A computer monitor on a desk displaying a photograph of a large cargo ship at a port at dusk. The ship is reflected in the water. The monitor is on a white desk, and a blue coffee cup is visible to the right. A red circle highlights the text on the left.

Standby LCs-Expect
The Unexpected
Understanding the
Risks-II



Global Transaction Services

Cash Management Trade Services and Finance Securities Services Fund Services

Standby Letters of Credit Expect the Unexpected

Understanding the Risks II

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- Quick Review
 - Definition/Principals/Flows/Rules
- The Beginning
 - Operative Clauses
 - Beneficiaries—One or More
- The Middle
 - Amendments
 - Additional Issues
- The End
 - Expiry Dates
- Summary
- Q&A

A Brief Recap—Standby Letter of Credit Defined

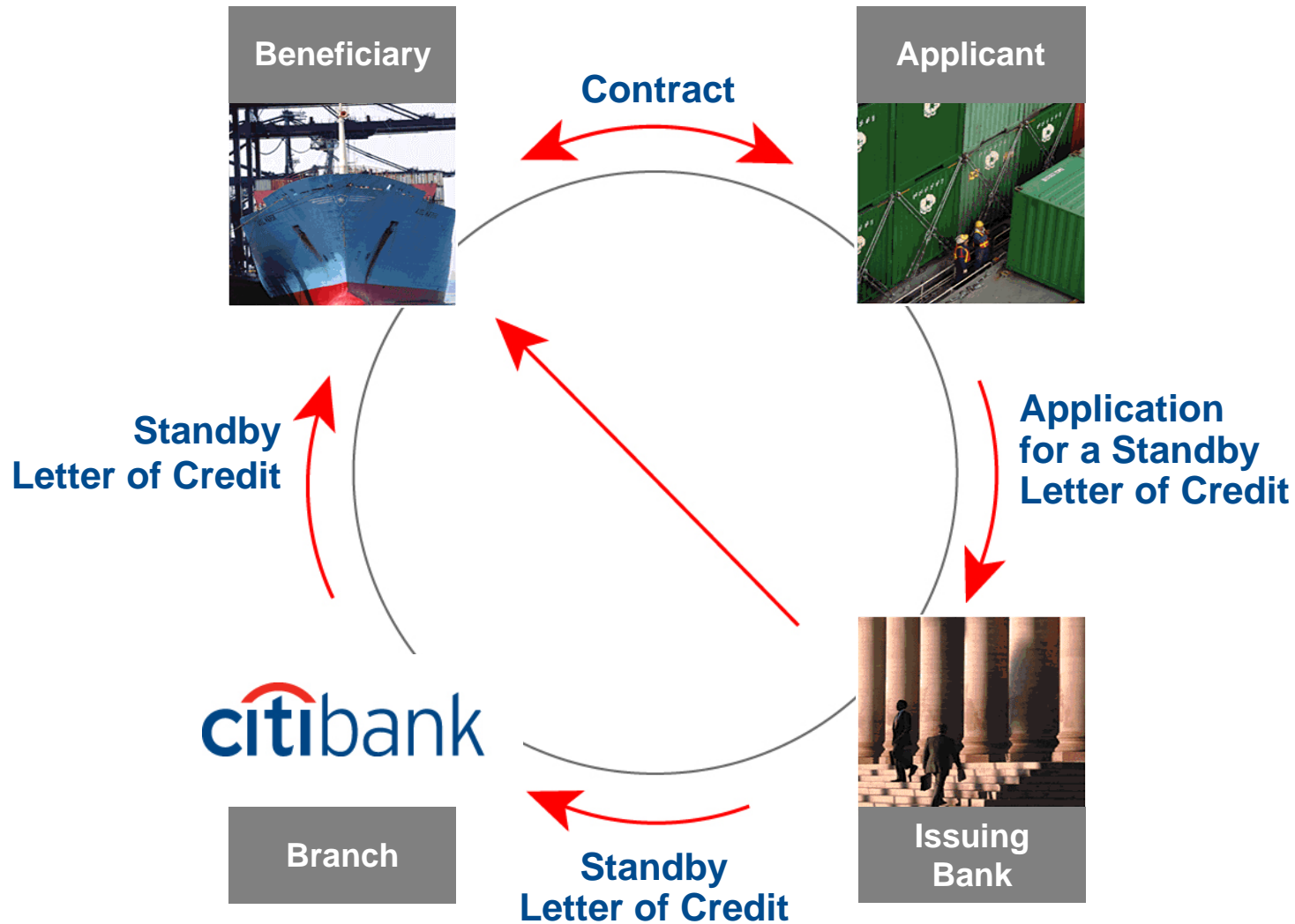


- A Standby Letter of Credit or any other similar instrument however named or described represents an irrevocable obligation of the issuer:
 - To make payment on account of any indebtedness undertaken by the account party,
Or,
 - To make payment on account of any default by the account party in the performance of a non-financial or commercial obligation,
- *upon certification by the beneficiary* that the account party has failed to fulfill its obligation to the beneficiary.

Recap—Standby Principles

- The bank will not investigate the underlying facts of the transaction—e.g., whether or not there was a default or contract breach.
- The Standby is separate from and independent of the underlying contract.
- The bank only reviews conditions that are evidenced by a document.
- The bank's commitment is contingent upon the presentation of the stipulated documents within the terms and conditions of the Standby.
- References to underlying purpose and references to related agreements and contracts are “for information only.”

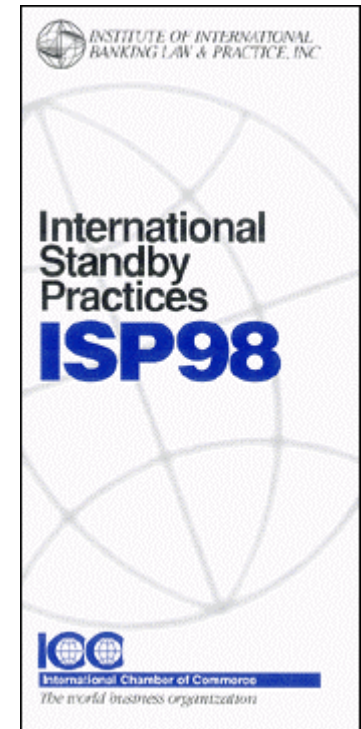
Recap—Transaction Cycle



