

# Different Types of Documentary Credits

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## Different Types of Documentary Credits

### 1. Sight Documentary Credit

A documentary credit in which payment is effected immediately upon presentation of the documents and drafts.

### 2. Time (Usance) Documentary Credit

A documentary credit in which payment is made at the maturity of the time drafts that was accepted upon presentation of documents conforming to the terms and conditions of the credit.

### 3. Back-to-Back Documentary Credit

The benefit of a documentary credit (the Master Credit) may be made available to a third party where the primary beneficiary uses the documentary credit as security / collateral to obtain another documentary credit (the Baby Credit) in favour of the actual supplier.

## **Different Types of Documentary Credits**

### **4. Front to Back Credit**

**A middleman requests the Bank to issue the Baby Credit in favor of the actual supplier prior to receipt of the Master Credit. At time of issuance of the Baby Credit, the Issuing Bank cannot use the Master Credit as security / collateral. Therefore, the middleman must have normal credit line with the Issuing Bank. The Issuing Bank can only rely on the information in the Sale Contract to issue the Baby Credit.**

## **Different Types of Documentary Credits**

### **5. Transferable Documentary Credit**

**A documentary credit in which the beneficiary (first beneficiary) may request the bank authorize to pay or negotiate (the Transferring Bank) to make the credit available in whole or part to one or more other beneficiaries (second beneficiary).**

### **6. Standby Credit**

**A credit in which it represents an obligation to the beneficiary on the part of the Issuing Bank to:**

- 1) repay money borrowed by the applicant, or advanced to or for the account of the applicant.**
- 2) make payment on account of any indebtedness undertaking by the applicant.**
- 3) make payment on account of any default by the applicant in the performance of an obligation.**

## **Different Types of Documentary Credits**

### **7. Red Clause Credit**

**A credit contains a clause traditionally printed in red enabling the seller to draw on the credit in advance of the shipment of the goods**

### **8. Revolving Credit**

**A credit in which the maximum value is restored after documents had been presented, in a manner provided by the credit. There are two types of revolving credit :**

- 1) Non-cumulative**
- 2) Cumulative**

# Four types of availability under each LC

LC available	Call for a draft	Financing allowed	Drawee of the draft
By payment (sight)	No	No	NA
By negotiation (sight or time)	Yes/No	Yes	Issuing /confirming bank
By deferred payment (time)	No	Yes (can only be prepaid by the nominated bank)	NA
By acceptance (time)	Yes	No (for accepted drafts, the bank may rely on bill of exchange law for discounting purposes)	Issuing/ confirming bank

# Negotiation

- ▶ It means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

# Holder in Due Course - Bill of Exchange Ordinance

A holder in due course enjoys certain rights in connecting with the instrument that are totally separate from the underlying transaction that originally gave rise to the instrument.

To be considered a holder in due course, a third party (i.e., one who was **Not** a party to the underlying trade or other transaction that gave rise to the instrument) must take the instrument:

- 1) For value
- 2) In good faith
- 3) Without Notice that it is overdue or has been dishonored



# LC Format (MT 700)

Advising Bank :	
Issuing bank:	
40A	Form of Documentary Credit
	IRREVOCABLE
20	Documentary Credit Number
31D	Date and Place of Expiry (in Beneficiary's country)
50	Applicant/Buyer
59	Beneficiary/Seller (Name and Full Address)
32B	Currency Code and Amount
39A	Percentage credit amount tolerance
41a	Available With
	ANY BANK BY NEGOTIATION
42C	DRAFT (if required) AT 30 (THIRTY) DAYS AFTER B/L DATE (BL DATE TO COUNT AS DAY ZERO)
42a	Drawee (if required)
43P	Partial Shipments
	ALLOWED
43T	Transshipment
	NOT ALLOWED
44A	Loading Port :
44B	Discharge Port :
44C	Latest Date of Shipment :
45A	Description of Goods and/or Services
	Incoterms: FOB/CIF/CFR

<b>46A Documents Required</b>	
<b>BELOW DOCUMENTS SHALL BE IN ONE (1) ORIGINAL AND TWO (2) COPIES UNLESS OTHERWISE STATED :</b>	
1	SIGNED COMMERCIAL INVOICE IN <b>1 ORIGINAL AND 2 COPIES.</b>
2	FULL SET OF 3 ORIGINALS AND 3 NON-NEGOTIABLE CLEAN ON BOARD OCEAN BILLS OF LADING ISSUED OR ENDORSED TO THE ORDER OF ( ) MARKED " <b>FREIGHT PREPAID</b> ".
3	CERTIFICATE OF QUANTITY
4	CERTIFICATE OF QUALITY
5	CERTIFICATE OF ORIGIN
<b>47A Additional Conditions</b>	
1	Third Party documents acceptable.
2	Charter party Bill of lading acceptable
3	Documents presented <b>later than</b> 21 days after the issuance of BL but within the validity of the credit acceptable.
4	Typographical or spelling errors that do not affect the quantity and value shall not constitute as discrepancy.
5	<b>All bank charges and commissions incurred at Applicant's bank are for account of Applicant. All bank charges and commissions incurred at Beneficiary's bank are for account of Beneficiary.</b>
6	Payment falling due on a Saturday, Sunday or a banking holiday in New York, shall be made on the last banking day prior.
7	Photocopies of documents instead of copies acceptable
8	
9	
10	
<b>53a Reimbursement clause:</b> Upon receipt of Negotiating Bank authenticated swift certifying that the documents presented under the above LC are in strict compliance with the terms and conditions of this letter of credit and that you have dispatched to issuing bank via courier, we shall reimburse the negotiating bank in accordance with their instructions at maturity, provided that such swift reaches us <b>two (2)</b> Hong Kong or New York banking days prior to due date. Otherwise, payment will be effected value one Hong Kong or New York banking day after receipt such swift.	
Unless otherwise stated, this credit is subject to Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600	

# Sample Letter of Credit (1/5)

Sender's Address: BAHKHHXXXX  
BANK OF ASIA  
168 FINANCE AVENUE  
HONG KONG

← Issuing Bank

: 27 : Sequence of Total : 1/1

: 40A : Form of Documentary Credit : IRREVOCABLE

← Issuing Bank cannot unilaterally  
cancel or amend the LC

: 20 : Documentary Credit Number : SLHI-654321

: 31C : Date of Issue : 130127

: 40E : Applicable Rules : UCP LATEST VERSION

← Subject to UCP 600

: 31D : Date and Place of Expiry : 130219 SINGAPORE

← Documents must be  
presented no later than  
this date

# Sample Letter of Credit (2/5)

: 50 : Applicant :  
ABC CO LTD,  
2901 ROAD NO.1, HONG KONG

← Buyer

: 59 : Beneficiary :  
XYZ PTE LTD,  
1056 ORCHARD ROAD, SINGAPORE 091231

← Seller

: 32B : Currency Code, Amount : USD234000,90 ← Max. amount payable and currency

: 41D : Available with ... By ... :

DBS Bank.  
SINGAPORE

← This is the "nominated bank". Documents must be presented to this bank.

BY NEGOTIATION

← This is the mode of availability. (In this case, DBS Singapore is authorized to negotiate.)

: 42C : Drafts at ... : AT SIGHT ← Tenor (payment term)

: 42D : Drawee :  
BANK OF ASIA  
HONG KONG

# Sample Letter of Credit (3/5)

: 43P : Partial Shipments : NOT ALLOWED

: 43T : Transshipment : NOT ALLOWED

: 44E : Port of Loading/Airport of Departure: SINGAPORE

: 44F : Port of Discharge/Airport of Destination: HONG KONG

: 44C : Latest Date of Shipment : 130210 ← Shipment date in B/L must not be later than this date

: 45A : Description of Goods and/or Services :

ACCESSORIES FOR SP-345A AS PER P.O. NO.ABC-135  
TRADE TERMS: FCA SINGAPORE INCOTERMS 2010 ← Goods ordered, for which this LC is issued

: 46A : Documents Required : ← Beneficiary is required to present the docs as stipulated

1. SIGNED COMMERCIAL INVOICE IN 1 ORIGINAL AND 2 COPIES
2. PACKING LIST IN 3 COPIES
3. FULL SET (3/3) SHIPPED ON BOARD BILLS OF LADING TO ORDER OF SHIPPER ENDORSED IN BLANK MARKED FREIGHT COLLECT AND NOTIFY APPLICANT WITH FULL ADDRESS

# Sample Letter of Credit (4/5)

4. CERTIFICATE OF ORIGIN ISSUED BY CHAMBER OF COMMERCE
5. QUALITY GUARANTEE ISSUED BY BENEFICIARY IN 1 ORIGINAL
6. BENEFICIARY'S CERTIFICATE TO THE EFFECT THAT COPY OF ORIGINAL BILL OF LADING WAS COURIERED TO APPLICANT WITHIN 3 DAYS AFTER SHIPMENT

Identification of LC in documents

: 47A : Additional Conditions :



1. ALL DOCUMENTS MUST SHOW PO NUMBER

2. A DISCREPANCY FEE OF USD45.00 OR ITS EQUIVALENT PAYABLE TO US IS TO BE LEVIED AND DEDUCTED FROM THE PROCEEDS OF ANY DRAWING IN THE EVENT OF PRESENTATION OF DOCUMENTS NOT IN COMPLIANCE WITH THE TERMS AND CONDITIONS OF THIS LETTER OF CREDIT.

