Credit tangle: on LoU ban

A month after the 12,800-crore letters of undertaking (LoUs) fraud at Punjab National Bank came to light, the Reserve Bank of India has decided to ban such instruments as well as letters of comfort issued by bankers to businesses for international transactions. While the government has been in firefighting mode, unleashing all investigative agencies to probe the fraud, this is the first major step by the central bank on the issue, apart from asking banks to ensure there are no slip-ups between their core banking systems and the SWIFT mechanism used for international money transfers. LoUs are among the most popular instruments to secure overseas credit by importers — known as buyers' credit in banking parlance — because of their attractive pricing. It is estimated that overall, bank finance for imports into India is around $140 billion, of which over 60% is funded through such buyers' credit. Naturally, industry is unhappy with the RBI decision as this would raise the cost for importers, who will now need to rely on more expensive instruments such as bank guarantees and letters of credit. The move will also impact the competitiveness of exporters who import raw materials for their products.

While the central bank had earlier blamed "delinquent behaviour by one or more employees of the bank" and failure of internal controls for the PNB-Nirav Modi fiasco, RBI Governor Urjit Patel has finally commented on the fraud. Mr. Patel said he had chosen to speak because the central bank also feels the anger and pain over the banking sector frauds that amount to "looting" the country's future by "some in the business community, in cahoots with some lenders". Reiterating that PNB's internal systems failed to take note of the RBI's warnings about such risks, Mr. Patel took on severe criticism about the RBI's inability to detect the fraud. He stressed that the RBI didn't have adequate powers to regulate public sector banks, and it could not remove any of their directors or liquidate such a lender, as it can in the case of private sector banks. He made an eloquent demand that the owner of public sector banks (that is, the government) must consider making the RBI's powers over banks 'ownership-neutral' and say what could be done with these banks. The RBI's stance is valid, as is its discomfort with knee-jerk reactions and the blame games since the fraud came to light. In the very same vein, its omnibus ban of LoUs will impact the $85 billion buyers' credit market that was mostly conducted in accordance with the law of the land. If an individual or some failed systems of a bank were indeed to blame, why should *bona fide* transactions suffer? Perhaps the RBI could have tightened the norms for LoUs and introduced safeguards based on the latest learnings. It is still not too late to do that.

The revival of the Trans-Pacific Partnership, sans U.S., must buttress the free trade debate

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