- Help to define the instrument as a letter of credit
- Represent banking practice
- Uniform Customs & Practice (UCP500/600)
- International Standby Practices (ISP98)

■ ISP98

- Consider using this set of rules
- Designed for standbys
- No hidden traps for beneficiaries
 - *Force majeure* rule: Beneficiary has 30 days to present after the bank reopens



When Is a Standby LC Actually a Standby LC?

Operative Clause

Business Need

A Standby LC with an Operative clause may only be considered available if a certain event occurs which triggers the “Operative” mechanism. The challenge is in providing the Issuing bank with the evidence that the trigger event has occurred. Consider the following example:

XYZ Bank issued a Standby Letter of Credit that will become available upon remittance of an advance payment by ABC Company. ABC Company makes the advance payment as required in their Contract.

Operative Clause I

SBLC Language—One Example

This Standby Letter of Credit will automatically become available for drawing(s) only after we confirm to you in writing that the amount of USD 50,000.00 was remitted in favor of ABC Company Ltd. to the account No. 123 with [Issuing Bank Name] as advance payment

Issues for Consideration

- The beneficiary does not have the ability to draw on this Standby LC until the Issuing Bank has evidenced that the “trigger event” has occurred.
- The evidence must be readily ascertainable.

Operative Clause II

SBLC Language

This Standby Letter of Credit will automatically become available for drawing(s) upon our receipt of written notification from The United Foods Corporation of its receipt of an acceptable Irrevocable Documentary Letter of Credit for the amount of U.S. \$1,000,000.00 in its favor.

Issues for Consideration

- The beneficiary must understand that the applicant has control over the standby letter of credit's effectiveness.

When Is the Beneficiary not Exactly the Beneficiary?

