

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

Presented by U Soe Win

Myanmar Vigour Company Limited

General Manager (Retired)

Myanma Foreign Trade Bank

Contents:

- Introduction to International Trade Finance
- Incoterms
- Documentary Collection
- Documentary Credits
- Special Letters of Credit

1 FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

■ Introduction

- Countries trade with one another because they are not self sufficient. Economical to specialize on advantageous productions and exchange with other nations for products which they could not produce.
- Trade within the country – local or domestic trade
- Trade with another country – foreign trade a.k.a international trade.

■ Fundamental Issues

- Problems and risks
 - Traders do not know each other personally, known only by reputation.
 - Different language and culture
 - Differences and fluctuations in currency exchange, different legal system
- Problems Seller may face: Uncertainty, delay in payment and exchange loss
- Problems Buyer may face: Uncertainty of delivery of goods; delay in delivery of goods; poor quality of goods and exchange losses

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

❑ Parties to the Foreign Trade Transactions

- The manufacturer
- The shipping company (or airline)
- The insurance company
- Lawyers
- Government bodies
- Embassies
- Chambers of commerce
- Professional bodies

Alternative names of buyer and seller:

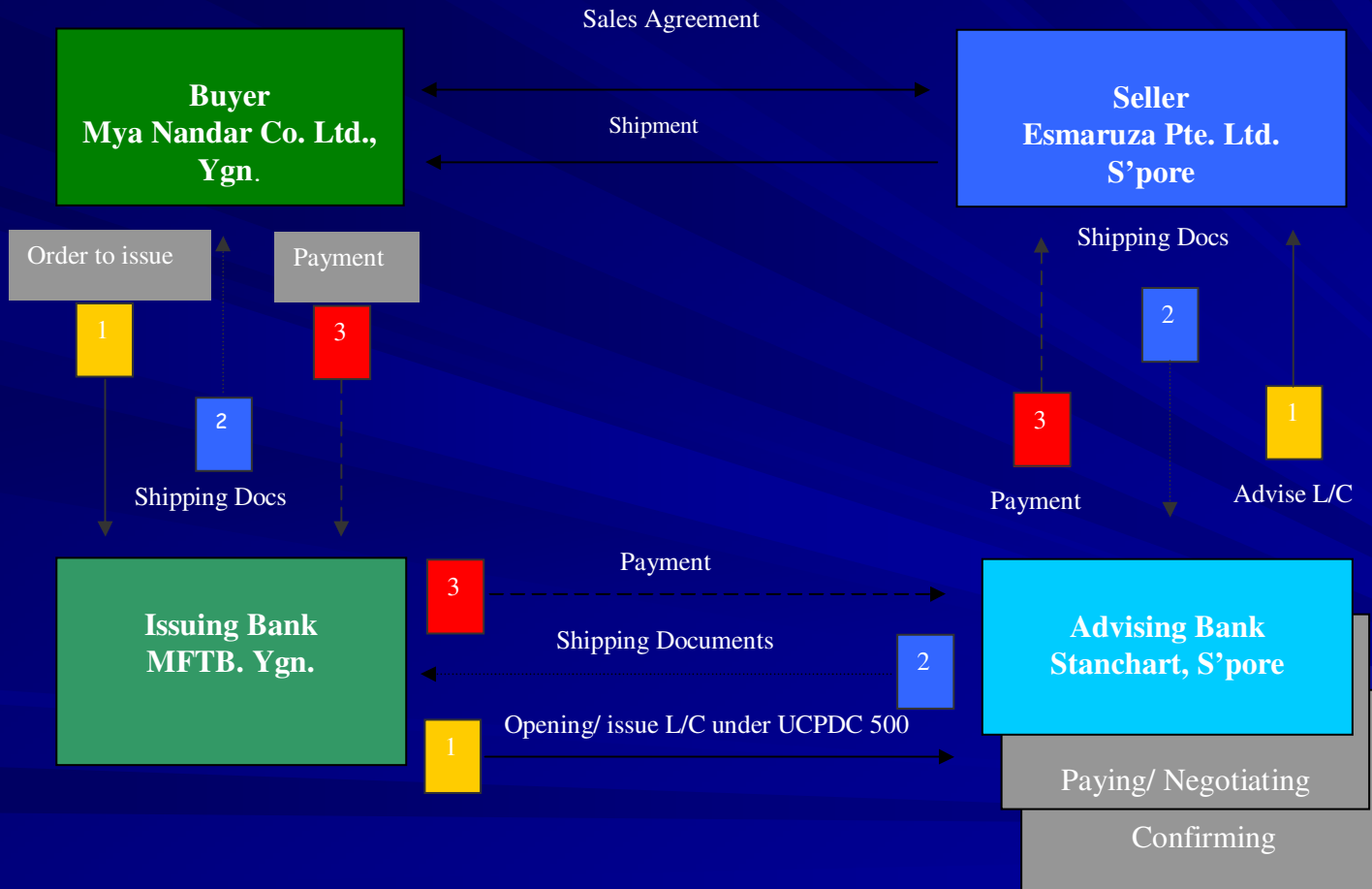
- Buyer – importer, applicants, accountee or drawer
- Seller – exporter, beneficiary, the drawee or the shipper

❑ Bank's Roll in Finance and Foreign Trade

- ❑ Provide financing, foreign exchange and other services
- ❑ Facilitate foreign trade transaction with extensive correspondent banking arrangements by a net work of branches

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

Parties to a Letter of Credit



FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

□ Documents Used in International Trade

- 1 Financial Documents: -bill of exchange / draft etc.

