Documentary Collections

Think of a documentary collection as an **international COD (Cash On Delivery)**: the buyer pays for goods at delivery. A documentary collection, however, is distinguished from a typical COD transaction in two ways:

(1) instead of an individual, shipping company, or postal service collecting the payment, **a bank handles the transaction**

(2) instead of cash on delivery for goods it is **cash on delivery for a title document (bill of lading) that is then used to claim the goods from the shipping company.**

Banks, therefore, act as intermediaries to collect payment from the buyer in exchange for the transfer of documents that enable the holder to take possession of the goods. The procedure is easier than a documentary credit, and the bank charges are lower. The bank, however, does not act as surety of payment but rather only as collector of funds for documents.

For the seller and buyer, a documentary collection falls between a documentary credit and open account in its desirability. Advantages, disadvantages, and issues for both buyer and seller will be discussed in the following pages.

- ## Documentary Collections vs. Documentary Credits

  In a documentary collection, the seller prepares and presents documents to the bank in much the same way as for a documentary letter of credit. However, there are **two major differences** between a documentary collection and a documentary credit:

  (1) the draft involved is not drawn by the seller (the "drawer") upon a bank for payment, but rather on the **buyer itself (the "drawee")**

  (2) **the seller's bank has no obligation to pay upon presentation** but, more simply, acts as a collecting or remitting bank on behalf of the seller, thus earning a commission for its services.

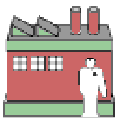
- ## The Uniform Rules for Collections (URC)

  Although documentary collections, in one form or another, have been in use for a long time, questions arose about how to effect transactions in a practical, fair, and uniform manner.

  The Uniform Rules for Collections (URC) is the internationally recognized codification of rules **unifying banking practice regarding collection operations for drafts and for documentary collections**. The URC was **developed by the International Chamber of Commerce (ICC) in Paris**. It is revised and updated from time-to-time; the c**urrent valid version is ICC publication No. 322**.

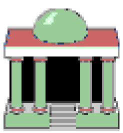
Introducing the Parties to a Documentary Collection

There are **four main parties** to a documentary collection transaction. Note below that each party has several names. This is because businesspeople and banks each have their own way of thinking about and naming each party to the transaction. For example, as far as businesspeople are concerned there are just buyers and sellers and the buyer's bank and the seller's bank. Banks, however, are not concerned with buying and selling. They are concerned with remitting (sending) documents from the principal (seller) and presenting drafts (orders to pay) to the drawee (buyer) for payment. The four main parties are



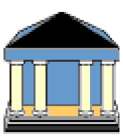
THE PRINCIPAL (SELLER/EXPORTER/DRAWER)

The principal is generally the seller/exporter as well as the party that prepares documentation (collection documents) and submits (remits) them to his bank (remitting bank) with a collection order for payment from the buyer (drawee). The principal is also sometimes called the remitter.



THE REMITTING (PRINCIPAL'S/SELLER'S/EXPORTER'S) BANK

The remitting bank receives documentation (collection documents) from the seller (principal) for forwarding (remitting) to the buyer's bank (collecting/presenting bank) along with instructions for payment.



THE COLLECTING OR PRESENTING (BUYER'S) BANK

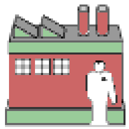
This is the bank that presents the documents to the buyer and collects cash payment (payment of a bank draft) or a promise to pay in the future (a bill of exchange) from the buyer (drawee of the draft) in exchange for the documents.

THE DRAWEE (BUYER/IMPORTER)

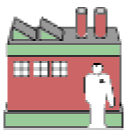
The drawee (buyer/importer) is the party that makes cash payment or signs a draft according to the terms of the collection order in exchange for the documents from the presenting/collecting bank and takes possession of the goods. The drawee is the one on whom a draft is drawn and who owes the indicated amount.

Basic Documentary Collection Procedure

The documentary collection procedure involves the step-by-step exchange of documents giving title to goods for either cash or a contracted promise to pay at a later time. Refer to the diagram on the opposite page for each numbered step.

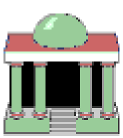
 **BUYER AND**  **SELLER**

The buyer and seller agree on the terms of sale of goods: (a) specifying a documentary collection as the means of payment, (b) naming a collecting/presenting bank (usually the buyer's bank), and (c) listing required documents.

