



**INTERNATIONAL** TRADE FINANCE SERVICES

**DOCUMENTARY LETTERS OF CREDIT**  
**A PRACTICAL GUIDE**

# CONTENTS

---

LETTERS OF CREDIT SIMPLY DEFINED . . . . .	2
BENEFITS OF A LETTER OF CREDIT . . . . .	3
SPECIAL TYPES OF LETTERS OF CREDIT . . . . .	4
OTHER TYPES OF LETTERS OF CREDIT . . . . .	5
STEPS IN AN IMPORT LETTER OF CREDIT TRANSACTION . . . . .	6
DOCUMENTS USUALLY REQUIRED UNDER A LETTER OF CREDIT . . . . .	7
STEPS IN AN EXPORT LETTER OF CREDIT TRANSACTION . . . . .	11
PAYMENT PROCEDURE . . . . .	12
SIGHT LETTER OF CREDIT . . . . .	13
TERM (USANCE) LETTER OF CREDIT . . . . .	14
WHAT TO DO IF DOCUMENTS ARE DISHONOURED . . . . .	15
A BRIEF EXPLANATION OF TRADE TERMS . . . . .	16
PARTIES INVOLVED IN A LETTER OF CREDIT TRANSACTION . . . . .	17

# PREFACE

---

As one of North America's largest financial institutions and a major international bank, Scotiabank is well-equipped to look after your importing and exporting needs.

This brochure will provide the exporter, importer and others engaged in international trade with a practical guide to documentary letters of credit.

Documentary credits, commercial letters of credit or just letters of credit, as they will be referred to in this brochure, play an integral part in facilitating international trade while providing a secure and reliable means of payment.

While this brochure deals mainly with documentary letters of credit, specialized information on other products and services is available in Canada directly from our Commercial Banking Centres and branches, and from our offices around the world.

This brochure should not be regarded as a text or operating manual nor an attempt to cover all possible situations.

This brochure is not intended to provide legal or other professional advice and readers should not act on information contained herein without seeking specific advice on the particular transactions with which they are concerned.

Within its limitations, it is hoped that this brochure will serve as a basic tool in understanding letters of credit.

# LETTERS OF CREDIT SIMPLY DEFINED

---

## **Definition**

In simple terms, a letter of credit is a bank undertaking of payment separate from the sales or other contracts on which it is based. It is a way of reducing the payment risks associated with the movement of goods.

Expressed more fully, it is a written undertaking by a bank (issuing bank) given to the seller (beneficiary) at the request, and in accordance with the buyer's (applicant) instructions to effect payment — that is by making a payment, or by accepting or negotiating bills of exchange (drafts) — up to a stated amount, against stipulated documents and within a prescribed time limit.

## **Why use a Letter of Credit?**

The need for a letter of credit is a consideration in the course of negotiations between the buyer and seller when the important matter of method of payment is being discussed. Payment can be made in several different ways: by the buyer remitting cash with his order; by open account whereby the buyer remits payment at an agreed time after receiving the goods; or by documentary collection through a bank in which case the buyer pays the collecting bank for account of the seller in exchange for shipping documents which would include, in most cases, the document of title to the goods. In the aforementioned methods of payment, the seller relies entirely on the willingness and ability of the buyer to effect payment.

When the seller has doubts about the credit-worthiness of the buyer and wishes to ensure prompt payment, the seller can insist that the sales contract provides for payment by irrevocable letter of credit. Furthermore, if the bank issuing the letter of credit (issuing bank) is unknown to the seller or if the seller is shipping to a foreign country and is uncertain of the issuing bank's ability to honour its obligation, the seller can, with the approval of the issuing bank, request its own bank — or a bank of international repute such as Scotiabank — to assume the risk of the issuing bank by confirming the letter of credit.

## **Basic Types of Letters of Credit**

There are three basic features of letters of credit, each of which has two options. These are described below. Each letter of credit has a combination of each of the three features.

### **SIGHT OR TERM/USANCE**

Letters of credit can permit the beneficiary to be paid immediately upon presentation of specified documents (sight letter of credit), or at a future date as established in the sales contract (term/usance letter of credit).

### **REVOCABLE OR IRREVOCABLE**

Letters of credit can be revocable. This means that they can be cancelled or amended at any time by the issuing bank without notice to the beneficiary. However, drawings negotiated before notice of cancellation or amendment must be honoured by the issuing bank. An irrevocable letter of credit cannot be cancelled without the consent of the beneficiary.

