

# **SITPRO**

**Simplifying International Trade**

**REPORT ON THE USE OF  
EXPORT LETTERS OF CREDIT  
2001/2002**

## **Executive Summary**

Numerous surveys have been carried out in the UK (including by SITPRO) suggesting the rejection rate of first time presentations against letters of credit is between 50-60%. These findings have led to much publicity about the costs and dangers of failure to present compliant documents with work being carried out by SITPRO and other organisations to help exporters improve their performance in the use of letters of credit.

Although much work has been carried out rejection rates seem to remain static. SITPRO felt that in order to move forward it would be ideal to examine why letter of credit presentations are rejected and what are the most common discrepant documents. This work commenced in 2001, with this report intended to consolidate the information gathered so far and look at ways in which further work can be carried out to help UK exporters in letter of credit operations. In order to ascertain the extent of the problem of rejection rates of letters of credit the review also estimates the cost to UK business of non-compliant presentations.

A list of the top ten discrepancies can be found on page 13, with more detail given in Appendix 1. It is interesting to note that some of the most common discrepancies are those which are the simplest to correct and within the control of the exporter: inconsistent data; late presentation and shipment and, perhaps most disappointingly, absence of documents. From this information it appears that some exporters are not giving the time or resource necessary to dealing with letters of credit, which is essential from the beginning of the contract negotiations through until correct documents have been presented and payment has been received.

The review estimates that in 2000 the UK lost £113 million through non-compliant documents being presented under letters of credit. This is merely the amount that can be measured and does not include other factors such as lost opportunity and cash flow problems. This is an enormous amount of money to be taken out of often very narrow profit margins. It is recommended in the report, that further work is undertaken by SITPRO into the use of electronic letters of credit and their rejection rates. Additionally SITPRO has the opportunity to look at the use of WebElecTra (the web based export documentation software system) in letter of credit operations.

The final section of the report looks at what can be done to counteract these problems and reduce the amount of money lost to UK business. Training, as ever, is an important part, but it is essential for UK business to take notice of the enormous sums of money that are being lost through what are often easily correctable mistakes. Consideration should be given as to whether the necessary expertise is available in-house. If not training (on the job training, external courses or, preferably, a combination of both) should be given to staff. Where this is not appropriate the use of external resources (e.g. a freight forwarder or other professional with expertise in letter of credit operations) should be considered.

Reports of demonstrated best practice are given to assist those involved in letter of credit operations – these will be publicised and issued as widely as possible to raise awareness of these issues. However, it is essential that senior management understand and support the need for a structured plan in the use of letters of credit in order that problems are resolved at the earliest stage in the process, before the documents are even presented to the bank.

## **Section 1 - Introduction**

### **Background**

The documentary letter of credit (also known as a documentary credit) has been used for more than 150 years to facilitate trade by providing payment against presentation of documents relating to the transaction as specified in the credit. They are used widely for international trade, covering transactions valued from as little as a few hundred pounds to many millions. They are used primarily at the request of the commercial parties for effecting payment; they may also be used because some importing countries require letters of credit as part of their exchange control regulations.

SITPRO's last survey into the use of letters of credit ('Exporters' Problems with Commercial Letters of Credit') was carried out between 1989-1991. This showed that beneficiaries found 48% of credits contained defects/errors, which would have made it difficult or impossible to secure settlement under the credit. This followed research carried out in a previous SITPRO survey, in 1983/1984, which showed that only about one presentation of documents in every two actually secured payment first time. These findings led to publicity about the costs and dangers of failure to present compliant documents with work being carried out by SITPRO and other organisations to help exporters improve their performance in the use of letters of credit.

Since these surveys were produced a new edition of the ICC's Uniform Customs and Practices (the ICC's rules governing the use of letters of credit) has been introduced which, it was hoped, would help to reduce the high incidence of rejection of first presentation of documents. However, despite this, rejection rates of 50%-60% are still being reported. Therefore, SITPRO decided that further research should be carried out between 2001-2002 to examine the most common discrepancies found in rejected letter of credit presentations and also to estimate the cost of non-compliant presentations to UK business.

This report intends to consolidate the information gathered so far and look at ways in which further work can be carried out to help UK exporters in letter of credit operations. It is aimed primarily at exporters who deal with letters of credit, however, the information will also be of interest to bankers, freight forwarders and those who provide training in the use of letters of credit.

### **Research**

Research was carried out on behalf of SITPRO by Major Issue, who used a variety of data sources for its findings, including National Statistics for the United Kingdom, the Ninth Survey of International Services Provided to Exporters commissioned by The Institute of Export and interviews with banks, exporters and freight forwarders.

Both Major Issue and SITPRO would like to thank all the banks and companies who have supported the research.

## **The Review**

The research is presented together with information on the whole cycle of a letter of credit within the international trade transaction. The report covers four main areas:

- an explanation of letters of credit and their use;
- global payment patterns including the use of letters of credit;
- the results of the research into rejection of documents including the most common discrepant documents and the cost of 'non-compliance' to UK plc; and
- ways to reduce the cost of non-compliance and areas of demonstrated best practice.

