

# Global Transaction Services

*Cash Management Trade Services and Finance Securities and Fund Services*

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## Maximizing the Benefits of Export Letters of Credit: A Risk Mitigation Tool

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# Exporter Objectives

**Grow sales by expanding  
into foreign markets . . .**

**. . . without incurring undue risk**

**. . . and without adverse impact  
on cashflow or balance sheet (DSO)**



# Exporter Risks

- **Commercial Risks**
  - Non-payment
  - Non-acceptance of goods
- **Political (Sovereign) Risk**
  - Political turmoil in importing country
- **Legal / Regulatory Risk**
  - Non-compliance with local regulations
- **Foreign Exchange (FX) Risk**
  - Currency fluctuations
- **Transfer Risk**
  - Foreign exchange controls
- **Convertibility Risk**
  - Insufficient foreign currency available

# Exporter Needs in Cross-Border Sales

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- **Risk mitigation**
- **Assistance with cross-border payments**
- **Financing / Managing working capital**
- **Information**
- **Automation and other outsourcing**

## Definition

***A irrevocable documentary credit constitutes the issuing bank's definite undertaking to honor payment to a seller upon presentation of documents in strict compliance with credit terms.***

***It remains an internationally recognized method of payment via the utilization of financial intermediaries, e.g., banks, which offers the buyer the benefit of documentary assurance before payment is effected and the seller payment assurance if credit terms and conditions are complied with.***

# Trade vs. Standby Letters of Credit

## Trade Letter of Credit

- For the payment of goods and/ or services
- Designed to be drawn on after product is shipped against presentation of stipulated documents
- Typically used for cross-border transactions, but can be used domestically

## Standby Letter of Credit

- Two types: guarantee (“default”) and payment (“direct-pay”)
- Used to support performance under a contract and payment obligations (e.g., unpaid open account invoices)
- Payment type SBLCs are used to effect payments directly to beneficiaries
- May be used to manage risks associated with complex projects or contracts

# Export Letters of Credit - Overview

Advantages	Risks
<ul style="list-style-type: none"><li>■ Title of goods may be controlled by banks</li><li>■ Can rely on bank's creditworthiness instead of importer's</li><li>■ May use LC to finance the production of goods</li><li>■ Mitigation of commercial, credit and country risks (if LC is confirmed)</li></ul>	<ul style="list-style-type: none"><li>■ Non compliance with LC terms and conditions would prevent bank from paying</li><li>■ FX risk if goods are priced in a foreign currency</li></ul>

# Parties Involved in a Letter of Credit

**1 Applicant - Importer - Buyer - Account Party:**

The applicant arranges for the issuance of the Letter of Credit through its bank.

**2 Beneficiary - Exporter - Seller:**

The party in whose favor the Letter of Credit is issued. Entitled to payment under the Letter of Credit if it meets the terms and conditions.

**3 Opening or Issuing Bank:**

The applicant's bank that opens or issues the Letter of Credit in favor of the beneficiary and substitutes its creditworthiness for that of the applicant.

**4 Advising Bank:**

A bank that verifies the apparent authenticity of the Letter of Credit and forwards it to the beneficiary.

**5 Paying Bank:**

The bank nominated in the Letter of Credit that makes payment to the beneficiary without recourse, after determining that documents conform, and upon receipt of funds from the issuing bank or another intermediary bank nominated by the issuing bank.

**6 Confirming Bank:**

The bank, which under the instruction from the issuing bank, substitutes its creditworthiness for that of the issuing bank, ultimately assuming the issuing bank's commitment to pay.

