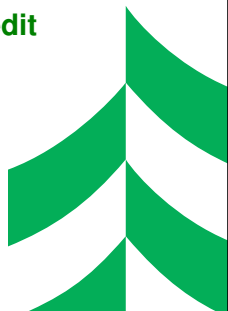


Introduction to Standby Letters of Credit

Paul Eversman, Vice President
Foreign Exchange & Trade Services
Tel: 414-283-2278
paul.eversman@associatedbank.com



WHAT IS A LETTER OF CREDIT?

- A conditional promise to pay
 - Up to a specified amount of money
 - To a specified beneficiary
 - Against presentation of specified documents
 - On or before a specified date
- Can include any conditions the parties and the bank can agree to with a stipulated document required to evidence compliance
- If even one condition is not met, the issuer is not obligated to pay



PARTIES TO A LETTER OF CREDIT

- Applicant
 - The party on whose behalf a payment promise is issued
- Issuer (usually a bank)
 - The party promising to pay on behalf of the Applicant
- Beneficiary
 - The party to whom the payment promise is issued
- Advising bank
 - International LCs should always be issued through a bank in Beneficiary's country for authentication
- Confirming bank (optional)
 - Assumes the foreign bank and country risk, for a fee



CREDIT APPROVAL

Letters of credit :

- Are unfunded extensions of credit
- Are subject to underwriting based on Applicant's finances and collateral
- May be approved separately or reserved against an existing credit line
- Reduce the amount of credit available to the Applicant

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TYPES OF LCS

- Commercial LC
 - Always trade-related
 - Always serves as the payment instrument
 - Always expected to be drawn upon
 - Drawing conditions relatively complicated
- Standby LC
 - Not necessarily trade-related but may be
 - Not usually intended as the payment instrument
 - Not usually expected to be drawn upon
 - Drawing conditions usually quite simple

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APPLICABLE RULES

- Uniform Customs and Practice for Documentary Credits, 2007 Revision (UCP600)
 - Applicable to all letter of credit transactions
- International Standby Practices (ISP98)
 - Omits those parts of UCP that only apply to commercial LCs, e.g., transport documents

Both okay for standbys if differences are understood:

- Force Majeure clause
- Risk of including transport documents under UCP600

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USES FOR STANDBYS

- Typical uses:
 - To secure open account credit obligations
 - To secure loans, IRBs or other indebtedness
 - To secure advance/progress payments from a buyer
 - In lieu of bid, performance or warranty bonds
- Performance vs. Financial Standbys
 - Banks must make the distinction for regulatory purposes
 - What does the Beneficiary want?
 - Specified action by the Applicant? = Performance
 - Payment of money? = Financial

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BENEFICIARY CONCERNS

- Issuing bank
 - Financially sound? Familiar with UCP and ISP?
- Expiration
 - Leave sufficient time to draw
 - Automatic extension better for open account standbys
- Force Majeure
 - ISP is preferable; make exception under UCP
- Transport Document
 - Avoid transport document in open account standbys subject to UCP

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APPLICANT CONCERNS

- Wrongful or arbitrary drawing
 - Build in whatever protections circumstances permit
 - Wrongful drawing insurance may be available in some emerging markets
- Cancellation of back-to-back arrangements

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DRAWING CONDITIONS

- Documentary requirements usually minimal
 - Often just Beneficiary's written statement claiming entitlement to the money
- Risk of discrepancy is usually small if deadlines are not missed
- If conditions are met, issuer **MUST** pay
- In case of wrongful drawing, Applicant may have to sue Beneficiary to recover funds

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PARTS OF A STANDBY

- Issuer's undertaking
- Drawing conditions
- Presentation instructions
- Expiration clause
- Automatic extension clause (optional)
- Applicable rules
- Engagement clause
- Summary clause

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ISSUER'S UNDERTAKING

By order and for account of our client, _____ (the "Applicant"), we (the "Issuing Bank") hereby issue our Irrevocable Standby Letter of Credit No. _____, in favor of (the "Beneficiary") in the amount of USD _____ (_____ and __/100 U.S. Dollars) in connection with _____.

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DRAWING CONDITIONS

Funds are available under this Letter of Credit upon presentation of Beneficiary's sight draft(s) drawn on (the Issuing Bank) accompanied by this original Letter of Credit, any subsequent amendments hereto, and the following:

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PRESENTATION INSTRUCTIONS

Presentation of such draft(s) and document(s) may be made at our office located at _____ (detailed address of Issuing Bank office where documents must be presented).

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EXPIRATION CLAUSE

This Letter of Credit is effective immediately and expires upon the earlier of:

- _____ (Expiration Date); or
- The date on which the amount of this Letter of Credit is reduced to zero by Beneficiary's draws hereunder; or
- The date on which the original Letter of Credit and all subsequent amendments have been returned to us together with irrevocable instructions from the Beneficiary to cancel this Letter of Credit.

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AUTOMATIC EXTENSION CLAUSE

It is a condition of this Letter of Credit that it shall be automatically extended for successive one-year periods from the current or any future Expiration Date, unless at least _____ days prior to any such expiration date we notify Beneficiary in writing by courier or other receipted means at the address indicated above that we elect not to extend it for any such additional period.

Notwithstanding such automatic extension provision, however, this Letter of Credit shall finally expire and become null and void on _____, whether or not the original Letter of Credit is returned to us for cancellation.

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APPLICABLE RULES

Except as otherwise expressly provided herein, this Letter of Credit is subject to the (choose one)

- Uniform Customs and Practice for Documentary Credits (2007 Revision), ICC Publication No. 600 (the 'UCP600').
- International Standby Practices, ICC Publication No. 590 (the 'ISP98').

