

## Description of Proposed Letter of Credit Master Guarantee Scheme

### 1 Defined Terms

“ <b>Confirming Bank</b> ”	means a bank that adds its confirmation to a letter of credit upon the Issuing Bank’s authorisation or request;
“ <b>Exporter</b> ”	means an exporter of goods or services;
“ <b>Issuing Bank</b> ”	means a bank that issues a letter of credit;
“ <b>ISP98</b> ”	means the International Standby Practices, ICC Publication No. 590, which are rules that were developed in 1998 by the Institute of International Banking Law & Practice Inc. in the USA and subsequently endorsed and promoted by the International Chamber of Commerce.
“ <b>LCGS</b> ”	means the proposed letter of credit guarantee scheme;
“ <b>UCP 600</b> ”	means the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600, published by the International Chamber of Commerce.

### 2 Description of the Proposed Scheme

- 2.1 A guarantee issued by ECGD to a Confirming Bank participating in the LCGS (“**Participating Bank**”) covering the risk of an overseas Issuing Bank failing to reimburse the Participating Bank amounts paid by such Participating Bank to an Exporter in respect of a letter of credit issued by the Issuing Bank to such an Exporter (“**Letter of Credit Master Guarantee**”).

### 3 Overview

- 3.1 It is proposed that a Letter of Credit Master Guarantee would be issued by ECGD in respect of Letters of Credit fulfilling eligibility criteria (the currently proposed criteria set out in paragraph 5 below) to Confirming Banks that satisfy the currently proposed criteria set out in paragraph 6 below.
- 3.2 It is proposed that a Participating Bank would only be entitled to reimbursement under a Letter of Credit Master Guarantee in the circumstances set out in paragraph 7 below.

- 3.3 It would be the intention that various mechanisms would be incorporated into the LCGS in order to limit exposure to risk under the LCGS. The currently proposed criteria are set out in paragraph 8 below.
- 3.4 It is proposed that the LCGS would incorporate particular protections relating to anti-corruption and bribery. The proposed protections are described in paragraph 9 below.
- 3.5 It would be necessary that ECGD be kept well informed of its overall exposure under the LCGS, and there would therefore be reporting obligations on the Participating Bank, as outlined in paragraph 10 below.
- 3.6 ECGD proposes to retain control of the recovery process in relation to any claims made under the LCGS as set out in paragraph 11 below.

#### **4 Proposed mechanics of implementation**

- 4.1 It is proposed that the LCGS would be delivered through a master guarantee agreement entered into between ECGD and the Participating Bank, rather than have a system of entering into a full set of guarantee documentation for each Letter of Credit transaction. This master agreement would clarify the premium, limits and maximum guaranteed percentages as described in paragraph 8 below.
- 4.2 A Confirming Bank would apply to enter into the master agreement and provide evidence of fulfilling the eligibility criteria set out in paragraph 6 below.
- 4.3 The Participating Bank would cede an incoming letter of credit to ECGD by a mechanism to be agreed and would provide specific information as set out in paragraph 10 below.
- 4.4 On or before the declaration to ECGD, the Participating Bank would carry out any further required “know-your-customer” and/or risk assessment checks and obtain relevant declarations from the Exporter.

#### **5 Proposed eligibility of Letters of Credit**

- 5.1 It is proposed that the LCGS would only apply in respect of Letters of Credit that: (i) are to be confirmed by the Participating Bank at the request of the Issuing Bank; (ii) are to be confirmed after declaration under the Letter of Credit Master Guarantee; (iii) are governed by the UCP 600; (iv) the relevant goods or services are eligible exports; (v) are denominated in sterling, US dollars or Euros, or such other currency as ECGD may approve; (vi) have an expiry date of not more than twelve months after the date on which they were issued, unless otherwise agreed by ECGD; (vii) are for a term or credit period less than twelve months commencing no later than the date of the final presentation of documents under it.
- 5.2 The LCGS would also cover stand-by Letters of Credit which are subject to wither UCP 600 or ISP 98.

- 5.3 At ECGD's discretion, the LCGS might be extended to letters of credit which would be the subject of negotiation and/or silent confirmation by the Participating Bank provided that the Participating Bank has the status of "Nominated Bank" (as defined in UCP600) and a direct right of reimbursement by the Issuing Bank.

The cover for Negotiated Letters of Credit and silent confirmations would be subject to the same conditions, exclusions, conditions as standard letters of credit, with appropriate modifications to reflect the nature and function of these instruments.

