

A Guide to

# Documentary Payments



# Short-Term Trade Finance

**A Primer on Letters of Credit,  
Import and Export Financing, and  
Other Banking Services for  
Exporters and Importers**

**Prepared by Walter (Buddy) Baker, ABN AMRO Bank**

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# DOCUMENTARY PAYMENTS & SHORT-TERM TRADE FINANCE

**A Primer on Letters of Credit, Documentary Draft Collections, Import and Export Financing, and Other Banking Services for Exporters and Importers**

## **CHAPTER ONE: INTRODUCTION**

**It is, of course, an understatement to say that doing business with someone in another country is more complicated than just finding ways to transport goods over long distances. One of the most obvious differences from doing business domestically is the fact that goods must clear customs when crossing international boundaries. This requires documentation of merchandise type and value.**

Another difference is the fact that steamship companies traditionally issue bills of lading as receipts for the goods they transport and require that the party who comes to the port of destination to claim goods surrender an original copy of the bill of lading to prove he has proper title to the goods—more documentation. Indeed, international trade revolves around documentation—documentation that the exporter of goods originates or obtains and that the importer of goods needs in order to gain possession of those goods. Because of this, buying and selling goods that cross national borders revolves around exchanging documents for payment.

### **Risks Involved in International Trade**

International trade presents uncertainties not found in domestic trade. First, there is political risk associated with the government in the buyer's country. This covers possibilities such as the imposition of foreign exchange controls and expropriation. Second, there is transfer risk involving the economy of the buyer's country. Transfer risk is the risk that, due to the fact his country has a negative balance of payments, no foreign exchange (U.S. dollars or other "hard" currency) may be available to the buyer when he is ready to pay for the goods he has purchased. The final uncertainty involves commercial risk, the normal risk, also found in domestic sales, of whether the buyer can and will pay the seller when payment is due. But in an international sale, because the buyer is in another country, the seller generally not only has less reliable information regarding his financial

condition and integrity but also typically has fewer avenues of redress should the buyer fail to pay or otherwise violate the agreed-upon terms of sale. The existence of these political, transfer, and commercial risks explains why only about half of international sales are made on an open account basis.

Despite these risks, the competitiveness of the international market often precludes insistence upon cash in advance. Just as in domestic trade transactions, the buyer's preference is to take as long as possible before paying. He will ask the seller to allow him some time to resell the goods or use them to otherwise generate the cash needed to pay for them. And, whereas North American companies are used to dealing with each other on open account terms of 30 days from invoice date, in international transactions it is not uncommon to see "supplier financing" of 60, 90, or even 180 days and more, depending on the goods. Thus a company is likely to experience ballooning of its accounts receivable and its "days-sales-outstanding" ratio due to export activity even as it is incurring increased risks.

But, because international trade revolves around documentation, some middle ground exists between open account and cash in advance—middle ground in which intermediaries conduct the exchange of documents for payment and may even provide pre-export financing for the seller and post-import financing for the buyer. ([\*See the chart at the end of this chapter for a comparison of international credit terms.\*](#)) The choice of credit terms will depend on many factors including industry norms, country practices, anticipated frequency and value of shipments, profit margin, payment history, and whether any bank financing is involved. We find two mechanisms, documentary draft collections and letters of credit, predominate in international trade.

### **Documentary Draft Collections—An Overview**

In a documentary draft collection, documents are entrusted to a bank for delivery only after the seller's collection instructions are met. Normally, these documents include the commercial invoice, the bill of lading, and any paperwork needed by the buyer to clear customs in his country. The bank acts only as a collection agent and does not assume any liability for payment. Neither the commercial risk associated with the buyer nor the political and transfer risks associated with the buyer's country are eliminated. When asked for payment by a bank, the buyer could simply refuse or the situation in his country could make payment impossible. Using a sight draft accompanied by properly consigned ocean bills of lading, however, ensures that title to the goods will not legally pass if the buyer refuses or is unable to pay, since documents will not be delivered until payment is tendered. Such control of title depends on having a title document, as in most ocean shipments, which is released to the buyer only after he has made payment; this control is not available when making air shipments or when using time drafts or clean drafts for any type of shipment.

Export collections require that the seller (exporter) forward documents with collection instructions to his bank which will, in turn, pass them on to a foreign bank for collection. To facilitate these transactions, most banks will provide a direct collection service for their exporting customers. Under this method, rather than sending documents to his bank for processing, the exporter or his agent uses a special form provided by his bank to send the documents directly to the buyer's bank. The exporter sends a copy of this form to his own bank, who will follow up from there.

This booklet contains a [chapter on documentary draft collections](#) in general, of interest to importers and exporters alike, and a [chapter on direct collections](#) in particular, for exporters.

## **Commercial Letters of Credit—An Overview**

A commercial letter of credit replaces the commercial risk associated with the buyer with that of the bank issuing the letter of credit. In a letter of credit transaction, the issuing bank commits up front to pay a specified amount of money to the seller when presented with a specified set of documents. Hence, the seller is no longer relying upon the buyer's promise to pay—with the confidence he can produce the required documents, he is relying upon the promise and ability to pay of the buyer's bank. If the seller wishes to reduce further the risks of non-payment, he can request that a bank in his own country be authorized to confirm the letter of credit. A bank which confirms a letter of credit undertakes to honor the credit as though it had issued it themselves.

Alternative risk-reducing structures might involve arranging a pre-committed sale of the anticipated receivable or taking out credit insurance covering non-payment. Although the exact protection differs (for example, credit insurance will not pay when there is a contractual dispute), from the seller's viewpoint, any of these alternatives would reduce or eliminate the foreign political and transfer risks and replace the commercial risk of the buyer and his bank with that of the confirming bank, receivable purchaser, or insurance company. In some cases, banks providing working capital or accounts receivable financing for goods being exported will require that the exporter obtain either letters of credit or credit insurance for all sales being financed. Sometimes insurance companies themselves will require letters of credit from specified buyers before granting coverage.

It is crucial to understand that a letter of credit is neither an unconditional guarantee of payment to the seller nor a means of assuring the buyer that goods paid for will be satisfactory—rather, payment will be rendered if and only if the documents required by the letter of credit precisely comply with the terms and conditions of the credit. Anyone selling on a letter-of-credit basis should read very carefully each one received to be certain the terms and conditions can and will be complied with. Discrepancies can delay or even preclude payment. And anyone buying on a letter-of-credit basis needs to understand that payment will be affected despite any disputes with the seller over compliance with the underlying contract just as long as the documents meet the letter of credit requirements.

Commercial letters of credit are often referred to as import credits and export credits. This division reflects only a difference of perspective, not different instruments. One company's export credit is another's import credit. This booklet contains a [chapter on import letters of credit](#) and a [chapter on export letters of credit](#), each written from the relevant perspective.

## **Standby Letters of Credit—An Overview**

Standby letters of credit do not cover the direct purchase of merchandise. Rather, they are based on the underlying principle of letters of credit that payment is made against presentation of documents—not necessarily shipping documents but whatever documents the applicant, beneficiary, and issuing bank may agree to. The party requesting a bank to issue a standby letter of credit (the applicant) need not be involved in a commercial transaction at all. In fact, most standby letters of credit are payable against the presentation of documents as simple as a certificate from the beneficiary stating that the applicant has not performed some act, has not complied with a specific contract or other



agreement, or has defaulted either in payment for certain goods and services or in making repayment on a loan. These are highly versatile instruments whose range of uses seems to be limited only by the imagination. This booklet contains a [chapter describing some of the ways standby letters of credit are commonly used by importers and exporters](#).

### **Bankers' Acceptances—An Overview**

Bankers' acceptances arise from the drafts covering certain international and domestic trade transactions. A banker's acceptance is a time draft "accepted" by the bank upon whom it is drawn. Once accepted, it constitutes an unconditional obligation on the part of the accepting bank to pay the draft at maturity (out of funds it expects to receive at that point in time—by creating the acceptance, the bank intermediates the risk of receiving these funds). There is a large market in the U.S. in which bankers' acceptances can be bought and sold in the months between their creation and maturity. Bankers' acceptances can arise from transactions involving letters of credit, documentary draft collections, or contractual sales and purchases. They are used by importers mainly as a low-cost alternative to loans: The importer asks the bank to create an acceptance which the importer then immediately sells, at a discount, to generate funds to pay for goods purchased; at maturity the importer must repay the amount of the acceptance to the bank. The investor earns the amount of the discount. Bankers' acceptances can be used by exporters in much the same way, to bridge the time between shipment of goods and receipt of payment, and they can even be used to sell receivables to a bank: The bank disburses funds to the exporter immediately after shipment of goods but obtains payment at maturity from the buyer of the goods. Their use by exporters is discussed further in the chapters on [draft collections](#) and [export letters of credit](#).

### **International Credit Terms/Payment Methods**

The following table covers the spectrum of credit terms offered in international trade transactions. It is arranged in order of risk: from highest risk to the exporter (which is lowest risk to the importer) to lowest risk to the exporter (highest risk to the importer).

TERM	DEFINITION	APPLICATIONS	ADVANTAGES	DISADVANTAGES
Extended Terms	Importer pays for goods over period of time during which they are used by importer, often 3 to 10 years. A set of promissory notes is normally issued upon shipment, payable at 6-month or 1-year intervals.	<ol style="list-style-type: none"> <li>1. Sale of machinery or other capital goods importer is using rather than reselling.</li> <li>2. Importer located in country with limited hard currency but importer makes something that is sold into hard currency countries.</li> <li>3. Goods among equipment and materials being acquired for major project.</li> </ol>	<ol style="list-style-type: none"> <li>1. Competitive.</li> <li>2. Importer gets to pay out of earnings generated by the goods purchased.</li> <li>3. It is possible to sell notes on the secondary debt market, although this probably requires importer's bank's "aval" (a type of payment guarantee) on the notes.</li> <li>4. Government loan guarantees (e.g., U.S. Eximbank) may be available for a major portion of transaction.</li> </ol>	<ol style="list-style-type: none"> <li>1. Risk of importer's willingness and ability to pay and to obtain hard currency extends over a period of years.</li> <li>2. Deep discounts may be necessary to sell notes on secondary market.</li> <li>3. Government loan guarantees may be expensive.</li> <li>4. Extensive structuring often required.</li> </ol>
Open Account, Clean Draft	Exporter makes shipment and awaits payment direct from importer. Any documents needed by importer sent directly by exporter when sale is invoiced.	<ol style="list-style-type: none"> <li>1. Importer has excellent credit rating.</li> <li>2. Importer is long-time, well-known customer.</li> <li>3. Importer is subsidiary of exporter or vice versa.</li> <li>4. Small shipments with good profit margins.</li> <li>5. Low-risk country.</li> </ol>	<ol style="list-style-type: none"> <li>1. Simple bookkeeping for exporter.</li> <li>2. Easy documentation.</li> <li>3. Competitive.</li> <li>4. Low cost.</li> <li>5. With prior approval, may be insured or factored, but exporter is still at risk in the event of a contract dispute.</li> </ol>	<ol style="list-style-type: none"> <li>1. Exporter assumes credit risk of importer, including simple refusal to pay, and risk of importer's country's political condition.</li> <li>2. Full brunt of financing falls on exporter.</li> <li>3. Problems of availability of hard currency.</li> <li>4. In matters of dispute, no interested third party is involved.</li> <li>5. Exporter vulnerable to slow payment.</li> </ol>
Time or Date Draft, Documents against Acceptance (D/A)	Exporter makes shipment and presents draft and documents to bank with instructions that documents are to be released to importer upon importer's acceptance of the draft (importer's acknowledgment of his debt and promise to pay at a future date).	<ol style="list-style-type: none"> <li>1. Importer has established a good payment history with exporter and is being considered for open account terms.</li> <li>2. Low-risk country.</li> <li>3. Country requires drafts in order to instigate legal collection proceedings and/or there is no legal framework for granting a security interest in accounts receivable.</li> <li>4. Short-term financing necessary to make sale.</li> </ol>	<ol style="list-style-type: none"> <li>1. Draft is evidence of indebtedness.</li> <li>2. Receivable may be financed by exporter's bank or possibly sold without recourse (importer's bank's guarantee or "aval" may be required).</li> <li>3. Gives importer time to resell goods before having to pay for them.</li> <li>4. Interested third party involved in case of dispute (bank).</li> <li>5. Low cost.</li> <li>6. With prior approval, may be insured.</li> </ol>	<ol style="list-style-type: none"> <li>1. Exporter assumes credit risk of importer and risk of importer's country's political condition.</li> <li>2. Exporter is financing shipment until maturity of draft.</li> <li>3. Problems of availability of hard currency.</li> <li>4. Exporter assumes risk of refused shipment and contract disputes (even if insured).</li> <li>5. Exporter vulnerable to slow payment.</li> </ol>
Consignment, Retention of Title	Exporter makes shipment and receives payment as goods are sold by importer. Sales contract and/or other legal documentation gives exporter right to repossess any unsold goods.	<ol style="list-style-type: none"> <li>1. Goods sold to a distributor or other company for resale rather than consumption.</li> <li>2. Countries that allow retention of title and have a legal framework for repossession of goods.</li> </ol>	<ol style="list-style-type: none"> <li>1. Exporter may recover goods not sold and paid for.</li> <li>2. Competitive.</li> </ol>	<ol style="list-style-type: none"> <li>1. Same as Open Account.</li> <li>2. Subject to local laws and customs.</li> <li>3. Legal expenses.</li> <li>4. Requires periodic inventorying of goods.</li> </ol>
Sight Draft, Documents against Payment (D/P), Cash against Documents (C.A.D.)	Exporter makes shipment and entrusts documents to a bank with instructions that documents be released to importer only upon payment of draft.	<ol style="list-style-type: none"> <li>1. Importer has good or excellent credit rating.</li> <li>2. Small shipments of goods with broad demand (not custom made for importer).</li> <li>3. Goods shipped by ocean carrier issuing negotiable bills of lading.</li> <li>4. Medium volume.</li> <li>5. Low-risk country.</li> <li>6. May be required in countries having foreign exchange restrictions not allowing open account purchases/sales.</li> </ol>	<ol style="list-style-type: none"> <li>1. Draft is evidence of indebtedness.</li> <li>2. Documents not released to importer before payment. (Exporter may retain title to merchandise by controlling bill of lading until paid.)</li> <li>3. Interested third party involved (bank).</li> <li>4. Low cost.</li> <li>5. With prior approval, may be insured.</li> </ol>	<ol style="list-style-type: none"> <li>1. Exporter assumes credit risk of importer and risk of importer's country's political condition.</li> <li>2. Exporter must wait until draft has been received and paid.</li> <li>3. Problems of availability of hard currency.</li> <li>4. Exporter assumes risk of refused shipment (even if insured).</li> </ol>

TERM	DEFINITION	APPLICATIONS	ADVANTAGES	DISADVANTAGES
Cash against Goods, Shipment into Bonded Warehouse	As opposed to traditional C.O.D., usually involves shipping goods to a warehouse operated by exporter in importer's country. Goods are released in relatively small amounts from warehouse by exporter's local agent.	<ol style="list-style-type: none"> <li>Multiple potential buyers in country where goods are warehoused.</li> <li>Importer wants "just-in-time" delivery.</li> </ol>	<ol style="list-style-type: none"> <li>Exporter assured of payment before delivery of goods to importer.</li> </ol>	<ol style="list-style-type: none"> <li>Importer must have cash available.</li> <li>Warehousing agreements must be set up.</li> <li>Warehousing and inventory financing expenses.</li> <li>Exporter may be required to pay foreign taxes for running an operation in the importer's country.</li> </ol>
Irrevocable L/C	Instrument issued by importer's bank in favor of exporter, payable against presentation to the issuing bank of specified documents. May be payable at sight or may incorporate bank-guaranteed financing.	<ol style="list-style-type: none"> <li>Importer's credit rating may be excellent, good, fair, or unknown.</li> <li>First-time sale.</li> <li>Large sale or custom-made goods.</li> <li>Low-risk country.</li> <li>Country that requires L/Cs.</li> </ol>	<ol style="list-style-type: none"> <li>Exporter looks to foreign issuing bank for payment if documents are proper and in order.</li> <li>Irrevocable L/C can be amended only upon concurrence of all parties.</li> <li>May be insured at preferred rate.</li> <li>Collection of all L/C payments easy to centralize.</li> <li>Quick payment possible. Banks may be willing to issue engagements to purchase documents without recourse.</li> <li>Payment despite contract disputes.</li> </ol>	<ol style="list-style-type: none"> <li>Cost of L/C.</li> <li>Documents must be carefully prepared by exporter.</li> <li>Exporter's credit risk is the foreign bank; country risks still exist.</li> <li>Importer exposed to possibilities of fraud.</li> </ol>
Confirmed Irrevocable L/C	Same as above, except importer's bank asks advising bank to add its confirmation. Payable upon presentation of compliant documents to the confirming bank. May be payable at sight or may incorporate bank-guaranteed financing.	Same as above but high-risk country.	<ol style="list-style-type: none"> <li>Exporter looks to confirming bank for payment immediately upon shipment if documents are proper.</li> <li>Irrevocable L/C can be amended only upon concurrence of all parties.</li> <li>Exporter's credit risk is the confirming bank; country risk eliminated (confirming bank must not be just another office of issuing bank).</li> <li>Payment despite contract disputes.</li> </ol>	<ol style="list-style-type: none"> <li>Cost of L/C and confirmation.</li> <li>Documents must be carefully prepared by exporter.</li> <li>Confirming banks chosen by foreign issuing banks, making it difficult for exporter to centralize or obtain consistent service.</li> <li>Importer exposed to possibilities of fraud.</li> </ol>
Cash in Advance	Importer sends good funds before exporter ships.	<ol style="list-style-type: none"> <li>Importer is good, fair, or unknown credit risk.</li> <li>One-time sale.</li> <li>Custom-made goods.</li> <li>Small shipment.</li> <li>High-risk country.</li> <li>Exporter may offer a discount for advance payment.</li> </ol>	<ol style="list-style-type: none"> <li>Exporter may use funds to prepare shipment.</li> <li>No risk to exporter.</li> <li>Low cost.</li> </ol>	<ol style="list-style-type: none"> <li>Importer bears costs of financing as well as risk of never receiving goods.</li> <li>Uncompetitive; may preclude repeat business.</li> <li>Some countries prohibit payment in advance.</li> </ol>



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## **CHAPTER TWO: DRAFT COLLECTIONS**

### **How Draft Collections Work**

Operationally, an international draft collection is quite simple. A draft is a very short form, resembling a check, which serves as a legal demand for payment. It is also known as a “bill of exchange” or just a “bill.” (Although most North Americans think of bills as invoices, in other countries the term refers to drafts. In such countries, it is the draft, not the invoice, that represents a legal demand for payment, and it may be difficult to sue for payment without having presented one.) The seller completes the draft together with a letter of instructions and sends them to his bank along with any documents he wants to have delivered. *(An example of a combined draft and draft-collection-instructions-letter form appears on the next page. The top part of the form is the draft.)* The letter of instructions indicates how the transaction is to be handled, who is to pay which fees and charges, and what procedures should be followed in the event difficulties should arise.

Any documents requiring endorsement, such as a negotiable (“to order”) bill of lading or insurance certificate, should be endorsed prior to sending them to the bank. Although the seller relinquishes title by this endorsement, he does so to the bank that is acting as his collection agent and that will authorize delivery of the documents to the buyer only in accordance with the seller’s instructions.

The flexibility of the collection method is apparent from the number and variety of basic instructions. For example, the seller may include special instructions to allow a discount for prompt payment, in which case the amount of the discount and the terms under which it may be granted should be clearly specified. Similarly, interest for delayed payment may be charged. In the event difficulties not covered in the seller’s instructions should arise, the collecting bank must revert to the seller for additional instructions. However, if the seller has an agent or representative in the country involved who is authorized to act on his behalf, his name, address, and scope of authority should be included in the collection instructions with

**One of the most commonly used methods of obtaining payment in international sales transactions is the collection of drafts drawn by the seller on the buyer. There are two broad classifications of draft collections: documentary and clean. Either can be drawn at sight (demanding immediate payment) or on a time basis.**

	U.S. \$ _____ 19 _____	
	of this <i>First</i> of Exchange (Second unpaid)	
	Pay to the Order of _____	
	United States Dollars	
	for Value received and charge the same to account of _____	
	To _____	
	No. _____	<small>Article 4 Copy</small>

---

D-

Gentlemen  
We enclose Draft Number \_\_\_\_\_ and documents listed below

for collection,  
 for \_\_\_\_\_  
 for payment negotiation under LIC

BILLS OF LADING	B/L COPY	COMM. # V	#6. CTE	CTE ORG.	COMM. # V	P&G. LIST	P&G. CTF	OTH. ER. DOCUMENTS
Please handle in accordance with instructions marked "X"								
<input type="checkbox"/> Deliver all documents in one mailing. <input type="checkbox"/> Deliver documents in two mailings. <input type="checkbox"/> Deliver documents against payment if sight draft, or acceptance if time draft. <input type="checkbox"/> All charges for account of drawer. <input type="checkbox"/> Do not make charges. <input type="checkbox"/> Protest for <u>non-payment</u> non-acceptance <input type="checkbox"/> Do not protest. <input type="checkbox"/> Present on arrival of goods. <input type="checkbox"/> Advise <u>non-payment</u> by <u>airmail</u> giving reasons, non-acceptance cable <input type="checkbox"/> Advise <u>payment</u> by <u>airmail</u> acceptance cable					<input type="checkbox"/> C/P & O/P & EED refer to: Name _____ Address _____ Who is empowered by us: a <input type="checkbox"/> To act full, on our behalf i.e. authorize reductions; extensions, free delivery, making of protest, etc. b <input type="checkbox"/> To assist in obtaining acceptance or payment of draft, as drawn, but not to alter its terms in any way.			
OTH. ER. INSTRUCTIONS:								

Please refer all questions concerning this collection to

Shipper \_\_\_\_\_  
 Freight Forwarder: \_\_\_\_\_

Article 4 Copy

### A Draft Collection Instructions Letter

permission to contact him “in case of need.” Whether the collection charges levied by the banks involved are to be borne by the seller (the “principal”) or by the buyer (the “drawee”) should be agreed upon in advance and indicated in the instructions letter. If the matter of charges has not been settled, the seller may instruct the banks to ask the buyer to pay them, although he should allow the banks to waive the charges if refused (in which event the seller must then pay them) so as not to delay payment or acceptance of the draft.

Although they can be numerous, collection instructions are generally simple, clear, and straightforward. It is important to understand that the seller’s bank, as a collecting agent, acts only in accordance with the instructions received from the seller.

Upon receiving the draft and documents, the seller’s bank (known as the “remitting bank”) will review the letter of instructions for correctness and then mail the draft and documents to a bank in the buyer’s country (known as the “collecting bank” or the “presenting bank”) under its own transmittal letter, essentially transcribing the seller’s collection instructions. The instructions concerning when documents may be released to the buyer should agree with the tenor of the draft. In the case of a documentary sight draft, the overseas bank will deliver the draft and documents upon collection of payment. For a documentary time draft, documents will be given to the buyer against his acceptance of (written promise to pay) the draft; collection of payment of the accepted draft will be attempted when it is due. A clean draft has no accompanying documents; the overseas bank will simply ask the buyer for payment when due (immediately if the draft is drawn at sight). *The differences among these three types of draft collection are further discussed in subsequent parts of this chapter.*

The overseas bank will forward payment or advice of acceptance (and maturity date) to the seller’s bank by airmail unless it has been instructed to do so by cable. It is recommended that payment always be requested to be effected by wire transfer. In the event of dishonor (refusal of payment or acceptance) of the draft, the seller must decide whether to “protest.” This decision should be made based on an understanding of the relevant laws in the buyer’s country. Protest is the legal means of proving presentation and dishonor. In some foreign countries the protest process is expensive, and its application and necessity depend upon the specific laws of the importer’s country.

To lessen the difficulties likely to be encountered by both banks and customers through differences in banking terminology and practices, the International Chamber of Commerce has developed a set of rules applying to collections. These rules, the [Uniform Rules for Collections](#) (1995 revision, International Chamber of Commerce Publication No. 522), have been adopted by banks in the United States and most countries of the world. The rules are short and easy to understand. Any exporter using a draft collection service should thoroughly familiarize himself with these rules to avoid errors in completing his letters of instructions. (A copy can be found in the appendix of this booklet.)

Problems in collecting payment of drafts can be avoided only if the seller obtains sufficient information as to the reliability and credit standing of his buyers. The seller must also stay informed of problems beyond the control of the buyers which could restrict their ability to pay, such as shortages of foreign exchange or other economic and political risks in the countries involved.

### **Documentary Sight Drafts**

Under a documentary sight draft, the seller entrusts his invoice, bill of lading, and other documentation required by the buyer to clear customs in his country and for any other purpose, together

with a draft calling for payment “at sight,” drawn by the seller on the buyer, to his bank for collection of payment. The seller’s bank forwards the draft and documents to its overseas correspondent bank with instructions that the documents may be delivered to the buyer only upon his payment of the draft (commonly described as “documents against payment,” “cash against documents,” or just “D/P” or “C.A.D.”). Furthermore, unless instructed otherwise, the Uniform Rules for Collections dictate that the documents may be released only if payment can be sent out of the country immediately (*i.e.*, foreign exchange is approved). The security of the sight draft lies in the buyer’s need to have the collection documents in order to pick up the goods and clear customs. The seller must be aware that this security exists only with ocean shipments, wherein the documents include a negotiable bill of lading. When shipment is made by air, truck, or rail, a non-negotiable “waybill” is used rather than a bill of lading and the carrier will simply deliver goods to the address specified by the shipper. For ocean shipments, however, this method often works as a good compromise between the desires of the buyer and those of the seller; (1) title and control generally remain with the seller until the draft has been paid and (2) the buyer is not required to pay for the merchandise until he receives documents showing goods have been shipped and giving him title upon payment.

In an air, truck, or rail shipment, the seller risks losing his merchandise and never being paid—essentially the same risk as selling open account. Even with a negotiable bill of lading involved, the risk remains that an untrustworthy buyer may refuse to accept the shipment for some reason (such as a price decline) or that the buyer becomes unable to pay because of his own cash flow problems, a major swing in foreign exchange rates or complete unavailability of hard currency, or a change in government regulations in the buyer’s country. If the shipment is refused, the seller or his agent must store the merchandise in the foreign country somehow and try to arrange for the return of the merchandise or find another buyer, possibly in another country. Either alternative can be very costly.

As has been pointed out, in air, truck, and rail shipments, the carriers involved require the shipper to name a consignee to whom goods will be delivered forthwith. In an attempt to keep the buyer from obtaining goods prior to paying for them, some sellers will ship goods consigned to the buyer’s bank. Goods should not, however, be consigned to a bank without prior agreement on the part of that bank as this may force the bank to give the carrier alternative delivery instructions or even cause the goods actually to be delivered to the bank. Banks are not responsible for the goods themselves, only for documents. In ocean shipments—and only in ocean shipments—the bill of lading is normally a title document (and even then, only so long as it is consigned “to order of” someone rather than just “to” someone), and delivery of goods will be made to whoever possesses the original. Even shipping goods to order of a bank is discouraged by the Uniform Rules for Collections as this may lead to situations in which the bank is called upon to assume undesired responsibilities.

