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**Demystifying Letters of Credit; What every
Credit Manager should know**

Presented by: Fred Dons

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Topics we will handle

- What is a Letter of Credit
- Who are the parties in an L/C, what are their roles
- How does the Lc work, how you can make it work for you
- What are the rules related to an L/C (no it is not just the ucp 600)
- What documents are generally required
- What are some of the additional or special conditions (the scary parts)
- How to sabotage an L/C



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What is a letter of credit



it is an irrevocable undertaking by a party (usually a bank), on behalf of a buyer (their client, called the applicant) to pay a certain amount if and when the seller (called beneficiary) presents "certain" documents, in time to the Bank where the L/C is "available" .



Such documents need to be in compliance with the L/C itself, the Uniform Customs and Practices of the ICC (UCP 600) and the International Standard Banking Practices



Or in more simple terms , the l/c is a promise to pay the beneficiary if he present credit conform documents to the bank within a given time period.

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Parties in a l/c

- **The applicant** or buyer, the party which asks their bank to issue an L/C to the buyer/beneficiary
- **Issuing Bank**, the bank of the buyer, the party which makes the initial promise to pay upon receipt of credit conform documents
- **Advising bank**, usually the bank of the seller, this party checks the authenticity of the lc before forwarding the lc to the beneficiary. Please note that the role of an Advising bank is not to give **Advice**, only to forward the lc and confirm that it is authentic.
- **Confirming bank**, this is usually the Advising bank and if and when confirming (the issuing needs to request this from the the advising bank) will add their confirmation to the l/c and create an additional payment undertaking on top of the undertaking of the issuing bank. That means that if credit conform documents are presented under the l/c the confirming bank will undertake to pay the beneficiary, regardless of whether the issuing bank will pay them.
- **Reimbursing bank**, if and when the l/c is issued for payment in a currency not used in the country of the issuing bank, the issuing bank will indicate a bank (for USD usually in NY) where the bank who has checked the documents can collect the principal amount.
- **Beneficiary**, the seller/exporter, the party who receives the lc and who by means of presenting certain credit conform documents "proves" that he has shipped and is entitled to the principal amount under the l/c

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What does
the lc
actually look
like

- Please note that the lc can be very extensive in detail but we will limit ourselves to the bare minimum, the lc can be issued in writing or by swift (99,9 % of all cases it is issued in swift format) if and when Issued by Swift it has a standard format and a certain order of conditions;
- L/c number (ref number of the issuing bank)
- Date of issue
- Name and address of the applicant (including country)
- Name and address of the beneficiary
- The currency and the amount
- The availability of the l/c (where do I need to present my documents in order to be in time)!!!!

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What does the lc actually look like

Partial/transshipment allowed? (truck vs container vs ocean going vessel)

Shipment "from" and "to" (loading port and discharge port)

latest date of shipment (if nothing is mentioned this is the expiry date of the lc, at the latest)

Goodsdescription

Documents required

Additional conditions

Latest presentation date

Charges (for whose account are they)

Confirm *yes/no

Bank to bank instruction : for instance reimbursement instructions

Special conditions(the scary part)

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Documents needed under an L/C

The "standard" documents requested in an L/C

- the invoice (showing the goods description, and the price agreed + the incoterms), it does not need to be signed however most lc's ask for a signed copy
- The transport document (bill of lading, truckway bill, airway bill)
- Insurance document (minimum 110 % of the CIP or CIF value)
- Packinglist
- Quality certificate
- Certificate of origin
- This list can be made as extensive as the importer wants (which is not always favoring the exporter)