### **UNCONFIRMED OR CONFIRMED**

An unconfirmed letter of credit carries the obligation of the issuing bank to honour all drawings, provided that the terms and conditions of the letter of credit have been complied with. A confirmed letter of credit also carries the obligation of another bank which is normally located in the beneficiary's country, thereby giving the beneficiary the comfort of dealing with a bank known to him.

# BENEFITS OF A LETTER OF CREDIT

---

## **To The Exporter/Seller**

- Letters of credit open doors to international trade by providing a secure mechanism for payment upon fulfilment of contractual obligations.
- A bank is substituted for the buyer as the source of payment for goods or services exported.
- The issuing bank undertakes to make payment, provided all the terms and conditions stipulated in the letter of credit are complied with.
- Financing opportunities, such as pre-shipment finance secured by a letter of credit and/or discounting of accepted drafts drawn under letters of credit, are available in many countries.
- Bank expertise is made available to help complete trade transactions successfully.
- Payment for the goods shipped can be remitted to your own bank or a bank of your choice.

## **To the Importer/Buyer**

- Payment will only be made to the seller when the terms and conditions of the letter of credit are complied with.
- The importer can control the shipping dates for the goods being purchased.
- Cash resources are not tied up.

## **Uniform Customs and Practice for Documentary Credits (UCP)**

The Uniform Customs and Practice for Documentary Credits is an internationally agreed upon set of rules for all parties involved in all types of letter of credit transactions. The rules, which were adopted by the International Chamber of Commerce in Vienna in 1933, have been revised several times and are used by banks in practically all countries.

The Uniform Customs and Practice for Documentary Credits, currently applicable, is a set of rules which, when not in contravention of local laws, are binding on the parties who have adopted them. The authority of UCP lies in its universal acceptance which is acknowledged by a statement on the letter of credit itself. All Scotiabank Documentary Letters of Credit are issued subject to UCP.

Copies of the Uniform Customs and Practice for Documentary Credits are available upon request from your nearest Scotiabank office.

## **General Principles of UCP**

- Letters of credit are separate transactions from the sales or other contracts on which they may be based, and banks are in no way involved with or bound by such contracts, even if reference to them is included in the letter of credit.
- In letters of credit transactions, all parties deal with documents and not with the underlying contracts to which the documents may relate.
- Before payment or acceptance of drafts is effected, banks bear the responsibility for examining the documents to ensure that they appear on their face to be in accordance with the terms and conditions of the letter of credit.
- Banks bear no responsibility for: the form or genuineness of documents; for the goods described in the documents; or the performance of the seller of the goods.

# SPECIAL TYPES OF LETTERS OF CREDIT

---

So far a description has been provided of the basic types of letters of credit used to cover the shipment of goods. In addition to these basic types, there are various specialized formats which meet particular sets of circumstances.

## **Red Clause Letter of Credit**

A red clause letter of credit incorporates a clause, traditionally written in red, which authorizes the bank acting as the negotiating or paying bank to pay the beneficiary in advance of shipment. This enables the purchase and accumulation of goods from a number of different suppliers, and the arrangement of shipment in accordance with the letter of credit terms. Such advances will be deducted from the amount due to be paid when the documents called for are presented under the letter of credit. If the beneficiary fails to ship the goods or cannot do so before the expiry of the letter of credit, the issuing bank is bound to reimburse the negotiating or paying bank, recovering its payment from the applicant.

Variations of such credits may also require that any advances be secured by temporary warehouse receipts until shipment is effected. Beneficiaries of red clause letters of credit are invariably brokers/agents of buyers in a particular field.

## **Transferable Letter of Credit**

A transferable letter of credit allows the beneficiary to act as a middleman and transfer his rights under a letter of credit to another party or parties who may be suppliers of the goods. Depending on whether the letter of credit permits partial shipments, fractional amounts may be transferred to more than one beneficiary. The letter of credit however, can be transferred only once: the secondary beneficiaries cannot transfer their rights to a third party. Transfer of a letter of credit can be made on specific application by the original beneficiary to the authorized transferring bank

To be transferable, a letter of credit must be so marked by the issuing bank which can only do so on the applicant's specific instructions. The applicant should be aware that any second beneficiary, the probable supplier, is usually a party not likely known to the applicant.

The terms and conditions of the transferred letter of credit must be identical to those of the original letter of credit with the following exceptions:

- The original beneficiary may be shown as the applicant on the transferred credit.
- The amount of the letter of credit, and unit prices if any, may be less than in the original letter of credit (the difference being the original beneficiary's profit margin).
- The latest shipment date, if any, and expiry date as shown on the original letter of credit should be shortened.
- The percentage of insurance coverage, if any, should be increased to satisfy the requirements of the original letter of credit.
- When a drawing takes place, the original beneficiary normally substitutes his invoices for those of the second beneficiary for up to the amount and unit prices available under the original letter of credit, and draws the difference as profit.