### **Documentary Time Drafts**

Under a documentary time draft, the seller draws a draft on the buyer payable a certain number of days after sight or after the date of draft, invoice, or bill of lading. The “tenor” of the draft must be negotiated and agreed to between the buyer and seller ahead of time. Note that the maturity of a “days-date” draft is known to the seller at the time the draft is completed; the maturity of a “days-sight” draft will be determined by the buyer based on the date he acknowledges as “sight” of the draft. It is highly recommended that drafts be made payable on a “days-date” basis rather than “days-sight” in order that



the seller can properly age his receivables; otherwise there are often disputes about whether buyers are past due in their payments.

The draft and documents are sent by the seller's bank to the overseas collecting bank with instructions to "deliver documents against acceptance." The collecting bank will obtain the buyer's signed acceptance on the face of the draft before delivering the documents to him. (Be aware that the bank that obtains acceptance is generally not responsible for the genuineness of signatures or for verifying the authority of any signatory to sign and accept the draft.) Once accepted, the draft is equivalent to a promissory note, with a fixed amount and maturity. At maturity, the collecting bank will attempt to collect payment of the accepted draft in the currency of the draft.

Although it may seem that time-draft terms are only a short distance, risk-wise, from sight-draft terms, use of a time draft allows the buyer to obtain the documents—and, thereby, the goods—before paying. The seller finds himself in a less favorable position because now he is relying entirely upon the buyer's ability and willingness to pay as promised in his acceptance of the draft. Non-payment of the draft by the buyer at maturity may necessitate legal action to collect since the buyer has already taken possession and may have disposed of the merchandise. But for the fact the seller will have an accepted draft, which may simplify the ensuing lawsuit, time draft transactions differ very little in terms of credit risk from open account transactions. As in open account sales, payment at maturity may be beyond the control of the buyer, lying instead with government authorities in his country.

### **Avalized Drafts**

An important variation on the time draft is the "avalized" draft. An avalized draft combines many of the features of a sight draft with those of a time draft and throws in a bit of the protection found in a letter of credit. The twist is that a bank is asked to add its guarantee, or "aval," to the time draft after obtaining the buyer's acceptance but before releasing the documents. The bank then assumes responsibility for the proper authority of the individual(s) accepting the draft and, more importantly, undertakes to pay the draft themselves if the buyer fails to do so at maturity. (Different countries have different practices regarding the number of days the buyer may go past due before being judged in default and triggering the bank to step up. This interim period is referred to as the "grace period" or "days of grace.") Even with avalized-draft terms, the seller continues to take the same risk as with a sight draft that the buyer may simply refuse to accept the draft. There is also the chance the buyer will accept the draft but the bank will refuse to add its aval. If the buyer refuses to accept the draft or the bank refuses to add its aval, the seller retains control of the documents, as with a sight draft. The bank could be asked to write a commitment ahead of time to guarantee payment of drafts which are expected to be accepted by the buyer (sometimes referred to as a "letter of guarantee"), but this is likely to cost just as much as a letter of credit while leaving a great deal of opportunity for misunderstandings between parties. If this degree of protection is what is desired, it is recommended that the seller simply ask for a letter of credit.

Once the draft has been avalized, the risk becomes foreign bank risk, as on a letter of credit. Furthermore, there is an active market for avalized drafts and the seller can most likely sell the draft at an attractive discount rate for immediate cash, close the receivable, and eliminate all political and transfer risks. The purchaser of the draft accepts the risks of collecting payment at maturity. Banks that buy avalized drafts are called "forfaiters" and are often willing to quote indicative discount rates for

acceptable foreign banks and even to lock in these rates in advance, for a nominal fee. This provides the seller with the ability to build the discount into the price of the goods when offering extended terms of payment. Note that the buyer must also pay a fee, to the avalizing bank (usually a per annum percentage), greatly increasing his expense over the fees he would pay for a simple time draft. Nonetheless, it is still quite possible the all-in cost to the buyer of “offshore supplier financing” of this sort will be lower than if he borrowed from his bank (probably in local currency, at local rates) in order to pay for his purchases at sight.

### **Choosing Among the Different Types of Documentary Drafts**

Documentary sight or time drafts are typically used when the exporter considers the purchaser a good credit risk. Avalized drafts are used when the exporter is willing to take the risks of producing and shipping the goods, as with a sight draft, but does not wish to carry the financing risk normally involved with a time draft. In general, an exporter will use documentary draft collections with clients with whom he has prior experience, who are located in stable countries. In the absence of substantial evidence of creditworthiness, a new exporter would be well advised to seek more secure terms, such as a letter of credit, which provide protection against the buyer’s inability or plain refusal to pay. Nonetheless, if drafts are the customary terms of trade for the goods involved, then the exporter will most likely have to assume the buyer’s commercial risk, along with the political and transfer risks of the buyer’s country, to acquire the account. The decision of whether to use a documentary sight or time draft, an avalized draft, or a letter of credit is simply one of risk vs. cost. Time drafts, as previously noted, are riskier than sight drafts or avalized drafts. A letter of credit is clearly less risky, yet insisting upon one may cause the exporter to lose the sale.

#### **Clean Drafts**

Under a clean draft, the seller sends the shipping documents directly to the buyer and submits only his draft drawn on the buyer, and/or possibly an invoice, to his bank for collection. This procedure should, of course, be used only when the seller has complete confidence in the buyer because control of the merchandise is surrendered to the buyer independently from his payment or acceptance of the draft.

Clean drafts are generally used between affiliated companies (*e.g.*, parents and subsidiaries) and companies with long-standing relationships. The purpose is normally just to satisfy some regulatory formality in the buyer’s country before he is allowed to pay for goods in a foreign currency. An advantage of the clean draft over a documentary draft is that documents get to the importer faster than if they went through bank channels.

It should be noted that a corporate check received in payment for an export sale is considered a clean draft. A check is nothing more than a sight draft drawn on a bank where funds are presumably on deposit. It constitutes the drawer’s instructions to the drawee bank to pay the named payee. A check must be presented to the drawee bank for collection of payment. As a bank will not honor a check if the customer tells it not to (*i.e.*, stops payment) or if he does not have sufficient funds or if foreign exchange controls prohibit payment, an exporter can place no more confidence in being able to collect a check than any other clean draft. If asking for cash in advance, the seller should specify that payment

should be made by wire transfer or, at least, a bank draft (essentially a check or money order written by a bank) drawn on a U.S. bank.

### **Borrowing Against Draft Collections**

Some banks are willing to lend money to their exporting customers against foreign receivables, including those covered by drafts in the process of collection. This is commonly done with bankers' acceptances and it may involve arranging and assigning credit insurance against commercial, political, and transfer risks and executing an agreement pledging to the bank the proceeds of these drafts. Transactions may be aggregated or financed individually. If the drafts have been insured or avalized, or if the bank knows the foreign buyer, the bank may even be willing to purchase the drafts without recourse, similar to factoring of receivables.

## **CHAPTER THREE: DIRECT COLLECTIONS**

### **How Direct Collections Work**

**Direct collections speed up the collection process. They allow the seller to send documents with collection instructions directly to the buyer's bank. Since the form used is filled out by the seller, or his freight forwarder, processing at the seller's bank is lessened, the possibility of transcription errors is eliminated, and documents are received sooner at the buyer's bank for collection from the buyer.**

Direct collection service, primarily for regular draft collection users, enables the seller or his freight forwarding agent to forward the collection instructions and documents directly to the buyer's bank rather than present them to the seller's bank for processing. Airmailing documents and instructions directly to the overseas bank speeds up the collection process. Procedurally, the same information must be specified in a direct collection form as in a standard documentary draft collection instructions letter. (*An example of a direct collection form can be found on the facing page.*) A bank that is lending to an exporter against documents in the process of collection, however, is likely to require the exporter to submit all documents through them (rather than send the documents directly to any foreign bank) in order to maintain maximum control over the collection process.

In order for a seller to start using a bank's direct collection service, the bank will provide him with a supply of direct collection forms or software for creating these forms. Forms usually have four parts: the original is to be mailed to the overseas bank with the documents, part 2 is to be mailed (or electronically transmitted) to the seller's bank, and parts 3 and 4 are to be retained by the seller and/or his freight forwarder. Because the form is on the letterhead of the seller's bank, the overseas collecting bank will treat the documents and the instructions as though received from the seller's bank. Because the form is filled out by the seller or his forwarder and sent straight to the buyer's bank, processing at the seller's bank is lessened, the possibility of transcription errors is eliminated, and documents are received sooner at the buyer's bank. The seller's bank will charge a lower fee and payment may be collected faster. The seller's bank, however, does not check the collection instructions for correctness. If there are any problems, the overseas bank will revert to the seller's bank for instructions just as it would on any other draft collection. And from the point at which the seller's bank receives its copy of the direct collection form, it

**LaSalle Bank N.A.**  
**International Trade Services**

200 W. Monroe Street, Suite 1100  
 Chicago, Illinois 60606-5002  
 (312) 904-8462  
 SWIFT Address LASLUS44  
 Telex No. 6737792

Always Quote Our Number <b>D903733</b>
Date

**DIRECT COLLECTION LETTER**

**Original 1**

To be airmailed by Shipper, Forwarder or U.S. Correspondent to bank abroad along with all original shipping documents.

We enclose for collection and remittance the item described below. Please process this collection for the account of LaSalle Bank N.A., International Trade Services. Kindly acknowledge receipt and advise us promptly of acceptance, maturity or payment as instructed below:

Subject to the Uniform Rules for Collections 1995 Revision, International Chamber of Commerce Publication No. 522.											
Airmail to Collecting Bank						Drawer and Address, Telephone, Fax					
<input type="checkbox"/> Presentation is restricted to this Collecting Bank											
Date of Draft			Tenor			Amount			Invoice No.		
Drawee Name and Address, Telephone, Fax						Other Reference No(s).					
						Description of Merchandise					
Bill of Lading Orig	Copies	Air Waybill Orig (#3)	Copies	For. Cargo Orig	Receipt Copies	Invoice	Insur. Cert.	Packing List	Cert. of Origin	Other Documents	
Deliver documents against <input type="checkbox"/> Acceptance <input type="checkbox"/> Acceptance and avalization by yourselves (contact us immediately if clarification is desired) <input type="checkbox"/> Payment						Advise acceptance/avalization and maturity by: <input type="checkbox"/> Cable <input type="checkbox"/> Airmail					
All charges including stamps, exchange, taxes, your collections fees, avalization (if requested), etc. should be charged to drawee plus our charge of: _____						Advise non-acceptance/non-avalization by: <input type="checkbox"/> Cable <input type="checkbox"/> Airmail indicating reasons given for non-acceptance/non-avalization					
<input type="checkbox"/> Waive charges if refused <input type="checkbox"/> Yours <input type="checkbox"/> Ours						Advise payment by: <input type="checkbox"/> Cable <input type="checkbox"/> Airmail					
<input type="checkbox"/> Do not waive charges						Advise non-payment by: <input type="checkbox"/> Cable <input type="checkbox"/> Airmail indicating reasons given for non-payment					
<input type="checkbox"/> Protest for: <input type="checkbox"/> Non-acceptance <input type="checkbox"/> Non-payment						... all such advices at: <input type="checkbox"/> Drawee's expense <input type="checkbox"/> Our expense					
if not accepted/paid within _____ days of first presentation											
<input type="checkbox"/> You may hold for arrival of merchandise without protesting						<input type="checkbox"/> Hold accepted/avalized drafts for collection of payment at maturity					
<input type="checkbox"/> Do not protest						<input type="checkbox"/> Return duly accepted/avalized drafts to us					
<input type="checkbox"/> If dollar exchange is not immediately available on presentation (if drawn at sight), you may release documents against provisional payment in local currency pending availability of dollar exchange. At time of deposit of local currency obtain from drawees their written undertaking to be responsible for any exchange differences. The draft must not be surrendered to drawees until payment is remitted for face amount in U.S. dollar exchange (or the currency of the draft).											
<input type="checkbox"/> Allow a discount of _____ if paid											
<input type="checkbox"/> Collect interest at the rate of _____ % per annum based on _____ from _____ until _____ <input type="checkbox"/> actual days/360 days per year <input type="checkbox"/> other _____ <input type="checkbox"/> date of first presentation <input type="checkbox"/> other _____ <input type="checkbox"/> date of local payment <input type="checkbox"/> other _____											
In case of need refer to						<input type="checkbox"/> Who is empowered by us to act fully on our behalf, i.e., authorize reductions, extensions, free delivery, waiving of protest, etc.			<input type="checkbox"/> Who may assist in obtaining acceptance or payment of draft, as drawn, but is not to alter its terms or other instructions given here in any way.		
Other instructions											

**PLEASE REMIT ALL PROCEEDS BY CABLE TO LASALLE BANK, N.A. ATTN: IBD COLL. DEPT., FED ROUTING NUMBER 071000505 UNDER SWIFT (LASLUS44) OR TELEX (49650512 LASBNK UI) ADVICE TO US, QUOTING OUR REF: **D903733****

<p><b>LaSalle Bank N.A.</b>                  200 W. Monroe Street, Suite 1100                  Chicago, Illinois 60606-5002</p> <p>Exchange for                  U.S. \$ _____ U.S.A. _____ 1999                  At _____ of this <b>SOLE</b> of Exchange                  pay to the order of <b>LaSalle Bank N.A., Chicago, Illinois</b>                  the sum of _____ United States Dollars                  To _____                  No. _____ By _____</p>	<p><b>Bill of Exchange</b></p>
---	--------------------------------

**A Direct Collection Form**

will treat the transaction just as it would any other documentary draft collection, sending out tracers, generating reports, *etc.*

The most common errors in using direct collections include the following:

1. Bills of lading and insurance certificates are not endorsed as required.
2. Drafts are incorrectly drawn or not signed by drawer.
3. Instructions regarding who will be responsible for the payment of collection charges are absent.
4. The amounts of the commercial invoice and the draft are different.
5. “Case-of-need’s” authority is not clearly defined.

Individuals familiar with the mechanics of documentary draft collections and the Uniform Rules for Collections find direct collections highly preferable to “normal” collections.

## **CHAPTER FOUR: LETTERS OF CREDIT**

### **How Letters of Credit Work**

**A letter of credit can be thought of as a certified check payable by attaching specified documents and presenting it back to the issuing bank.**

**Like a certified check, a letter of credit is normally obtained by someone ordering goods and sent to the seller, thus providing the seller a bank's assurance of payment.**

**But, unlike a certified check, the seller must present some evidence that the contract of sale has been fulfilled before he can cash the letter of credit. Letters of credit are also used in many circumstances not involving the purchase and sale of goods.**

A documentary letter of credit (“L/C”) is an instrument issued by a bank, at the request of an applicant, in which that bank promises to pay a specified amount of money to the named beneficiary upon his presentation of documents as stipulated in the credit. In a commercial transaction, the buyer (importer) of merchandise becomes the L/C applicant and asks that the seller (exporter) be named the beneficiary. The buyer’s bank’s promise to pay reduces the commercial risk incurred by the seller. Because the seller cannot receive payment until he presents the required documents and because these documents provide evidence that the desired goods have been shipped, the buyer receives some (but not total) assurance that the seller will comply with the agreed-upon terms of sale before being paid.

Two key points must be emphasized. First, a letter of credit does not guarantee payment to the seller regardless of circumstances. Rather, payment will be assured only if the seller complies exactly with the terms of the letter of credit and, even then, only if the issuing bank is willing and able to honor its obligation to pay. Second, because banks deal in documents and not in merchandise, a bank cannot assure the buyer that the goods shipped are, in fact, what the documents describe. A letter of credit cannot protect the buyer from fraud on the part of an unscrupulous seller. On the other hand, a letter of credit does protect a seller from an unscrupulous buyer who might fabricate a contract dispute and demand a price adjustment or refuse to pay.

Letters of credit can be issued in either revocable or irrevocable form. A revocable credit, once established, can be modified or canceled at any time without notice to or consent of the seller. Because an irrevocable letter of credit is a binding commitment, any change or amendment to the credit desired by the buyer or seller must be agreed to by all parties concerned. Nearly all credits are issued in irrevocable form. A revocable credit is properly regarded only as a notice from a bank that it is authorized to make payments on the buyer’s behalf against certain documents. Thus it serves as a medium to expedite payment but it does not shift credit risk to

the issuing bank. As it does not serve the traditional purpose of a letter of credit, a revocable credit should be rejected by the seller unless he totally understands what he is doing. Likewise, buyers (particularly new ones) should avoid the use of revocable letters of credit. Note that frequently the term “advising bank” is used for both the advising and the negotiating banks. Basically, the advising bank is the bank through which the letter of credit is delivered to the seller; the negotiating bank is the bank to whom documents are presented by the seller for collection of payment and is not necessarily the advising bank.

The negotiating bank will collect payment from the issuing bank according to the terms of the credit. Payment may be available immediately or the L/C may promise payment a set number of days after shipment or after presentation of the documents. Although the negotiating bank may be willing to advance proceeds to the seller prior to receipt of payment, this is viewed as a loan either to the seller or to the issuing bank. In fact, the term “negotiate” refers to advancing funds in this way, although it is at the negotiating bank’s discretion whether or not to do so. (*Further information about [selecting negotiating banks](#) can be found in Chapter 6: Export Letters of Credit.*) Ultimately, it is the issuing bank that is obligated to make payment.

### **Parties to the Letter of Credit**

There are three independent parties in the prototypical L/C transaction: the applicant (buyer/importer), the issuing bank (buyer’s bank), and the beneficiary (seller/exporter). Likewise, there are three contracts: the purchase order or sale contract (buyer-seller), the letter of credit application/agreement (buyer-issuing bank), and the letter of credit itself (issuing bank-seller). Other parties act as agents for these three. For example, the advising bank is actually just the issuing bank’s agent for the purpose of authenticating and delivering the letter of credit to the seller and the negotiating bank is, in effect, “hired” by the seller to examine documents and collect under the L/C.

The seller may wish to have the advising bank add its irrevocable promise to pay to that of the issuing bank. If the advising bank agrees, and obtains the issuing bank’s permission to do so, it becomes the confirming bank and a legal party to the transaction. An advising bank that has confirmed a letter of credit is obligated to pay the seller upon his complying with the terms of the letter of credit. On an unconfirmed letter of credit, the negotiating bank will commonly pay the seller only after it obtains funds from the issuing bank’s account. (This account may be at yet another bank whose role is to act as the issuing bank’s paying or reimbursing agent.) If immediate payment is desired, the seller may enter into an immediate-funds-availability agreement with the negotiating bank or request that the bank purchase the documents without recourse.

### **Contents of the Letter of Credit**

Banks normally issue letters of credit in computerized formats that clearly indicate the bank’s name and the extent of the bank’s obligation under the credit. In general, letters of credit contain the following information:

Whether the credit is *revocable* or *irrevocable*



*Expiry date*, which specifies the latest date for presentation of documents (In this manner, or by including a latest shipping date, the buyer may exercise control over the date of shipment.)

*Name of the seller*, who is also known as the *beneficiary*

*Name of the buyer*, who is also known as the *applicant* or *account party*

*Amount of the credit*, which should be the value of the merchandise plus any other charges intended to be paid under the credit

*Tenor of the draft*, such as sight, 90 days bill of lading date, *etc.*, which is normally dictated by the terms of the sale contract or purchase order

*General description of the merchandise*, which briefly and in only a general manner describes the merchandise covered by the letter of credit

*Shipping terms* such as FOB Rotterdam, FCA Chicago, CIP Pittsburgh, *etc.*, indicating whether the price includes freight and insurance, where responsibility for the goods changes, who is to arrange transportation, and so forth

*Documents required*, which will normally include commercial invoices, original bills of lading, consular or customs invoices, packing lists, and, if the insurance is to be effected by the seller, insurance policies or certificates

Further details about [letter of credit contents](#) can be found in Chapter 5: Import Letters of Credit.

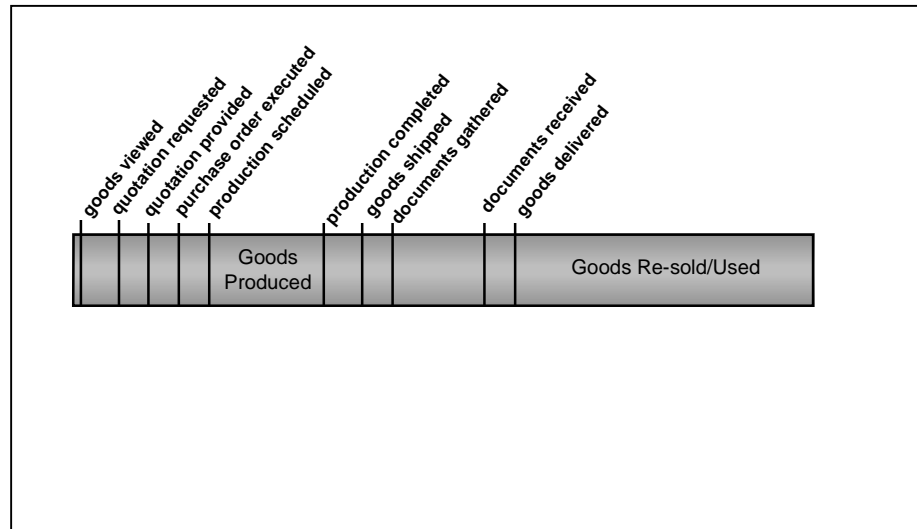
### **Some Uses of Letters of Credit**

Letters of credit are versatile instruments. They may provide for advance or down payments, progress payments, and payments for repairs during a warranty period. They do not always involve international trade. Unusual uses have included alimony payments and the awarding of prize fight money to the winner of the fight (against presentation of a newspaper clipping as documentation). Standby letters of credit have become very popular as “backing” for bonds and other commercial paper. It is not even necessary that letters of credit be payable in money. A bank may engage in a credit to deliver an item of value, such as title to a building or stock certificates it is holding for the applicant, against presentation of stipulated documents, much like an escrow arrangement.

In subsequent sections, “[revolving](#),” “[installment](#),” “[clean](#),” and “[evergreen](#)” credits will be discussed as well as [letter of credit transfers](#), [assignments of letter of credit proceeds](#), and some [special uses of standby letters of credit to support trade transactions](#).

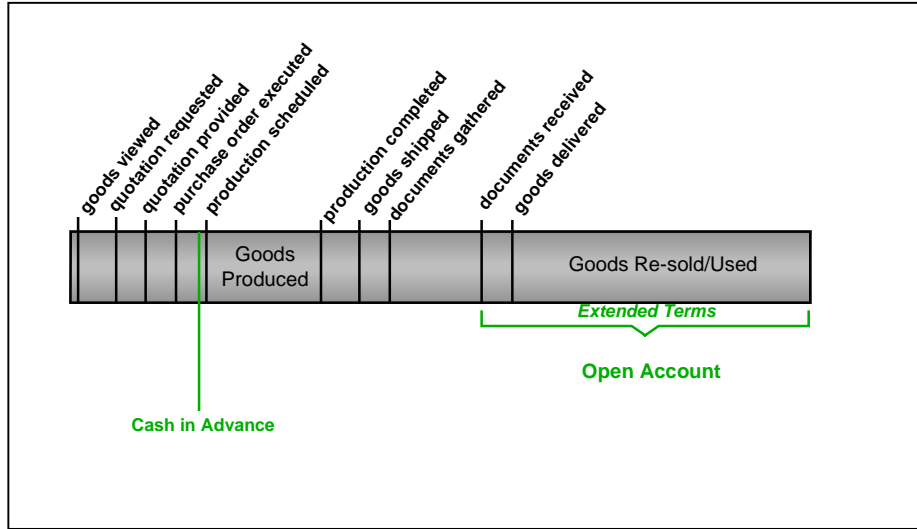
## Why Use Letters of Credit

Commercial letters of credit are used in a wide variety of circumstances. Certain countries require that all international trade be conducted on a letter-of-credit basis. Some companies make a policy of selling goods to foreign buyers only against letters of credit. Letters of credit often provide a mechanism for obtaining bank financing covering the entire life of a commercial transaction, from the accumulation of raw materials and production of goods, to the time goods are shipped by the seller, to the time goods are resold by the buyer.

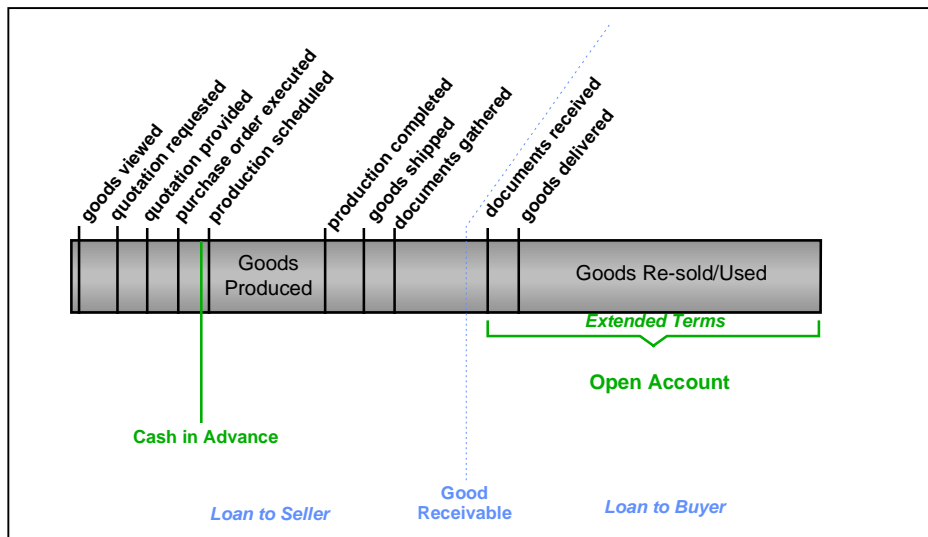


The key advantage to the seller is that a letter of credit reduces commercial risk, both pre-shipment (contract risk) and post-shipment (financing risk). Whereas a collection requires assuming the commercial risk associated with the buyer, a letter of credit requires assuming only the commercial risk associated with the issuing bank. In both cases, the seller assumes foreign political and transfer risks. If the letter of credit is confirmed (or covered by a so-called “silent confirmation”), the relevant commercial risk is that of the confirming bank and the political and transfer risks are those of the confirming bank’s country. When a letter of credit includes post-shipment “supplier financing” (*i.e.*, payment a set period of time after either shipment or presentation of documents rather than at sight), the issuing and/or confirming banks will generally give the seller the option of immediate payment if desired. The seller can thus obtain immediate payment, close the receivable, and eliminate all further risk, even while providing financing desired by the buyer, who will pay the banks at the agreed due date. (*Further information on [confirmed L/Cs](#), “[silent confirmation](#),” and “[supplier financing](#)” can be found in Chapter 6: Export Letters of Credit.*)

The buyer under a letter of credit also receives some protection. Having a bank examine the documents increases the likelihood of detecting errors in the shipment. It does not, however, ensure that



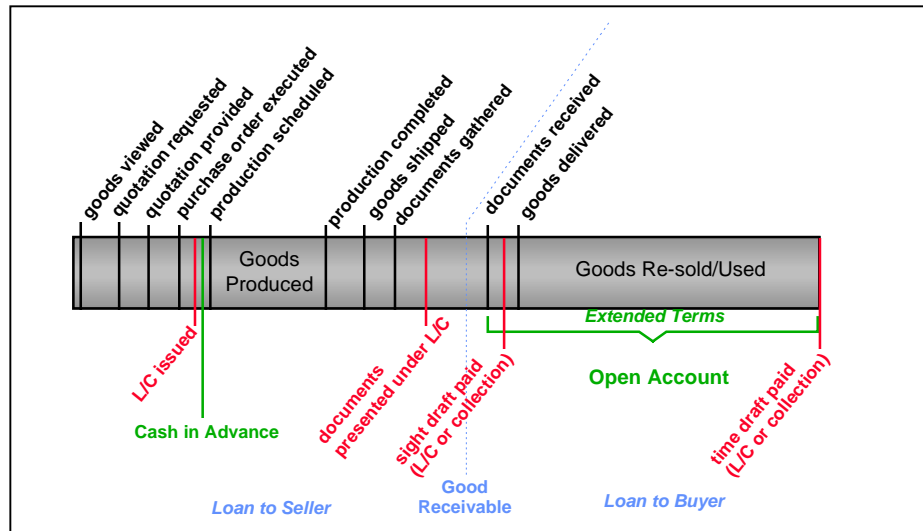
the goods actually shipped are in the quantity or of the quality described in the documents. Another important reason for a buyer without experience in international trade to use a letter of credit is to eliminate delays involved in establishing his own credibility. In fact, new buyers are generally required



to obtain letters of credit because suppliers are not willing to sell to them on more liberal terms.

