

## CHAPTER XI: MINISTRY OF TEXTILES

### National Textile Corporation Limited

#### 11.1 *Doubtful recovery due to lack of due diligence in export of yarn*

**Doubtful recovery of ₹5.91 crore due to lack of due diligence in export of yarn to two private parties in Pakistan without verification of their credentials and acceptance of Letter of Credit issued by M/s General Equity, New Zealand which was reported by Financial Markets Authority, New Zealand to be engaged in misleading and deceptive conduct**

The New Minerva Mills, Karnataka, one of the mills of National Textiles Corporation Limited (NTC) exported (August 2015) yarn amounting to ₹5.91 crore to two consignees/buyers in Pakistan viz. M/s Transtrade Global and M/s Madina Impex International on the strength of two irrevocable Letters of Credit (LC) dated 28 July 2015 & 05 August 2015 of General Equity, New Zealand (GE). NTC received the LC through Krung Thai Bank, Mumbai Branch which was issued by Suisse Credit Capital (2009), London on behalf of GE.

Audit noticed that GE, New Zealand was only a building society formed in 2007 to assist its members/clients. It was not a licensed financial market participant in New Zealand. It was neither a bank registered under the Reserve Bank of New Zealand Act, 1989 nor it was regulated by the Financial Markets Authority<sup>1</sup> (FMA).

FMA had publicly issued a warning (September 2014) on its website that persons dealing with GE should exercise extreme caution before obtaining any financial services or acquiring any financial products from it. In particular, FMA cautioned that GE was not a licensed financial market participant in New Zealand and does not have to meet any prudential requirements in New Zealand and was not a New Zealand bank or a non-bank deposit taker. GE had made misleading and deceptive statements in respect of assets it claimed to hold and the same was used to give a misleading impression of adequate asset backing to support the issuance of LC by GE. Further, in view of most of GE's business being conducted outside of New Zealand that were subject to the laws of, and oversight of financial markets regulators of those places where it conducts that business, FMA cautioned that it had limited ability at law to take action in connection with financial services provided by New Zealand entities outside of New Zealand.

FMA had ordered that the said warning in respect of GE be displayed on the website of GE so that those dealing with it are made aware of FMA's concerns. Accordingly, the said warning was displayed on the main page of GE's website.

FMA made the warning disclosure order for the following reasons:

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<sup>1</sup> *New Zealand government agency responsible for financial regulation of all financial market participants, exchanges and the setting and enforcing of financial regulations.*

- (a) It was important that those dealing with GE were made aware of FMA's concerns as expressed in the warning.
- (b) A disclosure order would ensure that the warning was disseminated directly by GE, which would result in a wider and more targeted and relevant distribution than might otherwise be the case if FMA relied solely on publishing the warning on the FMA website.
- (c) In particular, individuals and entities from overseas who might be dealing with GE were more likely to be made aware of the warning if it was published by GE.

Audit observed that NTC sought (July 2015) consultation from Corporation Bank on the LC issued by GE. However, all containers were shipped<sup>2</sup> (August 2015) by NTC even before receiving any verification advice from the Bank.

As per the terms and conditions of the LC, GE had to release the payment on the 90<sup>th</sup> day from the date of Bill of Lading<sup>3</sup>. Accordingly, the payment against the said exports became due in November 2015<sup>4</sup>. Though, Consignment Handling Agent (CHA) of NTC had informed that all the ten consignments had been released, NTC had received proof of delivery for only eight consignments, the payment of which has not been received by NTC till date. The Corporation Bank informed (February 2016) NTC that it had received a SWIFT<sup>5</sup> message from GE stating that GE was informed by their clients that the goods did not meet the description and GE had received letters of cancellation of transaction from NTC. GE further informed that it was now a matter between the parties and it had closed the file. However, NTC claimed that the said letters were forged as it had never issued such letters. Moreover, despite being called for, GE did not return the original Bill of Ladings.

NTC asked (April 2016) the Corporation Bank to make payment along with interest on or before 30 April 2016 as it did not get proper service, guidance and help for recovery despite paying each and every charge as it was purely a banking side service issue. In response to the same, the Bank pointed out (May 2016) that by accepting LC directly from GE without their advice made them assume that the buyer was known to NTC and the NTC being a commercial organization had exercised due diligence on buyers as well as applicants on its financial strength, antecedents, etc. before entering into a sale contract for such a big amount.

