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## Special Vostro Accounts through the Lens of International Law and its Position in the Indian Economy's Context

Ishwari D. Kuwar<sup>a</sup>

<sup>a</sup>NALSAR University of Law, Hyderabad, India

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*The Reserve Bank of India (hereinafter RBI) had in July 2022 introduced a mechanism of setting up Special Vostro Accounts. Through the said move, the aim is to facilitate global trade and render a boost to Indian Exports. As a result, promoting the international community's interest to trade in the Indian rupee. For the said purpose, the importers and exporters would require holding a Special Vostro Account. The present article intends to discuss in detail the nature, and functions of these Special Vostro Accounts and their significance in International Law. Further, an emphasis would be laid on the proposed mechanism's outcomes in the context of the Indian Economy, how it would aid India to maintain trade relations with other countries, and construing the mechanism from a legal perspective.*

**Keywords:** *vostro, rbi, Indian economy, rupee, trade relations.*

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### INTRODUCTION

It will be of relevance to be acquainted with the definition of Special Vostro Account (hereinafter Vostro Accounts or Rupee Vostro Accounts in the present circumstance) and the similar kinds of accounts held by a bank. Though specifically emphasis would be laid on the Vostro Accounts. There are generally three accounts, i.e., Vostro Accounts, Nostro Accounts, and Loro Accounts.

As per the Cambridge Dictionary, a Vostro account is “an account that a bank holds in its currency for a bank in another country”<sup>1</sup> whereas a Nostro Account connotes “an account which a bank keeps for itself in a bank in another country, usually in that country’s currency.”<sup>2</sup>

While a Loro Account means “when domestic banks use the account of third party banks which holds a Nostro account to settle foreign exchange transactions then these type of transactions are included under the Loro Account.”<sup>3</sup> In a nutshell, Vostro, Nostro, and Loro are Italian words that connote 'Your', 'Our', and 'Their' respectively. Therefore, Loro Accounts are third-party accounts that are held by a domestic bank for another domestic bank that doesn't have a Nostro Account. Diverting to the main topic of discourse, both the Nostro and Vostro Accounts involve bilateral correspondence. Sometimes, these accounts are construed as being the same, but they aren't.

Some illustrations can be substantiated to clarify the difference. For instance, if ICICI bank (an India-based bank) opens an account in HSBC bank (U.K. based bank) with the currency being the U.K. Pound, then it would be a Nostro Account. While the converse, i.e., HSBC operating an account in ICICI with the currency of the Indian Rupee will be a Vostro Account. Thus, it is significant to observe if the RBI is successful in achieving the desired goal. The present article extensively revolves around Vostro Account System implemented in India and attempts to analyze it from the Indian legal perspective. Besides, the article aims to shed some light on the position of the general trade settlement and transaction mechanisms in International Law.

## **POSITION OF TRADE SETTLEMENTS IN INTERNATIONAL LAW: A CASE FOR SPECIAL VOSTRO ACCOUNTS**

International Law is a wider branch of law among the varied fields of law dealing with different aspects. Though there is considerable debate among scholars about it being considered a 'law'

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<sup>1</sup> 'Vostro Account' (*Cambridge Dictionary*) <<https://dictionary.cambridge.org/dictionary/english/vostro-account>> accessed 10 December 2022

<sup>2</sup> 'Nostro Account' (*Cambridge Dictionary*) <<https://dictionary.cambridge.org/dictionary/english/nostro-account>> accessed 10 December 2022

<sup>3</sup> Raj Vardhan, 'Nostro, Vostro and Loro Accounts? Explained with Easy Examples' (*Thesis Business*, 22 October 2019) <<https://www.thesisbusiness.com/nostro-vostro-loro-accounts.html>> accessed 10 December 2022

in the true sense, as it doesn't have a concrete structure as compared to domestic law. But as it binds the international community by certain conventions, treaties, etc., it is perceived as soft law. International law provides a normative framework for the conduct of interstate relations. In this sense, international society is no exception to the maxim of *ibi societas, ibi ius*: where there is social structure there is the law.

