Module 7:

Foreign Trade Finance Operations

Table of Contents

Module 7: Foreign Trade Finance Operations

Train For Employment

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Importance

The economical strength of a country is measured by the difference resulting from import and export transactions. Countries classified according to these results. The banks are the main players to facilitate such business. We need to properly understand main type and main features of each of these types to be able handle such unlimited area of banking experiences.

Learning Objectives

Upon the completion of this module, you will be able to:

- Define terms of payments in foreign trade
- Identify the types of letters of guarantee
- List the various foreign trade instruments

Definition of Terms of Payment in Foreign Trade

- International trade is the main base of economical strength. Countries all over the world give the maximum priority to support their trade transactions specially export activities.
- Economical strength measured by the difference resulting from import and export transactions. Countries classified according to these results. Lately the economical strength became the most important measurement of the countries strength beside the military strength and their only way of demonstrating other countries guiding them to serve their interests, the clearest proof of this demonstration appears in the control of USA on other countries.

- In the past trade transactions were depending on exchange of products between individuals to satisfy each other's needs, one was producing a specific kinds of goods which meets the needs of others whom producing other kinds of goods meets the needs of others and so on … , through exchanging these products the individuals fulfill their needs . This was the primary shape of trade transactions.
- Traders were traveling with their own goods to several markets to sell and buy goods in order to gain profits from the difference between selling and buying prices. Using this traditional way of executing commercial transactions was including several risks to the trader such as robbery, potential damages to goods itself and in addition to waste time and efforts of the trader himself .as a result of rapidly changes and development happened in the field of communications and transportation in international trade, trade transactions took another shape which is more complicated than before, and because of inconsistent interests of the parties involved in the trade transaction the needs of rules that governing this trade transaction and interference of an independent party became a must. And this independent party must have trust from all parties involved in the trade transactions. So we are facing a case of un-trust between the seller and the buyer in the trade transactions can be noticed from the inconsistency of the interests between sellers and buyers as follows:

- The seller interests
  - Selling his own goods safely
  - Be sure of selling the goods produced
  - Collecting goods value before releasing goods
  - Securing the goods movement to the buyer premises
  - The buyer interests:
  - Receiving the goods with same specifications agreed with the seller
  - Having the ability to refuse the un-complied goods
  - Possessing the goods before paying its value
  - Securing the goods movement to his premises

- In order to satisfy both buyer and sellers needs there is a must of finding another party who have a common acceptability to both parties. This party was of course banks in order to serve the international trade process.
- At first banks interfere in such transactions by issuing a tool called "Traveler's Letters" which appears on the mid of nineteenth century and gave traders a reasonable limit of security. The traveler's letters were issued by the trader's bank in a specific amount which was collected from the trader in his country -as a cover- and receive in return the traveler's letter which was addressed to the trader's bank correspondent in the country which the trader was intend to travel to instructing this correspondent to support trader in executing his trade transactions in the easiest way and to introduce the trader to other traders in this country. the trader receive the traveler's letter in order to give it to the correspondent of the issuing bank in the other country to collect the needed funds for purchasing goods in this country and the correspondent bank decrease the available amount of the traveler letter by writing on its back the amount withdrawal by the trader if he withdraw a part or the full amount of the letter. And to secure such letters the issuing bank send a copy of the letter by mail directly to his correspondent address informing him of the potential withdrawals of funds by the trader.

- This way of interference was applied for a long time and because of the continuously changes in ways of communications and trade ways this way became unacceptable so banks began to search for another tools that can serve the international trade more efficiently which was:

Letters of Credit

The International Chamber Of Commerce

- It was established on 1919 by "Etan Clementel" Minister of French ministry of commerce. The ICC was founded based on a unique and unchanged goal "Serving the international trade sector" through supporting trade and investments by opening a new markets for goods and services and freedom of cash flow between countries in a way that help business men to perform their trade transactions in the easiest and secured way.

- In addition and because of the power of its founder "Etan Clementel" he succeeded to establish the arbitration court which was responsible for taking decisions in cases of disputes arising between parties of the trade transactions. Because of this distinguished role members of ICC can be counted by thousands of banks, financial institutions and most powerful companies in 130 countries all over the world.

- Because of the influence of the ICC at members and the need of commonly agreed rules the ICC issued rules that governing trade transactions called "Uniform Customs Practice" (UCP). These rules including all regulations and principals that gives parties involved in the trade transactions using letters of credit as a payment tool the full guarantees required to secure the trade transaction, and where there is a need of modifying or changing these rules the ICC updates it's editions of UCP according to the changes happened in the international trade process in a way that helps and support international trade to achieve its goals of enhancing countries economical performance.

- Herein after we will monitor the publications of ICC that issued to serve the international trade process

ICC payment tools publications

Publication name	Term	Previous edition	Current edition	Application date
Uniform Customs practice	UCP	400	500	Jan. 1994
Electronic Uniform Customs practice	E-UCP	New	1/500	Apr. 2002
Uniform rules for collection	URC	322	522	Jan.1996
Uniform rules for bank-to-bank Reimbursement	URR	New	525	July 1996
International commercial terms	INCOTERMS	460	560	Jan. 2000
Uniform Rules for Demand Guarantees	URDG	325	458	Jan. 1993
International standby practice	ISP98	New	590	Jan. 1996
International standard banking practice	ISBP	New	645	Jan. 2003

الأعراف الموحدة للإعتمادات المستندية
UNIFORM CUSTOMS PRACTICE (UCP)

القواعد الموحدة للتقديم الإلكتروني
ELECTRONIC UNIFORM CUSTOMS PRACTIC (EUCP)

الأعراف الموحدة للتحصيلات المستندية
UNIFORM RULES FOR COLLECTION (URC)

قواعد التغطية من مصرف لمصرف
UNIFORM RULES FOR BANK-TO-BANK REIMBURSEMENT (URR)

المصطلحات التجارية الدولية
INTENATIONAL COMMERCIAL TERMS (INCOTERMS)

القواعد الموحدة لخطابات الضمان
UNIFORM RULES FOR DEMAND GUARANTEES (URDG)

الإعتمادات الضامنة (الجهوز)
STAND BY LETTERS OF CREDIT (ISB)

المعايير القياسية للفحص المستندي
INTERNATIONAL STANDARD BANKING PRACTICE (ISBP)

Society for World Wide Interbank Financial Telecommunication “SWIFT"

- Because of the rapid changes and movements in executing the banking transactions the ways of communicating between banks and financial institutions became very complicated and need to be improved so a group of 239 banks from 15 countries established the SWIFT organization to facilitate communications between each other

- The Telex by this time was the only way of overseas mean of tele-communicating, it has a lot of disadvantages and very risky. The most risks were the difficulty of receiving and issuing a large number of messages per day, the absence of standards in writing messages, the probabilities of receiving false messages in addition to the high cost of sending and receiving messages . Because of reasons mentioned above the need of an organization that help banks to solve these problems became a must.

- Now a days the members of SWIFT organization became about 7600 member in 200 country and the number of the daily messages were about 300000 message according to June 2005 statistics .
- The SWIFT organization staff has analysis the daily work of all departments in the banking field and specifies the needs of messages in the department regular working process; the data which should appears in each message and began to name fields for every message each field contain specific characters and give a name for each message related to its function. This helps bankers to unified the way they use to settle the daily transactions, moreover it prevent issuance of a message that in an incomplete format or missing some necessary data and in a unified order. This way of handling messages between banks protect them from any disputes arising in transmitting incomplete data.
- As banks start to use swift in transmitting all messages between them most or even all disadvantages of using telex disappeared , as a result the documentary credits department was the first and most departments that gain advantages using this way of communication as they were facing a lot of problems in using old fashion ways of communications.
- To be more efficient swift organization classified messages into categories began from (category 1) up to (category 9). Documentary credits and letters of guarantee located in (category 7).

CATEGROY 7:

MESSAGE TYPE	MESSAGE TITLE	FROM TO
700/701	ISSUE OF D/C	ISSUING BANK – ADVISING BANK
705	PRE-ADVICE	
707	AMENDMENT MESSAGE	
710/711	THIRD PARTY ADVICE	
720/721	TRANSFER OF D/C	TRANSFERRING BANK TRANSFEREE BANK
730	ACKNOWLEDGEMENT	ADVISING BANK ISSUING BANK
732	ADVICE OF DISCHARGE	ISSUING BANK NEGOTIATING BANK
734	ADVICE OF REFUSAL	
740	AUTHORIZATION TO REIMBURSE	ISSUING BANK REIMBURSEMENT BANK
742	REIMBURSEMENT CLAIM	NEGOTIATING BANK REIMBURSEMENT BANK
747	AMENDMENT TO AN AUTHORIZATION	ISSUING BANK REIMBURSEMENT BANK
750	ADVICE OF DISCREPANCIES	NEGOTIATING BANK ISSUING/CONFIRMING BANK
752	AUTHORIZTION TO PAY	ISSUING BANK NEGOTIATING BANK
754	ADVICE OF PAYMENT / ACC. / NEGO.	NEGOTIATING/CONFIRMING BANK ISSUING BANK
756	ADVICE OF REIMBURSEMENT	ISSUING BANK NEGOTIATING BANK
760	GURANTEE	ISSUING BANK ADVISING BANK
767	GURANTEE AMENDMENT	
799	FREE FORMAT	ANY BANK – ANY BANK

Shipping Documents

- Shipping documents are the most important requirements of the commercial transactions it play the biggest role in securing the commercial transaction parties. Shipping documents does not mean the transport document only but all required documents under the commercial transaction hereunder we will discuss all characteristics of each document of shipping documents taking into consideration that some of these documents may be requested under a specified l/c and not in other as the case may be.

Shipping Documents

1- Commercial Invoice
2- Packing/Weight list
3- Transport Document
4- Insurance Document
5- Certificate of Origin
6- Inspection Certificates
7- Health Certificates
8- Other Documents
9- Bill of Exchange (The Draft)

Commercial invoice

The commercial invoice represents the document of property of the goods and the evidence of selling the named goods/services to the buyer. in issued on the letter head of the seller addressed to the buyer as a request of paying the specified sum of money in return of the sold goods/services and include a full details and description of goods/services (specifications , weight, quantity , prices , terms of payment and any other terms and conditions related) . The commercial invoice may be signed by the issuer (seller) or not. The commercial invoice must be issued by the seller
Packing/Weight list

From its name it represents a list of contents. In other words the packing/weight list is a list in which the seller describe to the buyer in which way the goods were stowed and packed and what kind of packages used and the number of packages if any . these lists facilitate the receiving of goods by the buyer in order to be sure that all goods required and paid were received in addition the packing list is an essential need of the customs authorities to apply the customs tariff by withdrawing a random samples of goods as described in the packing/weight list instead of examining the whole shipment. It might be issued by the seller or other parties.

Transport Documents

- The most important document in letters of credit transactions. It is the documents of possessing goods only during its voyage from seller’s warehouse to buyer’s warehouse. In other words we can describe this document as the document which gives its bearer or the notify party the right to take over the title of the goods. This document issued by the carrier (only) who declare that he received the described goods in the transport document from the shipper (normally the seller) for the purpose of transporting them from named place to another (mentioned in the document) and signed the document delivering it to the shipper in order to deliver said goods to the bearer at the place of destination in return of receiving back all original of the transport document that delivered to the shipper at the place of loading.
- Following this mechanism the transport document could be described as a receipt issued the carrier/agent of the carrier in return of receiving goods. And due to the importance of this document the UCP contains about 11 articles out of 49 articles discussing the transport documents.