- *Bill of Exchange = Document of demand issued by seller to buyer .*

- “An unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring person to whom it is addressed to be paid on demand or at a fixed or determinable further time, a sum certain in money to, or to the order of a specified person or to the bearer.”*

- *The tenor of the draft – On demand, at sight or After a fix term or usance period*

- 2 Commercial Documents:- required by the buyer – commercial invoice, packing list, certificate of inspection etc.
- 3 Official Documents:- required for government or customs – consular invoices, certificate of origin etc.
- 4 Transport Documents: - bills of lading - served as document of title of goods, multi-modal transport documents, airway bills, parcel post receipts, rail consignment notes, delivery orders etc.
- 5 Insurance Documents:- insurance certificate or policies

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

Sight (Draft) Bill of Exchange

Date: 1 April 2007

EXCHANGE FOR US\$ 100,000.00

At sight pay to the order of

the sum of United States Dollars One Hundred Thousand only.

Value received.

To **Mya Nandar Co. Ltd.**
No. 466 Pansodan Street
Kyauktada Township, Yangon

Ourselves

For *Esmaruza Pte. Limited*
Singapore

x x x x x x
(Signature)
Managing Director

Drawee

Payee

Drawer

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

- Term or usance draft is payable at the end of a fixed or determinable period specified in number of days (30, 60, 90 days) after sight or from date of draft.
- For example, a draft drawn on 15.2.07 is accepted by drawee (seller) on 1.3.07. Payment term is 30 days after sight. Therefore the draft will be payable on 31.3.07 i.e. 30 days after sight.
- Parties to the bill of exchange are:
 - Drawer: Seller
 - Drawee: Buyer
 - Payee: The receiving party
 - Acceptor: The person who accepts the bill of exchange
 - Endorser: The one who endorses on reverse of bill of exchange.

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

- **Air waybill:** A receipt from an airline company or its agent, for goods accepted for carriage by air. It is not a document of title.
- **Bill of Lading (BL):** A receipt issued by the carrier, or its agent, to the shipper goods accepted for carriage by sea.
 - Functions of BL are:
 - A receipt for goods,
 - Evidence of a contract for the carriage,
 - A document of title to goods, and
 - A legal document in case of claims.
 - The main parties to a BL are:
 - Shipper, Consignee, Notify Party and Carrier
 - Other forms of BL are:
 - Non-negotiable sea waybill
 - Charter-party bill of lading
 - Freight forwarder's transport document

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

- **Multi-modal Transport Document** (indicates)
 - Place of receipt,
 - Place of delivery; and
 - Different modes of transport covered in the journey of goods.
- **Commercial Invoice**
 - A statement of goods shipped; and
 - Payment due
- **Pro-forma Invoice**
 - Invoice issued prior to sale of goods for purposes of import license.
- **Consular Invoice**
 - It is called for by importer's country to ensure that the price is fair.

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

■ Insurance Policy/ Certificate

- Effective date of insurance is the most important factor
- It shows full details of risks covered
- Same currency as mentioned in credit

■ Certificate of Origin

- Prepared by the exporter or the Chamber of Commerce
 - Reasons of requirement:
 - Due to tax reasons
 - Due to political or religious reasons

■ Certificate of Inspection (Pre-Shipment Inspection Certificate)

- Issued by an independent inspection agency or surveyor after inspecting the goods before shipment.

■ Packing and Specification List

- A summary of number of boxes, crates shipped to buyer

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

■ Weight List or Weight Notes

- Document issued by a third party or the seller confirming the weight of the goods being shipped.

■ Health Certificate/ Veterinary Certificate/ Phytosanitary Certificate

- Confirms that the goods to be shipped, are not diseased, infested or infected.

FUNDAMENTALS OF INTERNATIONAL TRADE FINANCE

■ Payment Methods

- Advance Payment: Payment made before shipment.
- Open Account Terms: Payment in arrears.
- Documentary Credits (Letters of Credit): LC, undertaking of payment to the seller, issued by the buyer's bank.
- Documentary Collections

■ Standard Rules

- Uniform Customs and Practice for Documentary Credits, Publication No. 500 (UCP 500)(600)
- Uniform Rules for Collections , Publication No. 522 (URC 522)

2 INCOTERMS

■ **What are Incoterms**

- A contractual code made up of acronyms (words formed with first letter of a term.)

