Guide to the

Finance of International Trade

Edited by Gordon Platt

HSBC Trade Services
Marine Midland Bank
The Journal of Commerce

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INTRODUCTION

Journal of Commerce Guide to the Finance of International Trade

Getting paid on time for goods supplied or work done is critical to the success of any enterprise. So is getting the proper material to the correct location at the appropriate time. When companies trade domestically, close proximity and culture, a common credit information system and a common currency combine to make credit decisions relatively easy. But in international trade, many additional factors affect the smooth exchange of payment for goods.

This handbook is intended to be a simple reference source about financing international trade. You may be an importer, an exporter, a middleman, a banker, a freight forwarder or a customs broker. It is the hope that international salesmen and colleagues in the credit department will take advantage of this book to complete international deals. How often the credit manager wails about the fine mess the salesman got him into!

No matter what else you may remember from this handbook, never forget two golden rules of international trade finance: know your partner (vendor, customer, etc.) and pick your team carefully! The building blocks of international trade finance include:

a) How buyers mitigate risks of non-performance and sellers mitigate risks of non-payment.

b) How the tools and methods discussed affect the cash flow of buyers, sellers and middlemen.

c) What resources a U.S. exporter may use to enhance competitiveness.

d) How much cash an importer needs to secure a letter of credit.

e) How an exporter can enhance negotiations by focusing on the terms of payment (especially with payment by letter of credit).

Throughout the text, italicized phrases are explained in the glossary. The handbook is written for the subscribers of the Journal of Commerce, a U.S. publication serving parties interested in international trade since 1827. The readership of the Journal of Commerce is primarily American, but there is also an international subscription. The book is written in the American vernacular.

Your comments on this publication, general inquiries from callers in the U.S. and orders for further copies of this book will be welcomed by fax at (212) 658-1911.

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DELIVERING RELIABLE PRODUCT TO A GOOD CUSTOMER AT A FAIR PRICE

From the perspective of bankers, some fundamental principles influence decisions concerning financing of overseas business. If these fundamentals are in place, financing for an enterprise, importing or exporting, probably will not be far away.

The basic tenets are:

- Know your partner (customer, vendor, agent, etc.);
- Know your product; and
- Think success over the long term.

Know Your Partner

Judgment of human character is the essential skill of all successful businesspeople and no less important when the counterparty is a long way away, speaks a different language, is in a significantly different time zone, uses a different alphabet to the one you do, thinks differently from the way you do, and probably comes to work for reasons entirely different than yours.

Many people are willing to introduce you to overseas parties appearing to fit your requirements. For example, the United States Department of Commerce, with ready access to commercial attaches in U.S. embassies in about 150 countries, is very well placed and extremely willing to identify parties who may work with you.

Whether that party is dependable will be for you to decide (and important to your case for financing). Pointers in this area include:

- The clarity and turnaround time of responses to your questions posed through an independent translator, if necessary;
- The availability of references in your country showing prior

dealings with your party;

- The speed and willingness with which your partner divulges bank information (which you should always seek.)

There are no great secrets here: the details involve common-sense and require only due diligence and hard work. The message is simple: know your partner when you speak to anyone about financing a transaction, or a relationship.

KNOW YOUR PRODUCT

Confidence in the product is important for success in international trade, as in any other business. The place of your product in the overseas market, or of the foreign product in this market, must be absolutely clear in your mind before you speak to international bankers. Who are your competitors? How do they compare? Why is your customer prepared to pay more to obtain your product? Why are you obliged to attach six months of post-export finance to your product to get it sold?

THINK SUCCESS OVER THE LONG TERM

The definition of a good customer is one who pays the bills and keeps coming back. If your vendor relationships are important to you, you will be concerned with maintaining stable sources of supply over the long term. As outlined, courtship and due diligence represent time-consuming hard work: it is best if this task brings the dividends of long-term relationships. That is why bankers like to focus on "banking relationships". It will serve you to think long term.

Any application for international finance is going to rest on the history of the relationships of a business and the experience of the people involved. Be sure to document this exhaustively when speaking to financiers. If a business is new, the experience of those involved is going to be crucial to financing decisions.

If neither of these positive factors is available to a new business, keep expectations of financiers low and be prepared to finance your international trades yourself on a small scale to start a track record. Check Section 9 on Programs to aid exporters.

THE CONTRACT OF SALE: THE BOTTOM LINE

The following items are among those included in a typical contract:

- Goods (description, quality, specification, etc.)
- Labeling
- Packaging (and markings)
- Transport (method and cost)
- Insurance
- Documents
- Price
- Payment terms

Payment terms are “the bottom line” in this listing and, coincidentally, very often the last item on the agenda in a contract negotiation. Too often, trading parties are so exhausted by the details of contract negotiation that a superficial clause, such as “Payment by letter of credit,” seems to be a clear enough item in the contract.

That is a mistake. Think of the payment terms as a critical extension of the contract and an opportunity to negotiate favorable terms. Of course, all sellers will insist on payment in advance, and all buyers will insist on open account terms, to begin with but, as in all other forms of business, everything is subject to negotiation!

If payment is to be by letter of credit, sellers should remember the following critical details, and negotiate them, **before signing any contract:**

- Which bank will issue the letter of credit.
- Whether the seller is comfortable with the political risks inherent in the country from which the payment originates, and thus whether the seller wishes the letter of credit to be *confirmed.*
- Which bank will confirm the letter of credit (sellers should be wary when the U.S. branch of an overseas bank is the confirming bank because this does not really constitute a full confirmation).
- Whether the letter of credit will require any documents to be presented signed by "all parties," "*applicant*" or an independent third party not clearly known to the seller (such as an issuer of inspection certificates).
- Whether the letter of credit terms are feasible for the seller to meet (especially in terms of timing of shipment and expiration).

Should letters of credit be impossible for the buyer to arrange, the seller can use a documentary collection as an alternative. Again, it should be made clear which bank will present documents to the buyer and how the documents will control the release of goods until the point of payment (or acceptance in the case of supplier credit). The bottom line is the unexpected delay in payment to the seller because of lack of attention to the question of payment in the contract negotiation process.

TERMS OF SALE (INCOTERMS 1990)

Terms of sale are three letter acronyms everybody knows are important but fewer people understand (CIF, FOB, etc.). Known collectively as Incoterms 1990 and published by the *International Chamber of Commerce* (ICC Pub. No. 460), these terms of sale are critical when negotiating overseas contracts because they define how functions, risks and costs are divided when goods travel from seller to buyer.

INCOTERM	THE SELLER MUST:	THE BUYER MUST:	USAGE
EXW (Ex-Works)	Deliver goods at seller's premises.	Make all arrangements at buyer's cost and risk to take goods to their destination.	**All**
FOB (Free on board)	Deliver goods on board and provide clean on board receipt, an export license and pay export taxes.	Contract for transportation, pay freight and pay insurance premium.	**Ship**
CFR (Cost and Freight)	Contract for transportation, pay freight to named destination, deliver goods on board and provide buyer with clean "on board bill" of lading and an invoice, obtain export license and pay export taxes.	Accept delivery of the goods after documents are tendered, pay insurance premium.	**Ship**
CIF (Cost, Insurance and Freight)	As for CFR plus arrangement for insurance of goods, pay insurance premium and provide buyer with insurance policy.	Accept delivery of goods on shipment after documents are tendered.	**Ship**

INCOTERM	THE SELLER MUST:	THE BUYER MUST:	USAGE
FCA (Free carrier… at a named place)	Provide export license and evidence of delivery of the goods to the carrier.	Contract for transportation, pay freight, obtain export license, pay any export taxes and insurance premium.	All
FAS (Free alongside ship)	Deliver goods alongside ship, provide an "alongside" receipt.	Provide export license and evidence of delivery of the goods to the carrier.	Ship
CPT (Freight/ carriage paid to…)	Contract for transportation, pay freight to named destination; deliver goods to first carrier, obtain export license and pay any export taxes: provide buyer with invoice and transport documents.	After tender of documents, accept delivery of goods when they are delivered to first carrier, arrange and pay insurance premium.	All
CIP Carriage and Ins. paid to…)	(As for CPT plus arrangement of insurance for goods and pay premium, provide buyer with insurance policy.	Accept delivery of goods after documents are tendered.	All

