Best practices in global trade payments

Advanced standby and guarantee discussion

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Speaker introduction

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Bringing 22 years of experience in International Banking and Global Trade

Discussion roadmap

- World events and global trade risks
- Defining Standby Letters of Credit
- Primary Standby Letter of Credit uses
- How Bank Guarantees work and potential risks
- Other considerations for Standby LCs and Guarantees
- Governing rules
- Transaction roles

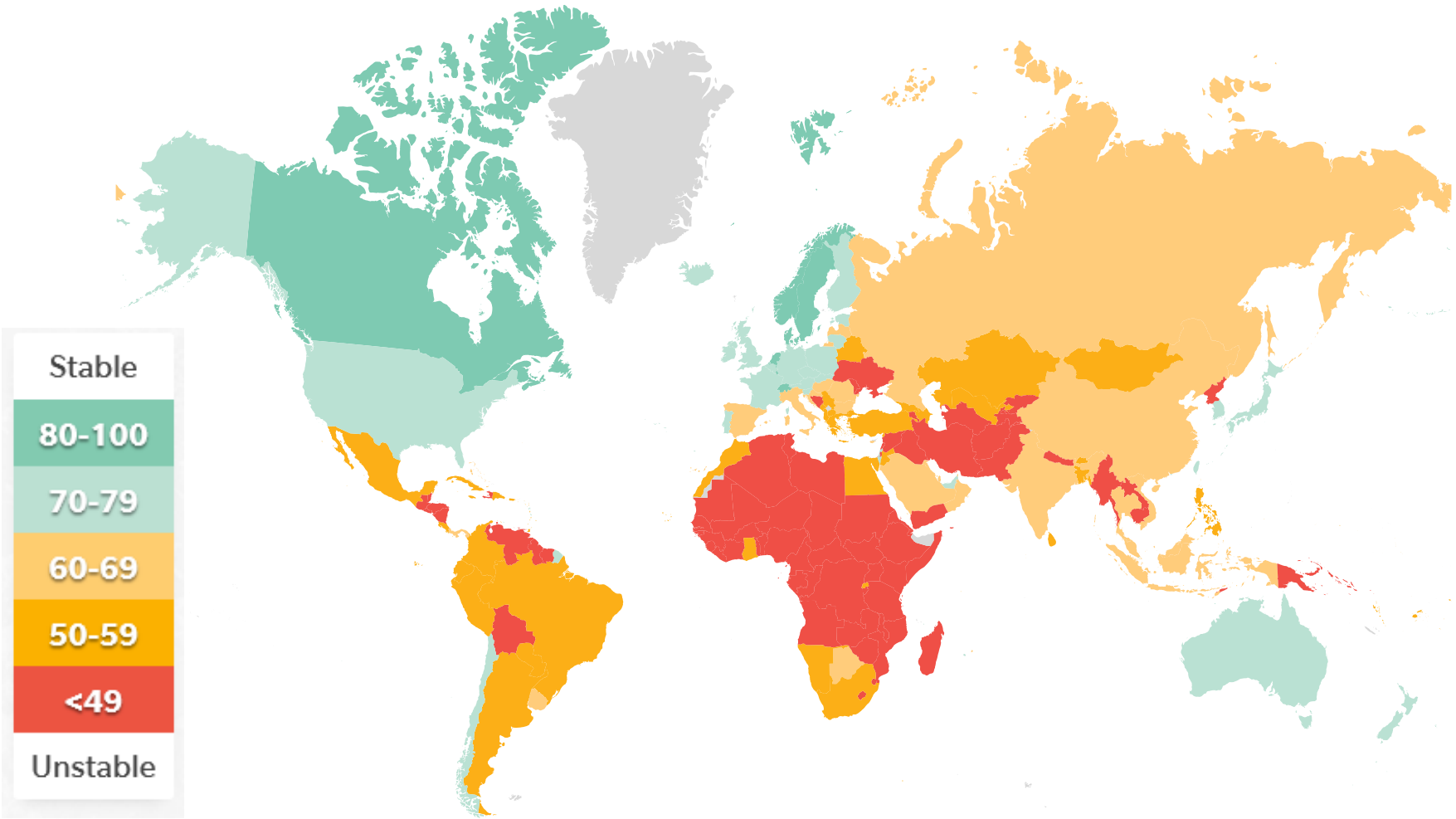
World events and global trade risks

Companies face a variety of risk factors

Consider all perspectives for your global trade approach

- Commercial
- Product
- Country
- Bank
- Documentary
- Transportation
- Compliance
- Geopolitical

Marsh/BMI research country risk index



Source: https://www.marsh.com/us/campaigns/political-risk-map-2019.html

Defining Standby Letters of Credit (Standby LC)

The basics of a Standby Letter of Credit

- A guaranty of payment issued by a bank on behalf of an applicant
- Used as a “payment of last resort” should the client fail to fulfill a contractual commitment with a beneficiary
- For use in trade transactions:
  - Bid bond
  - Prepayment guarantee
  - Performance or warranty bond
  - Support an ongoing open account relationship
  - SBLC versus a bank guarantee

A look at the two types of Standby LCs

Financial Standby	• Supports an obligation to pay money, including any instrument evidencing an obligation to repay borrowed money.
Performance Standby	• Supports an obligation to perform other than to pay money including for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions

Two ways to issue a Standby Letter of Credit

Direct	• The applicant's bank issues the Standby LC directly to the beneficiary • A paper LC is sent by the Bank directly to the Beneficiary via courier
Indirect	• The applicant's bank issues the Standby LC and forward to the Advising Bank to be authenticated and then formally advised to the beneficiary