■ **Origin of Incoterms**

- International Rules for interpretation of trade terms was first published in 1936 by ICC
- Current versions is 2000 publication

■ **Purpose of Incoterms**

- To eliminate barriers caused by distance, language and local business practices;
- To eliminate uncertainties and different interpretations of trade terms
- To reduce risks and time wasted, caused by misunderstanding, disputes and litigation;
- To provide a universal vocabulary accepted by financial institutions;
- To facilitate international commercial exchange

INCOTERMS

■ Categories of Incoterms

1. Ex-works (EXW) a&mif;olydkifeufwGif ukefypönf; vTJaNymif;Ncif; (ae&mudk azmfNy&ef)
2. Free Carrier (FCA) o,f,lydkUaqmifolxH ukefypönf; vTJaNymif;Ncif; (ae&mudk azmfNy&ef)
3. Free Alongside Ship (FAS) ,mOfab;wGif ukefypönf; vTJaNymif;Ncif; (qdyfurf;udk azmfNy&ef)
4. Free on Board (FOB) oabFmay:txd ukefypönf;wifay;Ncif; (ypönf;wif&ef qdyfurf;udk azmfNy&ef)
5. Cost and Freight (CFR) p&dwfESifY ydkUaqmifc a&mif;olu uscHNcif; (ypönf;a&muf&rnfY qdyfurf;udk azmfNy&ef)
6. Cost, Insurance and Freight (CIF) p&dwf?tmrcHESifY ydkUaqmifc a&mif;olu uscHNcif; (ypönf;a&muf&rnfY qdyfurf;udk azmfNy&ef)
7. Carriage Paid to (CPT) o,faqmifcay;NyD; (ypönf;a&muf&rnfY ae&mudk azmfNy&ef)
8. Carriage and Insurance Paid To (CIP) o,faqmifcESifY tmrcHay;NyD; (ypönf;a&muf&rnfY ae&mudk azmfNy&ef)
9. Delivered at Frontier (DAF) e,fpyfwGif ypönf; vTJaNymif;ay;tyfNcif; (ae&mudk azmfNy&ef)
10. Delivered Ex Ship (DES) a&mif;olu oabFmNzifY ta&mufydkUay;Ncif; (a&muf&rnfY qdyfurf;udk azmfNy&ef)
11. Delivered Ex-Quay (Duty Paid) (DEQ) aemufqHk;qdyfch wHwm;ay:ta&muf a&mif;oluydkYay;Ncif; (xdkqdyfurf;udk azmfNy&ef)
12. Delivery Duty Unpaid (DDU) taumufcGef,ruscHyLa&mif;olu ta&mufydkUay;Ncif;

INCOTERMS

■ Understanding the Incoterms

Buyers and sellers are encouraged to understand the Incoterms in order to:

- Know the extent of their responsibilities;
- Know the fees that will be charged to them;
- Have control over the fee and transfer of risks;
- Be in an advantageous position in negotiations;
- Set the selling prices as equitable as possible;
- Demonstrate their competencies; and
- Reflect the best professional image to everyone with whom they are dealing.

