

Letter of Credits :- A Buyer's perspective

Presentation by :

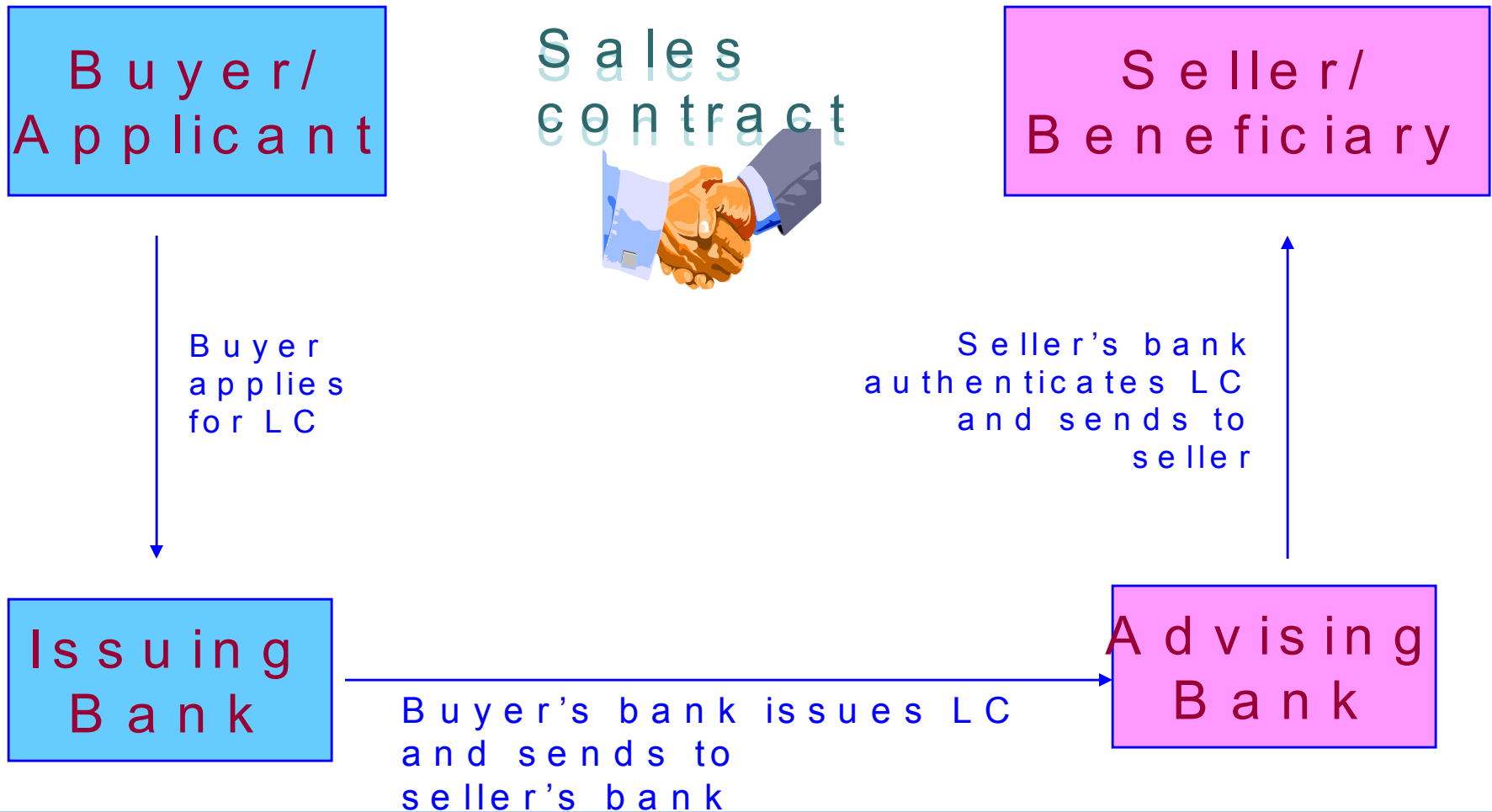
R D S O in collaboration with S B I and I R C O N

INTRODUCTION

- WHAT IS LETTER OF CREDIT (LC)

- Letter of Credit (Documentary Credit) is a conditional undertaking given by a Bank (the issuing Bank), at the request of a Buyer, to effect settlement to a Seller against presentation of Documents.

LC Parties - LC Issuance



NEED FOR LC

- **In International Business , Merchants are domiciled in different countries.**
- **Conflicting issues between them are:-**
 - Seller wants Advance payment of goods.
 - Buyer wants goods before payment.