INCOTERM	THE SELLER MUST:	THE BUYER MUST:	USAGE
DES (Delivered Ex-Ship)	Deliver goods on board at destination, provide buyer with documents for delivery of goods.	Pay discharge costs, import duties, obtain import license.	Ship
DEQ (Delivered Ex-Quay (Duty Paid)	Make goods available on the dock at destination. Provide buyer with documents to take delivery; obtain import license and pay import duties taxes, unloading costs and insurance.	Take delivery of the goods from the dock.	Ship
DAF (Delivered at frontier)	Deliver goods to frontier but before the customs border, provide buyer with documents to take delivery.	Pay for on-carriage, obtain import license and pay import duties.	Rail
DDU (Delivered duty unpaid)	Obtain import license, arrange and pay insurance, provide documents to buyer to take delivery.	Take delivery of goods at named destination and pay import duties.	All

INCOTERM	THE SELLER MUST:	THE BUYER MUST:	USAGE
DDP (Delivered duty paid)	Obtain import license and pay import duties, arrange and pay insurance, provide documents to buyer to take delivery.	Take delivery of goods at named destination.	**All**

METHODS OF PAYMENT

Either domestically or internationally, buyers and sellers have some basic objectives when they settle on a mutually acceptable method of payment:

- Buyers want to receive the goods they order on time and in good condition.
- Sellers want to be paid the agreed price promptly.

Methods of payment, in order of safety for the seller, include:

Payment in Advance — Total risk to the buyer
Confirmed letter of credit
Letter of credit (L/C)
Documentary collections (Documents against Payment)
Documentary collections (Documents against Acceptance)
Open Account — Total risk to the seller
Consignment

The advantages to the buyer and seller of each are summarized in the table:

PAYMENT METHOD	WHERE USED	ADVANTAGES TO BUYER	ADVANTAGES TO SELLER
Cash in Advance	New relationships. Smaller transactions. Buyer unable to obtain L/C.	None. Pays prior to receipt of goods and documents.	Eliminates risk of non-payment.
Confirmed Letter of Credit	Ability of importer and issuing bank to pay is uncertain. In countries with regulatory requirements. When seller needs L/C to obtain financing.	Provides reasonable assurance that proper shipment is made prior to payment. May obtain lower price due to reduced credit risk for seller.	Substitutes local bank's credit for that of buyer and issuing bank. Provides assured, prompt payment. Protects against cancellation of underlying sales contract.
Letter of Credit	Ability of importer to pay is uncertain. In countries with regulatory requirements. When seller needs L/C to obtain financing.	Provides reasonable assurance that proper shipment is made prior to payment. May obtain lower price due to reduced credit risk for seller.	Substitutes bank's credit for that of buyer. Provides assured, prompt payment. Protects against cancellation of underlying sales contract.

PAYMENT METHOD	WHERE USED	ADVANTAGES TO BUYER	ADVANTAGES TO SELLER
Documents against Payment (D/P)	Ongoing business relationship. Transaction does not require protection and expense of L/C. Sight payment.	Delays payment until receipt of documents.	Seller retains title to goods until payment. Relies on banks to collect payment from buyer.
Documents against Acceptance (D/A)	As for D/P, but allows for credit terms to buyer.	Delays payment until after receipt of goods. Buyer is financed directly by the seller.	Seller retains title of goods until acceptance. Relies on banks to collect payment from buyer.
Open Account	High trust relationships. Intercompany transactions.	Allows buyer to delay payment until goods have been examined.	Offers attractive terms to buyers (and therefore assists business growth) but at the risk of non-payment.
Consignment	High trust relationships. Buyer has no means to finance inventory.	Allows buyer to delay payment until goods have been sold.	Offers attractive terms to buyers (and therefore assists business growth) but at risk of non-payment and loss of merchandise.

LETTER OF CREDIT

A) Definition

A letter of credit can be defined as: An undertaking written by the *issuing bank* to pay the *beneficiary* a stated sum of money, within a certain time, against the presentation of conforming documents.

The issuer does not have to be a bank, but it usually is in practice. The issuing bank undertakes to pay on behalf of the importer (the buyer and the *applicant* of the credit). The beneficiary of the letter of credit is the exporter, or the seller.

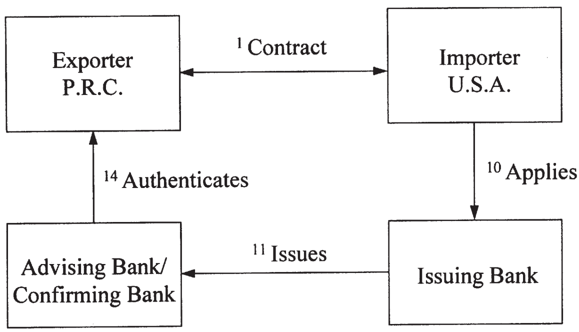
Other parties to a letter of credit may be the *advising bank,* the *confirming bank,* the *negotiating bank,* the *paying bank,* the *reimbursing bank* and the *collecting bank*. But the main contract of payment is between the issuing bank and the beneficiary. Since the issuing bank very often is located in a separate country from the beneficiary, the latter relies on the advising bank locally to advise of the arrival of the L/C and to authenticate it.

The purposes of the L/C are: 1) to convince the seller the capital has been allocated to pay the seller (and thereby show it is safe to start production of the order), 2) to list the documents that the buyer will need to clear the consignment, and specify the details the documents must bear, and 3) to bridge the gap between payment in advance and open account terms.

Importers with little experience should expect to collateralize the L/C issued on their behalf at 100 per cent of face value. After all, the bank expects to pay the face value of the L/C in due course. But from the perspective of the bank, issuing a commitment to pay is not the same as granting a loan, and an importer with a proven track record should be able to convince an *issuing bank* to write an L/C with somewhat less than 100 per cent collateral in place.

B) Issuance cycle

As an approximate guide, importers should expect a letter of credit to be delivered to the advising bank within 2 working days after issue, and then allow for mail delivery to the exporter. The process of issuance is illustrated. The numbers represent a typical number of business days elapsing from the day the contract is agreed.



If the advising bank adds its *confirmation* to the letter of credit, exporters should expect an additional delay of one or two days while a decision is made based on the creditworthiness of the issuing bank.

Article 9.c. of *UCP 500* indicates the confirming bank is not obliged to add its confirmation if it chooses not to, but must advise the issuing bank of its decision not to confirm the letter of credit.

B) Payment cycle

The payment cycle under a *letter of credit* begins when the *beneficiary,* the exporter, presents export documents to the bank. At this point the exporter wants to know, "How quickly will I get my money?" The answer will rest on three factors:

- whether the documents conform with the letter of credit;
- whether the letter of credit is available by *payment* in the country of the exporter, by payment in the country

of the importer, by *negotiation,* by *acceptance* or by *deferred payment;* and,

- whether the letter of credit is *confirmed.*

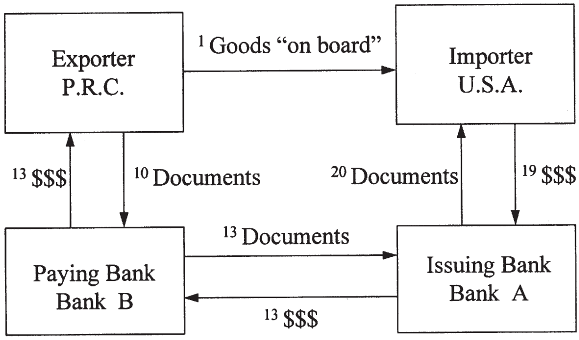
If the documents conform with the letter of credit, payment will be determined by the second of these factors. If they do not, the exporter has these options:

- Correct the discrepancies, if possible and if time allows;
- Wire to the issuing bank for agreement to accept the discrepancies, (the issuing bank will generally refer the discrepancies to the applicant.;
- Pay the exporter with recourse;
- Forward the documents to the issuing bank without paying the exporter; and,
- Accept, in some countries, an indemnity from the exporter and make payment immediately.

Evidently, the more simple a letter of credit, the better chance the exporters will have of presenting conforming documents. Some exporters may be surprised to learn they can take control of their payment by drafting an acceptable letter of credit for their customer.

