

## CDCS Study Material

### Roles and responsibilities of parties involved in a documentary credit

The most common structure of a documentary credit involves at least three parties:

- an issuing bank;
- an advising bank; and
- a beneficiary.

The advising bank could also be the confirming bank, if confirmation is authorised or requested in the documentary credit, and a nominated bank.

It should also be noted that a documentary credit could consist of only two parties:

- an issuing bank; and
- a beneficiary.

### Issuing bank (or opening bank)

**Article 2 defines an 'issuing bank' as the bank that issues a credit at the request of an applicant or on its own behalf.**

An issuing bank issues its documentary credit in favour of a beneficiary. In so doing, it incorporates its irrevocable and independent undertaking to honour – that is, to pay, to accept a draft and pay at maturity, or to incur a deferred payment undertaking and pay at maturity – provided that:

- all documents, as stipulated in the documentary credit, are presented; and
- the beneficiary has complied with all of the terms and conditions of the documentary credit.

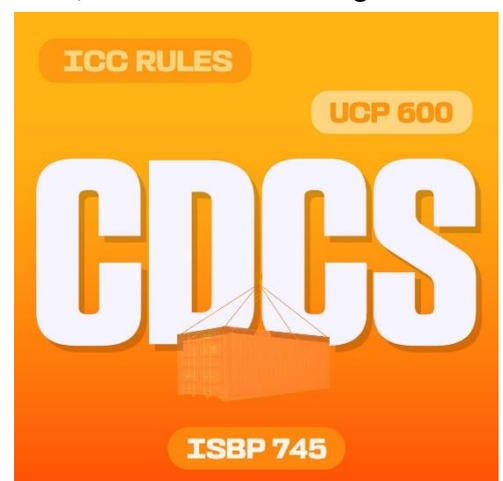
An irrevocable undertaking is enforceable against an issuing bank even if an applicant is unable or unwilling to reimburse it.

It should be noted from the UCP definition that, albeit in rare circumstances, an issuing bank could have two roles in a single transaction: one as the applicant of the documentary credit; and one as its issuing bank.

### Beneficiary (or seller or exporter)

**Article 2 defines a 'beneficiary' as the party in whose favour a credit is issued.**

Following shipment or dispatch of the goods, or when the required service or performance has been provided, the beneficiary will issue, collate and present the stipulated documents to the issuing bank, a confirming bank (if any), or a nominated bank for honour or negotiation.



### Advising bank

**Article 2 defines an 'advising bank' as the bank that advises the credit at the request of the issuing bank.** The transmission of a documentary credit to an advising bank is normally completed by the use of a Society for Worldwide Interbank Financial Telecommunication (SWIFT) MT700 message, but it could also be accomplished by telex, fax, email or letter, depending upon the arrangements that are in

### Confirming bank

**Article 2 defines a 'confirming bank' as the bank that adds its confirmation to a credit upon the issuing bank's authorization or request.**

A bank that adds its confirmation to a documentary credit, upon the authorisation or request of an issuing bank, provides a beneficiary with an additional irrevocable and independent undertaking that is separate from that of the issuing bank.

### Nominated bank

**Article 2 defines a 'nominated bank' as the bank with which the credit is available or any bank in the case of a credit available with any bank.**

An issuing bank, at the request of an applicant, or even as a matter of its own internal policy, may make a documentary credit available for payment, acceptance, deferred payment or negotiation with a named bank. A bank that agrees to act on a nomination of an issuing bank to pay, accept, incur a deferred payment undertaking or negotiate will be known as a nominated bank.

It should be noted that a documentary credit could be made available with the issuing bank only. In this case, there is no nominated bank and the beneficiary will be required to ensure delivery of the stipulated documents to the issuing bank no later than the expiry date and the latest date of presentation. A named nominated bank usually, but not necessarily, will also be an advising bank and could be a confirming bank.

### Applicant (or buyer or importer)

**Article 2 defines an 'applicant' as the party on whose request the credit is issued.**

It should be noted that although an applicant is responsible for completing an application form to issue, or to amend, a documentary credit, it is not a party to that documentary credit.

The interaction between an applicant and its bank prior to the issuance of a documentary credit is outside the scope of UCP 600

Following the issuance of a documentary credit, an applicant may subsequently request an amendment to its terms and conditions, or provide a waiver of discrepancies that have been identified by the issuing bank.

**An issuing bank is under no obligation to accept or take note of such request or waiver.**

### Reimbursing bank

**Sub-article 13(a) reimbursements** describes a ‘reimbursing bank’ as the bank named in a documentary credit upon which the nominated bank (the ‘claiming bank’) may claim in respect of any honour or negotiation that it has effected to the beneficiary.

### Second advising bank

**Article 9, sub-article 9(c)** describes a ‘second advising bank’ as a bank utilized by the advising bank to advise the credit or any amendment to the beneficiary

### Transferring bank

**Sub-article 38(b)** defines a ‘transferring bank’ as a nominated bank that transfers the credit or, in a credit available with any bank, a bank that is specifically authorized by the issuing bank to transfer and that transfers the credit. An issuing bank may be a transferring bank.

## Terms used in documentary credits and/or UCP 600

### Banking day

Article 2 defines ‘banking day’ as a day on which a bank is regularly open at the place at which an act subject to these rules is to be performed. If a bank is regularly open Monday to Friday, and also opens on a Saturday, but only to perform general banking services, Saturday is not considered a banking day for UCP purposes.

### Complying presentation

Article 2 defines ‘complying presentation’ as a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice. It also extends to other practices as determined by the ICC in its official opinions and DOCDEX decisions, and to established procedures that may apply between two or more countries and which can be equally described as representing such practice.

