SBLC's & DLC's

Re-creating wealth for Growth…through our product portfolio…

Bank Guarantees/Standby Letters of Credit

- Origin
  - Bretton Woods Institute: monetary management established the rules for commercial and financial relations among the world's major industrial states in the mid-20th century. The Bretton Woods system was the first example of a fully negotiated monetary order intended to govern monetary relations among independent nation-states

Bank Guarantees/Standby Letters of Credit

- What are BG's or SBLC?
  - Bank Guarantee is where one Bank (the Issuing Bank A) issues an indemnity(cover/insurance) to another Bank (the Beneficiary Bank B) or directly to a Beneficiary, on behalf of its account holder. The Issuing Bank will expect its account holder to pledge 'assets'/cash to the bank for its issue. node
  - There are effectively two main types of Bank Guarantees,

    (1) A Direct Guarantee where the account holder instructs his bank to issue a Guarantee directly in favour of the Beneficiary, and

    (2) An Indirect Guarantee where a second bank is requested to issue a Guarantee in return for a counter-Guarantee. In this case the Issuing Bank will indemnify losses made by this second bank in the event of claim against the Guarantee.

Bank Guarantees/Standby Letters of Credit

- A Bank Guarantee is considered a "Demand Guarantee" and as such is governed by the International Chamber of Commerce (ICC) Uniform Rules for Demand Guarantees (URDG).

- Purposes of BG's
  - Advance Payment Guarantee
  - Performance Guarantee (Performance Bond)
  - Payment Guarantee
  - Conditional Payment Guarantee (Conditional Payment Undertaking)
  - Guarantee securing a Credit Line
  - Order & Counter Guarantee

Bank Guarantees/Standby Letters of Credit

- Characteristics of Bank Guarantees
- are written specifically for a purpose; where an account holder will instruct his bank to issue a guarantee to another bank on behalf of their account holder.
- The bank will hold adequate assets/cash of the account holder as security for the Bank Guarantee.
- Bank Guarantees cannot be transferred to third parties unknown to the banks.
- They are relayed via swift mt760, bank to bank.
- They are issued for a specific time period.
- Upon Expiry, Bank Guarantees are terminated, they are not traded.
- A Bank Guarantee has no end value and does not accumulate any investment element or maturity value.
- They should not be considered as 'investment notes'.
- They should not be 'touted' on the open market as the issue of a Bank Guarantee is between closed parties (the Issuer-Applicant and Beneficiary bank- Beneficiary account holder only).
- Banks do not issue them to raise money and should not be confused with Medium Term Notes (MTNs).
- The strength of a Bank Guarantee is limited to the financial standing (and rating) of the Issuing Bank.

Issuing A Bank Guarantee

- Any person or corporate entity with an account held at a mainstream bank can apply to issue a Bank Guarantee. Provided they hold to their account adequate assets, there should be no reason why a Bank will reject an application to issue a Bank Guarantee for bona-fide business purposes.
- The account holder will simply request his Bank to issue a Guarantee and supply them with the reasons behind its issue. The bank would have a simple application form for this service. The account holder will submit the bank the application containing details of the underlying commitment being entered into whilst supplying the bank with information such as; (a) how long the Guarantee should be for, (b) any conditions on the payment, (c) the amount and currency, and of course (d) details of the Beneficiary and their bank details etc.
- The Bank in-turn will request that the account holder enters into some form of pledge agreement with them. This means that before the bank agree to issue a Guarantee, the Bank would require a pledge or lien over assets of the account holder to secure the Guarantee. The assets acceptable for a bank to issue a Guarantee are generally liquid assets such as cash at bank, stocks and shares and bonds or property. In other words, assets that can be instantly liquidated.
- In essence and for example, if an account holder wanted to issue a third party with a Bank Guarantee for US$50 million, it would be necessary to pledge cash, stocks or bonds or property to his bank for a higher value of this amount. It is highly unlikely that a bank would agree to issue a Guarantee on behalf of their account holder without holding assets of equal or higher value. It is 'for value received…..'.
- Once the bank has charged, liened or blocked the assets on the account holders bank account at the bank, the same bank will issue a Guarantee in accordance with their account holders specifications.
- The Issuing Bank will remit the Bank Guarantee to the Beneficiary Bank initially by SWIFT. See SWIFT
- Normally, the Bank may pre-advise the Beneficiary Bank by sending a SWIFT MT799 which is only a notice outlining the Issuing Banks instructions to remit a Guarantee, or to verify information in advance of the issue.
- The Issuing Bank will then send the Bank Guarantee also by SWIFT MT760. See MT799 and MT760.
- Most banks will also send an original paper copy (which takes the appearance of a letter) by post to the Beneficiary Bank. It is courteous for the Beneficiary Bank to remit a message or letter back to the Issuing Bank confirming its safe receipt and acknowledgment.

Receiving A Bank Guarantee

- If you are lucky enough to have a Bank Guarantee issued to you, you will certainly know what it is for. Most commonly, landlords may receive Bank Guarantees for rent deposits from their tenants for example. If you have entered into a separate contract for an investor to issue you a Bank Guarantee to secure a credit line, then you would have certainly executed contracts with them by this stage.
- It is highly unlikely that a Bank Guarantee will pop onto your bank account by surprise! If you do receive a Bank Guarantee and have no idea why, you should contact your bank immediately.
- In receiving a Bank Guarantee, your bank will generally notify you and send you a copy of it (normally a SWIFT terminal printout) for your information. They will also inform you that it is verified and valid and will await your further instructions.
- If you plan to receive a Bank Guarantee, it is important that you bank with a multi-national bank that understands them and can offer you a 'private' banking service. Generally we would advise working with Banks who operate the procedure well.
- If you are intending to receive a Bank Guarantee from an 'investor' in order to secure a line or credit or loan, it is important to negotiate this facility with your bank before the Bank Guarantee arrives. This will save time and expenses.
- The Bank Guarantee will normally be posted to a separate account in your name that the bank will open upon its arrival. It will be held on this account until it is either called for payment or it expires.