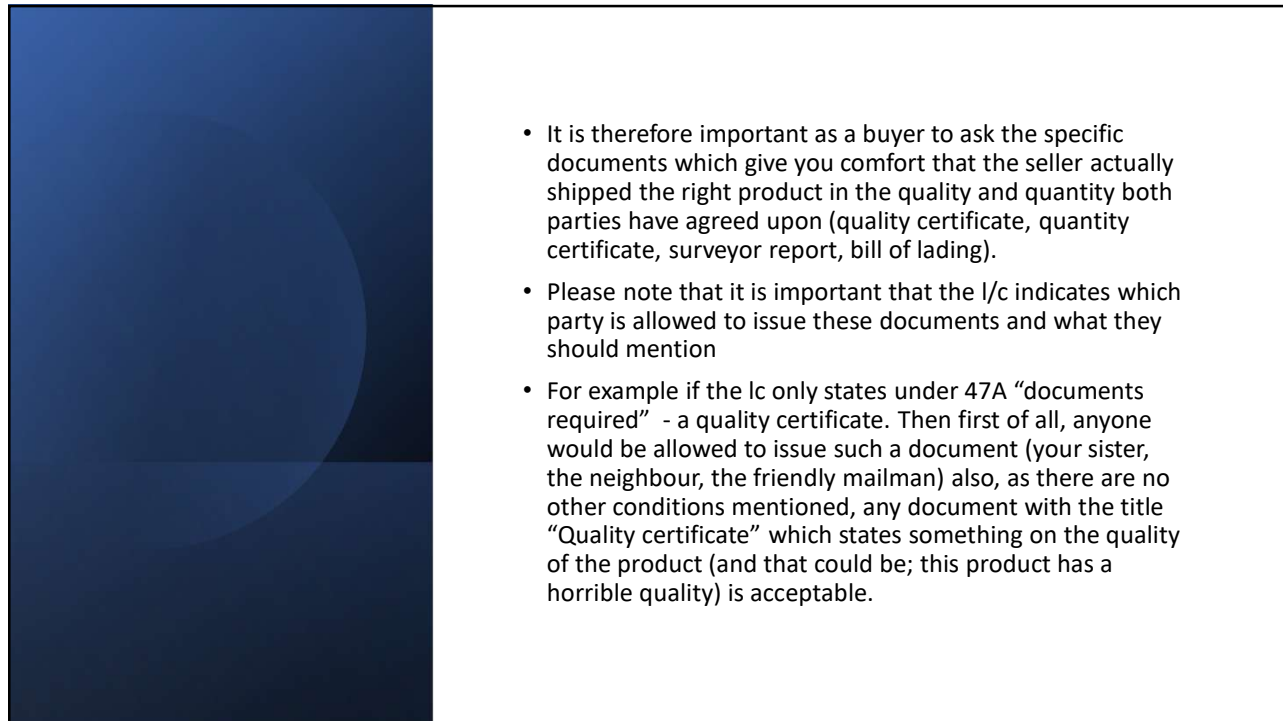
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How does the l/c work ?

First a caveat, banks only deal in documents, not in goods (!). That means that if the exporter for instance ships an empty container but presents credit conform documents, the bank will have to pay out. Also if the buyer for instance becomes aware that the goods are spoiled, this is not a valid reason for the issuing bank to refuse payment.

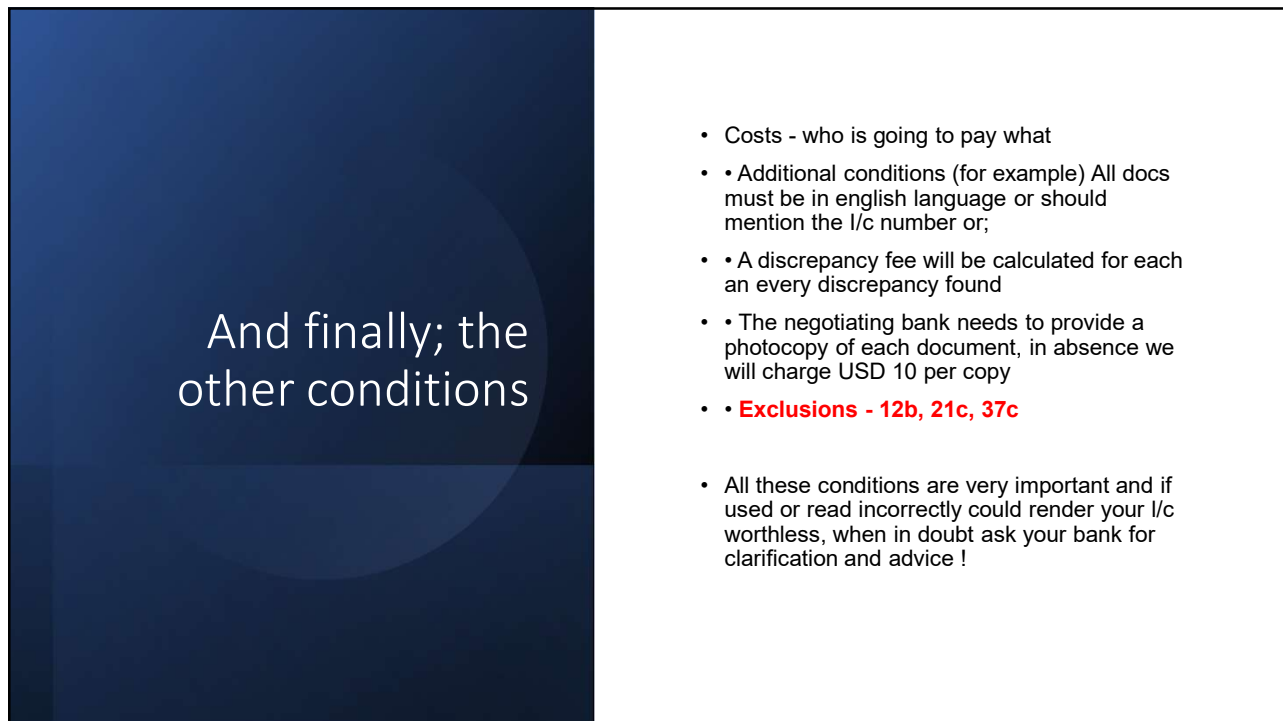
Another caveat, 60 to 70 % of all documentary presentations are discrepant i.e. do not comply with the l/c conditions (so don't feel too sorry for yourself)