### Confirmation

Article 2 defines ‘confirmation’ as a definite undertaking of the confirming bank, in addition to that of the issuing bank, to honour or negotiate a complying presentation.

- A request is an instruction in the documentary credit for a bank, usually the advising bank, to add confirmation – by the use of words such as ‘confirm’ or ‘add your confirmation’.
- An authorisation is an instruction in the documentary credit to add confirmation upon a specific request of the beneficiary – by the use of the words ‘may add’.

### **(Documentary) Credit**

Article 2, in the context of an irrevocable undertaking, defines 'credit' as any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.

### **Honour**

Article 2 defines 'honour' as:

- 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 and pay at maturity if the credit is available by acceptance.

### **Negotiation**

Article 2 defines 'negotiation' as the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

### **Presentation**

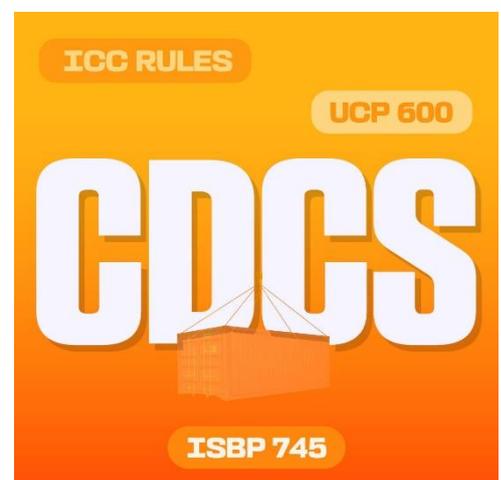
Article 2 defines 'presentation' as either the delivery of documents under a credit to the issuing bank or nominated bank or the documents so delivered.

### **Presenter**

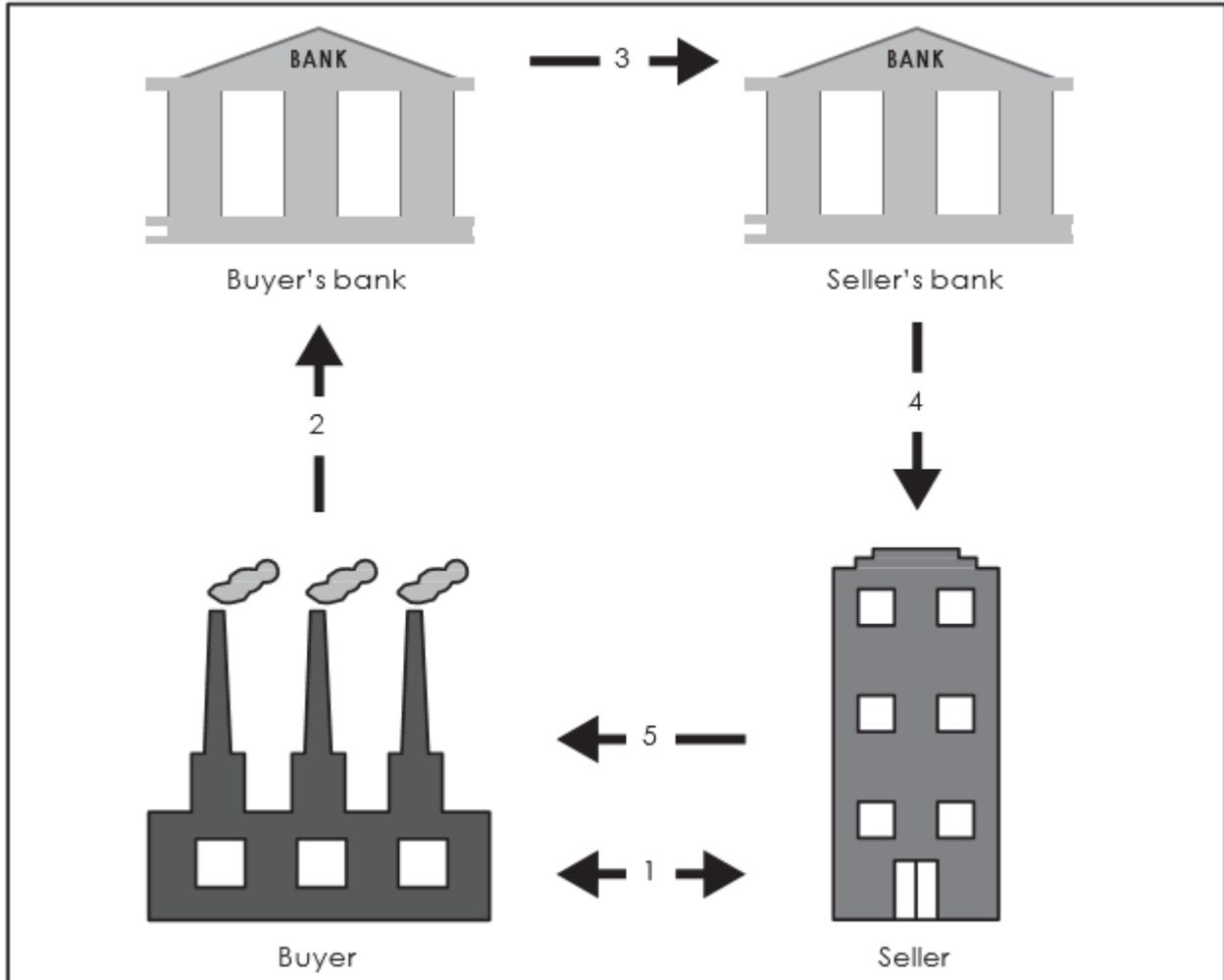
Article 2 defines 'presenter' as a beneficiary, bank or other party that makes a presentation. The presenter may or may not be the beneficiary of the documentary credit.