Fee imposed by  
issuing bank on  
discrepant docs

# Sample Letter of Credit (5/5)

: 71B : **Charges** : ALL BANKING CHARGES OUTSIDE TIMBUKTU ARE FOR ACCOUNT OF BENEFICIARY. CONFIRMING CHARGES ARE FOR ACCOUNT OF BENEFICIARY.

Allocation of charges beyond this period would be non-complying.

: 48 : Period for Presentation : WITHIN **15 DAYS** AFTER DATE OF SHIPMENT

: 49 : Confirmation Instructions : **CONFIRM**

Advising Bank (DBS Singapore) is authorized to add confirmation to this LC.

: 78 : Instructions to the Paying/ Accepting/ Negotiating Bank :

UPON RECEIPT OF COMPLIANT DOCUMENTS AT OUR COUNTER, WE WILL REMIT PROCEEDS IN ACCORDANCE WITH NEGOTIATING BANK'S INSTRUCTION.

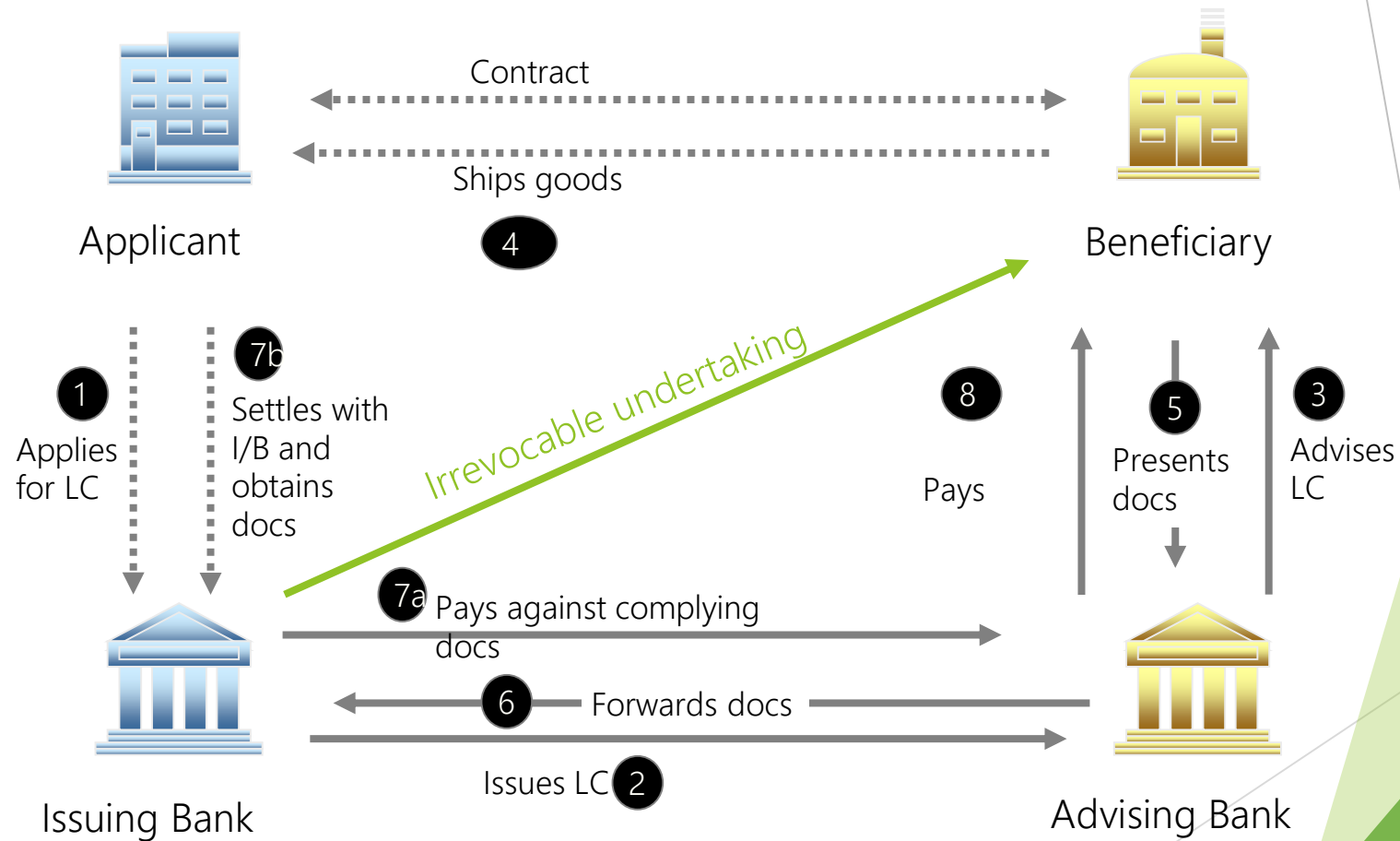
Reimbursement clause

DOCUMENTS TO BE SENT BY PRESENTING BANK TO ISSUING BANK AT 168 FINANCE AVENUE, HONG KONG IN ONE MAIL BY COURIER.

THE AMOUNT DRAWN MUST BE ENDORSED ON THE REVERSE OF THE LC.

# Sight LC

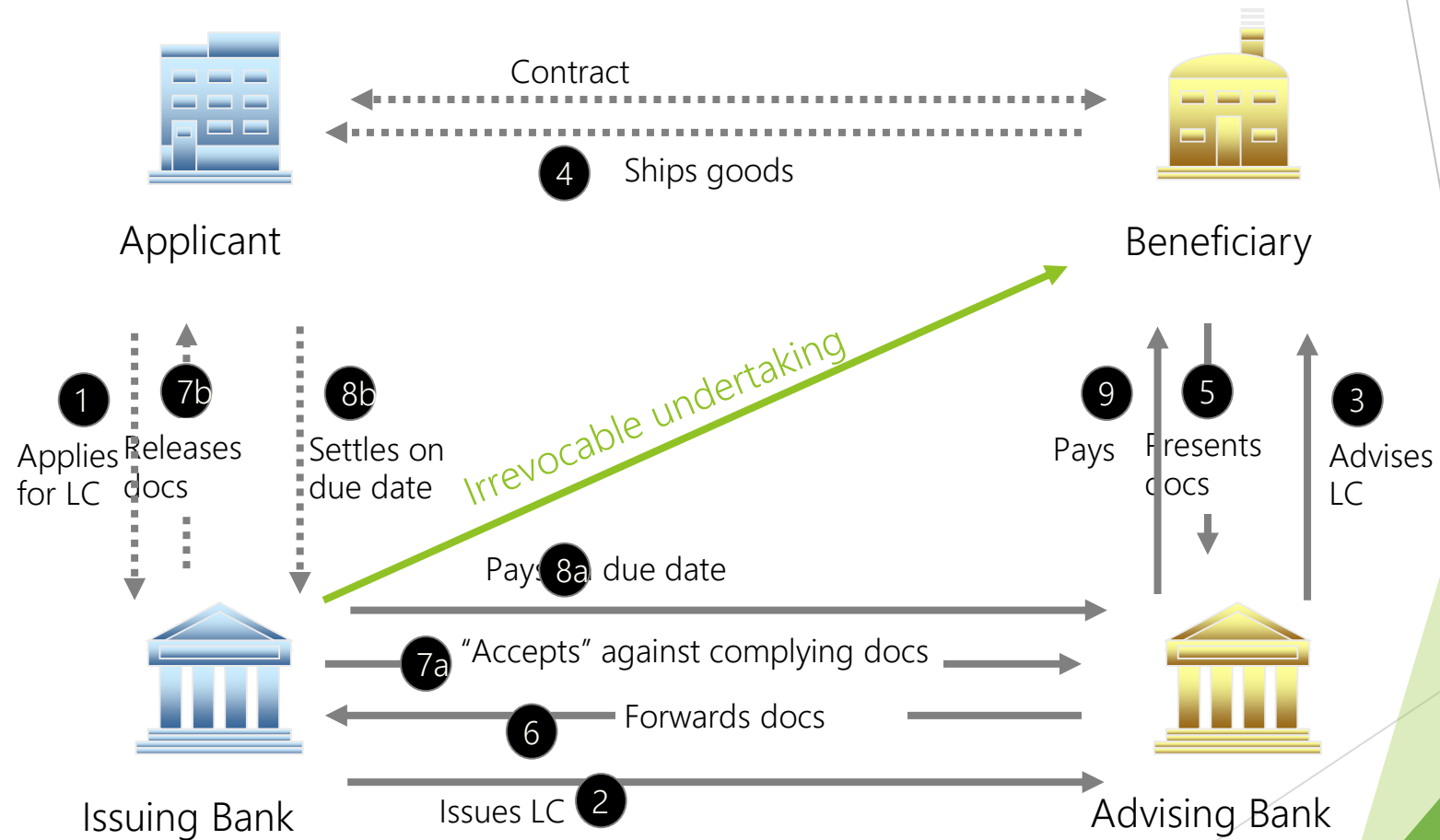
Payable promptly upon presentation of complying documents