## **Section 2 - Letters of Credit – An Explanation**

A letter of credit is defined as an undertaking by an issuing bank to the beneficiary to make payment within a specified time, against the presentation of documents which comply strictly with the terms of the credit. Therefore, the risk to the seller of non-payment by the buyer is transferred to the issuing bank (and the confirming bank if the letter of credit is confirmed) as long as the exporter presents the documents in strict compliance with the credit. It is important to remember that all parties in the letter of credit transaction deal with documents, not goods.

Other than cash in advance, a letter of credit is the most secure method of payment in international trade, with the payment undertaking of the bank, as long as the terms of the credit are met. The letter of credit also provides security for the importer who can ensure all contractual documentary requirements are met by making them conditions of the letter of credit.

### **Uniform Customs and Practice for Documentary Credits (UCP)**

UCP were originally formulated in 1933 by the International Chamber of Commerce and are the universally recognised set of rules governing the use of the documentary credits in international trade. The most recent revision came into effect in 1994 (ICC publication 500). All definitions and general documentary requirements referred to in this report are in accordance with UCP500 unless otherwise stated (it should be remembered that in some instances this may differ from national law).

With effect from 1 April 2002 UCP500 has an electronic supplement called eUCP, which provides for electronic presentation of documents. Although the survey did not distinguish between electronic and paper credits further work could be carried out into the use of electronic credits, their rejection rates and reasons for rejection. Additionally SITPRO has the opportunity to look at the use of WebElecTra (the web based export documentation software system) in letter of credit operations.

### **Those Involved in a Letter of Credit Transaction**

- Applicant – the importer
- Issuing Bank – the bank issuing the credit on the instructions of the applicant.
- Beneficiary – the exporter
- Advising Bank – usually the correspondent bank of the issuing bank in the exporter's country, which verifies the authenticity of the letter of credit and forwards it to the beneficiary.
- Nominated Bank – the bank authorised, within the letter of credit, to make payment to the exporter and to whom the documents are presented. The payment undertaking, however, is purely from the issuing bank so the country risk is not covered.
- Confirming Bank – usually the advising bank in the beneficiary's country, which adds its confirmation (where this is required) to the credit and undertakes an independent obligation to pay the exporter provided the terms of the credit are met.

It is important to negotiate, at contractual stage if possible, which party will bear bank charges. It is worth remembering that on a small transaction these may be totally out of proportion and if these costs are not included in the pricing any profit may be completely eroded.

### **Types of Letter of Credit**

- **Revocable**

A revocable letter of credit can be amended or cancelled at any time without the beneficiary's agreement (unless documents have been taken up by the nominated bank). Little protection is offered to the beneficiary with a revocable credit and they are rarely seen.

- **Irrevocable**

An irrevocable letter of credit can neither be amended nor cancelled without the agreement of all parties to the credit. Under UCP500 all letters of credit are deemed to be irrevocable unless otherwise stated.

- **Unconfirmed**

An unconfirmed letter of credit is forwarded by the advising bank directly to the exporter without adding its own undertaking to make payment or accept responsibility for payment at a future date, but confirming its authenticity.

- **Confirmed**

A confirmed letter of credit is one in which the advising bank, on the instructions of the issuing bank, has added a confirmation that payment will be made as long as compliant documents are presented. This commitment holds even if the issuing bank or the buyer fail to make payment. The added security of confirmation needs to be considered in the context of the standing of the issuing bank and the current political and economic state of the buyer's country. A bank will make an additional charge for confirming a letter of credit.

- **Standby Letters of Credit**

A standby letter of credit is used as support where an alternative, less secure, method of payment has been agreed. They are also used in the United States of America in place of bank guarantees. Should the exporter fail to receive payment from the buyer he may claim under the standby letter of credit. Certain documents are likely to be required to obtain payment including: the standby letter of credit itself; a sight draft for the amount due; a copy of the unpaid invoice; proof of dispatch and a signed declaration from the beneficiary stating that payment has not been received by the due date and therefore reimbursement is claimed by letter of credit. The International Chamber of Commerce publishes rules for operating standby letters of credit – ISP98 International Standby Practices. .

- **Revolving Letter of Credit**

The revolving credit is used for regular shipments of the same commodity to the same buyer. It can revolve in relation to time or value. If the credit is time revolving once utilised it is re-instated for further regular shipments until the credit is fully drawn. If the credit revolves in relation to value once utilised and

paid the value can be reinstated for further drawings. The credit must state that it is a revolving letter of credit and it may revolve either automatically or subject to certain provisions. Revolving letters of credit are useful to avoid the need for repetitious arrangements for opening or amending letters of credit.

- **Transferable Letter of Credit**

A transferable letter of credit is one in which the beneficiary has the right to request the paying, or negotiating bank to make either part, or all, of the credit value available to one or more third parties. This type of credit is useful for those acting as middlemen especially where there is a need to finance purchases from third party suppliers.

- **Back-to-Back Letter of Credit**

A back-to-back letter of credit can be used as an alternative to the transferable letter of credit. Rather than transferring the original letter of credit to the supplier, once the letter of credit is received by the exporter from the opening bank, that letter of credit is used as security to establish a second letter of credit drawn on the exporter in favour of his supplier. Many banks are reluctant to issue back-to-back letters of credit due to the level of risk to which they are exposed – a transferable credit will not expose them to higher risk than under the original credit.

The above is a brief explanation covering the basic issues of using a letter of credit. For fuller explanation readers are invited to look at the many publications available giving much fuller detail on this subject.