**Back-to-Back Letter of Credit**

Although not recorded on a letter of credit, “back-to-back” is a term used in transactions involving two irrevocable letters of credit.

Such transactions originate when a seller receives a letter of credit covering goods which must be obtained from a third party who in turn requires a letter of credit. The “second” issuing bank looks to the first issuing bank for reimbursement after paying under the second letter of credit.

The difference between back-to-back letters of credit and transferable letters of credit, is such that in a transferable letter of credit, the rights under the existing letter of credit are transferred. In a back-to-back transaction, different letters of credit are actually issued. Because technical problems can arise in back-to-back transactions, banks tend to discourage their use.

**Deferred Payment Letter of Credit**

Under a deferred payment letter of credit, the applicant does not pay until a future date determined in accordance with the terms of the letter of credit. No drafts are called for, which avoids “stamp duties” charged by some countries on bills of exchange (drafts). One reason an exporter might extend credit terms to an importer could be the competitiveness of the market and the need for the exporter to finance the importer if the exporter is to make the sale.

## OTHER TYPES OF LETTERS OF CREDIT

---

The letters of credit described thus far cover the movement of goods from one destination to another. There are other types of letters of credit which are not specifically related to the movement of goods. The principal one is as follows:

**Standby Letters of Credit**

Standby letters of credit may apply in general to transactions which are based on the concept of default by the applicant in performance of a contract or obligation. In the event of default, the beneficiary is permitted to draw under the letter of credit. Standby letters of credit may be used as a substitute for performance guarantees, or issued to guarantee loans granted by one firm to another, thereby securing payment to the creditor in the event the other party fails to repay its obligation on the due date. Even if the applicant claims to have performed, the bank issuing the letter of credit is obliged to make payment provided the beneficiary produces complying documents, usually a sight draft, and a written demand for payment.

# STEPS IN AN IMPORT LETTER OF CREDIT TRANSACTION

## The Sales Contract

The sales contract is the formal agreement between the buyer and seller specifying the terms of sale that both parties have agreed upon. The contract should include: a description of the goods; the amount; the unit price; the terms of delivery; the time allowed for shipment and presentation of documents; the currency; and the method of payment.

## Application & Agreement

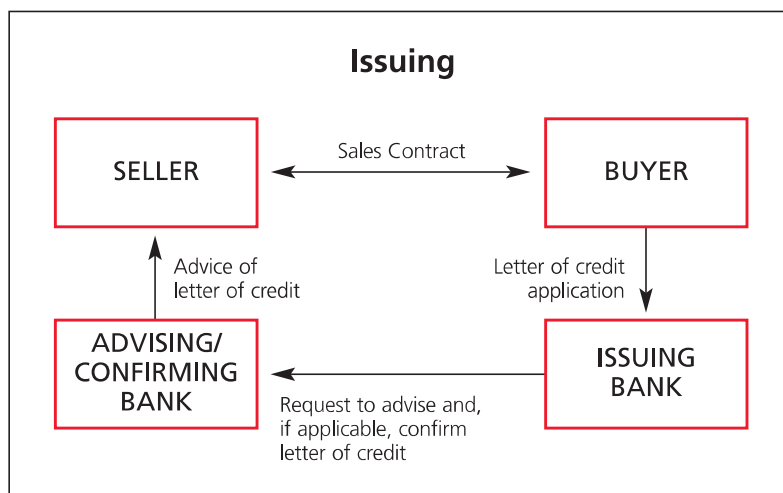
The bank's letter of credit application and agreement forms, when executed, constitute a payment and reimbursement contract between the issuing bank and its customer. It is also the customer's instruction to the issuing bank. The letter of credit must be issued exactly in accordance with the customer's instructions; therefore, it is important that the application be completed fully and accurately, so as to avoid the inconvenience of having to have the letter of credit amended. The agreement constitutes an undertaking by the customer to reimburse the issuing bank for drawings paid in accordance with the terms of the letter of credit, and normally takes the form of an authorization to debit the customer's account.

## Issuance of the Letter of Credit

The issuing bank prepares the letter of credit as specified in the application and forwards it by tele-transmission or airmail to the advising bank, (a branch or correspondent of the issuing bank). The issuing bank instructs the advising bank as to whether or not to add its confirmation, as per their customer's instructions.

## Advising

The advising bank forwards the letter of credit to the beneficiary (seller) stating that no commitment is conveyed on its part. However, if the advising bank has been asked to confirm the letter of credit and agrees to do so, it will incorporate a clause undertaking to honour the beneficiary's drafts, provided the documents evidence that all terms and conditions of the letter of credit have been complied with.





