

1st April 2003

Addressed to all heads of Ids/FEDs of Member Banks

Dear Sir,

International Standby Practices ISP 98

FEDAI Guidelines on Standby Letters of Credit

International Chamber of Commerce (ICC), Paris has come out with the publication of International Standby Practices - ISP 98 (ICC Publication No.590). Although the recourse to Standbys has been limited hitherto in several countries (including India), with the separate set of rules embodied in ISP 98, it is gaining more usage.

The question of adopting ISP 98 by banks in India was examined in detail by FEDAI and RBI. In this connection, we refer to RBI's AP (DIR Series) Circular No.84 dated 3rd March 2003 permitting authorised dealers to open standby letters of credit on behalf of their importer constituents for import into India of goods (which are permissible under the EXIM Policy) subject to adherence to the guidelines issued by FEDAI. Accordingly, taking into account the provisions of ISP 98, the existing regulatory requirements and prudent banking practices, our Technical Committee has prepared the guidelines regarding standby letters of credit which have been approved by our Managing Committee. A copy of the said guidelines is enclosed.

We would emphasise that while opening Standbys, care should be taken to ensure compliance with regulatory requirements with regard to import of goods and remittances therefor. We would advise member banks to make their concerned staff members familiar with the provisions of ISP 98. FEDAI also proposes to conduct specific programmes on ISP 98 for the benefit of officers of our member banks.

It is proposed to take a review of these guidelines after six months by which time we will have the benefit of the experience of banks. Accordingly, we would request you to send us in due course your suggestions / feedback on the issuance of commercial Standbys under ISP 98.

Yours faithfully,

Chief Executive

Encl. : a/a.

FEDAI GUIDELINES ON STANDBY LETTERS OF CREDIT

Preamble:

Traditional LC governed by Uniform Customs & Practice for Documentary Credits - ICC Publication No.500 (UCPDC) enable the seller to obtain payment after fulfilling his obligations as evidenced by the presentation of the documents stipulated under the LC. A standby LC is often used to cover the "non-performance" situation. To that extent, standby LCs act almost like a substitute for guarantees.

While UCPDC, inter alia, permits issuance of standby letter of credit, ICC formulated a separate set of rules relating to standby LCs in 1998 viz. International Standby Practices (ISP-98) ICC Publication No.590 which has come into force as on 1st January 1999. ISP 98 reflects the generally accepted practice, custom and usage of standby letter of credit.

After detailed examination of the various provisions of ISP 98, it has been decided in consultation with RBI to adopt ISP 98. Hence, it will be in order for authorised dealers to issue Standby Letters of Credit either under ISP 98 or UCP 500 as agreed upon mutually by the parties concerned.

1. Usage of Standby LC by Authorised Dealers

Standby LC may be undertaken for the following transactions:-

(i) As a document of promise in respect of "non-performance" situation especially as a substitution to the guarantees which ADs are permitted to issue under FEMA, such as issuing a guarantee in respect of any debt, obligation or other liability incurred by

- a. an exporter on account of exports from India
- b. owed to a person resident in India by a person resident outside India for a bonafide trade transaction, duly covered by a counter guarantee of a bank of international repute resident abroad.

(ii) Exporters may opt to receive Standby Letters of Credit in respect of exports from India

2. Commercial Standby for Imports into India

Authorised dealers in India are now permitted by RBI {vide AP (Dir Series) Circular No.84 dated 03.03.2003}, to issue standby LCs towards import of goods to India. Issuance of commercial standby LC covering import of goods is susceptible to certain attendant risks in the absence of evidence of shipment/ insurance cover. Importers should therefore be advised that Documentary Credit under UCP 500 should be the preferred route for imports of goods into India is to be considered on merits.

If Standby Letters of Credit are issued covering imports into India (either under UCP 500 or ISP 98), importer customers are to be explained of the risk factors involved/chances of abuse in acceding to the request for establishment of standby LCs for import of goods into India. Appropriate safeguards and precautions some of which are illustrated below shall be observed by authorised dealers where such standby credits are issued.

a. The facility of issuing Commercial Standby shall be extended on a selective basis and to the following categories of importers only:-

- i. Where such Standbys are required by applicants who are independent power producers/importers of crude oil and petroleum products.
- ii. Special category of importers viz. Export Houses/Trading Houses/Star Trading Houses/Superstar Trading Houses/ 100% E.O.Us
- iii. Public Sector Units/Public Limited Companies with good track record.

b. Satisfactory credit report on the overseas supplier should be obtained by the issuing bank before issuing Standbys.

c. Invocation of the Commercial standby by the beneficiary is to be supported by proper evidence. The beneficiary of the credit should furnish a declaration to the effect that the claim is made on account of failure of the importer to abide by his contractual obligations, along with the following documents.

i. a copy of invoice

ii. non-negotiable set of documents including a copy of non-negotiable Bill of Lading/transport document

iii. a copy of Lloyds/SGF inspection certificate wherever provided for as per the underlying contract.

d. Incorporation of a suitable clause to the effect that in the event of such invoice/shipping document has been paid by the authorised dealer earlier, provisions to dishonour the claim quoting the date/ manner of earlier payment of such documents may be considered.

e. The applicant of a Commercial Standby Letter of Credit (Indian importer) shall undertake to provide evidence of imports in respect of all payments made under standby. (Bill of Entry).

f. Authorised Dealers shall follow up evidence of imports as provided for under FEMA in all cases of payments made under standby covering imports into India.

