



LETTER OF CREDIT

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A Letter of Credit (LC) is a document that **guarantees the buyer's payment** to the sellers.

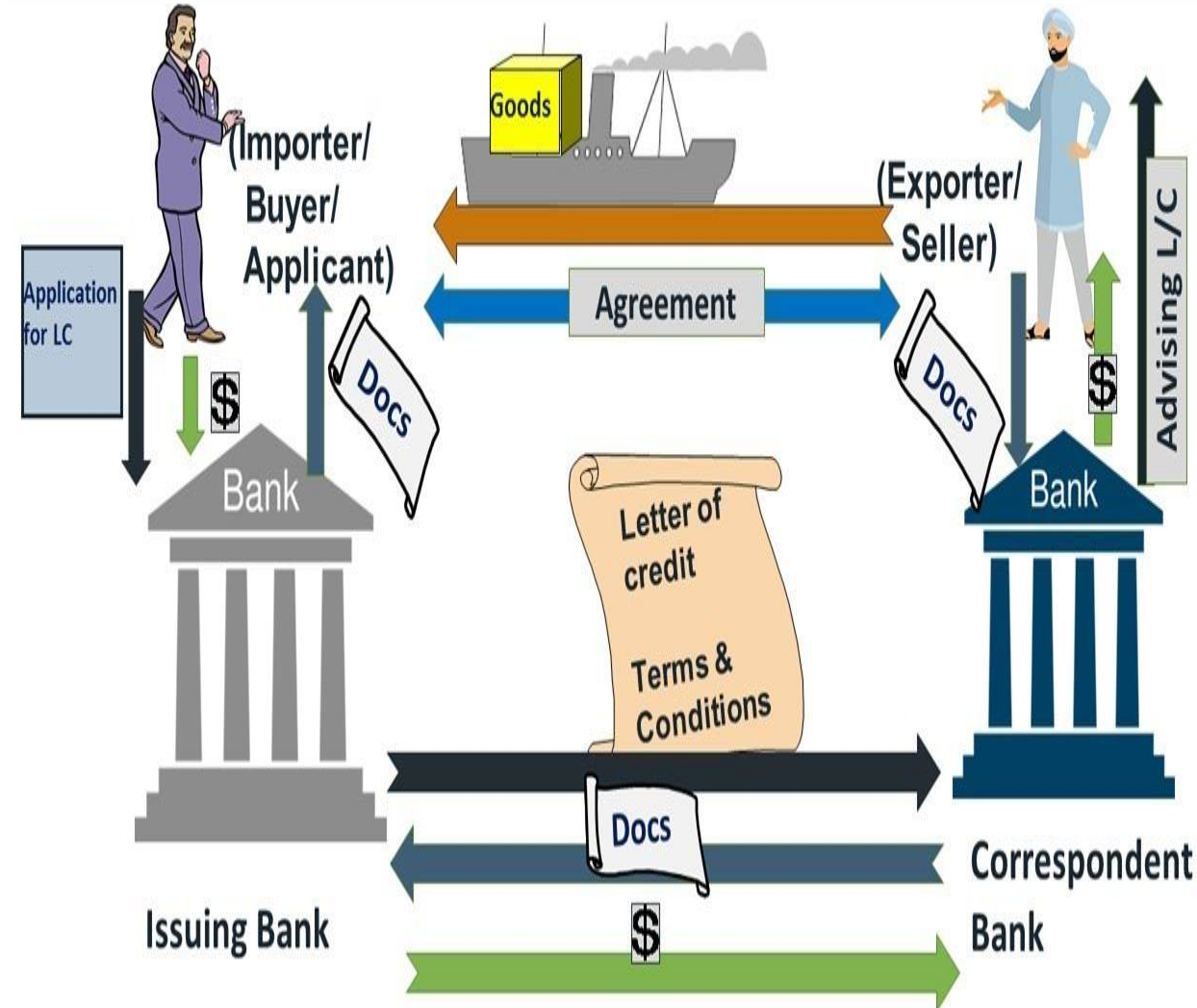
It is issued by a bank and **ensures timely and full payment** to the seller.

If the **buyer is unable to make such a payment**, the **bank covers the full** or the remaining amount on behalf of the buyer.

