



Documentary credit is still one of the key trade finance instruments

By **Pavel Andrlé**, an international trainer and consultant*.

My first job in international banking was in a foreign exchange bureau. Soon I was appointed head of a unit working with various forms of cheques, including bank cheques, travel cheques (which were bought by international travellers in their banks in a currency of destinations), money orders, etc. It was at that time when I first encountered a letter of credit. This letter of credit was in the form of a “travellers letter of credit”. These letters of credit were issued by banks in a paper form in favour of a traveller who was allowed to utilize it by presenting a sight draft on any bank which was authorized to negotiate it. Banks abroad had the specimen of these letters of credit and also the specimen of authorized signatories and their signatures. Needless to say, I only saw these specimen letters of credit to be issued by some foreign banks (most of them from Australia and New Zealand), I never saw them being actually issued or presented in my bank...

Since I thought that letters of credit are indeed very simple instruments and when I was offered a job in a new bank in the documentary credit department, I was very confident that this would be a nice and easy job to do.

I guess that everyone can imagine my big surprise when I realized that the documentary credit is really not an easy instrument to fully grasp at all! I still recall the urgent need to learn about documentary credits fast.. and the struggle to achieve it..

True, my boss had some good knowledge about doc credits, but only a short practice, and seemed inclined to keep most of the knowledge to himself. I was looking for practical books on the subject and eventually found that these were mostly legal books on documentary credits, or brochures published by some leading banks for their customers with focus on limited documentary credit operations such as preparation of documents and their main features to be examined by banks. Nothing explaining all documentary credit operations in a practical and easy to understand manner.

At that time (beginning of the nineties) many new banks emerged to accommodate growing number of exporters and importers in their international business operations and the documentary credit was one of the most in-demand payment instruments. Many of us, newcomers, faced the same need: to learn how to process documentary credits correctly and in line with the best international practices captured in ICC Rules.

I could not find any comprehensive practical books on all documentary credit operations. I started to dream about such a book which would help me to master the documentary credit instrument quickly. Often, if you want a dream to become true, you have to make it happen yourself!

So I made it happen.

After few books in my native Czech language, I wrote an English book on Examination of Documents under Documentary Credits which was published in two editions (2013 and 2015). And finally, I published that dreamed of practical guide on all documentary credit operations “**Documentary Credits in Practice**”.

So what can the reader of the book learn from it?

Firstly, the book explains the documentary credit as being one of the common payment methods used in international trade. It further elaborates on the main principles and features of documentary credits, describes various types of credits, relationships among parties involved in documentary credits and availability of credits including the so often misunderstood “negotiation”.

It is most practical to learn about documentary credits and relevant ICC rules and practices (UCP 600 and ISBP 745) by reading the credit itself. Most credits are issued in the form of SWIFT message, type MT700, therefore every field of the message is explained detailing all relevant ICC rules with many practical examples.



The second part focuses on many practical parts of the documentary credit transaction: preparations before the contract, contract of sale itself, i.e. specification of the documentary credit conditions in the underlying contract, and then on issuance of credits, advising, confirmation, amendments, preparation of documents requested by credits, drawing under credits – presentations, how to deal with discrepancies, etc.

A documentary credit is the realization of a payment condition agreed in the underlying contract of sale or similar legal relationship. The exporter and importer need to understand the documentary credit features and state its terms and conditions sufficiently and correctly in their contract. Documentary credits are mainly about agreeing on suitable documents, to be in line with other relevant contractual conditions such as delivery terms, quantity and quality of the goods, origin, etc. Most problems in practice, in my view, stem from badly issued credits, which is most likely by unclear or uncommercial contractual conditions or lack of them.

Many mistakes take place again and again regarding documentary credit conditions. Often the credit has unworkable conditions, sometimes even illegal ones such as a request for a fumigation certificate evidencing fumigation was done by using methyl bromide in countries of EU (where it is illegal). Or a certificate that a vessel is “a conference vessel” when such vessel is to operate in EU sea ports.¹ There are conditions which might be hard to fulfil, e.g. a request for a certificate of origin in two and more originals when such certificate is routinely only issued in one original and one copy. Credits often show place of expiry, i.e. place for presentation, being in conflict with the location of the bank(s) with which the credit is available. Documents conflict with the chosen Incoterm. The specified transport route is in conflict with requested transport document, e.g. the credit requires an ocean bill of lading but states place of receipt and/or place of final destination. When insurance documents are requested, the credit often states confusing or even conflicting conditions. Many commonly requested conditions are hard to fulfil in practice such as request for “claims being payable in the importer’s country” or showing “name and address of the payment (claims) agent in the importer’s country”. Insurance companies have hardly any payment agents abroad, they usually only have survey agents, and not in all places in the world!

Documentary credits are not only secured payment instrument but also financing tools. Various forms of import and export financing are explained, including, e.g. pre-shipment financing, post-financing, usance credits payable at sight, discounting of deferred payment and acceptance credits and negotiation.

Examination of documents presented under documentary credits is a key documentary credit competence, consequently a significant part of the book is devoted to it. General principles applicable to all documents as well as detailed checklists for each document commonly presented under documentary credits form the fourth and closing part of book.

It is true that use of documentary credits in foreign trade has significantly decreased in the last twenty years. However, it still remains a very important payment and financing tool, accommodating roughly ten percent of international trade. It is still being developed, especially with the emergence of various forms of electronic documents and more recently fully digital solutions.

Most certainly, to become an expert on international trade finance one must master the traditional documentary credit, the king of documentary trade finance!

For more information about the publication and order details, visit the website: <https://www.tradefinanceconsulting.com/publications/>

* Pavel Andrlé is an international trainer and consultant. He is founder, owner, and managing director of Trade Finance Consulting, s.r.o., www.tradefinanceconsulting.com. He can be reached at: pa@gmail.cz

¹ Such requirements are in conflict with the EU legislation.