# DOCUMENTS USUALLY REQUIRED UNDER A LETTER OF CREDIT

---

There is no limit to the number and variety of documents which letters of credit may stipulate. The following is a list of documents most commonly seen in a letter of credit transaction. Each document is described in brief with a check-list for preparing the document.

As already stated, the beneficiary should, on first being advised of the letter of credit, examine it carefully and be satisfied that all the documentary requirements can be complied with. Unless the documentary requirements can be strictly complied with, the beneficiary may not receive payment from the issuing bank. If there are any requirements that cannot be complied with, the beneficiary should immediately request the applicant to arrange for an appropriate amendment to the letter of credit.

## **Draft**

A draft is a bill of exchange and a legally enforceable instrument which may be regarded as the formal evidence of debt under a letter of credit. Drafts drawn at sight are payable by the drawee on presentation. Term (usance) drafts, after acceptance by the drawee, are payable on their indicated due date.

### **Checklist**

- Drafts must show the name of the issuing bank and the number and date of the letter of credit under which they are drawn.
- Drafts must be drawn and signed by the beneficiary of the letter of credit.
- The terms of the draft must be expressed in accordance with the tenor shown in the letter of credit; e.g., at sight or at a stated number of days after bill of lading/shipment date.
- The amount in words and figures must agree and be within the available balance of the letter of credit and in the same currency as the letter of credit.
- The amount must agree with the total amount of the invoices unless the letter of credit stipulates that drafts are to be drawn for a given percentage of the invoice amount.

## **Commercial Invoice**

The commercial invoice is an itemized account issued by the beneficiary and addressed to the applicant, and must be supplied in the number of copies specified in the letter of credit.

### **Checklist**

- The invoice description of the goods must be identical to that stipulated in the letter of credit.
- Unit prices and shipping terms, ie., CIF, FOB, etc., must be as stipulated in the letter of credit. Extensions and totals should be checked for arithmetical correctness. For definitions of CIF, FOB etc., see page (16).

## **Consular or Customs Invoice**

A consular or customs invoice is prepared by the beneficiary on forms either supplied by the buyer or local consulate offices.

#### Checklist

- Consular invoices must be visaed (officially stamped) and signed by a consular officer of the importing country and be supplied in the official form and number of copies as stipulated in the letter of credit.
- All headings of the forms must be completed.
- The value of goods required must agree with that shown on the commercial invoice.

#### Bill of Lading

A bill of lading is a receipt issued by a carrier for goods to be transported to a named destination, which details the terms and conditions of transit. In the case of goods shipped by sea, it is the document of title which controls the physical custody of the goods. There are two different types of bill of lading:

- A STRAIGHT BILL OF LADING is one that names a specific consignee to whom goods are to be delivered. It is a non-negotiable document.
- An ORDER BILL OF LADING is one that is written "to order" or to order of a named party making the instrument negotiable by endorsement. Letters of credit usually call for an order bill of lading blank endorsed, meaning the holder of the bill of lading has title to the goods.

Given that each bill of lading must be either "straight" or "order", the following is a list of more common types of bill of lading:

- An OCEAN BILL OF LADING is one issued by an ocean carrier in sets, usually three signed originals comprising a complete set, any one of which gives title to the goods. Ocean bills of lading may be issued in "straight" or "order" form.
- A SHORT FORM BILL OF LADING is one issued by a carrier which does not indicate all the conditions of the contract of carriage. This is acceptable unless otherwise specified in the letter of credit.
- A CHARTER PARTY BILL OF LADING, is one which shippers may, when large or bulk cargoes are concerned, lease the carrying vessel for a stated time or specific voyage under a charter party contract with the owner. Goods carried are then covered under a form of bill of lading issued by the charterer and indicate as being shipped, subject to the term and conditions of the charter party. Charter party bills of lading are not acceptable unless specifically authorized by the letter of credit.
- A MULTIMODAL TRANSPORT DOCUMENT is one covering shipments by at least two different modes of transport.

#### Checklist

- Ensure that the port of loading and port of discharge are as stipulated in the letter of credit.
- The shipment must be consigned in the manner stipulated in the letter of credit.
- A general description of the goods is acceptable if consistent with but not necessarily identical with the description specified in the letter of credit and other documents.
- If the letter of credit calls for an "on board" bill of lading, it must be evidenced by a "shipped on board" bill of lading, or by marked or stamped "on board" notation indicating the date the goods were loaded on board.
- If the letter of credit stipulates that freight is to be prepaid; or if the invoice is priced CIF or CFR; or if the ocean freight has been added to the FOB or FAS value: the bill of lading must be marked "freight paid" or "freight prepaid". Expressions such as "freight to be paid" or "freight payable" are not acceptable.