3 DOCUMENTARY COLLECTION

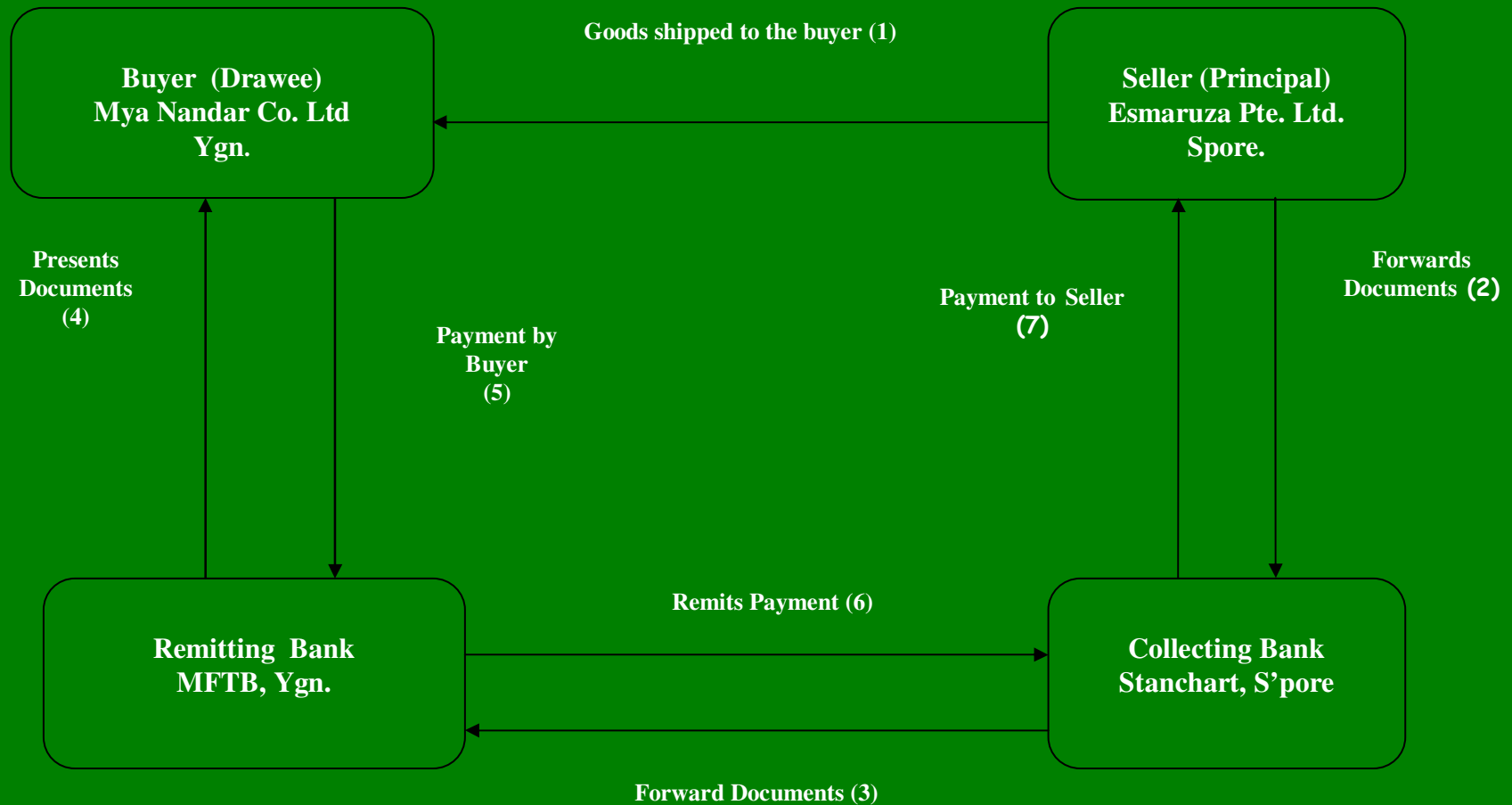
- Trade transactions handled by Banks:
 - Documents under documentary credit; and
 - Documents not under documentary credit a.k.a. “collections”

- Collection is
 - A request for payment for goods sent

- Two kinds of Collection
 - Clean collection
 - Documentary collection.

