Offshore Banking

Meaning of Offshore Banking: Offshore banking refers to the international banking business involving non-resident foreign currency-denominated assets and liabilities. It refers to the banking operations that cover only non-residents and do not mix with the domestic banking.

Meaning of Offshore Banking centre: An offshore banking centre is a place where deliberate attempt is made to attract international banking by offering many concessions in the form of taxes and levies being imposed at lower rates or not being charged, moderate or light financial regulation, secrecy in banking etc.

Meaning of Offshore Banking units (OBUs): Offshore banking units in the centre can carry on their activities of deposit taking from and lending to international enterprises or investors without conflict with the domestic fiscal and monetary policy. Offshore banking units are branches of international banks or subsidiaries. They do not carry retail business, but generally provide wholesale banking services, namely project financing, syndicated loans, merchant banking activities in foreign currency denominated bonds and equity shares. MNCs mostly prefer transacting in Offshore financial centres because of tax benefits, freedom from exchange control regulations, maintenance of secrecy of deals etc.

Presence of OBU worldwide: Offshore banking is carried out in about 20 centres throughout the world which offer the following benefits:
1. Exemption from minimum reserve requirements i.e CRR, SLR
2. Freedom from control on interest rates
3. Low or non-existent taxes and levies
4. Entry is relatively easy
5. Licence fees are generally low

Features of OBUs:
1. Involves non-resident foreign currency-denominated assets and liabilities
2. Enjoy many concessions in taxation, exchange control regulations and other banking regulations
3. The markets operates 24 hours a day
4. Offshore banking is an extension of the concept of Eurocurrency to East. These centres exist in almost all Asian countries like Singapore, Hongkong, Korea, Philippines, Colombo and Bahamas.
5. Provide Wholesale banking services
6. MNCs prefer banking with OBUs due to tax advantages, secrecy of transactions, freedom from exchange control etc.
7. Provides better access to international capital markets

Participation of the Indian banks
Few Indian banks, such as State Bank of India, Indian Overseas Bank, Bank of India and Bank of Baroda, have set up offshore banking units for deposit taking and final lending at Bahrain, Hong Kong, Colombo, Cayman Islands, and so on. Indian Bank, Bank of Baroda and Union Bank of India jointly floated a deposit taking company, IBU International Finance, in Hong Kong for both offshore and onshore banking. The benefits for the Indian banks from these ventures are:
1. Sizeable profits — as these ventures involve relatively low operating costs.
2. With multi-currency deposit bases, the banks would be able to serve better the needs of their customers who have set up joint ventures abroad in the form of foreign currency finance.
3. The banks would strengthen the country's balance of payments through repatriation of profits from the venture.

Offshore banking centre in India
Financial experts have been pleading to establish an offshore banking centre in India. Geographically, India provides distinct advantages in attracting offshore banking units, because it has a stable economic and political performance, a vast market, technical manpower that could find employment in these centres. Another
advantage is that the Indian market would open a little before the Tokyo market closes, and close before New York opens, thus providing a vital time link for international money market dealers. In an era where many Indian corporations are functioning abroad, and many corporations are granted permission to seek overseas finance, establishing an offshore unit will help tap the resources.

The benefits of Offshore Banking:
1. Exporters would benefit in terms of finer margins on loans and better foreign exchange rates available via an offshore banking unit.
2. The benefits of multi-currency operations which, to an extent, minimise currency fluctuation risk, will be an added advantage.
3. Salaries paid by offshore banks and local expenditure incurred by them contribute to the economy’s welfare. For smaller countries, the benefit would be greater. For a larger country such as India, however, this may not form a significant portion of the total income.
4. India may earn revenue in the form of licence fees, profit taxes imposed on the banks operating in the area. It may also get the benefit of banks’ funds in the form of capital and liquidity requirements.
5. The country can gain improved access to the international capital markets.
6. The domestic financial system may become more efficient through increased competition and exposure of the domestic banks to the practices of offshore banks.
7. The offshore banking centres will provide opportunities to train the local staff which will, in turn, contribute to faster economic growth.
8. The offshore banking units would help channelise non-resident Indian investments.
9. Setting up offshore banking centres would trigger enforced development of more advanced communication facilities — a must for their functioning.

