

The future of documentary trade

Reducing discrepancies in letters of credit

BY ANAND PANDE, REGIONAL TRADE PRODUCT MANAGER, CITIBANK TRADE SERVICES

Today, an estimated 15% of world trade, worth US\$1 trillion, is transacted through the use of letters of credit. Letters of credit offer an effective risk management tool for companies to engage in global trade. These instruments allow companies to grow their international business by making available an independent financially trusted partner in the form of a bank to guarantee the payment will be effected as long as the sellers submit documents complying to the terms and conditions of the letter of credit. This helps the seller grow their business as they are now not reliant on the credit standing of the buyer and have an international bank backing up the transaction.

In order to provide a common set of standards for what constitutes compliant documents under letters of credit, the International Chamber of Commerce (ICC) published the Uniform Customs and Practice for Documentary Credit (UCP 500). These rules, last updated in 1993, are to be used by all letter of credit parties worldwide for examining documents so as to facilitate the trade cycle between sellers and buyers. The concept was to go beyond geographical boundaries in terms of local country laws, regulations, and practices, and instead have an international set of uniform rules that help in facilitating and growing the global trade business.

In reality, this utopian world was never achieved. More than 60% to 70% of cases involving presentation of documents by sellers are classified discrepant by the buyers' banks issuing the letters of credit.¹ This leads to a number of inefficiencies across the entire value chain in terms of the sellers' working capital being unnecessarily

tied up as their payments are delayed. In addition, the goods incur demurrage and are subject to potential damage while the discrepancies await resolution. The buyers, sellers, and their banks are engaged in thrashing out and clarifying whether the discrepancies pointed out are meaningful or significant or how they get resolved. This is due to the rules in the UCP 500 being open to interpretation, as evidenced by the hundreds of enquiries received by the ICC since the UCP was last revised. With the expansion of international trade, and the entry of new countries and new practitioners, the discrepancies in practice have compounded.

In order to clearly define what constitutes standard international banking practices so as to significantly bring down the level of discrepancies, the ICC developed the International Standard Banking Practices for the Examination of Documents Under Documentary Credits (ISBP). The objective of this document was to clarify the meaning of stated practices as defined in the UCP 500 and

The ISBP is a step in the right direction - creating a win/win/win situation for all - exporters, importers and banks.

Figures show that 60%-70% of letter of credit documents are rejected for discrepancies on first presentation. The International Standard Banking Practices document, by encouraging a uniformity of practice worldwide, is expected to cut these figures dramatically and, by doing so, will facilitate the flow of world trade.

clearly define how to put into practice the rules set forth in the UCP 500.

The defining event

On October 31, 2002, the National Committees of the International Chamber of Commerce Banking Commission voted in favor of the adoption of the ISBP. More than two years in the making, the ISBP was written by a 13-member task force authorized by the ICC Banking Commission and co-chaired by Citibank's Donald R. Smith, Vice President, Product Management, Trade Services. According to Smith, "The vote for the adoption of the ISBP was a clear mandate to resolve the longstanding and costly ambiguities surrounding the use of documentary letters of credit, ensuring their continued prominence as a primary payment vehicle of international commerce."

The impact of ISBP

The potential impact of the ISBP is substantial. Global adoption of the ISBP will reduce the discrepancies and confusion that surround letter of credit documentation. It will speed the flow of payments to exporters and documents to importers, and enhance straight-through-processing for the banks.

For Citibank, the largest generator of commercial letters of credit with more than US\$4.6 billion in LC outstanding, we look forward to faster turnaround times with our correspondent banks, as all parties begin to view the UCP rules from the same perspective. Citibank's four regional trade processing centers in Penang, Malaysia; Tampa, Florida; Lewisham, United Kingdom; and Mumbai, India which support between themselves the processing needs of our network in 102 countries, can significantly reduce the cycle time for processing transactions on an end-to-end basis.

Furthermore as in a significant number of cases, if the

importer and exporter both bank with Citibank, we can shorten the cycle times further as the transaction goes through the same backend system. Documents can be examined in a more expeditious manner due to our use of a single common operating platform.

Reducing discrepancies through analytical tools

ISBP provides a new framework, which in delivering more clarity around the document checking process will reduce discrepant documents and speed up the trade cycle. Additionally, both exporters and importers alike are making efforts to improve the process.

We are seeing more and more clients wanting information and better analysis of the frequency, type and origin of discrepancies. Corporate customers of Citibank for example, can use our web-based corporate banking platform, CitiDirect® Online Banking, to get a wide range of reports both for imports and exports including discrepancy analysis to improve and reduce the overall number of differences.

Another key focus is outsourcing document preparation. Through our outsourcing solution, Citibank Electronic Documents, we assist exporters in reviewing the workability of the letter of credit as well as preparation of export documents so as to target zero discrepancies in the export documents. In some cases, we may even go a step further and may offer to buy these receivables to reduce the balance sheet exposure for the exporter.