## **6 Proposed eligibility of Confirming Banks**

- 6.1 It is proposed that the LCGS would only be available to Confirming Banks that are established or incorporated in an OECD member country and/or in a Member State of the European union, that carry out business in the UK and that provide Letters of Credit that are covered by the LCGS through its offices in the UK. It may be required that the Confirming Bank is subject to regulation by the Financial Services Authority and to current UK/EU legislation and regulations prohibiting money laundering, bribery and corruption.<sup>1</sup>
- 6.2 There may also be criteria seeking to ensure that the Confirming Bank has an established business of providing short term trade finance to UK exporters. ECGD may wish to retain the discretion to require approval of the Confirming Bank's "know-your-customer" and risk assessment procedures.

## **7 Principal proposed features of cover**

- 7.1 Subject to the caveat in paragraph 7.2 below, the Letter of Credit Master Guarantee would cover the obligation of the Issuing Bank to reimburse the Participating Bank after the failure has continued for a period to be agreed.
- 7.2 It is proposed that there would be some exclusions of liability to make any payment under the Letter of Credit Master Guarantee. The principal exclusions being considered are:
- (i) where the reason given by the Issuing Bank for not paying the Participating Bank is due to discrepancies in the documents presented to the Participating Bank;
  - (ii) there is some other failure by the Participating Bank to comply with UCP 600, or
  - (iii) fraud has been committed or is alleged to be committed (unless and until such allegation has been resolved) in relation to any party in connection with the letter of credit and/or the underlying sale contract.

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<sup>1</sup> It is noted that EU banks doing business in London may be regulated in part by the FSA and in part by the financial authorities in their country of incorporation.

## **8 Principal proposed limitations on exposure**

- 8.1 Various features of the LGCS would limit the overall risk exposure, including the following:
- (i) The Letter of Credit Master Guarantee would be issued for a premium.
  - (ii) Exposure would be limited in time. There would be a limitation of the guarantee period and ability of ECGD to issue an early termination notice in respect of future eligible Letters of Credit.
  - (iii) The guarantee itself would not exceed a certain percentage of the amount actually paid by the Participating Bank under the letter of credit. Therefore, the Participating Bank will retain an exposure under the letter of credit. It is proposed that if the Participating Bank decides to sell down any of its exposure, it may do so, but must retain a certain minimum percentage of exposure for its own account. The Participating Bank would therefore be encouraged not to take on risks it may otherwise take.
  - (iv) ECGD would, from time to time, set/alter limits on the maximum exposure to sovereign risk and to Issuing Bank risk for each Letter of Credit Master Guarantee in order to reflect the total exposure under all guarantees issued under the LCGS (but with no impact on exposures already ceded).
  - (v) The Participating Bank would be required to undertake that it will not disclose to the Issuing Bank that a letter of credit has been guaranteed by ECGD.

## **9 Principal proposed warranties and reassurances**

- 9.1 In order to minimise exposure to Issuing Banks, ECGD proposes to require the Participating Bank to warrant that it is not aware of any previous defaults by the Issuing Bank.
- 9.2 ECGD would also require a reporting requirement whereby Participating Banks will let ECGD know of any events that could potentially give rise to a claim.
- 9.3 Each Participating Bank would be required to give warranties on its own behalf (and/or procure certification from its Compliance Officer) relating to money laundering, bribery and corrupt activities, including a warranty relating to its "know-your-customer" and risk assessment procedures.
- 9.4 In addition, each Participating Bank would be required to give undertakings relating to carrying out particular checks and compliance with rules and regulations regarding money laundering, bribery and corrupt activities.
- 9.5 Each Participating Bank would further be obliged to obtain legally binding representations from and recourse rights against the eligible

exporter relating to bribery and corrupt activities in relation to each letter of credit.

- 9.6 In the event that after payment of a claim under a guarantee it transpires that there has been a breach of any of these warranties by the Participating Bank, the proposed structure means that ECGD would have rights against the Participating Bank. Also, in the event that after payment of a claim under a guarantee, bribery is proven against the exporter, ECGD would further control such rights of recourse as the Participating Bank has against the eligible exporter and take the benefit of them.

## **10 Proposed reporting Requirements**

- 10.1 ECGD would agree with a Participating Bank the format of risk management information to be provided by the bank.
- 10.2 ECGD may reserve the right to audit the compliance of a Participating Bank with the agreed terms of the LCGS and/or the Letter of Credit Master Guarantee.

## **11 Proposed rights of recovery**

- 11.1 ECGD proposes that the LCGS would incorporate mechanics to ensure that ECGD will receive its proper share of recoveries subject to ECGD's direction.