A letter of credit is **issued against a pledge of securities** or cash.

Banks typically collect **a fee**, i.e., a percentage of the size/amount of the letter of credit.

What is Letter of Credit ?



Buyer/ Importer



Applicant

Requests LC

Payment

Documents



Opening Bank
/ Issuing Bank

LC



Advising Bank

LC

Seller/ Exporter



Beneficiary

Ships Goods

Guarantee



Confirming Bank

Payment

Documents

Payment

Documents



Nominated or
Negotiating Bank

LETTER OF CREDIT - FEATURES

- LC IS ISSUED AGAINST COLLATERAL – Bank Deposit, FD etc.
- Bank Charge a Fees for issuing LC (based on types of LC)
- Guidelines issued by International Chamber of commerce (ICC)

Correctness of LC is very Important.

- Name of Seller, Date, Amount, Product Name, and Quantity and other details – Precise and clear.
- Slight mistake in Lc – Eg: Misspelling of seller's name or Product Name, Shipping Delay – Bank will not pay any money against that LC.
- All parties in Lc deal in Documents and not on Goods and Services
- Payment will not depend on defect in Goods or Quality of Goods and Services

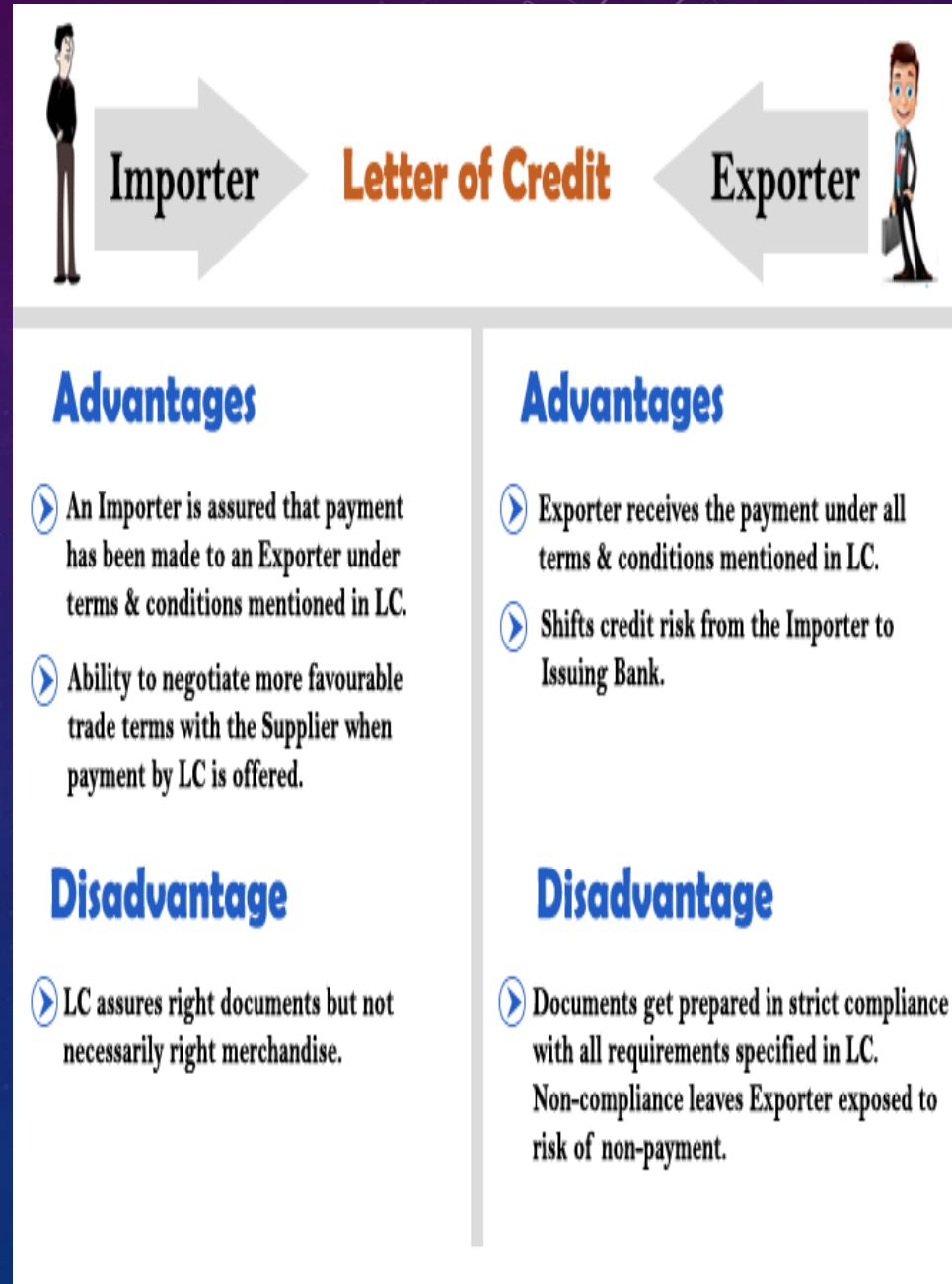
ADVANTAGE & DISADVANTAGE OF LC

FOR SELLER –

1. Protection against **buyers payment default**
2. **Reduced production risk** (in case order is changed or cancelled)

For Buyer –

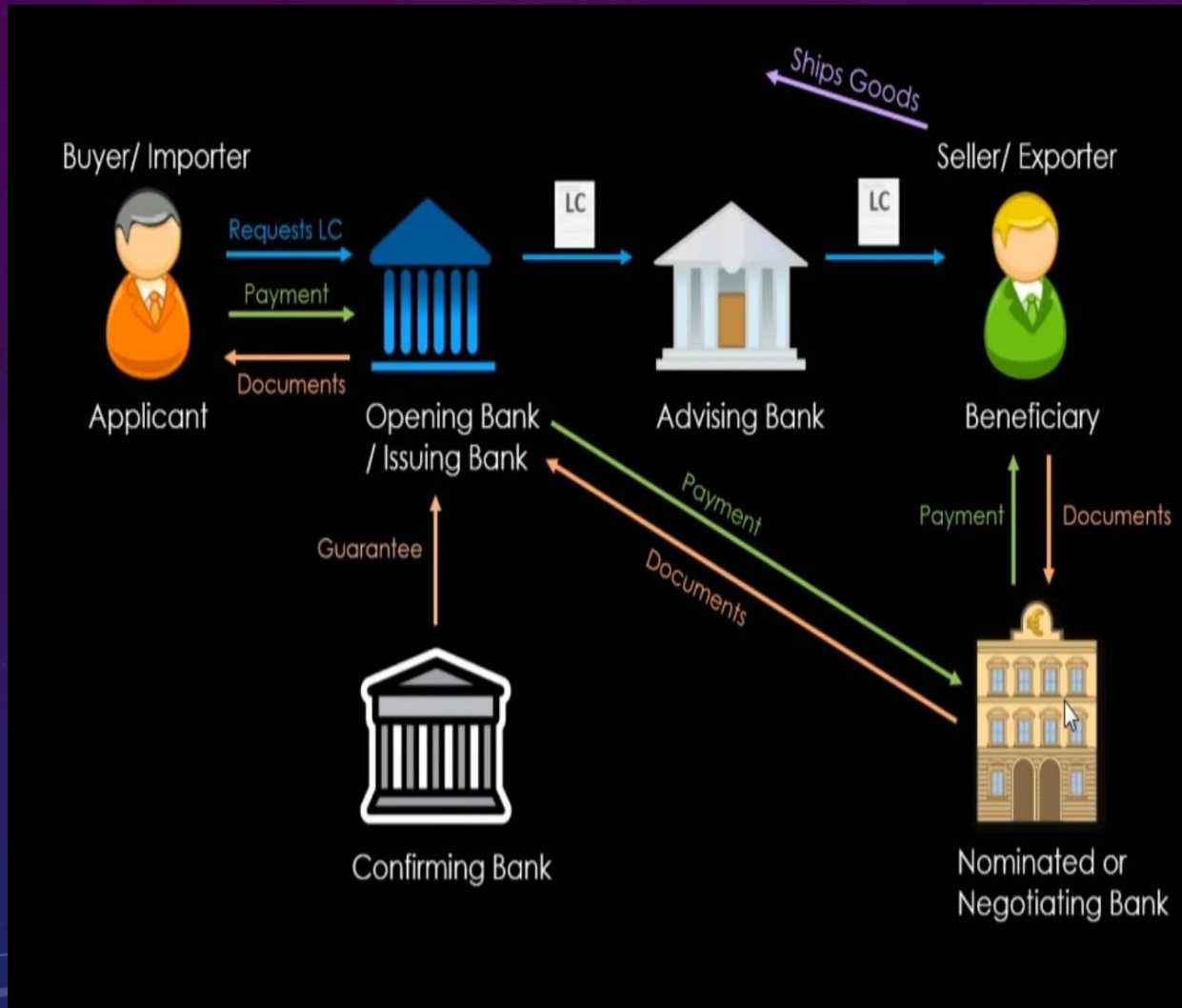
1. **Certainty of Goods** to be received
2. **LC shows solvency for the buyer** and allow the buyer to reduce or eliminate initial payment.