But establishing offshore centres also comes with a price/ Disadvantages
1. The supervision and regulation of offshore banks may involve substantial costs.
2. Encouraging offshore banking may result in the diminution in autonomy of domestic monetary policy, since it is difficult to draw a line always between the offshore and onshore operations, particularly in the absence of exchange control.
3. Offshore banking provides scope for tax evasion by residents. For instance, in Hong Kong, it was found that residents place deposits with offshore banks and take loans of the same amount. The interest on loan would be a deductible expenditure for taxation, while the income from interest on deposits is not taxed.
4. Offshore banks may prove to be harmful competitors to the local banks and may inhibit their growth.

In India Offshore banking units are permitted to be set up in SEZs. These branches would be virtually foreign branches of Indian banks but located in India. These OBUs are exempt from CRR, SLR and they provide international finance to SEZ units and SEZ developers.

Loan Syndication:
Meaning: Syndicated loans are loans made by two or more lenders and administered by a common agent using similar terms and conditions and common documentation. Since’ Eurocredit runs into a huge amount, it is not safe or possible for a single bank to undertake the entire amount. Thus few banks form a syndicate to provide funds to the borrower. The practice is also partly due to the US laws which provide limitations on loans of any single bank to any single borrower. Bank syndicates are not permanent groupings. They are formed in each case by banks willing to participate in the credit.

Parties in Loan Syndication:
1. Lead Manager or Arranger
2. Co-managers
3. Participating Banks
4. Managing Agent

Ellaborate their role from the explanation given in the process of mechanism of loan syndication on p.g. 21.

Benefits of Loan Syndication:
To the Borrower:

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1. Loan Syndication allows the borrower to access from a diverse group of financial institutions. The borrower is not required to deal with different lenders separately. He has to deal with the lead manager and the managing agent only, thereby saving time and resources.

2. Borrowers can raise funds more cheaply in the syndicated loan market than they can borrow the same amount of money through a series of bilateral loans. This cost saving increases as the amount required rises.

3. Raising finance through this method is quicker and simple way of raising huge funds as compared to issue of bonds or equity.

4. Flexibility in structure and pricing. Borrowers have a variety of options in shaping their syndicated loan, including multicurrency options, risk management techniques, and prepayment rights without penalty.

5. Syndicated loan facilities can increase competition for banks, prompting other banks to increase their efforts to put market information in front of you in hopes of being recognized. This would benefit the borrower by strengthening his bargaining position.

To the Lending Banks and participants:
1. The most important advantage to the bankers is diversification of risk because each member of the syndicate contributes part of the loan amount.
2. Small lending institutions also get the opportunity to finance large proposals as have to contribute a part of the capital provided by way of loan.
3. The lead bank/arranger gets fee based income without committing capital.
4. Lending syndication process increases banks credibility and its network with other banks.
5. Loan syndication provides extra business opportunity to the lenders.

EXIM Bank:
Export-Import Bank of India is the premier export finance institution of the country, set up in 1982 under the Export-Import Bank of India Act 1981. Government of India launched the institution with a mandate, not just to enhance exports from India, but to integrate the country’s foreign trade and investment with the overall economic growth. Since its inception, Exim Bank of India has been both a catalyst and a key player in the promotion of cross border trade and investment.

Objective:
“... for providing financial assistance to exporters and importers, and for functioning as the principal financial institution for coordinating the working of institutions engaged in financing export and import of goods and services with a view to promoting the country’s international trade...”

“... shall act on business principles with due regard to public interest”

: The Export-Import Bank of India Act, 1981

Exim Bank offers the following Export Credit facilities, which can be availed of by Indian companies, commercial banks and overseas entities.

For Indian Companies executing contracts overseas
Pre-shipment credit: Exim Bank’s Pre-shipment Credit facility, in Indian Rupees and foreign currency, provides access to finance at the manufacturing stage - enabling exporters to purchase raw materials and other inputs.

Supplier’s Credit: This facility enables Indian exporters to extend term credit to importers (overseas) of eligible goods at the post-shipment stage.

For Project Exporters:
Indian project exporters incur Rupee expenditure while executing overseas project export contracts i.e. costs of mobilisation/acquisition of materials, personnel and equipment etc. Exim Bank’s facility helps them meet these expenses.

For Exporters of Consultancy and Technological Services:
Exim Bank offers a special credit facility to Indian exporters of consultancy and technology services, so that they can, in turn, extend term credit to overseas importers.

**Guarantee Facilities:** Indian companies can avail of these to furnish requisite guarantees to facilitate execution of export contracts and import transactions.

**For commercial Banks:** Exim Bank offers Rediscounting Facility to commercial banks, enabling them to rediscount export bills of their SSI customers, with usance not exceeding 90 days.

