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**FINAL LEVEL- MAY 2021
PAPER 2: STRATEGIC FINANCIAL MANAGEMENT**

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NOSTRO, VOSTRO AND LORO ACCOUNTS

In interbank transactions, foreign exchange is transferred from one account to another account and from one center to another center.

Therefore, the banks maintain three types of current accounts in order to facilitate quick transfer of funds in different currencies

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**Nostro
Account**

**1.Vostro
Account**

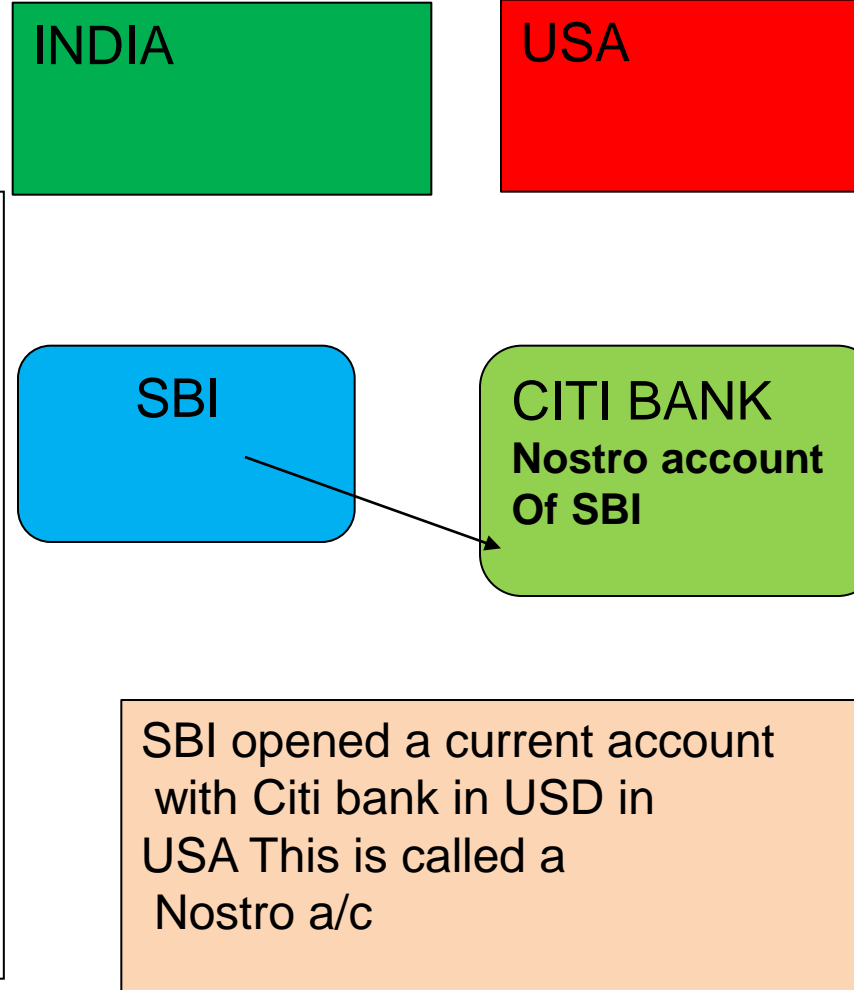
**1.Loro
Account**

Nostro Account

A bank's foreign currency account maintained by the bank in a foreign country and in the home currency of that country is known as Nostro Account

Example-NOSTRO AND VOSTRO ACCOUNT

- Let us say, SBI Bank, India wants to make and receive payments in US Dollar, in the US.
- for this transaction, SBI, India will tie up with , say, Citibank in the US.
- Citibank, US will act as its representative or correspondent bank.
- SBI, India will have an account in Citibank US
- Its USD receipt and payment will happen from this account
- this account of SBI, India in Citibank, US is SBI's Nostro Account and Citibank's Vostro Account.



NOSTRO ACCOUNT

A Nostro account is a reference used by Bank X to refer to "our" account held by Bank Y.

Nostro is a shorthand way of talking about "our money that is on deposit at your bank

The Nostro account is the record of the bank that has money on deposit at another bank.

These accounts are often used to simplify settlements of trade and foreign exchange transactions.

VOSTRO ACCOOUNT

Vostro is the term used by Bank Y, where bank X's money is on deposit.

Vostro is a reference to "yours" and refers to "your money that is on deposit at our bank."

