

'LoU ban to hit importers as costs rise'

CII, Assocham say RBI's move to hurt export competitiveness, especially for SMEs

LALATENDU MISHRA
MUMBAI

The Reserve Bank of India's directive barring banks from issuing Letters of Undertaking (LoUs) has brought the \$85 billion buyers' credit market – a key source of low-cost trade finance for the country's importers – to an abrupt standstill.

The RBI's move on Tuesday, coming in the wake of the \$2 billion LoU fraud at state-owned Punjab National Bank, evoked sharp reactions from trade and industry organisations, which argued that the abrupt move would push up financing costs for the country's importers and exporters. Many exporters used the LoUs to help fund their imports of raw materials and the central bank's decision would

hurt their competitiveness, the lobby groups said.

'Disruptive impact'

"The decision would have a disruptive impact on the buyers' credit market, in the immediate term," Shobana Kamineni, president of the Confederation of Indian Industry, said in a statement. "The traders who have been conducting business through these instruments will now have to necessarily shift their transactions to Letters of Credit and Bank Guarantees. The result would be that cost of credit may go up, especially for the SMEs."

Industry bodies said the gems and jewellery sector was likely to be the worst affected by the LoU ban.

"A lot of people, especial-

ly genuine businessmen, will be impacted and the ban is not exactly the proper thing to do," said Rajesh Mehta, Chairman, Rajesh Exports Ltd., one of India's largest bullion exporters.

Mr. Mehta said costs for the trade would rise as the LoU was a simple method to avail international trade finance.

LIBOR-based pricing

LoUs were the cheapest source of funding as the credit provided against them were typically priced 20-30 basis points above the three-month or six-month LIBOR. The total cost was about 2.3%, which is much lower than the average of 10% or more for any rupee loan product. Since the LoU route is no longer available, impor-

ters have to provide bank guarantees or letters of credit, which are more expensive.

Assocham secretary general D.S. Rawat said following the ban, importers – essentially in the gems and jewellery trade – were unable to raise money to secure their shipments.

'Few black sheep'

"The costs have gone up since raising money through the LoU was the cheapest source of raising finance. We had a product which was an important instrument of trade finance, particularly for import-based exporters; so, if a few black sheep have taken advantage of the situation, the fault does not lie with the LoU," Assocham's Mr. Rawat said.