in other commodities as well.

Kindly advise us the systems put in place in your bank for ensuring the adoption of safeguards as advised in FED circular referred to above in case of gold imports as also other commodities.

Please acknowledge receipt.

Yours faithfully,

-Sd-

(R.C. Arora)  
Chief General Manager