

Export Letters of Credit: Best Practices to Ensure Payment



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Export Letters of Credit: Best Practitioner's Practices



We love to hate letters of credit

- Except for me. I love them! Which pretty much makes me a weirdo.
- Time consuming
- Exacting
- Expensive
- Working with freight forwarders, carriers and inspectors to get complying documents.
- Commercial Invoices
- Packing Lists
- Drafts
- Presentation Period
- Sanctions
- Choice of law
- Export compliance
- Lions and tigers and...uhm...rhinos? OH MY!
Haven't ever been icon bombed by a rhino before...





Documentary Letters of Credit

➤ Definition

- A written undertaking by a bank
- Given to the Supplier at the Buyer's request
- Promising to effect payment of a stated amount at a stated time
- Against presentation of documents in compliance with the terms & conditions stated in the credit agreement.

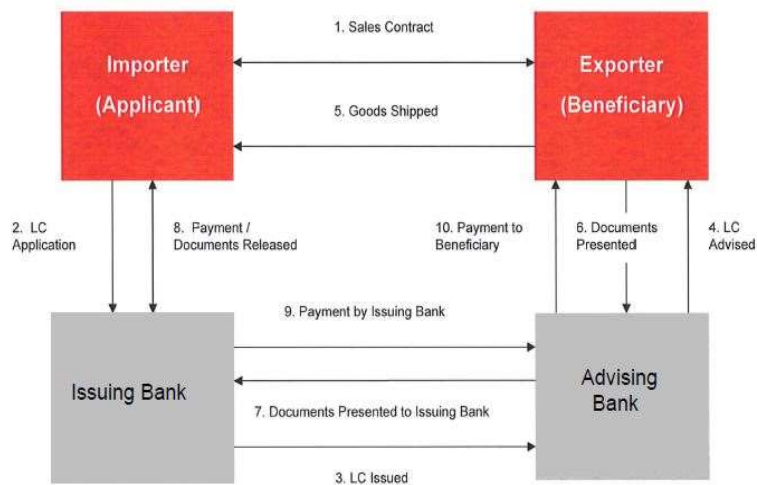
➤ Types of payment

- Sight LC
- Usance LC

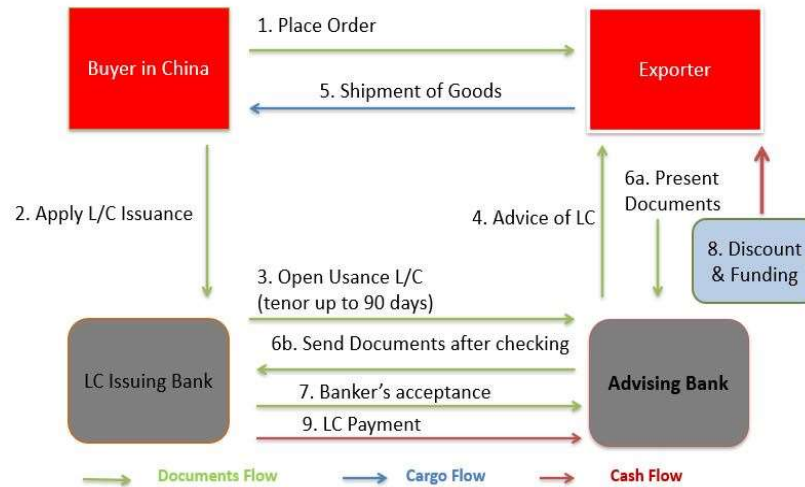
Terminology

- ▶ **Applicant**
 - Buyer/ Importer/ Account Party
- ▶ **Beneficiary**
 - Seller/ Exporter/ Drawer
- ▶ **Issuing Bank**
 - Importer's bank
 - Guarantees payment against correct documents
- ▶ **Advising Bank**
 - Correspondent Bank- close to seller, but not always seller's bank
- ▶ **Confirming Bank**
 - Located in beneficiary's country
 - Adds "guarantee" of payment
- ▶ **Negotiating Bank**
 - Correspondent Bank
 - Close to Seller
 - Often advising bank
 - Always the confirming bank (if any)
 - Sometimes the paying bank
 - Checks and processes documents

Documentary L/C - Sight



Documentary L/C - Usance



Letters of Credit – Risk Profile

BUYER

Benefits:

- 1) Only obliged to pay after documentary evidence that the goods have been shipped and presentation of compliant documents.
- 2) Control over shipment schedules and timing.
- 3) Ability to work with enhanced supplier base

Key Risks:

- 1) Issuing Banks make "payment" determination based purely on the documents presented that appear on their "face" to be compliant with the terms of the LC. There is no absolute certainty of receiving the correct goods. "Banks deal in documents, not goods."
- 2) Import LC's require credit facilities to be in place or cash collateral, which can affect the company's cash flow.