## **Documentary credits and other methods of settlement**

A beneficiary would be well advised to seek the advice of its bankers on the suitability of the issuer of a documentary credit, because there may be various risks that require consideration. For example, the availability of foreign exchange, political risks, etc. as well as the creditworthiness of the issuer, are potential concerns that may impact any payment due to that beneficiary.



## Advance payment



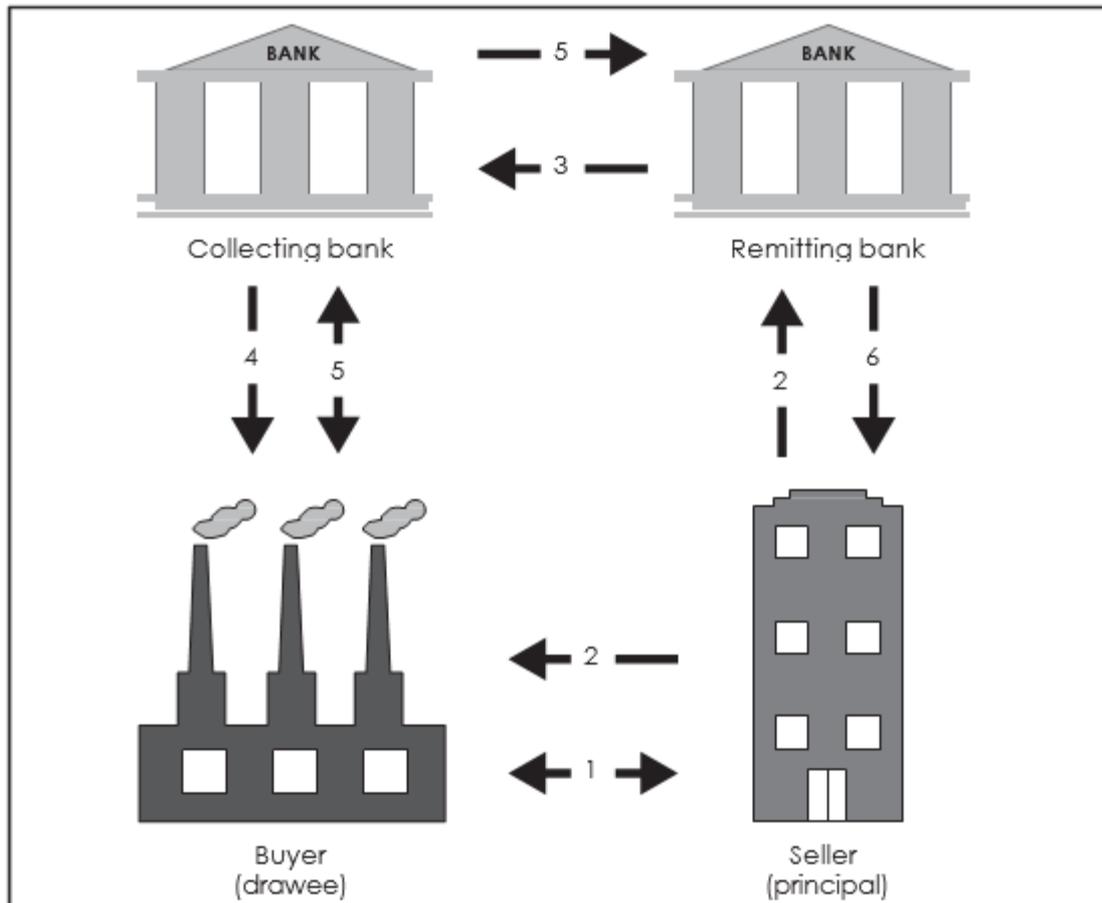
1. The contract is agreed between the buyer and seller, indicating advance payment as the method of settlement.
2. Buyer instructs its bank to make payment to the seller's account with a specific bank.
3. Buyer's bank makes payment, as requested.
4. Seller's bank credits the amount to the account of the seller under advice.
5. Seller ships the goods.

## Open account

1. Contract is agreed between the buyer and seller, indicating settlement by open account terms.
2. Seller arranges shipment of the goods according to the agreed terms and **forwards the underlying shipping documents to the buyer.**