- The name of the transport document differs according to the mode of transport which can be illustrated as follows:

Means of transport	Transport document	إسم مستند النقل	إسم وسيلة النقل
By vessel	Marine bill of lading	بوليصة شحن بحري	بحري
Charter Vessel	Charter party bill of lading	بوليصة مؤاجرة	مؤاجرة
By two or more kinds of transport	Multimodal bill of lading	بوليصة شحن بحري متعدد	متعددة
Forwarder	Freight Forwarder	بوليصة متعهد نقل	متعهد نقل
By Air	Airway bill	بوليصة شحن جوي	جوي
By truck	Truck consignment note	بوليصة شحن بري	بري
In water land	In water land bill of lading	بوليصة شحن نـهري	نـهري
Rail	Railway bill (Mmanifesto)	منافيستو	سكك حديدية
Post office	Postal receipt	إيصال تسليم بريدي	البريد

- The transport document represent to who the title of goods should be. So some documents give this title to the bearer others do not. So the transport document has very special importance and characteristics that all of parties involved must be aware of it.

Transport document parties

- The carrier
- The consigner (shipper)
- The consignee
- The notify party

Insurance document

- It may be insurance policy, insurance certificate or cover note. The insurance document is the most important second document required under letters of credit because it gives the buyer a reasonable limit of security against risks and damages that might happened to goods during its voyage from buyer's premises to seller premises. The insurance document must be issued by insurance companies or their agents and normally issued favor the buyer or his bank and the charges of issuance will be paid by the assure (the seller or the buyer as the case may be) party and of course the buyer will pay these charges always or will be included in the cost of the goods if paid by the seller.
- In all cases the insurance document issued to cover all potential risks, some may be required to issued covering special risks as a result the premium will differ according to risks covered

- When the letter of credit require an insurance policy then presenting an insurance policy only not any other insurance documents became a must and when an insurance certificate required an insurance policy or an insurance certificate might be presented but when a cover not required the seller must present a cover note only .

- The insurance certificate represent a part of a large insurance policy issued in big amount the seller use this kind of insurance documents because of the potential discount that he might gain from issuing a big insurance policy which he issued due to his continuously commercial transactions that need insurance . Where a cover note issued by an agent on behalf of insurance company.

Certificate of Origin

- A document required particularly as an evidence of the origin or the country of production of the shipped goods and this document normally issued by the chamber of commerce in the seller's country . This document required mainly as a necessary document to release goods from customs according to the rules of the importing country because sometimes the governing authorities in the importing country restrict importing goods from specified countries due to the political, economical, health respects.

Inspection certificates

- Due to the non assurance of shipping the agreed goods and the difficulty of presence of the buyer himself or his representative at the time of loading the buyer may request an independent inspector's certificate in which they must certify that shipped goods are in accordance of special standards, mention the chemical analysis of goods, declare that the carrying ship (vessel) in accordance of special requirements mentioned in the credit or any other requirements if any. The cost of issuance of such certificates by default will be on the buyer account (either included in the cost of good or through a direct payment by the buyer) .

- The responsibility of requiring such certificates relayed only on the buyer's account and he bear the full responsibility of requesting insufficient certificates those securing his interests as he will pay against documents before releasing goods .

Health certificate

- In many cases and because of the nature of the goods itself the buyer may require a health certificate to accompany the documents. This document normally issued by a governmental authority in the buyer or the seller country as the case may be.

Other documents

- As we emphasize before the responsibility of requesting documents under the letter of credit to be sure that the required goods are shipped exactly as agreed is totally on buyer's responsibility. For the seller he must not start to produce the required goods unless he be sure that he can get the documents mentioned in the letter of credit so other documents may differs from transaction to another according to nature of the goods, governmental regulations, buyer's needs, etc….

These documents might be

- Shipping advice
- Fumigation certificate
- Shipment advices
- Seller's certificates
- Shipping company certificate
- Inspection certificate and other…………

Bill of exchange (the Draft)

- It is a commercial instrument that might be used as an instrument of re-finance to the holder. The issuance of drafts organized in many countries by the force of local law as they are a negotiable commercial paper.
- All of the above mentioned documents may be required in full or partially according to the agreement between the buyer and the seller. But in all cases the shipping document may be used in all kinds of payment tools. The only difference represented in the responsibilities in handling these documents to all parties involved.

International Payment Tools

Payment tools used in the international trade are as follows:

1- Advance Payment
2- Open Account
3- Collections
   - Clean Collection
   - Direct Collection
   - Documentary Collection

4- Letters Of Credit
   - Direct L/C
   - Transferable L/C
   - Back - To - Back L/C
   - Advance Payment L/C
   - Red Clause L/C
   - Bridge L/C
   - Revolving L/C
   - Standby L/C

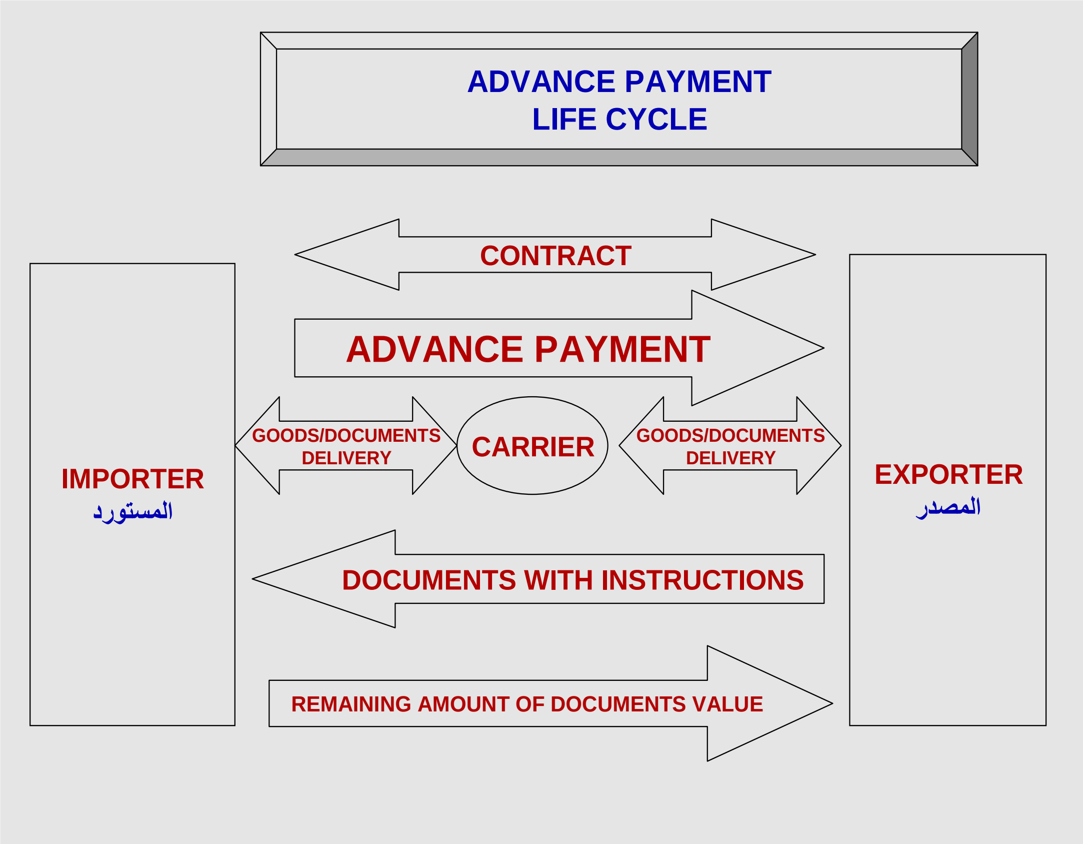
Commercial Transactions Parties

- Manufacturer
- Exporter (The seller)
- Exporter's bank
- Importer (the buyer)
- Importer's bank

Advance Payment

- One of payment tools that including unlimited trust between the buyer and the seller. By using this tool the importer pay in advance a sum of money to the exporter representing a percentage from the whole value of the goods in order to help the exporter to start produce the required goods. after receiving this sum of money the exporter prepare the goods and ship it getting the transport document and prepare the other necessary documents and immediately send all documents to the importer directly meanwhile the goods were arrived at the importer's country so by presenting the documents he received from the exporter he can release the goods and by this time he pay the remaining amount of goods value.

- By reviewing this payment tool we can notice that each party in this transaction face a risk of non-completing the commercial transaction but by depending on trust only the other party perform his obligations and complete the transaction. So the trust here is the only factor that the whole transaction is relayed on.



This tool has advantages and disadvantages for both parties.

- From Importer Point of View

- Advantages

In case of any increase in market price he will not pay more getting very competitive prices as he offer an advance payment.

- Disadvantages

Facing the risk of losing the advance payment in case of any failure related to the exporter In case of any decrease in prices he cannot cancel the deal the cost of un-working funds.

- From The Exporter Point of View
- Advantages

Be sure of pre-selling of the produced goods no need for external finance (cost of loans).

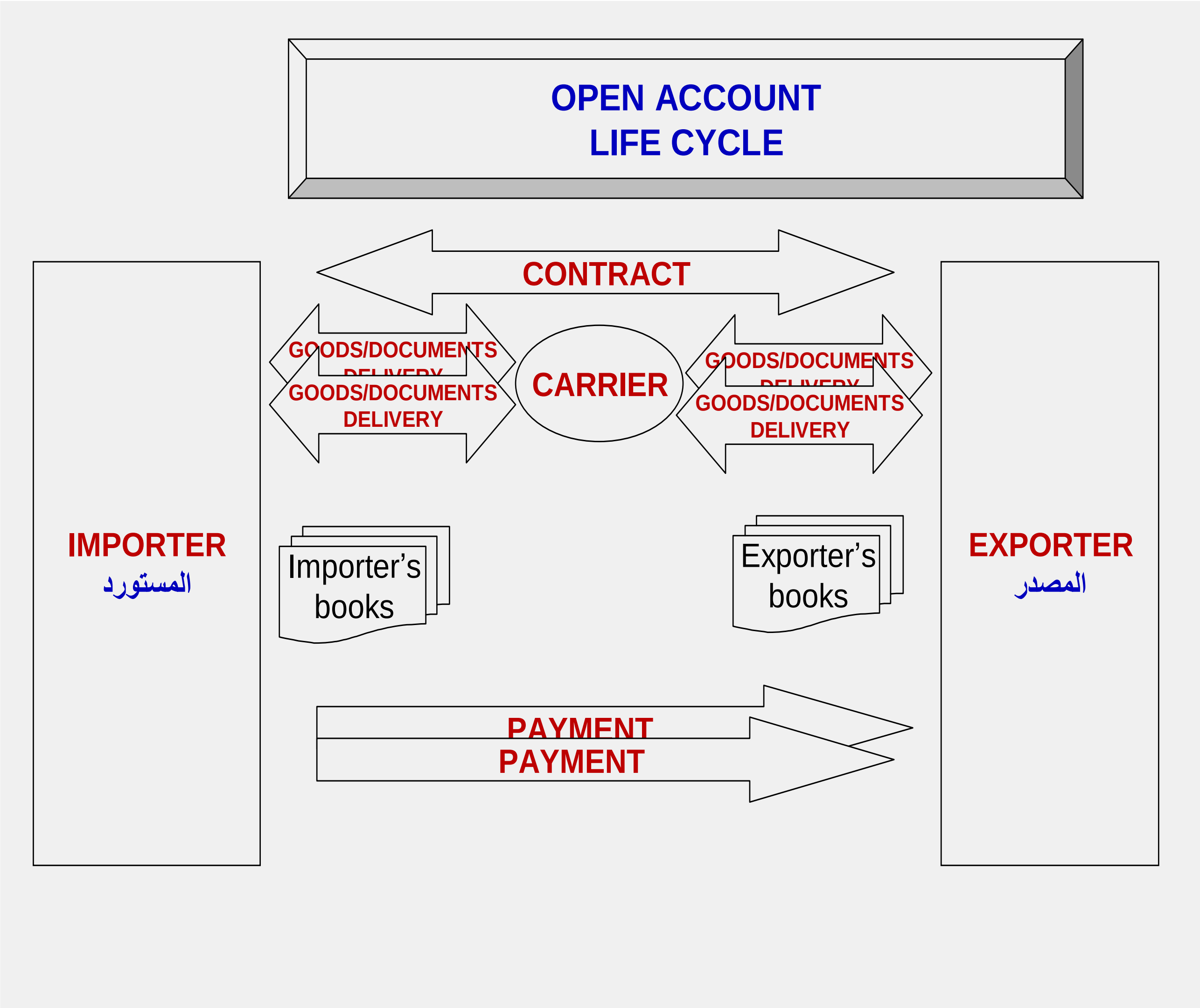
- Disadvantages

The un-certainty of receiving the remaining value of goods .

