LETTER OF CREDIT (LC)

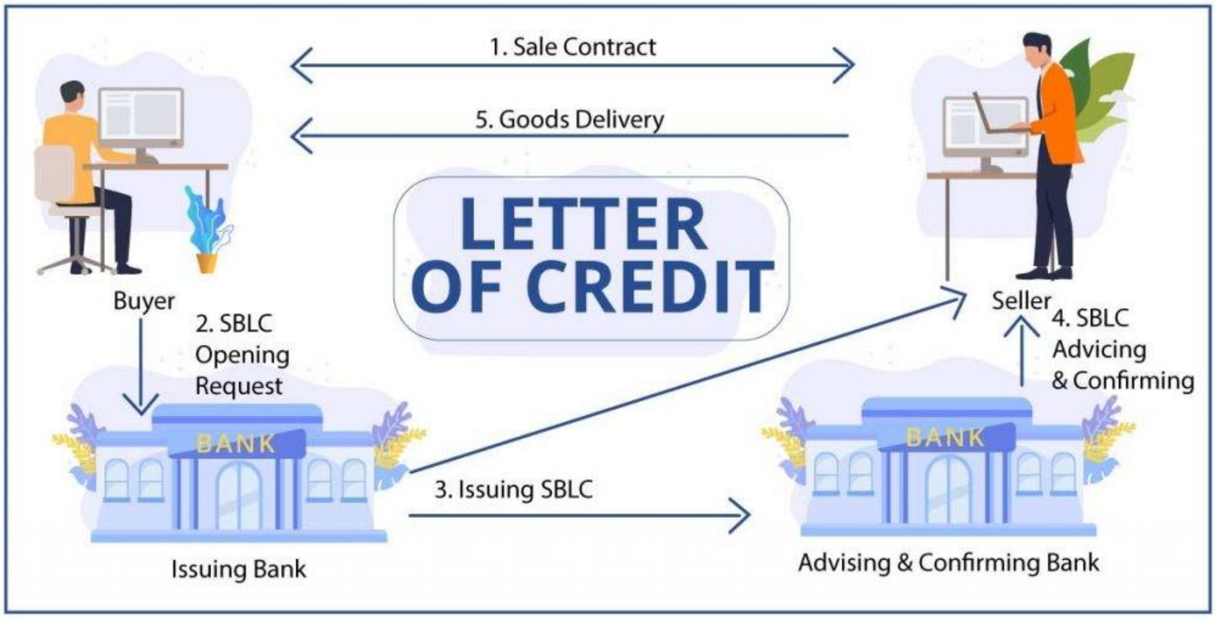
Letter of credit is an unconditional undertaking given by the Issuing Bank on behalf of Importer in favour of the Exporter, undertaking to make payment on presentation of documents as per the terms and conditions of LC. LCs are governed by UCPDC.

MAIN PARTIES TO LC

Importer/Applicant	Buyer or Importer on whose request the LC opened.
Opening bank	LC Opening Bank, which opens LC on behalf of importer.
Beneficiary	Party in whose favour LC is opened i.e. Exporter of goods.
Advising bank	Bank authorised by the opening bank, to advise the LC to the Beneficiary. It is liable for ensuring the genuineness of LC.
Confirming bank	Bank authorised by the Issuing Bank to confirm the LC. By confirmation, this Bank adds its guarantee & undertakes to negotiate the documents as per the terms of LC.
Negotiating bank	The Bank, which negotiates the documents. It may be Confirming Bank or any other Bank.

OPERATIONS OF LETTER OF CREDIT

With the involvement of the several parties, the LC transaction operates between the two nations:



1. The **buyer and seller enter into the sales contract**, for purchase/ sale of certain amount of specified goods at specified rates, but agree to cover the transaction under Letter of Credit.
2. The buyer in country A (applicant/ importer) requests his bank, to open LC in favour of the seller in country B (beneficiary) for the specified amount.
3. the buyer's bank, i.e. opening bank, issues the LC and sends the same to the beneficiary in country B, through its own branch or correspondent (or at times directly, if the beneficiary is known).
4. the advising bank in country B, advises the LC after authenticating the signatures/ swift message. The bank, in country B, which advises the LC to the beneficiary, is called **Advising Bank.**
5. If the seller desires for the LC to be confirmed by some bank, in his own country, the bank, which agrees to do so, at the request, and as per arrangement and on behalf of the opening bank, is called the **Confirming Bank.**