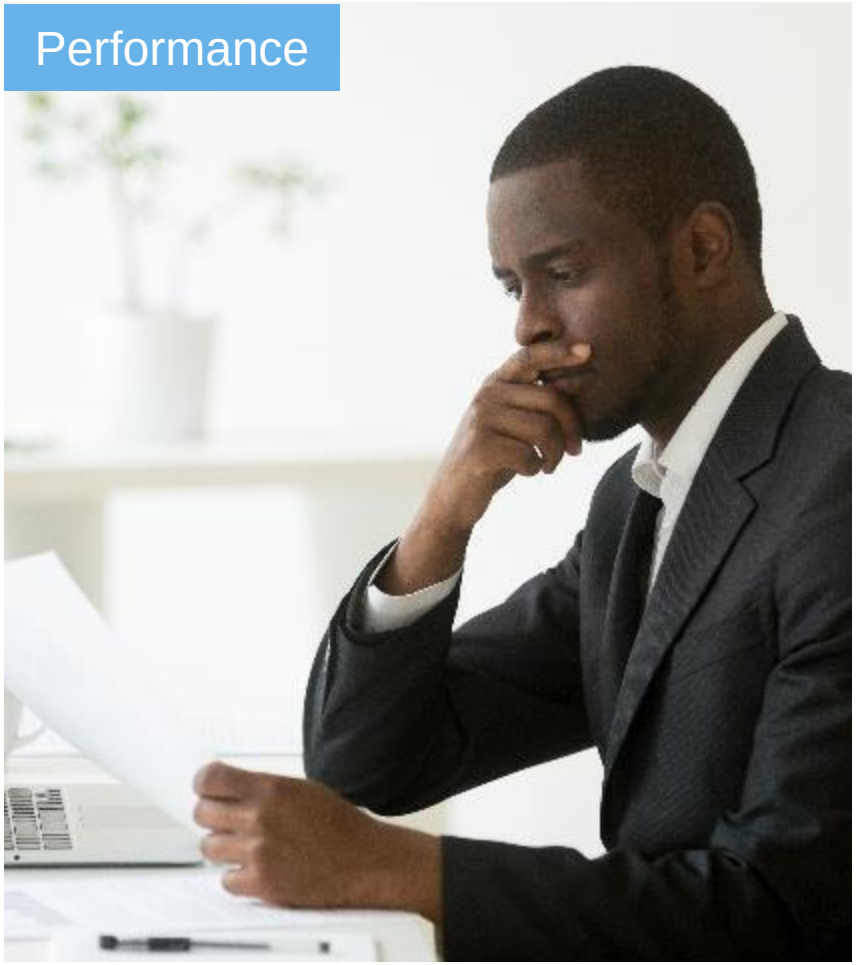
Primary Standby Letter of Credit uses

Common reasons for a standby letter of credit

- Bids
- Advanced payment
- Unpaid invoices
- Performance
- Warranty
- Lease
- Insurance

Bids

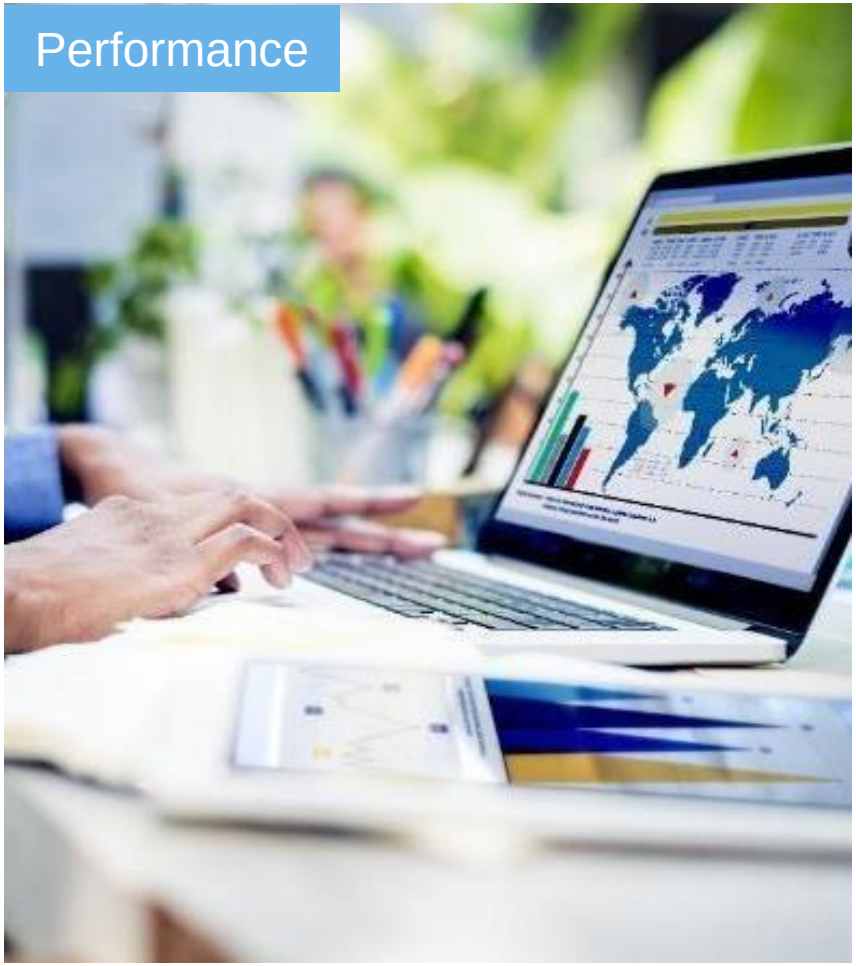
Performance



- Suppliers/contractors bidding on a project or sale
- Assures buyer the bid will be honored
- Usually issued for a percentage of the contract amount
- Beneficiary can draw if bidder has:
  - Withdrawn bid
  - Failed to enter into a contract
  - Failed to establish acceptable performance security
  - Failed to pay the service

*according to the terms of the SBLC

Advance payment



- Supports an obligation to account for an advance payment made by the beneficiary to the applicant
- Supplier asks for payment upfront from the buyer
- Can be for all or some of the value of the shipment
- Sometimes issued in conjunction with an Export LC
- Beneficiary can draw if supplier doesn’t ship goods or complete project