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- It is therefore important as a buyer to ask the specific documents which give you comfort that the seller actually shipped the right product in the quality and quantity both parties have agreed upon (quality certificate, quantity certificate, surveyor report, bill of lading).
- Please note that it is important that the I/c indicates which party is allowed to issue these documents and what they should mention
- For example if the I/c only states under 47A “documents required” - a quality certificate. Then first of all, anyone would be allowed to issue such a document (your sister, the neighbour, the friendly mailman) also, as there are no other conditions mentioned, any document with the title “Quality certificate” which states something on the quality of the product (and that could be; this product has a horrible quality) is acceptable.

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And finally; the other conditions

- Costs - who is going to pay what
- Additional conditions (for example) All docs must be in english language or should mention the I/c number or;
- A discrepancy fee will be calculated for each an every discrepancy found
- The negotiating bank needs to provide a photocopy of each document, in absence we will charge USD 10 per copy
- **Exclusions - 12b, 21c, 37c**
- All these conditions are very important and if used or read incorrectly could render your I/c worthless, when in doubt ask your bank for clarification and advice !

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how does an l/c work

Assuming you agreed to the conditions of the l/c, and the lc is issued, the seller/exporter/beneficiary will now ship the product and prepare the documents under the l/c (invoice, bill of lading, insurance certificate, packinglist etc)

Once all documents are complete, the documents will have to be presented to the bank, please note that if the lc does not mention a presentation period, the latest date for presenting these documents will be XX days after shipment date however within the validity of the l/c, so make sure this period is long enough for you and don't wait too long for presenting documents as you might need time to correct documents.

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How does the l/c work

- The bank has 5 working days to check documents, please note (!) that these working days are not curtailed by the expiry date, so if you decided to present documents within the 21 days after shipment period but 2 days before the expiry of the l/c, the bank can still take 5 working days to check them and if it comes back on day 4 with the remark; please note that the invoice is discrepant (mentioning what is actually wrong with it (!)) you could have had the option to repair the invoice but as the l/c has already expired, you are out of luck

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How does the l/c work

- Assuming documents are credit conform and depending on the l/c type, the bank will now forward the documents to the issuing bank and request for payment
- Upon receipt of the documents by the issuing bank they will check them as well and if in order debit the account of the buyer/applicant/importer and release documents to the buyer/applicant
- Please note that this was the easy version, they are many options to make an l/c with a multitude of payment options

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How does a bank actually check documents (and how you should you prepare them)

- First of all the against the conditions in the l/c itself, these are drawn up under the UCP 600, the rules designed by the ICC on how to issue L/C's, to check the documents etc. So as said, first the l/c conditions, anything which is unclear the UCP refers.
- The UCP 600 are 39 rules, and are quite high level (not for the faint of heart)
- Therefore the ICC has also issued the ISBP, the international standard banking practices, which is basically a "how to read" or a manual to the UCP 600
- Lastly "the Opinions"

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UCP 600

- 39 rules
- It deals a/o with the parties in the l/c;
- The standard of docchecking;
- The undertaking of the various parties;
- The expirydate / presentation date;
- The form and content of the documents needed; etc

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ISBP

- The manual on how to read the UCP; example
- - partial shipment; shipment on for instance more than one truck/trailer constitutes a partial shipment even when both trucks/trailers leave from the same place at the same date
- - goodsdescription; on all documents except for on the invoice it may be written in general terms not contradicting the L/C
- - how to calculate a maturity date (xx days sight)I

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Opinions

- If and when a bank and the beneficiary, or the bank and the applicant or the banks between themselves (in a letter of credit transaction), cannot agree how to apply a certain clause or do not agree on whether a document presentation is discrepant or not, they can bring the case forward, first to the local ICC and if needed the local ICC can present this case to the ICC in Paris.
- After a lengthy (global) process the ICC will present an opinion on this topic ,which will be leading onward,and becomes a precedent that can then be used going forward to decide in similar cases without having to go to the ICC.

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How to sabotage an I/c

- From obvious to more nefarious;
 - Ask for a document which has to be co-signed by buyer
 - Ask for a document which does not exist
 - Ask for a document which you do not have control over
 - Have the docpresentation period be too short
 - Mismatch the shipment period with the lifetime of the I/c (SBLC)
 - Ask for shipping documents under an I/c with an Exworks inco term
 - Abuse the incoterms (DDP)



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