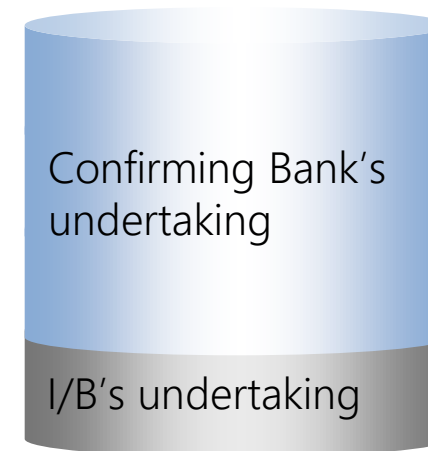
# Time (Usance) LC

Payable on due date in accordance with the tenor

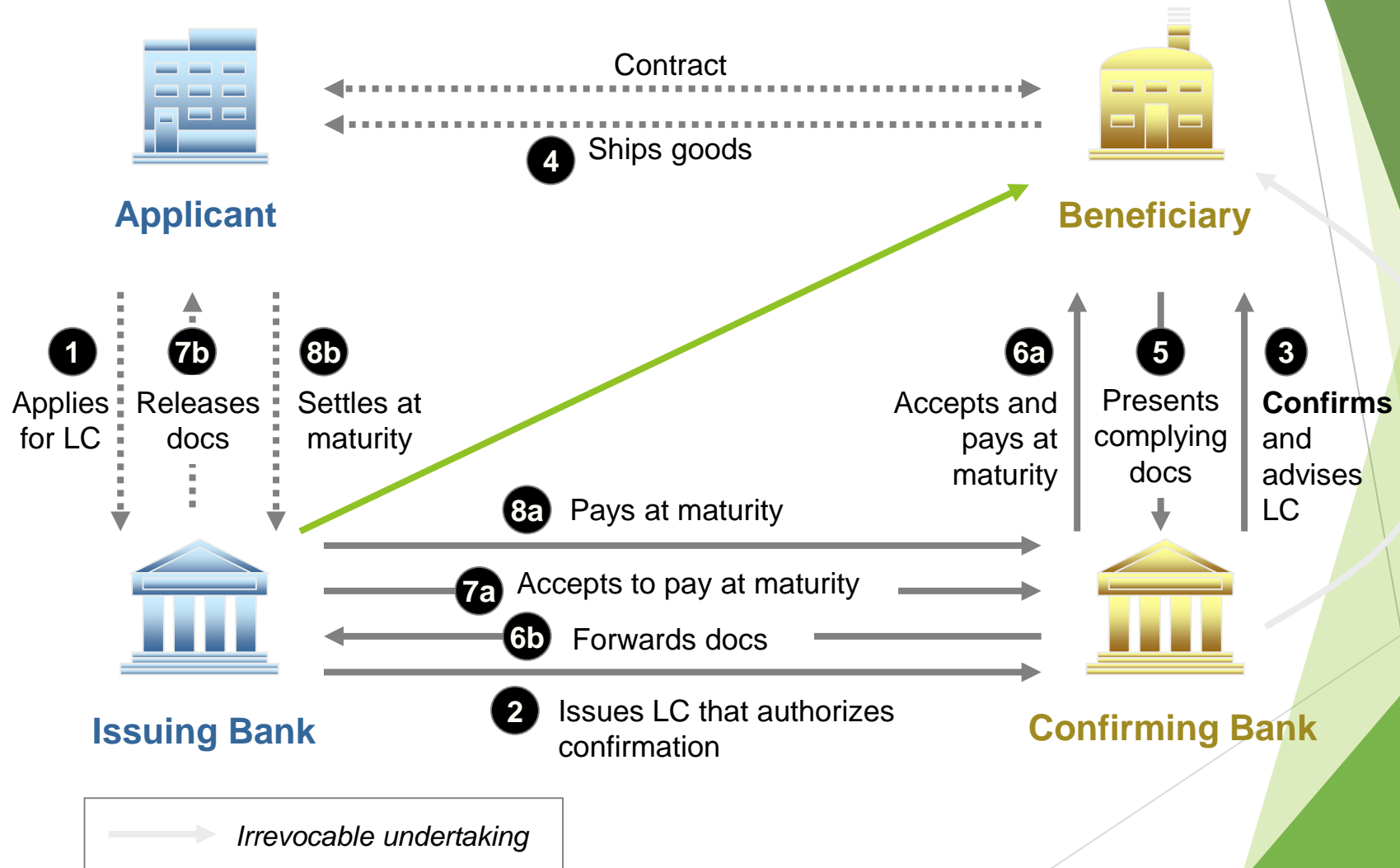


# “Confirmation” for risk mitigation

- Confirmation: Definite undertaking of the confirming bank, in addition to that of the issuing bank.
- Confirming bank pays beneficiary against complying documents, regardless of whether it is reimbursed by issuing bank.
- Beneficiary is protected as of date of confirmation.



# LC Confirmation: How it works



## Special Conditions for adding confirmation

Apart from the terms and conditions, the following requirements must be satisfied:

- The credit must be authenticated original
- The credit must authorize Issuing Bank as confirming bank
- The credit must be advised by Issuing Bank
- The credit must be available with Issuing Bank and expire at their counter
- For sight LC, it must be available with Issuing Bank by payment or negotiation
- For Time LC, it must be available with Issuing Bank by deferred payment or available with issuing bank by acceptance
- The confirmation fee must be paid upfront prior to adding confirmation unless the charges are paid by the issuing bank

## Special Conditions for adding confirmation

The following special conditions must be inserted in covering letter:

“We confirm the subject credit in accordance with UCP 600 Article 8 that drafts and/or documents drawn and/or tendered in conformity with the provisions of this credit and presented at our counter within the validity hereof will be honored.

“It is a condition of our confirmation that we reserve the right at any time not to pay or process documents presented bearing reference to any country, entity or individual that may be subject to any boycott, sanction or embargo imposed by laws, executive orders or regulations of any countries.”

# Silent Confirmation

- Confirmation of a credit is made by bank upon the authorization or request from the issuing bank.
- In order not to offend the buyer or issuing bank with a requirement that the credit must be confirmed, or perhaps also not to inconvenience the applicant with a request for an amendment to the credit, some banks are prepared to guarantee payment under the credit without the request of the issuing bank. This method is usually referred to as a “silent confirmation” or “without recourse negotiation”.
- It is important to note that it is not a confirmation in a technical sense of the word. A bank issuing a “silent confirmation” does not enjoy the protection under UCP 600.
- It is rather a kind of guarantee to pay provided that complying documents are presented. The scope of risks covered is exclusively regulated by the agreement entered into. For example, most banks do not want to cover documentary risks, therefore, they will only discount after the issuing bank has accepted the documents.

# Red Clause Documentary Credits

The clause in the credit could read as follows:

**“The beneficiary may ask for an advance of up to 50% of the credit amount in order to make it possible to purchase the goods. The nominated bank may make such advance against beneficiary's receipt and declaration stating that he will present documents in compliance with the stipulations of this credit before the expiration.**

**The advance, including interest, is to be deducted from the proceeds of the payment under this credit.**

**The issuing bank undertake to reimburse the nominated bank in case the amount advanced should not be repaid. All advances must be notified to us.”**

# Revolving Documentary Credits

**Revolving credit** is a type of credit that does not have a fixed number of payments.

It is an arrangement which allows for the loan amount to be drawn in any manner and any number of times, until the credit expires.