*according to the terms of the SBLC

Unpaid invoices

Financial

- Useful for repetitive shipments under the same repetitive condition
- Typically smaller invoice values
- Also used if buyer/seller have familiarity with each other for larger invoice values
- Allows the shipper to have confidence to be paid and also allows for the buyer to not have to pay all in advance

*according to the terms of the SBLC

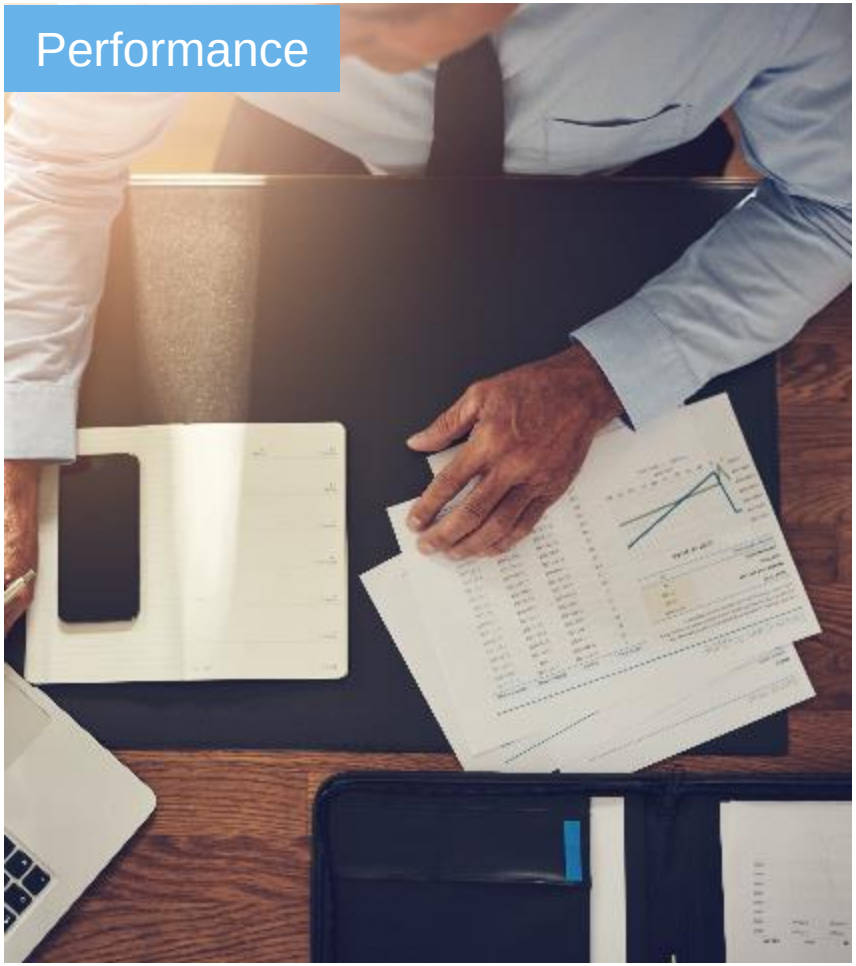
Performance

- Used to support completion of a contract or as warranty for newly installed equipment
- Beneficiary can draw if terms of the contract/agreement are not satisfied

*according to the terms of the SBLC

Warranty

- Beneficiary can draw if the Applicant fails to satisfy under the warranty terms