Advantage: exporters and importers

The ISBP results in the following advantages for our clients be they exporters or importers:

Exporters (beneficiaries of letters of credit) will see improvements in cash flow and efficiency as a result of the transparency in the document preparation and

presentation process. The reduced time spent on document correction and faster payment will lower costs and significantly improve working capital management.

Importers (applicants of letters of credit) will benefit from faster receipt of import documents, thus avoiding demurrage charges and delays in receipt of goods, ultimately reducing the cost of the goods.

We do not see the demise of letters of credit to facilitate trade in the near future. The industry, through new standards such as the ISBP, is addressing key problems that add unnecessary delays and costs to the trade cycle, while banks such as Citibank continue to provide innovative new ideas to further improve the trade flow between exporters and importers. Steps are being made in the right direction. The result is a win/win/win situation for all - exporters, importers and banks.

The ISBP clarifies common issues which are often the cause for discrepancies. Some examples are:

Abbreviations

The use of generally accepted abbreviations, for example 'Ltd' instead of 'Limited', 'Int'l' instead of 'International', 'kgs' or 'kos.' instead of 'kilos' does not make a document discrepant. (paragraph 6)

Misspellings or typing errors

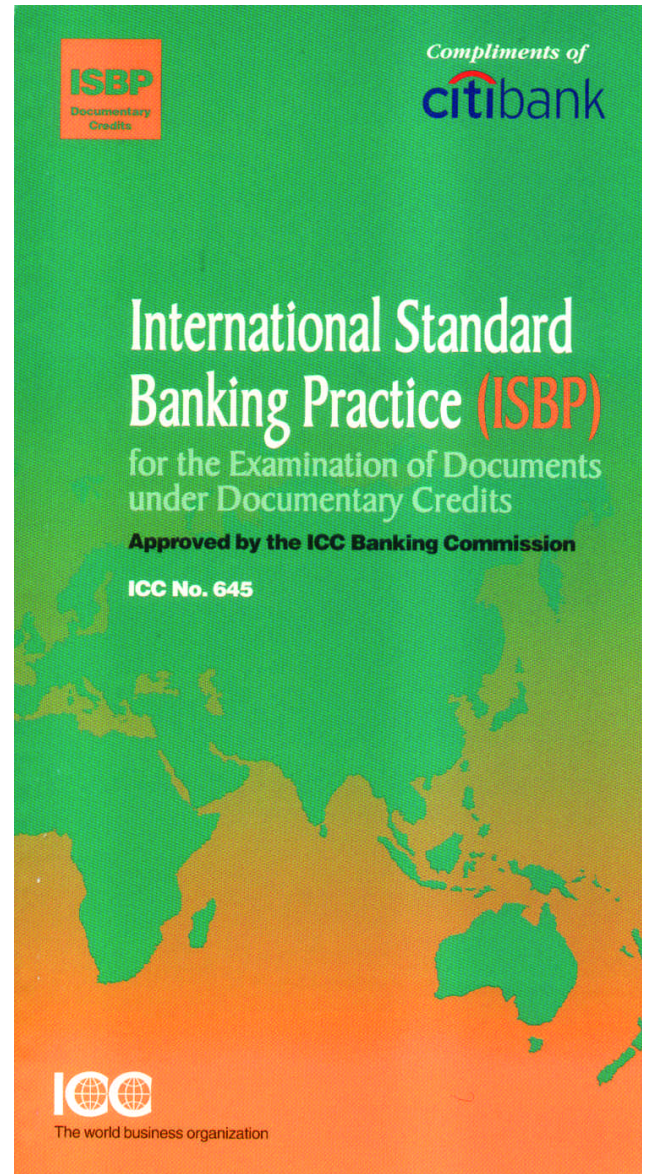
Misspellings or typing errors that do not affect the meaning of a word or the sentence in which it occurs, do not make a document discrepant. For example, spelling 'mashine' instead of 'machine'; 'modle' instead of 'model' would not make the document discrepant. However a description as 'model 123' instead of 'model 321' would not be regarded as a typing error and would constitute a discrepant. (paragraph 28)

General issues relating to invoices

If a trade term is part of the goods description in the letter of credit, or stated in connection with the amount, the invoice must state the exact same trade term. For example, a credit term "CIF Singapore Incoterms 2000" would not be satisfied by "CIF Singapore Incoterms". (paragraph 65)

Are you ready?

To obtain a complimentary copy of the new ISBP publication, contact your Citibank Trade Services representative, or the local Citibank contact listed in the directory at the back of this yearbook. ■



The new International Standard Banking Practice (ISBP) for the Examination of Documents under Documentary Credits booklet

Reference

¹*Discrepancies in Presentations against Commercial Letters of Credit*, Ronald J. Mann, Documentary Credit World, November/December 2000, p.23