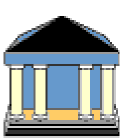
 **PRINCIPAL (SELLER)**

1. The seller (principal) ships the goods to the buyer (drawee) and obtains a negotiable transport document (bill of lading) from the shipping firm/agent.

2. The seller (principal) prepares and presents (remits) a document package to his bank (the remitting bank) consisting of (a) a collection order specifying the terms and conditions under which the bank is to hand over documents to the buyer and receive payment, (b) the negotiable transport document (bill of lading), and (c) other documents (e.g., insurance document, certificate of origin, inspection certificate, etc.) as required by the buyer.

 **REMITTING BANK**

3. The remitting bank sends the documentation package by mail or by courier to the designated collecting/presenting bank in the buyer's country with instructions to present them to the drawee (buyer) and collect payment.

 **COLLECTING BANK**

4. The presenting (collecting) bank (a) reviews the documents making certain they are in conformity with the collection order, (b) notifies the buyer (drawee) about the terms and conditions of the collection order, and (c) releases the documents once the payment conditions have been met.

BUYER/DRAWEE

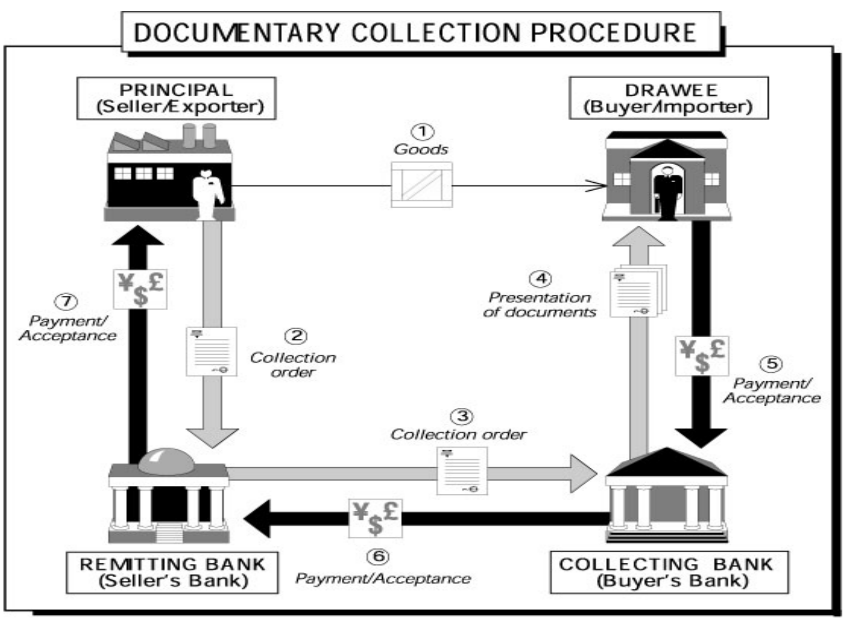
5. The buyer (drawee) (a) makes a cash payment (signing the draft), or if the collection order allows, signs an acceptance (promise to pay at a future date) and (b) receives the documents and takes possession of the shipment.

COLLECTING BANK

6. The collecting bank pays the remitting bank either with an immediate payment or, at the maturity date of the accepted bill of exchange.

REMITTING BANK

7. The remitting bank then pays the seller (principal).



A NOTE CONCERNING CORRESPONDENT BANKS

The remitting bank may find it necessary or desirable to use an intermediary bank (called a correspondent bank) rather than sending the collection order and documents directly to the collecting bank. For example, the collecting bank may be very small or may not have an established relationship with the remitting bank.

Three Types of Collections

There are three types of documentary collections and each relates to a buyer option for payment for the documents at presentation. The second and third, however, are dependent upon the seller's willingness to accept the option and his specific instructions in the collection order. The three types are

1. DOCUMENTS AGAINST PAYMENT (D/P)

In D/P terms, the collecting bank releases the documents to the buyer only upon full and immediate cash payment. D/P terms most closely resemble a traditional cash-on-delivery transaction.This type of collection offers the **greatest security to the seller**.

Note: The buyer must pay the presenting/collecting bank the full payment in freely available funds in order to take possession of the documents. This type of collection offers the **greatest security to the seller**.

2. DOCUMENTS AGAINST ACCEPTANCE (D/A)

In D/A terms the collecting bank is permitted to **release the documents to the buyer against acceptance (signing) of a bill of exchange or signing of a time draft at the bank promising to pay at a later date (usually 30, 60 or 90 days).**

The completed draft is held by the collecting bank and presented to the buyer for payment at maturity, after which the collecting bank sends the funds to the remitting bank, which in turn sends them to the principal/seller.