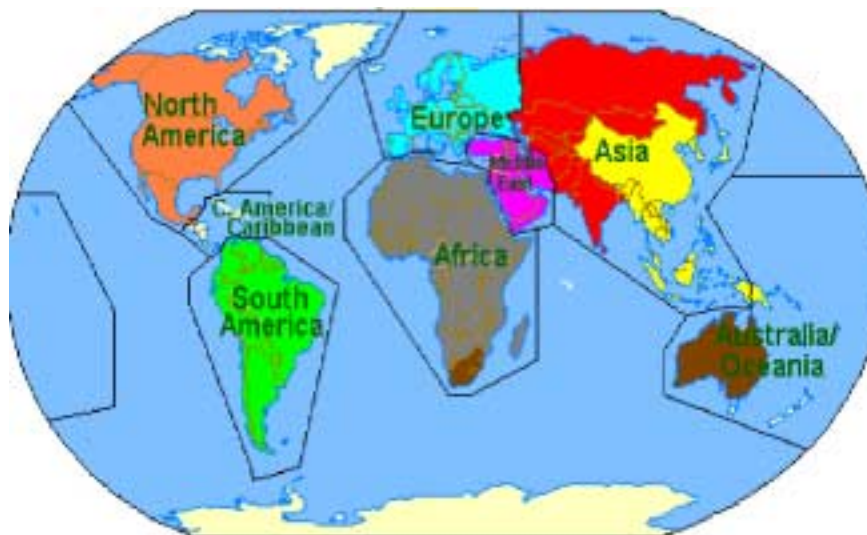
### **Section 3 - Global Payment Patterns**

Trade between the United Kingdom and its international trading partners can be split regionally, with the method of payment being based upon:

- risk profile of the buyer and country;
- long term trading practice; and
- competition.

Other factors can sometimes encourage exporters to use more secure terms, such as political and economic instability and influences exerted by credit insurers. Exporters need to be aware of the internal and external factors impacting on their overseas markets and have a flexible payment strategy that can change according to the risk profile of the buyer's country. Information about the major factors influencing trade in particular markets can be obtained through newspapers and trade press, the internet and from credit insurers and banks.

The following map demonstrates the predominant global trading patterns for open account, documentary collections, letters of credit and payment in advance.



Europe/North America	Open Account
S. America/Middle East/Asia	Letters of Credit
South Africa/Australia	Documentary Collections/Open Account
Africa/Russia	Adv Payment/Letter of Credit

The following list shows the volume of letters of credit use by geographic region.

<b>Region</b>	<b>Letters of Credit Usage by Geographic Region</b>
European Union	9%
Rest of Europe	20%
North America	11%
Latin America	27%
Middle East	52%
Asia Pacific	43%
Africa	49%
Asia	46%
Aust. & New Zealand	17%

(Source: Ninth Survey of International Services Provided to Exporters, commissioned by the Institute of Exporters.)

### **Why Use a Letter of Credit?**

Letters of credit may be used in international trade for a number of reasons, some of which are detailed below.

- **New Trading Relationship**

It may often be advisable to use a letter of credit in a new trading relationship as security is given to both the exporter and the importer. The exporter knows that he will get paid if he complies precisely with the letter of credit and the importer can ensure that he requests all the documentation required by the contract of sale and purchase and knows that the exporter will not be paid unless he complies with the letter of credit terms. However, for the exporter, this decision should be made carefully with thought given to the cost of using a letter of credit and the fact that competitors may be prepared to trade on more flexible payment terms. Once a stable trading relationship is established the situation should be re-assessed and consideration given to more flexible and competitive payment terms, where possible.

- **Letters of Credit Required by Credit Insurers**

Credit insurers will specify the need for sellers to trade on letter of credit terms to buyers in certain markets. When exporters are required to trade on irrevocable letters of credit (not confirmed), the underwriters will be at risk in the event that documents are presented to the advising bank in compliance with the terms of the letter of credit and funds are not available to make payment under the letter of credit.

- **'Always Traded This Way'**

Exporters may have always used letters of credit for a particular customer or region without periodically re-assessing the reasons for requesting this method of payment. It is important to examine carefully the reasons for using a letter of credit to ensure that they are using the most competitive and cost effective methods possible in the circumstances.

- **Legal Reasons**  
Some countries insist that imports are paid for under letter of credit to help manage exchange control regulations.
- **Recommended by Banks**  
Domestic bankers may advise exporters that the best method of payment is a 'confirmed irrevocable letter of credit' irrespective of the country, strength of issuing bank and without much regard to the value of the consignment. Although this is, other than advance payment, the most secure method of payment it is not always suitable and can place the exporter at a significant price disadvantage if they are competing against other suppliers selling on less secure terms.
- **Strategic Decision Made by the Exporter**  
Unfortunately, few companies have a clearly defined strategy on how they will sell to certain buyers in specific markets. The strategy should be flexible to adapt to the changing risk profile of both the country and the buyer. A strategic approach to risk management will allow the exporter greater flexibility in protecting the payment risks and will inevitably lead to reduced bank costs because the most effective and cost efficient solution will be adopted.

### **Payment Strategy**

It is important for exporters to be certain that it is necessary to use a letter of credit. As well as the cost of using such a method of payment, there is also the time that is used to check and present the documents under a letter of credit, and, if the presentation is rejected, to correct any errors.

