

UCPDC – 600 Edition effective from 1st July 2007

Documentary Credit means any arrangement that is **irrevocable** and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.

Complying presentation

a presentation that is in accordance with

- the terms and conditions of the credit,
- the applicable provisions of these rules (UCP 600) and
- international standard banking practice.

Honour

- a. to **pay** at sight if the credit is available by sight payment.
- b. to incur a **deferred payment undertaking** and **pay** at maturity if the credit is available by deferred payment.
- c. to **accept** a bill of exchange ("draft") drawn by the beneficiary

Notes



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LETTER OF CREDIT

- Three main contracts underlying LC
 - Sale Contract between Buyer & Seller
 - Application-cum-Guarantee between Applicant(Buyer) and Issuing Bank
 - LC itself (contract between Issuing Bank and Beneficiary/Seller)
(LC independent of other two contracts)

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Mechanics of Documentary Credit

CONTRACT



Notes

Parties to Letter of Credit

- Opener/Buyer
- Issuing Bank
- Advising Bank
- Beneficiary/Seller
- Nominated Bank/Negotiating Bank
- Confirming Bank
- Reimbursing Bank

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Types of credit

Security to beneficiary

Confirmed

Mode of settlement

Payment/ deferred payment

Acceptance

Negotiation

Involving middlemen

Transferable

Back to back

Involving advances

Red Clause Credit

Green Clause Credit

Involving repeated transactions

Revolving

Stand by

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Transferable Credits

- Credit has to be opened as transferable
- The beneficiary is normally a trader or agent
- He transfers credit to his supplier - second beneficiary.
- Transferred by a bank at the request of first beneficiary
- Second beneficiary can supply goods and negotiate documents as if he had received the credit.
- He may pay commission to first beneficiary for the order
- There can be more than one second beneficiary.
- No third beneficiary is permitted.

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Transferable Credits

- The following parameters may be changed while transferring a credit
 - Amount of credit, unit price and quantity of goods
 - Date of expiry, last date of shipment and last date of negotiation can be brought forward
 - % of insurance cover may be increased.
- First beneficiary has the right to substitute documents negotiated by second beneficiary.

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Back to Back Credits

- Exporter receives a credit from his buyer (Selling credit)
- He has to procure goods from other suppliers
- He opens a credit for purchase of the goods (buying credit)
- Second credit is said to be back to back to the first one.
- Bill proceeds of the export LC (Selling LC) will be used to meet liabilities under the second (Buying LC)
- Amount of back to back credit will be lower.
- Usance period of the back to back credit should be equal to or more than that of the export credit.
- Bank still at risk if the customer fails to export
- No concession in margin and security norms.

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Revolving Credits

- Credit is opened to cover a series of regular transactions over a longer period
- Beneficiary will submit a series of documents
- Maximum value of each document will be fixed and is the revolving limit
- LC amount is the maximum value of documents that can be handled under the credit.
- The credit may be reinstated automatically or after payment of earlier bill.
- It can be opened as cumulative or non cumulative.

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Standby Letters of Credit

- Credit is issued for a particular amount and for a particular period
- Trade takes place on running account basis.
- Beneficiary does not submit documents to bank.
- If there is a default, he can claim funds from opening bank giving a certificate of default
- No quibbling over discrepancies and documents
- Opening bank will pay on demand
- Works like a bank guarantee
- UCPDC is applicable if so declared in the credit

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LC Regulations

- Foreign Trade Policy requirements.
- FEMA requirements.
- Credit norms of Central Bank.
- UCPDC 600 Provisions.
- Bank's Internal Credit Policies/ procedures.
- Public notices issued by DGFT
- Uniform Rules for bank-to-bank reimbursements 525
- Incoterms 2010

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Bank's Obligation & Responsibilities

- Issuing Bank (opening bank)
(UCP Article 7)
 - the prime obligator*
 - to ensure credit-worthiness and trust-worthiness of the applicant*
 - *Once credit is opened, the bank is placing itself as a substitute for the buyer.*

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Bank's Obligation & Responsibilities

Negotiating Bank

- *to examine docs. Within 5 banking days after receipt of the documents at their counters(Art 14b).*
- *to ensure compliance of credit terms (on the basis of documents alone) as well as consistency of docs with each other.*

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Protection to Banks

- *Banks are not responsible :*
 - *for the **genuineness** or contents of any documents submitted (Art. 34)*
 - *For losses etc. arising from **transmission problems** (Art. 35)*
 - ***Force Majeure** (Art. 36)*
 - *For the failings of their correspondent Banks (Art. 37)*

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Protection to Banks

- *Issuing Bank is responsible for all Bank charges and other costs at home or abroad even if they are supposed to be paid by other party (Art. 37 c).*
- *Applicant is responsible for any adverse consequences of foreign laws (Art. 37d).*

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LETTER OF CREDIT Appraisal / Assessment

- satisfactory track record.
- dealings with only one bank.
- Liabilities of the applicant to the Bank and third parties.
- Means by which the applicant is expected to meet his commitment once the bills arrive.
- Margin he should deposit.

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Appraisal Issues..

Limit to be commensurate with turnover and CC limits.

Should be for genuine trade/ manufacturing activity.

Usance period of the LC should ordinarily have relation to the working capital cycle.

Level of inventory carried should be commensurate with industry norms / past trends.

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Appraisal Issues....

- LCs for purchase of machinery / capital goods should be backed by borrower's own funds or a term loan sanctioned for the purpose.
- Wherever warranted, in addition to margin, where prescribed, we may also retain a lien on the undrawn portion of the CC limit for the value of bills to be received under the LC.

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