- The bill of lading must be “clean”. Any superimposed marking indicating a defect in the packaging or condition of the goods renders the bill of lading “unclean” and unacceptable.
- Bills of lading indicating goods shipped “on deck” are not acceptable unless specifically allowed in the letter of credit.
- The total number of packages comprising the shipment, shipping marks and numbers, and any gross weight must agree with those on the commercial invoice and other documents.
- Letters of credit should stipulate a period of time after date of issue of the bill of lading or other shipping document for presentation of drawings. If no such period is specified, banks will refuse documents and consider them to be stale dated if presented later than 21 days after the date of “on board” endorsement, or, in the case of a shipped bill of lading or other shipping document, 21 days after the date of issue.
- The bill of lading is to cover only goods described in the invoice and specified in the letter of credit.
- Any correction or alteration must be initialled by the party signing the bill of lading.
- The name of the carrier must appear on the front of the bill of lading where the particulars of the shipment are shown.
- If the bill of lading is signed by an agent, the name of the agent as well as the name of the carrier must be shown.

### **Air Waybill**

An air waybill is a receipt issued by an air carrier indicating receipt of goods to be transported by air and showing goods consigned to a named party. Being a non-negotiable receipt it is not a document of title.

#### **Checklist**

- Only the goods invoiced and specified in the letter of credit may be covered by the air waybill.
- If the letter of credit stipulates that freight is to be prepaid; or if the invoice is priced CIF or CFR; or if freight is otherwise included in the invoice: the air waybill must indicate that freight has been paid.
- The airport of departure and airport of destination must be as stipulated in the letter of credit.
- The number of packages and gross weight shown on the air waybill must be consistent with the other documents.
- An air waybill issued by a forwarder is not acceptable.

### **Insurance Policy or Certificate**

Under the terms of a CIF contract, the beneficiary is obliged to arrange insurance and furnish the buyer with the appropriate insurance policy or certificate. The extent of coverage and risks should be agreed upon between the buyer and seller in their initial negotiations and be set out in the sales contract.

Since the topic of marine insurance is extremely specialized and with conditions varying from country to country, the services of a competent marine insurance broker are useful and well-advised.

#### **Checklist**

- If the letter of credit calls for an insurance policy, an insurance certificate is not acceptable and the policy must be provided. Broker's cover notes are not acceptable unless specifically allowed in the letter of credit.
- If the insurance policy or certificate indicates that it is issued in duplicate, both copies must be presented.
- Unless the amount to be insured is stipulated in the letter of credit, the amount should cover at least the CIF value plus 10 percent if invoiced in those terms. Otherwise, the amount should be for the greater of the draft amount or the total invoice value plus 10%.
- The amount insured must be expressed in the same currency as the letter of credit.

- The description of the goods insured must be consistent with that in the other documents although not necessarily identical.
- The number of packages comprising the shipment and shipping marks and numbers must agree with those shown on the invoice and bill of lading.
- The name of the carrying vessel, port of loading and port of discharge must agree with those shown on the bill of lading.
- The insurance document must cover transshipment if transshipment is indicated on the bill of lading.
- The insurance document must cover specifically those risks stipulated in the letter of credit. The “all risks” clause in the insurance document does not cover risks of war, which must be separately shown as covered, if required by the letter of credit.
- Unless the letter of credit specifies to whom loss is to be payable, the insurance document must be endorsed by the party to whose order it is made so as to be in negotiable form.
- The date of the insurance document should not be later than the date of shipment as shown by the bill of lading or other transport document. However, the insurance document may be dated after the date of shipment provided it evidences that cover is effective from date of dispatch ie., by way of “warehouse to warehouse” clause.
- Any alterations or corrections to the insurance document must be initialed by the party signing the document.
- The insurance document must be signed by an authorized person.

The foregoing are the most common documents usually called for in an export letter of credit. The following may also be asked for to satisfy government requirements or for the convenience of the buyer.

### **Certificate of Origin**

As the name suggests, a certificate of origin certifies as to the country of origin of the goods described and should comply with any stipulations in the letter of credit as to originating country and by whom the certificate is to be issued. The certificate should be consistent with and identified with the other shipping documents by shipping marks and numbers, and must be signed.

### **Inspection Certificate**

When a letter of credit calls for an inspection certificate it will usually specify by whom the certificate is to be issued; otherwise, the same general comments as in the case of the certificate of origin apply.