Need for LC (Contd)

- Therefore banks step into the shoes of Buyer and Seller to complete the transaction
- This way both Buyer and Seller are secure.

Parties to an LC

- Applicant (Importer/Buyer)
- Applicant's/Issuing Bank
- Advising Bank (Seller's Bank)
- Beneficiary (Seller/Exporter)
- Confirming Bank (Optional) :-
Where another bank steps into the shoes of the applicant's bank for a price

Types of LC - 1

As per degree of security

Revocable LC :- The LC can be revoked by the issuing bank without the beneficiary's consent (Not very Popular)

Irrevocable LC :- After LC is opened the same cannot be cancelled/revoked/amended without the consent of all the banks involved.

Types of LC -2

As per payment terms

Sight LC:- Here the Beneficiary receives payments within 5 banking days from the date of receiving of docs by the Issuing Bank. (unless there are discrepancies).

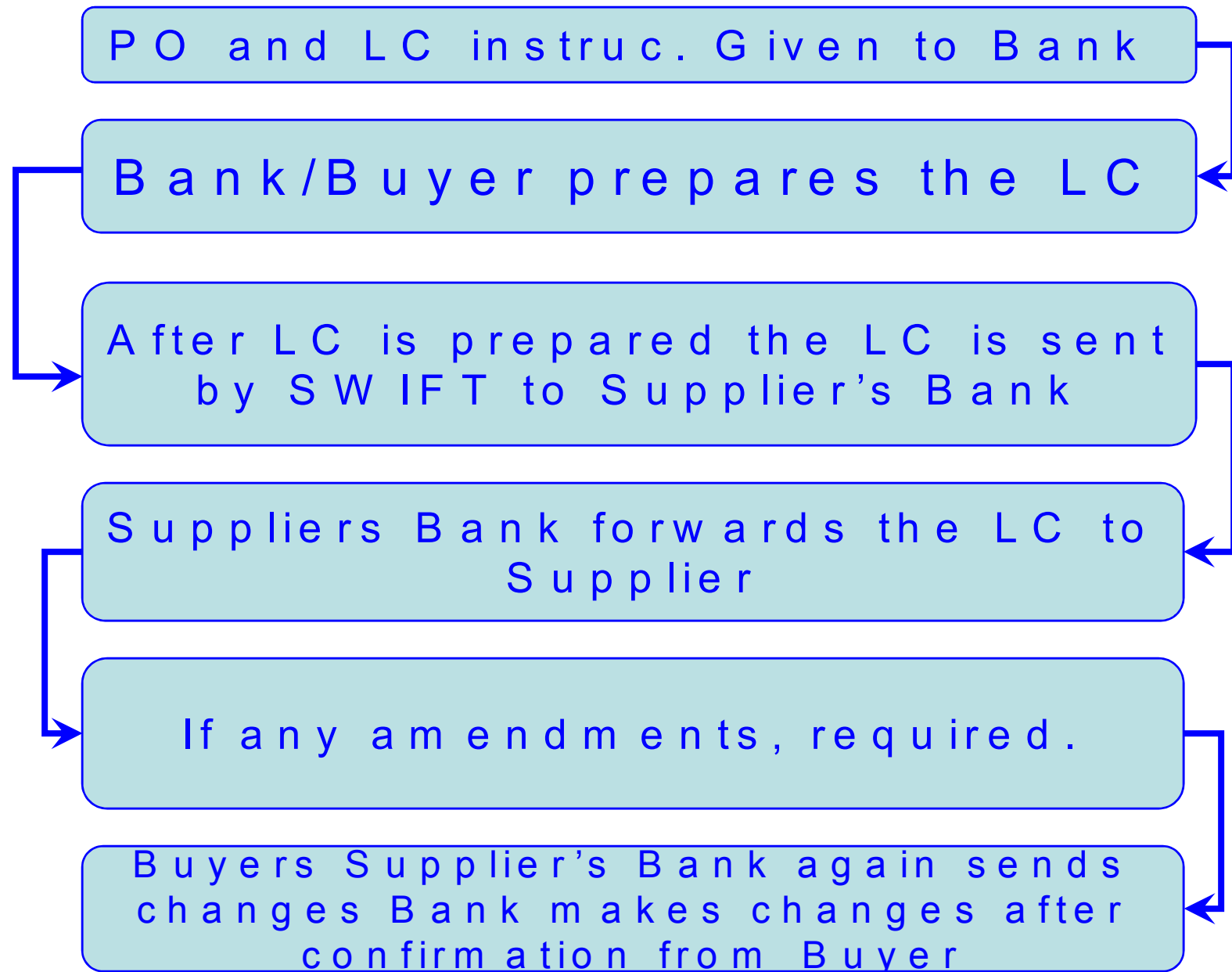
Usance LC:- Payment is made by the issuing bank after certain number of days of shipment/ presentation of documents as per LC terms. (has additional charge).