Sometimes, even established buyers use letters of credit because they provide their suppliers with something they can take to their banks to obtain financing. This depends on a bank's willingness to take the risk that if it provides a seller with pre-export funding to produce and ship the goods, the seller will do so properly and perform according to the letter of credit requirements to obtain the money

needed to repay the loan. This is less risky to the buyer than sending the seller cash in advance since the local bank takes on the performance risk of the seller. Also, because there is a built-in source of repayment, it is less risky to the local bank than simply lending working capital to the seller.



A letter of credit may also contain built-in financing for the buyer. When the goods are shipped and the proper documents presented, the issuing bank may have agreed with its customer, the buyer, to pay the seller immediately but defer obtaining reimbursement from the buyer. This can allow the buyer to resell the goods or use them to produce other goods which can be sold to generate the cash necessary to reimburse the bank. Thus, letters of credit can be used to reconcile the desire of an exporter to receive cash in advance and cover all production costs with the desire of an importer to obtain extended payment terms allowing him to sell the goods before paying for them.

It is worth emphasizing that a letter of credit is not a substitute for good business judgment. The buyer must trust the seller. A letter of credit will not prevent a seller from invoicing goods as called for in the credit and shipping goods of a different nature. In addition, the seller needs to understand the political and economic situation in the buyer's country, particularly in the area of foreign exchange.

### The Letter of Credit Cycle

Although the letter of credit cycle appears quite complex at first, it is not difficult to understand. This cycle merely involves the exchange of documents (and money) through intermediaries. The diagrams on the next three pages depict the cycle in a pictorial way.

# The Letter of Credit Cycle

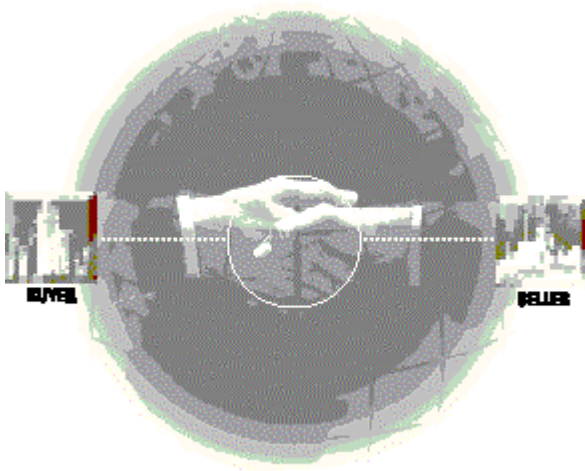


FIGURE 1.  
The buyer agrees to purchase goods from the seller using a letter of credit as the mechanism of payment.

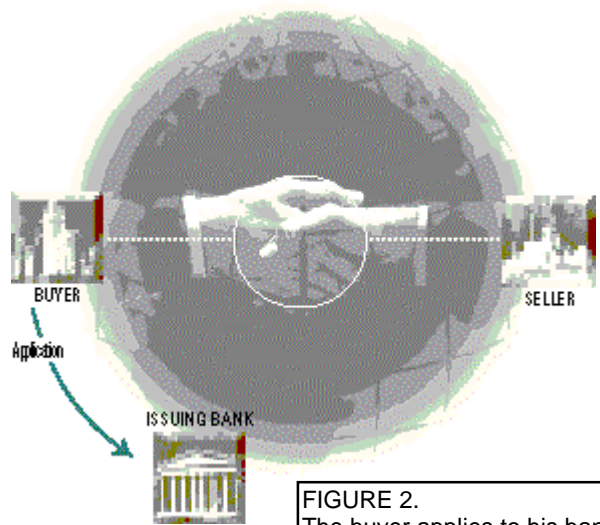


FIGURE 2.  
The buyer applies to his bank for a letter of credit, signing the bank's letter of credit application/agreement form.

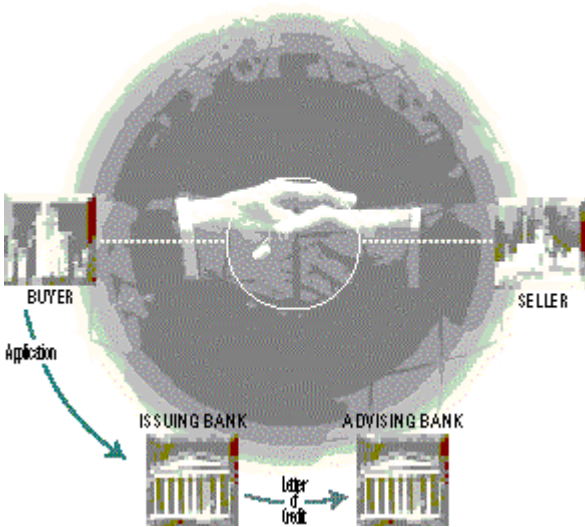


FIGURE 3.  
After approving the application, the issuing bank issues the actual letter of credit instrument and forwards it to the advising bank.

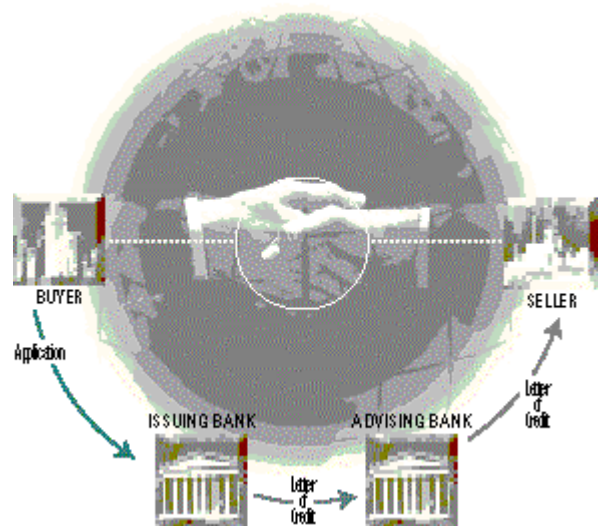
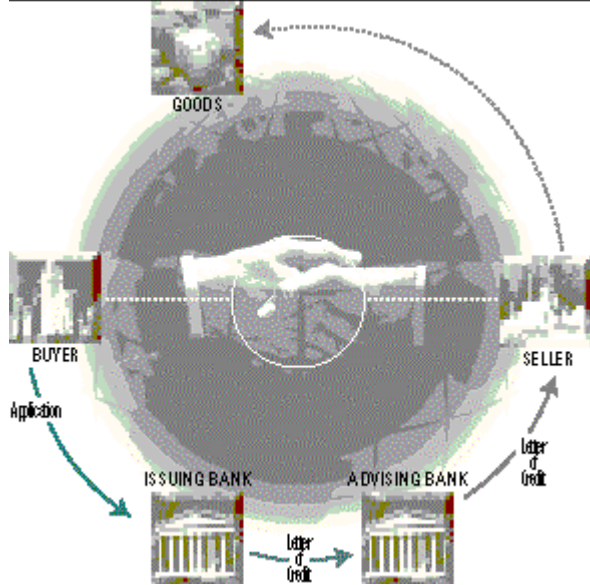
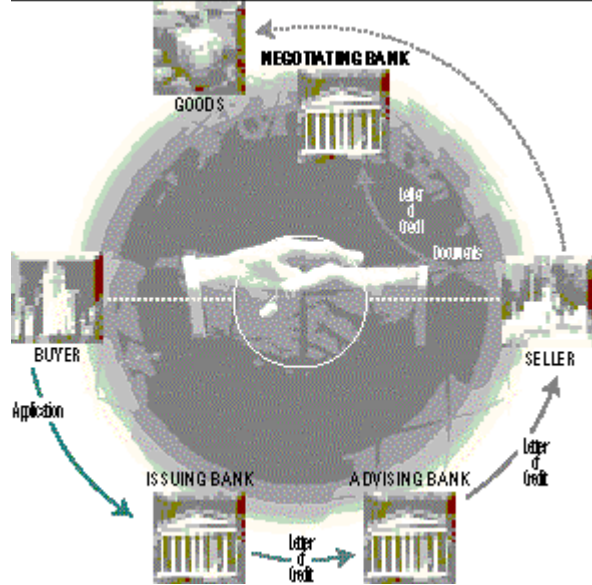


FIGURE 4.  
The advising bank authenticates the letter of credit and delivers it to the beneficiary (the seller).

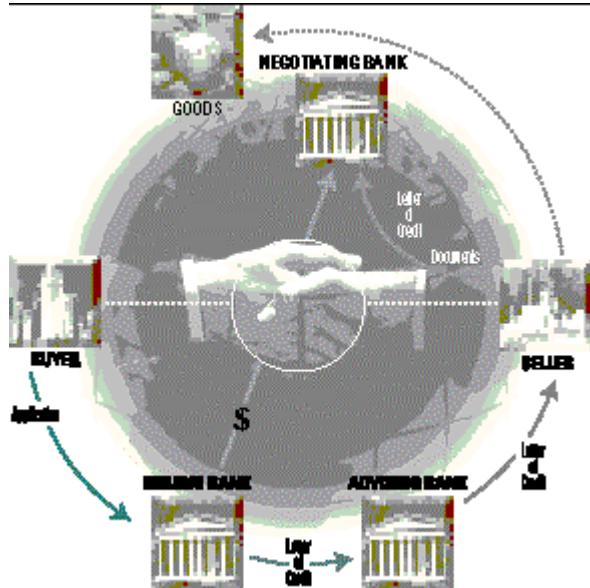
# The Letter of Credit Cycle



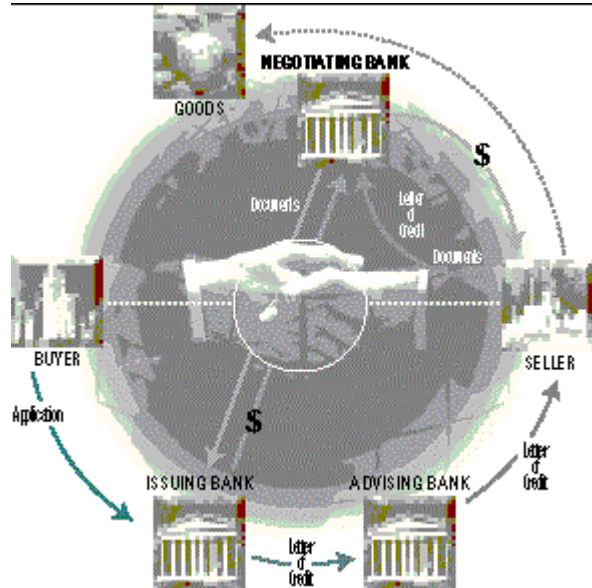
**FIGURE 5.** Having received the issuing bank's assurance of payment, the beneficiary (seller) ships the merchandise to the applicant (buyer).



**FIGURE 6.** The beneficiary (seller) prepares the documents called for in the letter of credit and presents them to the negotiating bank. The letter of credit may specify a negotiating bank or it may say it is "available with any bank," giving the beneficiary the freedom to choose.



**FIGURE 7.** The negotiating bank examines the documents and, if they comply, obtains funds for payment to the beneficiary in accordance with the terms of the letter of credit.



**FIGURE 8.** The negotiating bank transfers payment to the beneficiary (seller) and forwards the documents to the issuing bank.

# The Letter of Credit Cycle

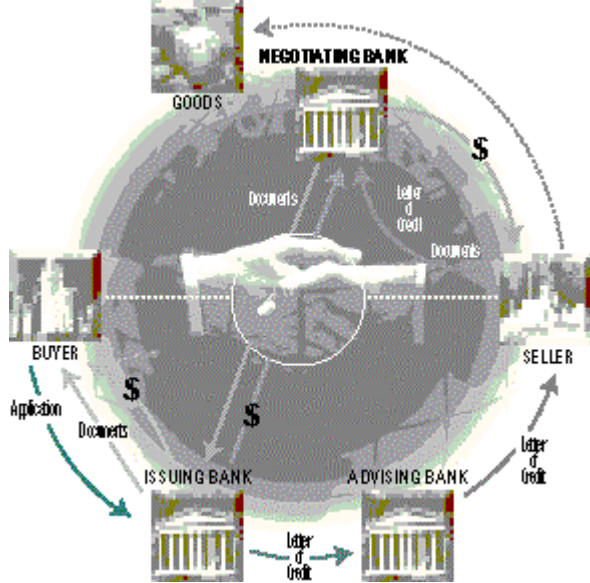


FIGURE 9. The issuing bank examines the documents. If it agrees with the negotiating bank that the documents comply with the letter of credit, the issuing bank obtains payment from the applicant (buyer) in accordance with the terms of the applicant's letter of credit agreement and forwards the documents to the applicant.

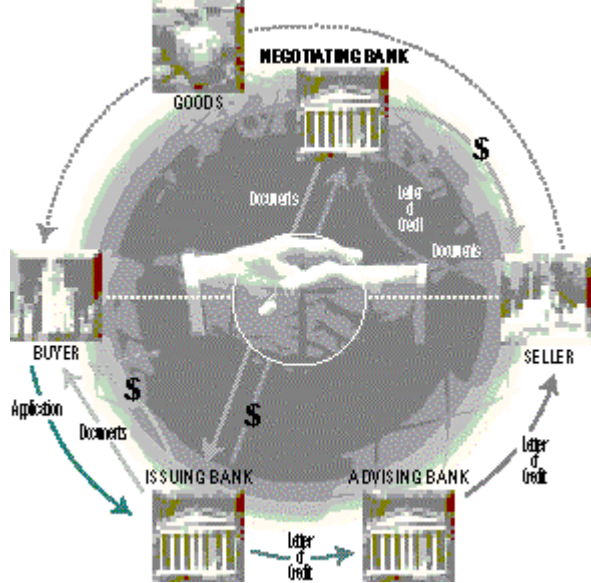


FIGURE 10. The applicant (buyer) uses the documents to pick up the merchandise from the carrier, completing the letter of credit cycle.

**CHAPTER FIVE:  
IMPORT LETTERS OF CREDIT**

**Letter of Credit Mechanics on the Import Side**

**An import letter of credit is a very common means of paying for goods ordered from someone in another country. It is important for the importer to understand that the issuing bank will be committing to pay the amount requested upon presentation of certain documentation. This documentation should be clearly described for the bank by the importer and should reflect the contract of sale. Since the bank asked to issue the letter of credit will be undertaking to make a payment on behalf of the importer, the decision of whether or not to do so is similar to the loan approval process.**

Once an importer and a foreign seller have established a contract of sale and have decided that payment is to be effected through a letter of credit, the importer will submit an application for a commercial letter of credit to his bank. (*See the example of a letter of credit application on the facing page.*) The credit is prepared from this application; hence, the information included in the application must not be inconsistent with the terms of the underlying sales contract. It must also be consistent with the [Uniform Customs and Practice for Documentary Credits](#) (the international standards of practice established for bankers by the International Chamber of Commerce), local law (the [Uniform Commercial Code](#) is the law in the United States), and ordinary practices of banks dealing with letters of credit. Because the application is a legal agreement between the bank and the applicant, it must be signed or made subject to a separate, signed agreement. (A separate agreement is normally used to allow for transmission of L/C applications electronically.) To avoid amending the letter of credit, the importer should ensure the letter of credit terms and required documents are consistent with the seller's needs as well as his own country's import regulations. The key items in the application are as follows:

- Applicant:* Name and address to be shown on the L/C for the importer, sometimes also referred to as the account party
- Beneficiary:* Name and complete address of the seller
- Amount:* The total of the value of the merchandise and any shipping charges, *etc.*, intended to be paid under the credit



**LaSalle Bank N.A.**

**International Trade Services**

200 W. Monroe Street, Suite 1100  
 Chicago, Illinois 60606-5002  
 (312) 904-8462 fax (312) 904-6303

**LASALLE BANKS**

Date: \_\_\_\_\_

L/C no. \_\_\_\_\_  
 (For Bank Use)

**APPLICATION FOR IRREVOCABLE COMMERCIAL LETTER OF CREDIT**

Subject to our Master Letter of Credit Agreement with yourselves, please issue an irrevocable Commercial Letter of Credit (L/C) substantially as set forth below, and

- send the original L/C directly to the Beneficiary
  - send the L/C to the Advising Bank indicated or your chosen correspondent, as applicable (for delivery to the Beneficiary)
- by  airmail.  courier.  cable (SWIFT/telex/cablegram).  other: \_\_\_\_\_

Advising Bank (optional)	Applicant (name & address)
Beneficiary of L/C (name & address expected to appear on invoices)	Amount (U.S. dollars unless otherwise indicated) up to: _____ plus or minus ____%
	Expiry Date of L/C (month in words, day, year) _____ in the country of the Beneficiary unless otherwise indicated

Please make the L/C subject to the Uniform Customs and Practice for Documentary Credits (UCP) currently in effect.  
 Documents must be presented within \_\_\_\_\_ days after shipment (21 days if not otherwise specified) but, in any case, within the validity of the credit.  
 Draft(s) must be drawn at (specify "sight" or other tenor) \_\_\_\_\_ for \_\_\_\_\_% (100% unless otherwise specified) of Commercial Invoice value drawn on you or (specify other drawee) \_\_\_\_\_ and accompanied by the following documents:

- Original and \_\_\_\_\_ copy(ies) of Commercial Invoice covering (describe goods as in the Beneficiary's proforma invoice but only in generic terms, omitting details as to grade, quality, etc.):
    - EXW (Ex Works, Ex Factory At) \_\_\_\_\_ (place)
    - FCA (Free Carrier At) \_\_\_\_\_ (place)
    - CPT (Carriage Paid To) \_\_\_\_\_ (place)
    - CIP (Carriage & Insurance Paid To) \_\_\_\_\_ (place)
    - FOB (Free On Board At) \_\_\_\_\_ (port of loading) (for port-to-port ocean shipments only; otherwise use FCA)
    - CFR (Cost & Freight Paid To) \_\_\_\_\_ (port of discharge) (for port-to-port ocean shipments only; otherwise use CPT)
    - CIF (Cost, Insurance & Freight Paid To) \_\_\_\_\_ (port of discharge) (for port-to-port ocean shipments only; otherwise use CIP)
    - Other terms \_\_\_\_\_
  - Marine Cargo Insurance Policy or Certificate (for CIP and CIF shipments) in negotiable form for at least \_\_\_\_\_% (110% unless otherwise specified) of Commercial Invoice value, endorsed in blank and covering the following risks:
    - All risks warehouse-to-warehouse
    - All risks warehouse-to-warehouse including war risks and strikes, riots and civil commotions
    - Other (specify) \_\_\_\_\_
  - Copy of a cable or fax message addressed to the Applicant giving date and means of shipment and description and value of the goods shipped, bearing the Beneficiary's original signed certification that "This is a true and accurate copy of a message sent as addressed within two days of shipment of the described goods" (for insurance purposes on EXW, FCA, CPT, FOB, and CFR shipments).
  - Full set of Multimodal Transport (Door-to-Door) Bills of Lading showing place of receipt as \_\_\_\_\_ and place of delivery or final destination as \_\_\_\_\_ consigned to the order of the shipper, endorsed in blank.
  - Full set of Port-to-Port Bills of Lading showing port of loading as \_\_\_\_\_ and port of discharge as \_\_\_\_\_, consigned to order of shipper, endorsed in blank.
    - Transshipment prohibited (only applies to Port-to-Port Bills of Lading).
  - Original Shipper's Copy of Air Waybill, showing airport of departure as \_\_\_\_\_ and airport of destination as \_\_\_\_\_, consigned to \_\_\_\_\_.  
    - Beneficiary's certificate that "one extra set of documents is accompanying the air shipment" (not applicable to ocean shipments).
- The above Bills of Lading, Air Waybill or other transport documents are to be marked and evidence:  
 Freight:  Collect  Prepaid      Notify Party: \_\_\_\_\_  
 Partial shipments:  Allowed  Not allowed      Shipment not later than: \_\_\_\_\_
- Forwarder's Cargo Receipt issued by \_\_\_\_\_ showing merchandise received no later than \_\_\_\_\_, consigned to or held at the disposal of the Applicant.
  - Original and \_\_\_\_\_ copy(ies) of Packing List.
  - Original and \_\_\_\_\_ copy(ies) of Certificate of Origin.
  - Original and \_\_\_\_\_ copy(ies) of \_\_\_\_\_.

**SPECIAL CONDITIONS/INSTRUCTIONS**

- Please make the L/C transferable in full or in parts by any bank.
- All bank charges other than those of the Issuing Bank are for the account of the Beneficiary.  All bank charges are for the account of the Applicant.
- Discount charges, if any (applicable only to drafts other than "sight"), are for the account of the  Beneficiary.  Applicant.
- All documents are to be sent to you in one lot by  Courier.  Airmail.
- Other conditions/instructions: \_\_\_\_\_

Account Party name (if different from Applicant name above) \_\_\_\_\_

Authorized signature \_\_\_\_\_ phone number \_\_\_\_\_ fax number \_\_\_\_\_

**A Letter of Credit Application Form**

<i>Expiry date:</i>	Latest date documents may be presented for negotiation, payment, or acceptance
<i>Tenor of draft:</i>	Whether draft should be drawn at sight or a certain number of days (e.g., 30, 90, 180) after sight or after the date of one of the documents
<i>Documents required:</i>	Documents and number of originals and copies required by the importer including those necessary to clear merchandise through customs
<i>Covering:</i>	General description of the merchandise, unit price, if any, and shipping terms (CPT [“Carriage Paid to”] Atlanta, <i>etc.</i> ) as defined in the Incoterms
<i>Insurance:</i>	The application should indicate whether insurance is to be effected by the importer or by the seller. Indication should also be given as to the coverage required if insurance is to be covered by the seller (e.g., “marine and war risks for at least 110% of the CIP value”). If the seller is arranging transportation, it is generally a good idea to let him also arrange insurance in order to avoid miscommunications that may result in no one’s obtaining insurance. Nonetheless, many importers negotiate to arrange for insurance; then, in the event of loss or damage, they will be dealing with insurance companies and coverage of their own choosing.
<i>Multimodal Transport (door- to-door) Bills of Lading:</i>	Transport document required when the seller is to arrange shipment including both inland transportation and an ocean leg, and payment is to take place as soon as the merchandise is picked up by the carrier (consistent with shipping terms of FCA [“Free Carrier”], CPT [“Carriage Paid to...”], and CIP [“Carriage and Insurance Paid to...”]).
<i>Air Waybill:</i>	Transport document required when shipment is to be made by air. An air waybill is <u>not</u> a title document; goods will be delivered to the importer regardless of whether he has obtained an original copy.
<i>Forwarder’s Cargo Receipt:</i>	Document required when the importer is arranging all transportation through his own freight forwarder with offices in the seller’s country. Seller’s responsibility for the goods ends with delivery to the forwarder (consistent with shipping terms of “Ex

Works”).

*Notify party:* It is customary to indicate in the transport document a party to be notified by the carrier upon arrival of the goods at their place of destination. Normally the notify party is the custom house broker and/or the importer.

*Partial shipments:* Unless specifically indicated otherwise, partial shipments will be permitted. If the importer desires one shipment only, the application should be marked “partial shipments not allowed.”

*Please note:* Some importers believe they can ensure performance by the seller under the sales contract by asking their banks to include numerous details and a lengthy description of the merchandise in the letter of credit. The insertion of these details, however, serves only to impede and hamper the effectiveness of the letter of credit. It will not prevent a seller intent upon fraud from invoicing goods and forging other documents as called for in the credit and shipping material of an entirely different nature (or none at all). As the conditions become more numerous and complex, the likelihood of trivial discrepancies increases, resulting in delays, cable expenses, *etc.*, and annoyances to both the importer and the seller trying to do business legitimately.

The issuance of a letter of credit constitutes a credit exposure on the part of the issuing bank to the importer since the bank will have to pay regardless of the importer’s financial ability at the time documents are presented. Therefore, the credit will be issued only if the credit standing of the importer is satisfactory to the issuing bank. Collateral may be required but it would be very unusual for this to be in the form of cash. The application will be reviewed for completeness, consistency, and appropriateness. Upon approving the application, the bank will issue the letter of credit.

The importer must instruct the issuing bank how the credit is to be transmitted to the seller. It is customary to have the issuing bank forward the letter of credit to the seller through one of its branches or correspondents located near the seller. In some cases, usually with domestic letters of credit, the buyer may choose to have the letter of credit sent directly to the seller. Most letters of credit nowadays are transmitted by the issuing bank to the advising bank by electronic data interchange. The advising bank is responsible for authenticating the credit and delivering it to the seller.

Upon receipt of a credit, the seller sometimes finds that he will not be able to meet its terms. He will then generally ask the importer to amend the letter of credit. It is crucial to note that any modifications agreed to between the importer and seller must also be agreed to by the issuing bank and incorporated into the letter of credit through amendments.