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ENGAGEMENT CLAUSE

We hereby engage with you that all drawings made under and in compliance with the terms and conditions of this Letter of Credit will be duly honored if presented at our counters as indicated above on or before the expiration date.

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SUMMARY CLAUSE

This Letter of Credit sets forth in full our undertaking, which shall not in any way be modified, amplified or limited by reference to any document, instrument or agreement referred to herein, except only by the (UCP600 or ISP98) referred to herein, and any such reference shall not be deemed to incorporate herein any such document, instrument or agreement.

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SIGHT DRAFT

Date: _____

Re: Irrevocable Standby Letter of Credit No. _____ Dated _____

Pay to the order of _____ ("Beneficiary") the sum of _____ dollars (\$ _____).

Drawn under (Issuing Bank) Letter of Credit No. _____ dated _____.
_____ (Beneficiary)

By: _____
(Beneficiary's Authorized Signer)

Name: _____
Title: _____

[Remember to endorse the draft on the reverse]

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OPEN ACCOUNT DRAWING

Payment is available against presentation of . . . and:

- Beneficiary's written statement certifying that the amount drawn represents funds due under unpaid invoices for goods ordered by and shipped to (Applicant) [and that no aspect of the transaction is disputed by (Applicant)].
- Copy(ies) of relative invoices marked 'Unpaid'.
- **Beneficiaries: Avoid copies of transport documents if LC is subject to UCP600**

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BID BOND DRAWING

Payment is available against presentation of . . . and Beneficiary's written statement certifying as follows:

"With respect to an invitation to bid dated _____ for the supply of _____:

- (Applicant) has withdrawn its bid during the period of bid validity; or
- Despite being notified that it is the successful bidder (Applicant) has failed to:
 - Execute a contract based on the terms and conditions and within the time set forth in the Invitation to Bid, and/or
 - Provide the performance security as required in the Invitation to Bid."

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ADVANCE PAYMENT, PERFORMANCE, WARRANTY DRAWING

Payment is available against presentation of . . . and Beneficiary's written statement certifying as follows:

"(Applicant) has failed to fully comply with the terms and conditions of that certain contract dated _____ between (Applicant) and Beneficiary for the delivery of _____."

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STANDBY FEES

- Applicant
 - Issuance fee is usually a percent per annum calculated like interest, actual/360.
 - Fee rate should in theory be the same as the spread on a loan, but usually 1% to 2%
 - Financial standbys use same capital as a loan
 - Miscellaneous fees: Swift communications, courier, etc.
- Beneficiary
 - Advising fee (and confirming fee, if any)
 - Negotiation/payment fee only if standby is drawn upon

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UCP 600 VS. ISP 98

• Force Majeure

- UCP Art 17: Banks assume no liability or responsibility for . . . Acts of God . . . Unless specifically authorized, banks will not, upon resumption of their business, pay, incur a deferred payment undertaking, accept Draft(s) or negotiate under Credits which expired during such interruption of their business.
- ISP 98 Art. 3.14: If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides

• Transport Document

- Most of UCP deals with transport documents
- Art. 43 says docs must be presented within 21 days of shipment
- Problematic for open account standbys.

• Use ISP for standbys, UCP only for commercial LCs

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ADVANCE PAYMENT PRECONDITION

- Seller requires down payment, Buyer requires standby to secure the funds. Who gives in?
- Make the standby unavailable for drawing until funds are received by the bank. Bank plays the honest broker between the parties.

This Letter of Credit is not available for drawing at this time but will be made available for drawing by amendment upon our receipt of USD _____ wired to us as follows:

Transfer to: Associated Bank, N.A.
2870 Holmgren Way
Green Bay, WI USA

Attention: Trade Services Dept.
ABA No.: 075900575
A/C Number: 369711000XXX
Reference: Standby LC No. _____

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ADVANCE PAY'T, PERFORMANCE, WARRANTY

Applicants should build in any protections the contract provides:

Payment is available against presentation of . . . and the following:

1. Beneficiary's signed and dated statement certifying that:
 - a) Applicant is in default of its obligations under a contract dated _____ between (Applicant) as Supplier and (Beneficiary) as Purchaser for the delivery of _____ (the "Contract").
 - b) The event or events of default and the respective itemized amounts due Beneficiary under the terms of the Contract are as follows: (to be inserted by Beneficiary).
 - c) The written notice of default required under the Contract has been duly given, and the event or events of default continue(s) uncured.
 - d) Beneficiary is not in default of any of its own obligations under the Contract.
 - e) The amount of the draft drawn represents amounts due Beneficiary by virtue of the default by Applicant.
2. Copy of Beneficiary's written notice of default to Applicant.
3. Copy of courier receipt evidencing dispatch of notice of default to Applicant no less than _____ days before the date of Beneficiary's drawing under this Letter of Credit.

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COMMERCIAL LC VS. OPEN ACC'T STANDBY

- Key to commercial LC is main transport document
 - One discrepancy voids issuer's payment obligation
 - Control goods until payment is received/assured
 - Key document usually ocean B/L or air waybill
- **But** – shipping in US (or Canada/Mexico?)
 - No ocean B/L or air waybill
 - Goods go by truck to buyer's door
 - Better to ship open account secured by standby

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STANDBYS VS. BANK GUARANTEES

- Guarantees are more common abroad than standbys
- US banks were prohibited from issuing true guarantees except in very limited circumstances
- Swift MT 760 (Issue of Bank Guarantee) is used for international standbys
- Issuance of back-to-back standby/bank guarantee
 - Local bank guarantee should always be returned to issuer for cancellation
 - Make rep/agent commission dependent on this
- Beware of accepting foreign bank guarantees:
 - Not authenticated by any US bank
 - Not subject to international LC rules

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Q & A

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