As a preventative measure against fraud or as a means of protecting the buyer against the possibility of receiving substandard or unwanted goods, survey or inspection certificates issued by a reputable third party may be deemed prudent. Such certificates indicate that the goods have been examined and found to be as ordered.

### **Packing List**

A packing list is usually requested by the buyer to assist in identifying the contents of each package or container. It must show the shipping marks and number of each package. It is not usually required to be signed.

# STEPS IN AN EXPORT LETTER OF CREDIT TRANSACTION

## Shipment of Goods

Upon receiving the letter of credit, the beneficiary should examine it carefully and be satisfied that all the terms and conditions can be complied with. If this is not possible, the beneficiary should request the applicant to arrange an amendment to the letter of credit. Once completely satisfied, the beneficiary will then be in a position to assemble and ship the goods.

## Presentation of Documents by Beneficiary

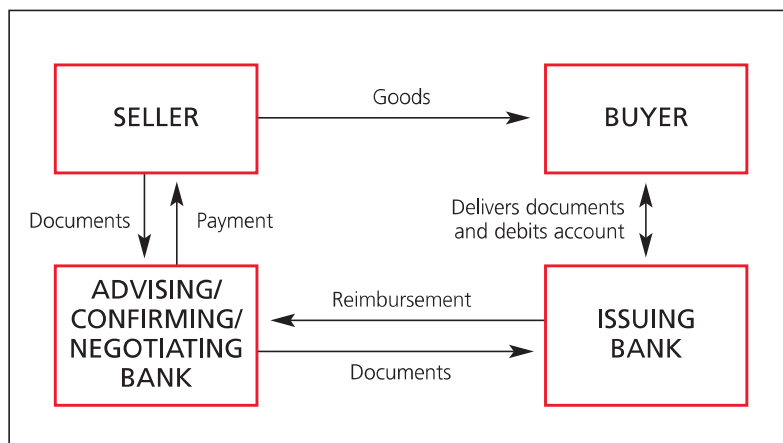
The beneficiary prepares an invoice in the number of copies required, with the description of goods shown exactly as stipulated in the letter of credit. The beneficiary obtains the bill of lading and/or other transport documents from the carrier and prepares and/or obtains all other documents required by the letter of credit. These are attached to the draft, drawn on the bank indicated and at the term stipulated in the letter of credit, and are presented to the advising/confirming/negotiating bank.

## Sending Documents to the Issuing Bank

The advising/confirming/negotiating bank checks the documents presented by the seller against the letter of credit. If the documents meet the requirements of the letter of credit, that bank will send them to the issuing bank, claiming reimbursement and paying the seller.

## Delivering Documents to the Applicant

The issuing bank will also check the documents for compliance and then deliver them to the applicant either against payment or as an undertaking to pay on maturity of the drawing under the letter of credit.



# PAYMENT PROCEDURE

---

## **Payment**

On presentation of the documents called for under the letter of credit, provided they are in compliance with its terms, the advising/negotiating bank, in the case of an unconfirmed letter of credit, may pay/negotiate the draft.

In the case of a confirmed letter of credit, the confirming bank is obliged to honour the drawing without recourse to the beneficiary.

## **Reimbursement**

The advising/confirming/negotiating bank will claim reimbursement from the issuing bank.

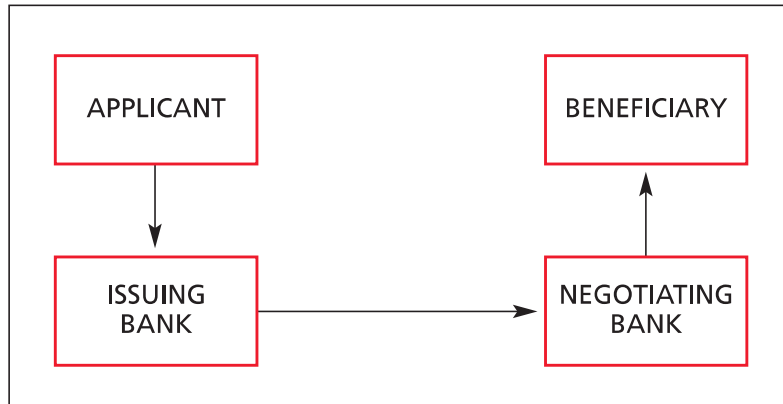
## **Settlement**

On receipt of conforming documents, the issuing bank will also be responsible for checking documents and will charge the applicant's account under the terms of the letter of credit application and agreement forms, effecting reimbursement to the negotiating bank.