- Open Account

The open account tool is similar to the advance payment tool in its mechanism but it began by the exporter not the importer.

- The exporter as agreed with the importer began to produce the goods and ship it to the importer preparing the required documents and send them to the importer without receiving a penny from the importer. He records the shipment amount on the importer's account in his books then the importer receive the documents and he goods in the same time recording them for the exporter account in his books and began to sell it. Meanwhile the exporter may be taking the procedure of sending the second shipment even he did not receive the first shipment value and so on . After a while the importer began to transfer the first shipment value favor the exporter at exporter's bank and so on. Using this tool including the same limits of trust in the previous payment tool.
- Importer and of course exporter must be aware that this way of settling commercial transactions must not be used unless they have a long a very good relations.



- This tool includes advantages and disadvantage to the exporter which can be noticed as follows:

- From exporter point of view
- Advantages

Having the ability to open new markets Possess the ability to compete with other producers.

- Disadvantages

Possibility of losing the goods value in case on nonpayment by the importer
Cost of the working capital

Collections

Definition of collection

"Collection" means the handling by banks of documents as defined in accordance with instructions received, in order to:-

Obtain payment and/or acceptance

Or

Deliver documents against payment and/or against acceptance

Or

Deliver documents on other terms and conditions

From this definition we also have to know kinds of documents presented under collections:-

"Documents" means financial documents and/or commercial documents:

"Financial documents" means bills of exchange, promissory notes, cheques, or other similar instruments used for obtaining the payment of money

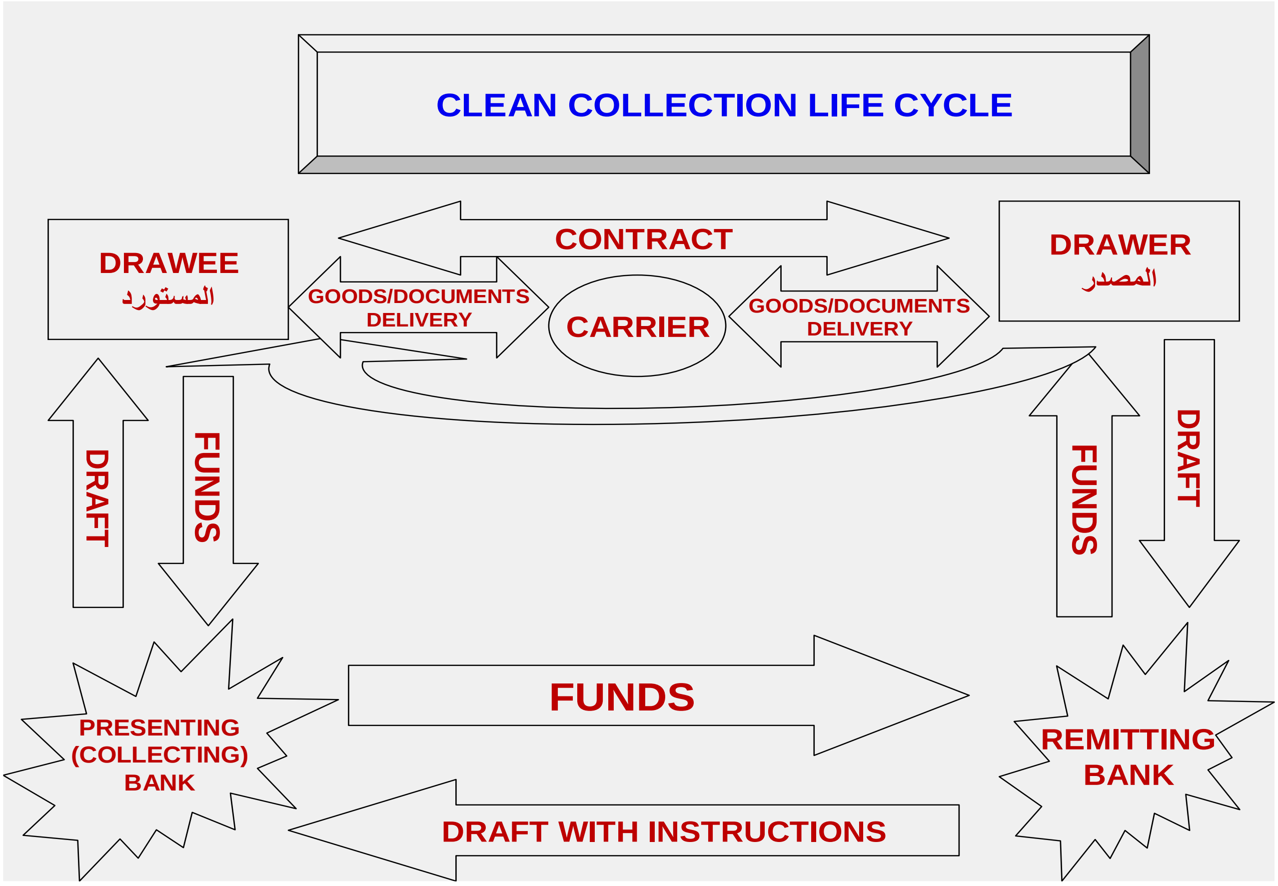
"Commercial documents" means invoices transport documents, documents of title or other similar documents, or any other documents whatsoever, not being financial documents

- Collections parties
- Drawer (exporter – seller)
- Remitting bank (exporter's bank)
- Collecting bank (exporter's bank correspondent)
- Presenting bank (importer's bank)
- Drawer (importer – buyer)

Clean Collection

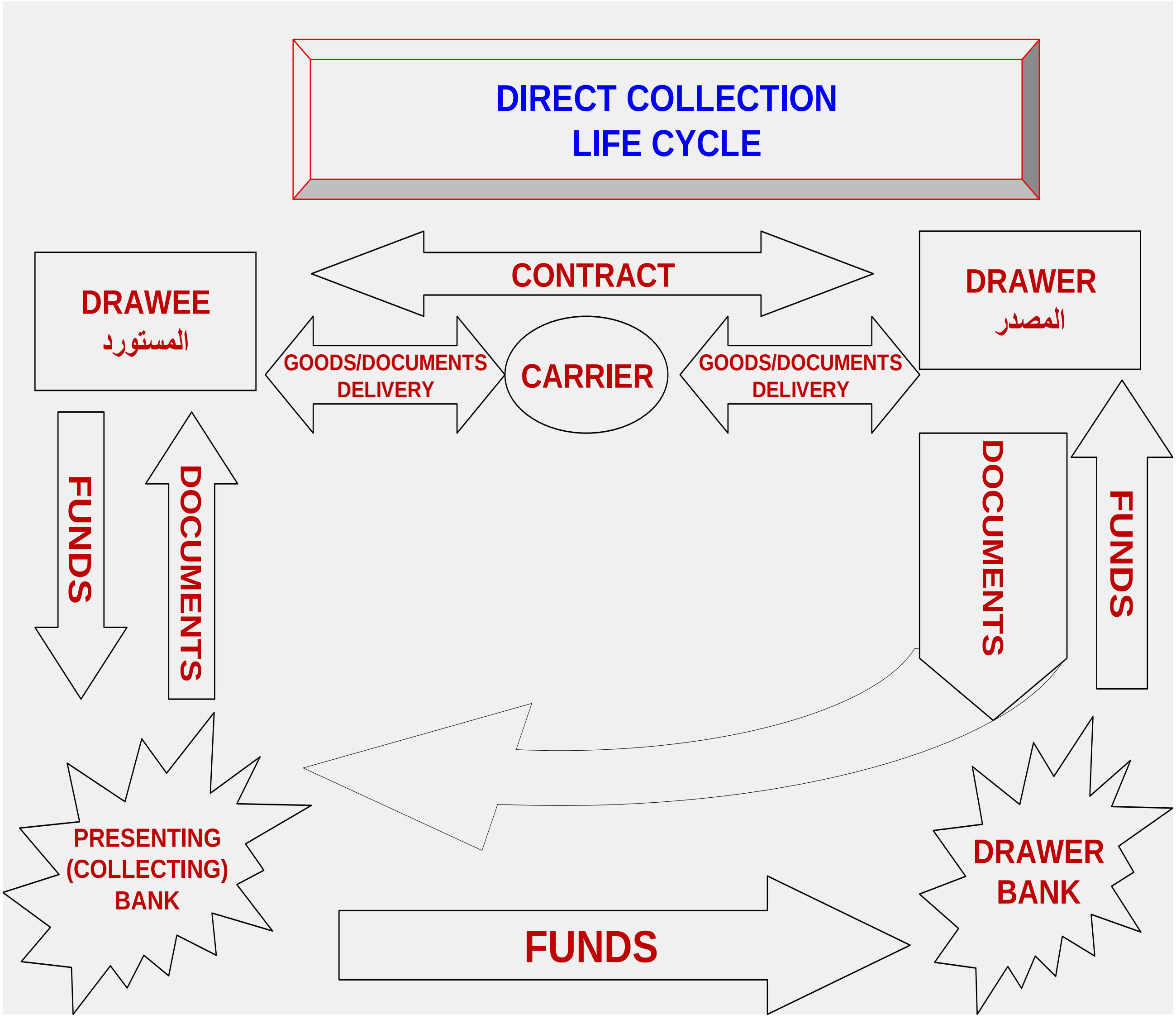
- Out of definition of documents under collections the clean can be defined as:-
- "Clean collection" means collection of financial documents not accompanied by commercial documents
- From this definition we can analysis the mechanism of using this type of collections
- First the drawer (exporter) make all arrangements to ship the goods and get the documents which he sent it directly to the drawer (importer) as agreed and prepare a draft (bill of exchange) to be presented to his bank by instructions to send this draft to the drawee's bank to collect it . The exporter's bank act according to these instructions and send the draft to the importer's bank for collection in the view of exporter's instructions.
- Neither importer nor his bank obligated to pay this draft as the importer have already received the shipping documents and released the goods so the only this that the exporter is relaying on is the trust in importer's intend to pay goods value .