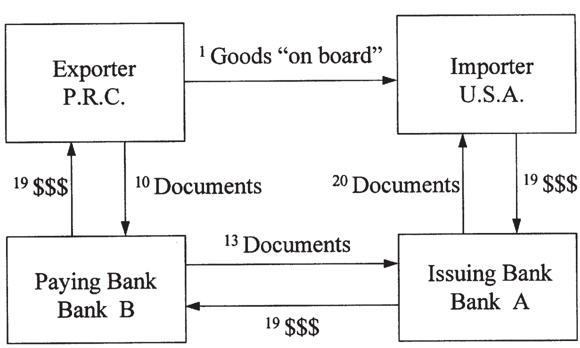
Assume for now documents conform to the L/C. The illustration shows the influence on the cash flow of the exporter (and the importer) of the various types of L/C.

If a letter of credit is available by payment in the country of the exporter, the exporter presenting conforming documents should expect payment, without recourse, as soon as the documents have been found to conform (within about three days). An approximation of how the documents and funds would flow between the various parties might look like this:

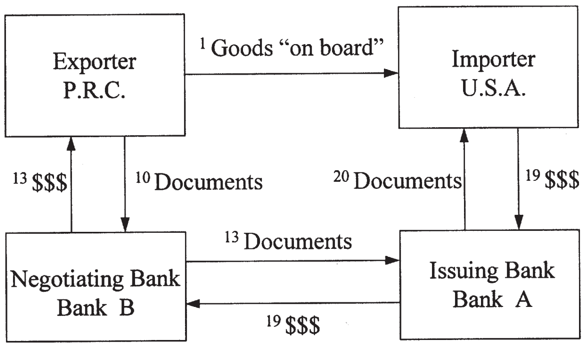


In this case the exporter is paid three days after presenting conforming documents, without recourse. In the case shown, since the issuing bank is out of funds from day 13 to day 19, the importer should expect to pay *transit interest* to the issuing bank for the time the bank is out of funds.

If a letter of credit is available by payment in the country of the importer, the exporter presenting conforming documents must await payment, without recourse, to be remitted by the issuing bank. The flow of documents and funds between the various parties might look like this:

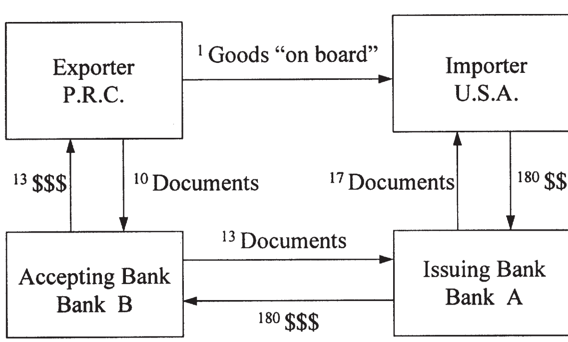


The exporter has to wait from day 10 to day 19 to get paid. *UCP 500* gives banks seven working days to check documents. Thus the scenario in the illustration above is a little generous, and the exporter might have to wait for payment somewhat longer than shown. That is the predominant reason why many sight letters of credit are made available by negotiation, which looks like this:

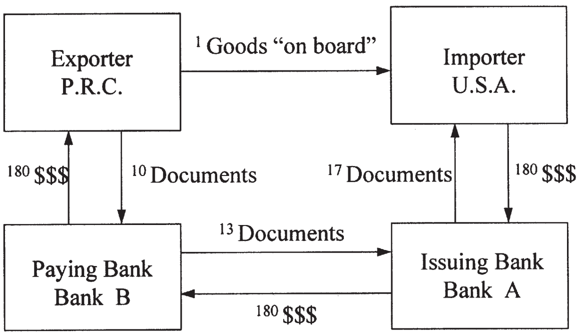


In this instance, Bank B has paid the exporter, **with** recourse, and is out of funds from day 13 to day 19. Bank B expects to be reimbursed by Bank A but if, for any reason, it is not, it will revert to the exporter for the advance to be repaid. This is the essence of negotiation under a letter of credit.

All the illustrations are samples of sight letters of credit, but what happens if the exporter has given the importer six months to pay for the merchandise, dating from the day the goods are put on the boat? The exporter still needs a letter of credit, to be sure payment will be forthcoming, and to provide a vehicle for financing the intervening period. If the financing is to be provided by the exporter's bank, then the parties would expect the letter of credit to be available by acceptance. The flow of cash and funds might look like this:



If the exporter is able to fund the importer, without the aid of a bank, then the parties would expect the letter of credit to be available by deferred payment. The flow of funds and documents in that scenario would look like this:



Clearly letters of credit can have many subtle variations influencing the cash flow of the importer and exporter. In both cases of deferred payment and acceptance L/Cs payment is made to exporters **without** recourse.

Exporters who are not in the habit of drafting letters of credit with their customers **before they are issued** are going to be disappointed because they will expect payment sooner than it actually arrives. Expect your trade finance bank to help you with this process.

D) TRANSFERABLE LETTER OF CREDIT

A transferable L/C is a documentary letter of credit designated as transferable. (Look for the wording, "This L/C is transferable.") It can be transferred by the first beneficiary (transferor) to the second beneficiary (transferee). If it allows for partial shipments, it may be transferred to one or more second beneficiaries, each party receiving its own portion of the transaction.

The second beneficiary is not allowed to transfer to a third beneficiary unless specified in the L/C (see Art. 48.g. of UCP 500).

Transferable L/Cs often are used when:

- the first beneficiary is unable to supply some or all of the merchandise called for in the letter of credit, or,
- the first beneficiary acts as agent of, or principal supplier to, the applicant. Such L/Cs are usually issued for a large amount and the first beneficiary will be responsible for distributing portions of the L/C to various suppliers, or,
- the first beneficiary is unable to secure back-to-back letter of credit facilities from bankers.

Underlying any transferable L/C is the request of the beneficiary to have it made transferable. This tells the applicant that the party they are buying from is not the supplier of the goods.

Transferred portions of these L/Cs are identical to the original except in these respects:

- The name and address of the applicant will most likely be that of the first beneficiary.
- The amount and the unit price may be reduced.
- The expiration date and shipment dates may be shortened.
- The quantity of goods may be reduced if partial shipments are allowed.
- The insurance may be increased to cover the amount of the original credit.

E) BACK-TO-BACK LETTER OF CREDIT

This is a *documentary letter of credit* opened at the request of an exporter who is the *beneficiary* of an export letter of credit (the *master L/C*).

Banks only open these for *middlemen* who first prove that they know what they are doing. They are popular because they allow the middleman with limited financial resources to purchase goods from a supplier who will only sell on L/C terms. The middleman opens the back-to-back L/C, or *baby L/C*, in favor of the seller for a smaller amount than the master L/C, the difference between the two being profit. Another reason these instruments are popular is confidentiality: it is possible to obscure the name of the supplier of the goods from the ultimate buyer and vice versa, which protects the position of the middleman.

In back-to-back L/C operations, the shipping documents tendered by the supplier under the baby L/C are usually used by the middleman to obtain payment under the master L/C. Documents submitted by the middleman would include the *commercial invoice* and the *bill of exchange.* The terms and conditions of the baby L/C are usually the same as those of the master L/C (so called "mirror basis"), but some requirements may differ:

- The value of the back-to-back L/C is less than that of the master L/C.
- The latest shipment and expiration date on the baby L/C is earlier than specified on the master L/C.
- The period allowed for presentation of documents is usually at least seven days less than that allowed in the master L/C.
- Back-to-back L/Cs are usually stated to expire at the counter of the issuing branch. This allows the middleman time to prepare documents for presentation under the master L/C.

Be prepared to sign a power of attorney before a bank will issue a back-to-back L/C for you. Should anything happen to you once the L/C is opened, the bank would want to present documents on your behalf under the master L/C.

F) STANDBY LETTER OF CREDIT

This is a *letter of credit*, popular in the U.S., usually issued with the purpose of guaranteeing payment in the event of non-performance by the *applicant.* Similar in method to *commercial letters of credit* and subject to *UCP 500*, standby L/Cs differ from commercial L/Cs in three significant aspects:

- Beneficiary's statement or claim of default suffices to draw funds under the L/C (in contrast to the detailed export documents under commercial L/C). This has the effect of making the standby L/C a tangible security as safe as cash. Consequently,
- the discrepancy rate in standby letters of credit is non-existent. Thus,
- any applicant wanting a bank to issue a stand-by L/C may be asked to collateralize the transaction at 100 per cent of face value.