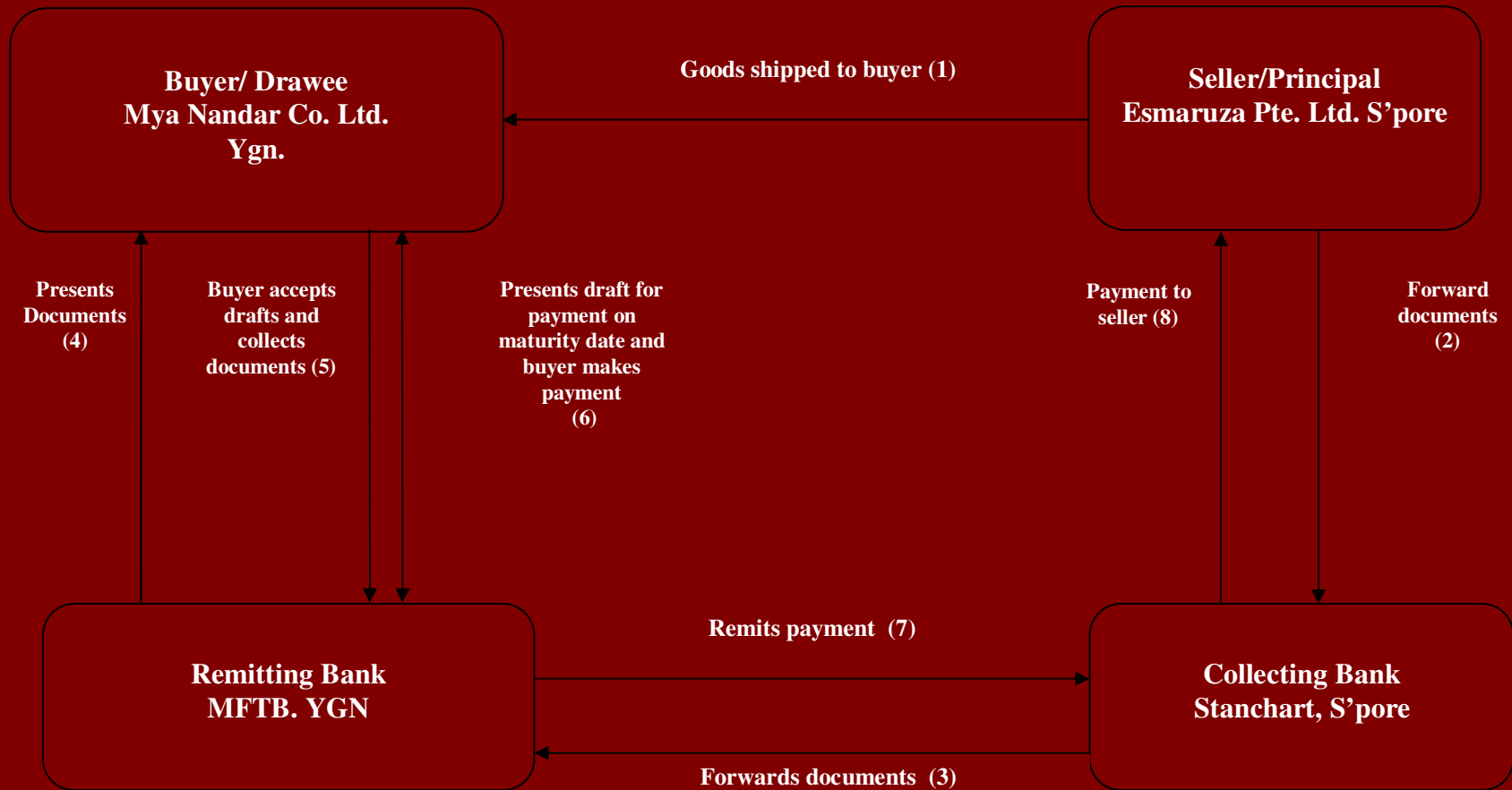
DOCUMENTARY COLLECTION

Documents Against Payment (at sight)



DOCUMENTARY COLLECTION

Documents Against Acceptance



DOCUMENTARY COLLECTION

- **D/A Riskier than D/P**

- **Under DP,**

Seller keep control of goods until buyer pays. If buyer refuse to pay, seller can

- **take the buyer to court, or**
- **find another buyer in the importer's country, or**
- **arrange for sales by auction**
- **ship back to sellers country.**

- **Under DA,**

- **Buyer signs, promising to pay the bill at a fixed future date. Documents released.**
- **Seller effectively loses control of the goods from that point onwards and runs following risks:**
 - 1 buyer might refuse payment saying goods not to satisfaction or**
 - 2 cheat or**
 - 3 become insolvent.**

DOCUMENTARY COLLECTION

■ What if the Buyer Refuses the Documents?

- Protest
- Store
- Find another buyer
- Auction

Conclusion

A seller should only agree to payment under documentary collection if:

- Seller does not have doubt on the buyer's ability and willingness to pay
- Buyer's country is politically and economically stable;
- There is no foreign exchange restriction in the buyer's country;
- The shipped goods are easily marketable or alternate buyers can be easily found.

4 DOCUMENTARY CREDITS

■ What is a Documentary Credit

- A written undertaking by a bank (Issuing Bank)
- Given to the seller (Beneficiary)
- Acting upon the request and instructions of a customer (the Applicant),
- To pay -:
 - at sight, or
 - at a determinable future date
 - up to a stated sum of money,
 - within a stated time limit,
 - against stipulated documents, and
 - in compliance with the terms and conditions

■ Parties involved in a Documentary Credit Transaction

- Buyer (a.k.a applicant/ importer)
- Seller (a.k.a. beneficiary/exporter)
- Agents (representing the buyer or the seller)
- Banks (representing the buyer or the seller)
- Insurance Company
- Shipping Company
- Manufacturer, etc.

DOCUMENTARY CREDITS

- Different names of bank in the LC transactions:
 - Opening Bank/ Issuing Bank
 - Advising Bank
 - Confirming Bank
 - Negotiating Bank
 - Paying Bank
 - Reimbursement Bank
 - Accepting Bank
- Uniform Customs and Practice for Documentary Credits (UCP)
 - Pre-printed statement of banks on LC forms:

“so far as otherwise expressly stated, this documentary credit is subject to Uniform Customs and Practice for Documentary Credits 2000 Revision, International Chamber of Commerce Publication No. 500.” (600)

DOCUMENTARY CREDITS

■ Advantages to Seller

- The seller is the beneficiary of the LC
- The Issuing Bank undertakes to accept, negotiate and pay upon the presentation of documents drawn in conformity to the terms of LC
- Cannot amend or cancel an irrevocable LC without seller's consent.
- The seller may use the irrevocable LC to request his bank to issue Back-to-Back LC
- Seller does not have to worry about exchange control regulations.
- Control over the goods is retained by the seller or his bank until payment is made or accepted, if it is a usance LC
- An irrevocable LC can be used to obtain pre-shipment credit, if such facilities are available.
- If it is a usance LC, the accepted bill of exchange could be discounted for immediate cash.

DOCUMENTARY CREDITS

■ Advantages to Buyer

- He will receive the documents that were specified by him in the LC.
- He is assured that he will have to pay the value of the LC only.
- He will enjoy better cash management as he does not have to pay in advance.
- His ability to do business abroad is increased as the LC assures the seller for payment, which indirectly increases the financial standing of the buyer in the eyes of the seller.
- As an LC assures payment, he may be in a better position to negotiate better prices and terms.
- His sources of supply can be broadened.
- Ensure that the seller supplies exact requirements by calling for specific documents to certify quality, specification etc.
- He could, possibly, obtain import financing from the issuing bank.
- He can stipulate the most convenient shipping date.