As discussed earlier a letter of credit does provide security to both the exporter and the importer. The security offered, however, must be weighed against the additional costs and the exporter must understand the conditional nature of the letter of credit – payment will not be made unless the terms of the credit are met precisely.

When planning a payment strategy, the following issues should be examined when the use of a letter of credit is being considered.

- Is it a legal requirement in the importing country?
- What is the value of the order – will the bank charges be out of proportion to the value?
- Does the importer insist on a letter of credit or would they prefer an alternative method of payment?
- What is the credit rating of the importer and are they a new customer or has a trading relationship already been established?
- What is the country risk of the importing country (would a confirmed letter of credit be more suitable)?
- What is the standing of the issuing bank (would a confirmed letter of credit be more suitable)?
- What is the usual practice in trading with that country and in that particular commodity?
- Are there any other measures that could be taken to protect the exporter (e.g. credit insurance)?

When looking at the charges involved in using a letter of credit, it should be remembered that confirmation costs, if required will be on top of the usual costs. Confirmation costs will vary according to the country involved, but for many countries considered a high risk will be between 2%-8%. There also may be countries issuing letters of credit which banks do not wish to confirm – they may already have enough exposure in that market or not wish to expose themselves to that particular risk at all.

Having considered the above issues along with company policy, exporters should be in a better position to decide if they should use a letter of credit and if so whether it is necessary to have it confirmed. In some cases other options may be more appropriate.

- **Advance payment**

Under these terms the goods will not be despatched until payment is received in full. This type of transaction involves no credit risk and is the most secure method of payment (more secure than a letter of credit) for the exporter. However, it is uncompetitive and the majority of importers will not wish to trade under these terms. The exporter may well need to be prepared to offer a discount to encourage an importer to accept this method of payment.

- **Open account**

This is the least secure method of payment for exporters, where after a credit limit and period have been agreed, consignments are despatched and the buyer is invoiced. This procedure will generally be used where there is a good trading relationship between the exporter and importer. Geographically open account is generally used when trading with the rest of Europe and North America (although more secure terms may be needed for parts of Eastern Europe). If an exporter is happy that they do not need the security of a letter of credit, they may wish to consider using open account transactions (perhaps backed up by credit insurance which is explained below), especially for smaller value consignments.

- **Documentary Collection**

This method is more secure than open account but less so than a letter of credit and can provide a viable, and cheaper alternative to using a letter of credit. Documents, along with a bill of exchange, are sent through the banking system. The buyer is offered the documents by the bank in exchange for payment or acceptance of the bill of exchange (if payment is due at a later date). In this system there is no guarantee of payment from the bank, and the buyer may refuse to take up the documents, but the exporter still retains some amount of control over the goods by sending the documents through the banking system. The ICC Rules for Collections (URC522) provides guidance for banks and other parties involved in documentary collections.

- **Credit Insurance**

In certain cases exporters may be able to obtain credit insurance to protect themselves against the commercial risk of the buyer not paying or indeed against the country risk of the importing country. Although usually only up to 90% of the invoice value can be recovered the process is much less time consuming than using a letter of credit. There may, however, be times where the credit insurer will not insure without a letter of credit, or indeed, will not insure at all. Although

credit insurance will not provide as much security as a letter of credit it is worthwhile for exporters to consider using this tool.

## **Section 4 - The Survey**

A number of banks were consulted during the course of the research and figures regarding types of discrepancy and their frequency were compiled by three of these banks. They were asked to examine discrepant documents and record the reason for rejection. Details of the results are given in Appendix 1. Below are listed the top ten discrepancies leading to rejection of letters of credit. Additionally the party with the responsibility for the error is given.

<b>Discrepancy</b>	<b>Reason</b>	<b>Responsibility</b>
Inconsistent data	Different information between the different documents.	Exporter
Absence of documents	Documents required by the letter of credit are missing	Exporter
Other	Other documentation reasons not specifically noted	Exporter; any third party e.g. PSI company, carrier
Late presentation	Documents presented later than 21 days after shipment or after the number of days stipulated in the letter of credit	Exporter
Carrier not named and signing capacity	The name of the carrier on the airway bill is missing or not signed on behalf of the carrier	The transport provider
Incorrect data	Information on the set of documents is not in conformity with the letter of credit	Exporter
Letter of credit expired	Documents presented after the letter of credit has expired	Exporter
Incorrect goods description	The goods description on the documents differs from that on the letter of credit	Exporter
Incorrect or absence of endorsement	The bills of lading, insurance certificate or bill of exchange not endorsed by the exporter or other party	Exporter or insurance company
Late Shipment	Goods shipped after the last date given for shipment	Exporter/carrier

It can be seen from this information that the responsibility for the majority of these top ten discrepancies is with the exporter – the party requiring security from the use of the letter of credit. Although there are times when events beyond an exporter's control may cause documents to be presented late or after the expiry of the letter of credit, with a planned strategy for dealing with letters of credit and well trained staff many discrepancies could be eliminated.

Ideas for a strategy for dealing with letters of credit are given in Section 5. In order for this to be effective support needs to be given to the strategy throughout the company, from clerks dealing with letters of credit through to Directors. If it is seen as necessary to use a letter of credit to provide a secure method of payment, then time must be given to ensure that an adequate strategy is in place, and is used, to ensure that letters of credit are dealt with in a professional and effective manner.