After shipping the goods and completing the documentation required by the letter of credit, the seller presents documents to a negotiating bank for collection and payment. The negotiating bank sends the documents to the issuing bank which will also scrutinize them before paying the negotiating bank. If the documents satisfy the terms of the letter of credit, the issuing bank must pay. Letters of credit may specify that they are payable immediately or on a deferred basis (*e.g.*, 90 days after the bill of lading date). The importer’s agreement with the bank may call for immediate reimbursement upon payment or deferred reimbursement.

In the event the documents are not correct, the issuing bank will have to decide whether or not to waive discrepancies. Normally, this involves discussions with the importer. The importer may wish

the bank to waive the discrepancies or to refuse the documents. In the former case, the bank may nonetheless refuse the documents but will more likely proceed as if the letter of credit terms have been satisfied. In the event the importer wants the bank to refuse the documents, he may ask the bank to relay to the seller the terms under which he will accept the merchandise. The seller is, however, free in these circumstances to try to find another buyer.

### **Revolving Letters of Credit**

Revolving letters of credit revert to their original amounts at certain specified intervals. For example, a credit may be revolving for US\$5,000 weekly, which would mean that the seller could draw drafts for up to US\$5,000 every week prior to the expiry date of the credit. The periods during which the amount of the credit could be drawn, or in other words revolve, might be daily, weekly, monthly, *etc.*

The importer should exercise a great deal of caution before providing the seller with an irrevocable revolving letter of credit. The maximum exposure of the importer under an irrevocable revolving credit is not the amount of the credit, but the amount of the credit multiplied by the number of periods the credit is to revolve. For this reason, some revolving letters of credit are issued in quasi-revocable form, indicating that they are available for a specified amount which will be reinstated automatically unless the issuing bank notifies the seller that further reinstatement is canceled. Such credits are very difficult to control, however.

Revolving letters of credit can be either cumulative or non-cumulative, but nearly all such credits are non-cumulative. Any amount the seller does not draw under a revolving, non-cumulative letter of credit during a given period may not be drawn in a later period. For example, if a revolving credit has been issued for US\$5,000 weekly, non-cumulative, and the seller draws only US\$2,000 in one week, he may still draw only US\$5,000 in each succeeding week. The revolving, cumulative letter of credit, on the other hand, permits the seller to carry over any amounts not drawn in previous periods. For example, if a revolving credit has been issued for US\$5,000 weekly, cumulative, and the seller draws only US\$2,000 in one week, the unused amount may be carried over and added to the amounts available in subsequent periods: the sum of US\$8,000 becomes available the next week or, if not used in that week, in any of the succeeding weeks.

Revolving credits are used by companies with repetitive sales or purchases. The most common users are retailers. For example, an importer of skis may be able to sell up to US\$10,000-worth each week from October through December. The non-cumulative letter guarantees that he will never have to pay for more than US\$10,000 of skis each week. In this manner the purchaser can exercise control over his inventory and warehousing costs. Such credits are also used by companies with buying agents overseas (in this case, the credits are generally issued in favor of the agents themselves but the agents are allowed to transfer the credits to other parties, namely the suppliers they locate).

### **Installment Letters of Credit**

An installment letter of credit is similar to a revolving, non-cumulative letter of credit with one key exception: once the seller misses a shipment, the credit ceases to be in effect. To take the previous

example of the ski importer, the installment letter of credit ensures that the retailer will receive US\$10,000 of skis every week until the seller fails to make a shipment. If this happens, a new letter of credit must be opened to import more skis, or the existing credit reinstated by an amendment. An installment credit normally includes a detailed shipping schedule and the amount and duration of each installment may vary. Obviously, the installment letter enables the retailer to formulate his sales plans more effectively than a revolving credit.

**CHAPTER SIX:  
EXPORT LETTERS OF CREDIT**

**Letter of Credit Mechanics on the Export Side**

**An export letter of credit provides an exporter with a bank's commitment to pay the amount specified upon presentation to the bank of the documentation described in the letter of credit. The exporter must be sure to clearly communicate to the importer the terms of sale and what documents he expects to present in order to demonstrate fulfillment of the sale contract. As long as the letter of credit calls for the documents the exporter intends to produce, the exporter can consider his risk to have shifted from the buyer to the buyer's bank.**

Once an exporter and a foreign buyer have agreed upon the terms of sale (including payment on a letter-of-credit basis), the foreign buyer submits an application for a letter of credit to his bank. This process is generally the same as that followed by a North American buyer, as explained in the previous chapter. (There is a common misconception that at this point the buyer gives his bank the cash needed eventually to pay the L/C and that these funds are then placed on deposit at the advising bank. While regulations in a few countries may require a partial or full cash deposit, this is, in fact, not only unusual but contrary to the normal reasons the buyer wants to use a letter of credit. If he had to put up cash in order to obtain an L/C, he might well consider paying cash in advance and trying to negotiate a lower price.) To avoid the need to obtain amendments to the L/C, the exporter should consider providing the importer with explicit guidelines for what documents to require. (*A format for developing a letter of credit instructions form appears pages 33-35.*)

The issuing bank forwards the letter of credit to an advising bank in the exporter's vicinity. The role of the advising bank is to verify the authenticity of the letter of credit and then relay it to the exporter. The advising bank has no obligation to pay the credit unless it adds its confirmation.

The exporter may ask the buyer to specify the advising bank and, if the exporter wants to have the letter of credit confirmed, he must also have the buyer include the request for confirmation on the application for the letter of credit. The advising bank is not authorized to confirm a letter of credit without specific authority from the issuing bank and has no obligation to do so even if requested.

The exporter must be aware, however, that the issuing bank will generally consider that it has the prerogative to choose the advising/confirming bank. This has caused great dissatisfaction among exporters, especially in recent years, as the confirming bank chosen is often a branch or affiliate of

***This format is for use in designing a Letter of Credit Instructions form appropriate for your own company.***

**LETTER OF CREDIT INSTRUCTIONS**

Date: \_\_\_\_\_

To: \_\_\_\_\_

From \_\_\_\_\_  
Address \_\_\_\_\_  
City & State \_\_\_\_\_  
Country \_\_\_\_\_ Zip Code \_\_\_\_\_  
Attn \_\_\_\_\_  
Telephone \_\_\_\_\_  
Fax \_\_\_\_\_

RE:  Our Pro-Forma Invoice# \_\_\_\_\_ Dated \_\_\_\_\_  
 Your Purchase Order# \_\_\_\_\_ Dated \_\_\_\_\_  
 Commercial Contract# \_\_\_\_\_ Dated \_\_\_\_\_

Gentlemen:

In connection with your above-referenced purchase, the following terms and conditions are for inclusion in your irrevocable letter of credit. We are providing you with these details as a confirmation of our understanding of the terms of sale covering this transaction. If these details do not agree with your understanding or if you are unable to comply with these terms and conditions, please notify us prior to the issuance of your letter of credit to avoid unnecessary delays and costs. Thank you for your patronage and cooperation.

1. The letter of credit must be issued no later than \_\_\_\_\_ by a bank acceptable to us.
2. The letter of credit must be irrevocable, state that it is available with any bank by negotiation, and be subject to the 1993 Revision of the Uniform Customs and Practice for Documentary Credits published by the International Chamber of Commerce (UCP500).
3. The letter of credit must be opened with full details by SWIFT or tested telex

In favor of: \_\_\_\_\_ [indicate the company name and address you will use in your invoices; if this is not the address you want your L/Cs mailed to, give separate instructions for where this L/C is to be sent]  
Attn: \_\_\_\_\_  
Telephone: \_\_\_\_\_

We will not initiate shipment until the actual letter of credit is received but it may expedite processing if you will fax a copy of the letter of credit to [name] at [fax number]. This must be a copy of your bank's actual SWIFT message sent to the advising bank. A copy of your letter of credit application is not sufficient.

4. The letter of credit must be payable in U.S. dollars for  
 up to an amount of \_\_\_\_\_  
 an approximate amount of \_\_\_\_\_
5. The letter of credit must be advised through an acceptable, "prime" U.S. or European bank such as:  
  
[list your preferred letter of credit advising banks]
6. The letter of credit must authorize the advising bank to add its confirmation only if requested to do so by beneficiary.
7. The letter of credit must authorize the negotiating bank to debit the issuing bank's account with a U.S. reimbursing bank with no deductions. It will expedite processing, and possibly reduce the reimbursing bank's charges, if your bank indicates their account number with the reimbursing bank in the L/C.
8. The letter of credit must be payable against drafts drawn, at the beneficiary's option, on the issuing bank, on the advising bank, or on the reimbursing bank. Drafts must be  
 at sight  
 at \_\_\_\_ days from the date of the transport document/forwarder's receipt.  
 at \_\_\_\_ days from the date of the invoice.
9. The letter of credit must indicate:
- All banking charges outside the applicant's country, including any amendment charges, are for the account of the  applicant  beneficiary.
  - Discount and acceptance charges for time drafts shall be for the account of the  applicant  beneficiary.
  - Reimbursement related charges must be for the account of the issuing bank. Please instruct your bank to reflect this in their reimbursement authorization as well as in the letter of credit.
10.  The letter of credit must be transferable by any bank.
11.  The letter of credit must allow partial shipments.
12. The latest shipping date in the letter of credit must be at least \_\_\_\_ days after the issuance date of the L/C.
13. The letter of credit must allow a minimum of \_\_\_\_ days after the date of transport document/forwarder's receipt for presentation of documents. Add 14 days if any documents required must be consularized or legalized or if they include an inspection certificate issued by S.G.S. or similar inspection service. Expiration should be this same number of days after the latest shipment date at the counters of the negotiating bank.



14. The letter of credit must require the commercial invoice to describe the merchandise, in accordance with our pro-forma invoice, as (use only generic terms, avoiding details as to grade, quality, etc.):

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- |   |   |
|---|---|
| <input type="checkbox"/> EXW (Ex Works, Ex Factory)         | <input type="checkbox"/> cleared for export<br><input type="checkbox"/> loaded on departing vehicle   |
| <input type="checkbox"/> FCA (Free Carrier At)              | <input type="checkbox"/> Seller's premises<br><input type="checkbox"/> Consolidator's terminal in Seller's country<br><input type="checkbox"/> Carrier's terminal<br><input type="checkbox"/> Airport of departure                  |
| <input type="checkbox"/> CPT (Carriage Paid To)             | <input type="checkbox"/> Customs terminal in Buyer's country<br><input type="checkbox"/> Consolidator's terminal in Buyer's country<br><input type="checkbox"/> Buyer's premises<br><input type="checkbox"/> Airport of destination |
| <input type="checkbox"/> CIP (Carriage & Insurance Paid To) | <input type="checkbox"/> Customs terminal in Buyer's country<br><input type="checkbox"/> Consolidator's terminal in Buyer's country<br><input type="checkbox"/> Buyer's premises<br><input type="checkbox"/> Airport of destination |

15. If you have selected a freight forwarder who will be receiving the goods for consolidation and/or shipment, payment must be available against a Forwarder's Cargo Receipt showing merchandise consigned to/at disposal of yourselves. Otherwise the L/C must require either a multimodal transport document consigned to order of the issuing bank showing place of receipt as \_\_\_\_\_ and place of delivery or final destination as \_\_\_\_\_ or an air waybill consigned to yourselves showing airport of departure as \_\_\_\_\_ and airport of destination as \_\_\_\_\_. L/C must require the multimodal transport document or air waybill be marked "Freight Prepaid" if terms are CIP or CPT or "Freight Collect" if terms are EXW or FCA.
16. If terms are CIP, you may require a marine cargo insurance certificate covering
- All risks warehouse to warehouse
  - All risks warehouse to warehouse including SRCC & War Risks

If terms are EXW, FCA, or CPT and we are arranging the shipment, you may require a copy of a cable or fax message to yourselves giving date and means of shipment and description and value of the goods shipped, certified by the beneficiary (ourselves) to be true and accurate and to have been sent no later than two days after shipment.

We anticipate receipt of your letter of credit conforming to these requirements.

the issuing bank. Normally, the seller should expect that confirmation will be added by a bank in his home country, thus eliminating political and transfer risks. At the very least, the seller who wants a confirmed letter of credit should expect the confirming bank to be in a different country from the issuing bank. If the confirming bank is a branch or subsidiary of the issuing bank or another bank in the buyer's country, the political and transfer risks are not reduced at all, and the confirmation should not be accepted. The seller must carefully evaluate the acceptability of the confirming bank since this is whose risk he is assuming. Even when the confirming bank is a major U.S. or European bank, some confirming banks have a disturbing tendency to charge large fees for what they view as captive business. Furthermore, even though the confirming bank may "second advise" the L/C through the bank the exporter asked to have confirm the credit. Unnecessary delays and charges can result, not only when the L/C is opened but with any amendments as well.

Due to the difficulties of getting the issuing bank to nominate an acceptable confirming bank, the seller should consider alternative ways to obtain protection against political and transfer risks. A "freely negotiable" letter of credit is one that allows the seller to go to the bank of his choice to collect payment. Upon receipt of a freely negotiable credit, the seller may ask his bank for a commitment to negotiate (*i.e.*, purchase) documents without recourse. This arrangement, often referred to as "silent confirmation," provides the seller with the same protections as letter of credit confirmation, but also provides the freedom to choose "confirming" banks. Another means of protection is to take out credit insurance with an insurance company offering such policies. Normally, credit insurance is not taken out for a single L/C but for all of a company's export sales, letter of credit and otherwise.

Whether or not the letter of credit is confirmed, the exporter is entitled to payment only if he complies with the requirements of the L/C. It is, therefore, important that the exporter examine the letter of credit carefully to ensure that it is consistent with the agreed-upon terms of sale and that he can meet its terms and conditions. (*A sample letter of credit appears on the opposite page.*) To make certain this examination catches all potential problems, the L/C should be reviewed by the exporter's credit manager, traffic/logistics department, freight forwarder, and negotiating bank. All parties should conduct their reviews as early as possible, before any customized goods are put into production and certainly before any goods are shipped. If changes are needed, the exporter should contact the buyer immediately to request an amendment to the letter of credit, prior to taking any action on the order. Otherwise, the exporter may incur the cost of acquiring, manufacturing, and shipping the merchandise only to have a request for a needed amendment refused.

An exporter may benefit from presenting documents to his own bank in order to centralize his business as well as to take advantage of special services and discounted pricing it may offer relationship customers. Exporters in most countries centralize presentation of all their letter of credit documents for these reasons. As previously described, this can be accomplished by asking for freely negotiable letters of credit and replacing confirmation with other alternatives. North American exporters, however, probably because letters of credit have traditionally represented a smaller percentage of their business than for their foreign counterparts, have not been as concerned about the service they receive and still customarily present their documents to the advising banks for collection of payment.

A negotiating bank effects normally effects payment under a letter of credit by obtaining funds from the issuing bank's account at its bank of deposit. (Authorization to do so must be contained in the

Prepared MAR08/99 14:21

KEY: SWIN 9603000708914700 SEQ NO: 960308500050

RECEIVED FROM: ABN AMRO BANK N.V., SINGAPORE BRANCH  
SINGAPORE

Authentication: CORRECT

1 :basic header : F 01 LASLUS44BXXX 1448 170261  
2 :application : 0 700 1519 968300 ABNASCSCAXXX 2456 743J92 960308 0709 N  
message type : 700-Issue of Documentary Credit N-Normal Message  
4 :message text :  
:27 :sequence of total : 1/1  
:40A:form of doc credit : IRREVOCABLE  
:20 :doc credit number : L960477  
:31C:date of issue : 990308  
:31D:date/place of expiry : 990430 IN U.S.A.  
:50 :applicant : ABC COMPANY  
21 ANY STREET  
SINGAPORE 659539  
:59 :beneficiary : XYZ COMPANY  
52 ANY STREET  
GREENWOOD, IN 48182  
USA  
:32B:currency/amount : USD10,000.00  
:41D:available with...by... : ANY BANK  
BY NEGOTIATION  
:42C:drafts at : SIGHT  
:42D:drawee : ABN AMRO BANK N.V., SINGAPORE BRANCH  
:43P:partial shipments : NOT ALLOWED  
:43T:transshipment : ALLOWED  
:44A:load/disp/take at/from : USA PORT  
:44B:for transportation to : SINGAPORE  
:44C:latest date of shipment : 990415  
:45A:description of goods : 1 (ONE) UNIT - PORTABLE CHILLER, MODEL : MX-7, SAYR 415/  
50 AS PER APPLICANT'S P/O NO. 2075 FOB USA PORT  
:46A:documents required : ++ BENEFICIARY'S SIGNED COMMERCIAL INVOICE IN ONE ORIGINAL AND  
THREE COPIES  
++ FULL SET ORIGINAL CLEAN ON BOARD PORT TO PORT BILLS OF LADING  
AND ONE N.N. COPY MADE OUT TO ORDER OF SHIPPER  
BLANK ENDORSED MARKED FREIGHT COLLECT AND NOTIFY APPLICANT  
INDICATING THIS CREDIT NUMBER.  
++CERTIFICATE OF USA ORIGIN IN ONE ORIGINAL AND ONE COPY ISSUED  
BY BENEFICIARY/CHAMBER OF COMMERCE  
++ PACKING LIST IN ONE ORIGINAL AND ONE COPY  
:47A:additional conditions : +ALL DOCUMENTS MUST BE DISPATCHED TO US IN ONE LOT BY  
REGISTERED AIRMAIL + INSURANCE WILL BE COVERED BY APPLICANT  
+ THIS CREDIT IS SUBJECT TO UCP 500.  
:71B:charges : ALL BANK CHARGES AND COMMISSIONS OUTSIDE SINGAPORE INCLUDING  
REIMBURSEMENT CHARGES ARE FOR BENEFICIARY'S ACCOUNT  
:49 :confirmation instructions : WITHOUT  
:53A:reimbursing bank : ABN AMRO BANK N.V.  
NEW YORK, NY  
:78 :instr to nominated bank : REIMBURSEMENT : PLEASE REIMBURSE YOURSELVES TO THE DEBIT  
OF OUR ACCOUNT WITH ABN AMRO BANK NV, NEW YORK, UNDER TESTED  
TELEX ADVICE TO US. A DISCREPANCY FEE OF USD40.00 (OR ITS  
EQUIVALENT) SHALL BE DEDUCTED FROM THE REIMBURSEMENT CLAIM/  
PROCEEDS UPON EACH PRESENTATION OF DISCREPANT DOCUMENTS AND THE  
LEVY OF THE DISCREPANCY FEE DOES NOT IN ANY WAY ALTER THE TERMS  
AND CONDITIONS OF THIS CREDIT.  
-  
5 :trailer :  
MAC : OC867BADE  
CHK : 05257AASDC1E  
DLM :

**An Export Letter of Credit**

L/C.) Thus the exporter is often paid before the issuing bank even sees the documents. Nonetheless, upon receipt of documents, the issuing bank will still examine them and, if they do not conform strictly to the terms of the credit, it may refuse them and demand a refund of the amount paid (plus interest). It follows, therefore, that a negotiating bank will pay an exporter only upon the presentation of documents which it feels certain will not be refused by the issuing bank. Because any discrepancy is grounds for refusal, the negotiating bank will insist the documents strictly comply with the terms of the letter of credit. In fact, over 60% of all documents are found to contain discrepancies.

While the documents required under letters of credit may vary, most credits commonly call for the presentation of a draft, commercial invoices, and bills of lading. The bank making payment is expected to examine these documents and any others specified with care to be certain they appear on their face to comply with the terms and conditions of the credit. It must be understood that in documentary credit operations all parties concerned deal in documents and not in goods. Since credits are almost always subject to the Uniform Customs and Practice for Documentary Credits, its provisions will be applied to documents presented under such credits in determining whether payment will be made.

Three common problems can be avoided if the exporter carefully checks the following:

1. The credit amount is sufficient to cover the shipment (particularly if the terms are CIF or CIP).
2. Documents will be available and can be presented before the expiry date of the credit.
3. The latest shipment date (if there is one) specified in the letter of credit can be met.

Common discrepancies encountered by banks examining documents under letters of credit include the following:

1. Documents are inconsistent with each other.
2. Documents were presented more than 21 days after date of shipment (or other presentation period specified in the L/C).
3. Full set of bills of lading was not presented or other required documents are missing.
4. Draft is drawn incorrectly or for the wrong amount.
5. Draft is not signed or not endorsed.
6. Invoice does not describe merchandise in exact accordance with the letter of credit. *Note:* If the letter of credit describes merchandise in a foreign language, then the exporter must describe the merchandise in that language in the invoice; translations are not acceptable.
7. Invoice does not show the same shipping terms as specified in the L/C.
8. Invoice includes charges inconsistent with the shipping terms in the L/C.
9. Invoice is not made out in the name of the applicant shown in the L/C.
10. Insurance coverage is insufficient or does not include the risks specified by the L/C.
11. Insurance certificate or policy is not endorsed.
12. Insurance certificate is dated later than the shipment date (acceptable if coverage is warehouse-to-warehouse).
13. Bill of lading is not clean (defective condition of goods or packaging is indicated).

14. Bill of lading does not clearly indicate the name and capacity of the signer and who the carrier is (must be signed “ABC Co. as carrier” or “XYZ Co. as agent for ABC Co., the carrier”).
15. Bill of lading is not consigned correctly or is not endorsed (if endorsement is required).
16. Multimodal bill of lading was presented when L/C calls for port-to-port, or simply “ocean,” bill of lading (acceptable if “on board” notation includes the name of the vessel and the port of loading).
17. Multimodal bill of lading was presented when shipping terms are FOB (*i.e.*, port to port) and does not indicate inland freight has been prepaid or otherwise fails to meet requirements for port-to-port shipment.
18. Bill of lading is not marked “freight prepaid” or “freight collect” as required under the credit or in agreement with the invoice and shipping terms.
19. Not all documents show license numbers, letter of credit numbers, or other identification required in the credit.
20. Documents are not signed in accordance with L/C terms (any document called a “certificate” must be signed).

If the exporter's documents cannot be corrected to comply with the credit terms, he has various alternatives available to still collect payment. It should be noted, however, that he has lost a key element of the letter of credit: the issuing bank's obligation to pay. Even if the issuing bank waives discrepancies, the confirming bank may choose not to extend its confirmation to cover the waiver, which is, in essence, an amendment to the credit. The most common course of action, despite the fact that it is expensive and time consuming, is that the exporter asks the negotiating bank to cable the issuing bank indicating the discrepancies and requesting authority to pay. The issuing bank will then contact the buyer and, if the buyer agrees to pay in spite of the discrepancies, the issuing bank will then cable the negotiating bank giving the authority to make payment. Alternatively, if the exporter is comfortable with his relationship with the buyer and thinks that there is no real danger the buyer will refuse to pay, the exporter can direct the negotiating bank to forward the documents with the discrepancies to the issuing bank for approval. The exporter may further request that the negotiating bank go ahead and pay against his indemnity. Under such an arrangement the exporter agrees to indemnify the negotiating bank against any loss or damage it may sustain in the unlikely event such payment is not approved by the issuing bank.

Although the use of such “shippers' indemnities” is infrequent in North America, banks are generally willing to accept such indemnities from their own customers so long as the credit standing of the customer is satisfactory. Despite the high discrepancy rate, the actual incidence of issuing banks' refusing documents is very low. (This is due to the facts that buyers who can obtain letters of credit to begin with are normally good credit risks, they want the merchandise that was shipped and will therefore agree to pay even though documents do not comply, they wish to remain on good terms with their suppliers, and, unless the underlying contract of sale has been violated, they are legally obligated to pay anyway.) The use of shippers' indemnities is highly recommended as a way to obtain payment days or weeks sooner as well as avoid cable expenses. Because indemnities will be accepted only by banks with whom the exporter has credit lines, beneficiaries wishing to make use of such arrangements should present documents to their own banks for negotiation rather than following the common, but often unfavorable, practice of submitting documents to the advising banks.

Once the negotiating bank is satisfied that the exporter has complied with the issuing bank's requirements (or has a satisfactory indemnity), it will trigger the payment mechanism outlined in the L/C. In the case of a sight draft, it will seek to collect funds from the issuing bank's account at the designated paying ("reimbursing") bank. If the seller is a relationship customer, the negotiating bank may be willing to advance funds to him prior to receipt of payment from the issuing bank.

In the case of a time draft, the negotiating bank will submit the draft to the drawee bank specified in the L/C for "acceptance" (a special form of endorsement similar to certifying a check). Once a bank officially accepts a time draft, it is legally obligated to pay the draft at maturity regardless of its role under the initial letter of credit. An accepted time draft is known as a "banker's acceptance" and may be held until maturity by the exporter or sold to the negotiating bank or any other bank that participates in the buying and selling of bankers' acceptances. The discount rate for such bank obligations (called the "banker's acceptance" or "B/A" rate) is usually much less than the company's normal borrowing rate (often even lower than the U.S. Fed Funds and international LIBOR rates at which banks lend money to each other), making such discounting an attractive alternative. A banker's acceptance is very similar to an avalized draft, as described in the chapter on draft collections, but a sale on avalized-draft terms does not include the pre-shipment risk protection of a letter of credit.

The exporter should indicate to the negotiating bank whether or not to mail the documents out before payment is received (or the draft is accepted).

### **Transfers Under Letters of Credit**

As already stated, letters of credit are versatile instruments. Use of a transferable letter of credit allows a middleman to put together a deal where he buys goods from one party and sells them to another. The ultimate buyer asks his bank to issue a transferable letter of credit to the middleman and the middleman asks his bank to issue a transfer of the letter of credit to the ultimate seller. The transfer will require all the same documents as the letter of credit itself. Thus, the ultimate seller will be called upon to perform the actual shipment of goods to the place at which they will be picked up by the ultimate buyer; *i.e.*, the transferee will be the actual exporter. Transfers do not work if the middleman will take possession of the goods or be responsible for their shipment in any way.

A letter of credit may be transferred only if it is expressly designated as "transferable." By this designation, the ultimate buyer acknowledges that he is dealing with a middleman and agrees, if necessary, to accept documents produced by someone other than the middleman from whom he has contracted to purchase goods. Although this makes "third-party" invoices acceptable under the L/C (normally they would not be acceptable), the bank that handles the transfer will give the middleman an opportunity to substitute his invoices for those of the transferee. By transferring the same description of merchandise but at a lesser value, the middleman can take a mark-up on the goods. Effectively, he can interject himself as buyer of the goods from the ultimate seller at the lower price and seller of the goods to the ultimate buyer at the higher price—all without ever taking possession of the goods. As the ultimate seller will never see the original L/C, only the transfer, and the ultimate buyer will never see the ultimate seller's invoices, ideally neither party will learn the other's identity.

