

SITPRO Briefings

Financial

Letters of Credit Best Practice



Who Is This Briefing For?

You should read this Briefing if you are involved in managing the payment and collection process in your company. You may be in Sales & Marketing as a Letter of Credit (L/C) has a significant impact on contract negotiation when it is used to effect payment. Or you could be in credit control and have responsibility for managing cash flow and ensuring prompt payment by your overseas customers. Or you could be in finance and be responsible for setting the payment policy in your company including advising the most appropriate payment method for your pattern of trade.

Whatever your position in the company you should make sure that all your colleagues are aware of the information in this Briefing, the accompanying Briefing, 'Letters of Credit - An Introduction' and the SITPRO set of three Checklists and Guides for the Exporter, the Export Sales Executive and the Importer.

What Does This Briefing Tell Me?

This Briefing aims to give you a simple, easy to read and understand best practice guide for the operation of a Letter of Credit. Topics covered in this Briefing include Negotiation, Checking the L/C on receipt, documentation requirements and, in the event of a worse case situation, what to do if a L/C is rejected on first presentation by the Bank.

Before Your Company Decides to Accept a Letter of Credit as a Payment Method

You may wish to consider other forms of payment such as:

- payment in advance, usually part payment up front, say 40% of selling price, with the remainder payable on agreed credit terms;
- documentary collection (Bills of Exchange)
- open account (credit) terms, with payment made at a set period after receipt of goods or invoice.

Your decision will be based on several factors:

- company policy including provision made for bad debt;
- cash flow considerations;
- relationship with the overseas customer;
- the conditions of the market of your overseas customer; your ability to meet the terms and conditions of the payment method;
- your 'gut' feeling.

The Negotiation Stage

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, desirable or more appropriate. If the Letter of Credit is the chosen method, 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 is responsible for bank charges?
- What are the payment terms - 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?
- The date up to which the credit will be valid and the number of days after shipment 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 importer 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.

Essential checks when the Letter of Credit is received

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?
- Are there any terms or conditions within the credit which cannot be met? If so immediate arrangements must be made with your importer for the credit to be amended.
- 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?

- Do the credit terms conform with the underlying sales contract?
- Are the names and addresses of both opener and beneficiary complete and correct?
- Is the credit irrevocable on the part of the overseas bank? (under UCP500 this is the case unless stated otherwise)
- Are drawings under the credit negotiable or payable in the UK rather than abroad?
- Are the description, price and quantity of the goods in accordance with the terms of the contract? (Remember that under-drawing a credit may sometimes cause problems, e.g. if trade discount has been forgotten when the opener instructed his bank)
- Are the insurance requirements of the credit acceptable?
- Can the required documentation be obtained?
- If part-shipments and transshipment of goods are prohibited, can the full quantity of the goods be exported on a vessel direct from the port of loading to the port of destination?
- Can the goods be shipped within the period specified and documents presented 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?

Compiling Documents Under a Letter of Credit

Amount payable

- Do not overstate of the amount to be drawn as this could lead to the rejection of documents when presented.
- Bear in mind that 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.
- Remember that, 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 number of packing units or individual items.

Shipment

- Can specified shipping documentation can be obtained?
- If you are chartering a vessel or shipping on deck, does the credit specifically permit such methods?
- Do the ports of shipment and discharge, if specified, conflict with your price quotations?
- If partial shipment or transshipments have to be made, does the credit allow this? Any instalments not shipped within a stipulated period will effectively cancel the credit.
- Is the time available for shipment sufficient and the period allowed for presentation of documents after shipment also sufficient?
- If a credit expires on a day when banks are not open, the validity is usually extended to the next working day. However, this does not apply to the stipulated time (after shipment) allowed for the presentation of documents (usually 21 days).

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. You should 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.
- Correctly dated.

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.
- Document of title to goods.

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 or 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;
- The 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.
- Any insurance policy or certificate made out to the order of the shippers has been blank endorsed.

Invoice

Check that:

- These have been completed by you in the name of the importer 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.
- The 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.
- 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.
- The certificate does not conflict with other documents with regard to value and country of origin.

Weight Note / List

Note that:

Disclaimer

SITPRO is the UK's Trade Facilitation Agency supported by the Department of Trade and Industry. Its mission is to use its unique status to improve the competitive position of UK traders by facilitating change through: identification and removal of barriers in the international trading process; identification and promotion of best trading practices; delivery of practical, value for money electronic commerce and associated trading solutions; and, influencing future trade policies.

Every effort is made to ensure that the information given herein is accurate, but no legal responsibility is accepted for any errors, omissions or misleading statements in that information caused by negligence or otherwise.

- 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.
- 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 which provide evidence of the movement of goods

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).
- Ensure that the correct copy is 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 a certificate is presented 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.
- The Post Office stamp shows a despatch date on or before the last stipulated date for shipment.
- The credit does not call for postal despatch on a FOB basis; these 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.

What to do if documents are Rejected

Should the documents be rejected, do not panic. You will still have the following options:

1. To correct the documents
2. To instruct the advising bank to request the issuing bank for permission to pay despite the discrepancies
3. To offer the bank an indemnity if they will pay despite the discrepancies.
4. To send documents to the issuing bank on a collection basis.

Options 1. and 2. are the best as the security of the Letter of Credit is maintained. On Option 3. the exporter may have to repay the money if the importer refuses to pay for discrepant documents and under Option 4. all security is lost.

A Letter of Credit will provide a quick and secure way of getting paid by your customer provided all the necessary precautions are taken to minimise the risks of discrepancies. It only takes a moment of carelessness to erode the security of using this method of payment and place an exporter in an awkward situation vis-à-vis his customer.



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