NOSTRO and VOSTRO Accounts

"Nostro" and "vostro" are two different terms used to describe the same bank account.

The terms are used when one bank has another bank's money on deposit, typically in relation to international trading or other financial transactions

NOSTRO and VOSTRO Accounts

Nostro comes from the Latin word for "ours," as in "our money that is on deposit at your bank."

Vostro comes from the Latin word for "yours," as in "your money that is on deposit at our bank."

Loro account

When domestic
banks use the
account of third
party banks

which holds a Nostro
account to settle
foreign exchange
transactions

these type of
transactions are
included under
the Loro Account.

Loro account - Example

HDFC Bank has an account with Citi Bank

but IDBI Bank doesn't have any Nostro account with Citi Bank

IDBI Bank has to pay the bill of imported machinery from the USA on behalf of its customers

IDBI Bank approaches to HDFC Bank and ask to settle the invoice on its own behalf.

HDFC bank worked as an intermediary between Citi Bank and IDBI Bank

IMPORTANT CONCEPTS

**Exchange
Position**

**Cash
Position**

Exchange Position

Balance of the aggregate purchases and sales made in foreign currency

It includes both spot and forward transactions

Transactions for, which the bank has agreed for a firm rate- firm commitments- like draft issued

The exchange position is worked out every day so as to ascertain the position of the bank in that particular currency and wherever remedial measures are needed they may be taken.

Examples of sources for the bank for purchase of foreign currency are:

Payment/ Purchase
of DD, Traveller
cheques, etc.

Purchase of bills.
(export bills)

Forward purchase
contract with export
customers. (Entered
in the position on the
date of purchase.)

Examples of avenues of sales are:

Issue of DD, MT, TT,
Traveler cheques, etc.

Payment of bills.
(imports)

Forward sale contract
with importer-
customers. (Entered
in the position on the
date of contract.)

Cash position

it is outstanding balance (debit or credit) in bank's Nostro account

Cash Position is effected only when actual delivery has taken place.

all transactions effecting Cash position will affect Exchange Position not vice versa.

Foreign Exchange Instruments

Telegraphic Transfer (TT)

- The money is deposited with the banks in India and the Indian banker sends a cable, telegram or fax to the foreign branch/correspondent to make certain payments to the specific party, on that very date.
- **Exchange Position : Immediate**
- **Cash position : Immediate**

Bank Drafts and Cheques

- The bank draft or demand draft is handed over to the buyer who sends it to the beneficiary.
- The beneficiary obtains payment on presentation to the bank on which the draft is drawn.
- **Exchange Position : Immediate**
- **Cash position : Not Immediate**

Forward Contracts

- They're essentially hedging instruments with no upfront payments.
- **Exchange Position : Immediate**
- **Cash Position : Not immediate only on delivery**

Foreign Exchange Instruments

Forward Telegraphic Transfer (TT)

- They're essentially hedging instruments with no upfront payments.
- **Exchange Position : Immediate**
- **Cash Position : Not immediate only on delivery**

DD purchased

- Demand Draft can be purchased from Bank for making payments in foreign currency.
- The bank draft or demand draft is handed over to the buyer who sends it to the beneficiary
- Exchange Position : Immediate
- Cash position : Not Immediate

Bill of Exchange

- A bill of exchange is an order drawn by a person upon bank or another person asking the latter to make payment to a third party.
- Bill of Exchange is prepared by the exporter and sent to the place of importer through a commercial bank along with the documents.

Foreign Exchange Instruments

BILLS PURCHASED

- **BILLS PURCHASED**, in trade finance, allows a seller to obtain financing and receive immediate funds in exchange for a sales document
- The bank will send the sales documents to the buyers bank on behalf of the seller.
- Exchange Position : Immediate
- Cash position : Not Immediate

Bill of Exchange

- A bill of exchange is an order drawn by a person upon bank or another person asking the latter to make payment to a third party.
- Bill of Exchange is prepared by the exporter and sent to the place of importer through a commercial bank along with the documents.



PRACTICE QUESTIONS



Exercise 1

- Suppose you are a dealer of ABC Bank and on 20.10.2014 you found that balance in your Nostro account with XYZ Bank in London is £65,000 and you had overbought £35,000. During the day following transaction have taken place:

	Amount £
DD purchased	12,500
Purchased a Bill on London (export bill)	40,000
Sold forward TT	30,000
Forward purchase contract cancelled	15,000
Remitted by TT	37,500
Draft on London cancelled	15,000

What steps would you take, if you are required to maintain a credit Balance of £7,500 in the Nostro A/c and keep as overbought position on £7,500?