*according to the terms of the SBLC

Lease

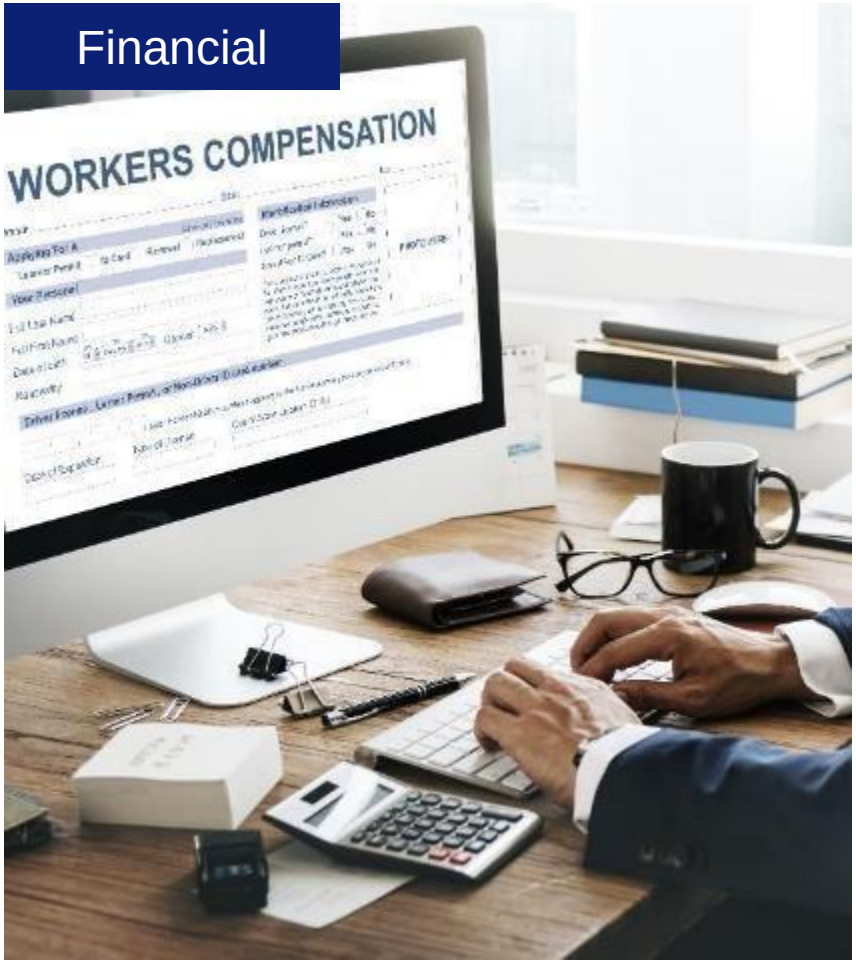
- When a company moves into a new space, the leasing company/landlord will often require a Standby Letter of Credit to cover expected rent for the term of the lease

Financial

*according to the terms of the SBLC

Insurance

Financial



- Supports an insurance or reinsurance obligation of the applicant
- Commonly used for unemployment and workers compensation insurance plans

*according to the terms of the SBLC

How Bank Guarantees work and potential risks

Differentiating a Guarantee from a Standby LC

Key differences of a Guarantee

Typically required to be issued by a bank that is local to the beneficiary	Usually subject to laws of the beneficiary's country instead of accepted rules for Guarantees—URDG 758	Local law may dictate the obligation continues after expiring

Best Practice	Always try to get acceptance of a Standby L/C before going to a Guarantee.

Counter Standby

- Supports the issuance of a separate undertaking by the beneficiary of the counter standby
- Standby Letter of Credit is issued in favor of an acceptable foreign correspondent bank who then issues the local Counter Guarantee
- A specific beneficiary or country may require a guarantee
- Different parts of the world are more familiar with Guarantees than Standbys

Understand the risks of a Guarantee

- Investigation of underlying transaction
- Subject to laws of issuing country, which might not be known
- More difficult to cancel
- Pay or Extend notices are common
- Multiple banks involved, means:
  - Additional banking charges
  - Extra time for issuance
- In case of a draw, documents are presented to the bank in Beneficiary's country that issued the Guarantee
  - If foreign bank deems presentation compliant per the terms of the guarantee, the foreign bank will present their demand against the counter standby that was issued in their favor.

Example

ABC Company is selling a custom machine to Egypt.

