

LETTERS OF CREDIT

This is provided only as an overview in which I use Local Bank as the bank nearest the shipper, and Destination Bank as the bank in the consignees' country.

Basically

Put into very basic terms, a letter of credit is a method of guaranteeing that the shipper gets paid, and the purchaser gets a shipment - or at least, this is what the intent is all about. The reality is not always quite so well defined. The letter of credit is only a good method of providing payment for freight - it is not a solid guarantee of receiving full payment, or that what was ordered is what gets shipped!

It is regularly the shipper/beneficiary who accepts all bank charges, and costs for conforming the required paperwork to a letter of credit's demands. Before entering into a Letter of Credit, the shipper should make themselves aware of the full amount of money their bank can, and may charge, and add these costs to the purchase price in order to cover themselves against the loss.

Making plenty of original commercial invoices, packing lists, certificates covering everything, correspondence, couriers and original bills of lading a requirement of the letter, these documents are only that - paper. Board of Trade Certification, Notarization, and even Embassy Legalization are only signatures and stamps testifying that the documentation looks to be authentic (it might not be, but it appears, on its face, to be the proper documentation - probably).

The forwarder, the Board of Trade, the Embassy, and the Bank review only the paperwork, not the commodity that the documents refer to. None of these companies open a crate, examine the contents of a container, see that a commodity is according to order, that it works, that it is the right color, texture, smell, or taste, that batteries are included, or that it was definitely made in the U.S.A. They are not expected to do this, nor will they - each are interested only in the paperwork (that it appears to be, on its face, to be the proper documentation).

The banks concern is that every piece of documentation (the paperwork - not the cargo), that was asked for, is provided in the time required, that every piece of documentation matches in every minutiae detail precisely what the letter of credit demands, and that, if they want additional changes made to the paperwork, this/these changes is/are done and delivered back within the prescribed time limit. That done, they will pay the shipper within a time *they* set - regardless of what arrives at destination, in whatever condition it is in, however early or late it is, on whatever conveyance, flying whatever flag it arrived on - regardless of whatever the paperwork showed.

With the increasing demands by the bank placed on the shipper/forwarder to prepare letter perfect documentation there are extremely few forwarders who will accept losing revenue for having to make minutiae changes, thus the cost of arranging for them is passed on to the shipper additionally. The old argument "...a forwarder who makes an error has to fix it at their cost..." is not acceptable where letters of credit are concerned for all the following reasons:

Banks now do a very high parity check

As a result of slow and non-payment by overseas banks who refused to part with funds simply because very minor flaws were found in the documentation presented, the local banks instituted a very high parity check for all letter of credit documents. Mundane documents that are noted in the letter of credit such as faxes sent from shipper to consignee, fax transmittal receipts, courier slips, and attachments, all these documents

(not just the real important commercial invoices, certificates of origin, original bills of lading, and insurance certificates) are checked against the letter for minute flaws.

Any error in presentation, spelling, punctuation, stamps, signatures - anything at all that the bank can find, is a discrepancy. When you multiply this over the number of original documents, and copies that are asked for, you start to see just how intricate a letter of credit is, and how superficial it can be.

Consider now that the banks have employees who work only one country, know it upside down (all the minutiae nit-picking details that do not appear on the letter of credit). For some destinations, this check goes well beyond the interpretation of the letter of credit itself, into a more detailed knowledge of that destination banks' own specific whims (through trial and error). The documentation may be perfect against the letter, but if the bank wants an adjustment to it in some way, for whatever reason, this must be complied with to avoid it going on "Approval".

It is because the banks check everything so meticulously that the forwarder has to point by point, line by line review, not only the documents they create, but that paperwork which they cannot do themselves. Some of this documentation includes (but is not restricted to):

- Steamship line original bills of lading
- Airline/Steamship certificates
- Engineers reports, and
- Inspection certificates

As these documents can be provided solely by this other company (The Steamship line, the Airline, the Manufacturer, Cotecna, Lloyds, etc.) of which the forwarder has absolutely no control, the forwarder can only provide instructions for this other company to follow. When the instructions are not followed to the letter, there is usually a discrepancy. It is up to the forwarder to correct the proof copies faxed them by these other companies before originals are issued. The period of time taken to check other company's documentation for errors often takes numerous days, and is unavoidable.