**Suppose
you are a
dealer of
ABC
Bank**

**and on 20.10.2014 you found
that balance in your Nostro
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**What steps would you take, if you are
required to maintain a credit Balance of
£7,500 in the Nostro A/c and keep as
overbought position on £7,500?**

Exchange Position:

Particulars	Purchase £	Sale £
Opening Balance Overbought	35,000	
DD Purchased	12,500	
Purchased a Bill on London	40,000	
Sold forward TT		30,000
Forward purchase contract cancelled		15,000
TT Remittance		37,500
Draft on London cancelled	15,000	
	1,02,500	82,500
Closing Balance Overbought		20,000

on 20.10.2014 you had overbought £35,000

£	
DD purchased	12,500
Purchased a Bill on London	40,000
Sold forward TT	30,000
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Draft on London cancelled	15,000

keep as overbought position on £7,500?

Nostro a/c (Cash Position)

Cash Position (Nostro A/c)	Credit £	Debit £
Opening balance credit	65,000	
TT Remittance		37,500
	65,000	37,500
Closing balance (credit)		27,500
Spot sale of Pounds £		20,000
Closing balance (credit)		7,500
	65,000	65,000

on 20.10.2014 you found that balance in your Nostro account with XYZ Bank in London is £65,000

	£
DD purchased	12,500
Purchased a Bill on London	40,000
Sold forward TT	30,000
Forward purchase contract cancelled	15,000
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you are required to maintain a credit Balance of £7,500

Exchange Position:

Particulars	Purchase £	Sale £
Opening Balance Overbought	35,000	
DD Purchased	12,500	
Purchased a Bill on London	40,000	
Sold forward TT		30,000
Forward purchase contract cancelled		15,000
TT Remittance		37,500
Draft on London cancelled	15,000	
	1,02,500	82,500
Spot sale		20,000
Total	1,02,500	1,02,500
Forward purchase contract of Pounds in inter bank market	7,500	

on 20.10.2014 you had overbought £35,000

£	
DD purchased	12,500
Purchased a Bill on London	40,000
Sold forward TT	30,000
Forward purchase contract cancelled	15,000
Remitted by TT	37,500
Draft on London cancelled	15,000

keep as overbought position on £7,500?

To maintain Cash Balance in Nostro Account at £7,500 you have to sell £20,000 in Spot which will bring Overbought exchange position to Nil. Since bank require Overbought position of £7,500 it has to buy the same in forward market

Exercise 2

- *You as a dealer in foreign exchange have the following position in Swiss Francs on 31st October, 2009:*

	Swiss Francs
Balance in the Nostro A/c Credit	1,00,000
Opening Position Overbought	50,000
Purchased a bill on Zurich	80,000
Sold forward TT	60,000
Forward purchase contract cancelled	30,000
Remitted by TT	75,000
Draft on Zurich cancelled	30,000

What steps would you take, if you are required to maintain a credit Balance of Swiss Francs 30,000 in the Nostro A/c and keep as overbought position on Swiss Francs 10,000?

Exercise

You as a dealer in foreign exchange have the following position in Swiss Francs on 31st October, 2009

What steps would you take, if you are required to maintain a credit Balance of Swiss Francs 30,000 in the Nostro A/c and keep as overbought position on Swiss Francs 10,000?

	Swiss Francs
Balance in the Nostro A/c Credit	1,00,000
Opening Position Overbought	50,000
Purchased a bill on Zurich	80,000
Sold forward TT	60,000
Forward purchase contract cancelled	30,000
Remitted by TT	75,000
Draft on Zurich cancelled	30,000

Exchange Position:

Particulars	Purchase SF	Sale SF
Opening Balance Overbought	50,000	
Purchased a bill on Zurich	80,000	
Sold forward TT		60,000
Forward purchase contract cancelled		30,000
TT Remittance		75,000
Draft on Zurich cancelled	30,000	
	1,60,000	1,65,000
Closing Balance Oversold	5,000	

	Swiss Francs
Balance in the Nostro A/c Credit	1,00,000
Opening Position Overbought	50,000
Purchased a bill on Zurich	80,000
Sold forward TT	60,000
Forward purchase contract cancelled	30,000
Remitted by TT	75,000
Draft on Zurich cancelled	30,000

keep as overbought position on Swiss Francs 10,000?