Different Types Of Letters of Credit

- Commercial Letter of Credit
- Export/Import LC
- Transferable & Non-transferable
- Revocable & Irrevocable LC
- Standby Letter Of Credit
- Confirmed & Unconfirmed
- Revolving LC
- Back to Back LC
- Red Clause Bank Credit Letter
- Traveler's Letter of Credit
- Credit on Sight/Sight Credit
- Time Credit/Acceptance Credit

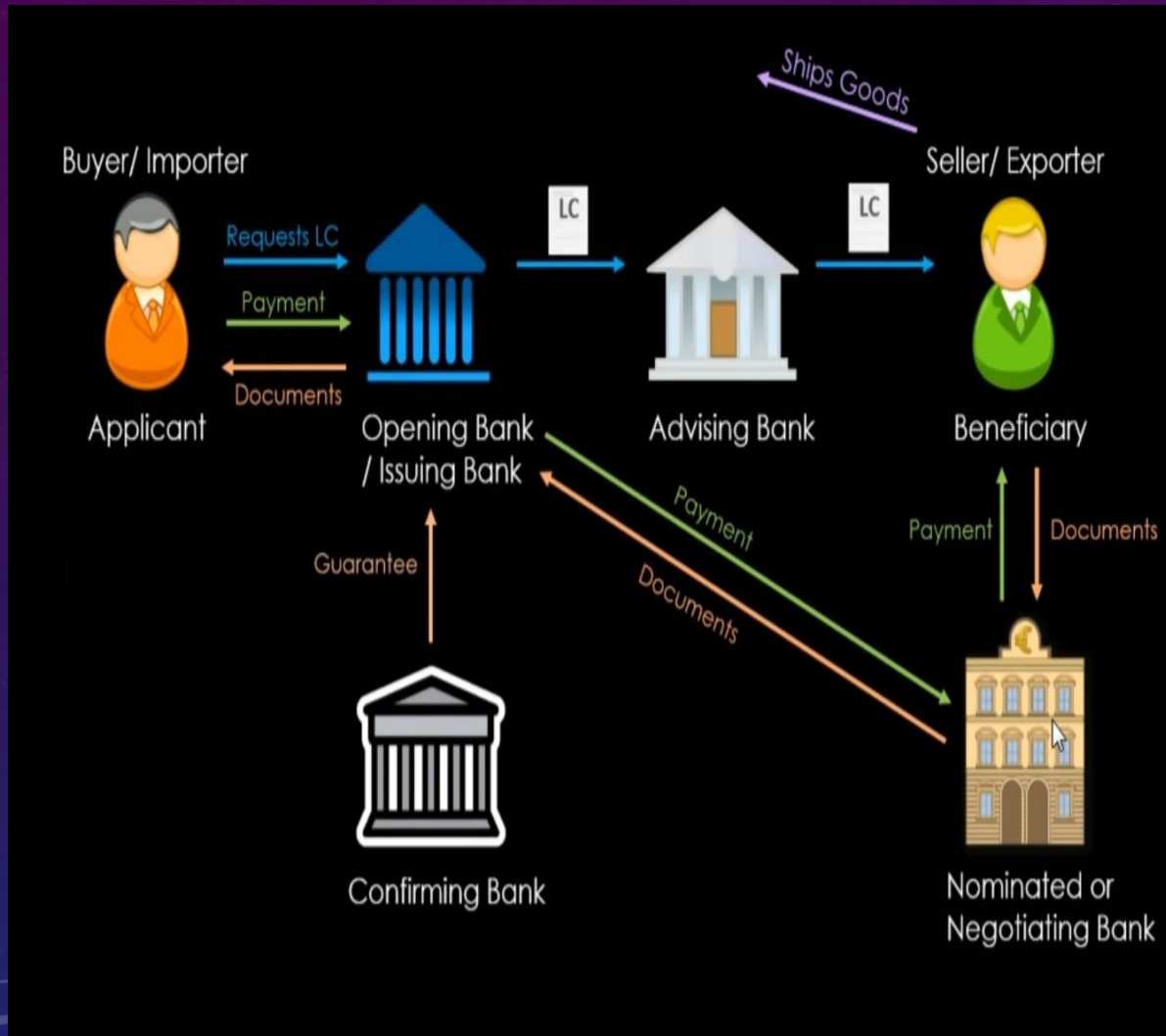
TYPE OF LETTER OF CREDIT



Import/export(Commercial) –

- **Most common** letter of credit in International Trade
- Subject to UCP (**Uniform Customs and practice for Documentary Credit**) by **ICC** (International Chamber of Commerce)
- The same credit can be termed an **import or export letter of credit** depending on whose perspective is considered. For the importer it is termed an Import LC and for the exporter of goods, an Export LC

