

# No more ambiguity

Industry-wide adoption of the ISBP is a genuine win/win for everyone, argues *Donald Smith*, vice-president, Global Trade Finance and Services, at Citibank. When all parties start to view the UCP rules from the same perspective, it should resolve longstanding and costly ambiguities surrounding the use of documentary letters of credit. Smith co-chaired the international taskforce that drafted the ISBP and as chair of the banking committee of the USCIB, represents the US banking community to the ICC Banking Commission.

On October 31, 2002, the National Committees of the International Chamber of Commerce (ICC) Banking Commission voted 32-3 in favour of the adoption of the International Standard Banking Practice for the Examination of Documents under Documentary Credits, also known as the ISBP. It was a historic day for letter of credit practitioners worldwide, especially those who think letters of credit are ancient history.

Because the fact is you're only half right. As far back as 15th century BC, Phoenician traders carried letters of credit to foreign ports in the form of clay tablets, stamped with the seals of prominent merchants; and during the Middle Ages they were written on sheepskins for use by traders such as Marco Polo.

But in the modern world, linked by economic interdependencies, the letter of credit is not only a key to the past, but to the future of world trade – a highly effective risk management tool that enables thousands of companies worldwide to

participate. In the last year, an estimated 15% of world trade with an approximate value of US\$1.023 trillion was transacted using letters of credit.

## Detail and patience

Using these instruments effectively, however, requires knowledge, patience and an adherence to detail. For instance, when the buyer (applicant) completes an application form asking the bank for a letter of credit, affirming its obligation to reimburse the bank for payments the bank makes to the seller (beneficiary), it is understood that the bank is providing a specialised form of undertaking to the seller – the right to receive payment on the timely presentation of documents that on their face comply with the terms of the letter of credit.

However, what is often not understood is that this right is not contingent upon the seller's actual compliance with the underlying contract of sale, but rather upon the seller's presentation of complying documents.

The bank's determination that the seller's documents are, or are not, in compliance is based on its understanding of the industry 'bible', a document entitled 'Uniform Customs and Practice for Documentary Credits' (UCP), first published by the ICC in 1933.

Although the most recent version was updated in 1993 (known as UCP 500), much of the original language remains almost unchanged. While more

knowledgeable practitioners understand the terminology, among the rapidly growing ranks of those less experienced it opens the door to confusion and misinterpretation. In the blunt words of Martin Shaw, a well-recognised 30-year veteran of international trade:

"Apparent/alleged discrepancies – that's the real problem: personal opinions, different experiences amongst practitioners, different attitudes, subjective approaches, questions of interpretation" (*DC Insight*, ICC Publishing, Volume 5, No 2, Spring 1999.)

In the last decade the situation has been compounded by the increasing number of new companies entering the market, as well as the declining experience level of letter of credit practitioners – reflected in a high level of discrepant documentation and subsequent rejection on the part of the banks.

In fact, in 2002 the rejection rate on first time submission to the banks was an astounding 60%.

## Taskforce set to work

When these dismal statistics were presented at the May 2000 meeting of the ICC Commission on Banking Technique and Practice, the membership recognised the need for clear and definitive answers.

An international taskforce was formed to document actual international standard banking practices as defined in the articles of UCP 500.

Their charge was to neither alter nor amend the UCP 500, but rather to determine the meaning

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Smith: In the co-chairing hotseat



of stated practices and how those practices are put into application. Subcommittees were formed to focus on some of the most frequently questioned practices. The ISBP dealt with these practices by providing specific explanations for each item as well as for issues such as multiple pages and attachments to riders, originals and copies, expressions not defined by the UCP, abbreviations, shipping marks, signatures, certificates

and declarations, corrections and alterations and even documents to which transport articles do not apply. In addition, the ISBP offered this important caveat: "Applicants ... should not assume that they may rely on these provisions in order to excuse their obligations to reimburse the issuer, since their obligations, rights, and remedies depend upon their undertaking with the issuer, the performance of the underlying transaction, and the timeliness of any objection under applicable law and practice. The ISBP deals solely with the application of the practices articulated in the UCP, and not with concerns not expressed herein."

#### National endorsements

When the official adoption of the ISBP was finally put to a vote at the October 2002 meeting of the ICC, it met with overwhelming support on the part of the national committees – effectively delivering the power of the organisation to the recommendations of the

taskforce.

The potential benefits to the industry are significant:
 

- ≈ ≈ Exporters or beneficiaries of letters of credit can look forward to improved cashflow and efficiency as a result of their improved knowledge of document preparation and presentation requirements. The reduced time spent on document correction and faster payment will help lower costs and improve profits.

- ≈ ≈ Importers or applicants of letters of credit can look forward to faster receipt of import documents, thus avoiding demurrage charges and delays in the receipt of goods, ultimately reducing the cost of the goods.

- ≈ ≈ For the banks the new consistency will enhance straight-through processing and correspondent banks can look forward to fewer disputes.

- ≈ ≈ The detailed nature of the letter of credit will no longer be a hurdle, but an asset to the participants and to the future profitability of world trade. In summary, industry-wide adoption of the ISBP is a genuine win/win for everyone; importers and exporters of all sizes as well as banks, insurance companies, carriers and ultimately, the consumer.

When all parties start to view the UCP rules from the same perspective, it will resolve the longstanding and costly ambiguities that have surrounded the use of documentary letters of credit, ensuring their continued prominence as a primary payment vehicle of international commerce.

*Any views or opinions in the article above are solely those of the author and do not necessarily represent those of Citibank NA or Citigroup Inc.*

## Subcommittees on most questioned practices

- ≈ Alterations: What constitutes an "alteration" or "addition" to a document, when and how should these be authenticated?;

- ≈ Certificates of origin: Particularly regarding consular invoices as well as all other documents;

- ≈ Drafts: Regarding endorsements, usance drafts, when "sighting" occurs if documents are discrepant, how to handle alterations;

- ≈ Signing of documents: Regarding how documents are to be signed, if not explicitly stated in the credit;

- ≈ Beneficiary and applicant addresses: How to handle typing errors on documents regarding name and address, different

addresses of same company, etc;

- ≈ Trade terms: Whether trade terms, such as Incoterms, must appear on the invoice;

- ≈ Mathematical calculations: Appearing on invoices and other documents;

- ≈ Combining documents: Whether a beneficiary's certificate must appear on the invoice or be included as a separate document;

- ≈ Transport documents: What constitutes the "face" of a document, and should a practitioner examine the reverse side to determine the name of carrier, description of the journey, etc?;

- ≈ Insurance documents: What constitutes a full set, a copy vs an original, endorsements and effective date?