Transferable credits are often used when a manufacturing company lacks the market knowledge and personnel necessary to sell its products in other countries. The manufacturer, therefore, agrees to work with another company that has the needed marketing capabilities. ("Export management

consultants” and “export trading companies” specialize in such business.) The company that obtains the sales may do so in its own name (this is the *modus operandi* for an export trading company) and will therefore be the first beneficiary of the letters of credit it generates; it will ask its bank to transfer the L/Cs to the manufacturer. The manufacturer ships the goods and presents the documents called for to the transferring bank. After the middleman is given the opportunity to substitute his invoices into the documents, they are then submitted by the transferring bank to the issuing bank for payment. Upon receipt of funds, the transferring bank pays both the middleman and the manufacturer.

As with all letters of credit, the obligation to effect payment lies with the bank that issued the L/C. The transferee should not expect the transferring bank to pay against documents that comply with the transfer unless the transferring bank has confirmed the credit. If documents do not comply with the transfer, matters quickly become quite complicated. It is recommended that companies contemplating using transferable letters of credit develop a thorough understanding of the rights and responsibilities of the various parties before commencing this sometimes tricky method of dealing.

### **Assignments of Proceeds Under Letters of Credit**

By assigning the proceeds of a letter of credit, the beneficiary of the credit can pledge the credit as collateral to another party. An assignment of proceeds may be made against any letter of credit; it does not have to be expressly designated as “transferable” or “assignable.” An assignment of the proceeds of a letter of credit is most often used by the beneficiary of the L/C to purchase, from another company, the goods he is shipping under the credit. Thus, an assignment of proceeds may be used in a situation similar to the normal one in which a transfer would be used but where a transfer won’t work. The most common reason a transfer cannot be used is that the company that obtained the sale (and the L/C) will be taking physical possession of the goods and making the shipping arrangements. To illustrate, a company with expertise in marketing in a certain country (*e.g.*, an export trading company) may obtain a contract to supply goods to an overseas buyer at a CIF price. He may then negotiate with the manufacturer of the goods to purchase them Ex Factory. Because the manufacturer will not be performing the shipment of the goods overseas, he will not be generating the documents needed to draw under the L/C. Hence the letter of credit cannot be transferred to him. Companies that specialize in marketing other companies’ products often are not cash rich and must therefore convince the manufacturers they are dealing with to sell them goods on open account terms, allowing them to take possession of the goods and ship them overseas before paying for them. To reassure the manufacturer that payment will be forthcoming, the middleman may show his contract of sale and his letter of credit, and he may actually pledge the proceeds of the L/C, to the manufacturer (with an assignment of proceeds) as security.

It must be recognized that the rights and responsibilities of the middleman and the manufacturer are very different under an assignment of proceeds than under a transfer of a letter of credit. By an assignment of proceeds, the beneficiary directs the bank involved in the payment or negotiation of documents to pay the assignee a certain portion of the beneficiary’s proceeds only after the documents have been presented and payment received. The middleman beneficiary retains responsibility for presenting all documents; the assignee obtains no rights to present documents and obtain payment himself. The assignment of proceeds has no monetary value until the proceeds actually come into existence. In other words, receipt of an assignment of proceeds does not guarantee payment; it ensures

that proceeds will be distributed in a certain way if the beneficiary presents the documents against the credit as required and the issuing bank pays. The assignee should view the assignment for exactly what it is: a security interest in an asset held by the beneficiary of the L/C.

For the assignee to receive payment from a particular bank, the assignment of proceeds must be made through that bank. To effect an assignment of proceeds the beneficiary must submit a written notice of the assignment (together with the original credit) to a bank authorized to negotiate or pay the credit. This bank will, upon receipt of such notice and agreement to handle the transaction, record the assignment of proceeds on the original letter of credit and advise the assignee by letter. This letter should indicate that the bank handling the assignment of proceeds is holding the letter of credit on behalf of the assignee as this is the procedure required to “legally perfect” his security interest in the credit.



**CHAPTER SEVEN:  
STANDBY LETTERS OF CREDIT**

**How Standby Letters of Credit Work**

**Standby letters of credit are remarkably versatile instruments for a bank to represent to a third party that they are willing to make payments on their customer's behalf, if and when called for. Most often, these payments are to be made when the customer has failed or refused to do so themselves. The value of the bank's commitment lies in the fact the bank is obligated to pay, even in the event of a dispute, as long as the documents specified in the L/C are presented as required.**

Federal regulations prohibit most banks in the U.S. from issuing guarantees. To fill this void, American banks developed the standby letter of credit as a means of financial support for a variety of trade and investment needs. Originally, these same regulations even required that all letters of credit be “conspicuously titled” as letters of credit. Banks in other countries have long issued letters of credit that they have designated to be “demand guarantees” or “independent guarantees.” These are not to be confused with “ancillary” or “contract” guarantees, which are not letters of credit. As U.S. banks are now, as of 1996, free to use any desired designation, the important thing to keep in mind is not what the arrangement is called, but how it works. Any letter of credit should state that it is subject to the [Uniform Customs and Practice for Documentary Credits](#) to ensure that it will work as expected.

Regardless of what it's called, a letter of credit represents the issuing bank's undertaking to pay the named beneficiary a sum of money upon presentation of specified documents conforming to the terms and conditions of the credit. As with a commercial L/C, the intent of a standby letter of credit is to substitute the creditworthiness of the bank for that of its customer, the applicant. The commercial letter of credit facilitates a commercial transaction through the use of shipping documents and negotiable drafts. A standby letter of credit, however, often takes the form of an obligation by the issuer to the beneficiary (1) to repay money borrowed by or advanced to or for the applicant, (2) to make payment of an indebtedness of the applicant, or (3) to make payment because of a claimed default by the applicant in the performance of an obligation. As such, it may require documents are simple as a statement signed by the beneficiary attesting to the existence of one of these types of situations.

Note that although the beneficiary of a standby credit may be required by the L/C to present a written statement claiming that some sort of default has occurred, in no case does the issuing bank agree to guarantee the completion of

any project or contract nor is it bound to make determinations of fact regarding the underlying transaction (as is generally the case with a “contract” or “ancillary” guarantee). The bank’s responsibilities and liabilities are financial only. If the beneficiary presents documents that comply with the letter of credit requirements, the bank must pay regardless of any assertions of fraud or non-validity made by the applicant. Furthermore, the applicant is legally bound to reimburse the bank. For this reason, the applicant for a standby letter of credit must trust the beneficiary not to draw improperly under the L/C.

The applicant for a standby letter of credit should consider the risks involved in having a bank issue a standby letter of credit for its account and can take two important steps to minimize these risks. The applicant should, just as in the commercial letter of credit transaction, know the beneficiary and be comfortable with the beneficiary’s character and business reputation. Many sources can assist the applicant: trade associations, credit reporting firms, chambers of commerce, *etc.* Second, the applicant and the beneficiary should negotiate and document the terms of the underlying transaction. This may take the form of a written contract or be as simple as a purchase order or pro forma invoice. Once the issuing bank has made payment, the applicant’s recourse to recover the payment through legal channels is only as strong as his ability to prove that the beneficiary has violated the contract.

If the beneficiary of a standby letter of credit is in a foreign country and the letter of credit is to remedy non-performance, the applicant should be sure that his contract with the beneficiary relieves the applicant from responsibility for non-performance due to *force majeure*. Strikes, military coups, hurricanes, and other events beyond the control of the applicant which prevent the applicant from fulfilling the contract should not constitute non-performance of the applicant’s obligations.

### **Bid Bonds**

Government buyers and buyers involved in sizable projects frequently request suppliers and contractors who are bidding on a sale or project to post “bid bonds” in the form of standby letters of credit, usually for a percentage of the contract amount. These are used for the bidding process only and assure the buyer that the original bid will be honored by the bidder selected. The winning bidder is commonly required to post a “performance bond” (*see below*) to prove his ability to honor his bid. If the performance bond is not posted in a timely manner, the amount of the bid bond will be forfeited as a penalty.

### **Performance Bonds**

When a buyer awards a large contract for goods and/or supplies, especially commodities like oil and grain, to a particular seller, he wants assurance that the agreed price will be honored and that the seller will not otherwise default on the contract. Similarly, throughout the life of a project, the contracting party is interested in ensuring that the project will in fact be completed in accordance with the terms and conditions of the contract. In cases like these, a standby letter of credit may be required to provide financial compensation in the event of default. These are generally designed to decrease in amount over the life of the contract until completion.

Performance bonds are also used to back up international warranties that machinery or other goods will work properly for a certain period of time. If the machinery breaks down and the manufacturer fails to provide timely repairs, the buyer may arrange repairs himself and draw on the L/C for costs incurred and/or a penalty.

### **Advance Payment Bonds**

When the manufacturer who has been awarded a sale begins work, partial payment may be required in advance for materials, start-up costs, or general working capital. The buyer often requests a bond or standby letter of credit for assurance that such advances will be used for the project. In the event of contract default, the advance can be recovered from the bank that issued the standby letter of credit. These standby L/Cs can be issued to decrease in amount progressively as shipments take place.

### **Credit Line Support**

When a buyer and seller agree to an “open account” or “cash-in-advance” relationship, a standby letter of credit can be used as financial security. In these situations, payments are made directly between the buyer and seller, but, in the event of default (*e.g.*, non-payment in an open account transaction or defective goods in a cash-in-advance transaction), the affected party has recourse to a commercial bank.

### **Evergreen Letters of Credit**

Sometimes a standby letter of credit will be issued with an initial expiration date but containing a clause that states that it will be automatically extended for additional periods unless the issuing bank provides notice to the beneficiary stating otherwise. Such a clause is called an “evergreen clause.” Such a credit, in effect, has no expiration date and will remain open until the beneficiary returns it for cancellation since the beneficiary will simply draw the full amount of the credit if he receives notice from the bank that it is not going to extend it. Of course, the applicant’s obligation to reimburse the issuing bank remains in effect as long as the credit is open.

### **Clean Letters of Credit**

In some instances, the beneficiary will request a letter of credit in which the only document required is a draft drawn on the issuing bank. This is sometimes called a “clean letter of credit.” The issuing bank is required to pay, and the applicant in turn is required to reimburse, once the draft is presented. Such a letter of credit is very open and the beneficiary’s ability to draw is limited only by the amount and expiration date of the letter of credit; it may be thought of as giving the beneficiary a cashier’s check and asking him not to cash it unless necessary.

# URC 522

## Uniform Rules for Collections

1995 Revision in force as of 1 January 1996

The Uniform Rules for Collections were first published by the ICC in 1956. Revised versions were issued in 1967 and 1978. This present revision was adopted by the Council of the ICC in June 1995, for issue as ICC Publication No. 522. This English language edition gives the official text of the 1995 Revision. Translations in other languages may be available from ICC National Committees.

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International Chamber of Commerce

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### A GENERAL PROVISIONS AND DEFINITIONS

#### Article 1

Application of URC 522

- a. The Uniform Rules for Collections, 1995 Revision, ICC publication No. 522, shall apply to all collections as defined in Article 2 where such rules are incorporated into the text of the “collection instruction” referred to in Article 4 and are binding on all parties thereto unless otherwise expressly agreed or contrary to the provisions of a national, state or local law and/or regulation which cannot be departed from.
- b. Banks shall have no obligation to handle either a collection or any collection instruction or subsequent related instructions.
- c. If a bank elects, for any reason, not to handle a collection or any related instructions received by it, it must advise the party from whom it received the collection or the instructions by telecommunication or, if that is not possible, by other expeditious means, without delay.

#### Article 2

Definition of Collection

For the purposes of these Articles:

- a. “Collection” means the handling by banks of documents as defined in sub-Article 2(b), in accordance with instructions received, in order to:
  - i. obtain payment and/or acceptance, *or*
  - ii. deliver documents against payment and/or against acceptance, *or*
  - iii. deliver documents on other terms and conditions.
- b. “Documents” means financial documents and/or commercial documents:
  - i. “Financial documents” means bills of exchange, promissory notes, cheques, or other similar instruments used for obtaining the payment of money;
  - ii. “Commercial documents” means invoices, transport documents, documents of title or other similar documents, or any other documents whatsoever, not being financial documents.
- c. “Clean collection” means collection of financial documents not accompanied by commercial documents.
- d. “Documentary collection” means collection of:
  - i. Financial documents accompanied by commercial documents;
  - ii. Commercial documents not accompanied by financial documents.

#### Article 3

Parties to a Collection

- a. For the purposes of these Articles the “parties thereto” are:
  - i. the “principal” who is the party entrusting the handling of a collection to a bank;
  - ii. the “remitting bank” which is the bank to which the principal has entrusted the handling of a collection;
  - iii. the “collecting bank” which is any bank, other than the remitting bank, involved in processing the collection;
  - iv. the “presenting bank” which is the collecting bank making presentation to the drawee.
- b. The “drawee” is the one to whom presentation is to be made in accordance with the collection instruction.

### B FORM AND STRUCTURE OF COLLECTIONS

#### Article 4

Collection Instruction

- a.
  - i. All documents sent for collection must be accompanied by a collection instruction indicating that the collection is subject to URC 522 and giving complete and precise instructions. Banks are only permitted to act upon the instructions given in such collection instruction, and in accordance with these Rules.
  - ii. Banks will not examine documents in order to obtain instructions.
  - iii. Unless otherwise authorised in the collection instruction, banks will disregard any instructions from any party/bank other than the party/bank from whom they received the collection.
- b. A collection instruction should contain the following items of information, as appropriate.
  - i. Details of the bank from which the collection was received including full name, postal and SWIFT addresses, telex, telephone, facsimile numbers and reference.
  - ii. Details of the principal including full name, postal address, and, if applicable, telex, telephone and facsimile numbers.
  - iii. Details of the drawee including full name, postal address or the domicile at which presentation is to be made and, if applicable, telex, telephone and facsimile numbers.
  - iv. Details of the presenting bank, if any, including full name, postal address, and, if applicable, telex, telephone and facsimile numbers.
  - v. Amount(s) and currency(ies) to be collected.
  - vi. List of documents enclosed and the numerical count of each document.
  - vii.
    - a. Terms and conditions upon which payment and/or acceptance is to be obtained.
    - b. Terms of delivery of documents, against:
      - 1) payment and/or acceptance
      - 2) other terms and conditions

It is the responsibility of the party preparing the collection instruction to ensure that the terms for the delivery of documents are clearly and unambiguously stated, otherwise banks will not be responsible for any consequences arising therefrom.

- viii. Charges to be collected, indicating whether they may be waived or not.
- ix. Interest to be collected, if applicable, indicating whether it may be waived or not, including:
  - a. rate of interest
  - b. interest period
  - c. basis of calculation (for example 360 or 365 days in a year) as applicable
- x. Method of payment and form of payment advice.
- xi. Instructions in case of non-payment, non-acceptance and/or non-compliance with other instructions.
- c.
  - i. Collection instructions should bear the complete address of the drawee or of the domicile at which the presentation is to be made. If the address is incomplete or incorrect, the collecting bank may, without any liability and responsibility on its part, endeavor to ascertain the proper address.
  - ii. The collecting bank will not be liable or responsible for any ensuing delay as a result of an incomplete/incorrect address being provided.

## C FORM OF PRESENTATION

### Article 5

#### Presentation

- a. For the purposes of these Articles, presentation is the procedure whereby the presenting bank makes the documents available to the drawee as instructed.
- b. The collection instruction should state the exact period of time within which any action is to be taken by the drawee.

Expressions such as “first”, “prompt”, “immediate”, and the like should not be used in connection with presentation or with reference to any period of time within which documents have to be taken up or for any other action that is to be taken by the drawee. If such terms are used, banks will disregard them.

- c. Documents are to be presented to the drawee in the form in which they are received, except that banks are authorised to affix any necessary stamps at the expense of the party from whom they received the collection, unless otherwise instructed, and to make any necessary endorsements or place any rubber stamps or other identifying marks or symbols customary to or required for the collection operation.
- d. For the purpose of giving effect to the instructions of the principal, the remitting bank will utilise the bank nominated by the principal as the collecting bank. In the absence of such nomination, the remitting bank will utilise any bank of its own, or another bank’s, choice in the country of payment or acceptance or in the country where other terms and conditions have to be complied with.
- e. The documents and collection instruction may be sent directly by the remitting bank to the collecting bank or through another bank as intermediary.
- f. If the remitting bank does not nominate a specific presenting bank, the collecting bank may utilise a presenting bank of its choice.

### Article 6

#### Sight/Acceptance

In the case of documents payable at sight, the presenting bank must make presentation for payment without delay. In the case of documents payable at a tenor other than sight, the presenting bank must, where acceptance is called for, make presentation for acceptance without delay, and, where payment is called for, make presentation for payment not later than the appropriate maturity date.

### Article 7

#### Release of Commercial Documents

#### Documents Against Acceptance (D/A) vs. Documents Against Payment (D/P)

- a. Collections should not contain bills of exchange payable at a future date with instructions that commercial documents are to be delivered against payment.
- b. If a collection contains a bill of exchange payable at a future date, the collection instruction should state whether the commercial documents are to be released to the drawee against acceptance (D/A) or against payment (D/P).
- c. If a collection contains a bill of exchange payable at a future date and the collection instruction indicates that commercial documents are to be released against payment, documents will be released only against such payment and the collecting bank will not be responsible for any consequences arising out of any delay in the delivery of documents.

### Article 8

#### Creation of Documents

Where the remitting bank instructs that either the collecting bank or the drawee is to create documents (bills of exchange, promissory notes, trust receipts, letters of undertaking or other documents) that were not included in the collection, the form and wording of such documents shall be provided by the remitting bank, otherwise the collecting bank shall not be liable or responsible for the form and wording of any such document provided by the collecting bank and/or the drawee.

## D LIABILITIES AND RESPONSIBILITIES

### Article 9

#### Good Faith and Reasonable Care

Banks will act in good faith and exercise reasonable care.

### Article 10

#### Documents vs. Goods/Services/Performances

- a. Goods should not be despatched directly to the address of a bank or consigned to or to the order of a bank without prior agreement on the part of that bank.

Nevertheless, in the event that goods are despatched directly to the address of a bank or consigned to or to the order of a bank for release to a drawee against payment or acceptance or upon other terms and conditions without prior agreement on the part of that bank, such bank shall have no obligation to take delivery of the goods, which remain at the risk and responsibility of the party despatching the goods.

- b. Banks have no obligation to take any action in respect of the goods to which a documentary collection relates, including storage and insurance of the goods, even when specific instructions are given to do so. Banks will only take such action if, when, and to the extent that they agree to do so in each case. Notwithstanding the provisions of sub-Article 1(c), this rule applies even in the absence of any specific advice to this effect by the collecting bank.
- c. Nevertheless, in the case that banks take action for the protection of the goods, whether instructed or not, they assume no liability or responsibility with regard to the fate and/or condition of the goods and/or for any acts and/or omissions on the part of any third parties entrusted with the custody and/or protection of the goods. However, the collecting bank must advise without delay the bank from which the collection instruction was received of any such action taken.
- d. Any charges and/or expenses incurred by banks in connection with any action taken to protect the goods will be for the account of the party from whom they received the collection.
- e.
  - i. Notwithstanding the provisions of sub-Article 10(a), where the goods are consigned to or to the order of the collecting bank and the

drawee has honoured the collection by payment, acceptance or other terms and conditions, and the collecting bank arranges for the release of the goods, the remitting bank shall be deemed to have authorised the collecting bank to do so.

- ii. Where a collecting bank, on the instructions of the remitting bank or in terms of sub-Article 10(e)i, arranges for the release of the goods, the remitting bank shall indemnify such collecting bank for all damages and expenses incurred.

#### Article 11

##### Disclaimer for Acts of an Instructed Party

- a. Banks utilising the services of another bank or other banks for the purpose of giving effect to the instructions of the principal do so for the account and at the risk of such principal.
- b. Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s).
- c. A party instructing another party to perform services shall be bound by and liable to indemnify the instructed party against all obligations and responsibilities imposed by foreign laws and usages.

#### Article 12

##### Disclaimer on Documents Received

- a. Banks must determine that the documents received appear to be as listed in the collection instruction and must advise by telecommunication, or, if that is not possible, by other expeditious means, without delay, the party from whom the collection instruction was received of any documents missing or found to be other than listed.

Banks have no further obligation in this respect.

- b. If the documents do not appear to be listed, the remitting bank shall be precluded from disputing that type and number of documents received by the collecting bank.
- c. Subject to sub-Article 5(c) and sub-Articles 12(a) and 12(b) above, banks will present documents as received without further examination.

#### Article 13

##### Disclaimer on Effectiveness of Documents

Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s), or for the general and/or particular conditions stipulated in the document(s) or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any document(s), or for the good faith or acts and/or omissions, solvency, performance or standing of the consignors, the carriers, the forwarders, the consignees or the insurers of the goods, or any other person whomsoever.

#### Article 14

##### Disclaimer on Delays, Loss in Transit and Translation

- a. Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any message(s), letter(s), or document(s), or for delay, mutilation or other error(s) in translation and/or interpretation of technical terms.
- b. Banks will not be liable or responsible for any delays from the need to obtain clarification of any instructions received.

#### Article 15

##### Force Majeure

Banks assume no liability or responsibility for consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars, or any other causes beyond their control or by strikes or lockouts.

## E PAYMENT

#### Article 16

##### Payment without Delay

- a. Amounts collected (less charges and/or disbursements and/or expenses where applicable) must be made available without delay to the party from whom the collection instruction was received in accordance with the terms and conditions of the collection instruction.
- b. Notwithstanding the provisions of sub-Article 1(c) and unless otherwise agreed, the collecting bank will effect payment of the amount collected in favour of the remitting bank only.

#### Article 17

##### Payment in Local Currency

In the case of documents payable in the currency of the country of payment (local currency), the presenting bank must, unless otherwise instructed in the collection instruction, release the documents to the drawee against payment in local currency only if such currency is immediately available for disposal in the manner specified in the collection instruction.

#### Article 18

##### Payment in Foreign Currency

In the case of documents payable in a currency other than that of the country of payment (foreign currency), the presenting bank must, unless otherwise instructed in the collection instruction, release the documents to the drawee against payment in the designated foreign currency only if such foreign currency can immediately be remitted in accordance with the instructions given in the collection instruction.

#### Article 19

##### Partial Payments

- a. In respect of clean collections, partial payments may be accepted if and to the extent to which and on the conditions on which partial payments are authorised by the law in force in the place of payment. The financial document(s) will be released to the drawee only when full payment thereof has been received.
- b. In respect of documentary collections, partial payments will only be accepted if specifically authorised in the collection instruction. However, unless otherwise instructed, the presenting bank will release the documents to the drawee only after full payment has been received, and the presenting bank will not be responsible for any consequences arising out of any delay in the delivery of documents.
- c. In all cases partial payments will be accepted only subject to compliance with the provisions of either Article 17 or Article 18 as appropriate.

Partial payment, if accepted, will be dealt with in accordance with the provisions of Article 16.

## F INTEREST, CHARGES AND EXPENSES

#### Article 20

##### Interest

- a. If the collection instruction specifies that interest is to be collected and the drawee refuses to pay such interest, the presenting bank may deliver the document(s) against payment or acceptance or on other terms and conditions as the case may be, without collecting such interest, unless sub-Article 20(c) applies.
- b. Where such interest is to be collected, the collection instruction must specify the rate of interest, interest period and basis of calculation.
- c. Where the collection instruction expressly states that interest may not be waived and the drawee refuses to pay such interest, the presenting bank will not deliver documents and will not be responsible for any consequences arising out of any delay in the delivery of document(s).

When payment of interest has been refused, the presenting bank must inform by telecommunication, or, if that is not possible, by other expeditious means without delay the bank from which the collection instruction was received.

Article 21  
Charges and Expenses

- a. If the collection instruction specifies that collection charges and/or expenses are to be for account of the drawee and the drawee refuses to pay them, the presenting bank may deliver the document(s) against payment or acceptance or on other terms and conditions as the case may be, without collecting charges and/or expenses, unless sub-Article 21(b) applies.

Whenever collection charges and/or expenses are so waived they will be for the account of the party from whom the collection was received and may be deducted from the proceeds.

- b. Where the collection instruction expressly states that charges and/or expenses may not be waived and the drawee refuses to pay such charges and/or expenses, the presenting bank will not deliver documents and will not be responsible for any consequences arising out of any delay in the delivery of document(s). When payment of collection charges and/or expenses has been refused the presenting bank must inform by telecommunication or, if that is not possible, by other expeditious means without delay the bank from which the collection instruction was received.
- c. In all cases where in the express terms of a collection instruction or under these Rules, disbursements and/or expenses and/or collection charges are to be borne by the principal, the collecting bank(s) shall be entitled to recover promptly outlays in respect of disbursements, expenses and charges from the bank from which the collection instruction was received, and the remitting bank shall be entitled to recover promptly from the principal any amount so paid out by it, together with its own disbursements, expenses and charges, regardless of the fate of the collection.
- d. Banks reserve the right to demand payment of charges and/or expenses in advance from the party from whom the collection instruction was received, to cover costs in attempting to carry out any instructions, and pending receipt of such payment also reserve the right not to carry out such instructions.

**G OTHER PROVISIONS**

Article 22  
Acceptance

The presenting bank is responsible for seeing that the form of the acceptance of a bill of exchange appears to be complete and correct, but is not responsible for the genuineness of any signature or for the authority of any signatory to sign the acceptance.

Article 23  
Promissory Notes and Other Instruments

The presenting bank is not responsible for the genuineness of any signature or for the authority of any signatory to sign a promissory note, receipt, or other instruments.

Article 24  
Protest

The collection instruction should give specific instructions regarding protest (or other legal process in lieu thereof), in the event of non-payment or non-acceptance.

In the absence of such specific instructions, the banks concerned with the collection have no obligation to have the document(s) protested (or subjected to other legal process in lieu thereof) for non-payment or non-acceptance.

Any charges and/or expenses incurred by banks in connection with such protest, or other legal process, will be for the account of the party from whom the collection instruction was received.

Article 25  
Case-of-Need

If the principal nominates a representative to act as case-of-need in the event of non-payment and/or non-acceptance the collection instruction should clearly and fully indicate the powers of such case-of-need. In the absence of such indication banks will not accept any instructions from the case-of-need.

Article 26  
Advices

Collecting banks are to advise fate in accordance with the following rules:

- a. Form of Advice

All advices or information from the collecting bank to the bank from which the collection instruction was received must bear appropriate details including, in all cases, the latter bank's reference as stated in the collection instruction.

- b. Method of Advice

It shall be the responsibility of the remitting bank to instruct the collecting bank regarding the method by which the advices detailed in (c)i, (c)ii and (c)iii are to be given. In the absence of such instructions, the collecting bank will send the relative advices by the method of its choice at the expense of the bank from which the collection instruction was received.

- c. i. ADVICE OF PAYMENT

The collecting bank must send without delay advice of payment to the bank from which the collection instruction was received, detailing the amount or amounts collected, charges and/or disbursements and/or expenses deducted, where appropriate, and method of disposal of the funds.

- ii. ADVICE OF ACCEPTANCE

The collecting bank must send without delay advice of acceptance to the bank from which the collection instruction was received.