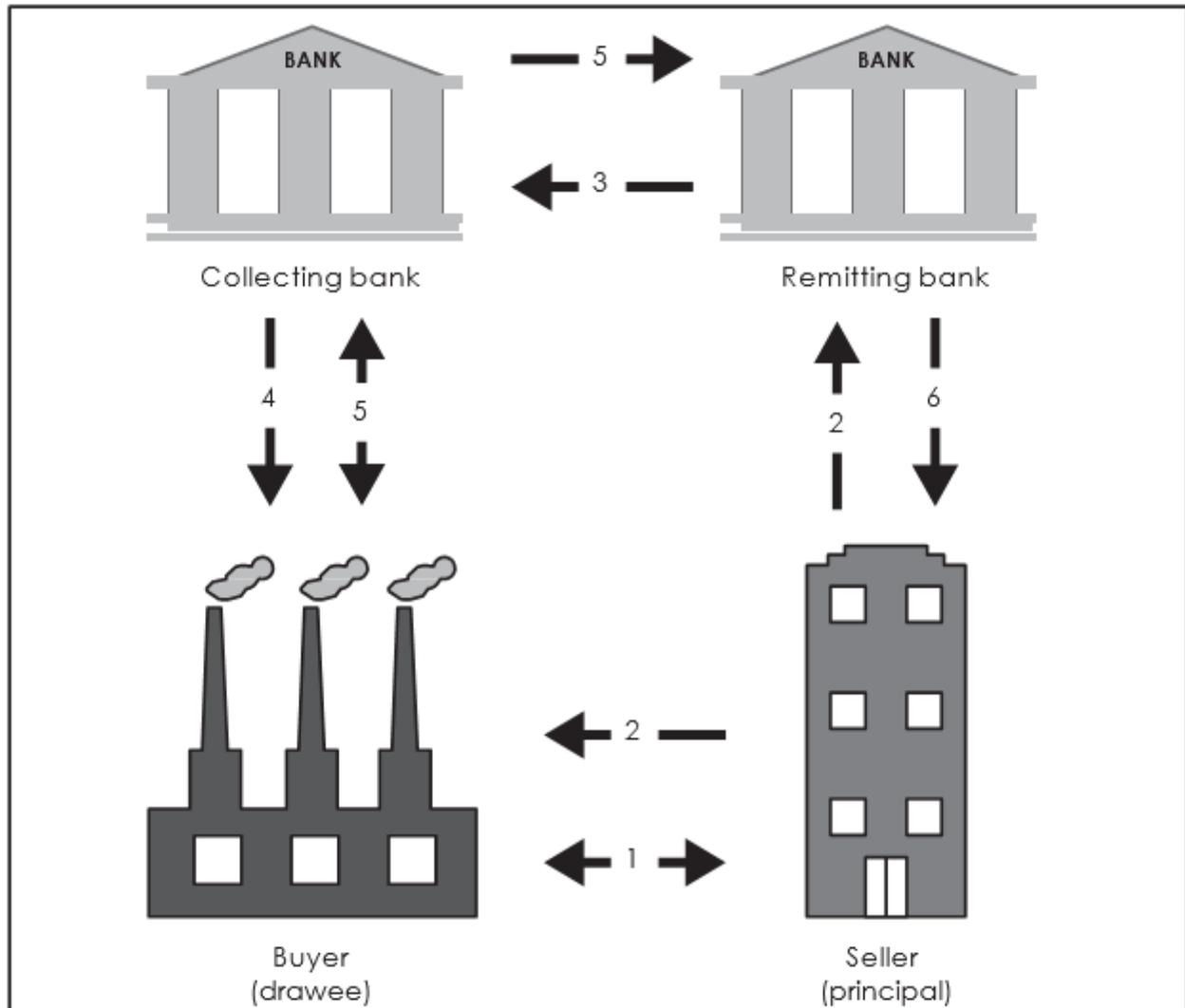
3. Buyer, if satisfied with the goods and/or the documents, instructs its bank to make settlement to the seller as requested.
4. Buyer's bank makes payment to the seller's bank.
5. Seller's bank credits the amount to the seller's account under advice.

### Documentary collection payable on a sight basis



1. Contract is agreed between the buyer and seller, indicating a documentary collection payable at sight as the settlement method.
2. Seller arranges shipment of the goods on the agreed terms and forwards the shipping documents to its bank, known as the 'remitting bank'.
3. Remitting bank sends the documents to the buyer's bank, known as the 'collecting bank'.
4. Collecting bank makes the documents available for review at its counters, so that the buyer can make a payment decision.
5. Buyer authorises payment, and the collecting bank pays the remitting bank and releases the documents to the buyer to collect the goods.
6. Remitting bank credits the amount to the seller's account under advice.