DOCUMENTARY CREDITS

■ Disadvantages to Seller

- If it is a revocable LC, he runs the risk of the LC being cancelled or amended without receiving prior notice.
- He must ensure documents are prepared strictly in accordance with LC terms and conditions, including meeting shipping dates and presentation of documents.
- He is exposed to the risk of documents being rejected due to discrepancies.
- If not confirmed by a local bank, he runs the risk of non payment if the issuing bank becomes insolvent or due to other problems associated with the issuing bank.
- If not confirmed by a local bank, or another acceptable bank, he runs the risk of non-payment due to imposition of exchange control regs.

■ Disadvantages to Buyer

- Has to bear the cost of opening the LC.
- Once an irrevocable LC has been issued, it cannot be cancelled or amended without the consent of the seller and others in the chain.

DOCUMENTARY CREDITS

■ Types of LCs

- Revocable credits
- Irrevocable credits; and
- Irrevocable and confirmed credits

■ Availability of LC

- Payment to the seller can either be made:
 - at sight, i.e. payment on demand; or
 - After a stipulated period
- The different ways of authorizing payment by LC are
 - Payment LC (sight)
 - Deferred Payment LC
 - Acceptance LC
 - LC available by negotiation

DOCUMENTARY CREDITS

■ LC Application

- Does the applicant (buyer) have an established line of credit ?
- Authenticate the application
- Is an import license required?
- Is exchange control approval required or complied with?
- Is status reports on the Beneficiary received and acceptable?
- Shipping terms?
- All other instructions given should be clear and complete?.
- If the application is in order, it is processed and the LC issued.

■ Transmission of LC

- LC by tele-transmission can be issued by way of telex or SWIFT.

S.W.I.F.T. stands for the Society for Worldwide Inter-bank Financial Telecommunication. It is a private international telecommunication network. In 1970, a group of international bankers gathered with the objective of setting up a joint computerized international telecommunication system and became operational in 1977. SWIFT is operational in most countries in the world, and has more than 3,000 institutions as members.

DOCUMENTARY CREDITS

■ Advising Bank's Role and Obligations

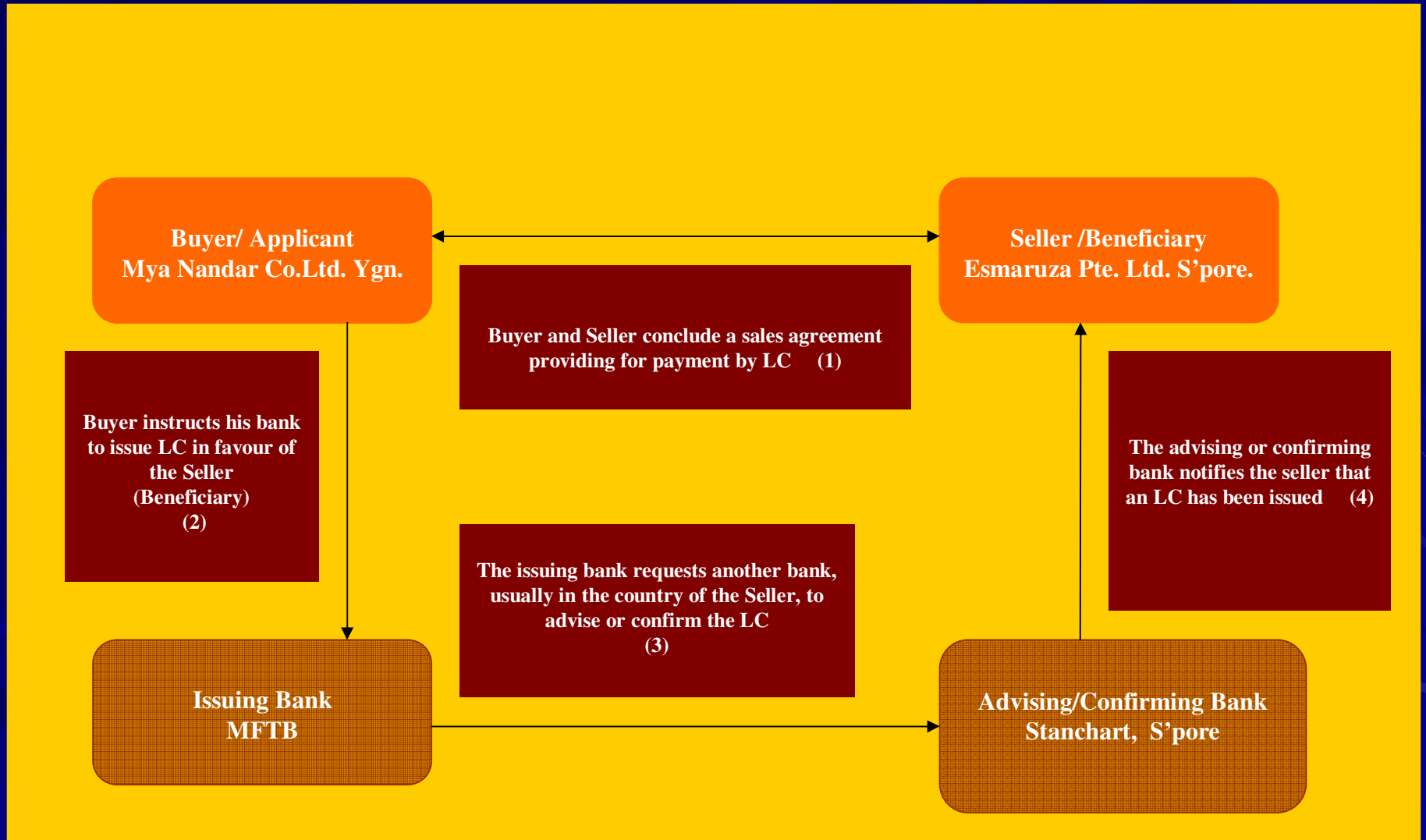
- LCs issued by the Issuing Bank are advised to the Beneficiary through another bank (Correspondent Bank). This enables the Advising Bank to confirm the authenticity of the LC.
- Article 7 of the UCP 500 indicates:
 - A Credit may be advised to a beneficiary through another bank (Advising Bank), if it elects to advise, shall take reasonable care to check authenticity. But if the bank choose not to advise the Credit, it must inform the Issuing Bank without delay.
 - If the Advising Bank cannot authenticate it must inform, without delay, the bank from which the instructions are received about inability to authenticate. If it nonetheless choose to advise the Credit, it must inform the Beneficiary that it has not been able to authenticate of the Credit.