# SIGHT LETTER OF CREDIT

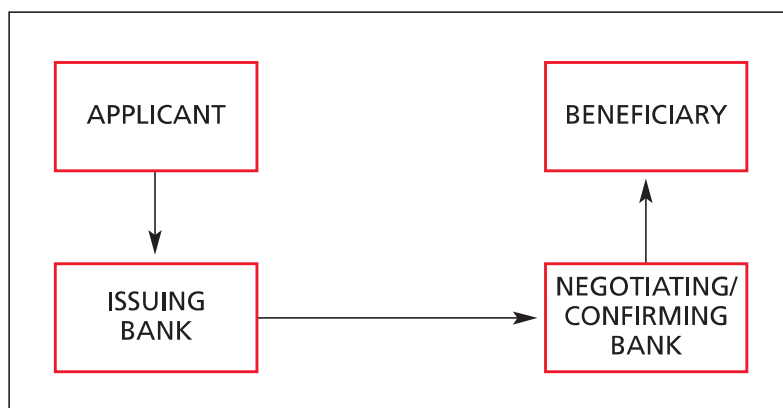
## Unconfirmed Sight Letter Of Credit

With an unconfirmed sight letter of credit, payment of funds flows from the applicant (buyer) to the beneficiary (seller).



## Confirmed Sight Letter Of Credit

With a confirmed sight letter of credit, the payment of funds also flows from the applicant (buyer) to the beneficiary (seller). However, the payment made by the negotiating/confirming bank is made without recourse to the beneficiary.

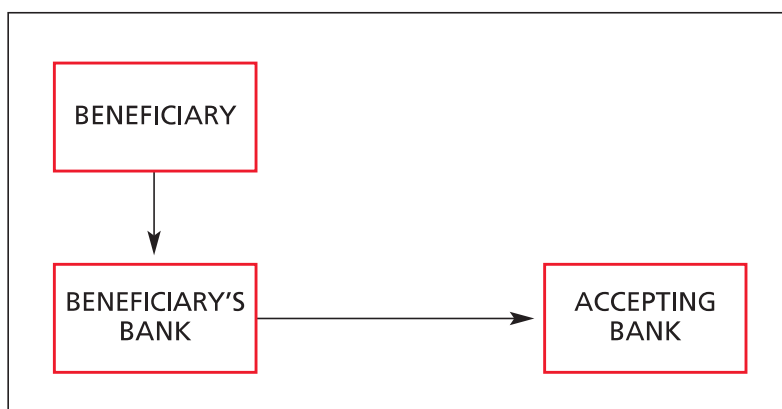


## TERM (USANCE) LETTER OF CREDIT

### Acceptance

On presentation of the documents called for under the letter of credit, provided they are in compliance with its terms, the beneficiary's bank, which may be the advising bank, will send the documents and the draft to the accepting bank for acceptance. The accepted draft may be held by the accepting bank until it matures or it may be returned to the beneficiary at the beneficiary's option, who may hold it until maturity or discount it at the best rate with any bank.

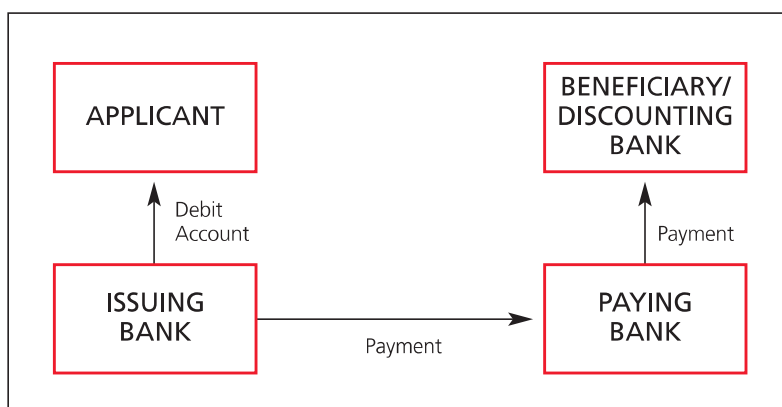
The chart below tracks the term draft and documents to the beneficiary's bank which, in turn, presents these items to the accepting bank for acceptance.



### Payment

On maturity of the accepted draft, the accepting bank will pay the beneficiary or the discounting bank and claim reimbursement from the issuing bank who will charge the applicant's account and will remit the proceeds. The discounting bank would be any bank which had purchased the accepted draft at a discount.

The chart below tracks this procedure. The applicant (buyer) pays the issuing bank who in turn pays the beneficiary or discounting bank through the paying bank.





