RBI/2006-2007/303
DBOD No. Dir.BC.72/ 13.03.00/2006-07

April 3, 2007

Chief Executives of all Scheduled Commercial Banks
(Excluding RRBs)

Dear Sir,

Guarantees for Export Advance

It has come to our notice that exporters with low export turnover are receiving large amounts as export advances, in low interest rate currencies, against domestic bank guarantees and are depositing such advances with banks in Indian Rupees for interest rate arbitrage. Further, the guarantees are being issued even before the receipt of the advances, with a proviso that the guarantees would be operational only upon receipt of the advances. The guarantees have been issued at par values, against the discounted values of the export advances. The exporters have also been allowed to freely book, cancel and rebook forward contracts without any crystallized exports and / or past performances, in contravention of the FEMA regulations. It has also been observed that the exporters keep a substantial part of their Indian Rupee – US Dollar leg of the currency exposure open, thereby exposing both the exporters and the domestic banks to foreign exchange risk. In such cases, generally no exports have taken place and the exporters have neither the track record nor the ability to execute large export orders. The transactions have basically been designed for taking advantage of the interest rate differential and the currency movements and have implications for capital flows.

2. The guarantees are permitted in respect of debt or other liability incurred by an exporter on account of exports from India. It is therefore intended to facilitate execution of export contracts by an exporter and not for other purposes. In terms of the extant instructions banks have also been advised that guarantees contain inherent risks and that it would not be in the banks' interest or in the public interest generally to encourage parties to over-extend their commitments and

embark upon enterprises solely relying on the easy availability of guarantee facilities. It is therefore, reiterated that as guarantees contain inherent risks, it would not be in the interest of the banks or the financial system if such transactions as mentioned in para 1 above are entered into by banks. Banks are, therefore, advised to be careful while extending guarantees against export advances so as to ensure that no violation of FEMA regulations takes place and banks are not exposed to various risks. It will be important for the banks to carry out due diligence and verify the track record of such exporters to assess their ability to execute such export orders.

3. Banks should also ensure that the export advances received by the exporters are in compliance with the regulations/directions issued under the Foreign Exchange Management Act, 1999.

Yours faithfully,

(P. Vijaya Bhaskar)
Chief General Manager