Training is also an important part of ensuring smooth and efficient letter of credit transactions, for both export company staff and also for bank staff. Within the export company training is essential both for the export clerk who will be dealing directly with the letter of credit and associated documentation, but also for sales executives who will need to ensure that the correct terms are agreed for the letter of credit when contract negotiation takes place. On the job training is important – each company has its own way of dealing with exports and letters of credit. However, this really should be backed up by formal training. This could take the form of a short course (over one or two days) or longer term training either at a college or by distance learning. A list of organisations providing training in letters of credit are given at Appendix 2. This is by no means exhaustive, but should give some pointers for those dealing in letters of credit who are either untrained or feel the need to brush up on their formal knowledge.

One very important issue that should be dealt with on training courses is UCP500. It is important that those dealing with letters of credit should not only have access to this publication (available from the ICC), but also a knowledge and understanding of all the articles within UCP500. It is also important for bank staff who check letters of credit to have a detailed knowledge of UCP500. When returning discrepant documents to an exporter as well as details of the discrepancies the bank should include reference to the article(s) of UCP500 with which the documents do not comply.

### **The Cost of Non-Compliance to UK Businesses**

The information gathered in the survey showed that in many cases presentations of discrepant documents could easily be avoided. To show how important it is to eliminate discrepant documents in letter of credit trade an estimate has been made of the cost to UK businesses of non-compliant presentations.

The cost to exporters of discrepant documents under letters of credit is estimated at £113 million per year. This figure includes loss of interest due to delayed payment (using an average of 21 days delay getting paid and interest at 5%), charges imposed by the banks for discrepant documents and additional processing costs. Over and above this are other costs such as adverse cash flow and ultimately the loss of opportunity to trade. There is also the potential loss of business due to dissatisfied customers – where documents have been delayed, thereby delaying the clearance of goods on arrival.

## **Section 5 – Demonstrated Best Practice**

Best practice when dealing with a letter of credit starts before it is received. Firstly the exporter should consider whether it is necessary to use a letter of credit, or if another method of payment could be acceptable (these issues were looked at in Section 3). If it is decided that a letter of credit is necessary, the terms and conditions of the credit should be agreed at the contract negotiation stage with the importer. The following issues should be considered:

- who will pay which bank charges;
- will the letter of credit be payable at sight or will there be a credit period;
- should the letter of credit be confirmed (if this is the case this must be stipulated when it is opened);
- which documentation will be requested under the letter of credit; and
- the date up to which the credit will be valid and the number of days to be allowed for presentation of documents (normally 21 days).

In order to ensure that all these points are considered the exporter should provide their suggested letter of credit wording to the buyer as early as possible during the sales negotiations. If this is agreed and built into the sale and purchase contract, there is less likelihood that goods or payment will be delayed due to problems with the letter of credit.

Even when the above steps are followed, it is essential to check the letter of credit as soon as it is received. The following is a checklist to be reviewed immediately on receipt of a letter of credit:

- is the credit subject to UCP500?
- can the goods be shipped within the period set by the letter of credit?
- do any documents need to be legalised?
- can the mode of transport specified be used?
- can shipment be made from the port/airport specified?
- are the prices correct?

Check that the credit terms conform with the underlying sales contract and in particular that:

- the names and addresses of both opener and beneficiary are complete and correct;
- the credit is irrevocable on the part of the overseas bank (under UCP500 this is the case unless stated otherwise);
- drawings under the credit will be either negotiable or payable in the UK rather than abroad;
- the description, price and quantity of the goods are in accordance with the terms of the contract. Remember that underdrawing a credit may sometimes cause problems, e.g. if trade discount has been forgotten when the opener instructed his bank;
- the insurance requirements of the credit are acceptable;
- the required documentation can be obtained;

- if partshipments and transshipment of goods are prohibited, the full quantity of the goods can be exported on a vessel direct from the port of loading to the port of destination;
- the goods can be shipped within the period specified and present documents to the bank within 21 days from the date of shipment, unless a shorter time is stipulated, but, in any case before the credit expires.

The exporter should send a copy of the credit to their shipping and forwarding agent.

If there are any terms or conditions within the credit which cannot be met, arrangements must be made, immediately, for the credit to be amended. Only the applicant (the buyer) can instruct the bank to amend the letter of credit. This will take time and there will also be a cost involved, but is better than the alternative of leaving the credit as it is and risking rejection of the documents when they are presented.

Once the exporter is certain that all the terms and conditions in the letter of credit can be met care must be taken to compile all the documentation correctly. It must be remembered that the documents must be in strict compliance with the letter of credit – the banks mandate to pay depends entirely on the correctness of the documentation.

A number of issues that should be considered as well as points to check when preparing individual documents are set out at Appendix 3.

Should the documents be rejected the exporter has the following options:

- correct documents;
- instruct the advising bank to request the issuing bank for permission to pay despite the discrepancies;
- offer the bank an indemnity if they will pay despite the discrepancies; or
- send documents to the issuing bank on a collection basis.

Options one and two are the best as the security of the letter of credit is maintained. With the third option the exporter may have to repay the money if the importer refuses to pay for discrepant documents and under the final option the security is lost.

