

CHAPTER 27
EXCHANGE RATE MECHANISM

CHAPTER 27**EXCHANGE RATE MECHANISM****INDEX**

Para No	TOPIC	Page No
27	Rate of Exchange	3
27 1	Purchase and Sale Transactions	3
27 2	Purchase	3
27 3	Sale	4
27 4	Types of Rates	4
27 5	Computations of Rates	5
27 5 1	Base Rate	6
27 5 2	Exchange Margin	6
27 5 3	Margin	6
27 6	TT Buying Rate	7
27 6 1	Computation	7
27 7	Bill Buying Rate (OD Buying)	7
27 8	TC Buying Rate	8
27 9	Currency Buying Rate	9
27 10	TT Selling Rate	9
27 11	Bill Selling Rate	10
27 12	TC Selling Rate	10
27 13	Currency Selling Rate	10
27 14	Cross Rate	11
27 15	Internal System - Uniform Rate Quotation	11
27 15 1	Fine Rates/ Finer Rates / Superfine Rates	12
27 15 2	Matching Transactions	13
27 15 3	Sharing of Exchange Commission	13
27 16	Hours of Business	14
27 17	Position Maintaining Branches	14
Annex No	Annexure	
1	Nostro account details	15

1. RATE OF EXCHANGE

The rate at which one currency is converted into another is called the exchange rate. There are two methods of quoting the exchange rate.

- 1) Direct Method
- 2) Indirect Method.

A given number of units of local currency for a unit of foreign currency is the 'Direct Method' for quoting exchange rate e.g. USD 1 = Rs.61.50. In the Direct Method, home currency is variable. In India the direct method of quotation is used since August 1993. However, certain foreign currencies are quoted for 100 units, since their one unit value is less than one Rupee e.g. Japanese Yen etc. In the 'Indirect Method' of quotation, the variable is the foreign currency expressed in a fixed unit of home currency. For e.g. Rs.100 = USD 1.6260..

27.1. PURCHASE AND SALE TRANSACTIONS

All foreign exchange transactions undertaken have to be either a purchase or a sale transaction for the bank. The type of transaction (i.e. whether it is purchase or sale) is to be determined based on whether the Bank dealing with the foreign exchange is buying or selling the same.

27.2. PURCHASE

In a purchase transaction the Bank receives foreign exchange.

Example :

- i) Export-Bank gets or buys the foreign exchange from the exporter and pays equivalent Indian Rupees.
- ii) Tender of foreign currency notes/traveller cheques /DD / cheques by a customer.
- iii) Inward remittance by way of a telegraphic transfer from abroad.

27.3. SALE

In a sale transaction, the Bank parts with foreign exchange.

Example -

- i) Import : Bank delivers foreign exchange against Indian Rupees paid by the importer
- ii) Issuance of TT/DD payable abroad.

27.4. TYPES OF RATES

All purchase/sale transactions are not alike and hence attract different rates.

Although both, payment of an import bill and issuance of a TT in foreign currency are sale transactions, the rate for the former would be costlier (or 'worse') as compared to the latter. The issuance of a DD is comparatively simple and while the Rupee equivalent is recovered immediately, the payment made overseas is at a later date, giving the Bank some float funds. In the case of an import bill, there is considerably higher work like scrutiny of documents, follow up, folder maintenance etc. The additional work involved is sought to be compensated by levying a bill collection commission and selling the foreign currency at a 'worse' rate as compared to the issuance of TT. Thus, other things being equal, there would be two rates, one for the import bill - "Bill Selling Rate" (BC Selling) and the other for the outward remittances - the "TT Selling Rate." Similarly, in case of purchase transaction, the exchange rate quoted for an export bill would be worse than the quote for an inward remittance. Thus other things being equal, there would be two rates, one for the export bill - "Bill Buying Rate" (OD Buying) and the other for the inward remittances - the "TT Buying Rate". Additionally, the quotes would vary because of differences in period of payment for bills of exchange drawn for exports. For issuance and buying of Foreign Currencies and Travellers Cheques respective Buying and Selling rates are defined.