- iii. ADVICE OF NON-PAYMENT AND/OR NON-ACCEPTANCE

The presenting bank should endeavor to ascertain the reasons for non-payment and/or non-acceptance and advise accordingly, without delay, the bank from which it received the collection instruction.

The presenting bank must send without delay advice of non-payment and/or advice of non-acceptance to the bank from which it received the collection instruction.

On receipt of such advice the remitting bank must give appropriate instructions as to the further handling of the documents. If such instructions are not received by the presenting bank within 60 days after its advice of non-payment and/or non-acceptance, the documents may be returned to the bank from which the collection instruction was received without any further responsibility on the part of the presenting bank.

# UCP 500

Uniform Customs and Practice for Documentary Credits  
1993 Revision in force as of January 1, 1994

The Uniform Customs and Practice for Documentary Credits were first published by the ICC in 1933. Revised versions were issued in 1951, 1962, 1974 and 1983. This revision was adopted by the ICC Executive Board in April 1993 and first published as ICC Publication No. 500 in May 1993. This English language edition of Publication No. 500 gives the official text of the 1993 Revision.

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## A GENERAL PROVISIONS AND DEFINITIONS

### Article 1

Application of UCP

The Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500, shall apply to all Documentary Credits (including to the extent to which they may be applicable, Standby Letter(s) of Credit) where they are incorporated into the text of the Credit. They are binding on all parties thereto, unless otherwise expressly stipulated in the Credit.

### Article 2

Meaning of Credit

For the purposes of these Articles, the expressions “Documentary Credit(s)” and “Standby Letter(s) of Credit” (hereinafter referred to as “Credit(s)”, mean any arrangement, however named or described, whereby a bank (the “Issuing Bank”) acting at the request and on the instructions of a customer (the “Applicant”) or on its own behalf,

- i. is to make a payment to or to the order of a third party (the “Beneficiary”), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary, *or*
- ii. authorizes another bank to effect such payment, or to accept and pay such bills of exchange (Draft(s)), *or*
- iii. authorizes another bank to negotiate,

against stipulated document(s), provided that the terms and conditions of the Credit are complied with.

For the purpose of these Articles, branches of a bank in different countries are considered another bank.

### Article 3

Credits v. Contracts

- a. Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defenses by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary.
- b. A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank.

### Article 4

Documents v. Goods/Services/Performance

In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate.

### Article 5

Instructions to Issue/Amend Credits

- a. Instructions for the issuance of a Credit, the Credit itself, instructions for an amendment thereto, and the amendment itself, must be complete and precise.

In order to guard against confusion and misunderstanding, banks should discourage any attempt:

- i. to include excessive detail in the Credit or in any amendment thereto;
  - ii. to give instructions to issue, advise or confirm a Credit by reference to a Credit previously issued (similar Credit) where such previous Credit has been subject to accepted amendment(s), and/or unaccepted amendment(s).
- b. All instructions for the issuance of a Credit and the Credit itself and, where applicable, all instructions for an amendment thereto and the amendment itself, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.

## B FORM AND NOTIFICATION OF CREDITS

### Article 6

Revocable v. Irrevocable Credits

- a. A Credit may be either
  - i. revocable, *or*
  - ii. irrevocable
- b. The Credit, therefore, should clearly indicate whether it is revocable or irrevocable.
- c. In the absence of such indication the Credit shall be deemed to be irrevocable.

### Article 7

Advising Bank's Liability

- a. A Credit may be advised to a Beneficiary through another bank (the “Advising Bank”) without engagement on the part of the Advising Bank, but that bank, if it elects to advise the Credit, shall take reasonable care to check the apparent authenticity of the Credit which it advises. If the bank elects not to advise the Credit, it must so inform the Issuing Bank without delay.
- b. If the Advising Bank cannot establish such apparent authenticity it must inform, without delay, the bank from which the instructions appear to have been received that it has been unable to establish the authenticity of the Credit and if it elects nonetheless to advise the Credit it must inform the Beneficiary that it has not been able to establish the authenticity of the Credit.

### Article 8

Revocation of a Credit

- a. A revocable Credit may be amended or canceled by the Issuing Bank at any moment and without prior notice to the Beneficiary.
- b. However, the Issuing Bank must:
  - i. reimburse another bank with which a revocable Credit has been made available for sight payment, acceptance or negotiation - for any payment, acceptance or negotiation made by such bank - prior to receipt by it of notice of amendment or cancellation, against documents which appear on their face to be in compliance with the terms and conditions of the Credit;



- ii. reimburse another bank with which a revocable Credit has been made available for deferred payment, if such a bank has, prior to receipt by it of notice of amendment or cancellation, taken up documents which appear on their face to be in compliance with the terms and conditions of the Credit.

#### Article 9

##### Liability of Issuing and Confirming Banks

- a. An irrevocable Credit constitutes a definite undertaking of the Issuing Bank, provided that the stipulated documents are presented to the Nominated Bank or to the Issuing Bank and that the terms and conditions of the Credit are complied with:
  - i. if the Credit provides for sight payment - to pay at sight;
  - ii. if the Credit provides for deferred payment - to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;
  - iii. if the Credit provides for acceptance:
    - a. by the Issuing Bank - to accept Draft(s) drawn by the Beneficiary on the Issuing Bank and pay them at maturity, *or*
    - b. by another drawee bank - to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Issuing Bank in the event the drawee bank stipulated in the Credit does not accept Draft(s) drawn on it, or to pay Draft(s) accepted but not paid by drawee bank at maturity;
  - iv. if the Credit provides for negotiation - to pay without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit. A Credit should not be issued available by Draft(s) on the Applicant. If the Credit nevertheless calls for Draft(s) on the Applicant, banks will consider such Draft(s) as an additional document(s).
- b. A confirmation of an irrevocable Credit by another bank (the "Confirming Bank") upon the authorization or request of the Issuing Bank, constitutes a definite undertaking of the Confirming Bank, in addition to that of the Issuing Bank, provided that the stipulated documents are presented to the Confirming Bank or to any other Nominated Bank and that the terms and conditions of the Credit are complied with:
  - i. if the Credit provides for sight payment - to pay at sight;
  - ii. if the Credit provides for deferred payment - to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;
  - iii. if the Credit provides for acceptance:
    - a. by the Confirming Bank - to accept Draft(s) drawn by the Beneficiary on the Confirming Bank and pay them at maturity, *or*
    - b. by another drawee bank - to accept and pay at maturity Draft(s) drawn by the Beneficiary on the Confirming Bank, in the event the drawee bank stipulated in the Credit does not accept Draft(s) drawn on it, or to pay Draft(s) accepted but not paid by such drawee bank at maturity;
  - iv. if the Credit provides for negotiation - to negotiate without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit. A Credit should not be issued available by Draft(s) on the Applicant. If the Credit nevertheless calls for a Draft(s) on the Applicant, banks will consider such Draft(s) as an additional document(s).
- c.
  - i. If another bank is authorized or requested by the Issuing Bank to add its confirmation to a Credit but is not prepared to do so, it must so inform the Issuing Bank without delay.
  - ii. Unless the Issuing Bank specifies otherwise in its authorization or request to add confirmation, the Advising Bank may advise the Credit to the Beneficiary without adding to its confirmation.

- d.
  - i. Except as otherwise provided by Article 48, an irrevocable Credit can neither be amended nor canceled without the agreement of the Issuing Bank, the Confirming Bank, if any, and the Beneficiary.
  - ii. The Issuing Bank shall be irrevocably bound by an amendment(s) issued by it from the time of the issuance of such amendment(s). A Confirming Bank may extend its confirmation to an amendment and shall be irrevocably bound as of the time of its advice of the amendment. A Confirming Bank may, however, choose to advise an amendment to the Beneficiary without extending its confirmation and if so, must inform the Issuing Bank and the Beneficiary without delay.
  - iii. The terms of the original Credit (or a Credit incorporating previously accepted amendment(s)) will remain in force for the Beneficiary until the Beneficiary communicates his acceptance of the amendment to the bank that advised such amendment. The Beneficiary should give notification of acceptance or rejection of amendment(s). If the Beneficiary fails to give such notification, the tender of documents to the Nominated Bank or Issuing Bank, that conform to the Credit and to not yet accepted amendment(s), will be deemed to be notification of acceptance by the Beneficiary of such amendment(s) and as of that moment the Credit will be amended.
  - iv. Partial acceptance of amendments contained in one and the same advice of amendment is not allowed and consequently will not be given any effect.

#### Article 10

##### Types of Credit

- a. All Credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation.
- b.
  - i. Unless the Credit stipulates that it is available only with the Issuing Bank, all Credits must nominate the bank (the "Nominated Bank") which is authorized to pay, to incur a deferred payment undertaking, to accept Draft(s) or to negotiate. In a freely negotiable Credit, any bank is a Nominated Bank.  
  
Presentation of documents must be made to the Issuing Bank or the Confirming Bank, if any, or any Nominated Bank.
  - ii. Negotiation means the giving of value for Draft(s) and/or document(s) by the bank authorized to negotiate. Mere examination of the documents without giving of value does not constitute a negotiation.
- c. Unless the Nominated Bank is the Confirming Bank, nomination by the Issuing Bank does not constitute any undertaking by the Nominated Bank to pay, to incur a deferred payment undertaking, to accept Draft(s), or to negotiate. Except where expressly agreed to by the Nominated Bank and so communicated to the Beneficiary, the Nominated Bank's receipt and/or examination and/or forwarding of the documents does not make that bank liable to pay, to incur a deferred payment undertaking, to accept Draft(s), or to negotiate.
- d. By nominating another bank, or by allowing for negotiation by any bank, or by authorizing or requesting another bank to add its confirmation, the Issuing Bank authorizes such bank to pay, accept Draft(s) or negotiate as the case may be, against documents which appear on their face to be in compliance with the terms and conditions of the Credit and undertakes to reimburse such bank in accordance with the provisions of these Articles.

#### Article 11

##### Teletransmitted and Pre-Advised Credits

- a.
  - i. When an Issuing Bank instructs an Advising Bank by an authenticated teletransmission to advise a Credit or an amendment to a Credit, the teletransmission will be deemed to be the operative Credit instrument or the operative amendment, and no mail confirmation should be sent. Should a mail confirmation nevertheless be sent, it will have no effect and the Advising Bank will have no obligation to check such mail confirmation against the operative Credit instrument or the operative amendment received by the teletransmission.
  - ii. If the teletransmission states "full details to follow" (or words of similar effect) or states that the mail confirmation is to be the

operative Credit instrument or the operative amendment, then the teletransmission will not be deemed to be the operative Credit instrument or the operative amendment. The Issuing Bank must forward the operative Credit instrument or the operative amendment to such Advising Bank without delay.

- b. If a bank uses the services of an Advising Bank to have the Credit advised to the Beneficiary, it must also use the services of the same bank for advising any amendment(s).
- c. A preliminary advice of the issuance or amendment of an irrevocable Credit (pre-advice), shall only be given by an Issuing Bank if such bank is prepared to issue the operative Credit instrument or the operative amendment thereto. Unless otherwise stated in such preliminary advice by the Issuing Bank, an Issuing Bank having given such pre-advice shall be irrevocably committed to issue or amend the Credit, in terms not inconsistent with the pre-advice, without delay.

#### Article 12

##### Incomplete or Unclear Instructions

If incomplete or unclear instructions are received to advise, confirm or amend a Credit, the bank requested to act on such instructions may give preliminary notification to the Beneficiary for information only and without responsibility. This preliminary notification should state clearly that the notification is provided for information only and without the responsibility of the Advising Bank. In any event, the Advising Bank must inform the Issuing Bank of the action taken and request it to provide the necessary information.

The Issuing Bank must provide the necessary information without delay. The Credit will be advised, confirmed or amended, only when complete and clear instructions have been received and if the Advising Bank is then prepared to act on the instructions.

## C LIABILITIES AND RESPONSIBILITIES

#### Article 13

##### Standard for Examination of Documents

- a. Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the Credit.

Documents not stipulated in the Credit will not be examined by banks. If they receive such documents, they shall return them to the presenter or pass them on without responsibility.

- b. The Issuing Bank, the Confirming Bank, if any, or a Nominated Bank acting on their behalf, shall each have a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.
- c. If a Credit contains conditions without stating the document(s) to be presented in compliance therewith, banks will deem such conditions as not stated and will disregard them.

#### Article 14

##### Discrepant Documents and Notice

- a. When the Issuing Bank authorizes another bank to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate against documents which appear on their face to be in compliance with the terms and conditions of the Credit, the Issuing Bank and the Confirming Bank, if any, are bound:
  - i. to reimburse the Nominated Bank which has paid, incurred a deferred payment undertaking, accepted Draft(s), or negotiated,
  - ii. to take up the documents.

- b. Upon receipt of the documents the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit. If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, such banks may refuse to take up the documents.
- c. If the Issuing Bank determines that the documents appear on their face not to be in compliance with the terms and conditions of the Credit, it may in its sole judgment approach the Applicant for a waiver of the discrepancy(ies). This does not, however, extend the period in sub-Article 13(b).
- d.
  - i. If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the Beneficiary, if it received the documents directly from him.
  - ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.
  - iii. The Issuing Bank and/or Confirming Bank, if any, shall then be entitled to claim from the remitting bank refund, with interest, of any reimbursement which has been made to that bank.
- e. If the Issuing Bank and/or Confirming Bank, if any, fails to act in accordance with the provisions of this Article and/or fails to hold the documents at the disposal of, or return them to the presenter, the Issuing Bank and/or Confirming Bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit.
- f. If the remitting bank draws the attention of the Issuing Bank and/or Confirming Bank, if any, to any discrepancy(ies) in the document(s) or advises such banks that it has paid, incurred a deferred payment undertaking, accepted Draft(s) or negotiated under reserve or against an indemnity in respect of such discrepancy(ies), the Issuing Bank and/or Confirming Bank, if any, shall not be thereby relieved from any of their obligations under any provision of this Article. Such reserve or indemnity concerns only the relations between the remitting bank and the party towards whom the reserve was made, or from whom, or on whose behalf, the indemnity was obtained.

#### Article 15

##### Disclaimer on Effectiveness of Documents

Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document(s), or for the general and/or particular conditions stipulated in the document(s) or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any document(s), or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers, the forwarders, the consignees or the insurers of the goods, or any other person whomsoever.

#### Article 16

##### Disclaimer on the Transmission of Messages

Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any message(s), letter(s) or document(s), or for delay, mutilation or other error(s) arising in the transmission of any telecommunication. Banks assume no liability or responsibility for errors in translation and/or interpretation of technical terms, and reserve the right to transmit Credit terms without translating them.

#### Article 17

##### Force Majeure

Banks assume no liability or responsibility for the consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or other causes beyond their control, or by any strikes or lockouts. Unless specifically authorized, banks will not, upon resumption of

their business, pay, incur a deferred payment undertaking, accept Draft(s) or negotiate under Credits which expired during such interruption of their business.

#### Article 18

##### Disclaimer for Acts of an Instructed Party

- a. Banks utilizing the services of another bank or other banks for the purpose of giving effect to the instructions of the Applicant do so for the account and at the risk of such Applicant.
- b. Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s).
- c.
  - i. A party instructing another party to perform services is liable for any charges, including commissions, fees, costs or expenses incurred by the instructed party in connection with its instructions.
  - ii. Where a Credit stipulates that such charges are for the account of a party other than the instructing party, and charges cannot be collected, the instructing party remains ultimately liable for the payment thereof.
- d. The Applicant shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

#### Article 19

##### Bank-to-Bank Reimbursement Arrangements

- a. If an Issuing Bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled, shall be obtained by such bank (the "Claiming Bank"), claiming on another party (the "Reimbursing Bank"), it shall provide such Reimbursing Bank in good time with the proper instructions or authorization to honor such reimbursement claims.
- b. Issuing Banks shall not require a Claiming Bank to supply a certificate of compliance with the terms and conditions of the Credit to the Reimbursing Bank.
- c. An Issuing Bank shall not be relieved from any of its obligations to provide reimbursement if and when reimbursement is not received by the Claiming Bank from the Reimbursing Bank.
- d. The Issuing Bank shall be responsible to the Claiming Bank for any loss of interest if reimbursement is not provided by the Reimbursing Bank on first demand, or as otherwise specified in the Credit, or mutually agreed, as the case may be.
- e. The Reimbursing Bank's charges should be for the account of the Issuing Bank. However, in cases where the charges are for the account of another party, it is the responsibility of the Issuing Bank to so indicate in the original Credit and in the reimbursement authorization. In cases where the Reimbursing Bank's charges are for the account of another party they shall be collected from the Claiming Bank when the Credit is drawn under. In cases where the Credit is not drawn under, the Reimbursing Bank's charges remain the obligation of the Issuing Bank.

## D DOCUMENTS

#### Article 20

##### Ambiguity as to the Issuers of Documents

- a. Terms such as "first class", "well known", "qualified", "independent", "official", "competent", "local", and the like, shall not be used to describe the issuers of any document(s) to be presented under a Credit. If such terms are incorporated in the Credit, banks will accept the relative document(s) as presented, provided that it appears on its face to be in compliance with the other terms and conditions of the Credit and not to have been issued by the Beneficiary.
- b. Unless otherwise stipulated in the Credit, banks will also accept as an original document(s), a document(s) produced or appearing to have been produced:
  - i. by reprographic, automated or computerized systems;
  - ii. as carbon copies;

provided that it is marked as original and, where necessary appears to be signed.

A document may be signed by handwriting, by facsimile signature, by perforated signature, by stamp, by symbol, or by any other mechanical or electronic method of authentication.

- c.
  - i. Unless otherwise stipulated in the Credit, banks will accept as a copy(ies), a document(s) either labeled copy or not marked as an original - a copy(ies) need not be signed.
  - ii. Credits that require multiple document(s) such a "duplicate", "two fold", "two copies", and the like, will be satisfied by the presentation of one original and the remaining number in copies except where the document itself indicates otherwise.
- d. Unless otherwise stipulated in the Credit, a condition under a Credit calling for a document to be authenticated, validated, legalised, visaed, certified or indicating a similar requirement, will be satisfied by any signature, mark, stamp, or label on such document that on its face appears to satisfy the above condition.

#### Article 21

##### Unspecified Issuers or Contents of Documents

When documents other than transport documents, insurance documents and commercial invoices are called for, the Credit should stipulate by whom such documents are to be issued and their wording or data content. If the Credit does not so stipulate, banks will accept such documents as presented, provided that their data content is not inconsistent with any other stipulated document presented.

#### Article 22

##### Issuance Date of Documents v. Credit Date

Unless otherwise stipulated in the Credit, banks will accept a document bearing a date of issuance prior to that of the Credit, subject to such document being presented within the time limits set out in the Credit and in these Articles.

#### Article 23

##### Marine/Ocean Bill of Lading

- a. If a Credit calls for a bill of lading covering a port-to-port shipment, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:
  - i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:
    - the carrier or a named agent for or on behalf of the carrier, or
    - the master or named agent for or on behalf of the master.
  - ii. indicates that the goods have been loaded on board, or shipped on a named vessel.

Any signature or authentication of the carrier or master must be identified as carrier or master, as the case may be. An agent signing or authenticating for the carrier or master must also indicate the name and the capacity of the party, i.e. carrier or master, on whose behalf that agent is acting, *and*

Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the bill of lading that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the bill of lading will be deemed to be the date of loading on board and the date of shipment.

In all other cases loading on board a named vessel must be evidenced by a notation on the bill of lading which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment.

If the bill of lading contains the indication "intended vessel", or similar qualification in relation to the vessel, loading on board a named vessel must be evidenced by an on board notation on the bill of lading which, in addition to the date on which the goods have been loaded on board, also includes the name of the vessel on

which the goods have been loaded, even if they have been loaded on the vessel named as the “intended vessel”.

If the bill of lading indicates a place of receipt or taking in charge different from the port of loading, the on board notation must also include the port of loading stipulated in the Credit and the name of the vessel on which the goods have been loaded, even if they have been loaded on the vessel named in the bill of lading. This provision also applies whenever loading on board the vessel is indicated by pre-printed wording on the bill of lading, *and*

- iii. indicates the port of loading and the port of discharge stipulated in the Credit, notwithstanding that it:
  - a. indicates a place of taking in charge different from the port of loading, and/or a place of final destination different from the port of discharge, *and/or*
  - b. contains the indication “intended” or similar qualification in relation to the port of loading and/or port of discharge, as long as the document also states the ports of loading and/or discharge stipulated in the Credit,

*and*

- iv. consists of a sole original bill of lading or, if issued in more than one original, the full set as so issued, *and*
  - v. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the bill of lading (short form/blank back bill of lading); banks will not examine the contents of such terms and conditions, *and*
  - vi. contains no indication that it is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only, *and*
  - vii. in all other respects meets the stipulations of the Credit.
- b. For the purpose of this Article, transshipment means unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge stipulated in the Credit.
  - c. Unless transshipment is prohibited by the terms of the Credit, banks will accept a bill of lading which indicates that the goods will be transhipped, provided that the entire ocean carriage is covered by one and the same bill of lading.
  - d. Even if the Credit prohibits transshipment, banks will accept a bill of lading which:
    - i. indicates that transshipment will take place as long as the relevant cargo is shipped in Container(s), Trailer(s), and/or “LASH” barge(s) as evidenced by the bill of lading, provided that the entire ocean carriage is covered by one and the same bill of lading, *and/or*
    - ii. incorporates clauses stating that the carrier reserves the right to tranship.

#### Article 24

##### Non-Negotiable Sea Waybill

- a. If a Credit calls for a non-negotiable sea waybill covering a port-to-port shipment, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:

- i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:
  - the carrier or a named agent for or on behalf of the carrier, or
  - the master or a named agent for or on behalf of the master,

Any signature or authentication of the carrier or master must be identified as carrier or master, as the case may be. An agent signing or authenticating for the carrier or master must also indicate the name and the capacity of the party, i.e. carrier or master, on whose behalf that agent is acting, *and*

- ii. indicates that the goods have been loaded on board, or shipped on a named vessel.

Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the non-negotiable sea waybill that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the non-negotiable sea waybill will be deemed to be the date of loading on board and the date of shipment.

In all other cases loading on board a named vessel must be evidenced by a notation on the non-negotiable sea waybill which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment.

If the non-negotiable sea waybill contains the indication “intended vessel”, or similar qualification in relation to the vessel, loading on board a named vessel must be evidenced by an on board notation on the non-negotiable sea waybill, which in addition to the date on which the goods have been loaded on board, includes the name of the vessel on which the goods have been loaded, even if they have been loaded on the vessel named as the “intended vessel”.

If the non-negotiable sea waybill indicates a place of receipt or taking in charge different from the port of loading, the on board notation must also include the port of loading stipulated in the Credit and the name of the vessel on which the goods have been loaded, even if they have been loaded on a vessel named in the non-negotiable sea waybill. This provision also applies whenever loading on board the vessel is indicated by pre-printed wording on the non-negotiable sea waybill, *and*

- iii. indicates the port of loading and the port of discharge stipulated in the Credit, notwithstanding that it:
  - a. indicates a place of taking in charge different from the port of loading, and/or a place of final destination different from the port of discharge, *and/or*
  - b. contains the indication “intended” or similar qualification in relation to the port of loading and/or port of discharge, as long as the document also states the ports of loading and/or discharge stipulated in the Credit,

*and*

- iv. consists of a sole original non-negotiable sea waybill, or if issued in more than one original, the full set as so issued, *and*
- v. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the non-negotiable sea waybill (short form/blank back non-negotiable sea waybill); banks will not examine the contents of such terms and conditions, *and*
- vi. contains no indication that is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only, *and*
- vii. in all other respects meets the stipulations of the Credit.

- b. For the purpose of this Article, transshipment means unloading and reloading from one vessel to another vessel during the course of ocean carriage from the port of loading to the port of discharge stipulated in the Credit.
- c. Unless transshipment is prohibited by the terms of the Credit, banks will accept a non-negotiable sea waybill which indicates that the goods will be transhipped, provided that the entire ocean carriage is covered by one and the same non-negotiable sea waybill.
- d. Even if the Credit prohibits transshipment, banks will accept a non-negotiable sea waybill which:
  - i. indicates that transshipment will take place as long as the relevant cargo is shipped in Container(s), Trailer(s), and/or "LASH" barge(s) as evidenced by the non-negotiable sea waybill, provided that the entire ocean carriage is covered by one and the same non-negotiable sea waybill, *and/or*
  - ii. incorporates clauses stating that the carrier reserves the right to tranship.

#### Article 25

##### Charter Party Bill of Lading

- a. If a Credit calls for or permits a charter party bill of lading, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:
  - i. contains any indication that it is subject to a charter party, *and*
  - ii. appears on its face to have been signed or otherwise authenticated by:
    - the master or a named agent for or on behalf of the master, or
    - the owner or a named agent for or on behalf of the owner.

Any signature or authentication of the master or owner must be identified as master or owner as the case may be. An agent signing or authenticating for the master or owner must also indicate the name and the capacity of the party, i.e. master or owner, on whose behalf that agent is acting, *and*
  - iii. does or does not indicate the name of the carrier, *and*
  - iv. indicates that the goods have been loaded on board or shipped on a named vessel.
 

Loading on board or shipment on a named vessel may be indicated by pre-printed wording on the bill of lading that the goods have been loaded on board a named vessel or shipped on a named vessel, in which case the date of issuance of the bill of lading will be deemed to be the date of loading on board and the date of shipment.

In all other cases loading on board a named vessel must be evidenced by a notation on the bill of lading which gives the date on which the goods have been loaded on board, in which case the date of the on board notation will be deemed to be the date of shipment, *and*
  - v. indicates the port of loading and the port of discharge stipulated in the Credit, *and*
  - vi. consists of a sole original bill of lading or, if issued in more than one original, the full set as so issued, *and*
  - vii. contains no indication that the carrying vessel is propelled by sail only, *and*
  - viii. in all other respects meets the stipulations of the Credit.
- b. Even if the Credit requires the presentation of a charter party contract in connection with a charter party bill of lading, banks will not examine such charter party contract, but will pass it on without responsibility on their part.

#### Article 26

##### Multimodal Transport Document

- a. If a Credit calls for a transport document covering at least two different modes of transport (multimodal transport), banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:
  - i. appears on its face to indicate the name of the carrier or multimodal transport operator and to have been signed or otherwise authenticated by:
    - the carrier or multimodal transport operator or a named agent for or on behalf of the carrier or multimodal transport operator, or
    - the master or a named agent for or on behalf of the master.

Any signature or authentication of the carrier, multimodal transport operator or master must be identified as carrier, multimodal transport operator or master, as the case may be. An agent signing or authenticating for the carrier, multimodal transport operator or master must also indicate the name and the capacity of the party, i.e. carrier, multimodal transport operator or master, on whose behalf that agent is acting, *and*
  - ii. indicates that the goods have been dispatched, taken in charge or loaded on board.

