

## LETTER OF CREDIT

### **General document notes:**

1. A letter of credit is a contract under which a bank agrees to pay a seller, in connection with the export of specific goods, against the presentation of specified documents relating to those goods. The letter of credit is issued by a bank in favour of the seller (called 'the beneficiary').

The letter of credit incorporates the Uniform Customs and Practice for Documentary Credits (UCP), International Chamber of Commerce (ICC) Publication No. 600.

2. What is the UCP? With the rapid growth of trade over the last sixty years or so, it has become necessary to ensure that the rights and obligations of traders and banks under letters of credit should be capable of being ascertained by reference to a single set of rules, and not the various domestic laws that would otherwise apply. Standardisation of the rules has been achieved by the efforts of the International Chamber of Commerce (ICC) in producing the Uniform Customs and Practice for Documentray Credits (UCP).

3. The UCP can be purchased from the ICC business bookstore, visit the ICC website for more information. The ICC has published ICC Banking Commission Opinions 2009-2011 (ICC Publication No. 732). The opinions give guidance on how ICC rules are interpreted in practice, including the UCP.

Issuing Bank: [NAME OF ISSUING BANK]

Number: [REFERENCE NUMBER]

Date of expiry: [DATE]

Place of expiry: [CITY AND COUNTRY]

Applicant: [NAME OF APPLICANT]

Beneficiary: [NAME OF BENEFICIARY]

Amount: (Maximum) US\$[AMOUNT]

[ISSUE DATE]

Dear [ ... ]

We hereby issue this [irrevocable **OR** revocable] letter of credit in your favour which is available

[by payment against presentation of the following documents:

**OR**

by acceptance of your draft drawn on [NAME OF NOMINATED BANK] bearing the clause "Drawn under documentary credit No. [NUMBER] of [NAME OF ISSUING BANK]" accompanied by the following documents:

**OR**

by negotiation of your draft drawn on [NAME OF ISSUING BANK] bearing the clause "Drawn under documentary credit No. [NUMBER] of [NAME OF ISSUING BANK]" accompanied by the following documents:]

[LIST DOCUMENTS TO BE PRESENTED]

### **Document note: Terms of letter of credit**

The first line specifies whether the letter of credit is revocable or irrevocable. The UCP applies only to irrevocable letters of credit. If the letter of credit is intended to be revocable, it must be expressed as such.

#### **1. The terminology**

### What is an 'Issuing bank'?

The buyer (B) will apply to its bank, the issuing bank, to open a letter of credit in favour of the seller (S). The issuing bank can be in a foreign country, for example Germany, and it may not have a branch in England or in a location which is convenient in relation to the place of shipment. The seller may not want to receive the credit directly from a bank in a different country or even from an English branch of that bank if it is not known to the seller.

### What is an 'Advising bank'?

In these circumstances the issuing bank will normally instruct another bank in England (or other relevant location) to advise company S when the letter of credit has been opened. This bank is the advising bank, as it will usually be the issuing bank's correspondent in the country in question. Once the letter of credit is advised to the seller, a contract arises between it and the issuing bank to pay on presentation of documents in accordance with the terms of the credit. Unless the advising bank is asked to, and does, confirm the credit, it will not undertake any obligation itself to the seller in respect of payment. The sole undertaking in that regard remains that of the issuing bank. However, Article 9 of UCP 600 does provide that the advising bank should satisfy itself as to the apparent authenticity of the credit which it advises and its advice should accurately reflect the terms and conditions of the credit. If it cannot establish such apparent authenticity it must inform the bank from which the instructions appear to have been received without delay, and if it elects nonetheless to advise the credit it must inform the seller that it has not been able to satisfy itself as to the apparent authenticity of the credit.

Fraudulent letters of credit issued or advised by fictitious banks can sometimes occur. The seller should exercise caution and should ask the opinion of its own bank before relying on the letter of credit.

### What is a 'Nominated bank'?

As a rule, the advising bank is also nominated by the issuing bank to be the bank at which the seller may present the documents required by the credit and obtain payment. Any bank that is nominated by the issuing bank for this purpose is according to the UCP a nominated bank. If the letter of credit is subject to the UCP, the issuing bank will be obliged to reimburse the nominated bank upon payment by the nominated bank under the letter of credit in accordance with its terms.

Once the credit has been issued, company S, for example, will ship the goods to Germany and present the documents required by the credit to the nominated bank for payment. The nominated bank will check the documents against the requirements of the letter of credit and if they are in order will pay S and deliver the documents to the issuing bank. The issuing bank will examine the documents and if they are in order will reimburse the nominated bank and deliver the documents to B for reimbursement. Once in possession of the documents, B will then be able to claim the goods from the carrier.

## 2. The options

This letter of credit provides various alternative options for the method of payment to the seller.

- **Option 1 (the simplest option for the seller).** This provides for a sight credit. The seller is paid on presentation of documents that comply with the terms of the letter of credit.
- **Option 2.** This provides for an acceptance credit. The seller will present, with the documents, a bill of exchange (aka 'draft' or 'time bill') drawn by it on the **nominated bank** as drawee. When the documents are found to be in order, the nominated bank will accept the bill and return it to the seller. On acceptance, the nominated bank is committed to pay the bill on its maturity date (which may correspond, for example, to 90 days after presentation of documents or 90 days after shipment).

However the seller does not have to wait until the maturity date. He can obtain immediate cash by discounting the accepted bill with a bank or discount house.

- **Option 3.** This provides for a credit available by negotiation of a time bill. The seller will present, with the documents, a time bill drawn by it on the **issuing bank** as drawee and provide that the letter of credit is available by negotiation at the nominated bank. On presentation of complying documents by the seller to the nominated bank, the nominated bank will purchase the time bill at a discount. The seller therefore receives payment immediately. The nominated bank will send the bill and the other documents to the issuing bank who will pay the nominated bank under the bill on its maturity date. Under the terms of Article 7 (c) of UCP 600, if the nominated bank negotiates a bill drawn on the issuing bank against documents which appear on their face to be in compliance with the terms of the letter of credit, then the issuing bank will be obliged to accept (that is, pay on its maturity date) the bill.

→ With all of these options, the letter of credit must specify the documents which the seller is required to present.

We hereby undertake that payment, by the method specified by this letter of credit, will be duly made against documents presented in conformity with the terms of this letter of credit.

All amounts due under this agreement from [NAME OF ISSUING BANK] to [NAME OF BENEFICIARY] shall be paid in full without any set-off, counterclaim, deduction or withholding (other than any deduction or withholding of tax as required by law).

#### **Document note: Set-off**

This letter of credit prohibits set-off, to prevent the issuer from setting off a debt owed to it by the beneficiary, under a separate unrelated transaction between them (which permits set-off), against the amount payable by it under the letter of credit.

This letter of credit and any dispute or claim arising out of or in connection with it or its subject matter or formation (including non-contractual disputes or claims) shall be governed by, and construed in accordance with, the law of England and Wales.

Each party irrevocably agrees that the courts of England and Wales shall have exclusive jurisdiction over any dispute or claim arising out of or in connection with this letter of credit or its subject matter or formation (including non-contractual disputes or claims).

Except to the extent it is inconsistent with the express terms of this letter of credit, this letter of credit is subject to the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600.

Yours faithfully [NAME OF ISSUING BANK]