

BILL OF EXCHANGE

The principal financial instrument of payment in documentary collection is the **Bill of Exchange**, also referred to as the draft or the bill.

The bill of exchange is an unconditional order in writing, signed and addressed by the Drawer (normally the exporter) to the Drawee (the importer or the Collecting Bank), requiring the Drawee to pay the Drawer a certain sum of money at sight or at a fixed or determinable future time.

DOCUMENTARY CREDITS

In this unit you will become familiar with the parties, obligations and key terminology used in **Documentary Credit** operations as well as learn about the key checklists to take into account when preparing documents for presentation under Documentary Credits.

A **documentary credit** is an agreement under which a bank acting at the request and on instructions of the importer makes an undertaking to effect payment to the exporter against presentation of the required documents within the specified period of time, provided that the documents strictly comply with the terms and conditions stipulated in the credit. Letters of credit are more favourable for exporters rather than importers, as they are aimed at protecting the exporter.

Documentary credits or letters of credit are bank conditional undertakings to make payment against the presentation of certain stipulated documents. They are widely and increasingly used, as barriers to world trade are reduced. In fact most purchases from the Far East (Taiwan, Korea, Hong Kong, Japan) are covered by documentary credits. Most exports to the Middle East, Africa and South America would also tend to be covered by documentary credits. Documentary credits are becoming a commonly used payment method for trade with Russia and other CIS countries.

To minimise the difficulties mentioned above, a documentary credit is used. Under a documentary credit the exporter is relying on the standing of a bank rather than the importer to obtain payment. This represents a major boost to international trade as it helps the traders get over the problems of dealing with local law, political instability, trading conditions, etc. Banks through their international connections and correspondent networks will assess the risk on the transaction and underwrite it by either issuing a documentary credit or underwriting the undertaking of the Issuing Bank by adding their confirmation to the Credit.

Other than **payment in advance**, the letter of credit is considered **the most secure method of payment for the exporter and therefore the most expensive for the importer**. The guarantee of payment under an irrevocable letter of credit is a definite

obligation of the Issuing Bank, provided that the exporter presents documents as stipulated in the documentary credit.

The latest revision of the documentary credit rules is presented in ICC publication No. 500 "*Uniform Customs and Practice for Documentary Credits*". The rules contained in this revision came into force on 1 January 1994 and are accepted by virtually every trading country. UCP500 provides the rules under which all letters of credit should be issued and operated. These rules reflect worldwide practice and incorporate operational experience. The rules have been compiled in order to help avoid confusion and the presentation of discrepant documents, thus reducing delays for the importer in receiving his documents and for the exporter in being paid.

Although the terms of UCP are not in themselves legally binding, in the case of a dispute, where a letter of credit was stated to have been issued subject to UCP, a court would take the rules into consideration when determining the contractual position of those involved in the transaction.

The **Beneficiary** is the person in whose favour a letter of credit is issued and who can claim payment from the Issuing Bank or another Nominated Bank, once the Beneficiary has complied with the terms and conditions stipulated in the letter of credit. The Beneficiary is normally the exporter.

The importer is known as the **Applicant**. The Applicant initiates a letter of credit, in that the Applicant applies to his bank to issue a credit in favour of the Beneficiary/exporter. The Applicant undertakes to reimburse his bank for the payments made under the Credit. The Applicant is normally the importer.

The **Issuing Bank** is the bank chosen by the importer; it manages and operates the opening or issuing of a letter of credit. The bank must effect settlement provided the terms and conditions stipulated in the letter of credit are complied with.

The **Advising Bank** is normally the Issuing Bank's correspondent and in most instances is located in the exporter's country. The Advising Bank checks the apparent authenticity of the Credit and advises the Beneficiary by passing on the letter of credit to the Beneficiary.

Paying Bank. This is a bank, usually in the exporter's country, nominated by the Issuing Bank to effect payment at sight or to incur a deferred payment undertaking against the presentation of required documents. It is very convenient for the exporter if the Paying Bank is located in his country. The Advising Bank can be one and the same bank as the Paying Bank.

Negotiating Bank. This bank negotiates a bill of exchange and/or documents presented under a letter of credit by the exporter. Although, the bill of exchange is usually usance or payable at a fixed future date, the exporter obtains payment at sight. In simple terms the Negotiating Bank "gives value" or "purchases the drafts and/or documents".

Accepting Bank. Its functions are similar to those of a Paying Bank, however, in this case the bank undertakes to pay the face amount of a draft (bill of exchange) at a definite maturity date.

Confirming Bank. This bank provides a payment undertaking of the letter of credit separate to that of the Issuing Bank. *One turns to such a bank, if we are unsure as to the solvency of the Issuing Bank or the country in which it operates.* Usually the Confirming Bank is also acting as the Advising Bank. Thus, the letter of credit can be advised and confirmed by the same bank.

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