Dispatch, taking in charge or loading on board may be indicated by wording to that effect on the multimodal transport document and the date of issuance will be deemed to be the date of dispatch, taking in charge or loading on board and the date of shipment. However, if the document indicates, by stamp or otherwise, a date of dispatch, taking in charge or loading on board, such date will be deemed to be the date of shipment, *and*

- iii.
    - a. indicates the place of taking in charge stipulated in the Credit which may be different from the port, airport or place of loading, and the place of final destination stipulated in the Credit which may be different from the port, airport or place of discharge, *and/or*
    - b. contains the indication "intended" or similar qualification in relation to the vessel and/or port of loading and/or port of discharge,

*and*
  - iv. consists of a sole original multimodal transport document or, if issued in more than one original, the full set as so issued, *and*
  - v. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the multimodal transport document (short form/blank back multimodal transport document); banks will not examine the contents of such terms and conditions, *and*
  - vi. contains no indication that it is subject to a charter party and/or no indication that the carrying vessel is propelled by sail only, *and*
  - vii. in all other respects meets the stipulations of the Credit.
- b. Even if the Credit prohibits transshipment, banks will accept a multimodal transport document which indicates that transshipment will or may take place, provided that the entire carriage is covered by one and the same multimodal transport document.

#### Article 27

##### Air Transport Document

- a. If a Credit calls for an air transport document, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:
  - i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by:
    - the carrier, or
    - a named agent for or on behalf of the carrier.

Any signature or authentication of the carrier must be identified as carrier. An agent signing or authenticating for the carrier must also indicate the name and the capacity of the party, i.e. carrier, on whose behalf that agent is acting, *and*

- ii. indicates that the goods have been accepted for carriage, *and*
- iii. where the Credit calls for an actual date of dispatch, indicates a specific notation of such date, the date of dispatch so indicated on the air transport document will be deemed to be the date of shipment.

For the purpose of this Article, the information appearing in the box on the air transport document (marked "For Carrier Use Only" or similar expression) relative to the flight number and date will not be considered as a specific notation of such date of dispatch.

In all other cases, the date of issuance of the air transport document will be deemed to be the date of shipment, *and*

- iv. indicates the airport of departure and the airport of destination stipulated in the Credit, *and*
  - v. appears to be the original for consignor/shipper even if the Credit stipulates a full set of originals, or similar expressions, *and*
  - vi. appears to contain all of the terms and conditions of carriage, or some of such terms and conditions, by reference to a source or document other than the air transport document; and banks will not examine the contents of such terms and conditions, *and*
  - vii. in all other respects meets the stipulations of the Credit.
- b. For the purpose of this Article, transshipment means unloading and reloading from one aircraft to another aircraft during the course of the carriage from the airport of departure to the airport of destination stipulated in the Credit.
- c. Even if the Credit prohibits transshipment, banks will accept an air transport document which indicates that transshipment will or may take place, provided that the entire carriage is covered by one and the same air transport document.

#### Article 28

##### Road, Rail or Inland Waterway Transport Documents

- a. If a Credit calls for a road, rail, or inland waterway transport document, banks will, unless otherwise stipulated in the Credit, accept a document of the type called for, however named, which:
- i. appears on its face to indicate the name of the carrier and to have been signed or otherwise authenticated by the carrier or named agent for or on behalf of the carrier and/or to bear a reception stamp or other indication of receipt by the carrier or a named agent for or on behalf of the carrier.

Any signature, authentication, reception stamp or other indication of receipt of the carrier, must be identified on its face as that of the carrier. An agent signing or authenticating for the carrier, must also indicate the name and the capacity of the party, i.e. carrier, on whose behalf that agent is acting, *and*

- ii. indicates that the goods have been received for shipment, dispatch or carriage or wording to this effect. The date of issuance will be deemed to be the date of shipment unless the transport document contains a reception stamp, in which case the date of the reception stamp will be deemed to be the date of shipment, *and*
  - iii. indicates the place of shipment and the place of destination stipulated in the Credit, *and*
  - iv. in all other respects meets the stipulations of the Credit.
- b. In the absence of any indication on the transport document as to the numbers issued, banks will accept the transport document(s) presented as constituting a full set. Banks will accept as original(s) the transport document(s) whether marked as original(s) or not.

- c. For the purpose of this Article, transshipment means unloading and reloading from one means of conveyance to another means of conveyance, in different modes of transport, during the course of carriage from the place of shipment to the place of destination stipulated in the Credit.
- d. Even if the Credit prohibits transshipment, banks will accept a road, rail, or inland waterway transport document which indicates that transshipment will or may take place, provided that the entire carriage is covered by one and the same transport document and within the same mode of transport.

#### Article 29

##### Courier and Post Receipts

- a. If the Credit calls for a post receipt or certificate of posting, banks will, unless otherwise stipulated in the Credit, accept a post receipt or certificate of posting which:
- i. appears on its face to have been stamped or otherwise authenticated and dated in the place from which the Credit stipulates the goods are to be shipped or dispatched and such date will be deemed to be the date of shipment or dispatch, *and*
  - ii. in all other respects meets the stipulations of the Credit.
- b. If the Credit calls for a document issued by a courier or expedited delivery service evidencing receipt of the goods for delivery, banks will, unless otherwise stipulated in the Credit, accept a document, however named, which:
- i. appears on its face to indicate the name of the courier/service, and to have been stamped, signed or otherwise authenticated by such named courier/service (unless the Credit specifically calls for a document issued by a named Courier/Service, banks will accept a document issued by any Courier/Service), *and*
  - ii. indicates a date of pick-up or receipt or wording to this effect, such date being deemed to be the date of shipment or dispatch, *and*
  - iii. in all other respects meets the stipulations of the Credit.

#### Article 30

##### Transport Documents issued by Freight Forwarders

Unless otherwise authorized in the Credit, banks will only accept a transport document issued by a freight forwarder if it appears on its face to indicate:

- i. the name of the freight forwarder as a carrier or multimodal transport operator and to have been signed or otherwise authenticated by the freight forwarder as carrier or multimodal transport operator, *or*
- ii. the name of the carrier or multimodal transport operator and to have been signed or otherwise authenticated by the freight forwarder as a named agent for or on behalf of the carrier or multimodal transport operator.

#### Article 31

##### "On Deck", "Shipper's Load and Count", Name of Consignor

Unless otherwise stipulated in the Credit, banks will accept a transport document which:

- i. does not indicate, in the case of carriage by sea or by more than one means of conveyance including carriage by sea, that the goods are or will be loaded on deck. Nevertheless, banks will accept a transport document which contains a provision that the goods may be carried on deck, provided that it does not specifically state that they are or will be loaded on deck, *and/or*
- ii. bears a clause on the face thereof such as "shipper's load and count" or "said by shipper to contain" or words of similar effect, *and/or*
- iii. indicates as the consignor of the goods a party other than the Beneficiary of the Credit.

#### Article 32

##### Clean Transport Documents

- a. A clean transport document is one which bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging.
- b. Banks will not accept transport documents bearing such clauses or notations unless the Credit expressly stipulates the clauses or notations which may be accepted.
- c. Banks will regard a requirement in a Credit for a transport document to bear the clause "clean on board" as complied with if such transport document meets the requirements of this Article and of Articles 23, 24, 25, 26, 27, 28 or 30.

#### Article 33

##### Freight Payable/Prepaid Transport Documents

- a. Unless otherwise stipulated in the Credit, or inconsistent with any of the documents presented under the Credit, banks will accept transport documents stating that freight or transportation charges (hereafter referred to as the "freight") have still to be paid.
- b. If a Credit stipulates that the transport document has to indicate that the freight has been paid or prepaid, banks will accept a transport document on which words clearly indicating payment or prepayment of freight appear by stamp or otherwise, or on which payment or prepayment of freight is indicated by other means. If the Credit requires courier charges to be paid or prepaid banks will also accept a transport document issued by a courier or expedited delivery service evidencing that courier charges are for the account of a party other than the consignee.
- c. The words "freight prepayable" or "freight to be prepaid" or words of similar effect, if appearing on transport documents, will not be accepted as constituting evidence of the payment of freight.
- d. Banks will accept transport documents bearing reference by stamp or otherwise to costs additional to the freight, such as costs of, or disbursements incurred in connection with, loading, unloading or similar operations, unless the conditions of the Credit specifically prohibit such reference.

#### Article 34

##### Insurance Documents

- a. Insurance documents must appear on their face to be issued and signed by insurance companies or underwriters or their agents.
- b. If the insurance document indicates that it has been issued in more than one original, all the originals must be presented unless otherwise authorized in the Credit.
- c. Cover notes issued by brokers will not be accepted, unless specifically authorized in the Credit.
- d. Unless otherwise stipulated in the Credit, banks will accept an insurance certificate or a declaration under an open cover pre-signed by insurance companies or underwriters or their agents. If a Credit specifically calls for an insurance certificate or a declaration under an open cover, banks will accept, in lieu thereof, an insurance policy.
- e. Unless otherwise stipulated in the Credit, or unless it appears from the insurance document that the cover is effective at the latest from the date of loading on board or dispatch or taking in charge of the goods, banks will not accept an insurance document which bears a date of issuance later than the date of loading on board or dispatch or taking in charge as indicated in such transport document.
- f.
  - i. Unless otherwise stipulated in the Credit, the insurance document must be expressed in the same currency as the Credit.
  - ii. Unless otherwise stipulated in the Credit, the minimum amount for which the insurance document must indicate the insurance cover to have been effected is the CIF (cost, insurance and freight (... "named port of destination")) or CIP (carriage and insurance paid to (... "named place of destination")) value of the goods, as the case may be, plus 10%, but only when the CIF or CIP value can be determined from the documents on their face. Otherwise banks will

accept as such minimum amount 110% of the amount for which payment, acceptance or negotiation is requested under the Credit, or 110% of the gross amount of the invoice, whichever is the greater.

#### Article 35

##### Type of Insurance Cover

- a. Credits should stipulate the type of insurance required and, if any, the additional risks which are to be covered. Imprecise terms such as "usual risks" or "customary risks" shall not be used; if they are used, banks will accept insurance documents as presented, without responsibility for any risks not being covered.
- b. Failing specific stipulations the Credit, banks will accept insurance documents as presented, without responsibility for any risks not being covered.
- c. Unless otherwise stipulated in the Credit, banks will accept an insurance document which indicates that the cover is subject to a franchise or an excess (deductible).

#### Article 36

##### All Risk Insurance Cover

Where a Credit stipulates "insurance against all risks", banks will accept an insurance document which contains any "all risks" notation or clause, whether or not bearing the heading "all risks", even if the insurance document indicates that certain risks are excluded, without responsibility for any risk(s) not being covered.

#### Article 37

##### Commercial Invoices

- a. Unless other stipulated in the Credit, commercial invoices;
  - i. must appear on their face to be issued by the Beneficiary named in the Credit (except as provided in Article 48), *and*
  - ii. must be made out in the name of the Applicant (except as provided in sub-Article 48(h)), *and*
  - iii. need not be signed.
- b. Unless otherwise stipulated in the Credit, banks may refuse commercial invoices issued for amounts in excess of the amount permitted by the Credit. Nevertheless, if a bank authorized to pay, incur a deferred payment undertaking, accept Draft(s), or negotiate under a Credit accepts such invoices, its decision will be binding upon all parties, provided that such bank has not paid, incurred a deferred payment undertaking, accepted Draft(s) or negotiated for an amount in excess of that permitted by the Credit.
- c. The description of the goods in the commercial invoice must correspond with the description in the Credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the Credit.

#### Article 38

##### Other Documents

If a Credit calls for an attestation of certification of weight in the case of transport other than by sea, banks will accept a weight stamp or declaration of weight which appears to have been superimposed on the transport document by the carrier or his agent unless the Credit specifically stipulates that the attestation or certification of weight must be by means of a separate document.

## E MISCELLANEOUS PROVISIONS

#### Article 39

##### Allowances in Credit Amount, Quantity and Unit Price

- a. The words "about", "approximately", "circa" or similar expressions used in connection with the amount of the Credit or the quantity or the unit price stated in the Credit are to be construed as allowing a difference not to exceed 10% more or 10% less than the amount or the quantity or the unit price to which they refer.

- b. Unless a Credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 5% more or 5% less will be permissible, always provided that the amount of the drawings does not exceed the amount of the Credit. This tolerance does not apply when the Credit stipulates the quantity in terms of a stated number of packing units or individual items.
- c. Unless a Credit which prohibits partial shipments stipulates otherwise, or unless sub-Article (b) above is applicable, a tolerance of 5% less in the amount of the drawing will be permissible, provided that if the Credit stipulates the quantity of the goods, such quantity of goods is shipped in full, and if the Credit stipulates a unit price, such price is not reduced. This provision does not apply when expressions referred to in sub-Article (a) above are used in the Credit.

#### Article 40

##### Partial Shipments/Drawings

- a. Partial drawings and/or shipments are allowed, unless the Credit stipulates otherwise.
- b. Transport documents which appear on their face to indicate that shipment has been made on the same means of conveyance and the for same journey, provided they indicate the same destination, will not be regarded as covering partial shipments, even if the transport documents indicate different dates of shipment and/or different ports of loading, places of taking in charge, or dispatch.
- c. Shipments made by post or by courier will not be regarded as partial shipments if the post receipts or certificates of posting or courier's receipts or dispatch notes appear to have been stamped, signed or otherwise authenticated in the place from which the Credit stipulates the goods are to be dispatched, and on the same date.

#### Article 41

##### Instalment Shipments/Drawings

If drawings and/or shipments by instalments within given periods are stipulated in the Credit and any instalment is not drawn and/or shipped within the period allowed for that instalment, the Credit ceases to be available for that and any subsequent instalments, unless otherwise stipulated in the Credit.

#### Article 42

##### Expiry Date and Place for Presentation of Documents

- a. All Credits must stipulate an expiry date and a place for presentation of documents for payment, acceptance, or with the exception of freely negotiable Credits, a place for presentation of documents for negotiation. An expiry date stipulated for payment, acceptance or negotiation will be construed to express an expiry date for presentation of documents.
- b. Except as provided in sub-Article 44(a), documents must be presented on or before such expiry date.
- c. If an Issuing Bank states that the Credit is to be available "for one month", "for six months", or the like, but does not specify the date from which the time is to run, the date of issuance of the Credit by the Issuing Bank will be deemed to be the first day from which time is to run. Banks should discourage indication of the expiry date of the Credit in this manner.

#### Article 43

##### Limitation on the Expiry Date

- a. In addition to stipulating an expiry date for presentation of documents, every Credit which calls for a transport document(s) should also stipulate a specified period of time after the date of shipment during which presentation must be made in compliance with the terms and conditions of the Credit. If no such period of time is stipulated, banks will not accept documents presented to them later than 21 days after the date of shipment. In any event, documents must be presented not later than the expiry date of the Credit.
- b. In cases in which sub-Article 40(b) applies, the date of shipment will be considered to be the latest shipment date on any of the transport documents presented.

#### Article 44

##### Extension of Expiry Date

- a. If the expiry date of the Credit and/or the last day of the period of time for presentation of documents stipulated by the Credit or applicable by virtue of Article 43 falls on a day on which the bank to which presentation has to be made is closed for reasons other than those referred to in Article 17, the stipulated expiry date and/or the last day of the period of time after the date of shipment for presentation of documents, as the case may be, shall be extended to the first following day on which such bank is open.
- b. The latest date for shipment shall not be extended by reason of the extension of the expiry date and/or the period of time after the date of shipment for presentation of documents in accordance with sub-Article(a) above. If no such latest date for shipment is stipulated in the Credit or amendments thereto, banks will not accept transport documents indicating a date of shipment later than the expiry date stipulated in the Credit or amendments thereto.
- c. The bank to which presentation is made on such first following business day must provide a statement that the documents were presented within the time limits extended in accordance with sub-Article 44(a) of the Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500.

#### Article 45

##### Hours of Presentation

Banks are under no obligation to accept presentation of documents outside their banking hours.

#### Article 46

##### General Expressions as to Dates for Shipment

- a. Unless otherwise stipulated in the Credit, the expression "shipment" used in stipulating an earliest and/or a latest date for shipment will be understood to include the expressions such as "loading on board", "dispatch", "accepted for carriage", "date of post receipt", "date of pick-up", and the like, and in the case of a Credit calling for a multimodal transport document the expression "taking in charge".
- b. Expressions such as "prompt", "immediately", "as soon as possible", and the like should not be used. If they are used banks will disregard them.
- c. If the expression "on or about" and similar expressions are used, banks will interpret them as a stipulation that shipment is to be made during the period from five days before to five days after the specified date, both end days included.

#### Article 47

##### Date Terminology for Periods of Shipment

- a. The words "to", "until", "till", "from" and words of similar import applying to any date or period in the Credit referring to shipment will be understood to include the date mentioned.
- b. The word "after" will be understood to exclude the date mentioned.
- c. The terms "first half", "second half" of a month shall be construed respectively as the 1st to the 15th, and the 16th to the last day of such month, all dates inclusive.
- d. The terms "beginning", "middle", or "end" of a month shall be construed respectively as the 1st to the 10th, the 11th to the 20th, and the 21st to the last day of such month, all dates inclusive.

## F TRANSFERABLE CREDIT

#### Article 48

##### Transferable Credit

- a. A transferable Credit is a Credit under which the Beneficiary (First Beneficiary) may request the bank authorized to pay, incur a deferred payment undertaking, accept or negotiate (the "Transferring Bank"), or in the case of a freely negotiable Credit, the bank specifically authorized in the Credit as a Transferring Bank, to make the Credit available in whole or in part to one or more other Beneficiary(ies) (Second Beneficiary(ies)).



- b. A Credit can be transferred only if it is expressly designated as “transferable” by the Issuing Bank. Terms such as “divisible”, “fractionable”, “assignable”, and “transmissible” do not render the Credit transferable. If such terms are used they shall be disregarded.
- c. The Transferring Bank shall be under no obligation to effect such transfer except to the extent and in the manner expressly consented to by such bank.
- d. At the time of making a request for transfer and prior to transfer of the Credit, the First Beneficiary must irrevocably instruct the Transferring Bank whether or not he retains the right to refuse to allow the Transferring Bank to advise amendments to the Second Beneficiary(ies). If the Transferring Bank consents to the transfer under these conditions, it must, at the time of transfer, advise the Second Beneficiary(ies) of the First Beneficiary’s instructions regarding amendments.
- e. If a Credit is transferred to more than one Second Beneficiary(ies), refusal of an amendment by one or more Second Beneficiary(ies) does not invalidate the acceptance(s) by the other Second Beneficiary(ies) with respect to whom the Credit will be amended accordingly. With respect to the Second Beneficiary(ies) who rejected the amendment, the Credit will remain unamended.
- f. Transferring Bank charges in respect of transfers including commissions, fees, costs or expenses are payable by the First Beneficiary unless otherwise agreed. If the Transferring Bank agrees to transfer the Credit it shall be under no obligation to effect the transfer until such charges are paid.
- g. Unless otherwise stated in the Credit, a transferable Credit can be transferred once only. Consequently, the Credit cannot be transferred at the request of the Second Beneficiary to any subsequent Third Beneficiary. For the purpose of this Article, a retransfer to the First Beneficiary does not constitute a prohibited transfer.

Fractions of a transferable Credit (not exceeding in the aggregate the amount of the Credit) can be transferred separately, provided partial shipments/drawings are not prohibited, and the aggregate of such transfers will be considered as constituting only one transfer of the Credit.

- h. The Credit can be transferred only on the terms and conditions specified in the original Credit, with the exception of:
  - the amount of the Credit,
  - any unit price stated therein,
  - the expiry date,
  - the last date for presentation of documents in accordance with Article 43,
  - the period for shipment,

any or all of which may be reduced or curtailed.

The percentage for which insurance cover must be effected may be increased in such a way as to provide the amount of cover stipulated in the original Credit, or these Articles.

In addition, the name of the First Beneficiary can be substituted for that of the Applicant, but if the name of the Applicant is specifically required by the original Credit to appear in any document(s) other than the invoice, such requirement must be fulfilled.

- i. The First Beneficiary has the right to substitute his own invoice(s) (and Draft(s)) for those of the Second Beneficiary(ies), for amounts not in excess of the original amount stipulated in the Credit and for the original unit prices if stipulated in the Credit, and upon such substitution of invoice(s) (and Draft(s)) the First Beneficiary can draw under the Credit for the difference, if any, between his invoice(s) and the Second Beneficiary’s(ies’) invoice(s).

When a Credit has been transferred and the First Beneficiary is to supply his own invoice(s) (and Draft(s)) in exchange for the Second Beneficiary’s(ies’) invoice(s) (and Draft(s)) but fails to do so on first demand, the Transferring Bank has the right to deliver to the Issuing Bank the documents received under the transferred Credit, including the Second Beneficiary’s(ies’) invoice(s) (and Draft(s)) without further responsibility to the First Beneficiary.

- j. The First Beneficiary may request that payment or negotiation be effected to the Second Beneficiary(ies) at the place to which the Credit has been

transferred up to and including the expiry date of the Credit, unless the original Credit expressly states that it may not be made available for payment or negotiation at a place other than that stipulated in the Credit. This is without prejudice to the Beneficiary’s right to substitute subsequently his own invoice(s) (and Draft(s)) for those of the Second Beneficiary(ies) and to claim any difference due to him.

## G ASSIGNMENT OF PROCEEDS

### Article 49 Assignment of Proceeds

The fact that a Credit is not stated to be transferable shall not affect the Beneficiary’s right to assign any proceeds to which he may be, or may become, entitled under such Credit, in accordance with the provisions of the applicable law. This Article relates only to the assignment of proceeds and not to the assignment of the right to perform under the Credit itself.

# UCC 5 Revised

Uniform Commercial Code (United States of America)  
Revised Article 5. Letters of Credit

**SECTION 5-101. SHORT TITLE.** This article may be cited as Uniform Commercial Code—Letters of Credit.

## **SECTION 5-102. DEFINITIONS.**

(a) In this article:

(1) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) "Dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 5-108(e) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "Good faith" means honesty in fact in the conduct or transaction concerned.

(8) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs

(i) upon payment,

(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or

(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(10) "Letter of credit" means a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(11) "Nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(12) "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(13) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other Articles applying to this article and the sections in which they appear are:

"Accept" or "Acceptance" Section 3-409

"Value" Sections 3-303, 4-211

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

## **SECTION 5-103. SCOPE.**

(a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, subsections (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

**SECTION 5-104. FORMAL REQUIREMENTS.** A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e).

**SECTION 5-105. CONSIDERATION.** Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

## **SECTION 5-106. ISSUANCE, AMENDMENT, CANCELLATION, AND DURATION.**

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

## **SECTION 5-107. CONFIRMER, NOMINATED PERSON, AND ADVISER.**

(a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c). The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

## **SECTION 5-108. ISSUER'S RIGHTS AND OBLIGATIONS.**

(a) Except as otherwise provided in Section 5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the

letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) to honor,

(2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or

(3) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in Section 5-109(a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement, or transaction,

(2) an act or omission of others, or

(3) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e).

(g) If an undertaking constituting a letter of credit under Section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) takes the documents free of claims of the beneficiary or presenter;

(3) is precluded from asserting a right of recourse on a draft under Sections 3-414 and 3-415;

(4) except as otherwise provided in Sections 5-110 and 5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

#### **SECTION 5-109. FRAUD AND FORGERY.**

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a)(1).

#### **SECTION 5-110. WARRANTIES.**

(a) If its presentation is honored, the beneficiary warrants:

(1) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in Section 5-109(a); and

(2) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in subsection (a) are in addition to warranties arising under Article 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles.

#### **SECTION 5-111. REMEDIES.**

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b), a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (a) and (b).

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

#### **SECTION 5-112. TRANSFER OF LETTER OF CREDIT.**

(a) Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or

(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in Section 5-108(e) or is otherwise reasonable under the circumstances.

#### **SECTION 5-113. TRANSFER BY OPERATION OF LAW.**

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e), an issuer shall recognize a disclosed successor of a beneficiary as

beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in Section 5-108(e) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under subsection (a) or (b) has the consequences specified in Section 5-108(i) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b).

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

#### **SECTION 5-114. ASSIGNMENT OF PROCEEDS.**

(a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

**SECTION 5-115. STATUTE OF LIMITATIONS.** An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

#### **SECTION 5-116. CHOICE OF LAW AND FORUM.**

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c).

(d) If there is conflict between this article and Article 3, 4, 4A, or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).

#### **SECTION 5-117. SUBROGATION OF ISSUER, APPLICANT, AND NOMINATED PERSON.**

(a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a).

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) the applicant to same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (c) do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

## GLOSSARY

**abusive draw** drawing on a standby letter of credit/demand guarantee when no violation of the underlying contract has occurred.

**acceptance** time draft “accepted” by the party upon whom it is drawn by so endorsing the front of the draft. Acceptance constitutes an unconditional obligation on the part of the accepting party to pay the draft at maturity. A draft accepted by a bank is called a “banker’s acceptance” whereas one accepted by a company is called a “trade acceptance.”

**account party** party for whom a letter of credit is opened. “Account party” and “applicant” are generally synonymous, but sometimes one party will agree with the issuing bank to make all payments under a letter of credit showing the name of another party (often two affiliated companies). Banks may refer to one of these parties as the applicant and the other as the account party, but there is no consistency among banks regarding which is which.

**advance payment** funds given by the buyer of goods to the seller prior to shipment, often just a percentage of the value of the goods with the remainder paid after shipment.

**advance payment bond** bond, guarantee, or standby letter of credit given by a seller receiving an advance payment to the buyer to assure that the funds will be returned if goods are never shipped.

**advising bank** bank that receives a letter of credit from the issuing bank for authentication and delivery to the beneficiary. The advising bank is usually a correspondent of the issuing bank located in the vicinity of the beneficiary.

**air waybill** document signed by an airline to show receipt of goods for air transportation from and to the airports indicated.

**ancillary guarantee** type of guarantee where the guarantor joins with one of the parties to the contract and agrees to fulfill that party’s obligations if necessary, effectively co-signing the contract. As opposed to an independent or demand guarantee, under an ancillary guarantee the guarantor also acquires rights under the contract and may resort to terms in the contract to dispute claims against the guarantee. Also called a “contract guarantee.” Although banks in the U.S. are generally prohibited by law from issuing ancillary guarantees, banks in other countries are not. U.S. banks instead issue demand guarantees or standby letters of credit.

**applicant** party requesting that a letter of credit be opened.

**approval, documents sent on** treatment of letter of credit documents wherein the negotiating bank does not certify that the documents meet the requirements of the L/C, but rather forwards the documents to the issuing bank with a request that it examine the documents, obtain waiver of any discrepancies, and pay.