The sources of international law define the rules of the system: if a candidate rule is attested by one or more of the recognized 'sources' of international law, then it may be recognized as part of international law.<sup>4</sup> Article 38(1) of the ICJ Statute famously sets out the key sources of international law.<sup>5</sup> These are provided from sub-clauses (a) to (c) and are as follows: the treaty law, International Customary Law, and the general principles of law. It is to be understood that even though these principles are stated separately, in general practice these complement each other. As stated above, as international law is broad, it is further divided into various categories.

One such category is the International Economic Law, under which the topic of discussion of this paper can be included, i.e., the Special Vostro Accounts. As International Economic Law as an independent field of study encompasses international trade law, International Financial Law, and other Private international laws, etc. which apply to International Trade Settlements and Business transactions. It also involves the conduct and regulations by the states, international organizations, and private entities working in the international economic arena. Therefore, of the three prominent sources discussed, the treaty law or treaties form the cornerstone of International Economic Law.

Concerning international Trade Law, the World Trade Organization's Agreements (hereinafter referred to as WTO) play a significant role. The WTO Agreements contain provisions, which give developing countries special rights. These are called special and differential treatment provisions.<sup>6</sup> In the Doha Declaration, member governments agreed that all special and

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<sup>4</sup> James R. Crawford, *Brownlie's Principles of International Law* (8th edn, OUP 2012)

<sup>5</sup> Andrew D. Mitchell and Elizabeth Sheargold, *Principles of International Trade and investment Law* (1st edn, Edward Elgar Publishing Limited 2021)

<sup>6</sup> 'Special and Differential Treatment Provisions' (*World Trade Organization*)

<[https://www.wto.org/english/tratop\\_e/devel\\_e/dev\\_special\\_differential\\_provisions\\_e.htm](https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm)> accessed 12 December 2022

differential treatment provisions are an integral part of the WTO agreements and that these provisions should be reviewed to strengthen them and make them more effective and operational.<sup>7</sup>

Some of these special provisions comprise of the following: 1. Measures concerning the advancement of trading opportunities for the developing countries, 2. Long time extensions for implementing agreements and commitments, 3. Rendering support to developing countries to build capacity to perform the work of the WTO in an efficacious manner, to handle disputes and the implementation of technical standards,<sup>8</sup> and 4. Provisions with regards to least developed countries.

The General Agreement on Trade and Services (hereinafter referred to as GATS) is an agreement among the other WTO agreements, which elaborates on the rules about trade and services. The GATS applies not just to the provision of services across borders to consumers in other countries, but also to the provision of services within countries by foreign suppliers.<sup>9</sup> The GATS has implications for banking; in 1997 financial services became a permanent feature of the GATS as a result of the financial services agreement. The definition of trade services in Article 1 includes the cross-border provision of services. Determining the provision of Foreign Service or supplier is provided for elsewhere.<sup>10</sup>

The GATS is based on three important concepts of the Most Favoured Nation Principle, Market Access, and National Treatment. Article 2 of the GATS mentions the Most Favoured Principle. The principle entails that the member countries should accord favourable treatment to any of their members, i.e., to the services and service suppliers as provided to other member countries. Whereas market access relates to various limitations on foreign banks, i.e., the types of legal entities through which banking services may be offered, assets, etc.<sup>11</sup> As per the market-access

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<sup>7</sup> *Ibid*

<sup>8</sup> *Ibid*

<sup>9</sup> 'Trade Guide: WTO General Agreement on Trade and Services' (*International Trade Administration*)

<<https://www.trade.gov/trade-guide-wto-gats>> accessed 12 December 2022

<sup>10</sup> Ross Cranston, *Principles of Banking Law* (2nd edn, OUP 2002)

<sup>11</sup> *Ibid*

provision of the GATS, each member simply agrees to accord access under the terms, limitations, and conditions it agreed upon.<sup>12</sup>