## **Section 6 - Conclusions**

Letters of credit are still an important tool used in international trade. They provide security for both buyer and seller where conditions may be uncertain or there is little or no previous trading relationship between the parties. However, letters of credit only provide this security when they are used in a prudent manner – it is essential that exporters remember that documents must be in strict compliance with the credit to secure payment. Treating letters of credit in a casual manner will remove the very level of security the exporter is seeking when selecting them as a method of payment.

To ensure that letters of credit are dealt with in a competent and professional manner it is important for companies to have an action plan or checklist when dealing with letter of credit trade. This should apply to both regular users and those who use letters of credit infrequently. Indeed it can be seen almost as more important for infrequent users to have these procedures in place due to their having less experience in dealing with these types of transactions. Many suggestions of how to deal with credits are given in Section 5 of this report. SITPRO also publish a set of three Letter of Credit Checklist and Guides for importers, exporters and export sales executives.

Whenever letters of credit and discrepancies are discussed the issue of training is nearly always raised. There is no getting away from the fact that in order to process letters of credit in a timely and accurate fashion staff must be adequately trained. In an ideal world this means both on the job training backed up by a formal training course or qualification. Formal training is available from a number of different organisations (see Appendix 2) either through attendance on courses or through distance learning methods.

Those companies who are dealing with letters of credit on an infrequent basis (and in some instances perhaps others who deal more often with letters of credit) may feel that it is not appropriate to have the expertise to deal with letters of credit in-house. In this case use may be made of outside expertise and experience for example their freight forwarder. This should be seen as a positive step taken to help ensure that the letter of credit process runs smoothly. However, using outside expertise does not preclude taking steps during contract negotiations to ensure that the credit is set up appropriately.

It is now recognised that electronic commerce can be used throughout the letter of credit chain. Indeed with effect from 1 April 2002 the ICC have introduced a supplement to rules for letters of credit (UCP500), which provides for electronic presentation of documents (eUCP). SITPRO consider that further work should be carried out to look at how far electronic letters of credit are used within international trade and whether their use reduces the number of discrepant documents causing rejection of credits. It is recommended that this work should not be carried out until at least 2003 to ensure that the new eUCP rules start to be widely used. This suggestion will be put to the SITPRO Board for further discussion and possible inclusion in future work programmes.

## **GLOSSARY OF COMMONLY USED TERMS IN DOCUMENTARY CREDITS**

Accepting Bank	The bank specifically nominated in the letter of credit as the bank on which a bill of exchange (draft) at a specified usance (time or term) is to be drawn.
Advising Bank	The bank, usually but not necessarily in the beneficiary's country, through which advice of the letter of credit is sent by the issuing bank.
Beneficiary	The party in whose favour the letter of credit is issued.
Confirmed Credit	Irrevocable letter of credit to which another bank (usually the advising bank) has added its payment undertaking on the instructions of the issuing bank. This is in addition to the irrevocable undertaking of the issuing bank.
Consignee	Party to whom the goods are to be consigned.
Consignor/shipper/ exporter	The party despatching the goods.
Draft	Another term for a bill of exchange.
Drawings	Separate presentations of documents under a letter of credit.
Incoterms	Uniform rules for the interpretation of trade terms developed by the International Chamber of Commerce (ICC) used and recognised by buyers and sellers throughout the world.
Irrevocable Credit	A letter of credit under which the issuing bank gives its irrevocable undertaking that payment, acceptance or negotiation will be effected if all the terms of the letter of credit are met and the specified documents are provided. This type of letter of credit cannot be amended or cancelled without the beneficiary's consent.
Issuing Bank	The bank which issues the letter of credit on the instructions of the importer (usually, but not necessarily, the importer's own bank).
Negotiating Bank	The bank specifically nominated in the letter of credit to purchase the bill of exchange (draft) drawn by the beneficiary on a drawee other than the negotiating bank. (If a letter of credit is freely negotiable, any bank willing to do so can be the negotiating bank).

Paying Bank	The bank specifically nominated in the letter of credit to which documents (and sight bill of exchange (draft) if called for) must be presented for payment.
Revocable Credit	A letter of credit that can be cancelled or amended without prior notice to the beneficiary and may, therefore, be of little value to him.
Transferable Credit	A letter of credit under which the original beneficiary has the right to give instructions to the bank with which the letter of credit is available to transfer it in whole or in part to a third party ("second" beneficiary).
Uniform Customs and Practice	Standard rules and documentary letters of credit developed by the International Chamber of Commerce (ICC) and adopted by most countries. Virtually all letters of credit issued these days are subject to the rules.