Where the forwarder is left entirely to provide all documents on behalf of the shipper (with the exception of the above paperwork) the knowledgeable ones can often have a conforming set in the bank with far greater rapidity than most shippers. The most important point here is a conforming set - it may take hours, days, or (in extreme cases) even weeks to put together a conforming set before presentation to the bank.

Advising your forwarder about a Letter of Credit

It is imperative that the forwarder is made aware in writing that there is a letter of credit involved, before they quote on the shipment, and to supply them with a copy as soon as it becomes available. Horrible costs to yourselves will be the result of procrastinating too long before advising the forwarder, simply because the longer you wait, the further along the shipment goes.

e.g. *Your accounting department gets a letter of credit, but they do not advise you, so you do not let the forwarder know. You want the shipment to move soonest, and you want the cheapest price for it. The forwarder gets the lowest price available to give you the best quote, but there is no other line that would accept the freight for that cost. You accept the quote, and a container gets dropped into your yard. You load it, and it gets sealed, and delivered back to the rail yard who load it onto a train and send it five hundred miles away to the dock side. **Suddenly**, your accounting department lets you in on the secret that there **is** a letter of credit involved, and it expressly forbids transit on the line the freight is going on. You either have to get an amendment at a cost payable*

to the bank (which there is every likelihood will not be acceptable), or you have to accept the costs that you will definitely incur in getting the forwarder to stop the container, source the market again for a conforming line, get it released from the terminal, move it to a facility that will unload it from the first line's container, then load block, and brace it into the other line's container, and to send it on to the terminal that the other line sails from (wherever that might be - another thousand miles away?). Think what would happen if it was loaded onto the vessel, and had already sailed! As you can see, the longer you wait before advising the forwarder, the more costly to yourselves and time consuming it becomes to fix the problem.

The forwarders job is to make the transport of your freight run smoothly; however, faced with something like the above example, the only thing the forwarder can do is to advise you of the problem faced, have you send them written confirmation that you will accept the charges to rectify the situation (whatever those charges turn out to be - a sort of blank cheque if you will), and to try and fix it in as fast a time as possible - sometimes weeks (if it can be fixed at all). Only you and your accounting department are to blame for failing to provide the forwarder the tools required to quote and handle the shipment properly from the outset.

All that said, you must make it clearly known to the forwarder what paperwork you wish them to prepare - the full set, or only the bill of lading, certificate of origin, and the insurance certificate, or perhaps all the documentation, but not to certify or legalize any of it - you get the picture. When you select those documentation requirements you want the forwarder to provide, you must be aware of your responsibility to provide swift payment to your company against documents *you* provide to the bank. While being slightly cheaper doing your own paperwork, your time is used, and you answer to your boss when you provide non conforming documents.

Most forwarders need a paper trail so when a verbal decision is made, you should follow it up in writing. This seems a very trivial point, but when it comes to pointing fingers, it is invaluable to have written proof, and confirmed receipts. This is the primary reason why a forwarder will procrastinate doing something verbally agreed upon if it is not swiftly followed up with a fax/email from yourself confirming it.

Since only you know the special points of interest about your shipment (its time sensitive delivery - the possible fines you may incur if not delivered on time, the Letter of Credit documentation you need prepared, the Sight Draft you have to have presented, and/or the hazardous nature of your shipment, etc.), these must be advised, in writing, to your forwarder - you cannot expect them to guess. Let them know, and you will get a much more complete quote, and service.

UCP 500

"UCP 500" (Uniform Customs and Practice for Documentary Credits - effective January 1, 1994) is a set of legal terms which the banks adopted covering specific terms, and their meanings - we suggest you contact your local bank for a free copy. They advise clearly what the liabilities are of the parties to the letter of credit, some of the terms that are to be included on certain documents, what paperwork is required, and a list of other points which clarified otherwise ambiguous terms previously. It does also appear to limit the banks liability - confirm with your bank what UCP 500 means to you, to them, and to your letter of credit paperwork.

The forwarders' responsibility

The forwarder is supposed to advise the shipper what problems there may be with a banking instrument, and offer suggestions. Should the forwarder fail to do this, it is often shown that their inaction caused costs to be incurred. At Musson, once we know we are handling a letter of credit shipment, we soon thereafter advise the shipper as many problems as are apparent, and should further points be found later, these are also

advised as they become known - while a problem did not present itself earlier, during documentation preparation, they will sometimes become apparent.

e.g. A line that previously accepted port of origin "Toronto, Ontario" on their bills of lading because they accepted the container in Toronto, and moved it from there, only recently decides to provide "New York" as a port of origin because that is where the vessel actually sails from. Try as a forwarder might, the line will not change them, so the letter must be amended, or the paperwork is discrepant, and goes on "approval".

