



InterNetLC.com™
We create trade and jobs.

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The Promise of International Trade eCommerce

Where international trade eCommerce is today and where it is going.

The Internet has not provided international trade with the rapid growth that domestic commerce has experienced. But it is coming. There is an approaching convergence of eUCP Internet Letters of Credit from trade banks, eBay type eCommerce web platforms, and non-bank financing for small business importers and exporters. This convergence will democratize and increase the rate of trade expansion by providing access to trade finance to hundreds of thousands of small businesses worldwide. International trade is an important factor for world peace because it creates jobs, raises living standards and promotes stability.

What Is Trade and Trade Finance

There is a great deal of confusion as to what is meant by “trade” and “trade finance”. The formal definition of “trade” is the exchange of tangible goods or services between a seller and a buyer in another country for cash, acceptance or other goods. The formal definition of “trade finance” is the settlement, or reimbursement for title, of a trade transaction with a Documentary Letter of Credit, Standby Letter of Credit, Documentary Collection or Bill of Exchange through the international banking system. The international banking system performs an escrow function between an importer and exporter to affect this exchange between documents representing title and payment. If the buyer and seller choose not to use the international banking system, it is not trade finance; the seller can simply send an invoice and the buyer can simply send money to complete the exchange of title for money.

The advantage of the international trade finance system is that it is a well and long established system of customs and practices that is followed by over 38,000 banks worldwide in over 190 countries. It is defined by published standards and has gained the understanding and trust of buyers and sellers in every nook and cranny of the globe. The accepted standards are derived and published by the International Chamber of Commerce in Paris, France, or ICC. These standards include the Uniform Custom and Practice for Documentary Credits, Incoterms 2000 and many others. Simple put, the system works; and has worked for literally hundreds of years.

The disadvantage of using trade finance to settle transactions is that it is both expensive and slow. Usually two banks are involved in each settlement and the direct cost of supporting the system is borne by the transaction itself in the way of bank fees. The buyer, or importer, pays the bank fees for his bank; and the seller, or exporter, pays the bank fees for his bank. The present system relies on manually signed paper hardcopy documents to make the final settlement which must be couriered and/or mailed back and forth between the parties involved who are in different countries. In addition, the average trade transaction documents are touched by at least twelve different entities to include freight forwarders, cargo carriers, customs brokers, carriage companies, inspection agencies, multiple banks and the buyers and sellers themselves.

International Payment Methods

International payments can be divided into three basic categories; payment at shipment, payment at delivery and payment after delivery. Each category has various methods for payment within the basic category. Payment at shipment means the payment is due when the goods are shipped. Payment at delivery means the payment is due when the goods are delivered to the location specified, usually a sea or air port. Open terms payment means the payment is due when the buyer receives the invoice for the goods and pays according to the terms of the invoice.

With payment at shipment, payment is due to the seller when the goods are on a ship, plane, train, truck or with courier that has left the seaport, airport or city of departure. The transport documents that are created to effect the shipment reflect evidence of movement, value and content. They usually consist of at least a bill of lading, invoice and packing list. These documents are exchanged for reimbursement from the buyer, at which time the title, or ownership, of the goods passes to the buyer. This payment method is normally done with a Documentary Letter of Credit that is payable when the transport documents are negotiated by a negotiating bank.

With a payment at delivery, the payment is due when the goods are delivered to the seaport, airport or city of destination. The documents agreed to between the parties are sent by the seller to the buyer through a trade bank that in turn sends them to the buyer's bank to exchange for reimbursement in the form of cash or acceptance. This payment method is normally done with an International Collection that is payable when the transport documents are exchanged for reimbursement by a collecting bank.

With open terms payment, the payment is due according to the terms of the invoice which is sent to the buyer after the goods are shipped. The goods are shipped with or at the same time as the documents representing title to the goods are sent to the buyer. There is no assurance of payment except the trust between the buyer and seller. Often credit insurance and/or a Standby Letter of Credit is in place to support the open terms.

Regardless of the payment method, the point of transfer of title and who is responsible for the freight charges and insurance is defined by the ICC Incoterms. There are 13 Incoterms that define when ownership passes and which party is responsible for paying the freight charges and insurance for getting the goods from point A to point B. The ICC Incoterms spell out whom in the logistics chain is responsible for what function and when title passes to the buyer of the goods.