Deferred payment LC:- similar to usance LC, except here bank has to pay on a certain specified date or after fulfilling of a certain commitment as per LC terms.

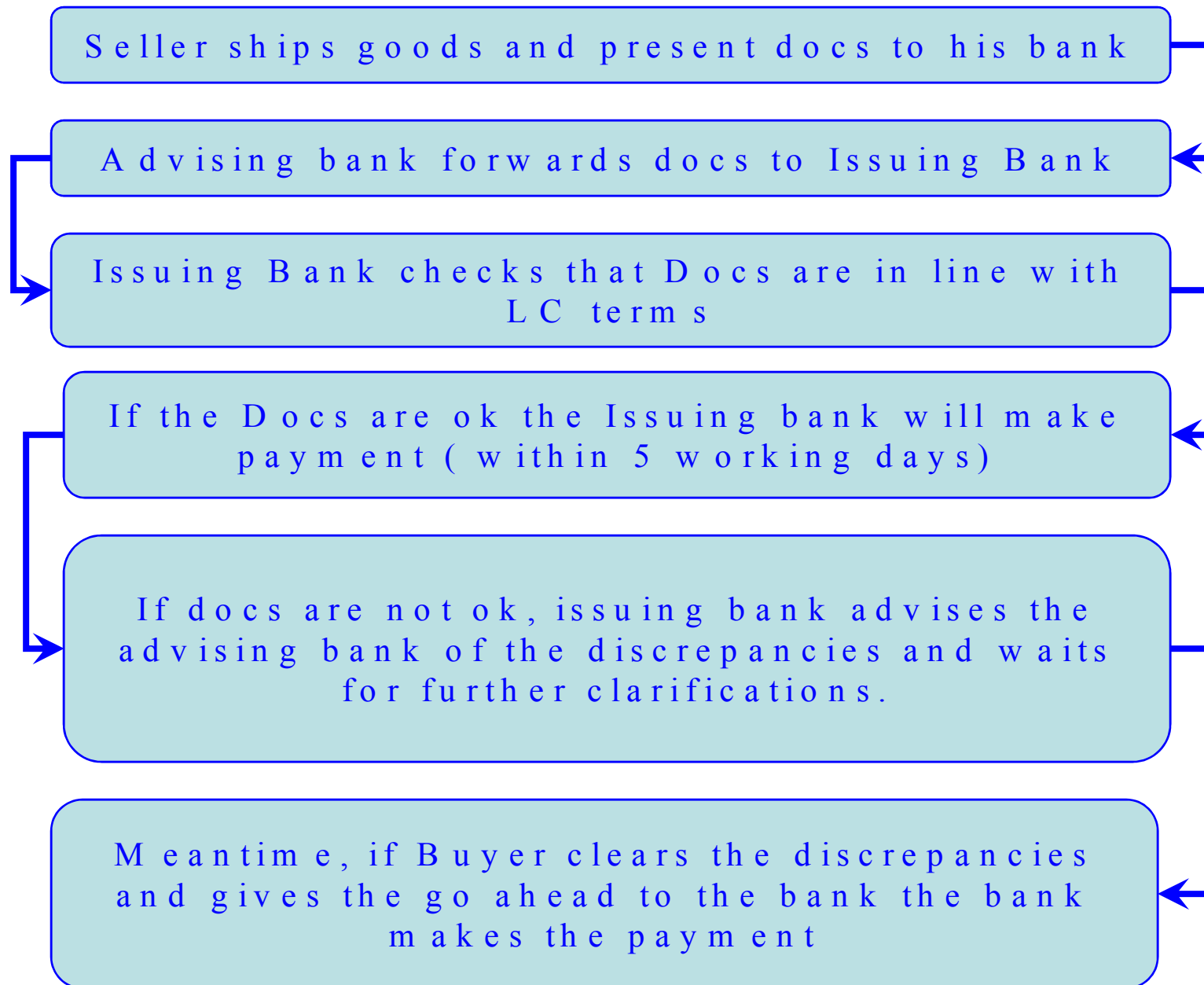
Documents under LC .