The different types of rates can be summarised as below:

Purchase

Sale

TT Buying	TT Selling
OD Buying	BC Selling
TC Buying	TC Selling
Currency Note Buying (Cash Buying)	Currency Note Selling (Cash Selling)

The foreign exchange quotation will also be determined by the date of delivery i.e. the date on which the transaction is completed. The delivery under a foreign exchange contract can be made in one of the following ways:

Ready or Cash	-	Delivery on the same day i.e. on the deal date
TOM	-	Delivery made on the next working day after deal date
SPOT	-	Delivery on the second working day after deal date
Forward	-	Delivery subsequent to SPOT date

‘Forward Rates’ are quoted either at a higher (premium) or lower (discount) rate than the spot rate. This is because in a free exchange market, the rates would be based on demand and supply, with the currency in excess supply tending to be cheaper and a scarce one costlier. Further, the exchange rate is also connected to the cost of funds (interest) in respective countries. In a totally free market, the premium/discount on forwards would be difference in the interest rate in the two countries. Currencies with higher interest rates tend to be priced at a discount while currencies with lower interest rates at a premium. **Always premium will be added to and discount deducted from the spot rate to arrive at the forward rate in the case of direct quotation.**

27.5. COMPUTATION OF RATES

The Bank is a trader in foreign exchange and hence the purchase/sale are not effected at the same rate. The purchases are made at a lower price and the sale at a higher price, with the differential being the exchange profit. The maxim practiced by the banks is ‘**Buy Low Sell High**’ for direct quotations. In the foreign exchange market, quotations are always ‘**two-way**’ i.e. for both buying and selling. The ‘two way’ quote for U.S.Dollar would appear as USD 1 = Rs.61.50/52 where the buying rate is Rs.61.50 and the selling rate is Rs.61.52.. The buying rate is known as the ‘**Bid**’ rate and the selling rate as the ‘**Offer**’ rate. FEDAI has given

freedom to Authorised Dealers for determining their own policy regarding the basis for quotation of rates for merchant transactions.

Basis of Exchange Rate quotation:

- a) BUYING:- Rate at which Foreign Currency bought from customer can be sold in the market i.e., market buying rate
- b) SELLING:- Rate at which Foreign Currency to be sold to the customers can be bought in the market i.e., market selling rate.

27.5.1. BASE RATE

Base rate is the rate derived from ongoing market rate, based on which buying / selling rates are quoted for merchant transactions. The interbank rates are normally for spot deliveries. Hence, for quoting rates for merchant transaction on cash basis (i.e. value Today), the base rate will be adjusted to the extent of cash/spot differences.

27.5.2. EXCHANGE MARGIN

The Base Rates, which are derived from the ongoing interbank spot rates, are applied for arriving at rates for merchant purchase and sale transactions. Banks have been given freedom to fix the quantum of exchange margin to be loaded to the base rate for quoting rates for different types of merchant transactions e.g. TT Buying/Selling, Bill Buying/Selling etc.

27.5.3. SPREAD

Spread is the difference between TT Selling rate and TT Buying rate of a given currency. FEDAI has stipulated that the spread should not exceed the following limit from the mean rate:

USD	1%
GBP, EURO, AUD, CHF, JPY	2%
All other currencies	Minimum possible spread

In line with the business maxim of “Buy Low Sell High” while arriving at the merchant rate the exchange margin is reduced from the base rate in case of purchases and added on for sale transactions in the case of direct quotation.

Given below are the broad principles on which the merchant rates are computed. Please note that the computations are purely illustrative.

27.6. TT BUYING RATE

The TT buying rate is applicable for:

- a. Clean inward remittances (TT/DD) for which cover has already been credited to our Nostro account.
- b. Proceeds of export bills/cheques etc. sent for collection.
- c. Cancellation of outward TT/DD etc.
- d. Cancellation of forward sale contract on or after due date.
- e. Conversion of RFC, EEFC, FCNR(B) deposits and PCFC/FC Loan into Indian Rupees.

27.6.1. COMPUTATION

- a. **Base Rate** : On USD being quoted at Rs.61.50/55 , the market will buy USD from us at Rs.61.50 and hence the base rate will be taken at Rs.61.50. . Cash/Spot difference will be loaded to arrive Base Rate.
- b. **Exchange Margin** : If the specified exchange/profit margin for TT Buying rate is 0.025% to 0.080% the exchange margin at 0.080% on Rs.61.48 is 5 paise. For buying transactions, as per the maxim (Buy low Sell High) the profit margin will be reduced from the Base rate i.e. Rs.61.48 - 0.05 = Rs. 61.43. (suppose Cash/Spot difference is say 2 paisa)
- c. **Rounding Off** : The rate offered to the customer is normally rounded off to the nearest paise. However, the rupee equivalent is rounded off to the nearest whole rupee i.e. without paise.

27.7. BILL BUYING RATE (OD BUYING)

The bill buying rate is applicable for purchase/discounting of bills and other instruments. Although the Bank on purchasing/discounting the export bill

immediately parts with the Rupee equivalent, the foreign exchange will be received (delivered) on a future date after realisation of the bill. In the case of usance bill, forward rate will be applicable. However, in the case of sight bill, forward rates are not quoted even though transit period is involved, as bills are likely to be realised early.