These flexible instruments are useful in many circumstances. To name a few:

- In support of an importer's frequent, small open account purchases.
- To cover brokerage firms' margin requirement.
- To serve as bid and performance bonds in the construction and service contract industries.
- To cover advance payments and/or performance bonds.
- To provide insurer's agents worldwide reimbursement of claims paid.
- To enable corporations issuing commercial paper to obtain a better borrowing rate.

G) Assignment of proceeds

This is an instruction from a *beneficiary* to a *paying bank* to pay the proceeds of a letter of credit, or part of them, to a third party. The most common uses of assignments are to secure banks against loans relating to exports or to persuade a third party to manufacture goods without giving away the right to present documents under a *transferable* L/C.

H) LETTER OF CREDIT CONFIRMATIONS

A confirming bank adds a commitment to pay against conforming documents to that of the issuing bank. If an exporter doubts the capacity of an issuing bank to pay, or doubts the stability of the country in which the issuing bank resides, the exporter would seek to have an L/C confirmed.

Confirmation of L/Cs is an assurance that should be researched and understood **before** a sale contract is signed, not after. The cost of confirmation may affect significantly the profit margin of the seller.

Confirmation fees are usually paid for by exporters, but they do not have to be, and they range in price depending on the prevailing view of bank and country risk. Confirmation prices up to 18 per cent of L/Cs have been paid for by some importers (a reflection on the costs of doing business in the area concerned). It should be added that most confirmation fees range from 1/10th of 1 per cent for three months up to 3/4 of 1 per cent.

Under Art. 9.b. of *UCP 500,* an issuing bank must authorize a confirmation of its L/C. Banks in some countries are prone to reject requests for confirmation, giving rise to the business of silent confirmations, which are not subject to UCP 500.

Exporters should check with the confirming bank to determine when they should expect payment without *recourse.* Some banks pay promptly upon checking that the documents presented conform with the L/C; others wait until it becomes clear that the issuing bank will not honor its commitment. The difference can wreak havoc on the cash flow of an exporter.

J) Sample L/C and related S.W.I.F.T. MT700 Message codes

Many letters of credit are delivered by *S.W.I.F.T.* The following describes the codes on the printed L/C. Here is a sample transaction to help decipher the L/C message: imagine that ABC Imports Co. in the U.S. applies for a sight letter of credit to pay XYZ Exports Co. for widgets on sale terms FOB, Malaysia. The L/C covering such a transaction to be transmitted across the S.W.I.F.T. network might look something like this:

HSBC Trade Services

Marine Midland Bank SAMPLE

member HSBC Group

IRREVOCABLE DOCUMENTARY CREDIT NUMBER: ABC123456	ISSUE DATE 20 May 2001
BENEFICIARY: XYZ Exports Co. 456 High Street Kuching, Malaysia	APPLICANT: ABC Imports Co. 123 Main Street Neartown, ST 12345, USA
ADVISING BANK: Hongkong & Shanghai Bank Bangunan Binamas Jalan Padungan 93000 Kuching, Malaysia	AMOUNT: USD 50000.00 USD Fifty thousand only VARIANCE PERCENT ALLOWED: +/- 0% FOB, Kuching
PARTIAL SHIPMENTS: Allowed TRANSHIPMENTS: Allowed SHIPMENT FROM: Kuching, Malaysia SHIPMENT TO: Neartown, ST, USA LATEST: 15 August 2001	DATE & PLACE OF EXPIRY: 30 August 2001 in country of beneficiary AVAILABLE WITH: Any bank BY: Negotiation DRAFTS AT: Sight, for invoice value DRAWN ON: Issuing Bank

DOCUMENTS REQUIRED:

+ Invoice
+ Packing List
+ Certificate of Origin
+ Full set, clean, on-board, ocean bills of lading consigned to shippers' order and endorsed in blank marked "freight collect" and notify...

GOODS: Widgets FOB, Kuching

ADDITIONAL CONDITIONS:

+ Insurance to be effected by buyer
+ All banking charges outside of the U.S.A. are for account of the beneficiary.
+ We engage with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms and conditions of this irrevocable letter of credit that such drafts will be duly honored on presentation at our counters, if negotiated on or before the expiry date herein.

PERIOD FOR PRESENTATION: 15 days after issue of shipping documents, but within the validity of this letter of credit.

CONFIRMATION INSTRUCTION: Without CONFIRMATION CHARGES: N/a

This letter of credit is subject to Uniform Customs and Practices for Documentary Credits (1993 Revision), International Chamber of Commerce Publication Number 500.

27	Sequence of Total	1/1
40A	Form of DC	Irrevocable
20	DC Number	ABC123456
23	Reference to Pre-Advice	PA-ABC123456
31C	Date of Issue	20 May 2001
31D	Expiry Date and Place	30 August 2001 in country of beneficiary
51A	Applicant Bank	Marine Midland Bank
50	Applicant N and A	ABC Imports Co. 123 Main Street Neartown, ST 12345, USA
59	Beneficiary N and A	XYZ Exports Co. 456 High Street Kuching, Malaysia

32B	DC Currency and Amount	USD 50000.00
39B	Maximum credit Amount	Not Exceeding
39C	Additional Amounts Covered	None
41A	Available With/By	Any Bank By Negotiation
42C	Drafts at	Sight
42A	Drawee	Issuing Bank
42M	Mixed Payment Details	None
42P	Deferred Payment Details	None
43P	Partial shipments	Allowed
43T	Transshipment	Allowed
44A	Loading on board/Dispatch/Taking From	Kuching, Malaysia
44B	For transport To	Neartown, ST, USA
44C	Latest Date of shipment	15 August 2001
44D	Shipment Period	Three weeks
45A	Goods Description	Widgets FOB, Kuching
46A	Documents Required	+ Invoice + Packing List + Certificate of Origin + Full set, clean, on-board, ocean bills of lading consigned to shippers order and endorsed in blank marked "freight collect" and notify...
47A	Additional Conditions	+ Insurance arranged outside the terms of L/C
71B	Details of Charges	All charges to beneficiary
48	Presentation Period	15 days
49	Confirmation Instructions	Without
53A	Reimbursement Bank	On our receipt of conforming documents
57D	Advise Thru.	Yourselves
72	Bank to Bank Info.	Documents to be dispatched in one lot to...

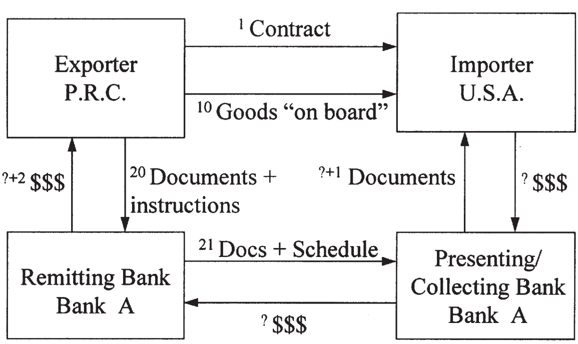
DOCUMENTARY COLLECTIONS

A collection may be clean or documentary. In this section the focus is on the handling of *documentary collections,* in which banks deliver export documents with instructions they be released (to the buyer) against payment or against acceptance. (Clean collections refer to check collections.)

Documentary collections are governed by *ICC* Publication No. 522 titled Uniform Rules for Collection (*URC 522*). These rules adhere to a principal/agent style arrangement, with all decisions being made by the exporter as he is appraised of the facts relating to the collection.

A) DOCUMENTS AGAINST PAYMENT

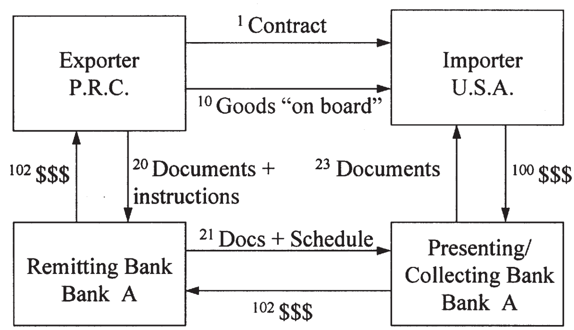
The flow of documents and cash in this process can be represented in this way:



Notice in this example it is not certain when the importer will pay for the documents. Yet the documentary collection is a very effective vehicle for sight payment if the exporter pays attention to the subject of *control of goods,* dealt with in the next section. In practice, exporters should expect payment to arrive approximately at the time that the goods arrive on the dock in the country of the importer.