- From above we can notice that the financial documents are the only documents presented to banks in clean collections. The mechanism of this kind of collection clearly from the following figure:



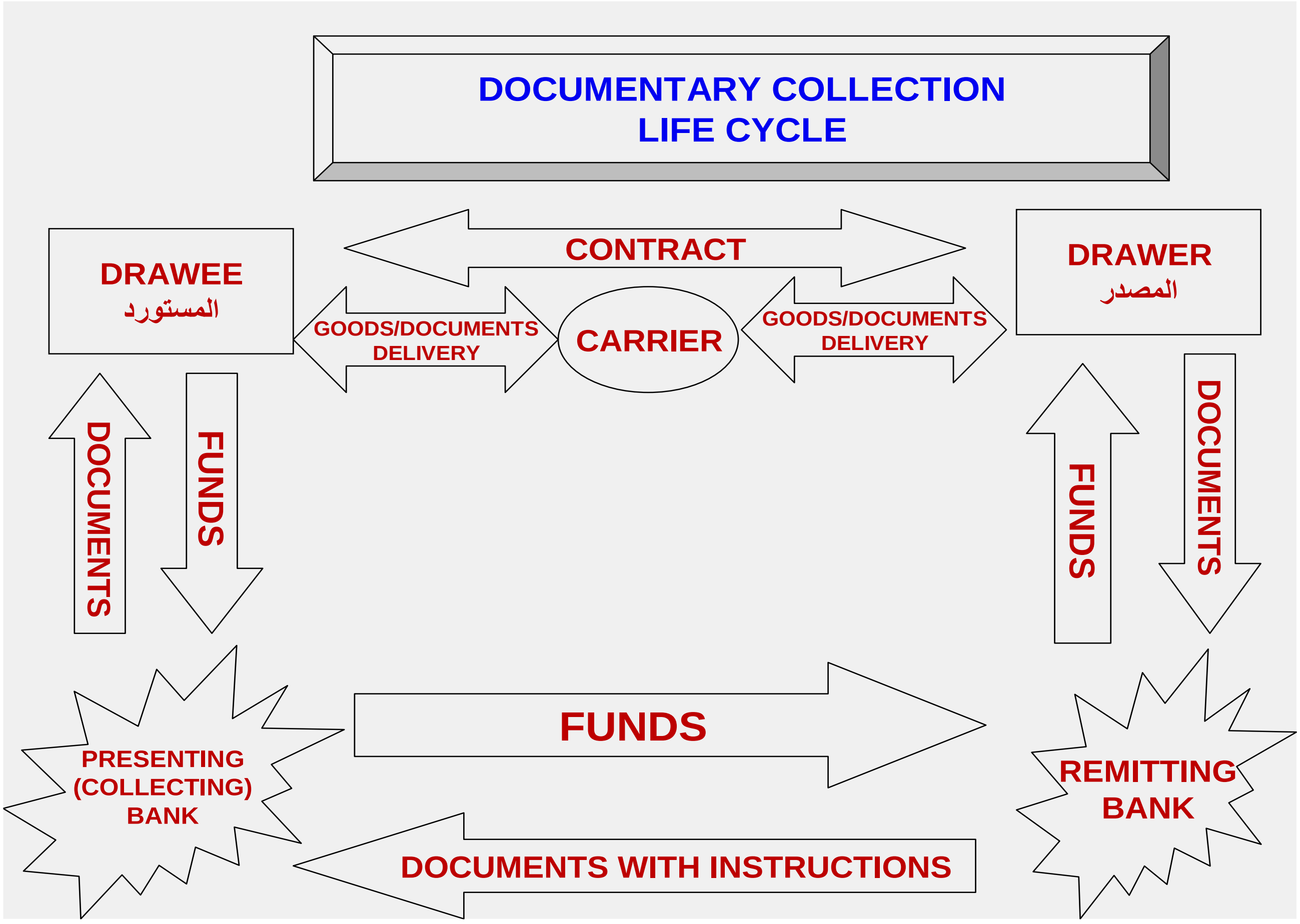
Direct collection

- In this kind of collections the exporter presents the shipping documents with instructions directly to the importer's bank in the country of the importer instructing him to transfer the documents amount to his (exporter) bank as agreed with the importer. In this case the importers bank acting as importer and exporter bank in the same time. The exporter may use this kind of collection because of his knowledge of the importer's bank and may due to the large no. of sets that he issued every day he can use the remittance of his bank in order to send these documents directly to the importer's bank .



Documentary collection

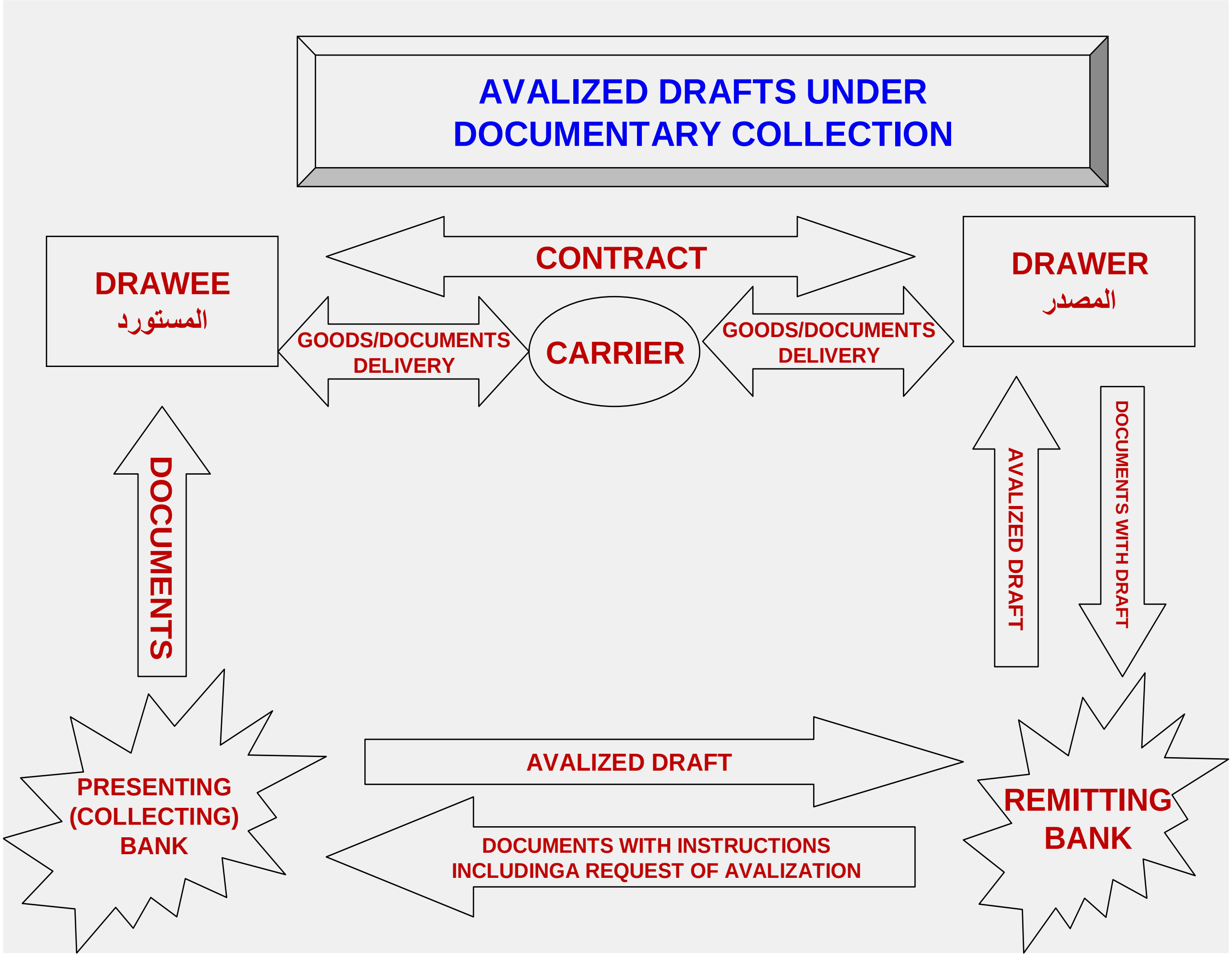
- In this kind the exporter deal with his bank only and deliver the documents to him instructing his bank to collect the documents amount as agreed with the importer and precisely specify the importer's bank (if not the exporter bank will send the documents to his correspondent in importer's country) in order to collect the documents value . The importer's bank will act only according to the instructions received from the exporter's bank as the documents sent in accordance with URC 522.
- The following figure will illustrate how this kind of collection works.



- The responsibility in collection is fully relayed on the exporter's account as he is the party who take the decision to start the commercial transaction regardless the contract between him and the importer.
- Banks have no effective role in the collections but only acting according to instructions received from the drawer.

Analyzed documents

- the role of banks in collections is very limited they only act according to drawer's instructions but in some cases the bank interfere in the collection transaction as a third party that guarantee the payment to the drawer by avalizing the draft presented under said collection or issue an undertaking to pay at maturity if there is no drafts presented along with the documents. The term "Avalize" means that the drawee's bank undertake to pay document's amount regardless the commitment of the drawee himself. Avalization is normally requested in the deferred transactions. In other words in the due date the drawer's bank will claim the payment from the drewee's bank (the undertaker) not from the drawee himself and regardless the drawee's financial position.
- Avalization of drafts can be used as an instrument of finance to the drawer or the bonfied holder of the avalized draft. But the acceptability of this avalized draft as an instrument of finance by discounting it depending on the undertaker financial position.



DOCUMENTARY CREDIT DEFINITION

- The expressions “Documentary Credit(s)” and “Standby Letter(s) of Credit” (hereinafter referred to as “credit(s)”), mean any arrangement, however named or described, where a bank (the “Issuing Bank”) acting at the request and on the instructions of a customer (the “Applicant”) or on its own behalf
- Is to make a payment to or to the order of a third party (the “Beneficiary”), or is to accept and pay bills of exchange (Draft(s)) drawn by the beneficiary,
- OR
- Authorizes another bank to effects such payment, or to accept and pay such bills of exchange (Draft(s))
- OR
- Authorizes another bank to negotiate.
- Against stipulated document(s), provided that the terms and conditions of the credit are complied with.
- So in credits banks have the major role in executing the commercial transaction and generally the exporter’s position in documentary credits is much better than collections as long as he presented the required and complied documents.
- In collections the governing rules were URC 522 but under documentary credits the governing rules are articles of UCP 500 (1993) and we can have an overlook on the UCP articles as follows

Documentary credit parties

- Applicant
- Issuing Bank
- Beneficiary
- Advising Bank
- Confirming Bank
- Reimbursement Bank

The above mentioned parties may differ as the case may be such as in transferable credits there are first and second beneficiary, transferring bank and so on ….

Direct documentary credit life cycle

- As mentioned above the documentary credit is a written undertaking issued by importer's bank and according to his instructions and these instructions based on the contract signed between the exporter and the importer. Then the importer at fist and depending on this contract by using the pre-printed application completes it (the application) and forwards it to his bank (the issuing bank) by this time and after completing the required arrangement (seek for the cover by cash or through using the importer line of facilities) the issuing bank issue the documentary credit after checking the technical requirements of issuing such credit.