Computation of Bill Buying Rate (USD)

The forward rates are quoted at a premium or discount over the spot rates for the end of the particular month. The currency is said to be at premium when its value appreciates and at discount when its value goes down in comparison to the present (spot) rate. To arrive at the bill buying rate the steps are as follows:

i)	Base Rate	Rs. 61.50
ii)	Add premium/deduct discount as the case may be, for the period of delivery/realisation.	
	Premium for 3 months say Rs.0.60	<u>Rs. 0.60</u>
		Rs.62.10
iii)	Less: Exchange Margin @ say 0.150%	<u>Rs. 0.09</u>
		Rs.62.01

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27.8. TC BUYING RATE

The TC buying rate is applied for purchase of foreign currency traveller cheques.

Computation of TC Buying Rate (USD)

i)	Base Rate	Rs. 61.50
ii)	Less : Margin say 1%	<u>Rs. 0.62</u>
		Rs. 60.88
iii)	Round off to nearest 5 paise	Rs. 60.85

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27.9. CURRENCY BUYING RATE

The currency buying rate is applied for purchase of foreign currency notes tendered by a customer:

Computation of Currency Buying Rate (USD)

i) Base Rate is TC Buying rate	Rs. 60.85
ii) Less: Margin say 0.5%	<u>Rs. 0.30</u>
	Rs. 60.55
iii) Round off to nearest 5 paise	Rs. 60.55
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Note :

The encashment/purchase of personal cheques/DDs/IMOs/Bankers cheques/Pay Order payable abroad would be effected @ O/D Buying Rate + Interest at prescribed rate for non-priority advances for a transit period of 15 days.

27.10. TT SELLING RATE

The TT Selling rate is applicable for :

- i) Outward remittance in foreign currency (TT/DD)
- ii) Cancellation of purchase
 - a) Bill purchased/returned unpaid
 - b) Bill purchased/transferred to collection a/c
 - c) Refund of inward remittances
- iii) Forward purchase contract cancellation on or after due date
- iv) Conversion of NRE deposit to FCNR/RFC deposits
- v) Recovery of interest on PCFC/FC Loan

Computation of TT Selling Rate (USD)

On being quoted USD 1= Rs.61.50/55 in the interbank market, the Bank will have to purchase the required US Dollar from the market at Rs.61.55.

i)	The base rate would be (after adjusting Cash/Spot Difference say 2 Paise	Rs. 61.53
ii)	Add : Exchange margin, say 0.150%	<u>Rs. 0.09</u>
		<u>Rs. 61.62</u>

27.11. BILL SELLING RATE

The Bill Selling rate is applied for transactions involving transfer of proceeds of import bills. It is to be noted that although the transfer may take place by way of a DD/TT etc. the TT selling rate is not to be applied.

Computation of Bill Selling Rate (USD)

i)	Base rate would be	Rs. 61.53
ii)	Add: Exchange margin, say 0.200%	<u>Rs. 0.12</u>
		<u>Rs. 61.65</u>

27.12. TC SELLING RATE

This rate is applicable for sale of foreign Traveller Cheques to the customers.

Computation of TC Selling Rate (USD)

i)	Base rate is TT Selling rate	Rs. 61.62
ii)	Add. Margin say 0.50%	<u>Rs. 0.30</u>
		<u>Rs. 61.92</u>
iii)	Rounded off to nearest 5 paise	Rs. 61.95
		=====

(Issuing branch to charge additional commission of 1%)

27.13. CURRENCY SELLING RATE

This rate is applicable for sale of foreign currencies :

Computation of Currency Selling Rate (USD)

i) Base Rate is TC Selling Rate	Rs. 61.95
ii) Add :Margin say 0.50%	<u>Rs 0.30</u>
	<u>Rs.62.25</u>
iii) Rounded off to nearest 5 paise	Rs. 62.25
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27.14. CROSS RATE

The U.S.Dollar being the most commonly denominated currency in international trade is the intervention currency where a quotation in Rupee has to be given for a currency other than the U.S. Dollar. The cross rate is worked out as follows:

1 USD = Rs.61.50 1 USD = CAD 1.1377
Therefore 1 CAD = Rs.54.05

27.15. INTERNAL SYSTEM - UNIFORM RATE QUOTATION

- ◆ The Bank has a well laid down system for informing the indicative exchange rates to the branches. The Dealing Room at Treasury Branch, Mumbai prepares the rate sheet, which is displayed in UBINET. The rate sheet will contain the merchant (card) rates (i.e. TT Selling, BC selling, TT Buying and OD buying) for 16 currencies as well as rates for Traveller Cheques/Cash for major currencies. Daily card rates as well as the market view are also displayed on the intra-net i.e., UBINET. The 'C' category branches are to contact the designated 'A'/'B' category branch for rate information.
- ◆ The card/merchant rates informed are only indicative rates and are applicable for transactions upto and equivalent of USD 5000 .
- ◆ The card rates are fixed in the morning by Treasury Branch and displayed in UBINET. "B" Category branches have been provided with RE-TAD application by which they can directly access to Dealing Room and obtain rates at the branch itself.

- ◆ All 'B' Category branches in India will report all the transactions to Treasury Branch, Mumbai only.

'B' Category branches have been provided with the RE-TAD application for obtaining rates from the system. However, for big transactions it is advisable to report the transactions to dealing room, Treasury Branch, Mumbai directly.

- ◆ For the sake of clarity, it is repeated that the Merchant Rates (Card Rates) as the name implies are the rates, which are to be applied for the forex transactions and include the exchange margin. Likewise, Rates obtained directly from the Treasury branch or the rates obtained in RE-TAD application available with the 'B' Category branches include the exchange margin. The branches are, therefore, not required to add/deduct the exchange margin. Para No, 27 .F. to 27.N. are included only for the sake of better understanding of the mechanism of computation of the exchange rate quotations.

27.15.1 FINE RATES / FINER RATES / SUPERFINE RATES

Fine Rates: The Dealing Room may quote fine rates on specific request of the branch for highly rated clients and for high value transactions. The request for fine rate must be followed immediately by a written confirmation from the Branch Manager/Chief Manager of the concerned branch.

Superfine Rates: 'B'/'C' category branches may approach Domestic Foreign Business and International Banking Department (DFB&IBD), Central Office for quoting improved margin over and above the fine rates to their good customers with high value transactions and better turnover as a regular facility, which will be approved for a period of one year and to be reviewed on yearly basis. For availing this facility, specialised branches like Overseas Branches and Industrial Finance Branches, may directly approach DFB&IBD while other branches may approach DFB&IBD through their respective controlling offices.

27.15.2 MATCHING TRANSACTIONS

When a customer has both export and import exposure, he generally arranges his transactions in such a way that his import transactions are matched with his export transactions. In such cases, bank need not go to interbank market for covering the export/import transaction if both the legs are of similar or matching amount. Since there is no dealing exposure for the bank on spot basis, Dealing rooms have been permitted to load concessional margins in respect of matching forex transactions. However, the transaction amount should be perfectly matching with 10% leeway e.g. inward remittance of USD 50000 can be matched with import/outward remittance of USD 45000 or vice versa.

Besides the laid down margin, the dealer should load forward premium on the transactions depending on the maturity / usance period.

The power of recommending matching rates vests with Branch Heads. However the branch should ensure that both the buy and sell transactions are of the same customer. Different firms/units in a group will be treated as different customers and hence not eligible for matching transactions. Further, matching transactions should be reported to the dealing room at the same time.

27.15.3 SHARING OF EXCHANGE COMMISSION

In order to compensate branches with their share of exchange profit, the 'B' category branch is required to keep a record of various transactions reported to the Dealing Room viz. Date, Bill Ref. No., Foreign Currency Amount, Rate, Rupee equivalent (transaction typewise). The claim is to be made at the following rates on the Rupee turnover on half yearly basis i.e. in September for transactions reported during March to August and in March for transactions reported during September to February. The share of exchange commission on transactions reported to Treasury Branch, Mumbai will be calculated and remitted to the 'B' category branch every half year in September and March.

NATURE OF BUSINESS	EXCHANGE COMMISSION RATE
Inward Remittance/Export Collection	0.0120%

Outward Remittance	0.0625%
Export Purchase	0.0625%
Imports	0.0625%

It may be noted that no exchange commission shall be passed on to the branches on the transactions where any type of finer rates or matching rates have been quoted.

27.16. HOURS OF BUSINESS

The hours during which forex business will be transacted are the normal banking hours of AD branches. However, on Saturdays, no forex transactions will be conducted except :

- i) Purchase/Sale of Foreign Currency Travellers Cheques / Foreign Currency notes
- ii) Any remittances payable to bonafide travellers or tourists

27.17. POSITION MAINTAINING BRANCHES

Treasury Branch, Mumbai is the position maintaining 'A' category branches of our Bank .

