

Unit III — Letter of Credit, Guarantees & Loan Commitments

Financial Credit and Risk Analysis | BMB FM 03 (also KMBN FM 05)

Unit III: Letter of Credit, Bank Guarantees and Loan Commitments

Syllabus: Quasi credit facilities — advantages of non-fund facilities; various types of NFB facilities; various types of letters of credit; assessment of LC limits; bills purchase/discounting under LC; loan commitments; unfunded lines of credit and their characteristics. Various types of bank guarantees — performance guarantee, financial guarantee, deferred payment guarantee; types of performance and financial guarantees; assessment of bank guarantee limit; period of claim under guarantee.

Exam Blueprint (2023-24 and 2024-25 papers)

Topic	Years asked	Marks
Types of Letter of Credit	2023-24 AND 2024-25	10
Letter of credit (define)	2024-25	2
Non-fund based facilities	2024-25	2
Classify types of NFB facilities	2023-24	2
Types of performance and financial guarantees	2023-24	2

YE QUESTION BAAR-BAAR AAYA HAI

Types of Letter of Credit is a **10-mark question** in **BOTH** available papers. Along with the Seven C's in Unit I, it is the most certain question in this subject. Learn **all the types with a one-line meaning and a use case**.

1. Non-Fund Based (NFB) Facilities — Quasi Credit

DEFINITION - RATTA MAARO

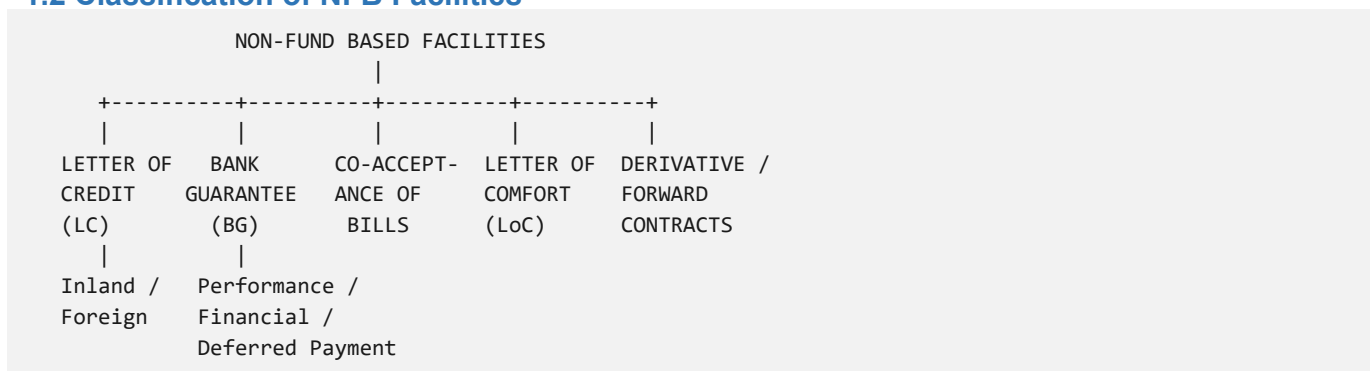
Non-Fund Based facilities, also called **quasi credit facilities**, are credit facilities in which the bank does **NOT** part with funds at the time of sanction. Instead, it **undertakes a commitment or obligation on behalf of the customer** to pay a third party **if the customer fails to perform or pay**. They create a **contingent liability** for the bank, which becomes a funded exposure only if the guarantee or LC is invoked.

(A 2-mark question in 2024-25, and a classification question in 2023-24.)

1.1 Fund Based vs Non-Fund Based — the basic comparison

Basis	Fund Based	Non-Fund Based
Outflow of funds	Immediate actual outflow	No immediate outflow
Nature of liability	Actual liability	Contingent liability
Balance sheet	Appears on the balance sheet as an asset	Appears off balance sheet, as a contingent liability
Bank's earning	Interest	Commission / fee
Cost to borrower	Higher (interest)	Lower (only commission)
Impact on bank's funds	Reduces lendable resources	Does not consume funds unless devolved
Risk	Immediate credit risk	Risk crystallises only on invocation/devolvement
Examples	Cash credit, term loan, overdraft	Letter of Credit, Bank Guarantee , letter of comfort, co-acceptance

1.2 Classification of NFB Facilities



Facility	Meaning
Letter of Credit (LC)	The bank undertakes to pay the seller on presentation of stipulated documents
Bank Guarantee (BG)	The bank undertakes to pay the beneficiary if the customer fails to perform or pay
Co-acceptance of bills	The bank adds its acceptance to a bill drawn on its customer, making itself liable on maturity
Letter of Comfort / Letter of Awareness	A softer, often non-binding assurance about a customer's standing; weaker than a guarantee
Standby Letter of Credit (SBLC)	An LC that functions like a guarantee — payable only on the customer's default; widely used internationally
Derivative and forward contracts	Forward exchange contracts and other derivative limits also create contingent exposure

1.3 Advantages of Non-Fund Based Facilities

To the **BANK**:

- Income without deployment of funds** — commission is earned without using lendable resources
- Higher return on assets** — no funds are blocked, so the return on capital employed is high