

SITPRO Briefings

Letter of Credit



Checklist and Guide for Exporters



Introduction

This is one of three SITPRO letter of credit checklists available on our website (www.sitpro.org.uk). Of the other two, one is designed for importers - to be used by purchasing staff when applying to local banks for letters of credit; and we strongly recommend you provide copies to such customers to back-up your own discussions with them. The third checklist is designed for export sales executives. It extends beyond advice on credits by pointing to some of the other responsibilities the executive has to assume on overseas visits

The SITPRO range of Checklists and Guides are designed to minimise unnecessary costs and risk when trading on the basis of letters of credit. They are aligned with the 1993 revision of the ICC "Uniform Customs and Practice for Documentary Credits" (commonly known as UCP 500), the current edition of the worldwide "rules".

The Checklist is intended primarily - but not only - for use in export sales and shipping departments. It will also be of regular assistance to those involved in financial and credit management and in production and supply. Working through the checkpoints set out in the various sections will help reduce discrepancies; associated unplanned costs; and the risk of losing the whole basis of secured payment for which the credit was established in the first place.

As successive SITPRO and other surveys have shown, well in excess of 50% of presentations are rejected by banks in the first instance. This percentage is considered by many to be a very conservative estimate. As the resultant cost both to the individual exporter and the UK economy is high, it is essential that credit transactions be handled correctly from contract stage to actual drawdown - by following the recommendations here.

Key Checks on the Day the Letter of Credit is Received

Before going any further...

- Check that the letter of credit states that it is subject to the 1993 revision of the Uniform Customs and Practice for Documentary Credits (UCP) of the International Chamber of Commerce, usually mentioning ICC Publication No. 500 (or perhaps "current revision").
- Check the authenticity of the credit. Forgeries are comparatively rare, but dangerous. Credits are normally sent through an advising/confirming bank in the UK. Any departure from this routine should be viewed with suspicion, for example, if it comes to you direct from overseas. If it comes from a UK address asking you to send documents abroad and you do not recognise the UK bank, check its authenticity with your own bank. UCP 500 commits an advising bank to take reasonable care as to apparent authenticity of a credit (see UCP 500 Article 7)

Nonetheless, if you receive an unexpected credit from a buyer unknown to you, even under cover of a seemingly genuine advice from a UK bank, check with the bank that everything is in order - particularly if it calls for goods direct to the buyer with only a PO Box number!

Having assured yourself on these points, proceed with the key checks, bearing in mind, as mentioned above, that over half of credit documents are rejected on first presentation to the paying / accepting banks. The main reason for this is that matters which could have been put right, given time, were not put right because the credit had not been checked early enough. Making these key checks on the day the credit arrives, consulting other departments accordingly and carrying out the more detailed checks immediately afterwards, will enable difficulties to be spotted in better time to take action.

Check that the type of credit gives you the level of payment security you sought. It may not be confirmed by a bank in the UK and may even be revocable i.e subject to cancellation without your knowledge. Credits issued under UCP 500 are irrevocable unless otherwise stated.

Check that you will be paid at the time you planned. The credit may specify payment some time after documents and/or drafts have been accepted by the paying bank. Additional delays and other problems may arise if payment/acceptance is to take place abroad.

Check that your company name and full title and those of the buyer are both correct.

Check that you can produce the goods, ship them, assemble the documents required and deliver them to the bank, all by the expiry date and within the transport document time limit. The bank has no discretion under UCP 500 and is not in a position to pay after expiry dates, nor if the documents are not completely in order.

If the credit has been sent electronically to a UK bank - "teletransmitted" - check that it provides details of the credit that you can act upon and that is not just a pre-advice. Unless it says otherwise, and provided it refers to UCP 500, it can be taken as the operative credit, can be safely acted upon and overrides any later mailed advice, since unless a pre-advice says otherwise, the issuing bank is bound to follow up the pre-advice by issuing the credit.

Check that only those bank charges you agreed to pay are stated to be for your account. Be careful over bank reimbursing charges with a credit not expressed in sterling.

If something is wrong, requiring an alteration or extension, complete the detailed checks below to see if there is anything else, then contact the advising bank immediately - it may

be an error/omission on their part. If that is not the case, contact the buyer without further delay and then ensure that any necessary amendments are received in time. If an import licence must be extended, this can take some time. If the licence cannot be extended and a new one has to be obtained the delay may well go beyond the expiry date of the credit.

At an early stage, it will be in your best interests to send a copy of the credit to your forwarder or whoever will obtain the transport documents. Similarly with your insurers if insurance is to be covered by you. Telephone instructions alone may easily result in mis-spellings and consequent rejection by the bank, or even a wrong type of transport or insurance document may be provided.