B) Documents against acceptance

Let us take an example where an exporter agrees to be paid by documents against acceptance "90 days after bill of lading date". The flow of documents and cash in this process can be represented in this way:



In contrast to *D/P* collections, all the guesswork as to when the payment is made to the exporter is removed in the *D/A* collection. But note also the delay before payment, a delay which dictates that, before settling on D/A terms, exporters should be confident of four things:

- Their product will satisfy their customer (if it does not, the importer may feel justified in reneging on the acceptance commitment with impunity);
- Their customer will not go bankrupt before final payment is made (no letter of credit has been issued prior to payment and that means that no bank is obligated to pay the exporter);
- The country of the importer does not sink into turmoil or suffer other obstacles which might frustrate payment at any time during the acceptance period;
- It is necessary for the supplier credit inherent in D/A terms to be extended to the importer for good business reasons (i.e., competition, relationship, etc.)

Documentary collections (whether D/A or D/P) are simple, fast and effective. Some exporters liken D/A collections to open account trading. In doing so, they ignore these benefits:

- A call from a nearby bank pressing for payment is very different to a fax from an irate supplier overseas.
- URC 522 Art. 24 allows for the possibility of *protest*, which though not equivalent to a law suit as it is perceived in the U.S., may embarrass a drawee sufficiently to exact payment.
- D/A collections financed by a resourceful bank will undoubtedly bring resources to bear which the exporter would be hard pressed to enlist and pay for otherwise.
- By accepting, a bill of exchange (an enforceable debt instrument) an importer becomes **legally liable** to pay at maturity.

CONTROL OF GOODS

While in L/C operations all parties "deal with documents, and not with goods" (see *UCP 500* Art. 4), banks financing any transaction, not just under L/Cs, are intensely interested to know whether the documents control access to the goods. So should exporters. This section seeks to point out how that control is observed and maintained through proper wording of *transport documents.*

To begin, with shipment by sea, carriers issue either *straight bills of lading* or *negotiable bills of lading*. Straight bills are not negotiable, and must be marked as such. Negotiable bills (order bills) are made out "to the order of" a consignee, or to the order of the shipper and endorsed by the shipper either in blank, or to a named consignee.

Very simply, negotiable bills of lading protect against a buyer collecting goods prior to payment, or acceptance, of a bill of exchange, whereas straight B/Ls do not. The exporter is protected because documents must be presented before the merchandise is delivered to the notify party. But if shipment is made on a straight bill, the buyer may obtain the goods without the documents, perhaps by posting a bond.

Airwaybills, covering shipment by air, are never negotiable instruments and suffer from the same drawbacks outlined here, as straight bills of lading.

It is quite common for issuing banks to write L/Cs that require either that transport documents be consigned to themselves or that a "full set" of negotiable bills of lading be presented. This way, no matter what form the bill of lading or airwaybill may take, the bank controls the release of the shipment. While this practice is to the benefit of the exporter, it may be unacceptable to some importers, because of delays associated with mailing documents to an intermediary bank, or obtaining necessary endorsements.

FOREIGN EXCHANGE

Middle-size U.S. companies, whether they import or export, too often ignore the impact of the foreign exchange markets on their international vendors and customers.

Take for example the attitude of one company president after a presentation on foreign exchange in the Midwest in early 1997: "I expect we're missing some opportunities, losing opportunities to competitors." But at the same seminar, another chief executive said, "When you deal in more than one currency, it gives you the same kind of edge as speaking more than one language. That's important, if you can come to a place of business and you're speaking their language."

The fact is that in any international trade transaction one party must deal in a foreign currency. The party that does this may well have the upper hand.

The plainest products available to U.S. companies from banks, to help them compete for international business can be summarized as foreign exchange contracts and options. In essence, contracts are binding obligations to exchange, whereas options are rights without obligation to exchange. To illustrate:

Spot exchange contract

The bank agrees to a conversion rate with a U.S. exporter to take foreign currency proceeds of a sale, and pay U.S. dollars in exchange. Conversely, it may agree with a U.S. importer a rate to provide foreign currency to pay an overseas vendor, and receive U.S. dollars in exchange.

Delivery of the currency and U.S. dollars occurs two days after the conversion rate is agreed. This gives all the parties time to settle commitments.

Forward exchange contract

The bank agrees to a conversion rate with a U.S. exporter to take foreign currency proceeds of a sale at a future date, say June 30, and deliver U.S. dollars in exchange on same day.

If the exporter does not **have** the currency on June 30, there still is an obligation to deliver it to the bank. In practice the bank will buy the foreign currency in the market and settle the profit, or loss, with the exporter. This is why prudent banks take margins when agreeing on exchange contracts with their customers.

Forward window exchange contract

The bank agrees to a conversion rate with a U.S. exporter to take foreign currency proceeds of a sale on any day within a range of future dates, and deliver U.S. dollars in exchange on the same day.

Usually the range is 30 days, and the exporter chooses the day within the range that is most suitable for the exchange. This is a more flexible arrangement than the forward exchange contract, and more popular, unsurprisingly. If the exporter does not have the currency by the end of the window period, the risk is the same as that described earlier and the exporter should be prepared to suffer the consequences, or reap the benefits.

Foreign exchange option contract

The bank agrees on a conversion rate with a U.S. exporter to take foreign currency proceeds of a sale at a future date, say June 30, and deliver U.S. dollars in exchange on same day. The exporter has the right to walk away from the arrangement if it does not suit the exporter's interest at the time of delivery.

Effectively an insurance policy against foreign exchange fluctuation. These are attractive products. Exporters and importers exploring them will be interested in currency volatility, market liquidity and premiums, which are subjects outside the scope of this guide.

The overwhelming majority of imports to and exports from the U.S. involve a currency exchange, though too many U.S. companies ignore that fact. U.S. exporters and importers ignoring foreign currency movements and working only in U.S. dollars are routinely ignoring opportunities to manage and profit from currency fluctuations. In addition, wiser competitors may bundle currency risk management into their product, gaining a march on the exporter who does not focus on the subject.

PROGRAMS TO AID EXPORTERS

Both the U.S. Export-Import Bank and the U.S. Small Business Administration encourage exporting by guaranteeing loans to exporters under their respective working capital guarantee programs. (Ex-Im Bank's mission is articulated in the slogan, "Jobs through exports".) Lenders are covered against non-performance by the exporter, as opposed to non-payment by the buyer.

There is some small overlap between the two agencies. In recent years, Ex-Im Bank has increased promotion of its programs to smaller businesses as well as training and delegating commercial banks to use its facilities independently.

Exporters must have at least one year's experience before engaging either of these agencies. Information is available from many banks or from some city and state business development agencies and from the U.S. agencies themselves. Generally, exporters have a better chance of success if they are making a sale which is routine business for them **except for its size.** The pre-export programs alleviate strain on the balance sheet, but they do not generate business by helping exporters to perform what they are not able to perform.

Ex-Im Bank also markets a wide range of post-export programs falling into the broad category of guarantees, insurance, and direct loans, all designed to help U.S. exporters compete in world markets, often against competitors backed heavily by their respective government export guarantee agencies.

GLOSSARY OF TERMS

Acceptance — A *bill of exchange* accepted by the drawee, as evidenced by the drawee's signature on the face of the bill. The drawee commits to pay the bill at maturity (The payee of the bill must be sure that the drawee has the means and the will to do this.)

Acceptance Letter of Credit — An L/C available "by acceptance" calling for a *time draft* (or *usance draft* in international parlance). Drawn on an intermediate accepting bank, these L/Cs are popular where both buyer and seller need interim finance to facilitate cash flow.

Advance Payment — The buyer delivers cash to the seller before the seller releases the goods. Some sellers ask for this in part payment to show good faith on the part of the buyer and also to enhance their cash flow related to the sale of a particular custom-made item. May not mean exactly the same as *payment in advance.*

Advising Bank — The bank, usually in the country of the exporter, that notifies the availability of the *letter of credit* to the exporter. The advising bank is responsible for authenticating and forwarding the L/C but makes no commitment to pay unless it agrees to act as *confirming bank.* See also *negotiating bank.*

Air Release — See *steamship guarantee.*

Airwaybill — Non-negotiable contract of carriage between an air carrier and a shipper (or freight forwarder).