6. The seller now prepares the goods, and ships as per instructions in the LC, submits the documents called for in the LC to the confirming bank (or may be a separate bank), which examines the same and if found in conformity to the LC terms, negotiates the documents and pays to the beneficiary.
7. This bank now becomes the negotiating bank, and steps into the shoes of the issuing bank, and by this act of negotiation, becomes rightful owner of the documents and claimant of the amount under LC from the opening/ issuing bank.
8. The negotiating bank sends the documents to the opening bank, and claims reimbursement from the reimbursing bank, for the amount paid, to the beneficiary, from the designated bank.
9. The bank, which reimburses the amount to the negotiating bank, is the reimbursing bank, and is usually the Nostro/Vostro bank of the opening bank.
10. The issuing bank, on receipt of the documents, presents the same to the applicant/ importers and gets the payment of the same on presentation/ acceptance or due date, as the case may be.
11. Upon payment by the applicants/ openers, to the issuing bank, and release of documents to the title of goods, as also other documents, as called for under the LC, the LC transaction is complete.

TYPES OF LETTERS OF CREDIT

- Uniform customs and practices of documentary credits (UCPDC) are universally recognized set of rules framed by International Chamber of Commerce (ICC), governing LC business.
- The UCPDC gives guidance and assistance to all concerned parties to LC transaction, specifically emphasizing upon the duties and responsibilities of the opening bank, buyers and sellers, advising

negotiating and the reimbursement bank, as also specifying the acceptable practices, in case of no specific instructions in the LC.

- UCPDC-600, i.e. the publication no. 600 of ICC, is the latest version of UCPDC and was made effective 1 July 2007.

IMPORTANT TYPE OF LCs

Revocable LC	An LC which can be **amended or cancelled by the issuing bank** without prior notice to the beneficiary before the documents are negotiated by the Negotiating Bank. Dispensed in UCP-600.
Irrevocable LC	An LC in which issuing bank gives a definite, absolute and irrevocable undertaking to honour its obligations provided the beneficiary complies with all the terms and conditions of LC. Once an irrevocable LC is issued, it cannot be revoked/ amended, without the consent of the beneficiary.
Irrevocable Confirmed LC/ Confirmed LC	An irrevocable LC where another bank adds its confirmation. In such a credit Confirming Bank gives definite undertaking to pay / accept/ negotiate if the terms and conditions of the credit are complied with
Transferable LC	LC containing a specific clause that it is transferable. This gives the beneficiary to Request the bank to make the credit available in whole or in parts to one or more beneficiaries. Transferable LC can be transferred in part or full but it can be transferred only once.
Red-clause LC	A LC in which a provision exists for **allowing pre -shipment credit** to the beneficiary for procurement manufacturing of goods to be exported. Also called as packing credit or anticipatory letter of credit
Green Clause LC	An LC in which apart from provision of allowing pre -shipment credit the issuing bank also has to arrange for storage / warehouse facility.
Back-to-back LC	Back to Back LC involves two irrevocable credit.

	Firstly, the inward credit (original LC) and the second called as outward credit (back-to-back), which is opened on the basis and security of the original LC.
Stand-By-LC	An LC very similar to bank guarantee by issuing bank, guaranteeing payment and / or performance (no movement of goods).
Revolving LC	under these LCs, the part amount, which has been utilized, is automatically restored & is available for further use. These are meant for more than one dealing. In such LC, roll-over of transactions take place
Restricted LC	LC in which negotiation is restricted to a particular bank.
Acceptance Credit/ usance LC	bill of exchange or drafts are drawn with certain usance period, and are payable, upon acceptance, at a future date, subject to receipt of documents conforming to the terms and conditions of the Letter of Credit. The usance period may be certain number of days from the date of shipment or date of bill of exchange, etc.
Deferred Payment Credit	There is no bill of exchange or draft drawn and is payable on certain future date, subject to submission of credit conformed documents. The due date is generally mentioned in the Letter of Credit. The absence of bill of exchange saves the beneficiary from the cost of stamp duty or other levies, as applicable in certain countries.
Negotiation Credit	In a Negotiation Credit, the issuing bank undertakes to make payment to the bank, which has negotiated the documents, i.e. give the value for draft and/ or documents drawn under the Letter of Credit. The documents negotiated should be strictly as per the terms and conditions of the LC. The LC may be freely negotiable or may be restricted to any bank nominated by the LC issuing bank.

DOCUMENTS UNDER LC

- Bill of exchange
- Invoice
- Transport Documents
- Insurance Documents (min. 110% of CIF)
- Other documents like certificate of origin, qualify certificate etc.