Documentary Letters of Credit – Payment at shipment

The Documentary Letters of Credit (Credit) is the most common international transaction method for assuring payment for an international trade transaction that is payable at shipment. All Credits are defined by the same standard published by the International Chamber of Commerce, Paris, France, in 1933; it is the Uniform Customs and Practice for Documentary Credits, or the "UCP". The current version is UCP 500, and it is revised about every 10 years. The UCP is the world standard for managing Documentary and Standby Letters of Credit between trading partners and their supporting banks and service companies. The UCP provides guidelines for types of Credits, advising and negotiating, transport documents, drawings, assignments and transfers to name a few.

A Documentary Letter of Credit assures payment to its beneficiary, who is usually the seller or exporter, at the time and place of shipment by the applicant, who is usually the buyer or importer. The Credit is supported by the issuing bank who guarantees its payment if the required documents called for in the Credit are presented that exactly match the Credit requirements for documents evidencing movement, value, content and quality. A Credit is an international escrow in the traditional sense. The trade bank

negotiator is the escrow person that both parties rely on to make the exchange between documents representing ownership of the goods and the buyer's reimbursement for the documents. He is the trusted third party that both the buyer and seller hire and pay for by their bank fees. Reimbursement may be with currency or promissory note depending on what the buyer and seller agreed too.

International Collection – Payment at delivery

The International Collection payment method is in effect, reimbursement on delivery. It does not assure payment, but it does protect the seller's title to the goods until payment. The documents representing ownership are given to the buyer in exchange for reimbursement. After shipment, the exporter sends the transport documents to the buyer through his trade bank to the buyer's bank. The buyer's bank contacts the buyer and exchanges the documents for reimbursement. If the buyer refuses to pay for the documents the ownership of the goods remains with the exporter.

Open Terms – Payment after delivery

The open terms payment method is reimbursement according to the terms of the invoice sent to the buyer. The terms may be payable on receipt or at some future date such as net 30 days from shipping or receipt of the invoice. Often the open terms payment is support with a Standby Letter of Credit or credit insurance.

Standby Letters of Credit

Standby Letters of Credit are used to support open terms as a payment method. The Standby Credit assures payment to the seller if the invoice he presented to the buyer is not paid. The Standby Credit is not a payment method, it assures payment in the event of default of open terms.

The UCP Paper World

The UCP guidelines for managing Credits assumes the required documents for negotiation are paper with manual ink signatures representing authentication. Credits have been issued electronically between banks by telex since 1953; it is only the required documents for negotiation that are paper with ink signatures. Documentary Letters of Credit can be issued and advised to a beneficiary within a few days from any country in the world to any other country in the world. They usually take weeks to negotiate and generate reimbursement to the beneficiary simply because the paper documents must be physically transported to the negotiating bank in one country and from there to the issuing bank for payment. Issuing, advising, presenting, negotiating and paying a DLC is an expensive proposition. The cost of a trade transaction using a Documentary Letter of Credit is 10's of times more expensive than direct reimbursement from the buyer to the seller. The assurance of payment must be balanced against the high cost and sufficient margins must be built into the pricing. It costs about \$450 in bank fees charged to the exporter for DLCs up to \$250,000 in value and 24 days to get paid from the shipping date. Bank fees include the advising fee, the confirmation fee, the negotiating fee, the reimbursement fee and the wire fee to name of few. Approximately 25% of the \$9 trillion in world trade dollars is settled with Documentary Letters of Credit.

Typically a set of negotiable documents required in Letter of Credit includes a transport bill of lading, an invoice, a packing list, a certification of quality and a certification of origin. Under the UCP these are assumed to paper documents that are gather together and presented to the bank for their negotiation and reimbursement from the escrowed funds in the foreign bank put their by the buyer.

The eUCP Internet World

On 1 April 2002, The Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation (eUCP) was published by the International Chamber of Commerce, Paris, France. The eUCP focuses only on presentation using electronic means, since Credits are already issued and advised electronically. The eUCP provides the guidelines for banks to accept documents in electronic form. The most important aspects of the standard include:

1. Article e1: Presentation can be completely electronic or a mixture of paper and electronic records.
2. Article e3: "Document" shall include an electronic record.
3. Article e3: "Place for presentation" means an electronic address.
4. Article e3: "Sign" shall include an electronic signature.
5. Article e3: "Electronic record" means data created, generated, sent, communicated, received, or stored by electronic means and capable of being authenticated and examined.
6. Article e3: "Authenticated" means the apparent identity of a sender and the "apparent" source of the data contained in it.
7. Article e4: "Credit must indicate format" - Electronic records can be in any accepted electronic format, to include pdf, tif, jpeg, html, gif, etc.
8. Article e5: "Electronic records must state a place for presentation (email)".
9. Article e5: The beneficiary must provide a "Notice of Completeness" when the presentation is complete.
10. Article e5: Electronic records must identify the Credit.
11. Article e8: Presentation of one electronic record satisfies the requirement for one originals and copies.
12. Article e12: By checking the apparent authenticity of an electronic record, the banks assume no liability for the identity of the sender or source of the information.