SELLER

Benefits:

- 1) The exporter has the Issuing Bank's undertaking to pay against compliant documents regardless of the financial capacity of the Buyer.
- 2) Ability to Confirm and/or Discount drafts.

Key Risks:

- 1) A high percentage of presentations made under LCs are discrepant therefore making the payment obligation of the issuing entity null and void.
 - 2) Depending on the country the goods are being shipped to, Country & Bank Risk can negate a major protective factor of LC's.
- **Two key factors for discrepancies are poor documentation and late shipment/presentation.

Export Letters of Credit: Best Practitioner's Practices

Best Practices are always a work in progress.

1. Develop a strong relationship with GOOD banker.
2. Ask for a draft copy before the LC is issued.
3. Require revisions or amendments when appropriate.
4. Ask questions. Then ask more questions. Ask a mentor, colleague or networking partner to review and provide feedback.
5. Always work with a copy of the LC. If you have the original, keep it pristine.
6. Read the ENTIRE LC including the fine print.
 1. Read the entire LC again.
 2. Read it upside down.
 3. Highlight key fields and instructions.



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When to Require a Confirmed Letter of Credit

- When required by company credit policy.

Or...

- When the sovereign rating of the applicant's country is low.
- When the issuing bank rating is sub-investment grade rated or not rated.
- When a country's central bank restricts the outflow of money.

Establish who pays for the confirmation with your sales department and the customer.

- Customary (but not required) for beneficiary to pay.
- If margins are too low, may require customer/applicant to pay.
- Your company policy may require your customer/applicant to pay.





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WHAT TO WATCH FOR IN THE LC:

- **The fine print** – choice of law. Make sure you know the laws and are confident that payment is enforceable. Require amendments if not governed by laws or statutes you can accept.
- Section 71B. **Review** to make sure there are no conflicting instructions elsewhere in the LC. Be sure you understand the fees you will be responsible for and agree to pay. Require amendments when not acceptable.
- **Watch** for extra long descriptions of goods when the LC requires that the entire description be included on any or all documents – abundant opportunities for discrepancies.
- **Where** does the LC expire? If you present at a negotiating bank in NYC within the presentation period, but the LC expires in London, you may have stale documents.
- **Non-standard documents** you may not be able to provide.

Common Discrepancies

- ▶ Credit expired
- ▶ Late presentation of documents
- ▶ Late shipment
- ▶ Short shipment
- ▶ Credit amount exceeded
- ▶ Shipment from/to incorrect ports
- ▶ Presentation of incorrect insurance
- ▶ Insurance coverage not in credit currency
- ▶ Under-insured
- ▶ Inconsistent documents
- ▶ Description of goods differ on credit and invoice
- ▶ Draft and invoice amounts differ
- ▶ **Consequences:**
 - Confirming bank undertaking becomes void – the bank must now rely on issuing bank/applicant, to accept discrepant documents
 - Guarantee to pay by issuing bank is voided – that bank must now request buyer's approval to pay against discrepant documents
 - Result: lost protection of the letter of credit

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Pitfalls to avoid in documents presented

- Verify that each document matches the LC, especially when requirements may be obscure.
 - LC may call for a “marine surveying company” or an “independent survey company” or the like. Make sure this designation is printed on the respective document.
 - Watch naming conventions in pre-printed boxes. One of the carriers we use has the Notify box entitled “Notify Address” on the BL. If your LC has simply “notify” you will be fine. But if the LC states “Notify Party”, your document may be discrepant.
 - Are you comfortable with “Consigned To Order and Blank Endorsed” Bills of Lading? Do you understand what this means and the associated risks?
 - Verify that each document is signed and endorsed when required.
 - Did you endorse the draft?
 - When BLs consigned “To Order” and blank endorsed, did you endorse?

Read documents you've created upside down. Helps find errors. 😊

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- What does it mean in field 41A available:
 - By Negotiation?
 - By Payment?
 - Any other?
 - What are the differences?
 - Is there one that is better to use than another?

Are cross-border documentary LCs always subject to UCP 600 even if not mentioned in the LC?

LCs are increasingly written to eliminate all risk and responsibilities for the issuing bank in the event there is/are discrepant document(s) that the bank releases to the applicant without receiving a waiver. How do we overcome this?

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These slides are for we, the unsung LC Superheros, who battle in the trenches and look to minimize the scars.

A few survival skills picked up over the years:

- Deep breathing exercises
- Plenty of rest
- One step at a time
- Networking with other seasoned LC professionals
- Two, three or more set of eyes are much better than one
- An overzealous desire to be perfect
- Talking to ourselves. And answering. Out loud.
- Holding our breath until we turn blue
- A seriously questionable sense of humor