There is also a measure, which states that if a Member State doesn't allow market access to foreign banks then in such a case it is obligated to allow any necessary monetary transfers. The third element is national treatment which functions when a foreign bank gains market access. The principle binds the member countries to treat such foreign banks in tandem with the national banks. Also, providing market access under the GATS members are vested with the power to subject such treatment to certain qualifications and conditions. The Annexure on Financial Services to the GATS under its Article 2 clause (a) confers the power to member countries to take any reasonable measures for safeguarding the rights and interests of their persons to whom the financial service supplier owes a fiduciary duty.

Such measures also extend to ensuring the stability and integrity of the financial system. Based on the general principles postulated by international organizations like WTO and the provisions under some of its agreements, special Vostro account mechanisms could be considered as some reasonable steps taken by the member countries to boost their trade with other countries. Also, the notion of correspondent banking is encouraged. In common parlance, correspondent banking connotes when banks (mostly local) need the assistance of other banks to perform services and their customer's behalf which would include the collection of cheques, bills of exchange, and advice on letters of credit. When approaching correspondent banking through the English context, it incorporates international relations. Even today, the international, multifunctional bank will have a very large number of correspondents, so that it can offer customers a full range of services around the world.<sup>13</sup>

These days the correspondent banks offer various services, which are complex in nature. Apart from the service of letters of credit, the banks deal with trade documentation concerning demand guarantees and countertrade. Account services now go beyond collecting bills of exchange to cover cash management (eg. accounts in a variety of currencies), cheque clearing,

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<sup>12</sup> *Ibid*

<sup>13</sup> Ross Cranston (n 10) 39

foreign exchange services, and payment in general. Banks need access to clearing services in all major currencies- the enormous growth in dealings on money and capital markets has been a driving force- and so use correspondents which are members of the local system.<sup>14</sup>

The Vostro Account mechanism enables the partner country to have an account with the correspondent bank of the other country in denominations of its currency. Therefore, this makes the process of business transactions and trade settlement between the concerned countries efficient and organized. The other benefits of the mechanism are that the countries don't need to convert their currency into U.S. Dollars for the transactions, (as it is the world's largest reserved currency) and the countries can save their conversion expenses. Besides, one major advantage of this mechanism is that in a situation where a particular country faces western sanctions (which are invoked due to a failure to comply with the principle of *erga omnes*) then trade settlement with such a country through the said mechanism would neither hamper the trade relations and opportunities of the particular country with other countries nor it would negatively impact the countries who are entering into trade agreements with the particular country.

For instance, the sanctions imposed on Russia as a result of its invasion and attacks on Ukraine. Therefore, in a nutshell, the Vostro Account Mechanism is a viable and flexible alternative for smooth trade transactions and settlements between trading countries. It also proves beneficial for a country to evade the western sanctions and still proceed with opportunities to trade with other countries that are willing to enter into trade agreements.

## **THE SCENARIO OF VOSTRO ACCOUNT MECHANISM IN INDIA: IMPACT ON TRADE RELATIONS**

Vostro Account or Rupee Vostro Account System has been in the news frequently since the RBI released an official notification announcing its decision to implement the system to streamline trade settlements and transactions in the Indian Rupee (INR) and to strengthen global trade through promoting the interest of trade in Rupee among the international community. The

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<sup>14</sup> *Ibid*

notification thus provides that the decision was taken " to put in place an additional arrangement for invoicing, payment and settlement of imports/ exports in INR."<sup>15</sup>

The move though targeted at attracting other foreign countries to strike trade transactions with India in the denominations of the Indian currency holds significance for India and Russia's trade relations. The reason being stated above, i.e., due to sanctions imposed on Russia. The notification enumerates the requirement of permission from the RBI's foreign exchange department by the Authorized Dealer Banks (hereinafter AD banks) before enforcing the mechanism.