**assignment of proceeds** legal mechanism by which the beneficiary of a letter of credit may pledge the proceeds of future drawings to a third party. Assigning proceeds involves giving the letter of credit to a bank, which will hold the L/C until drawn upon, along with irrevocable instructions to the bank to disburse proceeds, when generated, in a specified way, *e.g.*, “pay 75% of each drawing to XYZ Company.” The bank will acknowledge the assignment to the assignee but has no obligation actually to pay any funds to the assignee unless the L/C is drawn upon by the beneficiary and

payment is received from the issuing or confirming bank. An assignment of proceeds is not an assignment or transfer of the letter of credit and the assignee acquires no rights to perform under the L/C in order to generate funds.

**authority to pay** *see* “[cable for authority to pay.](#)”

**aval** guarantee added by a bank to an accepted time draft by endorsing the front of the draft “per aval.” The avalizing bank becomes obligated to pay the draft at maturity if the drawee/acceptor fails to do so.

**avalized draft** trade acceptance to which an aval has been added.

**B/A** abbreviation for “[banker’s acceptance.](#)”

**B/L** abbreviation for “[bill of lading.](#)”

**banker’s acceptance** time draft that has been drawn on and accepted by a bank. In a large and active market, investors buy and sell bankers’ acceptances at rates similar to, and often below, LIBOR. Rates are low due to the low risk of default on the part of a bank and the fact that there is generally an underlying trade transaction, the proceeds of which are pledged to cover the acceptance when it matures.

**beneficiary** party in whose favor a letter of credit is issued, who is entitled to present documents required by the L/C and receive payment.

**bid bond** bond, guarantee, or standby letter of credit that accompanies a bid, issued for an amount that will be forfeited if the bidder wins the bid but then reneges.

**bill of exchange** a [draft.](#)

**bill of lading** document signed by a transportation company (“carrier”) to show receipt of goods for transportation from and to the points indicated. Although U.S. law recognizes such a thing as a non-negotiable bill of lading, international law distinguishes bills of lading from waybills in that a bill of lading is a title document issued to order of a “consignee,” who can then transfer title (legal ownership of the goods) by endorsement and delivery (“negotiation”) of the bill of lading. Someone must present the bill of lading at the point of delivery in order to claim the goods. A waybill is not negotiable in this way and the transportation company will simply deliver the goods to the consignee. A transport document issued “consigned to order of...” is a negotiable bill of lading; one issued simply “consigned to...” is a non-negotiable waybill. *See also* “[multimodal bill of lading,](#)” “[ocean bill of lading,](#)” “[port-to-port bill of lading.](#)”

**bond** *see specific types:* “[advance payment bond,](#)” “[bid bond,](#)” “[performance bond.](#)”

**C&F** abbreviation for “[cost and freight \(...named port of destination\).](#)” Also CFR.

**C.A.D.** abbreviation for “[cash against documents.](#)”

**CFR** abbreviation for “[cost and freight \(...named port of destination\).](#)” Also C&F.

**CIF** abbreviation for “[cost, insurance, and freight \(...named port of destination\).](#)”

**CIP** abbreviation for “[carriage and insurance paid to \(...named place of destination\).](#)”

**CPT** abbreviation for “[carriage paid to \(...named place of destination\).](#)”

**cable for authority to pay** request for permission to pay a letter of credit drawing despite

discrepancies, sent electronically by the negotiating bank to the issuing bank.

**carriage and insurance paid to (...named place of destination)** shipping term included in a contract of sale (abbreviated as CIP) meaning that the seller agrees to arrange and pay for transportation and cargo insurance over the goods to the named destination, such costs being included in the price of the goods. Nonetheless, all risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered to the carrier, is transferred from the seller to the buyer when the goods have been delivered into the custody of the carrier.

**carriage paid to (...named place of destination)** shipping term included in a contract of sale (abbreviated as CPT) meaning that the seller agrees to arrange and pay for transportation of the goods to the named destination, such costs being included in the price of the goods. Nonetheless, all risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered to the carrier, is transferred from the seller to the buyer when the goods have been delivered into the custody of the carrier. It is up to the buyer to arrange cargo insurance.

**carrier** any person who, in a contract of transportation, undertakes to perform, or to procure at his own responsibility the performance of, transportation by rail, road, sea, air, inland waterway or by a combination of such modes. See “[multimodal bill of lading](#)” for further discussion.

**case-of-need** agent of the exporter located in the country of the importer who is to be notified by the presenting bank under a draft collection of any difficulties in collecting payment. The case-of-need may be given the power to change the collection instructions or even the draft amount, or may just be expected to make arrangements to store the goods and locate an alternate buyer. Whatever authority the case-of-need has should be specified in the collection instructions letter.

**cash against documents** term (abbreviated as C.A.D.) for documentary collection instructions requesting the presenting bank to deliver documents only upon receipt of payment from the drawee/importer. Synonymous with “documents against payment.”

**clean bill of lading** bill of lading that bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging.

**clean draft** draft which is not accompanied by documents.

**clean letter of credit** letter of credit that calls for presentation of nothing more than a draft to trigger payment. The term is sometimes used (incorrectly) to mean “[standby letter of credit](#).”

**collecting bank** any bank other than the remitting bank involved in the collection of a draft and/or documents.

**combined transport** see “[multimodal bill of lading](#).”

**commercial letter of credit** letter of credit intended to act as the vehicle of payment for goods sold by one party to another.

**commercial risk** risk that the buyer of goods cannot or will not pay the seller when payment is due.

**confirmed letter of credit** letter of credit to which the advising bank has added its own, independent undertaking to honor presentation of the required documents, *i.e.*, pay the beneficiary at

sight or at maturity, as specified by the L/C. *See also* “[silent confirmation](#).”

**confirming bank** bank that has added its confirmation to a letter of credit. This term is also sometimes used loosely to refer to a bank that has issued a commitment to purchase letter of credit documents without recourse, a practice called “silent confirmation.”

**consignee** party into whose possession goods are to be delivered. *See also* “[bill of lading](#).”

**consignment** term of sale wherein a seller delivers goods to the buyer but retains legal ownership of the goods until they are re-sold by the buyer. The buyer is responsible for remitting payment to the seller at time of re-sale to the end-buyer.

**contract guarantee** *see* “[ancillary guarantee](#).”

**contract risk** risk that the buyer of goods will renege on the contract (as opposed to simply being unable to pay).

**cost and freight (...named port of destination)** shipping term included in a contract of sale (abbreviated as CFR or C&F) meaning that the seller agrees to take full responsibility for delivering the goods to the port of loading, clear the goods for export, and arrange and pay for transportation of the goods to the named port of discharge, such costs being included in the price of the goods. Nonetheless, all risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered on board the vessel, is transferred from the seller to the buyer when the goods pass the ship’s rail at the port of loading. It is up to the buyer to arrange marine insurance for the ocean voyage and transportation from the port of discharge.

**cost, insurance and freight (...named port of destination)** shipping term included in a contract of sale (abbreviated as CIF) meaning that the seller agrees to take full responsibility for delivering the goods to the port of loading, clear the goods for export, and arrange and pay for transportation and marine insurance over the goods to the named port of discharge, such costs being included in the price of the goods. Nonetheless, all risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered on board the vessel, is transferred from the seller to the buyer when the goods pass the ship’s rail at the port of loading. It is up to the buyer to arrange transportation from the port of discharge.

**country risk** risk incurred by a seller of goods that a buyer in a different country will not be able to pay for the goods due to political or economic conditions in his country. The two components of country risk are “[political risk](#)” and “[transfer risk](#).”

**credit insurance** insurance against losses due to inability or failure of the insured’s customers to pay for goods sold by the insured. The insurance normally covers a specified percentage of each loss beyond a deductible indicated in the policy. Insurance is available covering a variety of risks, *e.g.*, political and transfer risks (“country risks”) and financial risks (called “commercial risks”). Even “comprehensive” insurance, however, will not cover non-payment for contract disputes.

**credit risk** risk incurred by a seller of goods that the buyer cannot or will not pay for them. *See also* “[commercial risk](#),” “[contract risk](#),” “[financing risk](#),” “[political risk](#),” “[transfer risk](#).”

**cumulative revolving letter of credit** revolving letter of credit that permits the seller to carry over any amounts not drawn into successive periods.



**D/A** abbreviation for “[documents against acceptance.](#)”

**D/P** abbreviation for “[documents against payment.](#)”

**days of grace** the number of days the acceptor of a draft may go past due before being judged in default and triggering any guarantor to pay on the acceptor’s behalf. When an avalized draft is sold to a forfaiter, the forfaiter will impute the days of grace into the financing period.

**deferred payment** payment a set period of time after shipment or presentation of shipping documents, as opposed to immediately or “at sight.” A distinction is drawn between a letter of credit that is available for deferred payment and one that is available for acceptance of time drafts in that no drafts are involved under a deferred payment L/C. Without accepted drafts, the beneficiary’s ability to sell, or “discount,” his right to payment to a lender or investor is restricted.

**deferred reimbursement** arrangement under a letter of credit where the issuing bank agrees up front with its customer, the applicant, to pay the beneficiary upon presentation of the documents required in the L/C but to defer charging the applicant until a later date, thereby financing the purchase of goods under the L/C, usually for the expected amount of time the applicant needs in order to re-sell the goods.

**demand guarantee** type of guarantee that is payable immediately upon presentation of documents specified, without inquiry as to the validity of the documents or into compliance with the underlying contract, as opposed to an “ancillary guarantee.” Also called an “independent guarantee.” Although there are separate rules of practice for demand guarantees and letters of credit, they are both considered letters of credit under U.S. law.

**direct collection** service for handling export draft collections in which the exporter’s bank provides him with forms that bear the bank’s own letterhead for mailing documents to the buyer’s bank for collection. To the buyer’s bank, it will appear that the documents were sent from the exporter’s bank, but time and expense are saved by bypassing unnecessary processing at the exporter’s bank.

**discrepancies** in the context of letters of credit, term used to describe deviations between documents presented and requirements set in the letter of credit or inconsistencies among the documents themselves.

**dishonor** failure or refusal by the drawee to accept a draft presented for acceptance or to pay a draft presented for payment.

**documentary credit** synonymous with “[letter of credit.](#)”

**documentary draft collection** process for collecting payment in a sale of goods wherein a legal demand for payment from the buyer is made by a bank acting as collecting agent for the seller. Demand is made by presenting a draft. The collecting bank is also entrusted with documents to deliver in accordance with accompanying instructions, usually once the draft is either paid or accepted. These documents are generally needed by the buyer to show title to the goods and/or to clear customs.

**documentary letter of credit** term sometimes used (incorrectly) to refer to commercial letters of credit—the term is redundant in that all letters of credit are documentary. See “[letter of credit](#)” and “[commercial letter of credit.](#)”

**documents against acceptance** term for documentary draft collection instructions requesting the presenting bank to deliver documents only upon acceptance of the draft by the drawee/importer. *See also* “[acceptance](#).”

**documents against payment** term for documentary collection instructions requesting the presenting bank to deliver documents only upon receipt of payment from the drawee/importer. Synonymous with “cash against documents.”

**draft** written demand for payment of a specified amount addressed to a named party, called the “drawee,” and signed by the “drawer.” A draft may demand payment immediately upon presentation (“at sight”) or on a specified maturity date and must also specify a party to be paid (the “payee”). Most drafts are “negotiable,” meaning the payee’s right to payment can be transferred by the payee to another party by endorsement and delivery of the draft.

**draft collection** process for collecting payment in a sale of goods wherein a legal demand for payment from the buyer is made by a bank acting as collecting agent for the seller. Demand is made by presenting a draft. *See also* “[draft](#)” and “[documentary draft collection](#).”

**drawee** party to whom a draft is addressed and from whom payment is demanded, or, in a documentary collection with no draft, party from whom payment is requested in exchange for delivery of documents.

**EMC** abbreviation for “[export management consultant](#).”

**ETC** abbreviation for “[export trading company](#).”

**EXW** abbreviation for “[ex works \(...named place\)](#).”

**evergreen letter of credit** letter of credit with an initial expiration date but containing a clause that states that it will be automatically extended for additional periods unless the issuing bank provides notice to the beneficiary stating otherwise.

**ex factory** synonymous with “[ex works](#).”

**ex works (...named place)** shipping term included in a contract of sale (abbreviated as EXW) meaning that the seller fulfills his obligation to deliver when he has made the goods available at his premises (*i.e.*, works, factory, warehouse, *etc.*) to the buyer. In particular, he is not responsible for loading the goods for export, unless otherwise agreed. The buyer bears all costs and risks involved in taking the goods from the seller’s premises to the desired destination.

**expiry date** last date on which documents may be presented or corrected in order to comply with a letter of credit. Presentation must be made to the bank indicated in the L/C.

**export letter of credit** term used by an exporter to describe a commercial letter of credit in his favor or by a bank to describe a letter of credit issued by a bank other than itself. The same L/C will be called an “import letter of credit” by the importer and the issuing bank.

**export management consultant** individual or company that assists other companies in identifying potential foreign markets for their goods, often named as a sales agent or representative of the company being served and paid a commission for each sale.

**export trading company** company that buys and sells goods with the objective of taking advantage

of market opportunities around the world.

**FCA** abbreviation for “[free carrier \(...named place\)](#).”

**FCR** abbreviation for “[forwarder’s cargo receipt](#).”

**FOB** abbreviation for “[free on board \(...named port of shipment\)](#).”

**factoring** service of assuming the credit risk of another party’s sales, generally including collecting payment when due. Factors often provide or arrange limited-recourse financing against the accounts receivable they are guaranteeing, referred to as “purchasing receivables.”

**Fed Funds rate** interest rate at which banks in the United States lend each other dollars for next-day repayment (“overnight loans”).

**financing risk** term used to describe the increasing uncertainty that the buyer of goods will have the capacity to pay when payment is due the longer the time period he is given to make payment.

**forfait** purchase of negotiable instruments, most often avalized drafts, without recourse. The forfaiter assumes the credit risk of being able to collect payment when due.

**forwarder’s cargo receipt** document issued by a freight forwarder or freight consolidator indicating goods have been received from the seller and are being held at the disposal of the buyer. Goods are generally received in the seller’s country and the forwarder/consolidator will arrange shipment, and possibly consolidation with other goods, to the buyer according to the buyer’s instructions.

**free carrier (...named place)** shipping term included in a contract of sale (abbreviated as FCA) meaning that the seller fulfills his obligation to deliver when he has handed over the goods, cleared for export, into the charge of the carrier, freight consolidator, or freight forwarder named by the buyer at the named place or point.

**free on board (...named port of shipment)** shipping term included in a contract of sale (abbreviated as FOB) meaning that the seller fulfills his obligation to deliver when the goods have passed over the ship’s rail at the named port of shipment, all costs of inland transportation and loading being included in the price of the goods. The buyer has to bear all costs and risks of loss of or damage to the goods from that point.

**freely negotiable letter of credit** letter of credit that indicates it is “available with any bank by negotiation.” By including this wording, the issuing bank authorizes the beneficiary to present documents to the bank of his choice for examination and collection of payment.

**freight forwarder** company that, as an agent for the shipper, arranges transportation for goods. Many freight forwarders offer additional services such as preparing export documentation, arranging for goods to be packed into shipping containers, arranging for goods to clear customs, *etc.*

**full set** all signed originals of a document. For example, bills of lading are often issued in three originals, all having the same validity for claiming goods at the place of delivery.

**grace period** *see* “[days of grace](#).”

**import letter of credit** term used by an importer to describe a commercial letter of credit he has asked a bank to issue or by a bank to describe a letter of credit it has issued. The same L/C will be called an “export letter of credit” by the exporter and all other banks.

**independent guarantee** synonymous with “[demand guarantee](#).”

**installment letter of credit** letter of credit calling for multiple shipments within specified date ranges.

**insurance** *see* “[credit insurance](#)” and “[marine cargo insurance](#).”

**irrevocable letter of credit** letter of credit that cannot be amended or canceled without agreement of both the beneficiary and the issuing bank. Any letter of credit subject to the UCP500 or to U.S. law is irrevocable unless it specifies otherwise.

**issuing bank** bank that has issued a letter of credit. The issuing bank is obligated to pay if documents are presented that comply with the L/C requirements.

**letter of credit** undertaking, usually on the part of a bank and at the request of one of the bank’s customers, to pay a named beneficiary a specified amount of money (or to deliver an item of value) if the beneficiary presents documents in accordance with the terms and conditions specified in the letter of credit.

**letter of guarantee** undertaking, usually on the part of a bank, either to fulfill the obligations of another party (*see* “[ancillary guarantee](#)”) or to pay a specified amount of money upon presentation of specified documents stating that the party being guaranteed has defaulted on certain obligations (*see* “[demand guarantee](#)”). One must be careful to discern which type of guarantee one is dealing with as they both require presentation of documents but work very differently thereafter.

**LIBOR** acronym for the London Interbank Offered Rate. The interest rate at which banks in London place Eurocurrency/Eurodollar deposits with each other for specified, fixed periods of time, most commonly six months.

**marine cargo insurance** insurance covering loss of or damage to goods in the course of international transportation. The term is anachronistic in that such insurance is used for air and land transportation as well as ocean transportation, but many of the concepts are based on perils of the sea.

**marine bill of lading** synonymous with “[ocean bill of lading](#).”

**multimodal bill of lading** bill of lading covering shipment of goods by more than one means of transportation but including an ocean leg. The two major forms of multimodal bill of lading are the combined transport bill of lading and the through bill of lading. Under the former, the carrier signing the bill of lading (the “contractual carrier”) frequently subcontracts the various legs to other carriers (the “actual carriers”), but still takes responsibility for delivery of the goods to the “place of delivery” and for any damage that might occur during carriage. Under the latter, the carrier takes responsibility for the goods only up to a specified point (still called the “place of delivery”) and then passes responsibility to a second carrier for “on-carriage” to the “final destination.”

**multimodal transport** shipment of goods by more than one means of transportation but including an ocean leg (*see* “[multimodal bill of lading](#)”).

**negotiable** quality belonging to a document of being able to transfer ownership of money, goods, or other items of value specified in the document by endorsement and/or delivery of the document. Checks, drafts, promissory notes, bonds, stock certificates, bills of lading, and warehouse receipts are

examples of documents often issued in negotiable form.

**negotiate** to “buy” documents representing ownership of money, goods, or other items of value. The seller is also said to “negotiate to” the buyer. Unless otherwise agreed between the buyer and seller (*e.g.*, by negotiating “without recourse”), the seller continues to be fully responsible for the enforceability of the documents. A bank that negotiates documents under a letter of credit advances funds to the presenter before submitting the documents to the issuing bank for payment.

**negotiating bank** bank to which letter of credit documents are presented by the beneficiary for collection of payment. The name derives from the fact that the negotiating bank is normally authorized by the issuing bank to negotiate documents (*see* “[negotiate](#)”), but it may or may not choose actually to do so. Furthermore, recognizing that this bank may be authorized to pay or accept drafts, rather than negotiate them, UCP500 now uses the term “nominated bank” rather than “negotiating bank.” Unless otherwise instructed, negotiating banks in North America generally examine the documents for discrepancies before forwarding them to the issuing bank, but this is properly viewed as a service separate from negotiating and is not even necessary when negotiating with recourse.

**non-cumulative revolving letter of credit** revolving letter of credit that does not permit the seller to carry over any amounts not drawn upon in previous periods.

**notify party** party to be notified by the carrier of arrival of the goods at their destination. Normally the notify party is the importer and/or the importer’s agent for clearing goods through customs.

**ocean bill of lading** bill of lading including shipment on an ocean vessel, also called a “marine bill of lading.” Although port-to-port, multimodal, and charter party bills of lading are all ocean bills of lading, many banks persist in issuing letters of credit that call simply for ocean bills of lading and then applying the requirements for port-to-port bills of lading. *See also* “[bill of lading](#),” “[port-to-port bill of lading](#),” “[multimodal bill of lading](#).”

**performance bond** bond issued at the request of one party to a contract in favor of the other party to the contract to protect the other party against loss in the event of default on the contract by the requesting party. The bonding agent may undertake to fulfill the contract or may simply undertake to pay a specific amount in monetary damages. A standby letter of credit or demand guarantee is often used as a performance bond with the latter characteristics.

**political risk** risk in a sale of goods that the government in the buyer’s country may take some action that prevents the buyer from paying. This covers possibilities such as the imposition of foreign exchange controls and expropriation as well as non-payment due to war or insurrections.

**port-to-port bill of lading** bill of lading covering shipment by ocean only. The shipper/seller is responsible for transporting the goods to the port of loading and the buyer for picking the goods up at the port of discharge. Multimodal, rather than port-to-port, bills of lading should generally be used for containerized shipments and other shipments where the place of receipt and/or the place of delivery is inland.

**pre-export financing** specific form of working capital lending in which the borrower is given funds needed to obtain or manufacture goods that have been ordered by a buyer in another country. As such financing is normally earmarked to individual sales, documentation of each sale must be provided to the lender, often in the form of a letter of credit with proceeds assigned to the lender.

Generally only a percentage of the sale value is lent.

**presenting bank** in a draft collection transaction, the bank that contacts the drawee, generally the buyer of goods, for acceptance and/or payment.

**principal** party entrusting a draft and/or documents to a bank for collection of payment, generally the seller of goods.

**progress payment** one in a series of payments made at stages in the performance of a contract of sale, *e.g.*, up front to obtain materials, after completion of manufacturing, upon shipment, upon installation, and upon final inspection.

**protest** in a draft collection transaction, the formal legal process of registering that payment or acceptance of the draft has been demanded but the drawee has refused to pay or accept the draft.

**reimbursing bank** in a letter of credit transaction, the bank with which the issuing bank maintains an account and which is authorized by the issuing bank to charge that account to pay claims received from the negotiating bank for documents that have been presented.

**remitting bank** in a draft collection transaction, the first bank in the chain of collection, *i.e.*, the principal's or seller's bank.

**retention of title** legal arrangement under which a seller of goods delivers these goods "on consignment" into someone's custody but ownership remains with the seller until he is paid. Retention of title allows the seller to repossess the goods whenever desired and to establish a claim against the custodian if the goods are sold or used without being paid for.

**revocable letter of credit** letter of credit that can be amended or canceled at any time without notice to or consent of the beneficiary. A letter of credit that is subject to the UCP500 or to U.S. law is revocable only if it clearly specifies so.

**revolving letter of credit** letter of credit that reverts to its original amount at specified intervals, *e.g.*, monthly, thereby preventing drawing too much in any one period. *See also* "[cumulative revolving letter of credit](#)" and "[non-cumulative revolving letter of credit](#)."

**shipper's indemnity** indemnity given by the beneficiary of a letter of credit to the negotiating bank to induce payment despite any discrepancies that may exist in the documents.

**shipping terms** that part of a contract of sale that specifies who, between the buyer and the seller, is responsible for each aspect of shipping the goods, *e.g.*, for packing, arranging and paying for transportation and insurance, clearing customs, *etc.*

**sight** time of presentation, as in a draft payable "at sight" or "90 days after sight."

**sight draft** draft that demands payment "at sight," or immediately, as opposed to a time draft, which may be payable "90 days after sight" or "30 days after bill of lading date."

**silent confirmation** term used for a bank's commitment to negotiate (*i.e.*, purchase) documents under a letter of credit without recourse at a future date. A silent confirmation is not a confirmation in the true sense, and will not use the word "confirm," but is rather an equivalent form of protection for the beneficiary. The bank will require that the letter of credit be negotiable or payable by itself in order to be able to establish holder-in-due-course rights equivalent to those of a confirming bank.

**standby letter of credit** as opposed to a commercial letter of credit, a letter of credit that does not cover the direct purchase of merchandise, so called because it is often intended to be drawn on only when the applicant for whom it is issued fails to perform an obligation. There is, nonetheless, a type of standby letter of credit that is intended to be drawn on, referred to as a “direct pay letter of credit.”

Standby letters of credit are based on the underlying principle of letters of credit that payment is made against presentation of documents—whatever documents the applicant, beneficiary, and issuing bank may agree to, not necessarily documents showing shipment of goods.

**supplier financing** arrangement where the seller/supplier of goods allows the buyer an extended period of time after shipment to pay for the goods.

**tenor** time at which a draft indicates it is payable, *e.g.*, “at sight,” “60 days after the bill of lading date,” or “on May 31, 2001.”

**time draft** draft that demands payment at a specified future date rather than immediately upon presentation.

**trade terms** synonymous with “[shipping terms](#).”

**transfer risk** risk incurred by the seller of goods that, due to the fact that his country has a negative balance of payments, no foreign exchange (U.S. dollars or other “hard” currency) may be available to the buyer when he is ready to pay for the goods.

**transferable letter of credit** type of letter of credit that names a middleman as beneficiary and allows him to give another party, the actual supplier, certain rights to present documents and receive payment under the letter of credit. Transfer must be effected by a bank authorized to do so by the issuing bank and involves notifying the transferee (called the “second beneficiary”) of what documents he must present. The documents must be the same as those required in the letter of credit itself but the price of the goods may be reduced and the middleman’s name may be required to be listed in the transferee’s invoices as the buyer, thereby allowing the middleman to substitute invoices at a higher price and receive the difference without disclosing the name of the actual end-buyer. The transferring bank is not obligated to pay documents presented under the transfer—such obligation remains with the issuing bank.

**UCC** abbreviation for “[Uniform Commercial Code](#).”

**UCP** abbreviation for “[Uniform Customs and Practice for Documentary Credits](#).” The 1993 revision is referred to as “UCP500” as it is publication number 500 of the International Chamber of Commerce.

**unconfirmed letter of credit** letter of credit that has not been confirmed (*see* “[confirmed letter of credit](#)”).

**Uniform Commercial Code** United States statute covering the rights and obligations of the various parties involved in the purchase and sale of goods. The UCC includes coverage of drafts and other negotiable instruments, documents of title, transfers of funds between banks, and security interests in assets as well as draft collections (in Article 4) and letters of credit (in Article 5).

**Uniform Customs and Practice for Documentary Credits** international standards of letter of credit practice established for bankers by the International Chamber of Commerce. Historically, the

UCP has been revised about every ten years to keep up with changing practice, the most recent revision, UCP500, having been completed in 1993. Although the UCP defines rights and obligations of the various parties in a letter of credit transaction, it is not law and any given letter of credit is subject to the UCP only to the extent indicated in the letter of credit itself.

**Uniform Rules for Collections** international standards of draft collection practice established for bankers by the International Chamber of Commerce. The Uniform Rules are not law but are more properly viewed as a handbook for banks used to establish common understanding of terminology and expectations.

**without recourse** negotiation of a draft, or other negotiable instrument, or letter of credit documents without the normal warranty on the part of the seller of the instrument/documents that the obligor named in the instrument (the “drawee,” “payor,” or “maker”) will pay. Although the seller is still responsible for the genuineness of the instrument and documents, the purchaser takes on the credit risk of being able to collect payment from the obligor when due. Unless negotiation is without recourse, the purchaser of the instrument/documents has the right to recover the face amount from the seller if the obligor fails or refuses to pay for any reason.