# Advantages

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- **Reduced commercial risk**
- **Cash flow facilities**
- **Access to a vast international branch and correspondent network**
- **Technical assistance provided by a highly experienced team**
- **Possibility of confirming the credit**
- **Possibility of discounting the time drafts**

# Risk Mitigation Techniques Using LCs

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- **Confirmed Letter of Credit**
- **“Silent LC confirmation”**
- **Standby Letter of Credit**

# Risks

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- **Whichever channel is being used for payment, the risk of fraud cannot be totally avoided.**
- **The two parties involved should obtain reputable information before engaging themselves in any sales transaction**
- **Knowing “Who you are dealing with” is certainly just as important as knowing “How to effect the deal”**

## Prior to LC Issuance – A Representative Process

**Sales to notify  
Finance/Credit  
of contracts  
requiring LCs**

**Finance/Credit  
to approve proposed  
LC issuing bank in  
advance of LC issuance**

**Finance/Credit to  
review payment  
terms specified in  
LC application**

- Buyer is instructed to fax the draft LC application to Finance/Credit for review prior to issuance
- In case of unacceptable issuing bank, LC confirmation to be pursued
- Confirmation charges may be for account of buyer, if arranged in advance
- Draft tenor
- Financing terms and conditions, and who bears financing charges

# Discretion of the Issuing Bank

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- **Choose the advising bank**
- **Choose the confirming bank (if any)**
- **Nominate a bank as paying, accepting or negotiation bank**
- **Choose reimbursing bank or stipulate other reimbursement method**
- **Refinancing terms**

# Responsibilities of the Advising Bank

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- **Verify apparent authenticity**
- **Deliver to beneficiary**

# Beneficiary Review of the LC

- Irrevocable
- Letter of Credit amount
- Expiry date
- Latest shipment date
- Shipping terms
- Merchandise descriptions
- Draft tenor  
(e.g., sight versus extended  
or “usance” terms)
- Documents
- Additional Conditions
- Bank Charges
- Payment/Reimbursement  
Instructions
- UCP 500\*  
(soon to be UCP 600)
- Bank’s engagement /  
acceptability of issuing  
bank

\* Uniform Customs & Practice Publication 500

# Handling Discrepancies

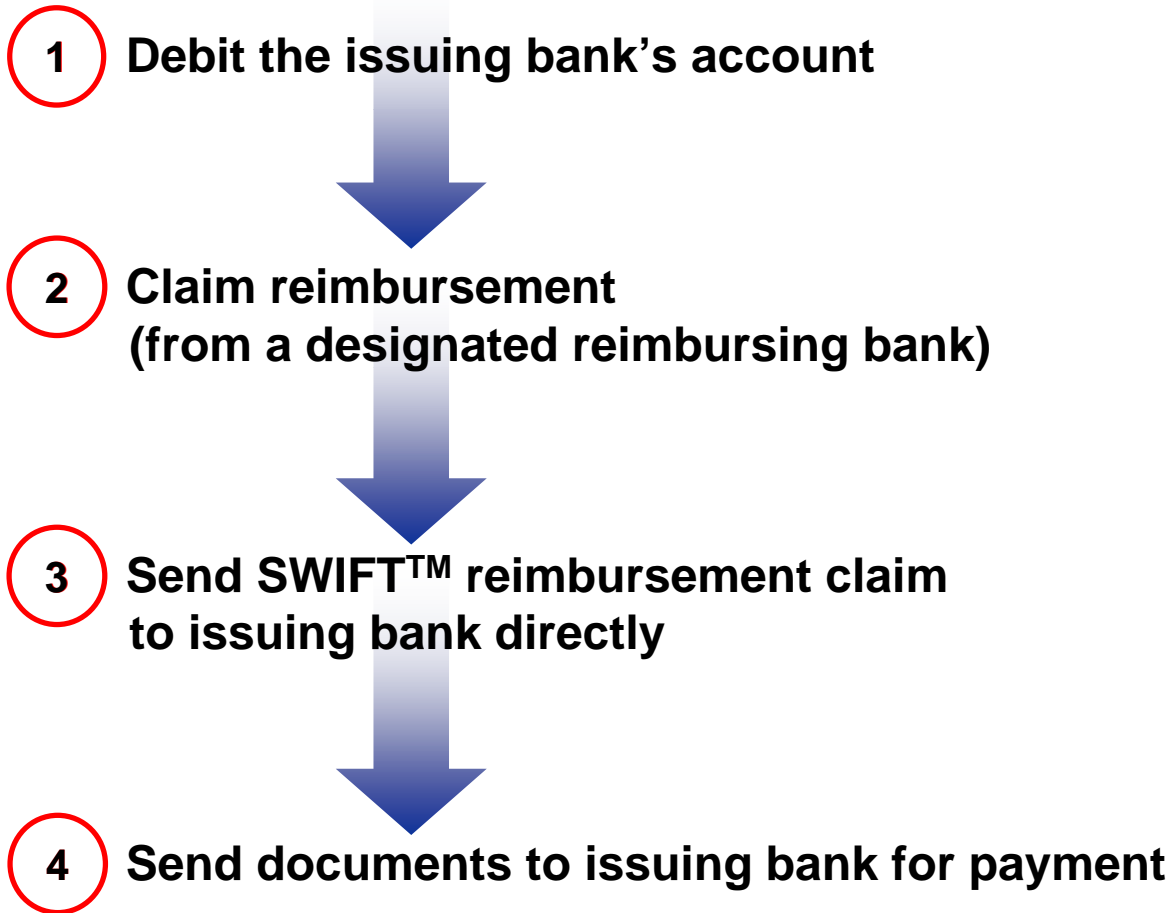
- 1** Notify beneficiary and agree on course of action
- 2** Beneficiary may correct repairable discrepancies
  - Beneficiary submits replacement document(s)
- 3** Beneficiary contacts buyer to arrange for waiver
  - Bank sends documents to issuing bank on approval basis