Typical characteristics :

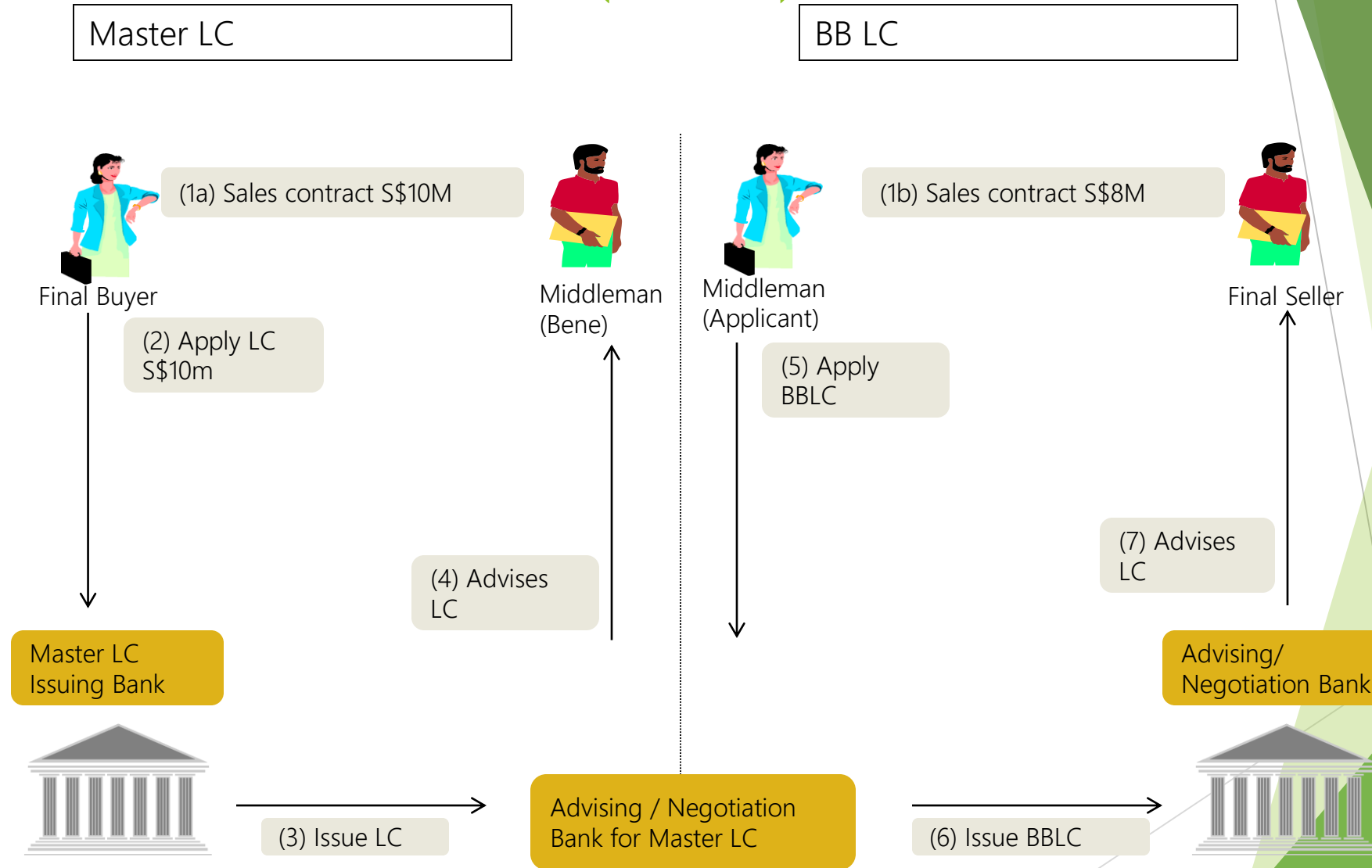
The borrower may use or withdraw funds up to a pre-approved credit limit at a agreed period, e.g every monthend.

- The amount of available credit decreases as per each shipment
- The credit may be used repeatedly.
- In some cases, the undrawn amount may be carried forward to next month (cumulative).