Nostro a/c (Cash Position)

Cash Position (Nostro A/c)		
	Credit	Debit
Opening balance credit	100,000	
TT Remittance		75,000
	1,00,000	75,000
Closing balance (credit)		25,000

	Swiss Francs
Balance in the Nostro A/c Credit	1,00,000
Opening Position Overbought	50,000
Purchased a bill on Zurich	80,000
Sold forward TT	60,000
Forward purchase contract cancelled	30,000
Remitted by TT	75,000
Draft on Zurich cancelled	30,000

*you are required to maintain a credit Balance of Swiss
Francs 30,000 in the Nostro A/c*

Nostro a/c (Cash Position)

What steps would you take, if you are required to maintain a credit Balance of Swiss Francs 30,000 in the Nostro A/c

Cash Position (Nostro A/c)		
	Credit	Debit
Opening balance credit	100,000	
TT Remittance		75,000
Buy spot Swiss Francs	5,000	
	1,05,000	75,000
Credit Balance of 30,000		

	Swiss Francs
Balance in the Nostro A/c	1,00,000
Credit	
Opening Position Overbought	50,000
Purchased a bill on Zurich	80,000
Sold forward TT	60,000
Forward purchase contract cancelled	30,000
Remitted by TT	75,000
Draft on Zurich cancelled	30,000

you are required to maintain a credit Balance of Swiss Francs 30,000 in the Nostro A/c

Exchange Position:

Closing Balance Oversold	5,000	
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keep as overbought position on Swiss Francs 10,000?

Particulars	Purchase SF	Sale SF
Opening Balance Overbought	50,000	
Purchased a bill on Zurich	80,000	
Sold forward TT		60,000
Forward purchase contract cancelled		30,000
TT Remittance		75,000
Draft on Zurich cancelled	30,000	
Buy spot SWISS FRANCS	5,000	
Buy forward Sw. Francs.	10,000	
	1,75,000	1,65,000
Overbought	10,000	

Solution

The Bank has to buy spot TT Sw. Fcs. 5,000 to increase the balance in Nostro account to Sw. Fcs. 30,000.

This would bring down the oversold position on Sw. Fcs. as Nil.

Since the bank requires an overbought position of Sw. Fcs. 10,000, it has to buy forward Sw. Fcs. 10,000.

Exercise 3

*XYZ Bank, Amsterdam,
wants to purchase
Rs 25 million against £*

*for funding their Nostro
account and they have
credited LORO account
with Bank of London,
London.*

*Calculate the amount of
£'s credited.*

*Ongoing inter-bank rates are per
\$,
Rs 61.3625/3700*

*& per
£, \$
1.5260/70.*

Solution

To purchase Rupee, XYZ Bank shall first sell £ and purchase \$ and then sell \$ to purchase Rupee. Accordingly, following rate shall be used

$\$1 = \text{Rs } 61.3625 - \text{Rs } 61.3700$
American quote

$\pounds 1 = \$1.5260 - \1.5270
European quote

$$\frac{\text{Rs}}{\$} \times \frac{\$}{\pounds} = \frac{\text{Rs}}{\pounds}$$

Solution

$$\begin{aligned} \text{Rs } 61.3625 \times 1.5260 \\ = \text{Rs } 93.6391 \end{aligned}$$

$$\begin{aligned} \text{Rs } 61.3700 \times \\ 1.5270 = \text{Rs } 93.7119 \end{aligned}$$

$$\pounds 1 = \text{Rs } 93.6391 - \text{Rs } \mathbf{93.7119}$$

$$\text{Rs } 1 = \pounds .01067 - \pounds .0107$$

Calculate the amount of £'s credited.

*XYZ Bank,
Amsterdam, wants to
purchase Rs 25
million against £ so
Ask rate applicable*

$$2,50,00,000 \times .0107 = \text{£ } 2,66,500$$

Examples of sources for the bank for purchase of foreign currency are:

1. Payment of DD, MT, TT, travellers cheques, etc.
2. Purchase of bills,
3. Purchase of other instruments like cheques.
4. Forward purchase contracts (entered to the position of the date of contracts).
5. Realisation of bills sent for collection.
6. Purchase in interbank/international markets.

Examples of avenues of sale are:

1. Issue of DD, MT, TT, travellers cheques, etc.
2. Payments of bills drawn on customers.
3. Forward sale contract (entered in the position on the date of contracts).
4. Sale to interbank/international markets.



Thank you