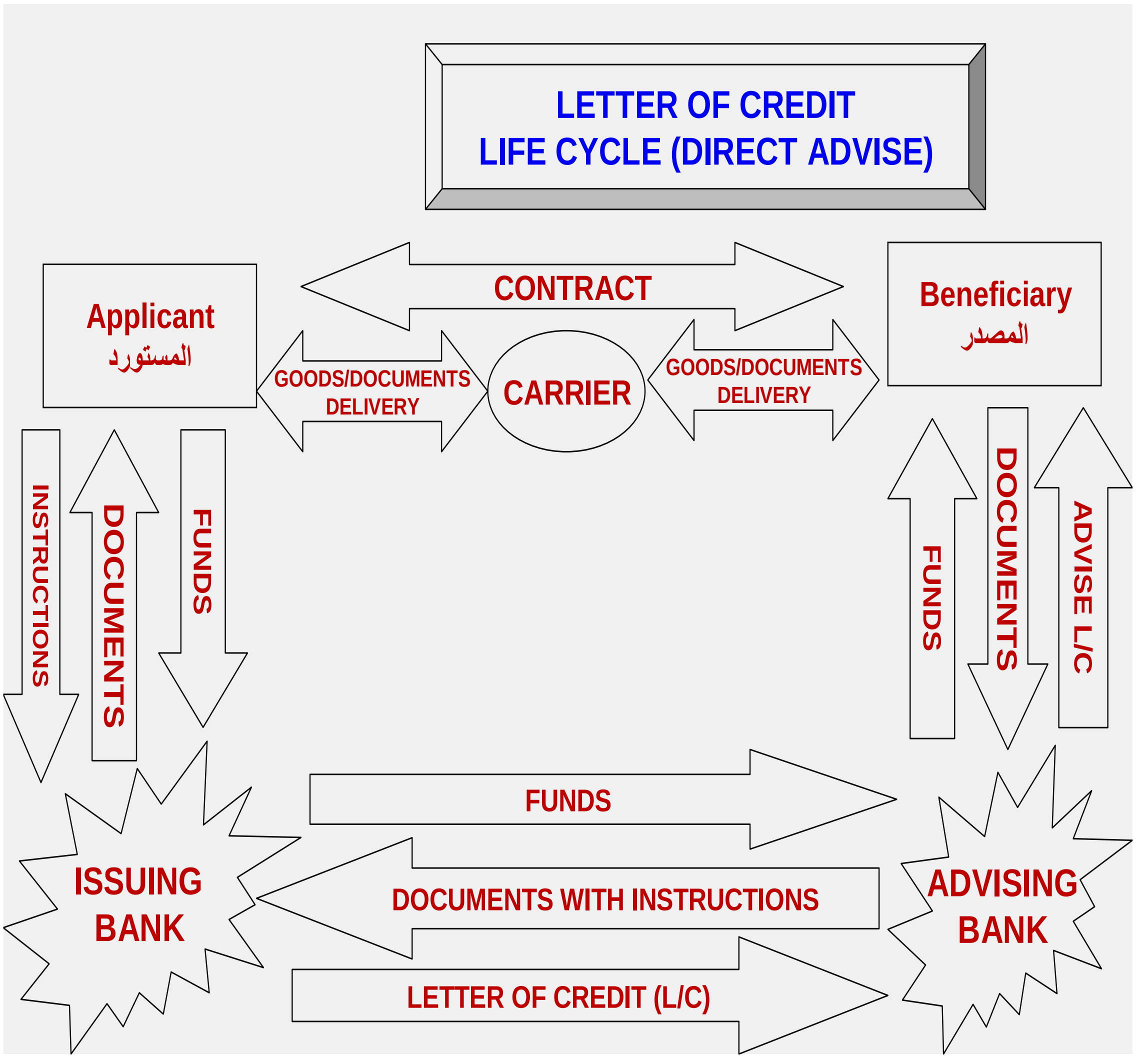
- <u>The issuing bank</u> forward this credit to the advising bank (exporter's bank) subsequently the advising bank advise such credit to the beneficiary whom check the terms and conditions f this credit with the terms and condition of the contract previously signed with the importer , upon finding it completely matches with the contract he start producing the goods agreed and ship it as required in the credit getting the required documents in the credit and present them to the advising bank along with his covering letter stating that the terms and conditions have strictly complied with .

- <u>The advising bank</u> examine the documents with the terms and conditions of the credit and forward them to the issuing bank with instruction to the issuing bank to pay documents amount according to credit terms and conditions as they were complied .

- The issuing bank examines the documents and determines that they were complied so he forward the documents to the applicant and pay the documents amount to the advising bank

- the advising bank accordingly receive funds and pay them to the beneficiary after deducting his commissions and charges if the credit states that they are on beneficiary's account .

- So as a result as long as the terms and conditions are met the beneficiary is guarded by the credit and the rules referred in it (UCP 500) and it is the responsibility of the exporter to be aware of the rules that governing the credit and may refuse to perform the whole transaction if he found some condition that he could not fulfill. The issuing bank is obligated to pay against complied documents only so if a discrepant documents presented the issuing bank is not obligated to pay unless he get the importer’s acceptance of discrepant documents , in other cases the issuing bank may refuse the discrepant documents if he found that there is something in document will not serve his interests . The following is the chart of direct documentary credit transaction



- to unite the way of advising the credit the issuing bank may advise this credit to the advising bank by a letter sent by mail or by using the proper message MT 700 (documentary credit issuance message) in all cases the following data must be fulfill so we will go through the MT 700 fields which will give us an idea about special terms used in documentary credits.

Classification of Documentary Credits- Letters of credit (L\Cs)

From Bank Point of View

- Export documentary credits
- Credits will be named as Export credits if the beneficiary is our customer (The Exporter)

Import documentary credits

- Credits will be named as Import credits if the applicant is our customer (The Importer)

From the Irrevocability of the Credit Point of View

- Credits may be issue either revocable or irrevocable. The irrevocable l/cs were issued in the past giving the ability of cancellation to the issuer regardless the acceptance or non-acceptance of the beneficiary or his bank these kinds of credits includes very high risk to the beneficiary as well as his bank. By using this kind of credits the issuing bank may cancel the credit without a prior acceptance of the beneficiary whom may have taken the necessary arrangement of producing the goods required which may be produced specially for this importer (special order with special specifications) and these goods may not fit or valid for other importers or buyers.
- So these kinds of credits are not frequently used in commercial transactions and if used the banks involved advise them without any responsibility on their part.

- Consequently irrevocable credits binding a definite undertaking on the issuing bank and once it issued cannot be cancelled without prior permission of the beneficiary or his bank as the case may be. So irrevocable credit gives a reasonable security to the beneficiary the once it issued he will get its value if he present the required documents complied with the credit terms and conditions.

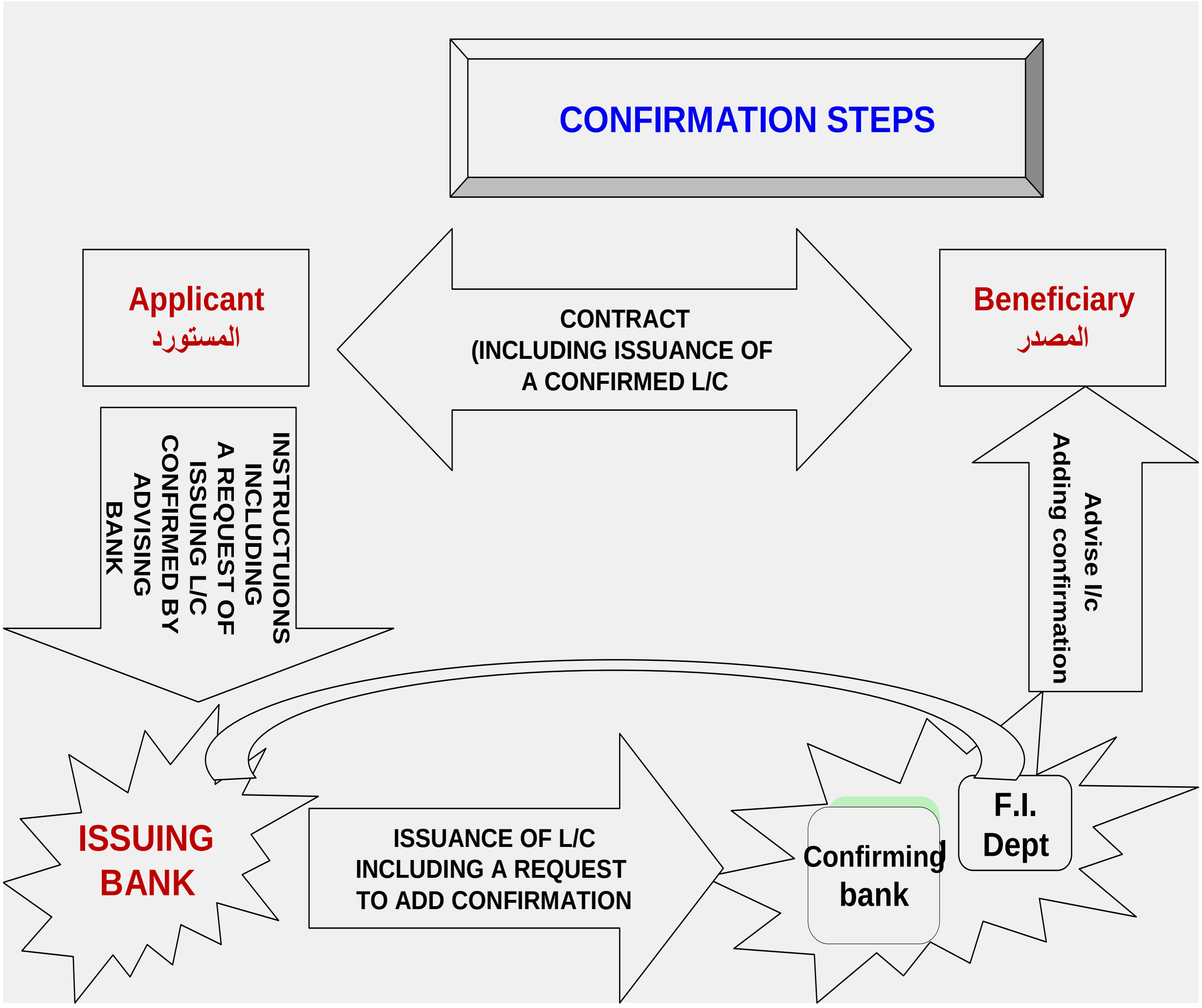
- An important notice should be taken into consideration that in case of revocable credits issued and the beneficiary present the required documents to the advising bank prior to the receipt of the request of cancellation by the issuing bank the credit automatically became an irrevocable.

From the confirmation point of view

- Confirmation means the additional assurance or guarantee provided by the exporter's bank to the exporter due to the un trust of the exporter that the importer bank could fulfill its obligations the exporter require the advising bank to add it's confirmation to the credit to make sure that in case of presentation of the required documents the issuing bank will pay the document's amount.
- The confirmation gives the exporter a reasonable security limit regarding the credit so the confirmation is exporter's shield toward any disputes arising related to the credit or its issuer.
- The confirmation related to many aspects when it added the confirming bank will not add it's confirmation unless it make sure that the issuing bank is really a well trusted bank and the country risk is calculated in addition to that the conditions of the credit does not prohibit confirmation and does not include any condition that makes the credit not valid.