The details of foreign currency accounts maintained by the Treasury Branch is furnished in Annexure 27(1).

NOSTRO ACCOUNTS-TREASURY BRANCH, MUMBAI

Sr.No.	Correspondence Bank and Place	Currency	Account Number	SWIFT
1	BANK OF CEYLON CLB - NOSTRO \$, SRI LANKA	ACUD	1977938	BCEYLK
2	JANATA BANK - DHAKA , BANGLADESH	ACUD	JBD/DLR/ACU/002/95	JANBBD
3	MYNAMA FOR.TR BK YANGON- YAGOON, MYNAMAR	ACUD	IDA1192905	MFTBM
4	STANDARD CHARTERED BK- KARACHI, PAKISTAN	ACUD	15000480401	SCBLPK
5	ANZ BANK - MELBORNE, AUSTRALIA	AUD	202945/00001	ANZBAU
6	COMMERCIAL BANK OF DUBAI, DUBAI	AED	1001396447	CBDUAE
7	BANK OF NOVA SCOTIA-TORRONTTO, CANADA	CAD	03198-13	NOSCCA
8	UNION BANK OF SWITZERLAND - ZURICH, SWITZERLAND	CHF	02300000086131050000Z	UBSWC
9	DEN DANSKE BANK - COPENHAGEN, DENMARK	DKK	3007527519	DABADK
10	ROYAL BANK OF SCOTLAND NV - AMSERDUM, NETHERLAND	EUR	529517000	RBOSNL
11	DEUTSCHE BANK, FRANKFURT, GERMANY	EUR	100 9534082 0000	DEUTDE
12	BANK OF INDIA PARIS, PARIS, FRANCE	EUR	330121610000007	BKIDFR
13	COMMERZE BK AG - DUSSELDORF, GERMANY	EUR	30040000/600068255900EUR	COBADI
14	INTESA SANPAOLO SPA- MILANO, ITALY	EUR	100100003601	BCITIT
15	SOCIETE GENERALE - PARIS, FRANCE	EUR	1016201290	SOGEFF
16	J.P.MORGAN AG, JUNGHOFSTRASSE14, FRANKFURT AM MAIN	EUR	6231608842	CHASDE
17	UNION BANK OF INDIA-HONG KONG, HONGKONG	EUR	10290-00002	UBINHK
18	BARCLAYS BANK PLC, 1-CHUCHILL PLACE, LONDON	EUR	20325359057533	BARCG
19	DEUTSCHE BANK, ACH-LONDON, U.K.	GBP	8400339168-6	DEUTGB
20	HSBC BANK PL - LONDON, U.K.	GBP	264243	MIDLGB
21	NATIONAL WESTMINSTER BANK PLC - LONDON, U.K.	GBP	4444019	NWBKGB
22	UNION BANK OF INDIA-HONG KONG, HONGKONG	HKD	00001-10290-00000	UBINHK
23	JP MORGAN CHASE BANK, HONGKONG	HKD	6896015267.00	CHASHK
24	BANK OF INDIA-TOKYO, JAPAN	JPY	424123401000008	BKIDJP
25	CIMB BANK(FORMERLY BHUMIPUTRA), MALAYSIA	MYR	14081198116054	CIBBMY
26	DEN NORSKE BANK - OSLO, NORWAY	NOK	70010204176	DNBAN
27	NATIONAL COMMERCIAL BANK - JEDDAH, SAUDI ARABIA	SAR	55535337000105	NCBKSA
27	NORDBANKEN AB - STOCKHOLM, SWEDEN	SEK	39527907365SEK	NDEASE
29	UNITED OVERSEAS BANK LTD.- SINGAPORE	SGD	1013991346	UOVBS
30	JP MORGAN CHASE BANK, ROBINSON ROAD, SINGAPORE	SGD	88-30-00045-5	CHASS
31	UNION BANK OF INDIA-HONG KONG, HONGKONG	USD	00001-10290-00001	UBINHK
32	BANK OF AMERICA INTERNATIONAL-NEW YORK, U.S.A.	USD	6550692276	BOFAUS
33	BANK OF NEW YORK ACH, NEW YORK, U.S.A.	USD	8900548541	IRVTUS
34	BANK OF NEWYORK-NEW YORK, U.S.A.	USD	8033163429	IRVTUS
35	J.P. MORGAN CHASE BANK- NEWYORK, U.S.A. 15	USD	11407368	CHASUS
36	CITIBANK N.A. - NEW YORK, U.S.A.	USD	10929227	CITIUS
37	STANDARD CHARTERED BANK - NEW YORK, U.S.A.	USD	3582091780001	SCBLUS