**or**

  - Bank sends message to issuing bank for approval
- 4** Beneficiary contacts buyer to arrange for amendment

# Methods of Reimbursement

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# Letter of Credit Confirmations

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What are your primary concerns?

- **Political stability of the country of the buyer**
- **Commercial credit risk of the issuing bank**
- **Protecting profit margins**

# “Silent” LC Confirmations

## Replacing LC confirmation:

- **Original LC issued without request to add confirmation**
- **Confirming bank gives exporter a commitment letter, known as a “Commitment to Negotiate”**
- **Issuing bank is not informed of LC confirmation**
  - Confirming bank assumes additional risks
- **Exporter may request payment without recourse (at a discount) for compliant documents**
- **Not all banks offer “silent confirmations” or take documentation risk on “silent confirmations”**

## Reasons a Bank May Not Confirm an LC

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- **Weak country credit risk**
- **Issuing bank credit line constraints**
- **Reimbursement instructions**
- **Draft and tenor**
- **Documentary conditions**
- **Legal issues**

# Potential Solutions – Summary

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## **You may still arrange an LC confirmation**

- Consult with your trade bank
- Determine their risk distribution capacity
- Identify possible amendments or structures to the LC
- Obtain third-party support for the confirmation

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- **May be used to manage risks associated with complex projects or contracts**

# Why Standby Letters of Credit?

## **Benefits:**

- **Typically less documentation required to draw**
- **Typically payable solely against beneficiary's written statement to the effect that something has or has not happened**
- **Useful for complex transactions**
  - Flexible enough to support multiple transaction types

## **But, ... keep in mind:**

- **Monitor expiry date as a deadline for presentation of documents.**
- **SBLCs may be more costly for your buyer**
- **“Silent confirmation” rarely available**
- **Should be governed by ISP 98**

# Manage LC Terms & Conditions

- **Design a Letter of Credit Instruction Form for buyers**
  - Provides buyers with your company's required LC terms/conditions
  - Can be customized for different countries, products and regions
  - May be detailed or contain only key data elements
- **Provide the LC Instruction Form to your sales representatives to present to buyers in advance or to attach to sales contracts**
- **Post your LC Instructions on your company's Web site**