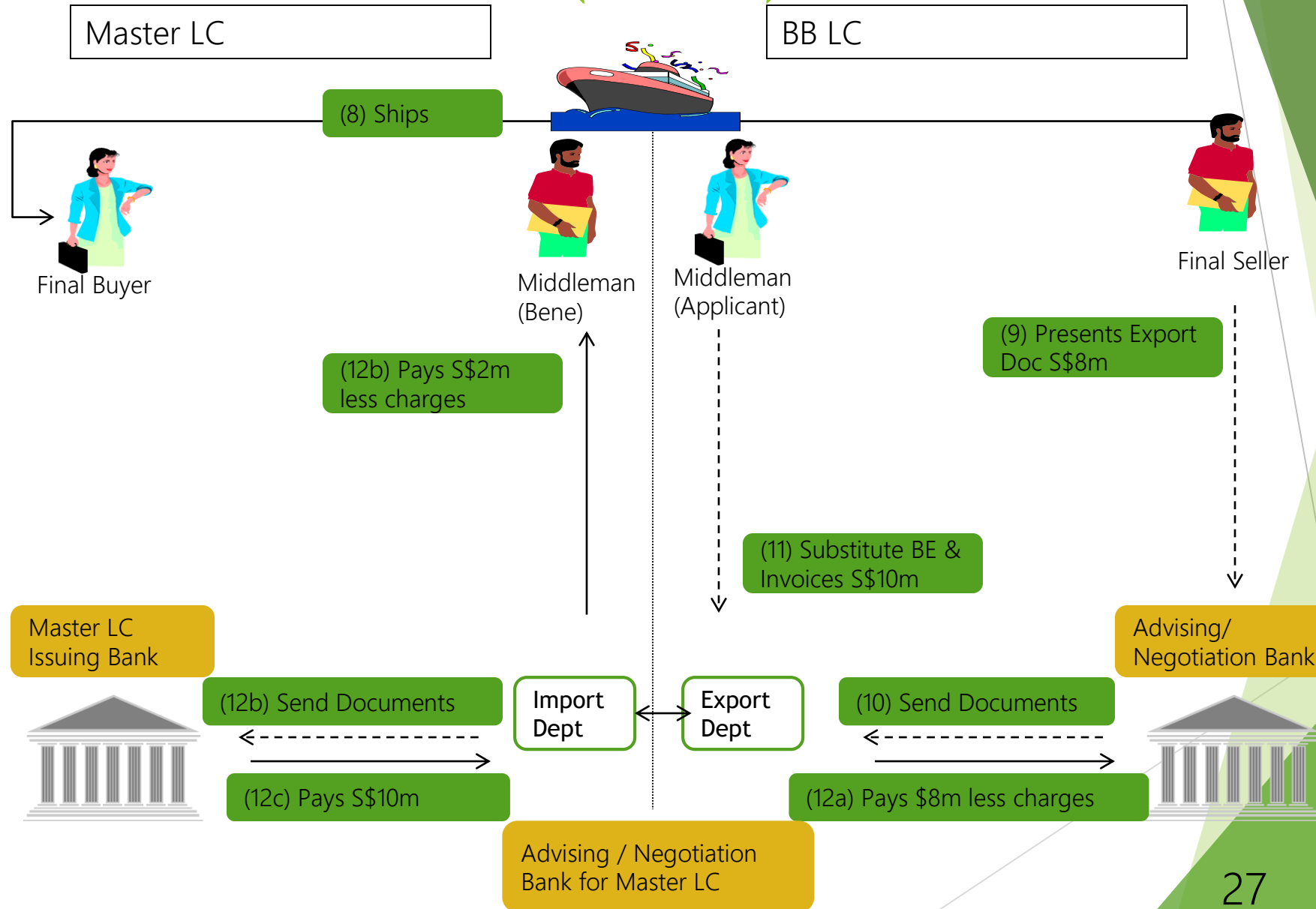


**BACK TO BACK CREDIT**

# Transactions Backed by Export LC - Back to back LC (Part I)

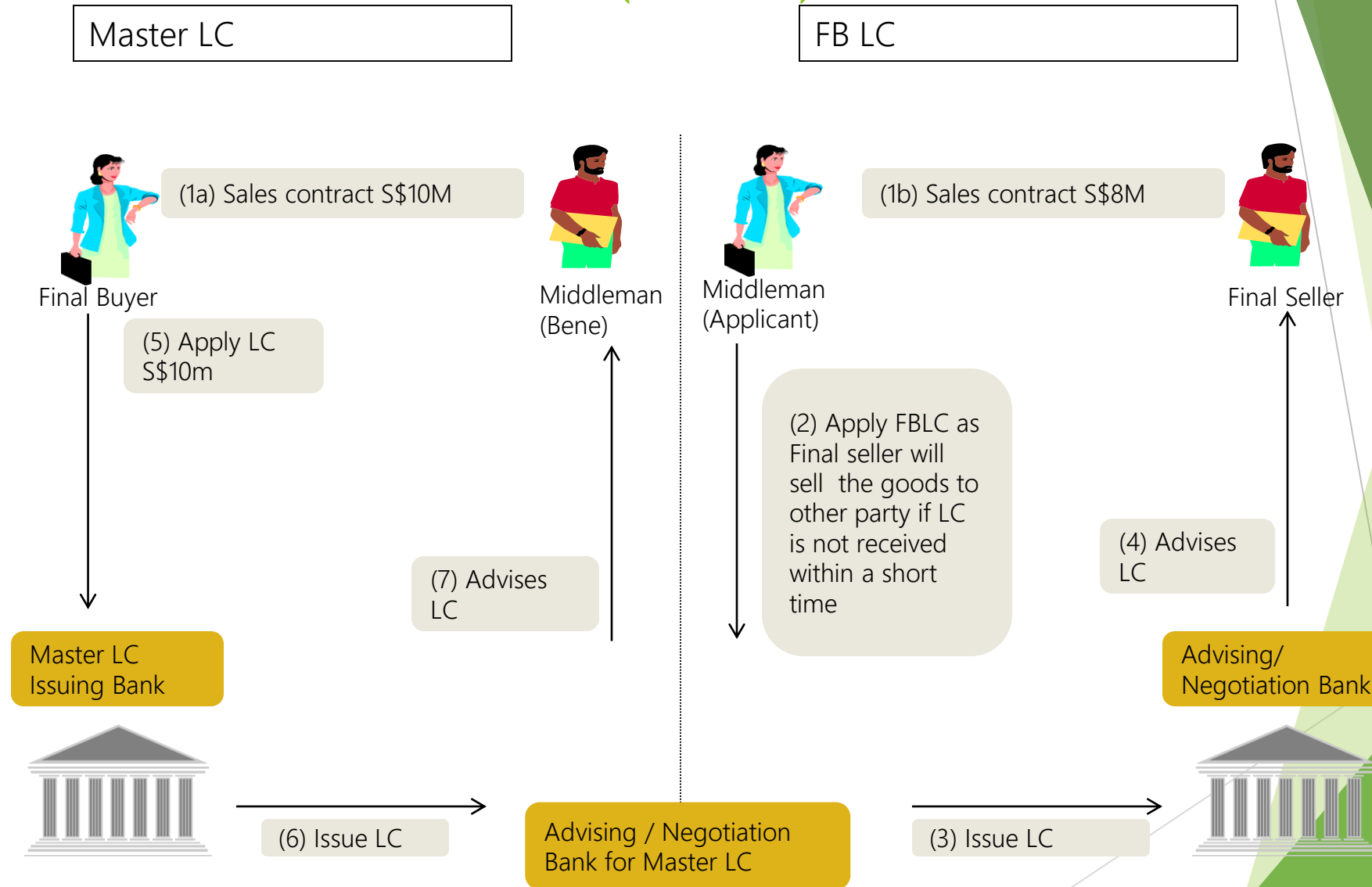


# Transactions Backed by Export LC - Back to back LC (Part II)

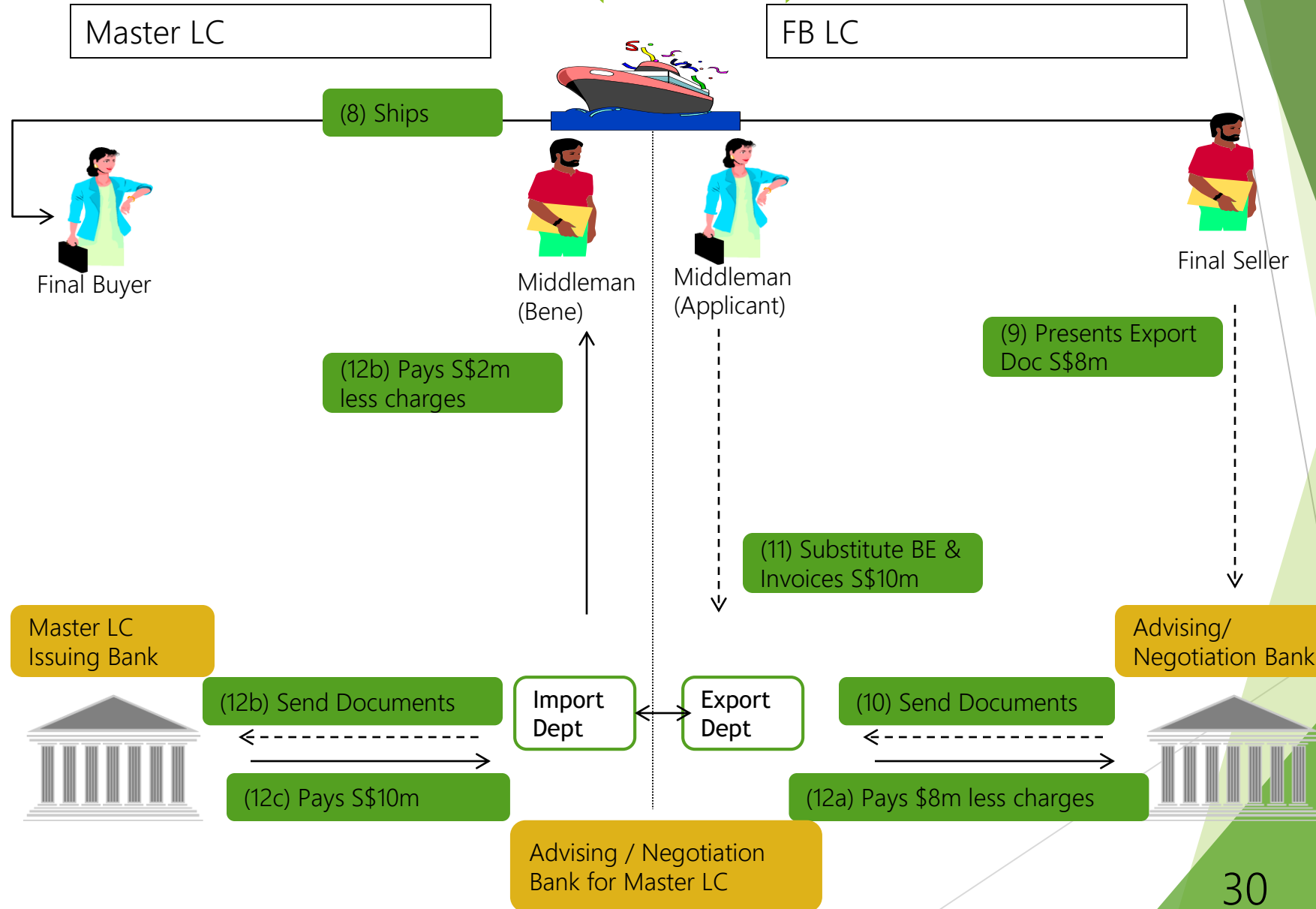


# FRONT TO BACK CREDIT

# Transactions Backed by Export LC - Front to back LC (Part I)



# Transactions Backed by Export LC - Front to back LC (Part II)



# TRANSFERABLE CREDIT

# Transferable Letter of Credits

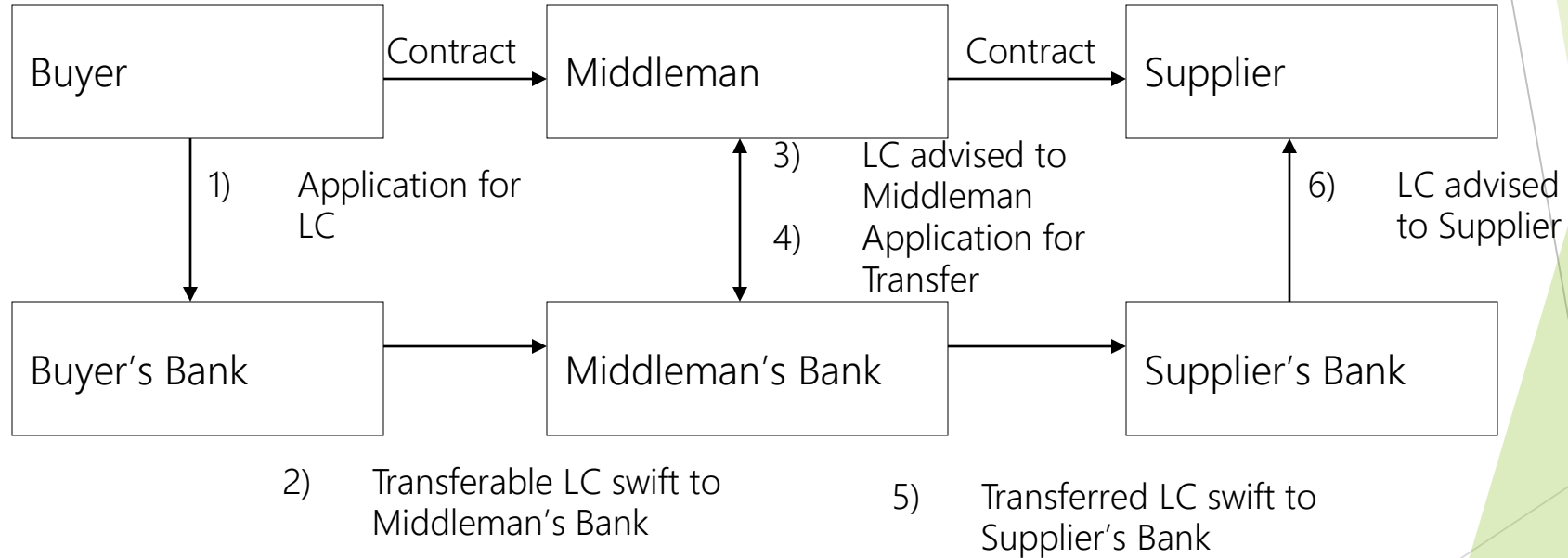
- ▶ What is Transferable Letter of Credit?
- ▶ A Transferable Credit is one where the Beneficiary may request the Bank authorised (Transferring Bank) to pay, incur a deferred payment undertaking accept or negotiate, or in the case of a freely negotiable credit, the bank specifically authorised in the credit as a Transferring Bank to make the credit available in whole or in part to one or more other Beneficiary(ies).