- Bill of Exchange :- Instrument in writing giving by the drawer to a drawee (bank) to make payment to certain specified person for a specific amount
- Bill of Lading/Lorry Receipt/rail receipt.
- Insurance Policy
- Commercial invoice
- Packing list
- Certificate of Origin
- Inspection certificate
- Promise of fulfillment of goods (for balance payments)

F L O W o f O P E N I N G O F L C s



F L O W o f R e t i r e m e n t o f D o c s .



Special checks to counter “over intelligent sellers”

- Try to inbuilt as many clauses of the LC to the Purchase order such as:-
 - Last date of shipment
 - Partial shipment allowed or not
 - Port of dispatch
 - Confirmed LC or not

Special emphasis on INCOTERMS

- What is INCOTERMS :-
 - They are standard trade terms defined by the international chamber of commerce used in international sales contracts.
 - There are 13 types of Incoterms. :-
 - EXW (Ex Works)
 - FCA -Free carrier
 - FAS (Free alongside ship)
 - FOB (Free on Board)
 - CFR (Cost and Freight)

Inco terms contd.

- C I F :- C o s t i n s u r a n c e a n d f r e i g h t
- C P T :- c a r r i a g e p a i d t o
- C I P :- c a r r i a g e a n d i n s u r a n c e p a i d t o
- D A F :- D e l i v e r e d a t f r o n t i e r
- D E S :- D e l i v e r e d E x s h i p
- D E Q :- D e l i v e r e d E x Q u a y
- D D U :- D e l i v e r e d d u t y u n p a i d
- D D P :- D e l i v e r e d d u t y p a i d

M o s t c o m m o n l y u s e d I N C O T E R M S

- C I F :- T h e p r i c e i s i n c l u s i v e o f C o s t
i n s u r a n c e a n d F r e i g h t
- F O B :- P r i c e i s “ F r e e o n B o a r d ” :-
W h i c h m e a n s t h a t t h e B u y e r h a s t o
p a y f o r t h e i n s u r a n c e a n d f r e i g h t .
(T o b e a v o i d e d)
- C F R :- C a r r i a g e a n d F r e i g h t o n l y :-
T h e b u y e r w i l l h a v e t o b e a r t h e
I n s u r a n c e

Special Tips and “Masala” to reduce cost

- Try to put in as many clauses of the LC into the Purchase order:- E..g
 - Transshipment
 - Partial shipment
 - Port of shipment/Port of destination
- Who will bear the LC charges should be spelt out in the Purchase order (preferably Seller)
- Above points will help in avoiding amendment of the LC at a later date and amendment charges

C o n f i r m a t i o n o f L C

- C o n f i r m a t i o n o f L C i s d e f i n e d a s w h e n t h e g u a r a n t e e o f t h e p a y m e n t i s m a d e b y a d i f f e r e n t b a n k i n s t e a d o f t h e i s s u i n g b a n k
- A d d e d c o s t o f a p p r o x 1 - 2 % .
- S e l l e r s s h o u l d b e t o l d t h a t s i n c e w e (R D S O) i s o p e n i n g L C t h r o u g h r e p u t e d i n t e r n a t i o n a l b a n k c o n f i r m a t i o n n o t r e q u i r e d
- I f S e l l e r s t i l l i n s i s t s t h e c h a r g e s s h o u l d b e t o t h e i r a c c o u n t

Dealing with Banks

- Set up non fund limits with banks
- Negotiate with banks before opening LC to avoid any ambiguities regarding bank charges
- Banks normally charge per quarter. However they can be per annum on proportionate basis also.
- No extra charges for amendment/extension within the quarter

F u r t h e r F i n e T u n i n g

- T r y n o t t o o p e n L C f o r t h e w h o l e t e n u r e a t o n e t i m e .
- T r y t o k e e p L C v a l i d i t y w i t h i n q u a r t e r s .
- I f t h e r e a r e p a r t s h i p m e n t s , o p e n d i f f e r e n t L C s p e r s h i p m e n t . T h i s w i l l a l s o r e d u c e c o s t .

C o n c l u s i o n

- L e t t e r o f C r e d i t s a r e i n v o g u e i n i n t e r n a t i o n a l t r a d e f o r m o r e t h a n 1 0 0 y e a r s a n d i s t h e m o s t p o p u l a r a n d r e c o g n i s e d m e a n s o f i n t e r n a t i o n a l t r a d e .
- T r y t o k e e p a c r i s p a n d l e s s c o m p l i c a t e d P u r c h a s e o r d e r s o t h a t t h e L C c l a u s e s a r e a l s o c r i s p . T h i s w a y t h e b u y e r , s e l l e r a n d t h e b a n k s a r e a l l h a p p y