Audit noticed that the applicant (One Anametrics Intertrade Limited, Thailand) mentioned in the LC was different from the consignees who had taken delivery of the consignment in Pakistan. Audit observed that NTC had not signed any formal written agreement/contract either with the consignees or with the applicant mentioned in the LC. Audit did not find on record any details of independent verification/evaluation of the credibility (financial profile) of the buyers/ applicant with whom the transaction was to be done especially in view of the

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<sup>2</sup> *Four on 08 August 2015 and six from 26<sup>th</sup> to 29<sup>th</sup> August 2015.*

<sup>3</sup> *8<sup>th</sup>, 26<sup>th</sup> & 29<sup>th</sup> August 2015*

<sup>4</sup> *6<sup>th</sup>, 24<sup>th</sup> & 26<sup>th</sup> November 2015*

<sup>5</sup> *Society for Worldwide Interbank Financial Telecommunications i.e. a messaging network that financial institutions use to securely transmit information and instructions through a standardized system of codes*

geographical location (Pakistan) of the buyers and due to the fact that NTC had never entered into any transaction with the said parties earlier.

Thus, overlooking the warning of FMA and solely relying on the LC issued by GE, an entity which was not even a bank or licensed financial markets participant was not in the favour of NTC.

It was also observed that there were no specific rules, policy or procedure framed by NTC governing the execution of export orders through LC.

After denial (February/April 2016) of payment by GE, the matter was taken up (March 2016) with International Chamber of Commerce (ICC) which replied (May 2016) that GE is not a member of ICC, New Zealand. Further, NTC requested Banking Ombudsman to intervene in the matter which was rejected (May 2016) by the latter stating that it was outside their purview.

In view of the above facts and the “limited ability” expressed publically by FMA, chances of recovery are remote.

The Management stated (September 2018) that:

1. The ECGC Limited had approved the credit limit application in respect of Transtrade Global on 12 June 2015 as the party was not in the caution list of ECGC. In the case of Madina Impex management had taken their credentials and found that they were registered tax payers in Pakistan and they had signed the contract before opening of LC.
2. NTC has taken necessary steps to safeguard the interest of the Corporation and there were no objections raised by the Corporation Bank at any point of time in relation to genuineness or otherwise of the LCs.
3. NTC had received the LC through Krung Thai Bank, Mumbai Branch which was a State- Owned Bank of Thailand. The Krung Thai Bank received the LC from GE through Suisse Credit Capital (2009), London with whom it had got a Relationship Management Acceptance (RMA) established for transmission of LC. It meant that Krung Thai Bank would have already checked the credentials of Suisse Credit Capital (2009) and GE at the time of establishing an RMA with them. Since the LC was received through a State owned bank there was no scope for a doubt on the credentials of the LC establishing Bank.
4. Now, NTC has been covering all exports under ECGC, apart from taking credit approval for all the overseas buyers before proceeding with export formalities. Hence it is ensured that no such instances are repeated in future.

Subsequently, it was also informed by the Management (April 2019) that a recovery suit has been filed by the company before the High Court of Sindh, Karachi, Pakistan and next date of hearing in the case is in August 2019.

Reply needs to be viewed against the following facts:

1. The said credit limit approved by ECGC was for arrangement of credit insurance in respect of M/s Transtrade Global, but audit scrutiny revealed that the export of goods was not insured by the Company. On being asked to furnish the signed copy of the contract with the buyer, management has provided copy of the signed Proforma Invoice with one of the parties only which cannot be construed to mean a valid contract/agreement. The fact remains that NTC failed to evaluate/verify the credibility of the buyers and the applicant before exporting the goods.
2. NTC had not exercised due diligence before export of goods and cannot place sole reliance on its own Banker and the transferor bank for correctness/genuineness of LC issued by GE. NTC had overlooked GE's status of not being a Bank or licensed financial market participant in New Zealand apart from other adverse facts mentioned in the warning about GE by FMA.
3. The Company has not furnished any specific reply on the audit observation regarding overlooking the warning about GE which was already displayed on its website as per the orders of FMA stating that GE was not a Bank or a licensed financial market participant in New Zealand apart from other adverse facts.

Thus, exporting goods without exercising due diligence led to doubtful recovery to the extent of ₹5.91 crore.

The matter was referred to the Ministry in October 2018; their response was awaited (May 2019).