DOCUMENTARY CREDITS

- Confirmation of LC
 - The Beneficiary may request, LC to be confirmed by a local bank.
 - Confirmation of the LC by a nominated bank is not automatic.
 - Confirmation of a LC constitutes a definite undertaking by that bank to assume the obligations and liabilities of the issuing bank under the LC.
 - Confirmation is not free. Confirming bank may ask confirmation charges usually, $\frac{1}{4}$ % to 1% for three months or part thereof or more, depending upon the risk they have to undertake.
 - Usually the confirmation charges are borne by seller who may add them into the price.

DOCUMENTARY CREDITS

Application and Issuance of LC



DOCUMENTARY CREDITS

■ **Export Documents under LC**

– *Documents handling – (by negotiating bank)*

- Try to understand the terms of LC and its amendments (if any)
- Check if the documents required by the LC have been submitted in correct number of copies and are consistent with one another.
- Check the discrepancies.
- If found, determine the degree of discrepancy.
- If not acceptable, inform the exporter and documents may be sent of collection basis.

– *Handling Discrepancies*

- Return the documents to the Beneficiary for rectification.
- Pay the Beneficiary against Beneficiary's indemnity.
- Pay against Beneficiary's bank's indemnity.
- Pay under reserve.
- Seek the Issuing Bank's permission.
- Forward documents under collection basis.

