

Documentary Credit (Letter of Credit)

Do you know how to avoid the commercial and political risk associated with your counterpart? If not, the solution is the Documentary Credit

Introduction

A Documentary Credit, also known as a Letter of Credit, is a form of conditional payment. At the request of the Buyer, the Buyer's bank (Issuing bank) issues a Documentary Credit in favor of the Seller. If the Seller presents the documents stated in the Documentary Credit, which complies with the Credit's terms and conditions and International Chamber of Commerce (ICC) rules for Documentary Credits, the Buyer's bank is obliged to pay the seller at sight or on a fixed day in the future.

How does it work for the Buyer and Seller

When a Buyer and Seller have signed a sales contract including payment by a Documentary Credit, the Buyer contacts his/her bank and applies for a Documentary Credit to be opened in favor of the Seller.

Upon receipt of the application, the Buyer's bank performs a credit analysis of the Buyer. This is an assessment of the risk the bank is assuming by Issuing the Documentary Credit. The element of risk is equal to a loan or credit limit.

A Documentary Credit guarantees the Seller payment against presentation

of documents in accordance with the terms and conditions of the Documentary Credit and ICC rules. By opening the Documentary Credit, the bank assumes an independent payment obligation, which is separate from the sale or other contracts on which it may be based. Banks only deal with documents and not with the goods, services or performances to which the documents may relate.

A Seller who is not prepared to assume the risk on the Buyer's bank should ask for a confirmation from his/her bank. The confirming bank will pay the Seller, provided the documents presented are in compliance with the Documentary Credit terms and ICC rules, even if the Buyer's bank is unable to fulfill its obligations.



The Seller should ask for a documentary Credit when:

- The counterpart is unknown or financially weak.
- The goods are specially designed or seasonal.
- The importing country is politically or financially unstable.

Advantages:

For the Seller:

- Secure and fast payment.
- Documentary Credits enable business with emerging markets.
- Documentary Credits are governed by international rules.
- Improved cash management

For the Buyer

- The Buyer can control the delivery time of the goods.
- Advance payment can be avoided.
- Documentary Credits are governed by international rules
- Documentary Credits offer Buyers reasonable security that the Seller has fulfilled his/her part of the agreement.
- Improved cash management if advance payment is avoided.

We can also help with the confirmation, discounting and pre-checking of documents.

International rules

The international Chamber of Commerce, ICC, Uniform Customs and Practice for Documentary Credits, 2007 Revision. Publ. No 600 (UCP 600).

Information

For more information, please contact your local Trade Finance Customer Support.