"Approval" does not mean the bank is pleased!

Sending documentation "on approval" is NOT GOOD!. It does *not* mean that the bank has given their seal of approval to your standard documentation, it means (rather) that they want your name as identification to confirm that you authorized the unacceptable documentation to be couriered to the receiving bank for their decision whether your company should get paid swiftly or not. Never agree to send your set "on approval" unless it has become absolutely necessary - since there is every likelihood that the receiving bank may want you to supply them with acceptable documentation before they pay your company.



Dinosaur terms

Numerous points are included in letters which are a throw back to decades past, and have not been updated in some letter of credit application forms. A few of these points include:

- Telexes of this certificate, or that (who has a telex today?)
- Certificates, certifying another certificate (what's the point - surely one certificate makes the point clear enough that another certifying the first's authenticity is redundant).
- Couriers to this, that, and the next party (often within the same company) - especially of original bills of lading. Each courier waybill has to meet the exacting needs of the letter perfectly, and surely one employee at the destination can give everyone else a copy?
- Insurance policies (the policy is the agreement between your company and the insurance company which covers all the shipments your company will ever send - it is not a per shipment "Certificate". While it is obvious that the intent of the letter is to ask for a certificate, the specific document called for is a policy and that is incorrect and discrepant. Insurance companies generally do not accept their certificates defaced to read something they were not intended to read, under any circumstances

There are no guarantees

Some shippers have been known to create paperwork that passes bank inspection, get their money, but not actually send the freight. To cut this kind of dishonesty, a number of letters include a line indicating that the freight must be checked by an independent authority which is certified to know the goods shipped are what was ordered. These

companies include (but are not limited to)  , and Cotecna to name a few. This safeguard does not guarantee that the freight will be received, or in good order so it is always a good idea to have it insured. The fact that you have faxed sailing details, and a full set of original through bills of lading does not mean that the freight might not transship some place, it does not mean that the freight will definitely arrive, or that it will be there on time. A forwarder would not necessarily be aware of a difficulty that may befall your shipments progress so it is always a very good idea to inform the forwarder immediately that freight does not arrive, or go as planned so they can track it at that time, and advise you.

Why not consider some other method of payment

C.O.D. payment prior to sending anything anywhere is the best method for guaranteeing payment. It means no cost or worries about moving anything until payment is received, but the consignee is given no assurance that the shipment will be sent after you do receive payment.

- If you trust the consignee to pay you, but still feel uneasy, you should consider sending the shipment on a Collection basis on C&F or CIF terms of sale through the forwarders' agent. The agent must hold the shipment at destination until payment for the value of the cargo (indicated by your commercial invoice) is received from the consignee. The drawback is that the agent will charge the consignee a collection fee, and the consignee can refuse the freight leaving the shipper no option but to return it at greater cost to themselves, or source another company nearby who requires their product.
- To simplify a Sight Draft, this includes Banks and couriers in the above situation at additional cost. It does mean the forwarders agent is not required, the collection fee they generate is not applicable (but the banks fees and courier costs could well make up for this, and are payable by the shipper rather than the consignee), but the bank is also likely to send you back the money swiftly, where a forwarders agent may not.
- The closest thing to guaranteed payment and guaranteed delivery is sending it on an Irrevocable Confirmed Documentary Letter of Credit with Inco terms showing CIF (freight and insurance is prepaid by the shipper up to arrival destination port) asking for a certificate from Cotecna, Lloyds, SGS, or some other Independent authority certifying the commodity. While costly to the shipper, and time consuming compared to a standard shipment, the benefit is that the consignee is assured a good product will be shipped, the freight is insured, the shipper is assured payment close to the value required (less bank fees and the costs for shipping, etc.) and the title to the goods remains with the shipper all the way up to destination port.

Discounting a letter of credit

Lets now consider that the consignee wants to pay you ninety days after it reaches him, but you want to be paid immediately after the documents are accepted. The banks will offer to pay you on a *discount* basis, meaning that they deduct a percentage from the value owing you, which they keep as the cost of discounting; you get paid immediately the value less that discount. The amount usually ranges from 6 to 15 percent of the value.

I hope this brief overview has proved beneficial to you, and you recognize the support that a knowledgeable forwarder will provide.