

PNB scam fallout: Trade finance hit as caution prevails, premium soars

Despite the immediate setback, bankers, however, feel that there will not be a complete freeze so that a genuine businessman's operations are affected

Press Trust of India | Mumbai March 05, 2018 Last Updated at 01:08 IST

In what can impact the exim trade, the Rs 126 billion Nirav Modi scam at Punjab National Bank has affected trade finance activities as lenders have become extra cautious, while the premium on Indian paper has shot up by 10-50 bps, say bankers.

"The PNB fraud has already affected trade financing. No bank is now prepared to extend letters of understanding (LoUs). The ability of a company to raise money through LoUs from abroad has been affected badly," a senior official from a state-run bank has told PTI.

A private sector banker closely associated with the activity echoed the same, saying lenders have taken a "cautious" approach in the aftermath of the largest financial fraud in the history of the nation.

Despite the immediate setback, bankers, however, feel that there will not be a complete freeze so that a genuine businessman's operations are affected.

The fraud unearthed at the Brady House branch of PNB had diamontiare Nirav Modi and his various



Pedestrians walk past a Punjab National Bank office in Mumbai (Photo: Reuters)

done, because an LoU is generally taken at face value.

"Historically, there has been no default on buyer's credit, as it is guaranteed by another bank, and so we take it as 100 per cent safe business. This is for the first time that we saw a problem. We are building some mechanisms to strengthen it," Union Bank of India managing director and chief executive Rajkiran Rai G told *PTI*.

"In the Nirav Modi case, our people got carried away by the PNB guarantee and they took that risk. Now, we are taking care of that and even though it is a guarantee from government-run bank, we'll evaluate counter-parties. We are putting certain limits in place so that in future such things do not happen again," Rai added.

The scam, came to light only on February 14, has also dented the country's profile at the world stage, said some other bankers who spoke off-the-record, adding the delay in finding a resolution will further dent the image.

company officials colluding with senior officials of the state-run lender, wherein LoUs were issued without proper checks and securities. The fraud went undetected for many years as the SWIFT, the financial transaction messaging system, was not linked to PNB's core banking system. As a result of this the issues LoUs were not shown in the bank's books.

An LoU is a guarantee by a bank to pay another lender for import by companies and is considered very crucial for cross-border trade which helps the importer access funds at lower costs.

Meanwhile, bankers said the cost of funds for domestic exporters/importers has gone up considerably following the scam, as for the LoUs already issued, a "risk premium" has already been set in for any Indian paper.

While one private sector banker said the trade is availing of the same, LoU-based short-term loans are coming in at a premium of 10-30 basis points, another private banker said in some cases it has gone up to even 50 bps.

One of the two bankers cited above said calls are being made to the issuer bank for re-confirming the genuineness even though it is not supposed to be

"If PNB does not honour the commitment of paying up as newer LoUs mature, it will affect the country as a lot as it may not be only Indian lenders which will be having exposures to Modi's firms through PNB issued LoUs," said another banker.

Although PNB managing director and chief executive Sunil Mehta had said the bank would honour all bonafide commitments under the LoUs, there are reports about some disputes between PNB and other lenders on repayment.

Bankers say more than the interest income, they look at trade finance as a source of fee income. This results in many banks using a vibrant secondary market to pass on their dollar exposure to other lenders, including foreign ones too.

"This is a business that we cannot stop. In foreign branches, 60-70 per cent business happens through letters of credit, buyer's credit and bill discounting. We are not slowing down but checks will be tougher," Rai said.

It can be noted that as of now, Modi has already defaulted on loans of over Rs 2.8 billion but more loans will be coming up for repayment as months pass by.

Another state-run banker said demand for LoUs has also come down following the scam. "It's not the time that companies will choose to raise money through LoUs. They will wait for sometime till the Modi issue settles down," the official said.

Lenders have also begun a process to improve their own practices so that a similar incident does not reoccur, say another banker.

Rai said UBI has improved monitoring mechanisms at its foreign branches, and has also mandated a monthly training module to the staff and will be careful about the quality of staff being sent on overseas assignments from now on.