Bill of Lading

A document signed between shipper (seller/agent) and carrier (shipping / logistic company) that details type, quantity and destination of goods being carried.

Seller's shipping agent issues 2 sets of documents

1. Original negotiable bill of lading (signed)
2. Non-negotiable Bill of Lading

Functions:

1. A **receipt** that goods have been loaded
2. Evidence of **contract** of carriage between shipper and carrier
3. Document of **title** of goods

TYPES OF BILL OF LADING

On-board Bill of Lading: It acknowledges that the goods have been put on board of the shipment. This is considered safe for negotiation purpose.

Clean Bill of Lading: Which bears no superimposed clause or notation that expressly declares the defective condition of goods, or packaging. Best for negotiation purpose.

Claused Bill of Lading: Which bears superimposed clause or notation that expressly declares the defective condition of goods or packaging Ship owner can disclaim his liability on loss to goods in case of such BL. Hence, it is not considered safe.

Long form Bill of Lading: All terms & conditions of carriage are given on the document.

Through Bill of Lading: That covers the entire voyage covering several modes of transport. There is no guarantee of the carriers for safe carriage of goods.

Short form Bill of Lading: Terms and conditions of carriage are not printed on the bill of lading but a reference to another document containing term and conditions is made.

Chartered party Bill of Lading: Issued to Chartered party who has hired space in vessel.

Straight Bill of Lading: Non-negotiable B/L that is issued directly in the name of the consignee, where the goods will be delivered to the consignee.

Uniforms Customs and Practices for Documentary Credits UCPDC - 600

UCPDC referred to as UCP – 600 are prepared by ICC implemented from July 01, 2007

Groupings

- **Articles 1 – 5** – General Provisions and Definitions
- **Articles 6 – 13** – Liabilities and Responsibilities
- **Articles 14 – 17** – Examination of Documents
- **Articles 18 – 28** – Documents
- **Articles 29 – 33** – Miscellaneous Provisions
- **Articles 34 – 37** – Disclaimers
- **Articles 38 – 39** – Transferable Credit & Assignment

UCP – 600

UCPDC - Uniform Customs and Practices for Documentary Credits - 600 (UCP 600) prepared by **International Chamber of Commerce ICC**, Paris by revising the UCPDC-500, is implemented w.e.f. July 01, 2007.

ARTICLE 5: Banks deal with documents and not with goods and service.

ARTICLE 14: Specifies the standards for examination of documents. As per new UCP the number of days available for examination of documents is reduced to **5 banking days.**

ARTICLE 14: A presentation must be made by or on behalf of the beneficiary not later than 21 calendar days after the date of shipment but not later than the expiry date of the credit.

ARTICLE 28

- **If there is no indication in the credit of the insurance coverage** required, the amount of insurance coverage must be at least 110% of the CIF – Cost, Insurance & Freight value of goods. Unless otherwise stipulated, the insurance policy should be in the currency of LC.

- **If the word 'about', 'approximation is used in connection with amount or unit price** stated in the LC, tolerance of +-10% is allowed
- **A tolerance of +- 5% is allowed where LC does not state quantity in terms of a stipulated numbers of packing units or individual items** and total amount of the drawings does not exceed the amount of LC.

ARTICLE 36: This article deals with disclaimer on *"force majeure"* means superior force. Now acts of terrorism has been added in this article. (FREES PARTIES FROM LIABILITY)

With or Without Recourse LCs: Where the beneficiary does not hold himself liable, the credit is said to be without recourse. As per RBI guidelines, banks should normally not open LCs and negotiate bills bearing the 'without recourse' clause.

The terms 'first Half 'second half of a month means 1 to the 15 and the 16 to the last day of the month, all dates inclusive

Beginning means the 1st to 10, middle 11th to the 20th and end of a month 21st to the last day of the month, all dates inclusive.

eRules and the eUCP - eUCP 600 (Version 2)

- To advance the digitalization of trade finance practices, ICC issued new electronic rules (eRules).
- The eRules will be continually monitored and updated to reflect future technological developments and trends that emerge in trade finance.
- ICC will ensure that the eRules remain applicable to banks and other trade finance institutions.

URR 725 – The Uniform Rules for Bank-to-Bank Reimbursements

- The URR 725 are the Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits ICC publication No. 725.
- URR 725 was approved by the ICC national committees at the ICC Banking Commission in April 2008. URR 725 has been effective since 01 October 2008.
- URR 725 is an updated version of previous rules for bank-to-bank reimbursements known as URR 525.

What is the Scope of URR 725?