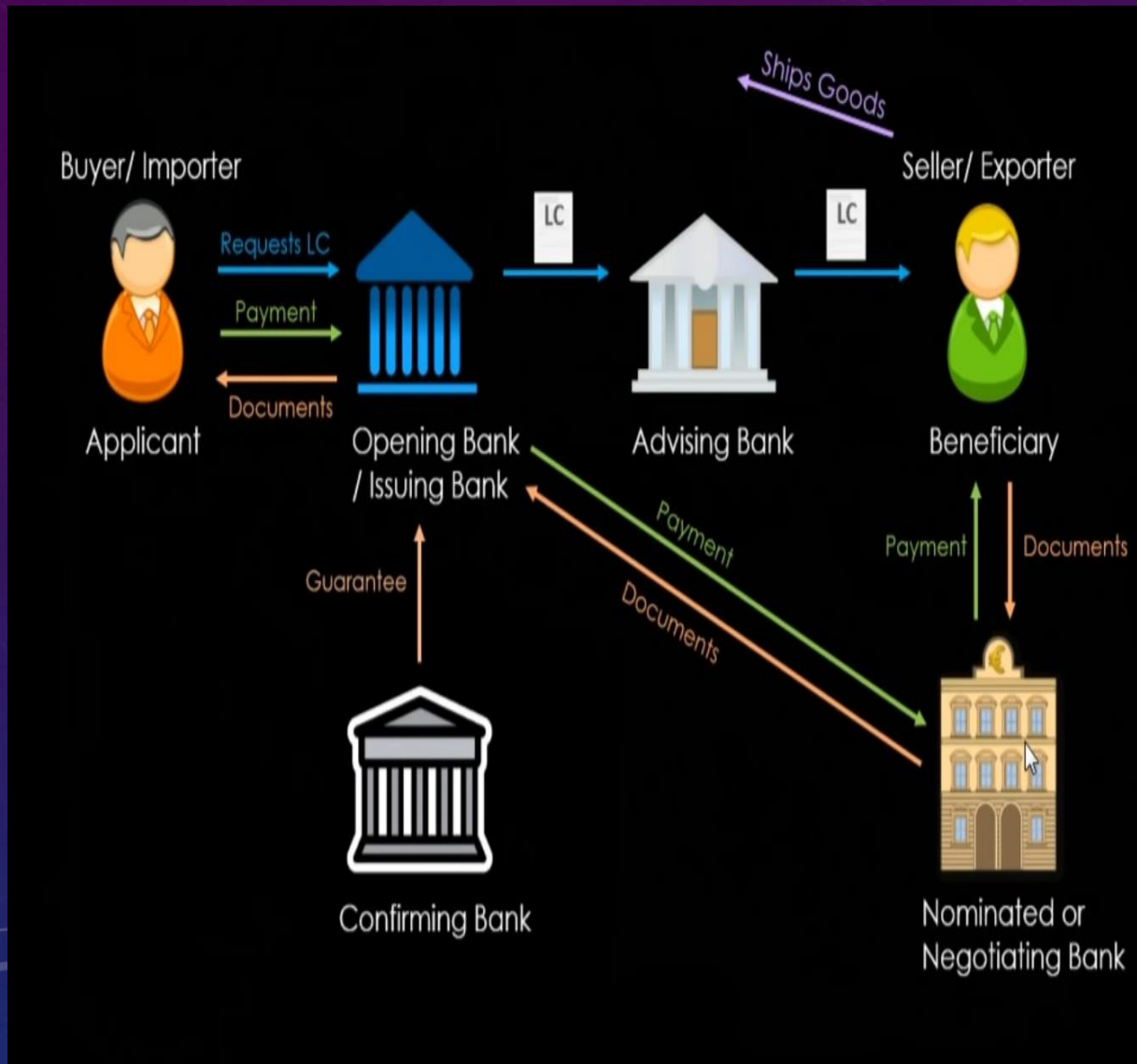
TYPE OF LETTER OF CREDIT



Standby Letter of Credit: (SBLC)

- Beneficiary of a standby LC is paid when there is a **breach of principal's obligation**.
- Eg: If a construction company fails to deliver a project, beneficiary of Standby Lc can apply to Nominated Bank for Payment.
- Governed by International standard practice (ISP) - **ICC**