## WHAT TO DO IF DOCUMENTS ARE DISHONoured

---

When documents are presented by the beneficiary and are found not to be in accordance with the terms of the letter of credit, the following courses of action are available:

- The documents may be corrected if possible. However, this option is only applicable if the discrepancies are such that the beneficiary, shipping company or whoever is concerned is able to correct the discrepancies before the expiry of the letter of credit and within the period of time allowed for presentation of the documents.
- If the discrepancies cannot be corrected, the beneficiary's bank may request authority from the issuing bank to negotiate the draft, despite the discrepancies.
- If, in the case of a sight draft, the beneficiary wishes to receive the proceeds of the drawing immediately, then an indemnity may be the expedient method. Under the indemnity the beneficiary agrees to indemnify the negotiating bank for payment of principal, interest and any other loss resulting from the refusal of the issuing bank to honour the drawing due to non-conformity of the documents. If the discrepancies are considered minor, the beneficiary's bank may be prepared to negotiate the draft "under reserve"; it being understood the beneficiary's bank will have recourse to the beneficiary if the discrepancies are unacceptable to the issuing bank.
- As a last resort, documents may be sent to the issuing bank on an "approval" basis; the documents to be delivered to the buyer only against the buyer's authority to pay or accept.

## A BRIEF EXPLANATION OF TRADE TERMS

---

Trade terms are defined in great detail in a publication of the International Chamber of Commerce entitled Incoterms. Explanations of four of the most common terms are:

- |     |   |
|-----|---|
| CFR | "Cost and Freight" to the named port of destination. The seller loads the goods on board the carrying vessel at his expense, prepays the freight and supplies the buyer with a "clean" negotiable "on board" ocean bill of lading. Insurance of the goods is the buyer's responsibility.  |
| CIF | "Cost, Insurance and Freight" to the named port of destination. The seller loads the goods on board at the port of shipment at his expense, prepays the freight and cost of marine insurance and supplies the buyer with a negotiable marine insurance policy and a "clean" negotiable, "on board" ocean bill of lading.  |
| FOB | "Free On Board" to the named port of shipment. The seller delivers the goods on board the carrying vessel and bears all costs and risks until goods pass over the ship's rail. The seller supplies the buyer with a "clean" negotiable "on board" bill of lading. The buyer is responsible for payment of freight and insurance.  |
| FAS | "Free Alongside Ship". The seller delivers the goods alongside the vessel at the loading berth named by the buyer. At this point the seller's obligations are fulfilled. This means the buyer bears all costs and risks of loss or damage to the goods from that moment. Unlike FOB, this term requires the buyer to clear the goods for export and pay loading costs in addition to freight and insurance. |

## PARTIES INVOLVED IN A LETTER OF CREDIT TRANSACTION

---

In order to help the reader understand the steps taken in a letter of credit transaction, the following is a brief description of the parties most commonly involved in letters of credit.

Accepting Bank	The bank named in a letter of credit on whom term drafts are drawn and who indicates acceptance of the draft by dating and signing across its face, thereby incurring a legal obligation to pay the amount of the draft at maturity.
Advising Bank	A branch or correspondent bank at or near the domicile of the beneficiary, to which the issuing bank either sends the letter of credit, or a notification that a letter of credit has been issued, with instructions to notify the beneficiary. The advising bank advises the beneficiary of the letter of credit without engagement.
Applicant	The buyer or the party who requests the letter of credit to be issued.
Beneficiary	The seller or the party to whom the letter of credit is addressed.
Confirming Bank	A bank usually in the country of the beneficiary which, at the request of the issuing bank, joins that bank in undertaking to honour drawings made by the beneficiary, provided the terms and conditions of the letter of credit have been complied with.
Discounting Bank	A bank which discounts a draft for the beneficiary after it has been accepted by an accepting bank.
Drawee Bank	The bank named in the letter of credit on whom drafts are to be drawn.
Drawer	The beneficiary of the letter of credit who will draw the draft in accordance with the terms of the letter of credit.
Issuing Bank	The bank which opens a letter of credit on behalf of the applicant and forwards it to the advising bank for delivery to the beneficiary.
Negotiating Bank	Usually the beneficiary's bank which, after satisfying itself that the documents conform with the letter of credit, agrees to purchase the draft (pay the beneficiary).
Paying Bank	The bank named in the letter of credit where drafts are to be paid. It is not necessarily the issuing bank, but often a branch of the issuing bank or its correspondent. Once drafts have been paid or accepted by the paying/drawee bank, there is no recourse to the drawers.
Reimbursing Bank	The bank authorized by the issuing bank to reimburse the drawee bank or other banks submitting claims under the letter of credit.

*Helping business do business around the world.*