## Application for the opening of a credit

- **Complete name and address of the beneficiary (exporter)**
- **The amount and currency of the credit**
- **The type of credit, is it:**
  - Irrevocable / Revocable
  - Advised / Confirmed
- **Availability: at sight, by deferred payment, by acceptance or by negotiation**
- **A clear, precise but brief description of the merchandise**
- **Freight paid in advance or payable at destination (INCOTERMS 2000)**
- **Required shipping documents**

# Application for the Opening of a Credit

- **The place of receipt and/or port of loading and the port of discharge and/or final destination**
- **Transshipment authorized or not**
- **Partial drawings and/or shipments authorized or not**
- **The latest shipping date**
- **The date and place of expiry of the credit**
- **Bank charges for Account of applicant or beneficiary**
- **When the credit must be transferred, the ordering party must expressly indicate so**
- **The type of transmission of the credit: by mail or by SWIFT/ Telex**

## At Sight

- **When the credit stipulates such terms, you, the seller have the right to receive payment upon presentation of documents in conformity with L/C terms**

# Negotiation Terms

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## **At Maturity**

- **This term indicates that the payment to the seller will be effected at specific date after presentation of documents**
- **The seller, however, has the opportunity to discount the draft before the maturity date**

## Key Technical Points to Remember

- **The issuing bank substitutes its credit rating for that of the buyer**
- **The seller can mitigate issuing bank/country risk via confirmation**
- **Banks deal in documents, not goods or the underlying contract**
- **The LC is a conditional payment undertaking to the seller, i.e., payment is made against presentation of compliant documents**
- **LC coverage may be lost when non-compliant documents are presented**
- **Documentary LCs should state that they are governed under UCP 500 (UCP 600 after July 1, 2007)**

# Practical Checklist for Exporters

## Insurance

- 1** Does the insurance document cover all the risks stipulated in the credit?
- 2** Is the insurance document the same as what it stipulated in the credit (policy, certificate, etc.)?
- 3** Is the document dated prior to or at least the same date as the bill of lading or other transport document?
- 4** Does the data in the document not conflict with data in all other documents e.g. weight, marks, transport mode, etc?
- 5** Is the insurance document in the same currency as the commercial invoice?
- 6** Is it correctly signed?
- 7** Does the insurance document cover the value of goods plus the percentage requested under the credit?

# Practical Checklist for Exporters

## Transport Documents

- 1 Is the type stipulated in the credit?
- 2 If necessary, is the bill of lading endorsed?
- 3 Are all parties indicated in the bill of lading as stipulated in the credit (shipper, consignee)?
- 4 Are the details found on the type of packing unit the same as stipulated in the credit? (i.e., weight, marks, number of units, boxes, etc.)
- 5 Is the transport document correctly signed?

# Conclusion - The Benefits of LCs in Cross-Border Trade

- **Letters of credit are versatile instruments that can**
  - Mitigate risk
  - Accelerate cashflow
  - Improve DSO (Days Sales Outstanding)
  - Facilitate international sales
  
- **Understanding the letter of credit process is key to deriving the greatest benefits from your LC transactions, while minimizing or eliminating the risks involved.**
  
- **Managing the process prior to LC issuance results in letters of credit that meet the needs of the seller and buyer, thus eliminating misunderstanding.**
  
- **Partnering with a strong trade bank provides technical expertise, committed service, innovative structuring, and opportunities to streamline the purchase order-to-cash lifecycle when payment terms are “Letter of Credit”**

# Any Questions?

Our **Technical Export Trade Specialists** are happy to answer your technical LC questions. Please mention that you attended our Export LC Webinar!

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# ANY QUESTIONS?

Our **Technical Trade Specialists** are happy to answer your technical LC questions. Please contact your local Relationship Manager or Citiservice representative and mention that you attended our Document Examination Webinar!