Transfer to Another Beneficiary

According to ISP98, the Beneficiary is a named person who is entitled to draw under a Standby. Standby LCs issued subject to either ISP98 or UCP 500/600 may state that the LC is transferable. Unless stated otherwise within the text of the SBLC, the rules define differences in how transfers are treated.

Issues for Consideration

- **ISP98 Rules 6.01-6.03** “A standby is not transferable unless it so states. A standby that states that it is transferable without further provision means that drawing rights may be transferred in their entirety more than once ... may not be partially transferred”

Transfer by Operation of Law

SBLC Language

The term “Beneficiary” includes a successor by operation of law of the named Beneficiary including, without limitation, any liquidator, rehabilitator, receiver or conservator. In the event the signers of the required drawing documents are the legal successor(s) to the Beneficiary, appropriate documents (acceptable to [Issuing Bank name].) to evidence the legal capacity of such successor(s) are required.

Issues for Consideration

- ISP98 has specific Rules (6.11-6.14) that address this issue. The issuing bank is entitled to ask for additional documentation to establish the identity/authority of any party other than the beneficiary that has requested action.

Multiple Beneficiaries—Case Study



ABC Bank issues a Standby Letter of Credit in favor of

The Best Toy Company

or

The Second Best Toy Company

A drawing is presented signed by both The Best Toy Company and The Second Best Toy Company.

Multiple Beneficiaries

SBLC Language

The Issuer should be clear as to the intent of nominating multiple beneficiaries.

“Any one Beneficiary or combination of Beneficiaries, acting individually or collectively, may draw on this Letter of Credit in full or in part, and any action taken by any or all beneficiaries hereunder shall bind each of them.”

Issues for Consideration

- ISP98 Rules 1.11 c ii-vi address this issue. Unless the context otherwise requires ... “A or B” means “A or B or both”; “either A or B” means “A or B, but not both”; and “A and B” means “both A and B”

When Is an Amendment Effective?

Detrimental Amendments I

SBLC Language

This Standby Letter of Credit is decreased by \$10,000.00 for a new balance of \$90,000.00. Please signify your agreement to this amendment by returning the attached copy with your signature to Fax # 813-604-9999.

Issues for Consideration

- The amendment is not effective until the beneficiary provides their consent. In the above example the balance remains at \$100,000.00 until the consent is received.

Detrimental Amendments II

SBLC Language

The expiry date of this Letter of Credit is amended to July 7, 2007 instead of September 7, 2007.

Issues for Consideration

- **ISP98 Rule 2.06c ii.**—The beneficiary's consent must be made by an express communication to the person advising the amendment unless the beneficiary presents documents which comply with the Standby as amended and which would not comply with the Standby prior to such amendment.

Detrimental Amendments Case Review



Case

A Standby Letter of Credit is issued for \$100,000.00. An amendment states that the amount is decreased by \$10,000.00 for a new balance of \$90,000.00.

Automatic Reduction Clause I

SBLC Language

Each draft honored by us under this standby letter of credit shall immediately reduce the amount available to be drawn hereunder by the amount of the payment made in respect of such draft. In addition, the amount available to be drawn under this standby letter of credit shall be reduced, automatically and without amendment, on each date (each, an "Automatic Reduction Date") set forth in the following Automatic Reduction Schedule by the amount (the "Reduction Amount") set forth opposite such date. However, such scheduled Reduction Amount(s) shall be reduced, or offset, by the amount of any payment made by drawing under this standby letter of credit on or prior to the relevant Automatic Reduction Date until such payment amount has been fully offset against such Reduction Amount(s).

AUTOMATIC REDUCTION SCHEDULE

| DATE | REDUCTION AMOUNT IN USD |
|--------------------|-------------------------|
| September 15, 2007 | \$50,000 |

Automatic Reduction Clause II

SBLC Language

The amount available to be drawn under this Standby letter of Credit shall be reduced automatically, without amendment, on September 15, 2007 (the “Reduction Date”) by the amount of USD 50,000.00 (the “Reduction Amount”).

However, such scheduled Reduction Amount shall be reduced, or offset, by the amount of any payment made by drawing under this Standby letter of Credit on or prior to the relevant Reduction Date until such payment amount has been fully offset against such Reduction Amount.