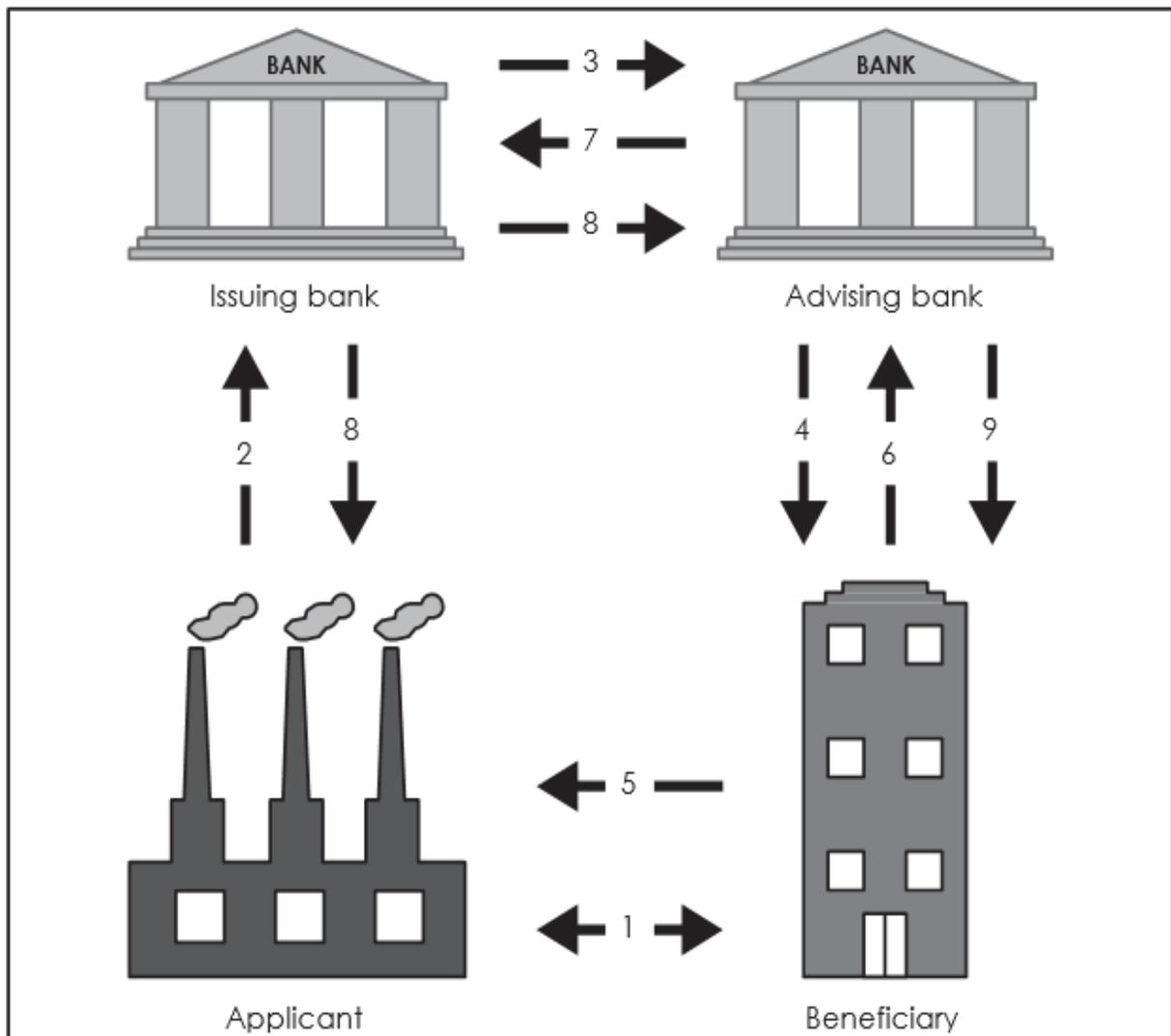
## documentary collection payable on a usance basis



1. Contract is agreed between the buyer and seller, indicating a documentary collection payable on a usance basis as the settlement method.
2. Seller arranges shipment of the goods and forwards the underlying shipping documents to its bank, known as the 'remitting bank', including a draft drawn on the buyer on the agreed payment terms or a request for a deferred payment undertaking of the buyer.
3. Remitting bank sends the documents to the bank of the buyer, known as the 'collecting bank'.
4. Collecting bank makes the documents available for review at its counters for the buyer to make a decision about acceptance of the draft or issuance of a deferred payment undertaking.
5. Buyer accepts the draft or issues its deferred payment undertaking, and the collecting bank informs the remitting bank and releases the documents to the buyer.

6. Collecting bank can retain the accepted draft or the deferred payment undertaking. An advice of acceptance/deferred payment is sent to the remitting bank, or the draft or deferred payment undertaking can be returned to the seller via the remitting bank for presentation prior to the maturity date. The seller will receive the accepted draft or deferred payment undertaking for re-presentation near to the maturity date or an advice of acceptance.

**Payment secured by a bank guarantee or standby letter of credit**



1. Contract is agreed between the buyer and seller, indicating open account terms or a documentary collection as the settlement method, supported by a bank guarantee.
2. Buyer applies to its bank to issue a bank guarantee, usually by completing the bank’s standard application form.

3. Subject to a credit facility being in place, and the bank agreeing to the terms and conditions that have been stated in the application form, the bank issues the guarantee and advises it through a bank in the country in which the beneficiary is located, known as the 'advising bank'.
4. Advising bank generates its advice of the guarantee and sends it to the beneficiary.
5. Beneficiary, if in agreement with the terms and conditions of the guarantee, arranges shipment of the goods. Having shipped the goods, the beneficiary issues, collates and presents its documents directly to the buyer (open account terms) or to the remitting bank (if documentary collection terms) for sending to the collecting bank.
6. If the open account transaction, or the documentary collection, is honoured, the guarantee is not used. However, if there is a payment default by the buyer, the seller issues a demand in accordance with the requirements of the guarantee and presents it to the advising bank.
7. Advising bank sends the demand to the issuing bank.
8. The issuing bank determines that the demand complies and arranges to debit the applicant's account for the value of the drawing. In return, the demand is handed over to the applicant. At the same time, the issuing bank reimburses the advising bank.
9. The advising bank, upon receipt of the proceeds from the issuing bank, effects settlement to the beneficiary in the manner requested.

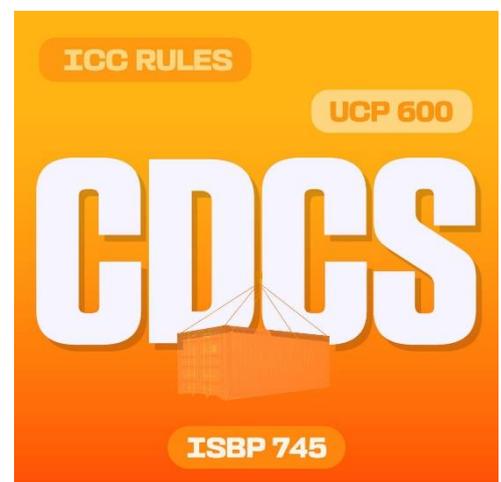
## The sale contract

A documentary credit, as a chosen method of settlement, is an undertaking separate from the sale or other contract on which it may be based.