All Risks — Insurance industry terminology denoting extensive insurance cover but excluding special risks (such as risks of war, strikes, perishing of goods, etc.).

Amendment — Change to a letter of credit, **usually** in the interest of the beneficiary. (Exporters should check Art. 9.d.iii of *UCP 500* very carefully especially regarding adverse amendments.)

Applicant — Party applying to *issuing bank* to issue the *letter of credit,* usually an importer.

Assignment of Proceeds — Document signed by the *beneficiary* under a *letter of credit* assigning the rights to proceeds from an L/C drawing to a third party. From the perspective of the assignee, an assignment differs radically from a *transferable letter of credit.* The latter conveys a right to the transferee to present documents under an L/C, the former does not.

Back-to-back Letter of Credit — A "baby" *letter of credit* in which the *issuing bank* is secured by a *master L/C*. The *applicant* of the baby will be the *beneficiary* of the master, and the terms of the two L/C's will be such that documents presented under the baby can obtain payment under the master. "Back-to-backs" are popular among middlemen wanting to protect their position between the buyer and manufacturer.

Baby Letter of Credit — Second of two letters of credit in a *back-to-back L/C* arrangement.

Banker's Acceptance — A *draf*t bearing the *acceptance* of a *drawee* bank thus qualifying for financing in the liquid U.S. dollars bankers acceptance market. (A useful vehicle for fixed-term, fixed rate financing especially for banks without access to low-cost U.S. dollars funds.)

Beneficiary — Party favored by a *letter of credit*, usually an exporter.

Bill of Exchange — A written, unconditional demand, signed by the drawer and addressed to the drawee, to pay a sum of money "at sight" or at some future date ("x days after sight" or "x days after bill of lading date") to the order of the payee, or to the bearer. Frequently known as a *draft* or as a "bill."

Bill of Lading — A receipt for goods delivered to carrier for shipment, a contract of carriage and a document of title issued by a carrier to the shipper. This *transport document* is the primary evidence of shipment of goods and the exporter's key to prompt payment. See also *charter party B/L.*

Blocked Currency — Cash deposit which cannot be transferred to another country because of local regulations or a shortage of foreign exchange.

Bonded Warehouse — Store for goods held until duties are paid, approved by the U.S. Treasury Department under bond or guarantee of compliance with revenue laws.

"C&F" — Cost and Freight: *Incoterm* indicating that the sale price includes all costs of shipment and freight up to the port of destination. The buyer must insure the cargo from the port of loading, for if the cargo is lost the buyer will bear the consequence. Note that C&F is an archaic terminology replaced by CFR since Incoterms were updated in 1989 and published in *ICC* 460 (Incoterms 1990).

Carnet — A customs document allowing special categories of goods to cross international borders without payment of duties.

Cash Against Documents — Method of payment otherwise known as *documentary collection*. Sometimes referred to as CAD.

Cash in Advance — Also *Payment in Advance.*

Certificate of Origin — Certificate stating origin of goods, usually signed by the embassy in the country of the exporter which represents the country of the importer.

CFR — Cost and Freight: *Incoterm* indicating that the sale price includes all costs of shipment and freight up to the port of destination. The buyer must insure the cargo from the port of loading, for if the cargo is lost the buyer will bear the consequence. Note that C&F is an archaic terminology replaced by CFR since Incoterms were updated in 1989 and published in *ICC* 460 (Incoterms 1990).

Charter Party Bill of Lading — A bill of lading issued subject to a charter party arrangement. Charter party bills of lading trouble bankers because the charter party agreement may give the owner of the vessel rights to the goods in transit which the banker expects to secure a trade transaction. Art. 25.b. of *UCP 500* states banks are not obliged to read charter party agreements presented under letters of credit with such B/Ls. Note also that charter party B/L's are not acceptable under letters of credit unless allowed explicitly (UCP 500 Art. 25.a. refers).

CIF — Cost, Insurance and Freight: *Incoterm* indicating that the sale price includes all costs of shipment and insurance and freight up to the port of destination. The seller must insure the cargo as far as the port of delivery, for if the cargo is lost the seller will bear the consequence. Incoterms were updated in 1989 and published in *ICC* 460 (Incoterms 1990).

Clean Bill of Lading — B/L without any clause or notation indicating a defect in the goods or packaging of goods received for shipment.

Collecting Bank — Bank in the importer's country involved in processing a collection.

Collection — Either a clean or a *documentary collection,* handled by banks, preferable according to URC 522.

Combined Transport B/L — A bill of lading used when more than one carrier is involved in a shipment, for example when a consignment travels by rail and by sea. Sometimes referred to as a multi-modal bill of lading.

Commercial Invoice — Seller's itemized list of goods shipped with descriptions, details, prices, costs addressed to buyer.

Commercial Letter of Credit — Common parlance in the U.S. for *documentary letter of credit*, or "DC", as it is known elsewhere. See *letter of credit.*

Confirmed Letter of Credit — A letter of credit bearing the confirmation, or commitment to pay, of a second bank, most often in the country of the exporter. Confirmations are the exporter's insurance against non-payment by the *issuing bank* for most reasons other than a *discrepancy.*

Confirmation — The act of a bank to add its commitment to that of the issuing bank to pay the beneficiary for compliant documents. Under article 9.b. of *UCP 500,* confirming banks must be requested or authorized by the issuing bank to "add their confirmation" to the L/C. Note that the act of confirmation **does not** relieve the issuing bank of its obligation to the beneficiary.

Confirming Bank — Bank adding its commitment to pay for compliant documents to that of the issuing bank, usually at the request of same. Confirming banks are very often *correspondents* of issuing banks. *L/C beneficiaries* should understand clearly how soon the confirming bank will pay after presentation of conforming export documents.

Consignment — Payment method in which the buyer pays for goods after selling them. The exporter retains title to the goods until they are sold (as well as 100 per cent risk of non-payment by the buyer).

Consolidator's Bill of Lading — B/L issued by consolidator (forwarder) to a shipper as a receipt for goods to be consolidated with other cargoes prior to shipment.

Control of Goods — Of vital interest to all parties involved in trade, control of goods is exercised through the *transport document*. It determines whether the buyer will be able to clear an inbound shipment without the *transport document,* (and thus without paying for the documents held at the bank).

Correspondent Bank — A bank overseas with which a local bank has a relationship. Relationships between banks are just one factor that determine appetite for *confirmation* and thus have relevance to importers and exporters.

Country of Origin — The country where a product is made, as determined by the amount of work done on the product in the country and attested by a *certificate of origin.*

Customs Broker — Firm representing the importer in dealings with customs responsible for obtaining and submitting documents for clearing merchandise through customs, arranging inland transport and paying related charges.

Date Draft — A bill of exchange that matures in a specific number of days after the date of issue.

DC — Popular acronym outside the Americas for *documentary letter of credit.* The equivalent in the U.S. is the L/C, or more properly the *commercial L/C.*

Deferred Payment L/C — A letter of credit available "by deferred payment" calling for a *time draft* (or *usance draft* in international parlance) drawn on the issuing bank. Popular in cases of supplier credit.

Demurrage — Storage fee for inbound merchandise held beyond the free time allowed by the shipping company.

Devaluation — The lowering of the value of one currency in terms of one or more other currencies. Devaluation may be market-driven, or dictated officially.

Discount —May be commercial (i.e., reduction in price) or financial (i.e., deduction from face value of commercial paper, especially *time drafts*)

Discrepancy — An instance in which documents presented do not conform to the L/C. Article 13.a. of UCP 500 states that "banks must examine all documents stipulated in the credit with reasonable care...." In fact banks exercise extreme care and "international standard banking practice" dictates that exporters must exercise detailed vigilance in preparing documents under *letters of credit* if they are not to be frustrated by delays in obtaining payment.

Dishonor — Refusal on the part of the *drawee* to accept a draft or pay upon maturity.

Documentary Collection — An order written by the seller to the bank to deliver *documents against payment,* or to *deliver documents against acceptance,* to the buyer. The seller's bank will act on the instruction of the seller in a principal/agent relationship and remit the documents to a branch, or a *correspondent,* in the country of the buyer, with instructions for collection. A key factor in the effectiveness of such collections is the *control of goods* exercised through the *transport document.*

Documentary Letter of Credit — A *commercial letter of credit* expressly designed to facilitate the exchange of cash against documents representing a transfer of goods. It is frequently referred to outside the Americas as a "DC" and contrasts in nature with a *standby letter of credit.*

Documents against Acceptance ("D/A") — *documentary collection,* frequently referred to as a "time draft" or, by bankers, a "usance draft," in which the seller, the drawer, mandates the release of export documents to the buyer against the acceptance of the latter to pay at some future date. From the perspective of the seller, Documents against Acceptance are far more risky than....