Note: The seller should be aware that he gives up title to the shipment in exchange for the signed bill of exchange that now represents his only security in the transaction.

3. ACCEPTANCE DOCUMENTS AGAINST PAYMENT

An acceptance documents against payment has features from both D/P and D/P types. **It works like this: (a) the collecting bank presents a bill of exchange to the buyer for acceptance, (b) the accepted bill of exchange remains at the collecting bank together with the documents up to maturity, (c) the buyer pays the bill of exchange at maturity, (d) the collecting bank releases the documents to the buyer who takes possession of the shipment, and (e) the collecting bank sends the funds to the remitting bank, which then in turn sends them to the seller.**

This gives the buyer time to pay for the shipment but gives the seller security that title to the shipment will not be handed over until payment has been made. If the buyer refuses acceptance of the bill of exchange or does not honor payment at maturity, the seller makes other arrangements to sell his goods. This type of collection is seldom used in actual practice.

General Notes and Cautions

Specific notes and cautions for sellers, buyers, and banks involved in documentary collection transactions are listed at the end of this chapter. Listed below are notes and cautions that are fundamental to the process and of importance to all parties to the transaction.

- The banks involved in a documentary collection do not guarantee payment or assume any credit risk, as they do in documentary credit transactions. The banks act merely as intermediaries to facilitate payment for a shipment.
- If the shipper/seller sends goods directly to the buyer's address, the shipment will be handed over without the buyer first making payment. The seller, therefore, will usually address the shipment to his agent in the buyer's country or to the collecting bank if it is known to him and prior agreement has been obtained to do so.
- Goods are transported, stored, and insured at the expense and risk of the seller until payment or acceptance occurs. Generally, banks are under no obligation to protect the goods. Banks are also not responsible if the shipment is seized by customs or confiscated to cover any accrued storage costs.
- Documentary collections have one additional safeguard over transactions conducted on an open-account basis. The existence of the draft itself, which has been duly presented and accepted through a bank in the buyer's country, is an acknowledged evidence of debt. However, this may not be of great value against a purchaser who is determined not to pay.
- In D/P terms the buyer may refuse to pay, in which case the seller maintains title to the shipment. The seller may decide to negotiate new terms with the buyer, locate another buyer, or have the goods returned, incurring the cost of shipping, insurance, and bank fees. If the goods are perishable, the seller may be in a difficult position to find a new buyer quickly.
- In D/A terms the buyer may refuse to accept the draft, in which case the seller is in the same position as in D/P terms where the buyer refuses to pay the draft. (See the preceding item for details.)
- In D/A terms the buyer may accept (sign) the draft, take possession of the goods, but then refuse to pay the draft at maturity. In this case the seller has neither payment nor the goods. The seller's options are effectively reduced to trying to enforce the buyer's obligation to pay the draft through banking channels or legal action, both of which involve additional costs.
- Since the banks are under no obligation to authenticate documents, it is possible that the seller will send a short shipment, the incorrect goods, or inferior goods. The only recourse available to the buyer is through direct contact with the seller or legal action.

Important Principles Regarding the Role of Banks

It is important to note that documentary collection procedures are not infallible. Things can and do go wrong. (Refer to the list of issues for sellers, buyers, and banks on the pages that follow.) Since banks act as intermediaries between buyers and sellers, both look to the banks as protectors of their interests. However, while banks have clear cut responsibilities, they are also shielded from certain problems deemed to be out of their control or responsibility. Several instances:

1. Banks act upon specific instructions given by the principal (seller) in the collection order. Seller's instructions left out of the collection order by mistake or omitted because "we've always done it that way" don't count. The principal, therefore, should take great care in preparing the collection order so that it gives complete and clear instructions.
2. Banks are required to act in good faith and exercise reasonable care to verify that the documents submitted APPEAR to be as listed in the collection order. They are, however, under no obligation to confirm the authenticity of the documents submitted.
3. Banks are not liable nor can they be held accountable for the acts of third parties. Third parties include freight forwarders, forwarding agents, customs authorities, insurance companies and other banks. Specifically, they are not responsible for delays or consequences resulting from Acts of God (floods, earthquakes, etc.), riots, wars, civil commotions, strikes, lockouts, or other causes beyond their control.
4. Banks also assume no liability or responsibility for loss arising out of delays or loss in transit of messages, letters, documents, etc.
5. Banks assume no responsibility regarding the quantity or quality of goods shipped. They are only concerned that documents presented appear on their face to be consistent with the instructions in the collection order. Any dispute as to quality or quantity of goods delivered must be settled between the buyer and the seller.
6. Without explicit instructions, the collecting bank takes no steps to store or insure the goods. This, of course, can be a problem for both the seller and the buyer. If the seller has not received payment he still has ownership and an insurable interest in the goods.
7. If a collection remains unpaid or a bill of exchange is not accepted and the collecting bank receives no new instructions within 90 days, it may return the documents to the bank from which it received the collection order.