Detailed Checks Immediately the Credit is Received

When checking your credit under the headings below, remember that UCP 500 states in more than thirty places “unless otherwise stipulated in the credit” or something similar. One or more of the following checkpoints may thus be overridden by conditions stipulated in your particular credit. In that case check what UCP 500 has to say on the point and with the UK bank if you are still unclear as to what the wording of the credit implies.

(Note - it is recommended that details of the credit are recorded at this point so that a progress check can be updated right through to presentation of the final documents to the bank for payment. The pre-printed “Exporter L/C Validation Form” from Chancellor Formecon (www.chancellor.co.uk) provides a convenient way for doing this.)

Does the type of credit give you the security of payment you want?

- Irrevocable but carrying only the undertaking of your customer’s bank in his/her country
or
- Irrevocable and confirmed, carrying the extra and separate undertaking of a second bank, usually in the UK
or
- Revocable - not normally a serious consideration, unless you have agreed it with your buyer under special circumstances. (Note UCP 500 Article 8 (a)).

Is it payable when and where you want?

- At sight, when correct documents are presented to the paying bank, in time
or
- At a later date, such as 90 days after the date of the transport document. (The technical terms sight payment, deferred payment, acceptance and negotiation are described in UCP 500 Article 9(a) and (b) and 10(b)(ii). Also check any bill of exchange requirements).
- In the UK with little or no delay after reasonable time for checking by the paying bank
or
- Abroad, with possible lengthy delays and some risk. If you were not expecting payment to be made abroad but are prepared to consider it, be sure you understand your position i.e that you are responsible for postal delays in presenting documents overseas within the time limits set by the expiry date of the credit and UCP 500 Article 43(a). This gives less time for replacing non-compliant documents with compliant ones.

Is the value of the credit correct? Does it allow for:

- Any extra agreed costs such as freight or inspection fees.
- Unplanned variations - the value of the credit must permit a corresponding drawing to be made. See Article 39(b) and (c) of UCP 500.
- Planned variation - “about” in a credit permits up to a 10% variation in whatever it refers to e.g

value, quantity or unit price.

Are the terms of delivery the same as you quoted? (e.g FOB, CIF, CIP) and do they and the price match properly? For example, if you quoted £10,000 FOB UK, and the credit states £10,000 CIF Hong Kong, you will naturally not be able to recover the freight and insurance. In addition to which the paying bank will refuse your documents if you exceed the credit amount or alter any unit price quoted in the credit. If the sales contract was subject to "INCOTERMS 2000" is this made clear in the credit?

Is your company name and address spelt correctly and shown exactly as on your invoice heading?

Are the buyer's details similarly correct? It is possible to copy a mis-spelled buyer's name on your invoice. However, if your own company is not correct then even if you alter it on your invoice heading to match, the bank may not agree to credit the payment to your account; this point should be clarified with the bank.

Are partial shipments prohibited? They are permitted unless otherwise stated in the letter of credit (UCP 500 Article 40(a)).

Can you meet the expiry date and also present documents within the transport document time limit? Allowing time for:

- Production and packing;
- Inspection - if required;
- Shipment - check sailing frequencies;
- Chamber of Commerce and consular work;
- Obtaining the inspection certificate;
- Assembling and checking documents;
- Presenting them to the bank

Note that the last four stages must be completed within 21 days of the date of shipment evidenced by the transport document in order to present documents in time - unless the credit specifies a different period which could be less. (Note: the validity date stipulated in the credit must be adhered to. It is not overridden by the 21 day rule although provided it still falls within the validity of the credit it might well be in your interest to ask for "in excess of 21 days" when arranging for the establishment of the credit).

Has the export or import licence been obtained, with adequate validity?

Are the goods described accurately enough to identify them properly (including any no charge items) and are quantities and other units correct? (Note UCP 500 Article 37(c)).

Does the credit restrict the way in which documents are prepared? Documents produced by copier, computer or carbons, marked as originals, and where necessary authenticated (import regulations in many countries require hand-signed documents), will be accepted as originals unless the credit stated otherwise. Article 20 of UCP 500 gives details.

Can you provide the transport document called for?

- "On deck" shipment must be authorised if the goods are dangerous or for any reason cannot be stowed under deck. (See UCP 500 Article 31)
- "Claused" transport documents must be permitted if your products legitimately attract such

clauses - such as superficial rust on steel. The credit must state which clauses are acceptable. (See UCP 500 Article 32).