Documents against Payment ("D/P") — *documentary collection,* frequently referred to as a "sight draft," or even just a "draft," in which the seller mandates the release of export documents to the buyer against cash payment.

Draft — Colloquial American terminology for a *documentary collection.* But internationally this may refer to the *bill of exchange.*

Drawback (Duty Drawback) — The refund of 99 per cent of Customs duty paid on an import which is later exported.

Drawee — Party upon whom a *bill of exchange* is drawn. Also, very commonly the party to whom presentation is to be made in accordance with a collection instruction.

Drawer — Party drawing a *bill of exchange.*

EDI — Electronic data interchange. The exchange between computers of trade documentation. EDI can take two forms, financial and documentary, and suffers from a curse common in the world of computers, at least two message format standards. They are ANSI (popular in the U.S.) and EDIFACT (popular elsewhere).

Endorsement — Signature on back of negotiable instrument (i.e., *bill of lading*) for the purpose of transferring rights to another.

Eurodollars — U.S. dollars on deposit in any branch of any bank located outside the United States. Likewise, euroyen are Japanese yen on deposit in banks outside Japan, and may be outside of Europe, too. Any "eurocurrency" is a foreign currency deposit and should be treated with care if offered as a form of payment. For example, a U.S. exporter offered U.S. dollars to be delivered in some countries may face a challenge to convert these eurodollars to U.S. dollars.

Evergreen Clause — A provision in the letter of credit for the expiration date to extend without requiring an amendment.

Exchange Rate — The price of one currency expressed in terms of another. Exchange rates may be quoted spot, for delivery within two working days, or forward, for delivery at some future time. Apt to fluctuate. Any international trader with a eye for profit will be aware of the currency circumstances affecting a partner.

Ex-Im Bank — Services of the U.S. Export-Import Bank can be summarized in four categories: 1) Pre-export working capital guarantees, 2) Post-export credit risk protection (via insurance and guarantees), 3) Foreign buyer credit (direct loans to overseas borrowers), and 4) Self-liquidating project finance for infrastructure developments.

Expiry Date — Date after which letter of credit is no longer available for payment.

Export License — Document issued by a U.S. Government agency allowing the export of goods.

Export Trading Company — Firm buying domestic products for sale overseas taking title to the goods (which an export-management company usually does not).

Factor — A finance company willing to purchase a receivable at a discount, either with recourse to the seller or without. In exchange for immediate payment, the seller will transfer title to the receivable to the factor. *Convenient but expensive alternative to other methods of converting receivables to cash.*

FAS — Free Alongside Ship: *Incoterm* indicating that the sale price includes the cost of transport to the port of embarkation, but not the costs of loading, export clearance, ocean freight or insurance. The buyer must insure the cargo as far as the port of delivery, for if the cargo is lost the buyer will bear the consequence. Incoterms were updated in 1989 and published in *ICC* 460 (Incoterms 1990).

FOB — Free On Board: *Incoterm* indicating that the sale price includes the cost of transport to and loading at the port of embarkation, but not the costs of export clearance, ocean freight or insurance. The buyer must insure the cargo as far as the port of delivery, for if the cargo is lost the buyer will bear the consequence. Incoterms were updated in 1989 and published in *ICC* 460 (Incoterms 1990).

Force Majeure — A clause in a contract excusing a party from fulfilling an obligation because of events beyond the control of the party.

Foreign Currency Account — An account maintained by a bank in foreign currency and payable in that currency.

Foreign Sales Corporation — A corporation within a U.S. possession, such as the Virgin Islands, or within a qualifying jurisdiction, such as Barbados, to exempt 15 per cent to 30 per cent of export profits from U.S. corporate tax.

Foreign Trade Zone — A site sanctioned by the authorities in which imported goods are exempted from duties until withdrawn for domestic sale or use. Can be used for commercial warehousing, assembly plants and re-export.

Forfeit — The sale of a term debt against a discounted cash payment in which the seller forfeits the right to future payments by the debtor. A popular method for U.S. exporters of capital equipment to dispose of long-term overseas debt.

Forwarder's Bill of Lading — B/L issued by forwarder to shipper, a receipt for merchandise to be shipped.

Fraud — All too common in international trade, especially transactional deals handling commodities and a perfect reason why any sensible importer, exporter or middleman will develop a relationship with a competent trade bank.

Free Trade Zone — A site sanctioned by the authorities in which imported goods are exempted from duties until withdrawn for domestic sale or use. Can be used for commercial warehousing, assembly plants and re-export.

Freight Forwarder — A company that books shipment of goods, often as an agent for an airline. Usually, many small shipments are combined to take advantage of bulk discounts. Forwarders also may provide other services, such as trucking, warehousing and document preparation.

G-7 — The Group of Seven industrialized nations that participate in annual economic summits: United States, Germany, Japan, United Kingdom, France, Italy and Canada.

GATT — The General Agreement on Tariffs and Trade, a Geneva-based organization that governed world trade until the formation of the World Trade Organization (*WTO*) in 1995. Formed by 23 countries at a conference in Geneva in 1947 to increase trade by lowering duties and quotas.

Guarantee Letter — Commitment popular outside the U.S. functionally similar to *standby letters of credit.*

Harmonized Code — Harmonized commodity description and coding system, an international classification system that assigns identification numbers to specific products. The code ensures all parties use a consistent classification for purposes of documentation, statistical control and duty assessment.

ICC — Refer to *International Chamber of Commerce.*

Import License — Document issued by a government allowing the import of goods. Normally required where exchange controls exist or where goods are controlled items i.e., armaments, pharmaceuticals.

Incoterms 1990 — Terms of sale indicating costs and responsibilities included in the price under a sales contract (i.e., EXW, FOB, CFR, CIF, DDP). Defined under ICC Publication No. 460, these are worldwide standardized terms that transcend borders and should be clearly understood by all parties negotiating an international sales contract. *The year 1990 refers to the date of the last revision to the Incoterms.*

International Chamber — Known as ICC for short, the International Chamber of Commerce is a non-governmental organization serving world-wide business. Members in 123 countries represent tens of thousand of business organizations and companies and promote world trade and investment based on free and fair competition. ICC Publishing SA, based in Paris, produces many publications, some of which are de facto standards in global commerce i.e., Uniforms Customs and Practices for Documentary Credits (UCP 500), Uniform Rules for Collections (URC 522) and Incoterms 1990 (ICC 460). *ICC Publishing SA has a sales office in New York, NY.*

Irrevocable — Adjective attached to *letter of credit* to denote an instrument that cannot be amended or canceled without the agreement of all parties to the L/C (including the beneficiary). The adjective is popular and redundant: Article 6 of *UCP500* states that credits should indicate whether they are revocable or irrevocable and that, in the absence of such indication, credits shall be deemed to be irrevocable. In most circumstances, revocable L/Cs are worthless and, as a consequence, they are very rare. Yet the initiated still refer to “irrevocable letters of credit” as if they are the exception, which they were prior to UCP 500, rather than the rule, which they are now.

Latest Shipment Date — Last day on which goods may be shipped (as evidenced by “on board” date on bill of lading, or flight date on airwaybill).

Letter of Credit — An undertaking written by the *issuing bank* to pay the *beneficiary* a stated sum of money, within a certain time, against the presentation of conforming documents.

Other parties to a letter of credit may be the *advising bank,* the *confirming bank,* the *negotiating bank,* the *paying bank* and the *reimbursing bank,* but the main contract of payment is between the issuing bank and the beneficiary. Since the issuing bank is very often located in a separate country from the beneficiary, the latter relies on the advising bank, locally, to notify of the arrival L/C and to authenticate it.

“Documents” in the definition above may comprise of various export documents, as in a *documentary letter of credit,* or a simple statement by the beneficiary, as in a *standby letter of credit.* Under Article 13c. of *UCP 500,* conditions expressed in a letter of credit without stating the document to may be ignored

Marine Bill of Lading — B/L for shipment by sea.