According to the FEMA Regulations of 2016, an India AD bank is allowed to operate a Vostro account as mandated under Regulation 7(1) which reads as " A deposit made by an authorized dealer with its branch, head office or correspondent outside India, and a deposit made by a branch or correspondent outside India of an authorised dealer and held in its books shall be governed by the directions issued by the Reserve Bank in this regard from time to time."<sup>16</sup> But, the proposed mechanism, has paved way for the foreign countries as well to open Rupee Vostro Accounts in India.

With this regard, the notification mentions that the bank of the partner country in a trade will have to approach the AD bank for operating Special Rupee Vostro Account. Consequently, such an AD bank would need approval from the RBI to inform it about such an arrangement. It should also ensure that the correspondent bank is not from a country, which is enlisted under the FATF's (Financial Action Task Force (on Money Laundering)) Public Statement on High Risk and Non-Cooperative Jurisdictions on which the FATF has called for countermeasures.<sup>17</sup> This entire mechanism will fall within the ambit of the FEMA Act, 1999, and its related Regulations and other laws related to its functioning. Primarily, FEMA would be applicable as

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<sup>15</sup> 'International Trade Settlement in Indian Rupees (INR)' (*Reserve Bank of India*, 11 July 2022) <[https://www.rbi.org.in/scripts/FS\\_Notification.aspx?Id=12358&fn=5&Mode=0](https://www.rbi.org.in/scripts/FS_Notification.aspx?Id=12358&fn=5&Mode=0)> accessed 12 December 2022

<sup>16</sup> Foreign Exchange Management (Deposit) Regulations 2016, r 7(1)

<sup>17</sup> International Trade Settlement in Indian Rupees (n 15)

the law was framed with the intent to facilitate external trade and payments in India and to consolidate the existing framework of laws about foreign exchange.

### **ANALYZING THE EFFECTIVENESS: ADVANTAGES AND OUTCOMES**

In light of the proposed move, there witnessed a plausible interest by the foreign countries to open Rupee Vostro Accounts with the Indian AD banks as over some time several correspondent banks of the other countries approached the Indian banks to operate an account. Under the mechanism, an Indian importer undertaking imports shall make payment in INR, which shall be credited into the Special Vostro Account of the correspondent bank of the partner country, against the invoices for the supply of goods or services from the overseas supplier.<sup>18</sup> Whereas, in the case of exports of goods and services under the mechanism, the exporter shall be made a payment from the balances in the Special Vostro account of the correspondent bank of the partner country.<sup>19</sup>

Initially, it was speculated that the arrangement was only to be used for Russia, as the correspondent banks situated there were among the first to get a Vostro Account opened in India followed by the banks in Sri Lanka. The Vostro account mechanism was thought to be a viable mode to maintain the trade between India and Russia because if the other partner country held a Vostro account in an Indian AD bank then it enabled the payment of invoices to be made in Indian Rupees. Besides, as discussed earlier, these two trading countries won't need to bear the expenses of converting the currencies nor would they need to consider the risks of fluctuating foreign exchange rates as the market forces of the trading partner countries determined the foreign exchange rate.

Russia was also terminated from the SWIFT system, i.e. a system that assigns a unique identification code to financial institutions and offers secure financial transactions between its members. There was uncertainty among banks as to how would the amounts of rupees would be repatriated without attracting penalties in situations involving banks from countries who are

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<sup>18</sup> *Ibid*

<sup>19</sup> *Ibid*



facing western sanctions. In addition, there was ambiguity concerning the exchange rate of the conversion of volatile currencies.<sup>20</sup> Though the rules provide that the surplus in Vostro accounts may be invested in treasury bills and government securities.<sup>21</sup>

But it is unclear how such instruments can be transferred to the buyer. Therefore, banks were sceptical of opening Vostro accounts. The other reason adding to the worries of the banks facing western sanctions was that despite condemnation from the international community, India rose its purchase of crude oil from Russia as it is the largest producer of crude oil. On the other hand, the mechanism was rapidly developing. By November 2022, the RBI had permitted the UCO Bank based in Kolkata and the IndusInd Bank to open nine Vostro Accounts, out of which one was opened with UCO, one each with Sber and VTB, and six others with IndusInd Bank.