- The places of acceptance and delivery - and the ports if a marine bill of lading is called for - should be checked. The UCP 500 Transport Articles are precise on this point.
- A transport document issued by a freight forwarder is acceptable unless specifically prohibited by the credit, provided it meets the detailed requirements of UCP 500 Article 30. Check also that it satisfies the requirements for the mode of transport used. (See UCP 500 Articles 23 - 28)
- Short form (blank back) transport documents and documents showing places of acceptance/final destination different from the ports of loading/discharge are acceptable unless the credit stipulates otherwise.
- "Intended" vessels and ports are acceptable in certain circumstances. (See UCP 500 Article 23, 24 sections (a)(ii) and (iii).
- "Received for carriage" or "received for shipment" documents are not acceptable under UCP 500 Article 23 (Marine/Ocean bill of lading) and Article 24 (non-negotiable sea waybills) unless specifically stipulated in the credit.
- Although the point should have been cleared when arranging the issuance of the credit, "Transshipment prohibited" should not normally be a condition of a credit. Nevertheless, if it is, banks will accept a transport document indicating that the goods will be transhipped provided that the cargo is shipped in containers etc and that the entire carriage is covered by one and the same Transport Document. (See UCP 500 Articles 23, 24, 26, 27 and 28).

Can you obtain insurance cover for the risks specified? If "all risks" is stipulated, banks will accept any "all risks" notation or clauses on insurance documents.

- Did your quotation cover the cost of insuring the risks specified?
- Can you provide the right type of insurance document, for example if the credit calls for a policy rather than a certificate?

If you are not asked to arrange marine insurance, for example on CFR or CPT sales, have you considered obtaining "seller's interest" or other CPT suitable cover for your own account, if available, outside the terms of the credit?

Can you supply all other documents in the way called for? Remembering that some - such as inspection certificates or consular documents - may take some time to arrange.

Are there any contradictions in the credit? Such as requiring bills of lading for air freight or an insurance certificate for CFR or CPT.

Are there any doubtful points of interpretation? - such as an advice of despatch being sent to the buyer "promptly" or "immediately" after shipment.

If the credit is wrong or ambiguous on any of these points, prompt decision and action is necessary on:

- Whether you can change your plans or paperwork to meet the requirement.
- Whether to ask the customer to amend the credit and who pays for the amendment.
- Whether to let things stand and risk non-payment.
- If in doubt, always consult your own bank and or/the paying bank for advice and make a record of the time, date and outcome of the contact. Also remember that only the buyer can authorise amendments, i.e. alterations or extensions, through his bank in the first place.

When Assembling Documents for Presentation to the Bank

Ensure that:

- You have the correct number of copies of each; they carry the information called for; the title of each is correct and it is issued by the party specified in the credit. The document name must match exactly what the credit calls for, e.g. "Certificate of quantity and quality".
- They are consistent - for example, the shipping marks, quantities/weights, transport details, references, and in general terms the descriptions, must tally so that they clearly relate on their face to the same shipment.
- The description of goods is correct. They may be described in general terms, not inconsistent with the credit, in all documents except the invoice, where the exact credit description must be reproduced. Credit details should preferably not be repeated in full in transport documents and some carriers will refuse to enter more than their minimum necessary information. This may cause a discrepancy if the information given does not relate sufficiently to the credit or other documents.
- Documents are authenticated where necessary - import regulations in some countries still make it essential to sign manually and possibly witness documents and any alterations or additions to them. (Note UCP 500 Article 20(d)).
- Any restrictions in the credit are catered for, for example if short form bills of lading are prohibited.

Check each document to ensure that it is in order.

• Transport Document

1. Type of transport document, e.g. sea, air, road, rail, inland waterway, multimodal, courier or postal despatches.
2. Consignor - can be different from beneficiary.
3. Consignee's name and spelling - can differ from buyer.
4. Places and ports.
5. Clauses.
6. On-deck shipment
7. "Intended", "received", "on board" or "transhipment" notations. An "on board" notation must be dated. The credit must specifically stipulate that an on board notation must be authenticated, if this is what is required.
8. "Freight paid" notation.
9. Full set of originals - unless otherwise permitted.
10. Date of shipment (on board or despatch or taking in charge date, as applicable) and date of issue - watch the time limit for presentation. (See UCP 500 Article 43).
11. Endorsed as may be stipulated in the credit.
12. For air despatches the transport document (Original No. 3 for Shipper) needs to comply in every detail. The Air Waybill (Air Consignment Note) must meet the requirements of UCP 500 Article 27.

• Insurance Document

1. Correct type e.g. a certificate or policy and number of documents as stipulated in the credit after certificate.
2. Correct amount e.g. CIF plus 10% is the minimum unless otherwise stipulated in the credit (See UCP 500 Article 34(f)).
3. Same currency as the credit unless otherwise stipulated in the credit.
4. Risk covered in the credit
5. Date no later than date of issue of the transport document, unless the insurance document clearly states that cover takes effect from the date of shipment/receipt of cargo i.e. warehouse-to-warehouse.
6. Endorsed, if necessary, exactly as required by the credit.