If there are any conclusions to be made from the above they are: first, that the buyer and seller should know each other and have at least some basis of trust to be doing business in the first place and second, that all parties to the transaction should take responsibility to follow through on their responsibilities carefully.

Notes, Tips, and Cautions For Sellers

1. A seller should only agree to a documentary collection payment if

    a. The seller does not doubt the buyer's ability and willingness to pay for the goods;
    b. The buyer's country is politically, economically, and legally stable;
    c. There are no foreign exchange restrictions in the buyer's country, or all licenses for foreign exchange have already been obtained; and
    d. The shipped goods are easily remarketable.

2. The seller should check on the buyer's creditworthiness and reputation before consenting to a documentary collection, especially D/A terms.
3. The seller should find out from the buyer what documents are required for customs clearance in the buyer's country. The seller should then assemble the documents carefully and make sure they are in the required form and endorsed or authenticated as necessary.
4. If the buyer does not get the required documents he may refuse the collection altogether, or in D/A terms he may unknowingly sign the acceptance and then find that he cannot clear the goods through customs. Although he is legally responsible for payment, he may be unable to pay because he never received the goods. Either leaves the seller in a compromised situation.
5. As a rule, the remitting (seller's) bank will not review the documents before forwarding them to the presenting/collecting (buyer's) bank. Review of the documentation is the primary responsibility of the buyer.
6. Because goods may be refused, the seller should only ship goods that are readily marketable to other buyers.
7. Risks to the seller center around the fact that payment is not made until after the goods are shipped.
8. The seller assumes liability for shipping, insurance, and storage while the goods are in transit and before payment is made. If the buyer does not pay the draft the seller is still responsible for these costs.
9. If the buyer refuses payment (in D/P terms) or acceptance (in D/A terms) the seller retains ownership of the shipment. The seller may have the goods shipped back or try to sell them to another buyer. If the buyer takes no action, customs may seize the goods and auction or otherwise dispose of them.
10. In D/A terms if the buyer signs the acceptance, takes possession of the goods, and then refuses to pay the bill of exchange at maturity the seller has given up title to the shipment and the only recourse is to the buyer, not the banks.

Notes, Tips, and Cautions For Buyers

A buyer should only agree to documentary collection payment terms if there is trust that the seller will ship the goods as specified in accordance with the agreement between buyer and seller.

1. The buyer should be aware of any documentation, certifications, or authorizations that may be required for customs clearance or for eventual sale of the goods in his own country.
2. The buyer should specify all documentation required of the seller in his agreement with the seller.
3. Upon presentation by the presenting bank the buyer must carefully inspect the documents to make certain they meet all specifications for customs clearance and for eventual sale of the goods in his own country.
4. As a special favor, the collecting bank may allow the buyer to take temporary possession of the documents for inspection before payment. The collecting bank, however, assumes responsibility for the documents until redemption.
5. In the above case, the buyer should immediately return the entire set of documents to the collecting bank if he is unwilling or unable to meet the agreed upon payment procedure.
6. In a documentary collection the buyer is generally in a secure position because ownership or responsibility for goods does not have to be assumed until documents have been paid for or a time draft signed.
7. The buyer may not sample or inspect the goods before accepting and paying for the documents unless authorized to do so by the seller. The buyer may, however, specify a certificate of inspection from a reliable third party as part of the required documentation package.
8. Unless bound by a separate contract, the buyer assumes no liability for goods if he refuses to take possession of the documents.
9. Partial payment in exchange for the documents is not allowed unless specifically authorized in the seller's collection order.
10. With D/A terms, the buyer may receive the goods and resell them for profit before the time draft matures, thereby using the proceeds of the sale to pay for the goods. The buyer is responsible for payment, however, even if the goods cannot be sold.
11. The main risk for buyers is that goods shipped might not conform to the goods specified. Because banks deal only in documents and not in goods, the buyer's only recourse is with the seller.