The eUCP provides the guidelines for trade banks to accept the negotiable document set over the Internet directly from the exporter, thus bypassing the advising and/or negotiating bank in the exporter's country, and bypassing the advising and negotiating banks fees and delays. The banks have not embraced this standard or issued any Documentary or Standby Letters of Credit under its guidelines as of October 2006. There are a number of reasons for this situation.

Graphic and/or Digital Signatures

Graphic and digital signatures are accepted as legal signatures in the United States and most other countries; however there is very little case law for a bank's attorneys to reference. Everyone is waiting for the other guy to have a problem to test the legal waters for how electronic signatures play out when there is a dispute between the parties.

Loss of Bank Fees

The handling and processing of Commercial Letters of Credit and International Collections by a banks trade services department is expensive in time, labor and money. The bank's fees seem expensive, but the process requires highly skilled and trustworthy personal. If the negotiable documents can be sent directly to the issuing bank and bypass the exporters bank, there will be no fees to charge. This requires a change in a trade banks business model so they can participate both in the issue and negotiation of a Credit transaction.

Ocean Bill of Lading Questions

The most important document in trade is the Ocean Bill of Lading, and most bank procedures revolve around its handling and transfer. Virtually all Ocean Bills of Lading are issued in three originals and three non-negotiable copies. Any one of the original B/Ls represents title to the cargo. The idea of three originals comes from the sailing ship days when one original went with the cargo, one was sent by post and one stayed with the issuing bank. The idea of an electronic record representing title is hard to grasp for many. In actuality there is no problem or conflict since there is no requirement in the eUCP for the B/L to be electronic, a mix of electronic and hardcopy documents is acceptable, or the Letter of Credit can be negotiable with copies.

Internal Bank Procedures

All banks have very rigid internal procedures for everything they do, especially how funds are transferred from one bank to another and from one person to another. Many banks have at least a one year audit cycle, which means even as new procedures are written, they may not be implemented for a period of time. The SWIFT organization has published the guidelines for issuing Letters of Credit under the eUCP, but each bank must determine its own procedures for the internal processing of the electronic records and signature authentication.

Present Bank Internet Trade Finance Services

Commercial bank web sites range from very functional to static pretty pictures. Some banks publish many of its customer forms with interactive PDF fields that can be filled out online and printed. Some banks have direct links with html forms and real time connections with its customers computers that go directly into the bank's back office processing. Letters of Credit can be applied for directly online and the status of issued Credits can be seen. The trend is for adding more PDF forms to a banks web site for its customers and branches to use. This type of form is universally understood how to fill in and print, fax or email. Direct Internet connections between banks and customers has its own set of problems to include; security, ongoing verification of the IP address of the customers computer(s); training of the employees, software maintenance and limited functionality. Functionality is limited because the systems do not tie into the banks general ledgers or allow for the presentation of documents.

A banks trade finance services center on issuing import Letters of Credit, advising and negotiating export Credits, issuing Standby Credits, managing documentary collections, transferring funds, discounting drafts and foreign exchange transactions. Because these are manually intensive services they are both expensive for the bank to perform and the customer to pay for. In turn the bank must concentrate on larger exporting companies that can pay for these services on a regular basis. The small exporter with one or two Letters of Credit to negotiate is at a disadvantage. One example; many banks will not discount a usance Credit if the exporter is not a customer with the bank, even though the Credit may have been advised by them, and in theory is "freely negotiable".

Coming Bank Internet Trade Finance Services

The new Internet model for trade banks will incorporate features that will allow large and small companies to access trade finance services more effectively. The most important of these will be implementing the eUCP for issuing and accepting negotiable documents from the Internet. This will facilitate banks to issue, advise and negotiate Credits directly to customers in any country, not just being a party to the importer or exporter's transaction in the country they are located in. These new features will necessitate the banks modifying their business models because they will no longer be able to hold their customers captive by only offering trade finance services to the banks account customers. Trade banks will be able to open accounts, issue and negotiate Commercial Letters of Credit to and from any company in any country. There are, of course, individual country restrictions that attempt to control imports, exports and the flow of currency across its borders. These restrictions erode as trading blocks are joined such as the EU, NAFTA, DR-CAFTA, etc.