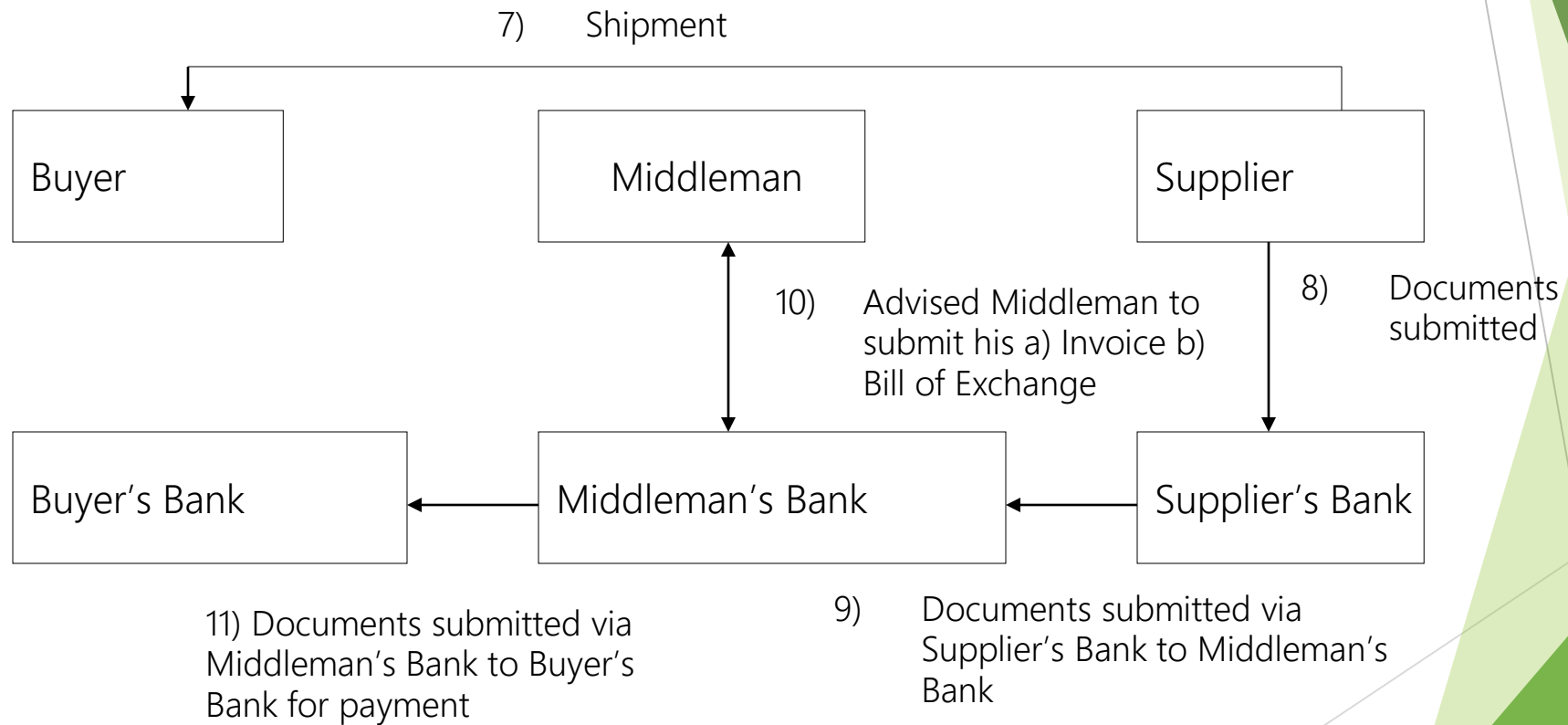
# Transferable Letter of Credits

- ← Credit can only be transferred on the Terms and Conditions specified in the Original Credit in accordance with Article 38 of UCP 600 with the exception of the following:
  - ⑩ 1) Amount of Credit or Any Unit Prices  
(Full or Partial Transfer)
  - ⑩ 2) Period of Validity
  - ⑩ 3) Period of Shipment
  - ⑩ 4) Documents Presentation Period
  - ⑩ 5) Insurance Value

# Transferable Letter of Credits

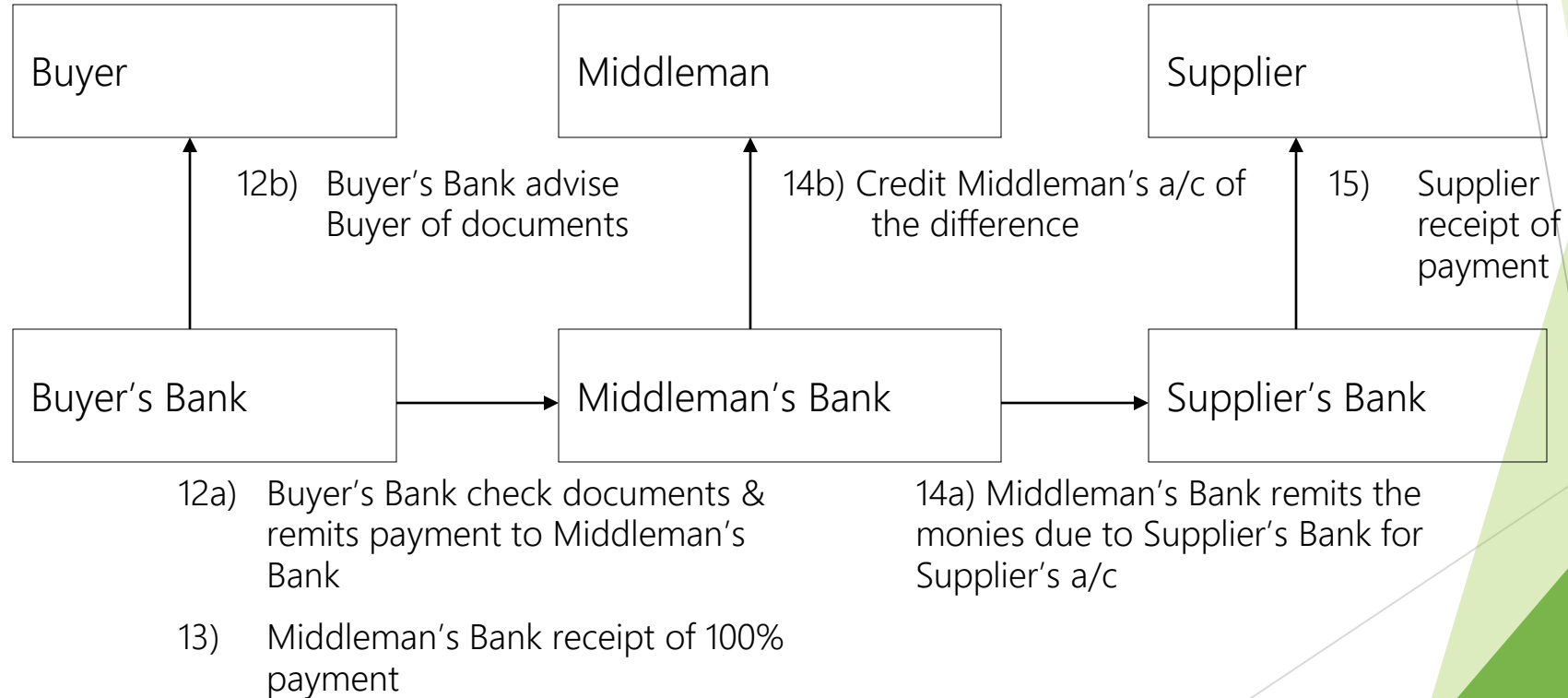


# Transferable Letter of Credits



# Transferable Letter of Credit

## ► Flow of Transferable Letter of Credit



# Comparison between Transferable and Back-to Back L/C

## ⑩ Transferable L/C

- ← Only 1 credit instrument
- ← 1 independent undertaking
- ← Unlimited number of 2nd ben.
- ← Importer/Importer may/may not know identity(ies) of Supplier.
- ← Limited to same currency as LC
- ← Variation of trade terms, currency not allowed.

## ⑩ Back-to-back L/C

- ← 2 credit instruments.
- ← 2 Independent undertaking.
- ← Only 1 Ultimate supplier.
- ← Importer/Importer will not know identity of supplier.
- ← May have different currency than the master L/C.
- ← Flexibility in variation of trade terms, and currencies.