Beneficiary only accepts a Guarantee, issued by a local bank.

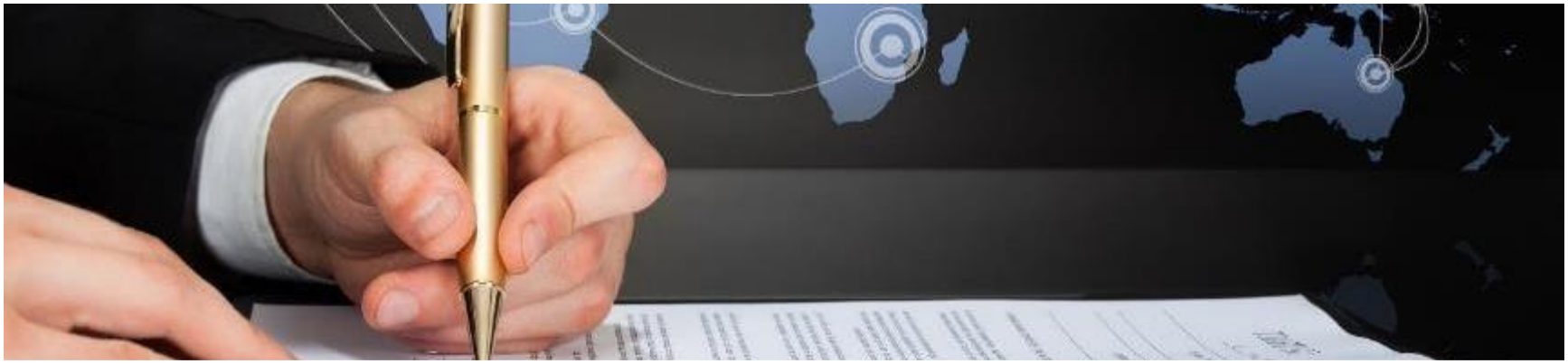
ABC Company asks their bank to issue a Standby LC to the Egyptian bank.

The Egyptian Bank will then in turn issue a local Guarantee to the buyer, subject to local law.

Other considerations for Standby LCs and Guarantees

When is an expiry date not an expiry date?

Local laws in some countries, even with a stated expiration date, allow the beneficiary to claim under the L/C for a stated period after the expiration date.



Sample language to include in the terms and conditions of your Standby LC or Guarantee:

"All demands for payment must be made prior to the stated expiry date."	"The beneficiary is requested to return this Guarantee immediately after the stated expiry date."

Example: In India, the beneficiary of guarantee can present a demand for payment up to one year after expiry. Issuing bank's counter standby must expire 13 months after the expiration date of guarantee to support this."

Auto extensions

A clause allowing the Standby Letter of Credit to be issued for a specific initial period (usually one year) with an “automatic” extension

Sample language for an auto extension:

“It is a condition of this Letter of Credit that it will be automatically extended without amendment for a period of one year from the Expiration Date hereof, or any future Expiration Date, unless at least ninety (90) calendar days prior to such Expiration Date, the Issuing bank sends notice to the Beneficiary in writing by courier or swift of election not to extend this Letter of Credit for an additional period.”

Amendments

Amendments which are detrimental to the beneficiary, such as decreasing the amount of the instrument or shortening the expiry date, require the beneficiary's approval.

If the beneficiary refuses, or if consent is not received, the Letter of Credit terms remain unchanged.

