

Discounting / Rediscounting of Bills by banks

DBOD.Dir.BC. 62/13.07.09/2002- 03

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**All Scheduled Commercial Banks
(excluding RRBs / LABs)**

Dear Sir,

Discounting / Rediscounting of Bills by banks

Please refer to our circular DBOD No. BC. 8/16.13.100/92-93 dated July 27, 1992.

2. Banks may be aware that in December 1999, Reserve Bank of India (RBI) had constituted a Working Group on Discounting of Bills by Banks under the Chairmanship of Shri K.R. Ramamoorthy, Chairman, Vysya Bank Ltd. The Working Group had examined in detail the suggestions of various banks, financial institutions and non-bank financial companies in regard to granting of freedom to banks in discounting of bills and banks evolving their own guidelines / safeguards for discounting of genuine trade bills. After considering the recommendations of the Working Group, it has been decided that in supersession of our Circular DBOD No. BC. 8/16.13.100/92-93 dated July 27, 1992, banks may adhere to the following guidelines while purchasing / discounting / negotiating / rediscounting of genuine commercial / trade bills :

- (i) Since banks have already been given freedom to decide their own guidelines for assessing / sanctioning working capital limits of borrowers, they may sanction working capital limit as also bills limit to borrowers after proper appraisal of their credit needs and in accordance with the loan policy as approved by their Board of Directors.
- (ii) Banks should clearly lay down a bills discounting policy approved by their Board of Directors, which should be consistent with their policy of sanctioning of working capital limits. In this case, the procedure for Board approval should include banks' core operating process from the time the bills are tendered till these are realised. Banks may review their core operating processes and simplify the procedure in respect of bills financing. In order to address the oft-cited problem of delay in realisation of bills, banks may take advantage of improved computer / communication network like Structured Financial

Messaging System (SFMS) and adopt the system of 'value dating' of their clients' accounts.

- (iii) Banks should open letters of credit (LCs) and purchase / discount / negotiate bills under LCs only in respect of genuine commercial and trade transactions of their borrower constituents who have been sanctioned regular credit facilities by the banks. Banks should not, therefore, extend fund based (including bills financing) or non-fund based facilities like opening of LCs, providing guarantees and acceptances to non-constituent borrower or / and non-constituent member of a consortium / multiple banking arrangement.
- (iv) For the purpose of credit exposure, bills purchased / discounted / negotiated under LCs or otherwise should be reckoned on the bank's borrower constituent. Accordingly, the exposure should attract a risk weight appropriate to the borrower constituent (*viz*; 100% for firms, individuals, corporates etc.) for capital adequacy purposes.
- (v) While purchasing / discounting / negotiating bills under LCs or otherwise, banks should establish genuineness of underlying transactions / documents.
- (vi) Banks should ensure that blank LC forms are kept in safe custody as in case of security items like blank cheques, demand drafts etc. and verified / balanced on daily basis. LC forms should be issued to customers under joint signatures of the bank's authorised officials.
- (vii) The practice of drawing bills of exchange claused 'without recourse' and issuing letters of credit bearing the legend 'without recourse' should be discouraged because such notations deprive the negotiating bank of the right of recourse it has against the drawer under the Negotiable Instruments Act. Banks should not therefore open LCs and purchase / discount / negotiate bills bearing the 'without recourse' clause.
- (viii) Accommodation bills should not be purchased / discounted / negotiated by banks. The underlying trade transactions should be clearly identified and a proper record thereof maintained at the branches conducting the bills business.
- (ix) Banks should be circumspect while discounting bills drawn by front finance companies set up by large industrial groups on other group companies.
- (x) Bills rediscounts should be restricted to usance bills held by other banks. Banks should not rediscount bills earlier discounted by non-bank financial

companies (NBFCs) except in respect of bills arising from sale of light commercial vehicles and two / three wheelers.

- (xi) Banks may exercise their commercial judgment in discounting of bills of services sector. However, while discounting such bills, banks should ensure that actual services are rendered and accommodation bills are not discounted. *Services sector bills should not be eligible for rediscounting.* Further, providing finance against discounting of services sector bills may be treated as unsecured advance and therefore, subject to the condition that 20% of a bank's unsecured guarantees plus the total of its outstanding unsecured advances do not exceed 15% of its total outstanding advances.
- (xii) In order to promote payment discipline which would to a certain extent encourage acceptance of bills, all corporates and other constituent borrowers having turnover above threshold level as fixed by the bank's Board of Directors should be mandated to disclose 'aging schedule' of their overdue payables in their periodical returns submitted to banks.
- (xiii) Banks should not enter into Repo transactions using bills discounted / rediscounted as collateral.

3. Banks should follow the above instructions strictly and any violation of these instructions will be viewed seriously and invite penal action from RBI.

Yours faithfully,

Sd/-

(C.R.Muralidharan)

Chief General Manager