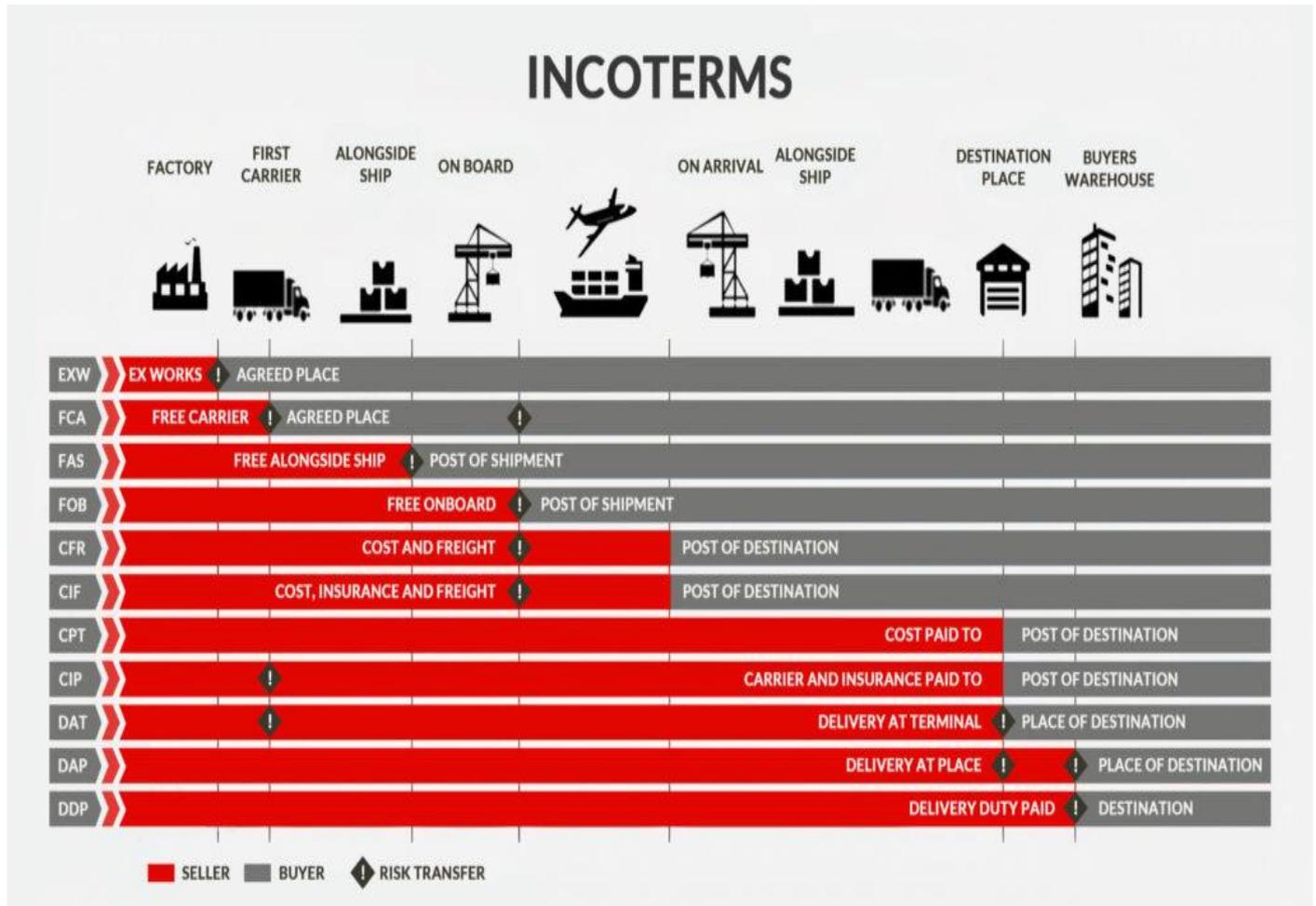
Potential for confusion makes it vital that a seller and buyer reach agreement over the precise content of their sale contract.

Banks play no role in the negotiation of the sale contract, which is signed only by the seller and buyer. In practice, a sale contract will contain more detail than only the quantity of goods and the sale price. It will usually also cover related items such as the time period for delivery, the method of payment and the manner in which the goods are to be delivered, usually by reference to a trade term (or an ICC Incoterm). A sale contract will often specify which country's law will apply and which court or arbitration system has jurisdiction to hear any claims in the event of a dispute.

In most cases, a sale contract is governed, at least in part, by the laws of the country in which one of the parties involved is located. The seller and buyer may themselves agree which law is to apply by including a specific provision in the sale contract.



## The use of Incoterms in trade



## Pre-issuance considerations and requirements

### The risks faced by an applicant

An applicant faces the following risks.

Non-delivery of goods as described in the presented documents

Short-shipment, or shipment of inferior goods

Goods received by the applicant prior to documents being received by the issuing bank

Loss or damage to goods in transit

Foreign exchange risk

Failure of the issuing bank

Fraud in the presented documents

## The risks faced by a beneficiary

Failure to comply with the terms and conditions of the documentary credit  
Failure of, or delays in settlement from, the issuing bank  
Documentary credit issued by an entity other than a bank  
Fraud  
Foreign exchange risk

**Sovereign and regulatory risks** – these are the risks that performance of the documentary credit may be prevented by government action outside the control of the parties.

**Legal risks** – while sovereign and regulatory risks may disrupt the documentary credit by means of events outside the framework of the documentary credit operation itself, legal risks concern the possibility that performance of a documentary credit may be disturbed by legal action relating directly to the parties and to their rights and obligations under the documentary credit.