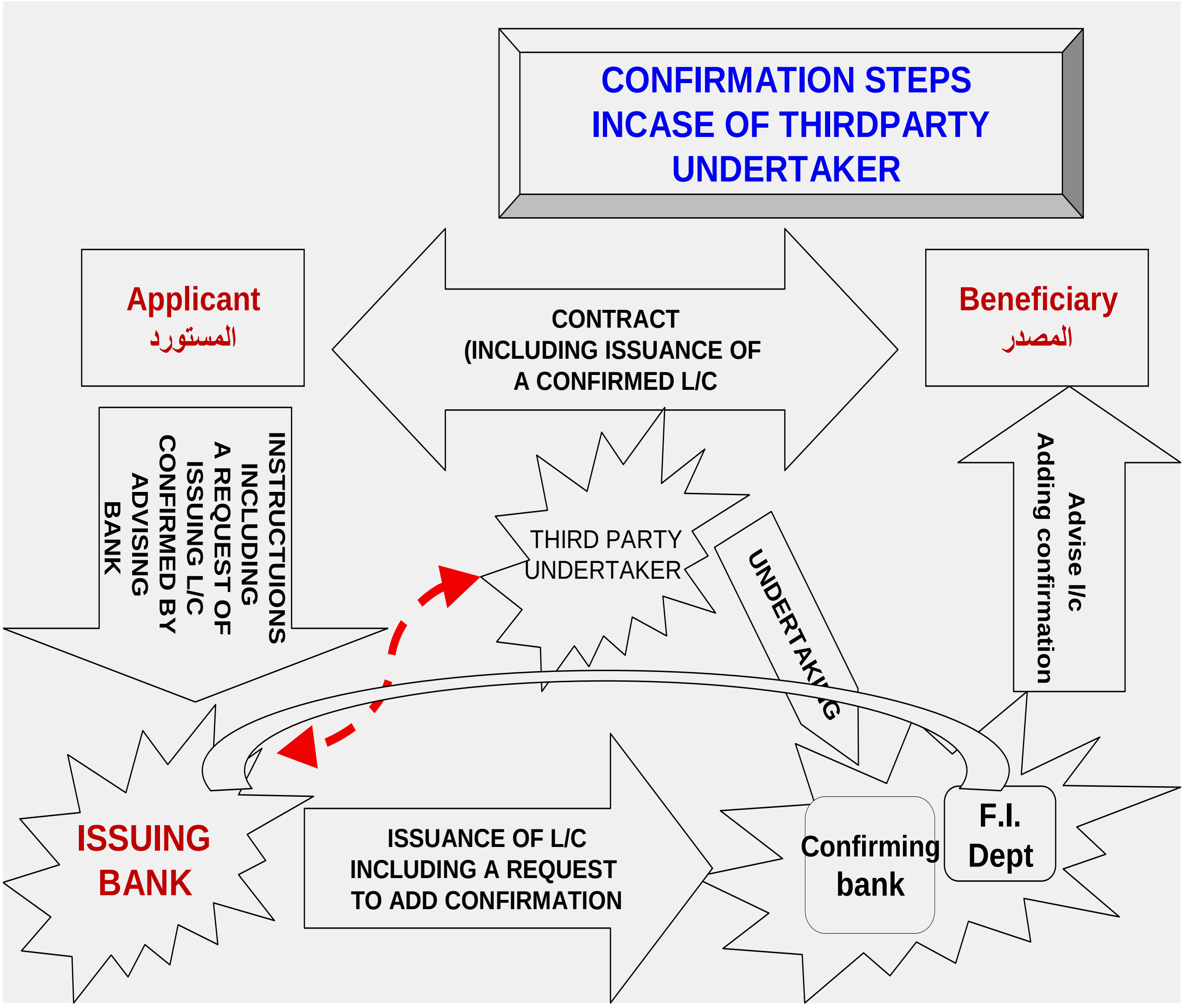
Steps of adding confirmation

- The issuing bank upon applicant's instructions issue its credit including a request to the advising bank to advise the credit adding it's confirmation.
- As the confirmation constitute a definite undertaking of the confirming bank in addition to the undertaking included in the credit itself .The advising bank (export dept.) began to check the credit terms and conditions to make sure that the confirmation may be added from documentary credits technicality wise, then prepare an internal memo with the necessary details to the financial institutions department, in order to get the approval of adding confirmation. The correspondent banking relations Dept. follow some procedures (calculate the creditability of the issuing bank, check the issuing bank line of facilities and determine the country risk) after making sure that the issuing bank is trusted enough to add confirmation to credits issued by him . The correspondent banking relation dept. approves adding confirmation to this credit. By this time the export dept. at the advising bank premises advice said L/C to the beneficiary adding confirmation.
- Normally advising banks do not add confirmation unless they have good relations with the issuing banks and they confirm each other's credits



Confirmation through third party confirmation

- As mentioned above the confirmation added after taking some procedures from the advising bank side, the most important that the issuing bank should have a relation with the advising bank who will add the confirmation. in case of non existence of these relations the advising bank requests the issuing bank to instruct one of the advising bank's correspondents (whom may be a common correspondent between the issuing and advising bank) to issue an irrevocable undertaking in which this third party undertake to settle any claims under said l/c in case of negotiation of strictly complied documents with the issuing bank directly ,this third party undertaker will credit the claimed amount to the advising bank without any objection from the issuing bank and regardless any failure that might happened to the issuing bank country or to the issuing bank himself . This undertaking valid only upon negotiations of strictly complied documents.



Classifying letters of credit according to payment methods

- Sight payment
- Deferred payment
- Acceptance payment
- Mixed payment

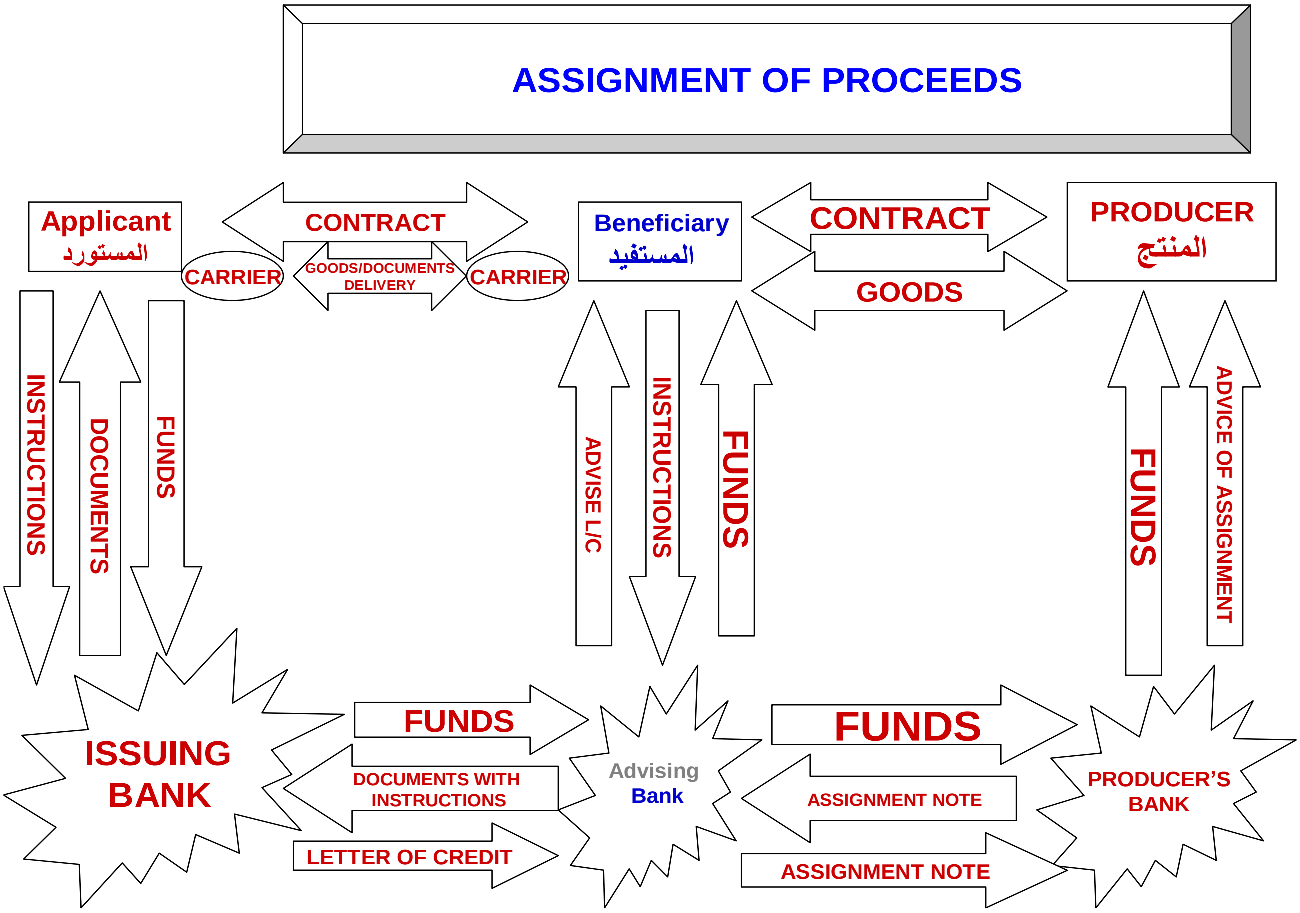
- Sight payment means payment of document's amount upon negotiation at sight in other words upon presenting documents at the counter of the nominated bank he should pay its value as long as it is complied with terms and conditions of the credit.

- Deferred/acceptance payment means that the beneficiary will receive document's amount after a specific period from shipment or from any fixed date. This period called suppliers facilities. In acceptance payment the documents accompanied with bill of exchange (draft) to be accepted by the issuing bank and returned to the beneficiary's bank to be presented at maturity.

- Mixed payment means that the credit may be issued part of it will be paid at sight and the other part paid after a fixed time or part of it in advance and the other is deferred and so on…..

Assignment of proceeds

- Assignment of proceeds has been referred in the last article of UCP (Art.49). the assigning of proceeds is a very common practice from beneficiaries as the producers are not familiar with the use of letters of credits so they prefer to receive an assigning note from the beneficiary's bank stating that from the proceeds of said l/c the amount of the assignment will be paid to them as mentioned in the assignment note it self. Depending on this assignment note the producer deliver the goods to beneficiary who ship it under the credit and deliver the documents to the advising bank who send the documents to issuing bank of the l/c and collect it's value. Upon receiving funds the advising bank first pay the assignment note value then pay the remaining amount to the beneficiary.
- By using this kind of payment tool the producer must be aware of it's risks related as he could not be sure that the beneficiary will ship the goods on the credit which the assignment issued under it more over if the beneficiary ship the goods under this credit the terms and conditions of the credit might be not matched. So it is the responsibility of the producer's only when performing commercial transactions only on the base of an assignment note.



Discounting documents

- It is method of refinancing the international trade practiced by banks, financial institutions and individuals. Discounting in general means buying a debt with a discount (the face value of the debt less interests on a present value basis) and collects this debt in a future date with its face value. The benefits of the buyer represented in the interests collected. So it is important to the buyer that the original debtor should be a well trusted entity. In documentary credits the discounting is practiced depending on the trust in the issuing bank who is the original debtor in documentary credits. So discounted normally happened in the deferred l/cs. the issuing bank issue its deferred l/c after negotiation and acceptance of documents the beneficiary may present the draft that accepted by the issuing bank to be discounted at any entity (the advising bank, the confirming bank, a financial institution or the issuing bank himself in some cases). The discounter must take some procedures to discount the accepted documents these procedures may differ from bank to bank but the common thing in any discounting transaction is that the discounter should have a relation with the debtor and the beneficiary of the discounted documents. In case of nonpayment by the debtor the beneficiary is obligated to pay the unpaid documents.

International Commercial Terms (Incoterms)

- The movement of the goods during its journey from beneficiary premises to the applicant premises includes several costs. These costs must be on either the account of the beneficiary or the applicant. So it must be clear in the sales contract by which it should be paid.
- Consequently it must be reflected in the credit. To avoid any misunderstanding these costs will be translated in a term that specifies the responsibilities and rights of each party.
- The applicable incoterms is incoterms 2010 it includes 11 terms starting by "EXW" ending by "DDP". "EXW" term represents the minimum costs and responsibilities to the beneficiary and the height to the applicant in contrast the "DDU" represents the maximum costs and responsibilities to the beneficiary (exporter) and the minimum to the applicant. It should be clear that using any term will be reflected in the unit price that mentioned in the credit, using the term "EXW" of course the unit price will be the lowest price that the applicant will pay in return of goods agreed (representing the cost of production only) and using the term "DDP" represent the highest price that the applicant will pay in return of goods agreed.
- The applicant must not use the term "EXW unless being sure of his ability to transport the goods from beneficiary's premises to his premises without any objection of any local authority in the exporting country and after calculating of all costs related to the transportation process of the goods and the opposite is applicable to the beneficiary in using the term DDP.
- Some of the incoterms used with specific mode of transportation only like "CFR" it must be used with transportation by sea or in water land.