# Appendix - The Route of the Life of a Documentary Credit

## In 9 Steps:

- 1. The buyer (importer) and the seller (exporter) enter a commercial contract in which they agree on the amount, price, method of payment of goods.**
- 2. The buyer (importer) asks his bank to open a Documentary Credit in favor of the seller (exporter).**
- 3. The buyer's bank may transmit the Documentary Credit to the seller via an "Advising Bank" in the country of the seller.**
- 4. The seller ships the goods and prepares/ obtains the documents required in the credit.**
- 5. The original credit and all the amendments, if any, along with any necessary documents are presented to the "Nominated Bank".**
- 6. The documents and draft(s) are then forwarded to the "Issuing Bank".**
- 7. The documents are received and examined by the "Issuing Bank" in order to verify that they are in conformity with the credit. Documents are remitted to the buyer (importer).**
- 8. The buyer (importer) picks up the goods from the shipping/transport company.**

The above are some of the typical steps that may occur during the life of a Documentary Credit

## Select Terms from “Commitment to Negotiate”

**Conditions to Issuance of Commitment:** In its sole discretion, the Bank may commit to Negotiate documents under the Credit, provided that, among other things, the following conditions have been met at the time the Requester requests such commitment to Negotiate: The Credit (including any amendment thereto) (i) **nominates the Bank or "any bank" as negotiating bank**, (ii) **is subject to the Uniform Customs and Practice for Documentary Credits (the “UCP”)**, and (iii) **is acceptable (in both form and substance) to the Bank in its sole discretion**. If the Bank decides to commit to Negotiate documents under the Credit, the Bank shall send the Requester a notification in the form of Exhibit A hereto. ...

In addition to any requirements stated in the Credit, the Bank must be provided with the original Credit instrument and all amendments thereto at the time of presentation of documents (or at the time of the request to purchase). ...

The Requester has fully performed its obligations in the transaction underlying the Credit, ...

The Requester has complied with all applicable export control laws and regulations and has no knowledge of (i) any pending or threatened injunction or similar proceeding affecting the Credit, (ii) any violation of law or regulation applicable to the Credit or any underlying transaction, or (iii) any claim by the applicant of Requester non-performance or other applicant objection to payment under the Credit or any indication that the issuing bank will not honor the Credit; ...

*These are a few, select, representative terms from a “Commitment to Negotiate.”*

# Sample Letter of Credit Instructions

*Exporter's Letterhead/Logo*

## Letter of Credit Instructions

1. The Letter of Credit must be **IRREVOCABLE**.
2. The Letter of Credit must be advised through **Citibank N.A., New York, NY USA (SWIFT: CITIUS33)**
3. **The credit is to expire in the country of the beneficiary (U.S.A.)**
4. The credit shall show as the beneficiary:
  - Company Name**
  - Exporter's Street Address**
  - Exporter's City, State, Zip/Postal Code**
  - Exporter's Country**
  
5. The credit is to be payable in **U.S.A. currency** in the amount **exactly as the purchase order**.
6. Merchandise is to be described in the Letter of Credit as according to the **purchase order, referencing the purchase order number. Description must also be generic.**
7. Latest shipment date shall be **90** days after opening date of Letter of Credit.
8. **The credit shall be payable at sight after the shipment date and must allow TT Reimbursement. Draft drawn on buyer not acceptable. Reimbursement bank must be in USA. LC should be available by payment with Citibank, N.A., New York.**
9. Insurance to be covered by the Buyer.
10. **All bank fees and bank charges** are for the account of the Applicant.
11. Partial shipments **allowed**.
12. Transshipment is **allowed**.
13. The credit shall allow a minimum of **21** days after the required shipment date for presentation of documents at the counters of the bank stated above.
14. The required documents should include:
  - Signed Commercial Invoice
  - Packing List
  - Air Waybill consigned to issuing bank and marked FREIGHT COLLECT notify Buyer.
  
15. The Letter of Credit state that it is issued subject to the International Chamber of Commerce Uniform Customs and Practice for Document Credits, Publication currently in effect.

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