## The prerequisites for the issuance of a documentary credit

The need for a credit facility

Completion of know your customer (KYC) and customer due diligence (CDD) formalities

## Issuing a documentary credit

### The risks applicable to an issuing bank

Applicant risk – the applicant may be unable to reimburse

**Financial crime** – the documentary credit may be used to facilitate criminal activity

**Errors in conveying** the requirements of the customer to the beneficiary

**Any errors in rekeying** will be the responsibility of the issuing bank

**Errors in document examination** or a failure to follow the requirements of article 16 when refusing documents

## The application of article 7

If an error or omission were of such a nature that, without the subsequent communication, the documentary credit would not be in a workable form for the beneficiary, or any nominated or confirming bank, it would not be an amendment, but would form an integral part of the documentary credit issued in favour of the beneficiary.

Sub-article 6(a) provides that a credit that is available with a nominated bank is also available with the issuing bank. Note that an issuing bank is not a nominated bank.

Sub-articles 7(a)(i)–(v) indicate that an issuing bank will honour (pay, accept a draft or incur a deferred payment undertaking) when a documentary credit is available with the issuing bank.

The autonomy of a documentary credit is evidenced in the following sub-article and article:

- sub-article 4(a), by emphasising that a documentary credit is separate from any sale or other contract on which that documentary credit may be based, even if there is reference to that sale or other contract in the documentary credit;
- article 5, by clearly stating that banks deal with documents and not with goods, services or performance to which any documents may relate.

## Receipt of the completed documentary credit application form

ISBP 745 places a responsibility on a customer (applicant) to provide clear instructions to issue or amend a documentary credit and to understand the impact of certain provisions of UCP 600.

Bank staff will be regularly called upon to discuss details of the application with a customer. Often, the information shown on the documentary credit application is not consistent with the documentation requested or is lacking in content or detail.

Once the documentary credit application is received, one or more of the following tasks are usually performed at the outset and will vary depending on the mode of delivery of the application form:

- recording and noting the time of receipt;
- allocating a unique reference number;
- determining the authenticity of the application;
- checking the customer facility availability;
- updating the bank's liabilities;
- updating the customer liabilities;
- blocking funds / taking marginal deposits, if appropriate; and / or
- recovering charges.

## Sight payment

When a documentary credit is issued available by 'sight payment', it means that settlement is due once a nominated bank or issuing bank has determined that the documents comply.

## Deferred payment

When a documentary credit is issued available by 'deferred payment', it means that:

- payment is not immediate;
- payment is at a time in the future, determinable in accordance with the terms and conditions of the documentary credit; and
- presentation of a draft is not required.

## Acceptance

When a documentary credit is issued available by 'acceptance', it means that:

- payment is not immediate;
- payment is at a time in the future, determinable in accordance with the terms and conditions of the documentary credit; and
- presentation of a draft is required.

## Negotiation

Negotiation is defined in article 2.

When a documentary credit is issued available by 'negotiation', it means that:

- an advance may or may not be made immediately by a nominated bank;
- drafts may or may not be required for presentation; and
- settlement, if the documentary credit is not negotiated earlier, is made on receipt of documents by the issuing bank (sight) or the maturity date of the draft (usance).

## The place and date of expiry

A documentary credit that expires at the counters of the issuing bank, but is available with a nominated bank by payment, deferred payment, acceptance or negotiation does not provide for the expiry date to be a latest date for presentation of documents to that nominated bank by, or on behalf of, the beneficiary.

**VV Imp:** a documentary credit that expires in the country of the beneficiary, but which is available only with the issuing bank, allows for the beneficiary to present its documents to any bank in its country on or before the expiry date. There is no nominated bank, and the issuing bank is the only bank authorised to pay, incur a deferred payment undertaking or accept a draft. Provided complying documents are presented to a bank in the beneficiary's country no later than the expiry date, the issuing bank will be required to honour that presentation even if received by them after the expiry date.

## Inoperative documentary credits

There might be occasions when it is necessary for a documentary credit to be issued as 'inoperative' or 'non-operative'. In these circumstances, the required practice is that the issuing bank clearly indicates in the documentary credit the action that is to occur to make the credit operative. Example:

'this documentary credit will become operative only upon the issuance of an amendment indicating that an import licence has been issued'; or

- 'this documentary credit will become operative upon your [or the issuing bank's] receipt of a performance guarantee in the following form ...'

## The workability of a documentary credit

Examination of the application form and close liaison with the customer at this stage is key to the success of the entire documentary credit transaction. Many of the problems that arise when documents are presented can be avoided if bank staff pay attention to detail and can anticipate problems that may occur before the documentary credit is issued.

### Goods description

A customer should be advised that its protection lies not in a lengthy goods description, but the documents that are requested to be presented, whether those documents have a named issuer or type of issuer, and the degree and type of data content to appear therein

#### Additional conditions

A bank should avoid inserting data in this field that is directly linked to one of the documents in the 'documents required' field, such as providing details for the packing of the goods when the documents required field merely mentions 'Packing list'.

### Period for presentation

The 'period for presentation' is the period of time (in terms of calendar days) after the date of shipment within which the documents are to be presented to a nominated bank or issuing bank. In the absence of any specific period, the default of 21 calendar days under sub-article 14(c) will apply.

### Confirmation instructions

An instruction stating 'confirm' is a request for the advising bank to add its confirmation. An instruction stating 'may add' is an authorisation for the advising bank to add its confirmation, if requested to do so by the beneficiary, and is usually subject to the beneficiary paying the confirmation fee in advance.

An instruction stating 'without' means that the documentary credit is to be advised without the confirmation of the advising bank.