## **Appendix 1 – List of Discrepancies and Frequency**

### **Consolidated Documentary Discrepancies for Exports**

Discrepancy Type:	<b>Bank A</b>	<b>Bank B</b>	<b>Bank C</b>
	Export % of Exp total	Export % of Exp total	Export % of Exp total
Sample			
DC Expired	1.6%	10.2%	4.4%
Late Presentation	6.3%	8.5%	8.1%
Late Shipment	0.0%	5.1%	3.3%
Shipping Schedule not complied with	0.0%	0.0%	0.0%
DC Over/Underdrawn	0.0%	1.7%	1.5%
Over/Under shipped	0.0%	1.7%	0.6%
Part Shipment	0.0%	1.7%	0.0%
Incorrect Goods Description	4.7%	5.1%	3.9%
Incorrect Data (other)	6.3%	6.8%	7.3%
Inconsistant Data	14.1%	6.8%	28.6%
Incoterms related	3.1%	0.0%	1.1%
Original / Duplicate Presented	0.0%	1.7%	2.1%
Unauthenticated Alterations	0.0%	5.1%	3.5%
Other	12.5%	10.2%	13.6%
Absence of Documents	17.2%	16.9%	8.0%
Insurance:			
Under Insured	1.6%	0.0%	0.6%
Incorrect Cover	3.1%	0.0%	0.9%
Incorrect Insured Party	0.0%	0.0%	0.0%
Movement Documents:			
Despatch Details	0.0%	3.4%	0.0%
Incorrect Consignee/ Notify party	4.7%	1.7%	0.4%
Incorrect Despatch/Destination	0.0%	0.0%	0.0%
Freight Status	3.1%	0.0%	0.6%
Carrier not Named & Signing Capac	10.9%	1.7%	9.4%
Intended Vessel	0.0%	0.0%	0.0%
Incorrect Carrier	3.1%	0.0%	0.0%
Incorrect/absence of endorsement	1.6%	5.1%	4.0%
On Board Notation	3.1%	0.0%	2.8%
Incorrect Mode of Transport	0.0%	0.0%	0.0%
Other	3.1%	5.1%	0.2%
	100.0%	100.0%	100.0%

## **Appendix 2—Organisations Providing Letter of Credit Training**

The following are organisations providing training in the use of letters of credit. Please note that SITPRO does in no way endorse these companies and is not responsible for the standard of training provided. If your company provides training in this area and you wish to be included in this list please let us know: [info@sitpro.org.uk](mailto:info@sitpro.org.uk)

The Institute of Export  
Export House  
Minerva Business Park  
Lynch Wood  
Peterborough  
PE2 6FT  
01733 404400  
[www.export.org.uk](http://www.export.org.uk)

Peter East Associates  
Hathaway House  
Popes Drive  
London N3 1QF  
020 8349 4434  
[www.petereast.com](http://www.petereast.com)

Institute of Credit Management  
The Water Mill  
Station Road  
South Luffenham  
Oakham  
Leicestershire LE15 8NB  
01780 722907  
[www.icm.org.uk](http://www.icm.org.uk)

ICC  
DC-PRO Mentor (the ICC's web-based training course on UCP500)  
IMS Maxims  
Clara House  
Glenageary Park  
Co Dublin  
Ireland  
Tel: +353 1 235 2166  
[www.iccwbo.org](http://www.iccwbo.org) (click on the DC-PRO icon)

## **Appendix 3 – Checklist for Compiling Documents Under a Letter of Credit**

### **General Considerations**

#### **Amount**

- As mentioned earlier, an overstatement of the amount to be drawn could lead to the rejection of documents when presented.
- The words "circa" or "about" relating to the quantity or unit price of the goods or to the amount of the credit allow a tolerance of 10% either way.
- Unless a credit stipulates that the quantity of the goods specified must not be exceeded nor reduced, a tolerance of 5% either way is permissible, always providing that the total amount of the drawings does not exceed the amount of the credit. However, this tolerance does not apply when the credit specifies quantities in terms of a stated number of packing units or individual items.

#### **Shipment**

Check that:

- Specified shipping documentation can be obtained.
- If you are chartering a vessel or shipping on deck, the credit specifically permits such methods.
- Ports of shipment and discharge, if specified, do not conflict with your price quotations.
- If partial shipment or transshipments have to be made, these are not prohibited in the credit.
- Time available for shipment is sufficient and that the period allowed for presentation of documents after shipment is also sufficient. It should be noted that, if a credit expires on a day when banks are not open, the validity is usually extended to the next working day. However, such an extension does not apply to the stipulated time (after shipment) allowed for the presentation of documents.
- If partial shipments within given periods are called for and any instalment is not shipped within the stipulated period, the credit is effectively cancelled unless it already covers such an eventuality.

Exporters are advised to read the payment instructions issued to advising banks which will include one of the following:

### **Points to Look for in Individual Documents**

#### **Draft**

The draft must be drawn by the beneficiary on the party specified in the credit or as requested by the advising bank. It must be drawn in accordance with the terms of the credit, bear the requisite reference number and also comply with the requirements of the Bills of Exchange Act. Also check that it is:

- correct in words and figures;

- drawn payable at sight (or sometimes at a given future time);
- claused in accordance with the credit terms; and
- correctly dated.

Bear in mind that a tenor draft accepted by a London bank can often be discounted at a comparatively fine rate.

### **Bills of Lading**

A traditional bill of lading has a threefold purpose:

- formal receipt by the ship owner for goods;
- evidence of the contract of carriage; and
- document of title to goods.

