



"Reliable payment is the first fundamental of free trade."

John W. Dunlop, is President of AVG Trade Group, providing Letter of Credit management, documents and payment via the Internet to clients worldwide.

What is Documentary Letter of Credit Management

"Manage" (verb) 1. to direct, control, or handle. 2. Wise use of means to accomplish an end. As in getting paid. It is your money. It is your responsible to direct, control, and handle the transaction. Not the bank's, not the freight forwarder's, and not the buyer's.

Begin During the Sales

The management of Documentary Letters of Credit begins at the beginning of the sales process. The sales negotiation must contain the terms and conditions of the planned Letter of Credit transaction so that buyer and seller know which costs each are going to be responsible for. In addition, and more important to their relationship, they define the transaction prior to the issuing bank arbitrarily deciding for them.

The Proforma Invoice

The Proforma Invoice is widely mistaken for a quotation. The quotation contains the unit prices, quantity discounts, specific part numbers and models, lot sizes and the like. The Proforma should be constructed after the Purchase Order is received. The Proforma Invoice is an estimate of the value of the Invoice the seller is going to present for payment to effect the Purchase Order. Its value specifies the value of the Letter of Credit

How do Manage a Letter of Credit Transaction.

Your international Letter of Credit Advising bank cannot help or advise you how to manage your Credit to make sure you get paid.

needed to comply with the Purchase Order. In addition to the product cost, it contains shipping costs, beneficiary bank fees, document and legalization fees, finance costs, insurance costs, inland freight costs, and depending on the INCOTERM, possibly customs duties and demurrage costs on behalf of the buyer. The Proforma also contains the brief Goods Description to be used in the Letter of Credit to avoid excessive detail and unit costs in the Credit to comply with UCP 500 guidelines.

The Letter of Credit Instruction

The Letter of Credit Instructions contain the terms and conditions your company will accept in the Credit when it is issued. These instructions include what documents are available for presentation, whether sight or usance draft terms are acceptable, the port of debarkation, INCOTERM, the advising bank you choose to use, transferability, and confirmation requirements.

The Letter of Credit Application

The buyer applies for a Documentary Letter of Credit to be issued from his bank through your advising bank to your company. To do this he fills out the issuing banks Letter of Credit Application with the Proforma Invoice and Letter of Credit Instructions provided by you, the seller. All banks use their own Credit Applications, which contain their banks and their countries local policies for issuing Letters of Credit. Please note; the local bank versions seldom (never) conform to the standard UCP 500 Letter of Credit Application from recommended in UCP 516. As such, the chances of the Credit being issued as the seller and buyer intended is virtually zero.

The Letter of Credit Review

When you receive the advised Credit, the bank will instruct you in their cover letter to review it, *and if you cannot comply with its terms or requirements, to contact your buyer to have it amended.* The bank does not assist you to accomplish this task.

First, you have to figure out what the Credit "really" says in understandable English by deciphering the SWIFT message fields. Second, you need to separate what your Applicant (buyer) put requested from what his bank added. Third, you need to sift out what the country requirements form what the buyer and issuing bank both asked for. Fourth, you need to understand what can be changed and what cannot before you ask for an amendment. And, fifth, you need to have an understanding between you and your buyer who is going to pay for the amendments. In the mean time your sale is on hold.

Amending the Advised Letter of Credit.

Once you have decided what must be changed to allow you to ship against the Credit, contact your buyer with precise wording of what must be changed. When the amendment is issued, begin the process all over again. Be prepared for the issuing bank to agree to your buyer's request for changes, and then ignore the request. Remember that your buyer is your ally, not the problem.

The most common problem with the credit will be the latest shipping, presentation period and expiry dates. Your buyer is trying to not block his collateral for any longer than is necessary, and will usually squeeze the export time for shipment, presentation and expiry of the Credit. The issuing bank delaying the

process to garner more fees further exacerbates this problem by repeated amendments.

The Negotiable Document Set

Generating the negotiable document set begins with providing your freight forwarder or carrier with a copy of the Letter of Credit and clear instructions that do no conflict with the Credit requirements, i.e. to ship FOB when the sales terms are CIF. Specialized computer programs that will reduce the probability of error and discrepancies should generate the document set.

In addition the document set should be scanned and password protected prior to bank presentation. If the goods arrive at their destination before the originals arrive from the banking pipeline, they can be cleared with an indemnification letter from the Credit issuing bank.

The Discrepancy Resolution

The trade bank industry average for discrepant presentations of negotiable document sets is eight out of ten submittals. In other words you have an 80% chance of your documents being discrepant with either your negotiating or paying bank. This probability can be reduced with good Credits to begin with, shipping on time, and the use of document preparation professionals. However, since the bank profits are directly proportional to your discrepancies, they are going to find and/or create problems. Have a good working relationship, by name, with your freight forwarder, bank examiner and Applicant, and as the problems arise, deal with them.

The Assignment of Proceeds

The assignment of proceeds process may be used if you are not the supplier of the goods, and must arrange sales terms with the actual supplier or manufacturer. Any portion of the value of the Credit may be formally assigned by you to the supplier to be paid by the bank when the Credit is paid. The shipper in this case must be willing to provide you the bill of lading for you to prepare the negotiable document set. This arrangement is

usually preferable to 30 day open terms since the advising bank easily verifies the payment mechanism.

The Transfer

If the actual supplier or shipper requires a Letter of Credit to be in his name as the beneficiary, you, the first beneficiary, to him as the second beneficiary, can transfer all or part of the Credit. However, the original Credit to you must have allowed "transferability" from your buyer the applicant. An assignment of proceeds is preferable over a transfer since it does not require Applicant prior approval and subsequent mention in the body of the Letter of Credit. In addition, you are relying on the second beneficiary to perform all of the requirements of the Credit, and your buyer is holding you accountable. A Credit can (usually) be transferred only once to avoid a broker daisy chain.

The Invoice Substitution

If the Letter of Credit is transferred to a second beneficiary, the first beneficiary (you) will have an opportunity to "substitute" your invoice for the first invoice when the documents are presented. This allows for a seller to receive the value he sold to the buyer and still pay the supplier his agreed to price. This is similar to a retail and wholesale relationship. This all may sound complicated, but so is rocket science to someone not directly involved. This is routine Credit management for any trade finance professional.

The Draft Purchase Agreement

To promote the sale of goods it is common to allow 30, 60, 90 or up to 180 day terms from the date of the bill of lading or when the documents are presented to the negotiating bank. The key phrase is negotiable documents. Both the negotiating and paying bank are very interested in purchasing the accepted bank time draft for the transaction. These drafts have the equivalent of post dated bank checks and can be discounted and immediately paid for the cost of finance.

If the cost of money for the number of days allowed in the Credit was included in the Proforma Invoice, and subsequently in the value of the Credit, this becomes a good mechanism for financing your customers, or even making additional profit.

Conclusions

The proverbial fly in the buttermilk is the lack of assistance and services from your advising bank. The professionals with the most experience are the least able to help you with the complexities of managing your Letter of Credit. Banks have decided that the legal exposure of helping is greater than the indirect payback from assisting their customers. This is not lack of compassion on their part, only international banking business reality. However, international banks are trying to find a way out of this dilemma since the source of new clients is the new customer with the least amount of knowledge.

Companies like AVG are now able to use the Internet to provide the Letter of Credit Management at low cost, and the banks are catching up. Until then, learn the ropes and good luck. Every transaction is an adventure.

AVG Trade Group

URL: <http://www.AVGTSG.com>

T: 619-692-9648 F: 619-692-9649

Email: johnwdunlop@avgts.com

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