Issues for Consideration

- **ISP98 Rule 2.06 a.** If a standby expressly states that it is subject to “automatic amendment” by an increase or decrease in the amount ... the amendment is effective automatically without further notification ... (Such an amendment may also be referred to as becoming effective “without amendment”)

Automatic Reduction Case Study & Poll

Case

A Letter of Credit is issued for \$100,000 with a \$50,000.00 automatic reduction scheduled for September 15, 2007. The beneficiary presents conforming drawing documents for USD 25,000.00 on August 1, 2007, what shall be the available balance on September 16, 2007.

Issues for Consideration

- How do drawings affect the balance of an Automatic Reduction Standby LC?

Automatic Increase Clause

SBLC Language

The available amount of this Standby letter of Credit will be increased automatically, without amendment, as per the following Schedule:

| DATE OF INCREASE | AMOUNT OF INCREASE IN USD |
|-------------------------|----------------------------------|
| September 15, 2007 | 50,000.00 |
| September 15, 2008 | 50,000.00 |

Issues for Consideration

- Additional amendments/drawings that might impact the balance

How Long Can One SBLC Remain Active?

SBLC Language

“It is a condition of this Letter of Credit that it shall be deemed automatically extended for an additional period of one year from the present or any future date hereof unless at least 30 (60/90) days prior to any such expiration date we notify you by courier or registered mail that we elect not to extend this Letter of Credit for any such additional period.”

Issues for Consideration

- Can the beneficiary draw under the Standby LC when they receive this notice?
- Can the Issuing Bank send the notice of non-extension by any additional means on top of those stipulated in the Standby LC?

Evergreen Clause—Case Study and Poll



XYZ Bank issues a Standby Letter of Credit with the following clause:

“It is a condition of this Letter of Credit that it shall be deemed automatically extended for an additional period of one year from the present or any future date hereof unless 30 days prior to any such expiration date we notify you by courier or registered mail that we elect not to extend this Letter of Credit for any such additional period.”

XYZ sends their notice of non-extension well in advance of the 30 day period. The beneficiary presents a drawing after the current expiry date stating that the non-extension notice is invalid as it was not sent exactly 30 days prior to the expiry date.

Expiry Dates—Final Cap

SBLC Language

“It is a condition of this Letter of Credit that its expiry date shall be automatically extended for additional period(s) of one year from the present or any future expiry date hereof unless at least 30 (thirty) days prior to any such expiry date we notify you by courier or registered mail that we elect not to extend expiry date of this Letter of Credit for any such additional period. *However, in no event will the expiry date of this Letter of Credit be extended beyond ___/___/___.*”

Issues for Consideration

- What if the underlying transaction is still in progress as the final expiry date approaches?

Terminations

SBLC Language

This standby letter of credit will terminate on earlier of (i) September 15, 200- or (ii) the date we receive the original of this standby letter of credit and your written confirmation authorizing us to cancel standby letter of credit.

Issues for Consideration

- An irrevocable standby letter of credit cannot be cancelled without the beneficiary's consent. "Such consent may be evidenced in writing or by an action such as return of the original standby in a manner which implies that the beneficiary consents to cancellation." (ISP98 Rule 7.01)
- *UCP 500*: Art. 9 stipulates that irrevocable credits may not be canceled without the agreement of the issuing bank (and confirming bank if there is one) and the beneficiary.

Additional Issues for Consideration

- Cancellation prior to expiry date
- Unilateral cancellation at request of the applicant
- Delivery of the SBLC to the applicant instead of the beneficiary
- Presentation of the original SBLC
- Indemnity for lost original SBLC at cancellation

- Know and understand the Rules, whether ISP98 or UCP500/600
- Terms and conditions should be explicit
- Understand the conditions to draw under the SBLC
- Understand the terms of expiry or cancellation
- and finally ... reach out to your bank experts ...we are there for you in your SBLC transactions.

Any Questions?



Our Standby LC Specialists are happy to answer your technical Standby LC questions. Please mention that you attended our Standby LC Webinar!

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