



"Reliable payment is the first fundamental of free trade."

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What are Letter of Credit Instructions?

It is the responsibility of the beneficiary, i.e. the seller, to inform the buyer exactly what terms and conditions he desires in the Letter of Credit from his buyer. These terms and conditions are contained in the seller's "Letter of Credit Instructions" to the buyer, and include all of the critical conditions he must comply with to get paid. These conditions include payment terms, shipping port, Incoterm, latest ship date, transferability, available documents, and the beneficiary's advising bank just to name a few.

Why are Letter of Credit Instructions Needed?

The advising bank's cover letter informing you that a Credit has been opened in your favor always states, *"If you are unable to strictly comply with it's terms, please communicate directly with the Applicant to have the Credit amended"*. If you had provided your buyer with Letter of Credit Instructions, you have something to compare the Credit to for your review. If you did not, you must start from scratch to analyze the jargon to figure out if you can comply or not, or if it needs amending. Unfortunately, the advising bank disclaims assistance and you're stuck with "now what do I do".

Your Letter of Credit Instructions

If you do not get a good Letter of Credit to support your international sale, it's probably your fault.

The Concept of a Letters of Credit Transaction

A seller receives a Purchase Order from a foreign buyer for a quantity of goods, at a certain price, to be delivered at a certain time, from a particular port to another port. The seller sends to the buyer a Proforma Invoice for the total value of the Letter of Credit that he expects to receive which will include the cost of goods, shipping, insurance, financing costs, banking fees, and inland freight. In addition to the Proforma Invoice, the seller should send the Letter of Credit Instructions with the terms and conditions he requires in the Credit. The buyer then submits a letter of credit application with this information to his bank for the Credit to be issued to the seller. The beneficiary (seller) is advised of the Credit from his advising bank, reviews and accepts the Credit, and subsequently ships the goods. After shipment he prepares and presents the documents required by the Letter of Credit to his bank to receive payment.

The Reality of a Letter of Credit Sale

The above simple and elegant process is a text book myth that never happens in an actual transaction. Regardless of what the buyer and seller agreed to, the issuing bank is going to issue the Credit the way it is most advantageous to the bank. If the seller was not definitive in his Letter of Credit Instructions to the buyer, the Credit will contain not only the bank management's changes, but also the creative imagination of the bank's clerk typist. All of these changes in the original intent of the buyer and seller's transaction will be done by the issuing bank in the name of protecting the buyer from himself and his "unscrupulous" seller.

The Beneficiary's Dilemma

The seller is notified by the advising bank that a Letter of Credit has been issued from his buyer. He is asked in the cover letter from the advising bank to please review the Credit, and if he cannot strictly comply with the terms, to communicate directly with his buyer to have it amended. Now the buyer is faced with a myriad of problems, not the least of which is the fact that he can't understand the banker's language and specialized terms used in the Credit in the first place. To increase the fun and games factor, his buyer and customer does not have a clue the Credit has a problem. The buyer paid the bank 110% collateral plus 2% to issue the Credit in accordance with his wishes contained in his Credit application to his bank.

For Example

Lets assume he is able to decipher the SWIFT message, and/or actual Letter of Credit terminology. He then discovers that the Credit requires a document that he is not able to generate, such as a Certificate of Origin by component from their originating countries. U.S. Chambers of Commerce do not certify parts from other countries. The Certificate of Origin requirements was added to by the issuing bank, not the buyer. When the buyer goes back to his issuing bank to get it amended, the bank explains it is bank policy, or quotes some obscure government regulation. The bank explains that it is done that way to make sure only politically correct products are imported into the country or some other local agenda that has nothing to do with importing beans to feed hungry people.

The Letter of Credit Instructions

The buyer and seller need to understand that a Letter of Credit is a payment mechanism, not a sales agreement, or a substitute for a Purchase Order. The buyer and seller need to agree during the sales process on the terms and conditions that are going to be included in the Letter of Credit to support the Purchase Order. And finally, the seller must include the required terms and conditions in Letter of Credit Instructions that accompanies the Proforma Invoice. These instructions must clearly delineate the beneficiary, Credit value, latest ship date, expiry date, Incoterm, ports to and from, documents available from the seller, presentation period, partial and trans-shipments allowed or not, confirmation required or not, transferability, advising bank, sight or usance terms, drafts drawn on, and paying bank. When both the applicant and beneficiary have the same information, it not only will eliminate confusion, but it provides the sheet music for the buyer to go to his issuing bank to request and hopefully demand amendments.

What to do After the Advise

First, review and understand the Credit. Decide what can and cannot be performed and complied with. If you had not previously put together Letter of Credit Instructions, do so as a bench mark for this Credit and all future Credits. Second, communicate in writing to the Applicant, i.e. the buyer, what to change, what to add, and what to delete in the Credit. Third, wait for the Amendment. When it arrives begin the process all over again, most of the changes you requested will not be complied with. Fourth, be prepared to reject the Letter of Credit and lose the sale because you didn't do your job in the first place. However, all is not lost because you can usually blame the salesman for only caring about his sale and not about the company getting paid.

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