Vostro Accounts

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What's in today's article?

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- **What is a Vostro account?**
- **What is the Special Rupee Vostro Accounts (SRVA) arrangement?**
- **How does SRVA arrangement function?**
- **How will this arrangement be beneficial for India?**

Why in news?

- Recently, government officials in India informed that 20 Russian banks have opened Special Rupee Vostro Accounts (SRVA) with partner banks in India.
- All major domestic banks have listed their nodal officers to sort out issues faced by exporters under the arrangement.

What is a Vostro account?

- A Vostro account is an account that a domestic bank holds for a foreign bank in the domestic bank's currency — which, in the case of India, is the rupee.

    - In other words, it is an account a correspondent bank holds on behalf of another bank.
- A vostro account is established to enable a foreign correspondent bank to act as an agent or provide services as an intermediary for a domestic bank.
- These services include executing wire transfers, withdrawals, and deposits for customers in countries where the domestic bank does not have a physical presence.
- Domestic banks use it to provide international banking services to their clients who have global banking needs.
- Hence, it helps domestic banks gain wider access to foreign financial markets and serve international clients without having to be physically present abroad.

What is the Special Rupee Vostro Accounts (SRVA) arrangement?

- The settlement through Indian Rupees (INR) is an additional arrangement to the existing system that uses freely convertible currencies.
    - Freely convertible currency is a currency which is permitted by the rules and regulations of the country concerned to be converted into major reserve currencies like U.S. Dollar, Pound Sterling.
    - For freely convertible currencies, a fairly active market exists for dealings against major currencies.
- In other words, SRVA is different from the already existing Rupee Vostro Account in the sense that the settlement of international trade through INR is an additional arrangement to the existing system of settlement.
    - Also, SRVA requires prior approval before opening unlike Rupee Vostro account.
- It works as a complimentary system and reduces dependence on hard (freely convertible) currency.

How does SRVA arrangement function?

- The framework entails three important components, namely:
    - **Invoicing** – all exports and imports must be denominated and invoiced in INR.
    - **Exchange rate** – The exchange rate between the currencies of the trading partner countries would be market-determined.
    - **Settlement** – The final settlement also takes place in Indian National Rupee (INR).
- **Process**
    - The authorised domestic dealer banks are required to open SRVA accounts for correspondent banks of the partner trading country.
    - Domestic importers are required to make payment in INR into the SRVA account against the invoices for supply of goods or services from the overseas seller/supplier.
    - Similarly, domestic exporters are to be paid the export proceeds in INR from the balances in the designated account of the correspondent bank of the partner country.

How will this arrangement be beneficial for India?

- This framework could largely reduce the net demand for foreign exchange, the U.S. dollar in particular, for the settlement of current account related trade flows.
  - This was highlighted by the **Economic Survey (2022-23).**
- The framework would also reduce the need for holding foreign exchange reserves and dependence on foreign currencies, making the country less vulnerable to external shocks.
  - In the present case, SRVA will help India to get around Western sanctions against Russia by carrying on trade in rupees.
- Indian exporters could get advance payments in INR from overseas clients.
- Hence, in the long-term, such mechanism would promote INR as an international currency once the rupee settlement mechanism gains traction.

Q1) What is Correspondent banking?

The term correspondent banking relationship acts as an intermediary or agent, facilitating wire transfers, conducting business transactions, accepting deposits and gathering documents on behalf of another bank.

Correspondent banks are most likely to be used by domestic banks to service transactions that either originate or are completed in foreign countries. Domestic banks also use correspondent banks to gain access to foreign financial markets and to serve international clients without having to open branches abroad.

Q2) How is the Special Rupee Vostro Account (SRVA) different from the already existing Rupee Vostro Account?

The settlement of International trade through Indian Rupees (INR) is an additional arrangement to the existing system of settlement. SRVA requires prior approval before opening unlike Rupee Vostro account.

Source: Explained | Vostro accounts and how they facilitate trade | RBI | RBI | Indian Express

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