Bank Web Sites

With the acceptance of graphical and digital signatures most of the document tasks for trade finance and commercial lending and transfers can be accessed and completed from the Internet. Larger customers will be offered access to their customer ledgers for matching incoming and outgoing transfers to transactions. Smaller customers will be able to open accounts, have Credits issued, and negotiate export Letters of Credit using the bank's web site and its interactive PDF or Word forms. In addition to the local bank's unique forms, the bank can offer generic invoices, packing lists, bills of exchange and other documents for their customers to use that comply with the eUCP standard for electronic records. The first banks to market with these services will have an edge to reach the thousands of small business that do not have access to these services today.

Issuing Letters of Credit Under the eUCP

The MT700 Field Specification for eUCP Issued Credits has been published by SWIFT. These guidelines for issuing eUCP Credits provide how to insert a return email address into the MT700 Message in Field 47A, Additional Conditions. The "@" sign in an email address is replaced with "(AT)". The "_" sign is replaced by "(UNDERSORE)". The exporter has the email address to send the negotiable document set to the issuing bank, bypassing the advising and/or negotiating bank. This email address can also be used by negotiating bank to forward the documents if they receive them in this form.

Negotiating Letters of Credit Under the eUCP

The internal procedures for handling documents must be modified to accommodate electronic records and graphic and/or digital signatures. The eUCP allows any electronic format so the bank must decide which format it will accept; i.e. PDF, html, tif, gif, jpeg, etc. Otherwise the eUCP requires the bank to accept any format presented. Major trade banks today are already centrally scanning document sets for examination by their negotiators.

New Revenue Model for Banks

Normally a Credit specifies that the applicant pay the issuing banks fees, and the beneficiary pay the advising and negotiating bank's fees. The issuing bank can also be the advising and negotiating bank and be eligible for both fees by issuing the Credit under the eUCP. The correspondent banking relationship is useful, but not needed if the beneficiary accepts the Credit directly from a fax copy or email attachment. Authentication procedures are readily available in commercial software such as Adobe Acrobat.

There is a belief that Documentary Letters of Credit are declining as a payment method and will go away someday along with the lucrative fees they generate. They are indeed declining as evidenced by the centralization of trade finance services and the personal that supports them by virtually all of the major banks. However, the Letter of Credit issued under the eUCP becomes an Internet payment method with all of the Internets efficiencies, which retaining the assurance of payment it has provided for hundreds of years.

A Trade eCommerce Example

A buyer in Spain goes onto the Internet and looking for a supplier of canned jalapenos. He finds several web sites and selects a company in Costa Rica that harvests, cans and ships jalapenos by the container. He requests a quote, checks their trade references, and places a purchase order. The supplier's term of sale is a Documentary Letter of Credit (LC) payable 30 days after shipment. The buyer in Spain applies for a Documentary Letter of credit through his bank's web site to issue a LC to the supplier. The bank issues the LC to the supplier as a link in an email from the bank. The LC is issued under the eUCP for Electronic Presentation of documents, allowing for the presentation of electronic records for payment. The supplier processes and cans the jalapenos, and loads and ships the container by the shipping date specified in the LC. The transport documents are generated as electronic records online and graphically signed. They are sent to the issuing bank to the email address contained in the Letter of Credit. The "documents" as electronic records are negotiated and the payment is made by wire transfer to the beneficiary's account four days later.

eCommerce Platforms

eCommerce web sites such as eBay, Amazon, Google, Yahoo and retail portals have the opportunity to become global retailers by providing the three international trade finance payment methods of Documentary Letters of Credit, International Collections and open account. Their present reliance on credit cards overlooks the \$9 trillion international trade market taking place between the hundreds of thousands of companies worldwide.

Non Bank Trade Finance

Non bank financing of trade transactions is used by exporters to get pre-shipment financing to purchase goods to perform against a Letter of Credit. The UCP allows for an assignment of proceeds to a third party who is paid when the Credit is paid. The third party loans funds to the beneficiary for the purchase of the goods and is repaid when the Letter of Credit is negotiated. After shipment a trade bank pays at sight or discounts a usance Credit and pays the assignee and beneficiary. This type of loan is transaction based rather than asset or balance sheet based and is made without collateral. Banks very rarely make loans based solely on the transaction without any collateral. This type of peer to peer financing is gaining notice and traction on the Internet. Rather than competing with banks, pre-shipment financing compliments the banks post shipment financing of Letters of Credit.

Summary

The coming convergence of Internet eUCP trade finance services, eCommerce web platforms, and peer to peer leading will open international trade to tens of thousands of small businesses around the world that do not have access today. There are no technical barriers to using the Internet to democratize trade using traditional trade finance payment methods. Imagine ten eBays with its 100's of millions of transactions per year offering goods and services to 200 countries supported with traditional trade finance payment methods and pre-shipment financing. Imagine trade and jobs being created everywhere.

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