INCOTERMS 2010

GROUP “E”
EXW (EX-Works …………………………………………... named place)

GROUP “F”
FCA (Free carrier …………………………………….... named place)
FAS (Free alongside ship …………………. named port of shipment)
FOB (Free on board …………………………. named port of shipment)

GROUP “C”
CFR (Cost and Freight …………………... named port of destination)
CPT (Carriage paid to ………………….. named place of destination)
CIF (Cost, Insurance, Freight …………... named port of destination)
CIP (Carriage, Insurance paid to…… name place of destination)

GROUP “D”
DAT (Delivered at terminal ………………… named port of destination)
DAP (Delivered at place ………………….. named place of destination)
DDP (Delivered Duty Paid ……………...named place of destination)

Letters of Guarantee (L/Gs)

Letters of guarantee definition

- The letter of guarantee is a bank undertaking issued by the order of a principal in favor of a beneficiary to pay a specific amount of money upon demand without any objection from the principal in accordance with the letter of guarantee terms and conditions and URDG 458 of the ICC.

- The letter of guarantee kinds
  - Bid bond L/G
  - Advance payment L/G
  - Performance Letter of Guarantee
  - Final Letter of Guarantee
  - Counter Letter of Guarantee

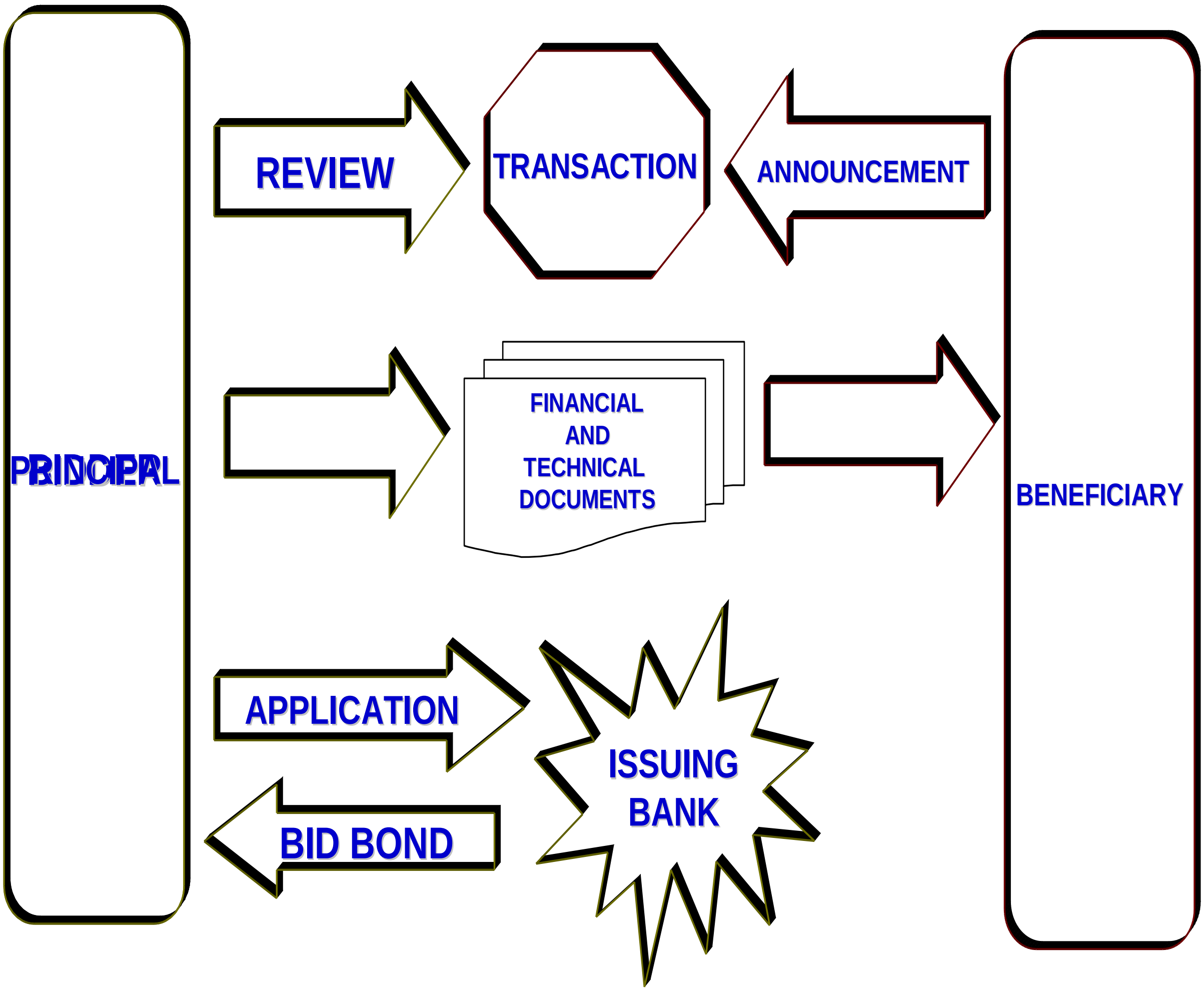
- Parties of the Letter of Guarantee
  - The principal
  - The issuing bank
  - The advising bank (as the case may be)
  - The beneficiary

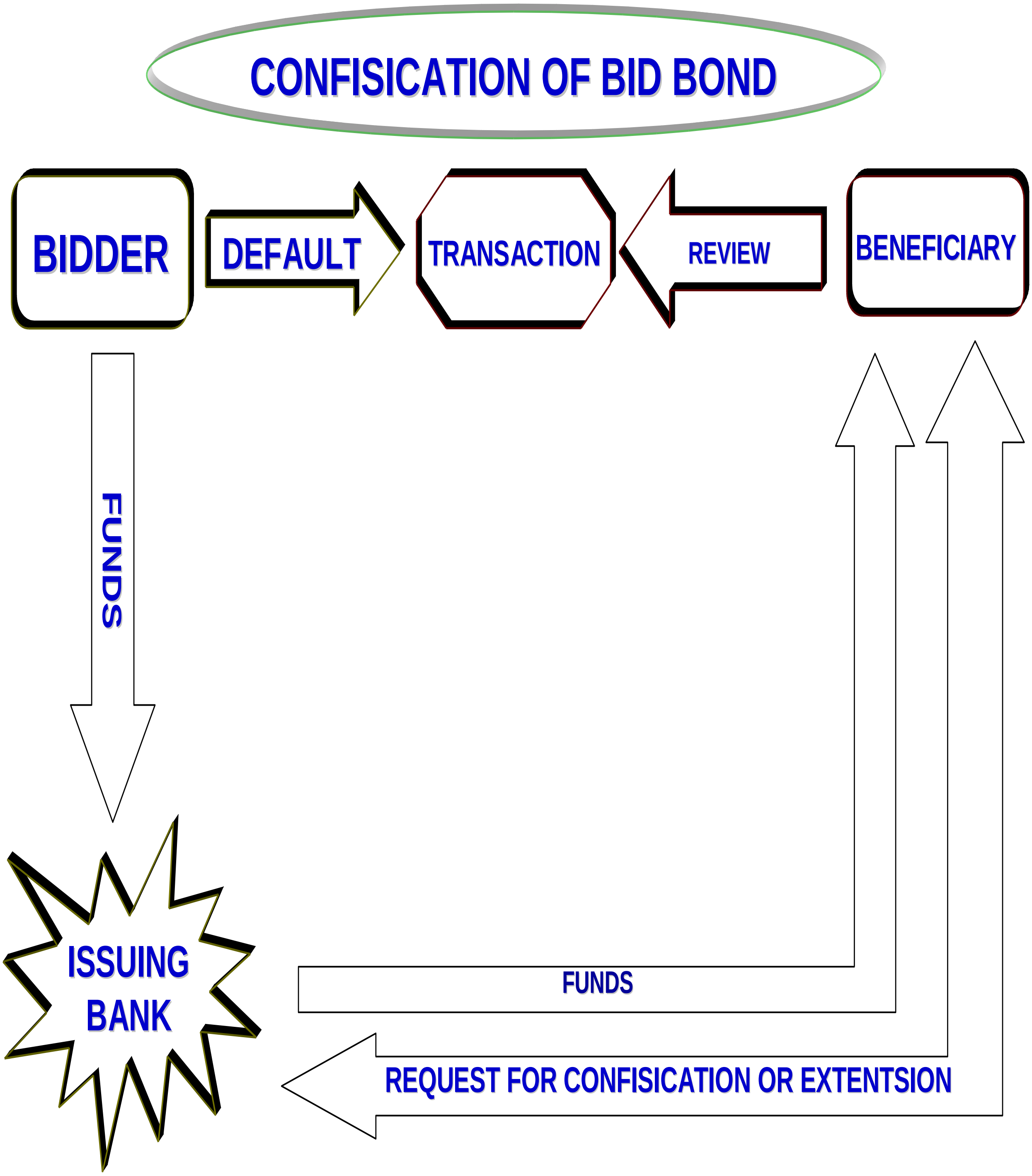
The letter of Guarantee Characteristics

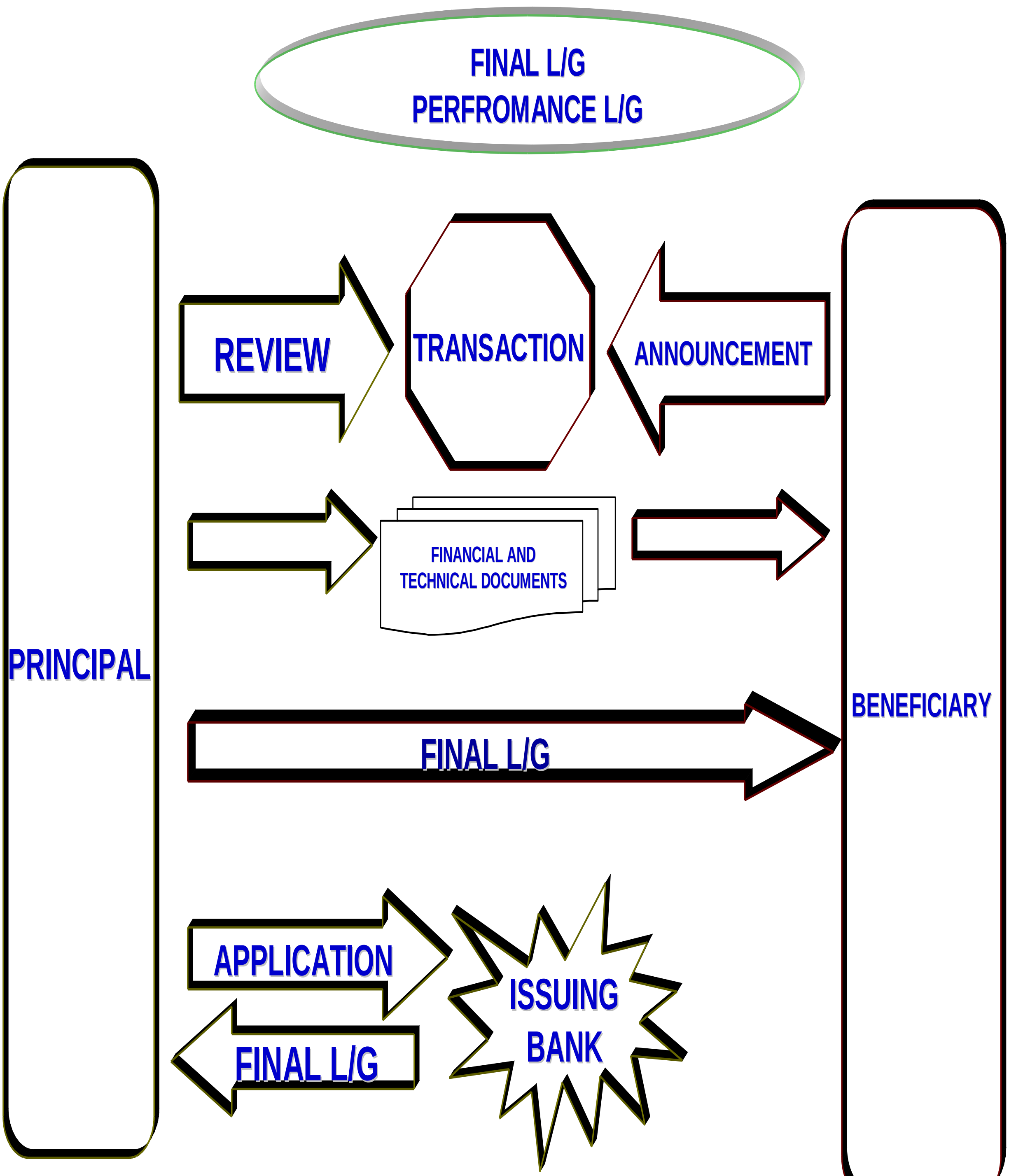
- Independent relationship
- Concerning sum of money
- Cannot be assigned
- Cannot be transferred
- Not negotiable
- It is not a credit tool
- Cannot be blocked