# Comparison between Transferable L/C and Back-to Back L/C

## ⑩ Transferable L/C

- ← L/C amount may/may not be the same (partial/full transfer).
- ← Second beneficiary look towards export (Master L/C) for payment.
- ← Falls (guided) under U.C.P.- [Article 38 a -j] .

## ⑩ Back-to-back L/C

- ← L/c amount will never be the same (Second L/C- is lesser amount).
- ← Second beneficiary looks towards second (Subsidiary) L/C issuing bank for payment.
- ← Not guided under U.C.P.- no relevant article (s).

What one is better ?



# UPAS LC for offshore financing

## Features

- **Usance LC payable at sight**
- **Negotiation LC with interest for applicant's account**
- **Allows drawing in excess of LC amount to cover the interest**
  - ▶ Benefits
    - Seller offers secured credit term and improves sales
    - Enables buyer to tap low financing cost at seller's location
    - Neutral to seller's balance sheet by post-acceptance negotiation
    - No financing cost for seller, as interest is for applicant's account

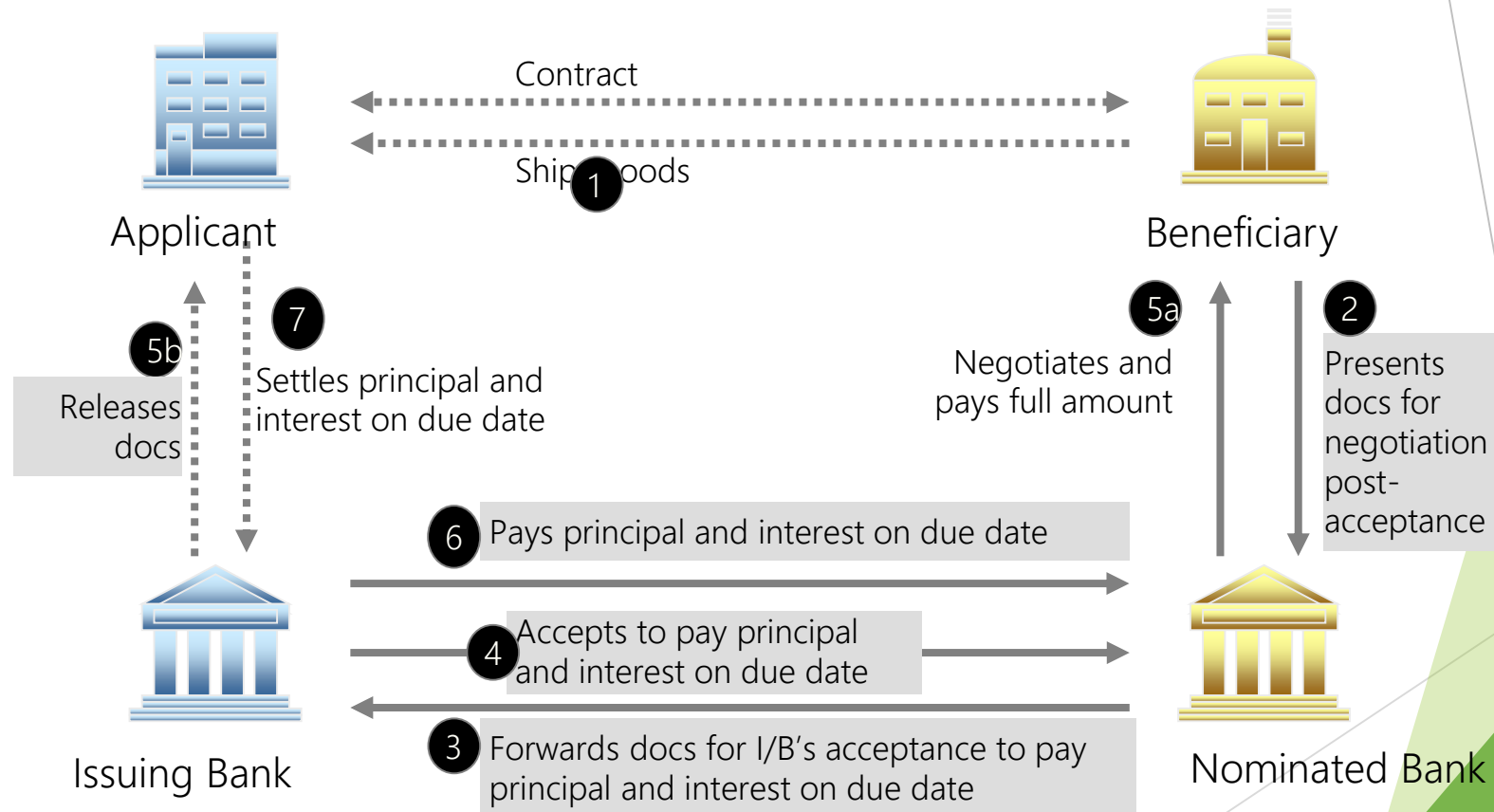
## Prerequisites

- **Buyer has credit limit for issuing usance LCs**
- **Issuing bank and country limits for post-acceptance negotiation**
- **Mutually agreed negotiation pricing**



# UPAS LC for offshore financing

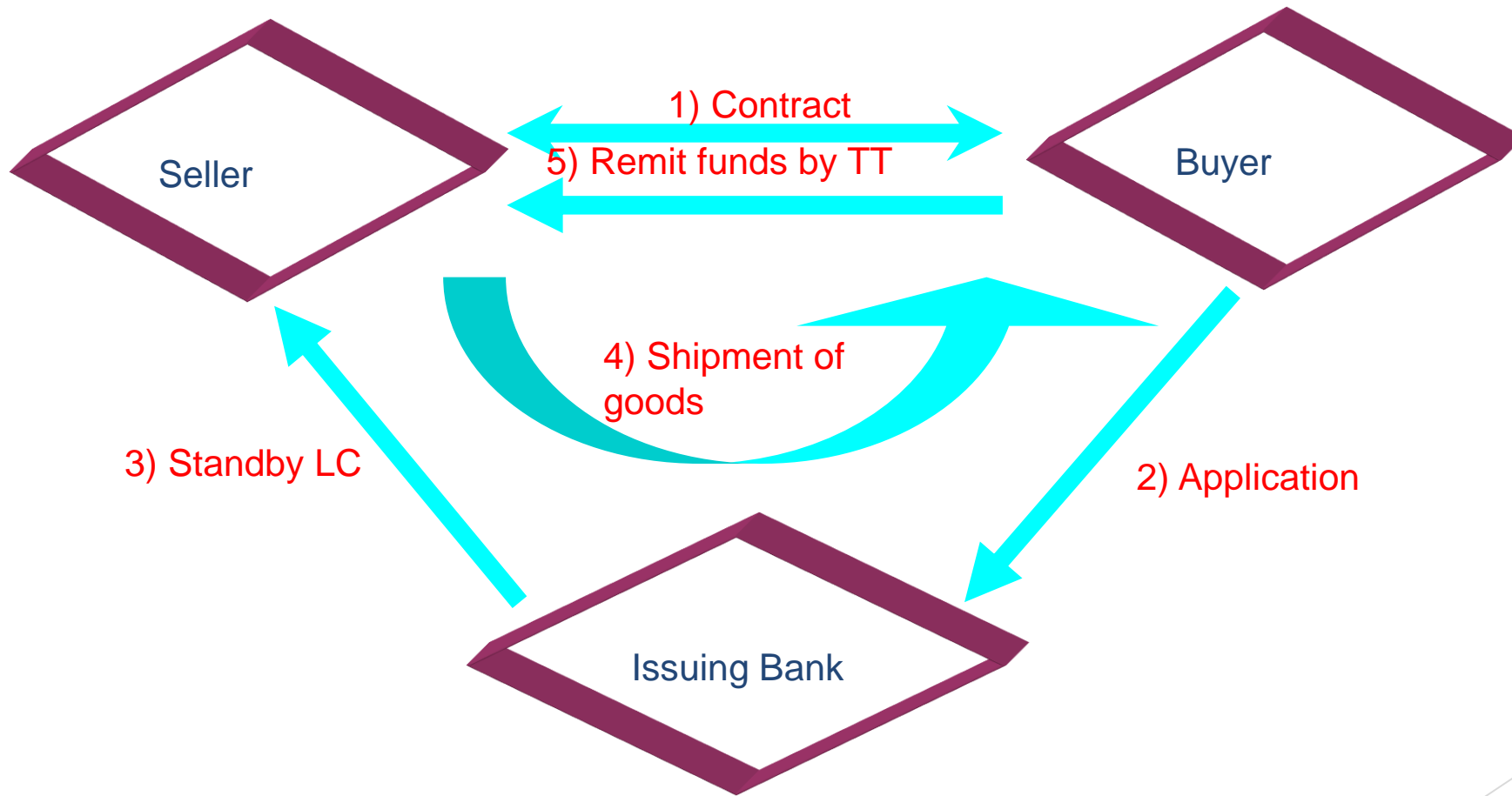
Beneficiary paid at sight basis, by negotiation of usance LC with interest for applicant's account