If the documentary credit is to be advised through a second advising bank, this information will be stated in field 57a. Where a second advising bank is indicated, and there is an instruction 'confirm' or 'may add', the name of the bank that is requested or authorised to add confirmation is to be stated, ie the advising or second advising bank. In the SWIFT MT700 message, these details will be given in field 58a 'requested confirmation party'.



## The need for conditions to be applied to documents

**non-documentary conditions** : a customer should be encouraged to act in this way and provide details of the document that is to evidence compliance with the condition, ie that such conditions will be disregarded.

## Absence of the name of an issuer and/or the absence of any data content

when a credit simply requires the presentation of a packing list with no further details, a packing list that **does not** provide packing details cannot be deemed to fulfil its function.

A customer should be advised to complete the documentary credit application form, wherever possible, with details of an issuer of a required document and the data content that is to appear within that document

## Acceptable clauses regarding the condition of goods on a transport document

Article 27 defines a 'clean transport document' as "one bearing no clause or notation expressly declaring a defective condition of the goods or their packaging".

## Instalment shipments

It should be noted that this article applies only when a documentary credit indicates a series of given periods, as opposed to a sequence of latest shipment dates. A given period has a start and an end date, and the dates of each period should not overlap.

## Documents to be issued or countersigned by an applicant

Wherever possible, an issuing bank should resist any requirement for a document to be issued or signed by an applicant unless it knows that the requirement has been agreed with the beneficiary.

## Selecting an advising bank and / or a confirming bank

Wherever possible, banks use their own branches, associate offices or preferred correspondent banks to advise a documentary credit to a beneficiary. The reasons are that:

- arrangements already exist for authentication of messages; and
- the lines of communication are well established, which enables the speedy resolution of any problems that may arise.

## Documentary requirements for a domestic or local documentary credit

A domestic or local documentary credit will usually require minimal documents. In most cases, this will consist of a commercial invoice and a delivery note or receipt.

For a local transaction, it is common for the applicant to be required to sign for the goods, and this will be evidenced on a delivery note or receipt that is issued by the beneficiary or the applicant.

## The issuance of a pre-advice of a documentary credit

A preliminary advice of a documentary credit, sometimes known as 'brief details' or a 'pre-advice', is very much a declining practice. Such advices were designed to provide early notice to a beneficiary that a documentary credit had been issued and that full details, in letter form, were being forwarded by airmail or courier.

## SWIFT details

MT700 is the SWIFT message type generally used to convey the details of a documentary credit to an advising bank, with or without a request or authorization for confirmation to be added. An MT799 message may also be used when a formatted message, such as the MT700, is not appropriate. Both of these SWIFT message types are authenticated messages.

An MT199 is unauthenticated, but it is free format and can be used for anything, while an MT999 is an unauthenticated message type.

To accommodate this, SWIFT has created the following code words to be used in Field 40E of the MT700 message series by the issuing bank.

- For UCP 600: 'UCPLATESTVERSION'
- For eUCP: 'EUPLATESTVERSION'
- For UCP 600 and URR 725: 'UCPURRLATESTVERSION'
- For eUCP and URR 725: 'EUCPURRLATESTVERSION'

## Amendments from an issuing bank perspective

### The risks applicable to an issuing bank

Applicant risk

Financial crime

Errors in conveying the requirements of the applicant

## The application of article 10 in respect of an issuing bank

As indicated in sub-article 10(b), an issuing bank is irrevocably bound by an amendment as of the time it issues the amendment. An issuing bank must, therefore, ensure that its amendment advice is complete and precise at the time of issuance.

Acceptance or rejection of the amendment is to be determined in accordance with sub-article 10(c).

## Receipt of the completed amendment request

The applicant may wish to consult the issuing bank regarding the actual text of the amendment, so that both the request to amend and the amendment itself are complete, precise and do not affect any other terms and conditions of the documentary credit.

Most banks do not maintain a standard amendment request form and will accept a simple letter from the applicant indicating its requirements. Banks that provide an online service may also provide for electronic delivery of an amendment request

## Reviewing the amendment request against an agreed credit facility

A review of the amendment request against the credit facility will need to occur for certain criteria, such as where the amount, validity date, or the period for settlement is to be increased. Some credit facilities may also make reference to the type of goods that are to be covered by any documentary credit that is issued, and the type of transport document that is to be called for and the consignee details that are to appear thereon.

## The workability of an amendment

The applicant submits an amendment request in the form DELETE "Full Set Bills of Lading ... Prepaid" and ADD "Forwarder's Certificate of Receipt", and indicates that all other terms and conditions are to remain unchanged.

Solution: On its face, the amendment in the example appears to solve the problem of the inappropriate transport document. However, the amendment request does not:

- delete the routing from Bangkok port to Shanghai port;
- change the emphasis from a latest shipment date to one of a latest date for receipt of the goods (if a forwarder's certificate of receipt is issued, there is only a date of receipt of the cargo and not a shipment date);
- address the issue of the consignee and notify party information (a freight forwarder's certificate of receipt is not a document that should be issued to order of a named entity); or
- address whether the Incoterm is still applicable.

## The routing of an amendment

When a documentary credit has been advised to the beneficiary through an advising or second advising bank, the issuing bank must use the same advising bank, and the advising bank must use the same second advising bank to convey the amendment to the beneficiary. This is made clear in sub-article 9(d).

The vast majority of amendments are issued in SWIFT MT707 format, and the transmitted details are considered to be the operative amendment. It is extremely rare for issuing banks to prepare a mail confirmation if details of the amendment have been transmitted in full.