TYPE OF LETTER OF CREDIT



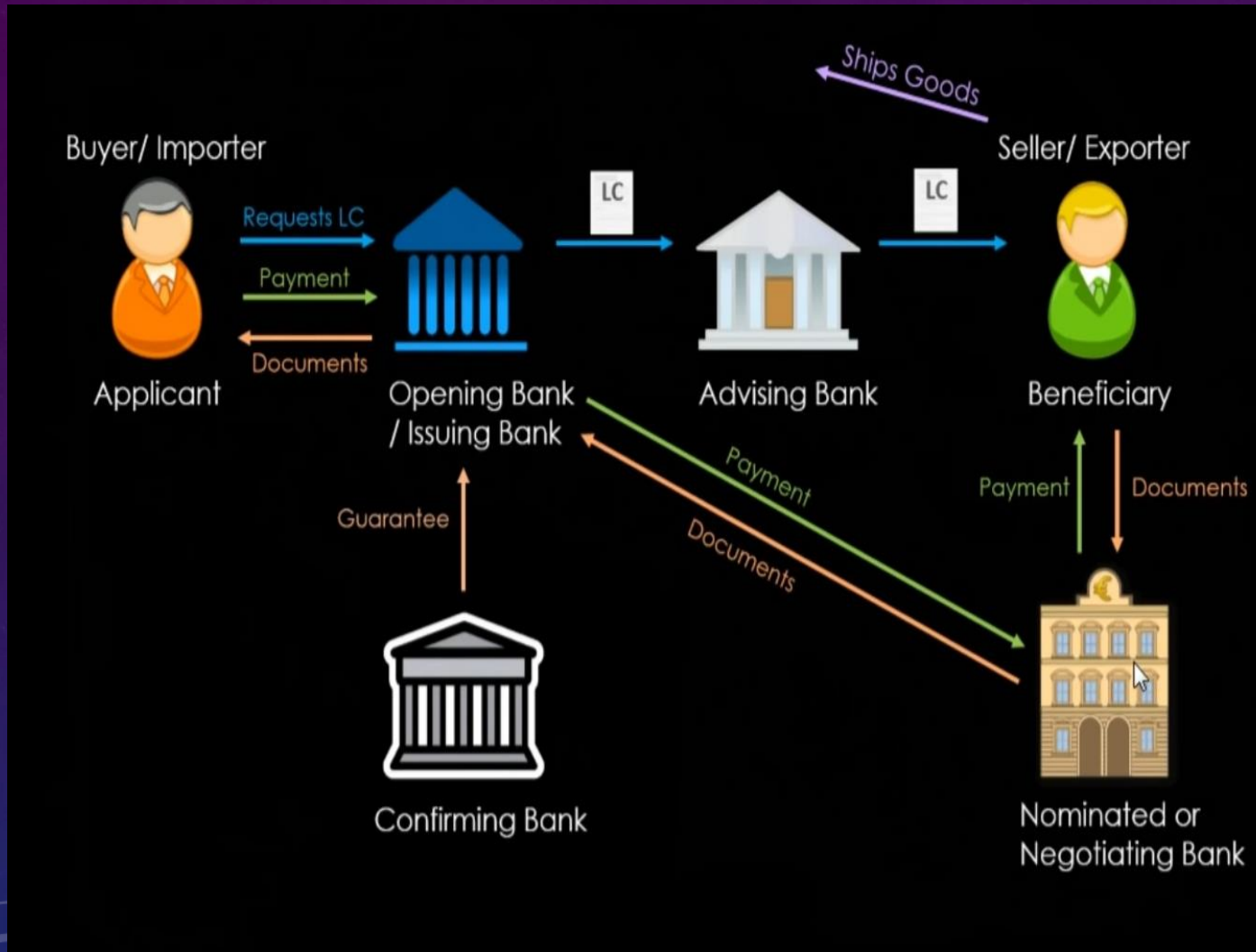
Revocable LC

- Issuing Bank can change or Modify the LC anytime without informing the beneficiary
- Not endorsed by UCP (ICC)
- Since, seller's interest is not protected, not used much

Irrevocable LC

- Cannot be changed or cancelled without the permission of other parties involved in it
- All LCs issued subject to UCP are irrevocable unless otherwise agreed between parties