We also offer Refinance of Supplier’s Credit, enabling commercial banks to offer credit to Indian exporters of eligible goods, who in turn extend them credit over 180 days to importers overseas.

**Other Facilities for Indian Companies:** Indian companies executing contracts within India, but which are categorized as Deemed Exports in the Foreign Trade Policy of India or contracts secured under international competitive bidding or contracts under which payments are received in foreign currency, can avail of credit under our Finance for Deemed Exports facility, aimed at helping them meet cash flow deficits.

**For Overseas Entities:**

**Buyer’s Credit:** Overseas buyers can avail of Buyer’s Credit from Exim Bank, for import of eligible goods from India on deferred payment terms.

**Eligible Goods:** Capital goods, plant and machinery, industrial manufactures, consumer durables and any other items eligible for being exported under the ‘Exim Policy’ of the Government of India.

**What is ECGC?**

Export Credit Guarantee Corporation of India Limited, was established in the year 1957 by the Government of India to strengthen the export promotion drive by covering the risk of exporting on credit.

Being essentially an export promotion organization, it functions under the administrative control of the Ministry of Commerce & Industry, Department of Commerce, Government of India. It is managed by a Board of Directors comprising representatives of the Government, Reserve Bank of India, banking, insurance and exporting community.

ECGC is the fifth largest credit insurer of the world in terms of coverage of national exports. The present paid-up capital of the company is Rs.800 crores and authorised capital Rs.1000 crores.

**What does ECGC do?**

- Provides a range of credit risk insurance covers to exporters against loss in export of goods and services
- Offers guarantees to banks and financial institutions to enable exporters to obtain better facilities from them
- Provides Overseas Investment Insurance to Indian companies investing in joint ventures abroad in the form of equity or loan

**How does ECGC help exporters?**

- Offers insurance protection to exporters against payment risks
- Provides guidance in export-related activities
- Makes available information on different countries with its own credit ratings
- Makes it easy to obtain export finance from banks/financial institutions
- Assists exporters in recovering bad debts
- Provides information on credit-worthiness of overseas buyers

**Need for export credit insurance**

Payments for exports are open to risks even at the best of times. The risks have assumed large proportions today due to the far-reaching political and economic changes that are sweeping the world. An outbreak of war or civil war may block or delay payment for goods exported. A coup or an insurrection may also bring about the same result. Economic difficulties or balance of payment problems may lead a country to impose restrictions on either import of certain goods or on transfer of payments for goods imported. In addition, the exporters have to face
commercial risks of insolvency or protracted default of buyers. The commercial risks of a foreign buyer going bankrupt or losing his capacity to pay are aggravated due to the political and economic uncertainties. Export credit insurance is designed to protect exporters from the consequences of the payment risks, both political and commercial, and to enable them to expand their overseas business without fear of loss.

Do from vipul text book: brief information of schemes of ECGC / guaranties provided

Some important points:
Make the most of holidays...u all are lucky batch to get holiday for a paper like IBF..dont waste time and finish portion before time...study smart..

P.g No. 1 to 13: Emphasize on the following questions:

1. Fixed Exchange Rate system – meaning, advantages & disadvantages
2. Flexible Exchange rate system – meaning, adv and disadvantages
3. Gold standard: Features, Advantages, Disadvantages/ reasons for failure
4. BWS: Features, Breakdown, Triffins paradox, Smithsonian agreement
5. Gold Standard v/s. BWS

Dont do EMU given on page no. 4 & 5

6. Balance of Payments – Meaning, Components (format), relevance
7. Shortnote on SDR
8. Rupee Convertibility: meaning (pg 5) and then insert point no 10, 11, 12 and current status from pt no. 13 of history of INR
   Advantages and Disadvantages of Rupee Convertibility
   Prerequisites and why no FCAC

Other chapters do all:
Note: Mechanism of ADR is same as GDR..just make changes wherever required in the answer

Distinction between Direct Exchange and Indirect exchange rate is important
Distinction between Indian GAAP rules and US GAAP rules is important
Keep time to study External hedging strategies from FSM..in our notes we have asked u to do from FSM...i.e Derivatives..Futures, options, forwards..

After doing theory completely keep time to refer to past board papers and understand how questions are framed..many times students don’t understand the required question and write wrong answers..

Also learn the format of advances as it appears in banks balance sheet and NPA from other subjects..

ALL the BEST
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