DOCUMENTARY CREDITS

■ Import Documents under LC

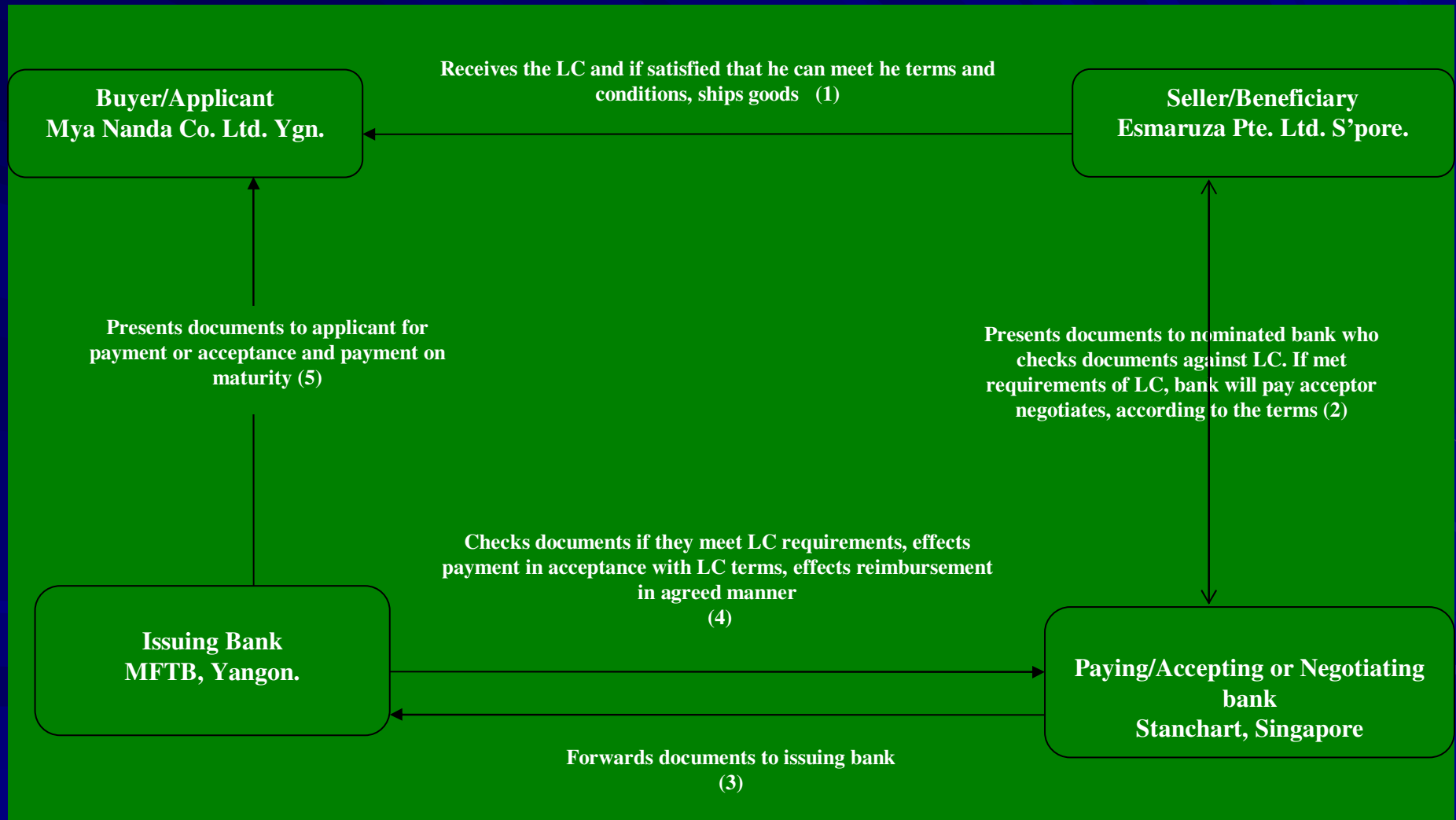
– *Documents handling – (by Issuing Bank)*

Article 13, UCP 500 reads:

- Banks must examine all documents stipulated in the Credit with reasonable care – determined by international standard banking practice.
- The issuing bank, the confirming bank, if any, or a nominated bank, shall each have a reasonable time, not to exceed seven banking days. (five banking days UCP 600)
- If a credit contains conditions without stating the document(s) to be presented in compliance, banks will disregard them.

DOCUMENTARY CREDITS

Presentation of Documents and Payments under LC



DOCUMENTARY CREDITS

■ Amendments to LC

- Due to the exporter's requirement of more time to:
 - Export, or ship the goods, or
 - Buyer instructs the exporter to provide extra documents, or
 - Submit document to the bank
- Revocable LC can be amended (or cancelled) at any time without reference to the Beneficiary.
- Irrevocable LC can only be amended or cancelled with the agreement of all parties to the LC.

5 SPECIAL LETTERS OF CREDIT

- Standby LC,
 - Transferable LC,
 - Back to Back LC,
 - Revolving LC, and
 - Red Clause LC
-
- Standby LC
 - LC issued to cover a “non-performance” by one party to the contract. Standby credits are used as a form of guarantee
 - Transferable LC
 - An irrevocable LC designated as transferable. The 2nd Beneficiary, however, is not allowed to transfer the LC further.
 - Back-to Back LC
 - Referred as a Counter LC.

SPECIAL LETTERS OF CREDIT

■ Similarities between Transferable and Back-to-Back LC

- Both LCs involve a middleman.
- Both involve substitution of another dealer's documents.
- When issuing a back-to-back or transferring a LC, the following terms would be, different in the second or transferred LC:
 - Price might be reduced;
 - Expiry and shipment dates might be brought forward;
 - Date of presentation of documents might be curtailed;
 - Insurance amount of the second LC be increased to comply with the amount required under the original LC; and
 - Any document which cannot be substituted - Certificates of Origin.

■ Differences between Transferable and Back-to-Back LC

- Back-to-back involve two LCs, whereas transferable involves only one .
- Back-to-back LC need not be designated transferable. Transferable LCs must be designated as transferable.
- Back-to-back LC are issued on the responsibility of the bank which issues the 2nd LC. Transferable LCs are transferred without any responsibility by the bank which transfers the LC.
- Both LCs are governed by the UCP 500.48.

SPECIAL LETTERS OF CREDIT

■ **Revolving LC**

- The amount is renewed or automatically reinstated without specific amendments

■ **Revolving in relation to time**

- Cumulative LC
- Non-cumulative LC

■ **Revolving in relation to value**

- The amount may be reinstated automatically upon presentation of the requested documents

■ **Red Clause Credit**

- A credit with a special clause incorporated. The clause authorizes the Advising or Confirming Bank to make advances to the Beneficiary before presentation of the documents, and is basically a pre-shipment loan.

Thank you