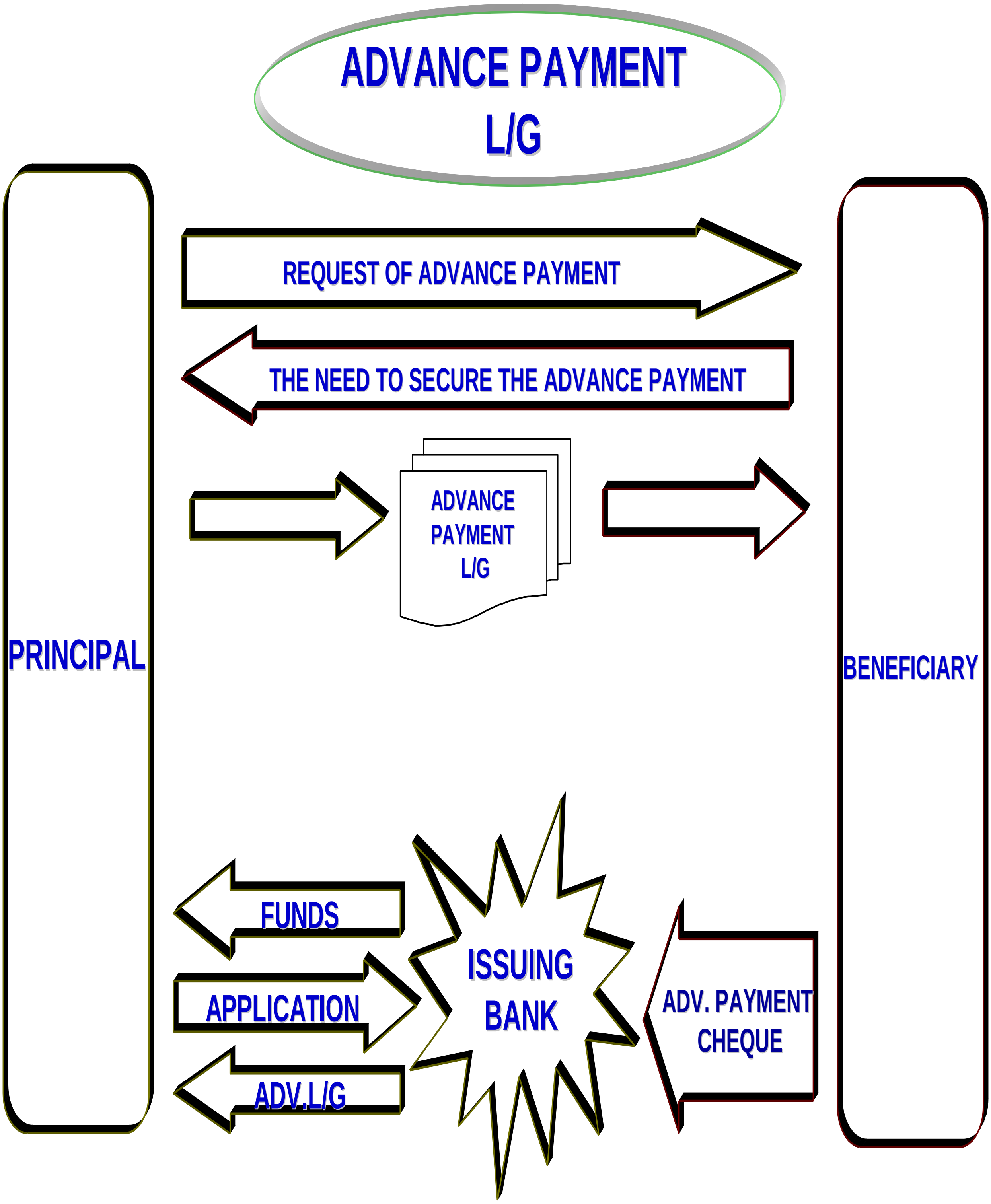
- Letters of Guarantee cover
  - Fully covered.
  - Partially covered using line of facilities.

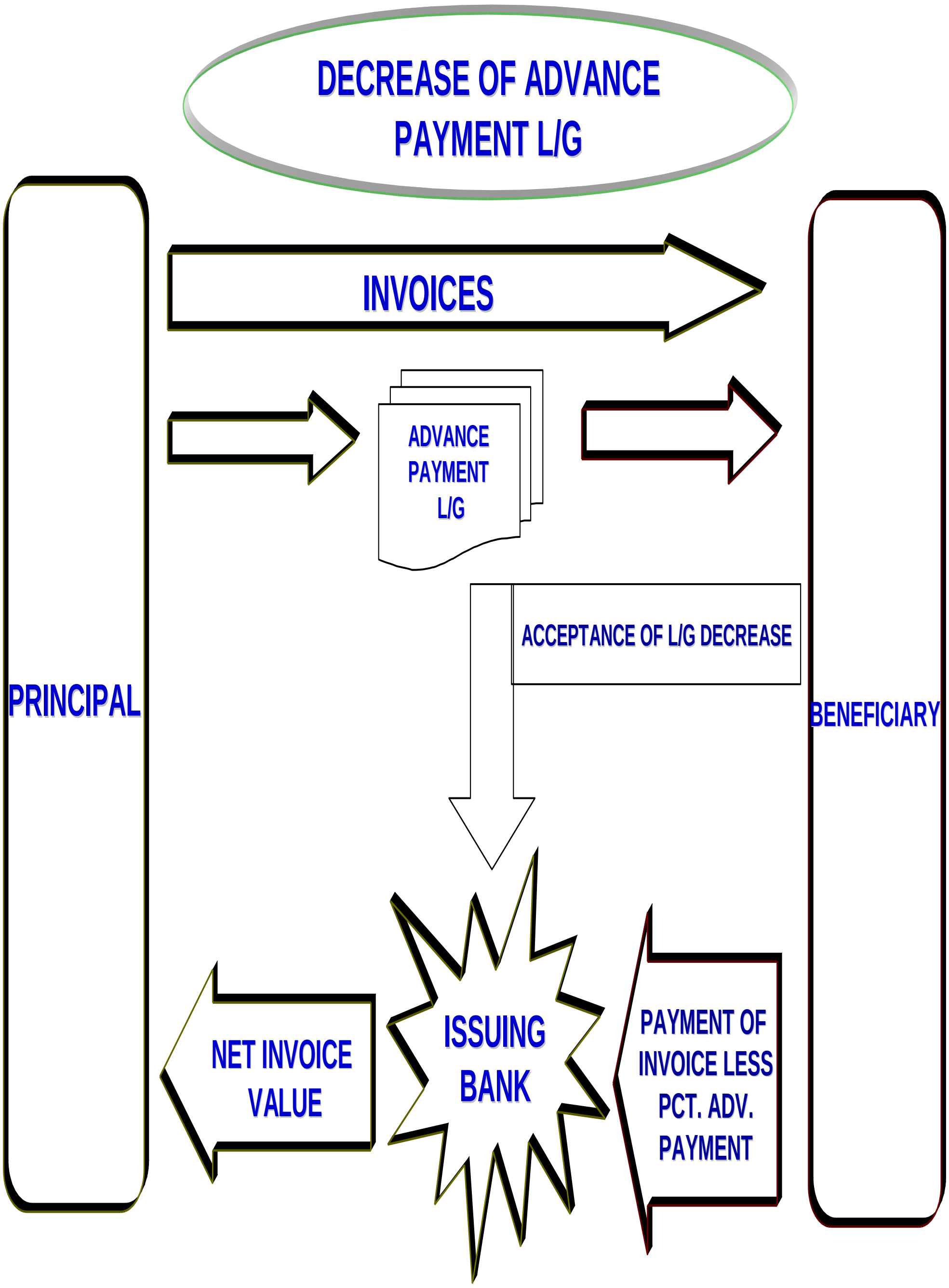
BID BOND LIFE CYCLE




CONFISICATION OF BID BOND
BIDDER
DEFAULT
TRANSACTION
REVIEW
BENEFICIARY
FUNDS
ISSUING BANK
FUNDS
REQUEST FOR CONFISICATION OR EXTENTSION


FINAL L/G
PERFROMANCE L/G
PRINCIPAL
REVIEW
TRANSACTION
ANNOUNCEMENT
FINANCIAL AND
TECHNICAL DOCUMENTS
FINAL L/G
BENEFICIARY
APPLICATION
FINAL L/G
ISSUING
BANK


ADVANCE PAYMENT L/G
PRINCIPAL
REQUEST OF ADVANCE PAYMENT
THE NEED TO SECURE THE ADVANCE PAYMENT
ADVANCE PAYMENT L/G
BENEFICIARY
FUNDS
APPLICATION
ADV.L/G
ISSUING BANK
ADV. PAYMENT CHEQUE


DECREASE OF ADVANCE PAYMENT L/G
INVOICES
ADVANCE PAYMENT L/G
ACCEPTANCE OF L/G DECREASE
PRINCIPAL
BENEFICIARY
ISSUING BANK
NET INVOICE VALUE
PAYMENT OF INVOICE LESS PCT. ADV. PAYMENT

Exercise:

1. What is the ICC publication for letter of credit?

   ……………………….

2. Mention 3 types of the International Payment Tools:

   1………………………..
   2………………………..
   3……………………….

3. Who get advantage from risk point of view when trading using The Open account.

Importer or Exporter

4. When using the Incoterm CIF we mean that the three items coverd are:

   1………………………..
   2………………………..
   3……………………….

5. Mention 4 types of Incoterms other than CIF

7. Who is the applicant of the "Back to Back Letter of credit"? Choose one of the following:

   1. The applicant of the first L/C.
   2. The Beneficiary of the first L/C.
   3. The forwarder of the shipment.

   ……………………..

Summary

In this module, you learned how to:

- Define terms of payments in foreign trade
- Identify the types of letters of guarantee
- List the various foreign trade instruments