Governing rules

Governing rules for Standby LCs and Guarantees

Uniform Customs and Practices
(UCP 600)

International Standby Practices
(ISP 98)

Uniform Rules for Demand Guarantees
(URDG)

Uniform Customs and Practices (UCP 600)

- Designed for Commercial Letters of Credit, but also used for Standby Letters of Credit
- Published by the International Chamber of Commerce (ICC)

International Standby Practices (ISP 98)

- Standby letters of credit should be subject to the ISP98 unless refused by beneficiary
- Reflects generally accepted practices, custom and usage
- Published by the International Chamber of Commerce (ICC)

Uniform Rules for Demand Guarantees (URDG)

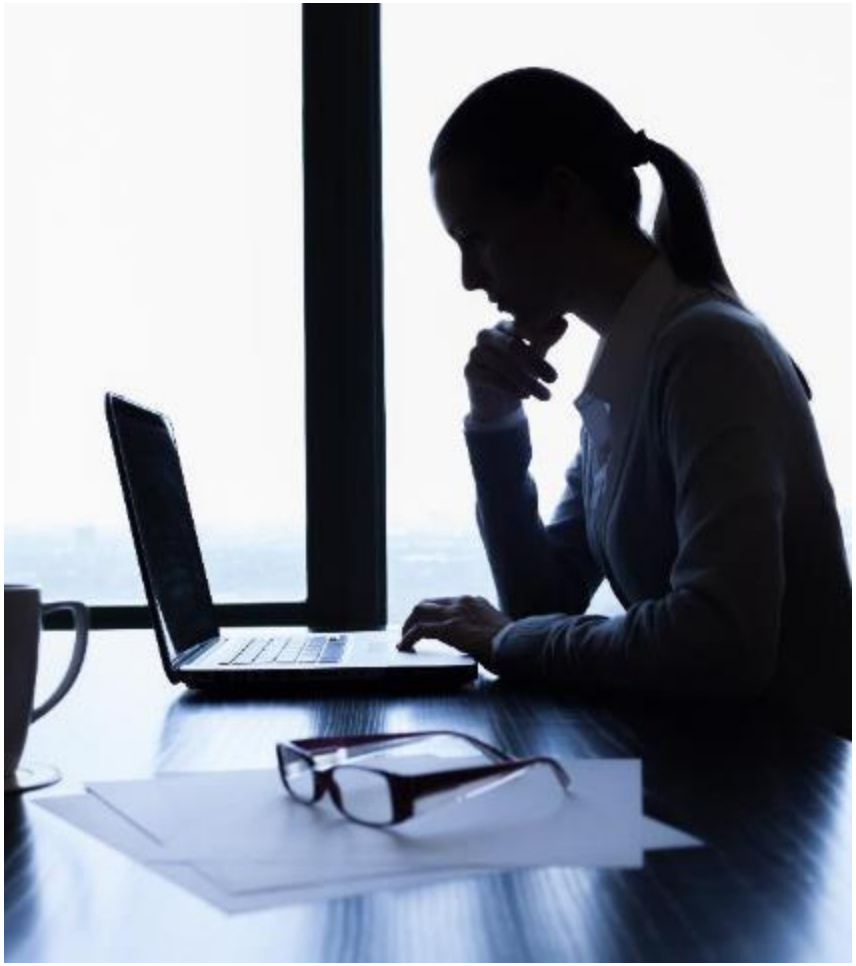
- Establishes agreed-upon rules for independent guarantees and counter-guarantees among trading partners
- Seldom used (other countries prefer local laws)
- Published by the International Chamber of Commerce (ICC)

Transaction roles

Key roles of the transactions

1. Applicant	2. Beneficiary	3. Bank

Best practices for the applicant



- Keep language clear, precise and simple
- Ask beneficiary to provide their preferred language
- Be aware of pricing and fee structure
- Avoid non-documentary conditions
- Be aware of specific local country conditions/ limitations
- Maintain continuous communication with the beneficiary
- Understand auto-extend provision
- Allow enough time

Best practices for the beneficiary

- Understand the auto-extend provision
- Review and understand the time limitations, as well as drawing requirements
- Maintain continuous communication with the applicant
- Have your bank involved

What the banks are responsible for

- They *ONLY* deal with documents, not the underlying transaction
  - The Standby Letter of Credit is a separate instrument, and is independent of the underlying contract
- Precise language for the Letter of Credit
- Issuing Bank commitment is contingent upon presentation of the stipulated documents within the terms and conditions of the Letter of Credit

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