Master Letter of Credit — First of two *letters of credit* in a *back-to-back L/C* arrangement.

Multi-Modal bill of Lading — A bill of lading used when more than one mode of transport is involved in a shipment, for example when a consignment travels by rail and by sea. Sometimes referred to as a combined transport bill of lading.

Negotiable Bill of Lading — B/L consigned to the order of, and endorsed in blank by, the shipper. Whoever carries a negotiable bill of lading in their hand carries the document of title to the goods. That is why banks often call for a “full set” of bills of lading under their L/Cs (see Section 7 on control of goods.) *See also straight bill of lading.*

Negotiating Bank — The bank that checks the exporter’s documents under the letter of credit and advances cash to the exporter, at a small discount, in the expectation of *reimbursement* by the issuing bank.

On Board Bill of Lading — B/L indicating goods have been loaded “on board.” The on board notation must be dated and signed.

Open Account — Payment term in which goods are released to a buyer prior to payment, or promise of payment (see *letter of credit*). A 100 per cent risk of non-payment on the part of the seller who should know his customer well before accepting a sale on these terms.

Opening Bank — Common terminology among bankers for *issuing bank* in the *letter of credit* process.

Packing Credit — Common parlance internationally, especially in Asia, for *pre-export finance* provided against a *letter of credit.*

Packing List — A list prepared by the seller itemizing goods shipped, quantities, sizes, weights and packing marks. Very common in trade finance, the packing list should be prepared so as to be consistent with other documents (especially under a *letter of credit*).

Paying Bank — The bank nominated in the L/C to pay out against conforming documents, without *recourse.* Exporters interested in their cash flow should understand whether the paying bank is in their own country, or that of their customer, the importer.

Payment in Advance — The buyer delivers cash to the seller before the seller releases the goods. Can be referred to as "cash in advance," or "CAD" and may not mean exactly the same as *advance payment.*

Pre-export Finance — Terminology of U.S. bankers for a loan to an exporter to finance the accumulation of materials, the manufacture, assembly, production, packaging and transport of physical goods to fulfill an export order. Commonly guaranteed by Ex-Im or SBA Working Capital Guarantee programs.

Presentation Period — Time allowed after issue of transport document to present documents under L/C.

Presenting Bank — Bank in a documentary collection process presenting export documents to the *drawee* for payment. The exporter and the presenting bank behave in a principal/agent relationship and it is therefore wise of the uncertain exporter to ensure that the collection is presented by some bank other than the importer's bank.

Pro-Forma Invoice — A provisional invoice written by the seller which serves the purpose of a quotation to the buyer.

Quotas — Restrictions imposed by governments on the quantity of certain goods imported during a specific time frame. Usually, quotas protect a domestic market. In the U.S., sugar, wheat, cotton, tobacco, textiles and apparel are governed by quotas.

Received for Shipment B/L — Bill of lading indicating goods received for shipment (but not "on board"). Unacceptable B/L unless specifically allowed by the letter of credit or unless it is marked "on board" with a date and signature.

Recourse — Payment with recourse means that the paying party retains the right to the funds in the event that reimbursement (from another party) is not forthcoming. An important concept in trade finance.

Red Clause Letter of Credit — An L/C with a "red clause" in it, allowing the *beneficiary* to draw down an *advance payment* prior to shipment, usually against presentation of a simple receipt. So called because traditionally it was written in red ink, the purpose of this clause is to finance the seller during the preparation of the export order. The applicant will be liable for any drawings even if goods are never shipped. This is one reason why importers should expect red clause L/Cs to be collateralized differently from plain import L/Cs.

Reimbursing Bank — The bank empowered by the issuing bank (i.e., with a bank balance) to charge the account of the issuing bank and pay to the bank collecting funds under a letter of credit.

Remitting Bank — Exporter's bank in a documentary collection process taking export documents and sending them to an *correspondent* in the country of the importer (the drawee in the collection process).

Revocable — Adjective applied to that *letter of credit* which may be canceled or amended unilaterally by the *issuing bank*. Revocable letters of credit are rare, for obvious reasons, but for example might be used between friendly parties to observe the spirit of government regulations.

Revolving Letter of Credit — L/C that reinstates automatically. May revolve in relation to time or value, the latter being cumulative or non-cumulative.

Sight Draft — A *bill of exchange* payable "at sight" by the drawee. In effect, a demand for immediate payment.

Spot Exchange — The purchase or sale of foreign currency, usually against an equivalent amount of local currency, for delivery within two working days after the agreement.

Standby Letter of Credit — An L/C popular in the U.S. issued with the purpose of guaranteeing payment in the event of non-performance by *applicant.* Similar in method to *commercial letters of credit* and subject to *UCP 500* but different in three significant aspects: 1) beneficiary's statement or claim of default suffices to draw (in contrast to a pile of detailed export documents under commercial L/C), thus 2) discrepancy rate is between low and zero, therefore 3) expect banks to collateralize standby L/Cs somewhat differently to commercial L/Cs (i.e., 100 per cent).

Steamship Guarantee — A guarantee issued by a bank to a steamship line against financial loss arising from the release of a consignment without the appropriate *transport document.* Popular because goods frequently arrive at the port of discharge before documents are available to clear them.

Straight Bill of Lading — B/L consigned directly to a party (as opposed to *negotiable bills of lading* issued opposed "to order" of shipper) who holds title to the goods. Discomforting to bankers if the consignee party is not the bank. A straight B/L cannot be endorsed to another party.

S.W.I.F.T. — Society for Worldwide Interbank Financial Telecommunication. A cooperative owned by a consortium of banks designed to carry formatted messages between them in a secure environment. The messages all relate to financial transactions between banks and their customers.

Tenor — The usance period of a bill.

TEU — Twenty-foot equivalent unit. A measurement of cargo based on a standard ocean shipment container, which is 20 feet in length.

Through Bill of Lading — B/L covering transport by more than one carrier from point of taking charge to the final destination (i.e., when a consignment travels by rail and by sea).

Time Draft — A *bill of exchange* payable by the drawee at some future date. In effect, a demand for payment "at x days after sight", or "at x days after bill of lading date", or "on 29 Feb. 2006", for example. Sometimes referred to among bankers as a *usance draft.*

Trade Acceptance — An *time draft* where the drawee signs the word "accepted" across the face and thus commits to pay the holder upon maturity. The instrument will be as valuable as the creditworthiness of the accepting party allows.

Transport Document — A bill of lading, an airwaybill, a truck receipt, any other document acting as a receipt for goods and a contract of carriage. Of all these transport documents, only a bill of lading is a document of title.

Transshipment — Shipment of merchandise to destination abroad on more than one vessel. Liability may pass from one carrier to the next, or it may be covered by a *through bill of lading* issued by the first carrier.

UCP 500 — Uniform Customs and Practice for Documentary Credits, Publication No. 500 of the International Chamber of Commerce. The indisputable authority on letters of credits recognized internationally. UCP 500 serves as the self-regulation of the L/C industry and renders L/Cs a more reliable form of payment. Copies of this crucial document (and of URC 522) can be obtained from the ICC Publishing Inc., 156 Fifth Avenue, Suite 820, New York, NY 10010 (Telephone (212) 206-1150) at the time of writing or, perhaps, from a bank that specializes in international trade finance. ICC has a whole range of interesting publications dealing with many aspects of international trade.

Be particularly careful of any L/C which does not clearly state it is subject to UCP 500. Usually in the final paragraph.

URC 522 — Uniform Rules for Collections, Publication No. 522 of the *International Chamber of Commerce.* An internationally recognized code for the handling of collections, clean or documentary.

Unconfirmed Letter of Credit — A *letter of credit* that does not carry any *confirmation* by a second bank, usually located in the country of the *beneficiary*. Exporters intent on collecting payment under such L/Cs should hold a view as to risk of non-payment for various reasons.

Usance — Banker's terminology, in use more commonly overseas than in the U.S., indicating time allowed for payment of a bill of exchange (contrast with sight above).

Usance Draft — More often referred to in the U.S. as a *time draft* (see also *documents against acceptance*).

Usance Letter of Credit — Sometimes referred to in the U.S. as a time L/C.

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Luis Clay has been vice president, HSBC Trade Services, the brand name under which Marine Midland Bank markets trade finance and other trade services, since 1994.

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Gordon Platt

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