- **Invoice**

1. Invoice heading in your company's name, expressed and spelt exactly as in the credit.
2. Made out in name of buyer, expressed and spelt exactly as in the credit.
3. Description of goods, including import licence or pro-forma details, price and terms of delivery, any no-charge goods or samples - worded and spelt exactly as set out in the credit.
4. Clauses or statements - word for word identically spelt and in any foreign language specified.
5. Value not more than the credit permits
6. Quantity - a 5% variation is sometimes permitted - see Article 39(b) and (c) of UCP 500 on variations. Alternatively, the credit may permit a specific variation, e.g. an 'about' amount (10% plus or minus).
7. Reproduced, signed and authenticated as necessary in a way allowed for by UCP 500 and in the credit e.g. copier, computer, carbons.

- **Other Documents**

1. Correct issuer.
2. Correct wording or content - Avoid unnecessary wording which might confuse the bank checker.
3. Clearly relates to the goods invoiced.
4. Electronic transmissions to the buyer and/or insurer correctly set out, addressed and dated.
5. Certificates to cover any other credit requirement only where a specific certificate is called for. (Note UCP 500 Article 13(c).
6. Do not enclose any documents not required by the credit.
7. All signed, authenticated or endorsed as necessary.

- **Bills of Exchange (if any)**

1. Date.
2. Signature identifies signatory.
3. Endorsement.
4. Clause.
5. Letters of Credit reference number
6. Term - sight or usance dates
7. Amount and currency
8. Words and figures tally
9. Drawn on correct party
10. Correct document e.g. "sole" or "1st and 2nd of exchange".

- **Covering note/letter to nominated bank.** (List the documents, preferably in the same order as they appear in the credit).

1. Give the name, telephone, email and fax numbers of the correct contact in your office and back-up contact in case of absence.
2. Ask the bank to notify any discrepancies electronically or by telephone, not by mail.
3. Indicate how to pay - cheque or direct to bank account (in which case show bank, branch, sort code, account name and account number).
4. If you have a forward currency contract for a letter of credit payable in foreign currency, provide contract details.

Present documents to the bank without delay and within the expiry date and transport document time limit.

- All documents must be complete and delivered to the bank by close of business on the expiry date and within the transport document time limit, whichever is earlier; or, if the bank is normally closed on that day, on the next business day. Obtain a time/dated receipt where appropriate.
- Check the transport document time limit very carefully - 21 days from the date of shipment (defined in Article 43(a) of UCP 500) unless the credit gives a longer or shorter period. This may well be earlier than the expiry date of the credit itself or than any specified "last date for presentation/negotiation".
- The import licence expiry date is equally important and it may not be possible to extend this.
- If any discrepancies are found and they can be put right, the corrected documents must still be

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presented to the bank by the original expiry date and within the time permitted from date of shipment evidenced by the transport document.

- Check and send any specified documents to the buyer if required to do so under the terms of the credit and/or buyer's order, enclosing a copy of your documents schedule as sent with your credit documents when making presentation to the bank for payment.

If There are Discrepancies

Unless you can correct discrepancies in time you may well lose your right to payment and all the cost and effort to obtain security will have been wasted.

What are the options?

- Correct the documents within the original expiry date and within the period allowed after the shipment evidenced by the transport document.
- The bank can be asked to teletransmit for permission to pay despite discrepancies. This can take time and such costs must be met but can produce a final result more quickly. (Note UCP 500 Article 14(c).
- An indemnity, either your own undertaking or one issued by or joined-in by your bank, may be acceptable. In such a case you are paid promptly but are still at risk and if the issuing bank decides not to pay, the money must be repaid to the paying bank with interest. Indemnities are often casually issued and financial directors are frequently unaware that a massive contingent liability is building up. (If an indemnity is decided upon, try to arrange a validity of six months maximum).
- The Bank may offer to pay under reserve which has the same practical effect as payment under an indemnity though without the paperwork, but there is normally no time limit applicable. If the issuing bank rejects the discrepant document money received has to be paid back with interest.
- Documents can be sent "on collection" within the security of the credit but cash flow is seriously hindered and an unscrupulous buyer may try to take advantage by offering a reduced price for a quick settlement against documents "as presented". With documents "on collection" the remitting bank should be requested to instruct the issuing bank that release of the documents to the buyer is to be only against payment being authorised.

These measures normally retain your control over the goods as the buyer cannot take delivery without the documents which are still in your control. Nevertheless, the buyer is in effect being asked whether, after all, he still wants the goods and is prepared to accept the discrepancies in the documents. He is quite free to refuse.