Fixing Limits for Standby/Undertaking to be obtained from the Applicant

1. Banks must assess the credit risk in relation to standby and explain to the importer customers the inherent risk in a standby covering importation of goods.

2. Discretionary powers for sanctioning standby LC limit for import of goods may be delegated to controlling office/zonal office only.

3. A separate limit for establishment of standby LC is desirable rather than permitting it under the regular documentary LC limit.

4. Due diligence on the importer as well as beneficiary is essential.

5. Unlike documentary credits, banks do not hold original negotiable documents of titles to goods (such as original B.L). Hence while assessing and fixing credit limits for standbys, banks shall treat such limits as clean for the purpose of discretionary lending powers and compliance with various RBI regulations.

6. Application cum guarantee for standby should be obtained from the applicant.

7. Banks may consider obtaining a suitable indemnity/undertaking from the importer clients that all remittances towards their import of goods as per the underlying contract for which standby LC is issued) will be made only through the same branch which has issued the Standby.

8. The importer should give an undertaking that he shall not raise any dispute regarding the payment made by the bank in standby LC at any point of time howsoever, and will be liable to the bank for all the amount paid therein. The importer should also indemnify the bank from any loss, claim, counter claims, damages, etc. which the bank may incur on account of making payment under the standby LC.

9. Presently, when the documentary LC is established through SWIFT, it is assumed that the documentary LC is subject to provisions of UCPDC. Accordingly, whenever standby LC under ISP 98 is established through SWIFT, a specific clause must appear that standby LC is subject to provisions of ISP 98.

10. It should be ensured that the issuing bank, advising bank, nominated bank etc. have all subscribed to ISP 98 in case standby is issued under ISP 98.

11. When payment under a standby LC is effected, the issuing bank shall report invocation/payment to Reserve Bank of India.

Implications of some of the Articles of ISP 98

Implications of the provisions of each of the articles of ISP 98 are to be carefully understood. We give below a few of the articles of ISP which need special attention. These are only illustrative and not therefore exhaustive.

Article 1.02

ISP 98 Rule supplements the applicable law to the extent not prohibited by that law. Hence, if there is any provisions in the Rules which conflict with Indian Law, such provision would not be applicable.

Article 1.09 - Business day

The terminologies “Business day” and “Banking day” have been defined under this article as under.

“Business day” means a day on which the place of business at which the relevant act is to be performed is regularly open; and “Banking Day” means a day on which the relevant bank is regularly open at the place at which the relevant act is to be performed.

The definition of “Business Day” and “Banking Day” may need to be properly addressed in the course of issuance/handling of a Standby Letter of Credit.]

Article 3.13 - Expiration Date on Non-Business day

Article 3.14 - Closure on a Business Day and Authorization of another reasonable place for presentation

The Article is reproduced below:

a. If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides.

b. Upon or in anticipation of closure of the place of presentation, an issuer may authorize another reasonable place for presentation in the standby or in a communication received by the beneficiary. If it does so, then

i. presentation must be made at that reasonable place; and

ii. if the communication is received fewer than thirty calendar days before the last day for presentation and for that reason presentation is not timely made, the last day for presentation is automatically extended to the day occurring thirty calendar days after the last day for presentation.

Our comments

As per Article 17 of UCP 500, banks assume no liability or responsibility for the consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes or lockouts. Unless specifically authorised, banks will not, upon resumption of their business, pay, incur a deferred payment undertaking, accept Draft(s) or negotiate under Credits which expired during such interruption of their business. Provisions of Article 3.13 & 3.14 have to be taken note of while dealing with Standby under ISP 98.

Article 5.01 Timely Notice of Dishonour

The article provides for timely notice of dishonour as per the provisions contained therein.

Our comments

Article 13 b of UCP 500 provides that the issuing bank, confirming bank if any or a nominated bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

However, ISP 98 provides that the notice given within three business days is deemed to be not unreasonable, and beyond seven business days is deemed to be unreasonable.

Banks should familiarise themselves with the different notice period in respect of UCP 500 and ISP 98 while examining the documents under standbys issued either under UCP 500/ISP 98 as the case may be.

Syndication/Participation

Article 10.01 and 02 relating to syndication/participation under standby LC may be taken note of by the banks issuing such standbys under syndicated/ consortium loan arrangements among authorised dealers.