Bills of lading should be carefully examined with the following points in mind. They should:

- be issued by a shipping company or its accredited agent;
- not be issued by a forwarding agent nor under a charter unless specifically authorised by the letter of credit unless it is a FIATA bill of lading and acceptable under the letter of credit;
- be shipped on board, unless the credit provides otherwise;
- bear a proper amendment, duly dated and signed by the shipping company, if a "received for shipment" item has been converted into a "shipped" document. The same applies to any other alteration;
- be in a complete set (unless otherwise indicated in the letter of credit) with any required number of non-negotiable copies, each negotiable copy being signed by the shipping company;
- be free from any detrimental clauses added by the shipping company indicating damage to goods or packing;
- cover an ocean voyage. Bills of lading evidencing shipment by a local vessel are not normally acceptable if transshipment is not allowed;
- bear a precise notation concerning payment of freight, i.e. either "freight paid" or freight payable at a given destination;
- bear goods description either in general or particular terms: however, the wording chosen must not conflict with the credit or other documents;
- bear shipping marks, number of packets and weights, consistent with all other documents. In particular, care should be taken that details on the bill of lading (often the last document to become available) do not contradict details typed on earlier documents;
- show ports of shipment and discharge in agreement with credit terms;
- be endorsed on the reverse if made out to the shipper's order;
- be presented within the time limit specified in the credit for presentation of documents. If no such period is stipulated, banks will refuse documents presented later than 21 days from the date of the bill of lading;
- must bear a shipment date on or before the last stipulated shipment date but, in any event, within the validity of the credit;

Unless otherwise stipulated in the credit, banks will accept:

- short form bills of lading issued by shipping companies or their agents;
- combined transport bills of lading issued by shipping companies or their agents.

### **Insurance Documents**

Check that:

- the extent of the cover agrees precisely with the credit terms, bearing in mind that Institute Cargo Clauses (All Risks) do not always cover special risks;
- the date of the insurance document is not later than the shipment date or, if dated after shipment, it bears a clause to the effect that cover commences not later than the date of shipment;
- claims are payable in the place specified in the credit;
- the amount payable is in accordance with the credit terms plus any specified percentage and is in the currency of the credit;
- marks, weights and description of the goods agree with the bill of lading and all other documents;
- policy or certificate required by the credit terms is signed by the insurance company, agents or underwriters and endorsed as necessary;
- cover is not by means of a broker's cover note, unless this is specified in the credit; and
- any insurance policy or certificate made out to the order of the shippers has been blank endorsed.

Bear in mind that, when a credit calls for an Insurance Policy, a certificate issued by Lloyds of London is normally acceptable to most banks.

### **Invoice**

Check that:

- these have been completed by the beneficiary in the name of the buyer unless the credit specifies otherwise;
- totals of all invoices agree with the amount of the drawing;
- prices and shipment terms (FOB and CIF etc) agree with the credit;
- if a combined invoice and certificate of origin is called for, the certificate of origin is duly completed and signed;
- if invoices have to be visaed, this has been done by the authority stipulated in the credit. Also remember the time lag between forwarding documents to a consulate and their return;
- full and exact description of the goods as shown on the credit appears on the invoice and that the quantity and specifications are as called for. If goods are described as being "..... in accordance with pro forma invoice number ..... dated .....", this can reduce superfluous, error-producing, detail;
- there are no additional goods, charges or deductions not authorised in the credit. However, a deduction of normal trade discount is allowed as long as the final amount is correct - neither overdrawn nor underdrawn;

- if both an invoice and a packing list are called for, no "combined invoice and packing list" should be offered. An appropriately detailed extra invoice may often satisfy the packing list need, if suitably headed;
- pro forma invoice numbers or reference numbers are required by the credit are shown; and
- marks and weights (nett unless the credit states otherwise), number of cases and name of vessel agree with the bill of lading and other documents.

### **Certificates of Origin**

An exporter's own certificate on a separate sheet is acceptable unless the credit states otherwise.

Check that:

- all details quoted, shipping marks and description of goods, agree with the letter of credit, bill of lading and other documents; and
- the certificate does not conflict with other documents with regard to value and country of origin.

### **Weight Note / List**

Note that:

- certificates of weight must bear an authorised signature of the person/firm/company issuing the certificate in the detail required;
- if a weight list is called for by the credit, this requires the individual weight of each parcel or package together with the total weight; and
- if a weight note is called for by the credit it can merely state the weights concerned in general terms, perhaps one total.

### **Other Documents**

There are various other documents which provide evidence of the movement of goods but which are not documents of title.

#### Air Waybill (air consignment note)

These should be issued and stamped by an airline on standard forms and should appear to be the original for the shipper (usually copy 3). This shows:

- name of consignee;
- goods, which must agree with the credit and all other documents;
- flight number and date;
- freight paid or to be paid at destination (again, in accordance with the terms of the credit); and

It is essential that the correct copy be submitted, bearing a clear reception stamp with signature of the carrier or his agent.

Air waybills issued by freight forwarders and referred to a master air waybill are not acceptable unless there is presented a certificate stating that the forwarders are acting as agents for the carriers.

Parcel Post Receipt

Check that:

- the receipt shows evidence of despatch to the party named in the credit; and
- the Post Office stamp shows a despatch date on or before the last stipulated date for shipment.

Note Credits calling for postal despatch on a FOB basis are not acceptable as postal charges to destinations have to be prepaid.

Forwarding Agent's Receipt

It is very important to establish at the outset whether there is a requirement for:

- a forwarding agent's receipt showing goods received for shipment; or
- a forwarding agent's receipt showing goods received and despatched, as in the case of the CMR note. Normally, one set of documents accompanies the goods on this type of journey.