A point to be mentioned, Sber Bank and the VTB were the two foreign lenders to obtain approval from RBI to start Rupee Vostro Accounts. Simultaneously, RBI also gave a nod to HDFC and Canara bank to open the Special Rupee Vostro account to carry out trade with Russia. By December 2022, i.e., the current month, the Central government has successfully established the trade in Rupees with three nations, namely, Russia, Mauritius, and Sri Lanka had called upon the banks and the trade bodies to seek more opportunities in other countries to strike trade agreements in Rupees. The idea behind doing so is to promote bilateral trade and internalization of indigenous modes of payment as part of the finance ministry's plans. These initiatives can thus, go a long way to promote cross-border transactions in the Indian Rupee. Hence, the grey areas that the Vostro Account is faced with can be coped with by the implementation of innovative technology and the RTGS.<sup>22</sup> Besides, the mechanism can act as a medium to reduce the depreciation of the rupee and result in minimum dependence on the U.S. Dollar.

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<sup>20</sup> 'Banks seek clarity on 'grey areas' from RBI on Rupee Vostro Accounts' (*Business Standard*, 16 September 2022) <[https://www.business-standard.com/article/economy-policy/banks-seek-clarity-on-grey-areas-from-rbi-on-rupee-vostro-accounts-122091600197\\_1.html](https://www.business-standard.com/article/economy-policy/banks-seek-clarity-on-grey-areas-from-rbi-on-rupee-vostro-accounts-122091600197_1.html)> accessed 12 December 2022

<sup>21</sup> *Ibid*

<sup>22</sup> Nikesh Singh, 'RBI permits banks to open 12 special Vostro accounts for trade in rupees' (*Business Standard*, 25 November 2022) <[https://www.business-standard.com/article/finance/rbi-has-given-approval-to-banks-to-open-12-special-vostro-accounts-122112501155\\_1.html](https://www.business-standard.com/article/finance/rbi-has-given-approval-to-banks-to-open-12-special-vostro-accounts-122112501155_1.html)> accessed 12 December 2022

## CONCLUSION

After a thorough analysis of the special Vostro accounts system, it can be concluded that the mechanism is one of the lucrative methods for trade settlements between partner countries. Even though there are no express provisions in international treaties and agreements such as GATS to regulate the system of Vostro accounts, it indirectly hints at mechanisms such as these that the member countries may implement to increase their trade opportunities and relations. And the mechanism also falls under the concept of correspondent banking.

Therefore, when emphasizing the RBI's move to implement the rupee Vostro account mechanism, may prima facie seem to be an ambitious herculean task because apart from the advancement of Indian exports and imports the underlying intent to strengthen the Indian rupee and present it as an alternative currency for trade transactions apart from the U.S. Dollar is a laudable and watershed decision which may be beneficial for the Indian Economy shortly. To substantiate the statement, a recent example of Sri Lanka will be appropriate. After having received approval to operate a rupee Vostro account, it requested the RBI to facilitate and promote trade and tourism in the SAARC region.<sup>23</sup> Therefore, the use of INR as a legal currency for international trade in Sri Lanka will help the country with the liquidity of money and in turn curb the economic crisis to an extent as a result of insufficient U.S. Dollars. Hence, the move will lead to investments in the country and enhance India's bargaining power. While promoting the trade mechanism, the government is also cautious of the factors such as exchange rate volatility and exposure to global shocks, etc.

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<sup>23</sup> Mukul Sharma, 'Sri Lanka to use Indian rupee for international trade, more countries to follow' (*Wion Colombo*, 17 December 2022) <<https://www.wionews.com/south-asia/sri-lanka-to-use-indian-rupee-for-international-trade-543895>> accessed 12 December 2022