The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits, ICC Publication No. 725, shall apply to any bank-to-bank reimbursement under documentary credits, when the reimbursement authorization expressly indicates that it is subject to these rules.

The rules are binding on all parties thereto, unless expressly modified or excluded by the reimbursement authorization.

INCOTERMS

- Incoterm is an acronym for International Commercial Terms.
- The Incoterms rules are a globally recognised set of standards for the delivery of goods by all modes of transport (road, rail, air and sea).
- They are the terms buyers and sellers involved in international and domestic trade agree on. They are recognised by governments and legal authorities across the world.

11 INCOTERMS CURRENTLY IN USE

The Incoterms rules provide globally accepted definitions and rules of interpretation for common commercial terms. These terms are better known by their three-letter acronyms.

There are currently 11 Incoterms in use. Some apply to all modes of transport while some are specific to a particular mode. These are the 11 rules briefly explained:

- **EXW (Ex-works):** This means that the seller makes the goods available at a specified location, usually the seller's factory. The buyer is responsible for onward transportation of the goods and bears the cost for the same.
- **DAP (Delivered at Place):** The seller is responsible for delivering the goods to a designated place.
- **FOB (Free on Board):** The seller completes delivery when he loads the goods on a ship specified by the buyer at a named port. Hence, the seller is "free" of responsibility once the goods are "on board" the ship. Any liability for damage or loss thereafter passes to the buyer. This rule applies to goods transported by sea or inland waterway.
- **FCA (Free Carrier):** The seller delivers the goods to a carrier or an agent nominated by the buyer at the seller's premises or another specified location.
- **FAS (Free Alongside Ship):** The seller delivers the goods alongside the ship (on a barge or quay, for example). The buyer must load the goods on the ship. This rule applies only to sea transport.
- **CFR (Cost and Freight):** The seller delivers the goods on a ship at the designated port and pays for cost and freight to bring the goods to the port.
- **CIF (Cost, Insurance and Freight):** The seller delivers the goods on the ship at the named port and pays for cost, freight and insurance to transport the goods to the port.
- **CPT (Carriage Paid To):** The seller delivers the goods to a named place and pays for carriage to that place.

- **CIP (Carriage and Insurance Paid To):** The seller delivers the goods to a named place, pays for both carriage and insurance of the goods to that place.
- **DPU (Delivered at Place Unloaded):** The seller delivers the goods at a designated place and unloads them, bearing the risks and costs of both. This is the only rule that requires the seller to unload the goods to complete delivery**. The buyer takes care of any import clearance charges, taxes and duties.**
- **DDP (Delivered Duty Paid):** The seller bears the maximum responsibility here as he arranges for carriage and delivery of goods at a named place, and pays for import clearance as well as any duties and taxes that might apply.

- There were 13 inco-terms before but there was addition of 2 i.e. DAP & DAT and 4 inco-terms i.e. DAF, DDU, DEQ and DES were removed.
- And in 2020 the DPU replaced DAT

STANDBY LETTER OF CREDIT (GUARANTEES)

- The usage of standby LC is mostly witnessed in countries like the USA, where guarantees are not used, and standby LC acts as a substitute for guarantee.
- This type of Letter of Credit is opened by banks in countries, where there is restriction on issuance of guarantees and therefore standbys provide a suitable substitute for performance or financial guarantees.
- Standby Letter of Credit (SLC, SBLC or SLOC) serves as a back-up and a secondary payment mechanism.
- The trigger for payment in a Standby L/C is usually a 'default' on part of the applicant (buyer) which then permits the beneficiary (seller) to draw under the letter of credit.
- The SLOC is used as a payment of last resort should the buyer of goods or services fail in fulfilling their financial or performance obligation.

Commercial Standby LC for Import of Goods

Banks have been permitted by Reserve Bank of India, to issue standby LCs towards import of goods into India.

Since standby LCs covering import of goods are susceptible to certain attendant risks in the absence of evidence of shipment/ insurance cover, importers should be advised and explained of the risk factors involved/ chances of abuse in acceding to the request for establishment of standby LCs for import of goods into India.

Invocation of the Commercial Standby LC by the beneficiary should be supported by proper evidence.

The beneficiary of the credit should furnish a declaration to the effect that the claim is made on account of failure of the importer to abide by his contractual obligations. Following documents must also be presented:

- Copy of invoice
- Non-negotiable set of documents including a copy of non-negotiable bills of lading/ transport document.
- A copy of inspection certificate, wherever provided for, as per the underlying contract etc.