TYPE OF LETTER OF CREDIT



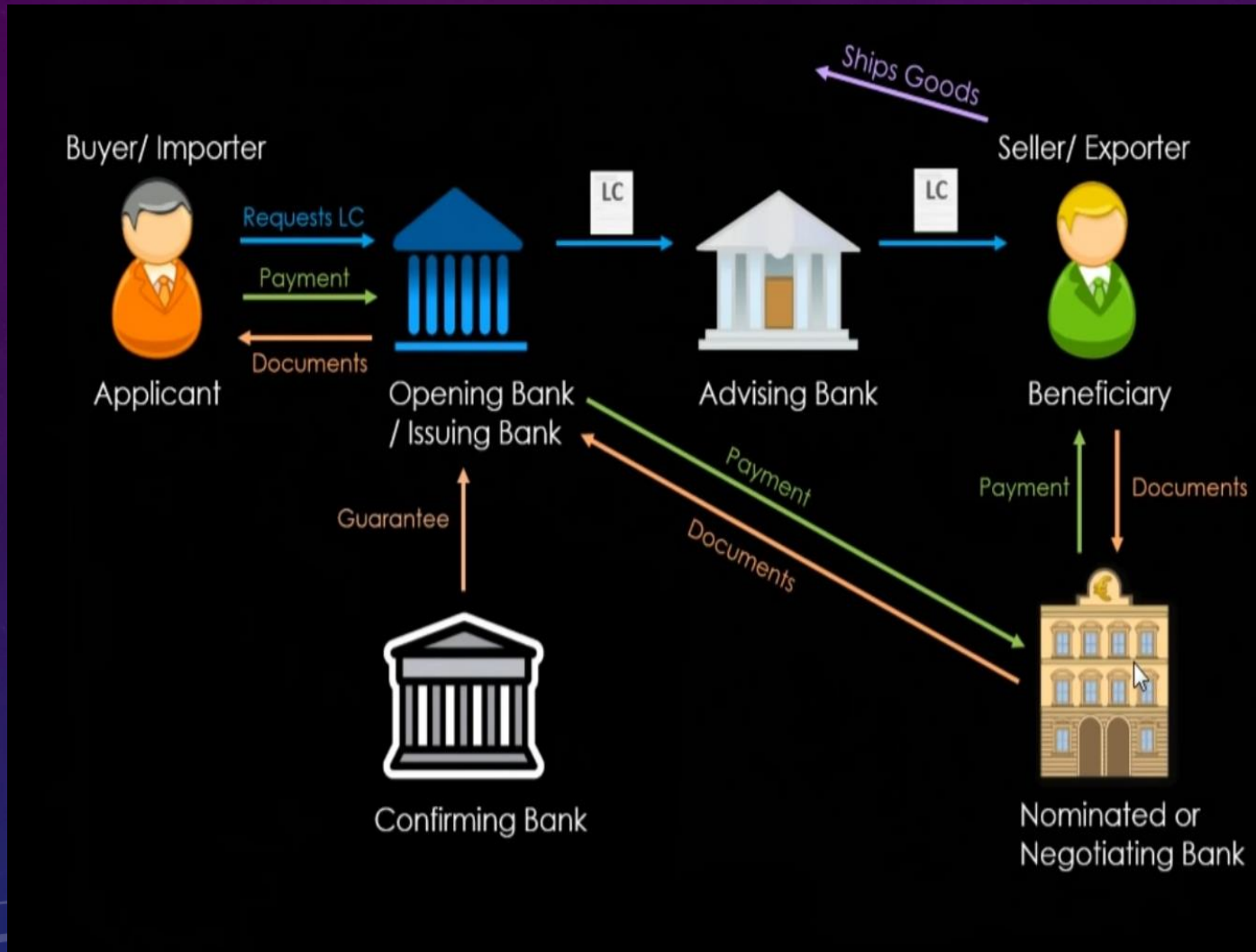
Unconfirmed LC -

- LC that is not guaranteed by any other bank other than issuing Bank

Confirmed LC -

- LC that is guaranteed by a second Bank in addition to issuing Bank
- Only irrevocable LCs can be confirmed

TYPE OF LETTER OF CREDIT



Transferrable LC –

- Enable seller to assign part or whole of LC to other parties

Used when:

- Seller is not sole manufacturer or
- Seller is a subsidiary company of a Holding Company

TYPE OF LETTER OF CREDIT



Back to Back LC:

- Used when seller is a Trader/ Export House
- Seller issues Back to Back LC to his supplier
- Advising Bank or Negotiating Bank of Seller will issue Back to Back LC by keeping Original Lc as collateral.
- Amount of Back to Back LC will be lower than Original Lc and the difference is Trader's profit.

TYPE OF LETTER OF CREDIT

Buyer/ Importer



Seller/ Exporter



Issuing Bank



Nominated Bank

Red Clause LC:

- Provided for **Advanced payment** to seller for Manufacturing, Packing, Dispatching and Shipment of Goods.
- Advance allowed by Nominated Bank of issuing Bank to allow Advance (in “**Red Ink**”)
- Advanced paid against receipt and a written undertaking from seller that he will **deliver the documents** before credit expires.
- **Unsecured Credit**, Credit Risk is there.
- Advanced is adjusted out of the proceeds later by Nominated Bank.

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Issuing Bank



Nominated
Bank

Green Clause LC:

- Provided for **Advanced payment** to seller for **Pre-shipment finance** and **storage at Export Terminal**
- Written in “**Green Ink**”. Usually used in Export of commodities.
- Advanced paid against receipt and a **written undertaking** from seller that he will deliver the documents before credit expires and a **receipt providing proof that the Goods to be shipped have been warehoused.**
- Secured Credit.
- Advanced is adjusted out of the proceeds later by Nominated Bank.

TYPE OF LETTER OF CREDIT



Revolving LC:

- Used when similar transaction will happen over a period of time
- Same one LC (Revolving LC) will be used for all transactions.
- Eg: USD 100,000 worth of wheat to be exported from India to Egypt per month for next 12 months.
- A Revolving LC can stipulate/specify that USD 100,000 can be drawn on monthly basis for 12 Months.

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Issuing Bank



Nominated
Bank

At Sight LC:

- LC that demands payment on submission of required documents.
- Payment is made to the seller if the documents meet conditions of LC, usually within 7 days, by the Nominated Bank

Deferred Payment LC:

- Payment doesn't happen immediately after document verification by Bank
- Bank releases payment only after an agreed time as per LC, Eg: 30 days after shipment date



Thank You!

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