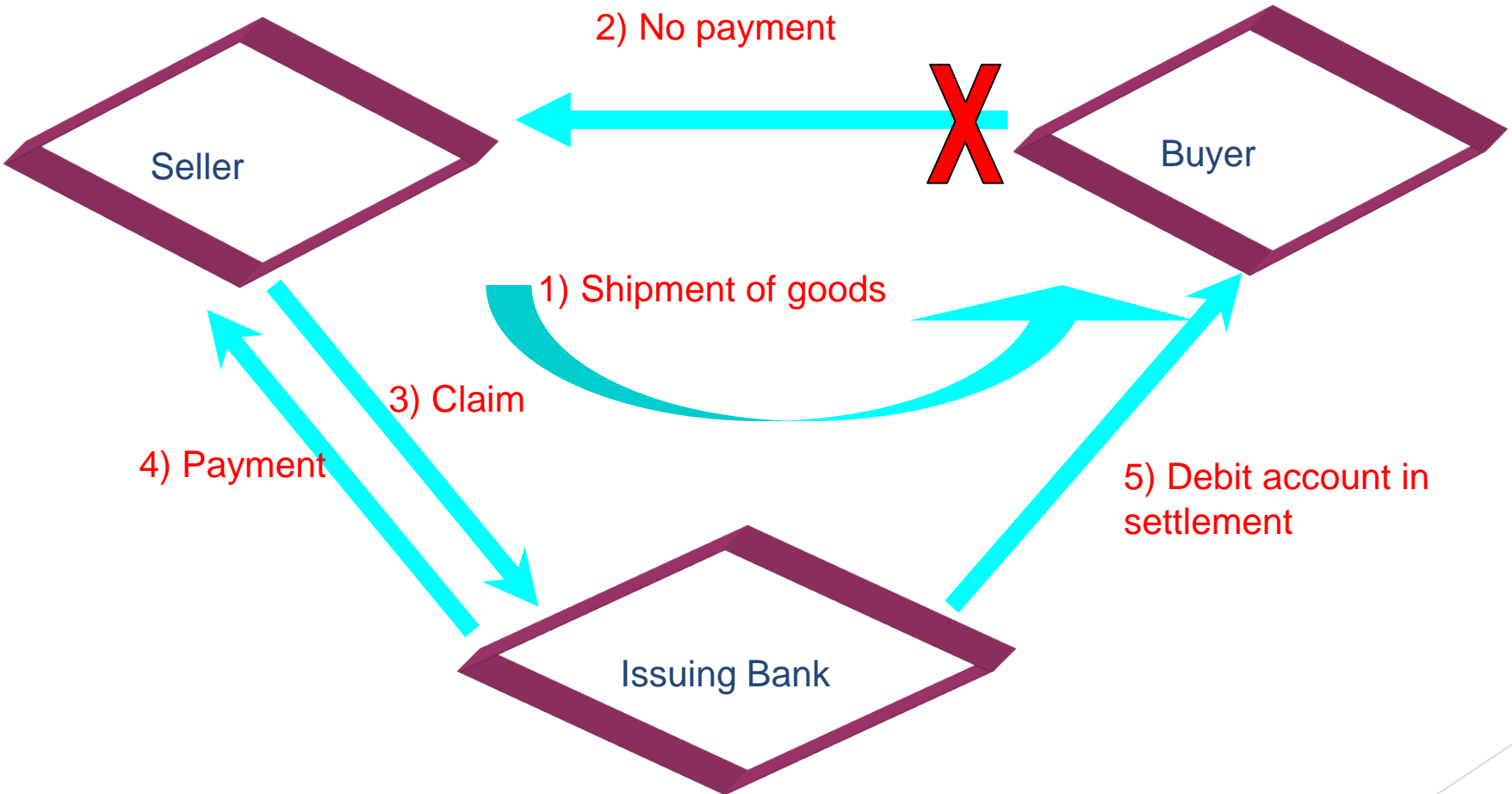
# Standby Letters of Credit

- ▶ **Standby L/Cs are:**
- ▶ Used in lieu of a Bank Guarantee
- ▶ Are not meant to be drawn on under normal circumstances.
- ▶ Often used to assure performance under a contract.
- ▶ Banks can issue Standby LC/Guarantee against buyer's failure to pay the price or against seller's failure to repay an advance payment in international trade
- ▶ A large number of standby LCs used are applied to secure the following financial transactions
  - ▶ - Payment Undertaking
  - ▶ - Loan
  - ▶ - Overdraft facility
  - ▶ - Aval (guarantee for payment of draft)
  - ▶ - Obligations under bonds issued.
  - ▶ - Mergers and acquisitions.
- ▶ Due to a high percentage of discrepancies noted in commercial LCs, a Direct Pay Standby is commonly used to secure payment. Payment is not expected to take place outside the function of the standby.

# Standby LC to support sale of goods under Open Account



# Standby LC to support sale of goods under Open Account



## Private Label LC

- ▶ There are some letters of credit which are advised by some banks in the usual way, but are actually **issued by a corporate**, or the finance arm of the corporate and not a Bank.
- ▶ Invariably they incorporate clauses to the effect that the L/C is subject to the UCP, and that where the UCP refers to “issuing bank” then the issuer is to be construed as acting in all respects as the “issuing bank”.
- ▶ Where a letter of credit is issued by a non-bank, the non-bank issuer should be held to the same obligation and standard of care as would a bank. In either case, the obligation is to pay against the presentation of documents that comply with the terms and conditions of the credit and that determination is to be made

## Private Label LC

- ▶ based solely on the documentary presentation and not on the status of reimbursement obligations or the underlying transaction, and local law should apply the same principles to an independent undertaking regardless of who makes it.
- ▶ Having concluded that a credit can be issued to the UCP by a non-bank, however, does not mean that is prudent for a beneficiary to accept such a credit. Issuance through an advising bank does mitigate the issue of whether the credit is authentic and presentation of documents to a bank does reduce some operational risks. There is, nonetheless, the risk of the creditworthiness of the country risk. These risks apply equally whether the issuer is or is not a bank and a beneficiary should always assess whether it is prepared to accept the credit and country risk associated with the issuer. If not, it should require confirmation by an entity with which it is comfortable.

## Opinions from ICC

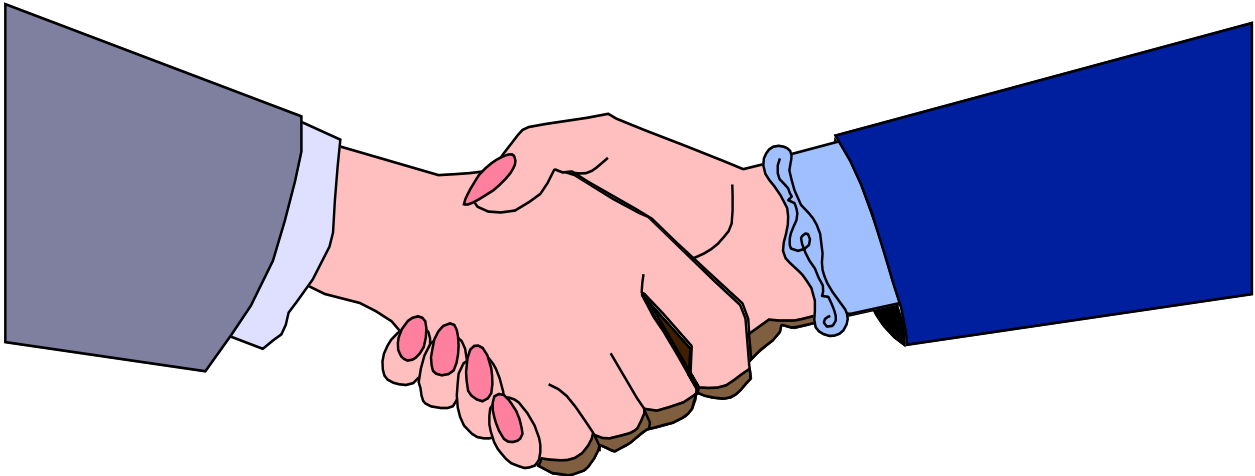
- ▶ “It **does not “violate”** the UCP for a non-bank to issue a credit subject to UCP even though such issuance is not contemplated in the rules. The UCP does not specifically provide for bank advice of non-bank issued letters of credit. Such an advice should accurately identify the issuer and indicate the Advising Bank’s limited role.”

## Impact on SWIFT (MT710)

- ▶ Applicable Rules      40E      UCP Latest Version
- ▶ Non-Bank Issues      50B      (This is a Non-Bank entity)
- ▶ Applicant      50



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Thank You