Format of a Bank Guarantee

- A Bank Guarantee will be drafted within strict and standard confines. When issued by SWIFT, the Bank Guarantee will contain fixed fields, each field is numbered and contains a specific item of data, such as date, expiry date, amount, etc.
- When the Bank issues a Bank Guarantee, it will generally send it also in original form to the Beneficiary Bank by post of courier. It will take the form of a letter.
- It will not look like a colourful certificate and will not contain fancy wax seals ! It will more than often look like a modest document printed on standard bank notepaper and signed off by an authorised officer of the bank.

Uniform Rules for Demand Guarantees

- The URDG758 (Uniform Rules for Demand Guarantees) are a set of contractual rules that apply to demand guarantees and counter-guarantees. As the URDG are contractual by nature, they apply only if the parties to a demand guarantee or counter-guarantee so choose.
- In simple terms, URDG offers a set of guidelines for the issue of Demand Guarantees which include Bank Guarantees in the way in which they are **worded** and **constructed**.
- These have recently been revised and are now clearer and more precise than their predecessor, URDG 458. The present revision (URDG 758) uses language consistent with that in the ICC's universally accepted Uniform Customs and Practice for Documentary Credits (UCP 600). - Validity
- These call for new definitions and interpretation rules to provide greater clarity and precision. A clear layout of the examination of the demand process and a roadmap to handling extend or pay demands for force majeure.
- **Benefits with using URDG 758**
- Once the URDG are incorporated in the guarantee or counter-guarantee text by contractual reference to the URDG, they are deemed to be entirely incorporated, unless specific article(s) are expressly excluded or amended.
- When drafting a URDG guarantee or counter-guarantee, it is important to make a choice and avoid conditions whose occurrence can only be determined through a forensic examination of the underlying transactions. Guarantors and applicants should avoid using ambiguous terms in the guarantee. Sound practice can only be built upon transparency and good faith. It is in no one's interest that the guarantee terms could only be understood through lengthy and costly litigation. Clear wording requires no judicial interpretation; therefore applicants can save considerable negotiating time and the cost of specialized legal assistance by benefiting from ready-to-use standard conditions in the model guarantee forms.
- A URDG guarantee and counter-guarantee are irrevocable undertakings; this protects the beneficiary against the risk of revocation of the guarantee at a time when the guaranteed obligation is still to be completed.
- A URDG guarantee and counter-guarantee enter into effect as from the date they are issued, unless their terms expressly postpone their entry into effect to agree with a later date or the occurrence of an agreed event. Accordingly, no demand for payment can be presented until the guarantee enters into effect following the occurrence of a specified date or event indicated in the guarantee.
- The essential characteristic of a demand guarantee is that it is independent of the underlying transaction between the applicant and the beneficiary that prompted the issuance of the guarantee. Further, a demand guarantee is also independent of the instruction relationship pursuant to the applicant having requested the guarantor to issue the guarantee in favor of the beneficiary.

What is SWIFT

- SWIFT stands for Society for World-wide Inter-bank Financial Telecommunications and is an international organisation. It provides means of secure communications between Banks and its members. Membership to the society is regulated and only vetted applicants are permitted to use the system at varying access levels.
- It ensures that banks can communicate with each other and provided validation and verification checks on their communications. It operates largely as a database of varying levels of communication and transmittance of financial documents and messages. Physical documents cannot be sent by SWIFT.
- To be able to send and receive authenticated SWIFT messages one must be accepted and subscribed to the Society.
- Banks will have a trained SWIFT operator responsible for the management of SWIFT messages, both out-bound and in-bound. In smaller Private Banks, this may be one single individual. Larger banks will have SWIFT operator departments.
- Each SWIFT message will have a Message Type (or MT) depending on the database field. For example, MT 100 relates to cash transfers and the sending of client funds between banks. MT 700 relates to Documentary Credits and Guarantees.
- It is important to not complicate or refer to these SWIFT Message Types in professional communications since it will not concern either the client or recipient and is meant for inter-bank communication only.

SWIFT MT 199/799/999

- In dealing in Bank Guarantees (Demand Guarantees) and Letters of Credit (Documentary Credits), one may hear the phrase 'MT799'.
- This is the SWIFT Message Type that Bank Guarantees can communicate authenticated free format messages securely. Inter-communicating banks may use this Message Type on their SWIFT systems to communicate various types of messages and offer pre-advice of intended transactions. This Message Type is free format, allowing the Operator to type freely various different messages connected with MT700 communications, i.e. Documentary Credits and Guarantees.
- In dealing in Bank Guarantees, one may hear the phrase 'MT760'.
- This is the SWIFT Message Type that Bank Guarantees are sent and received by inter-communicating banks. When sending a Bank Guarantee by SWIFT, the SWIFT Operator will enter the details on this Message Type relating to the specifics of the Guarantee.
- It is only Bank Guarantees that are sent with this Message Type 760.
- It is important not to get caught up in inter-bank jargon and would advise that this phrase is not used when discussing Bank Guarantees as it neither concerns the client nor the recipient. Its meaning is strictly inter-bank communication and nothing else.

Documentary Letters of Credit

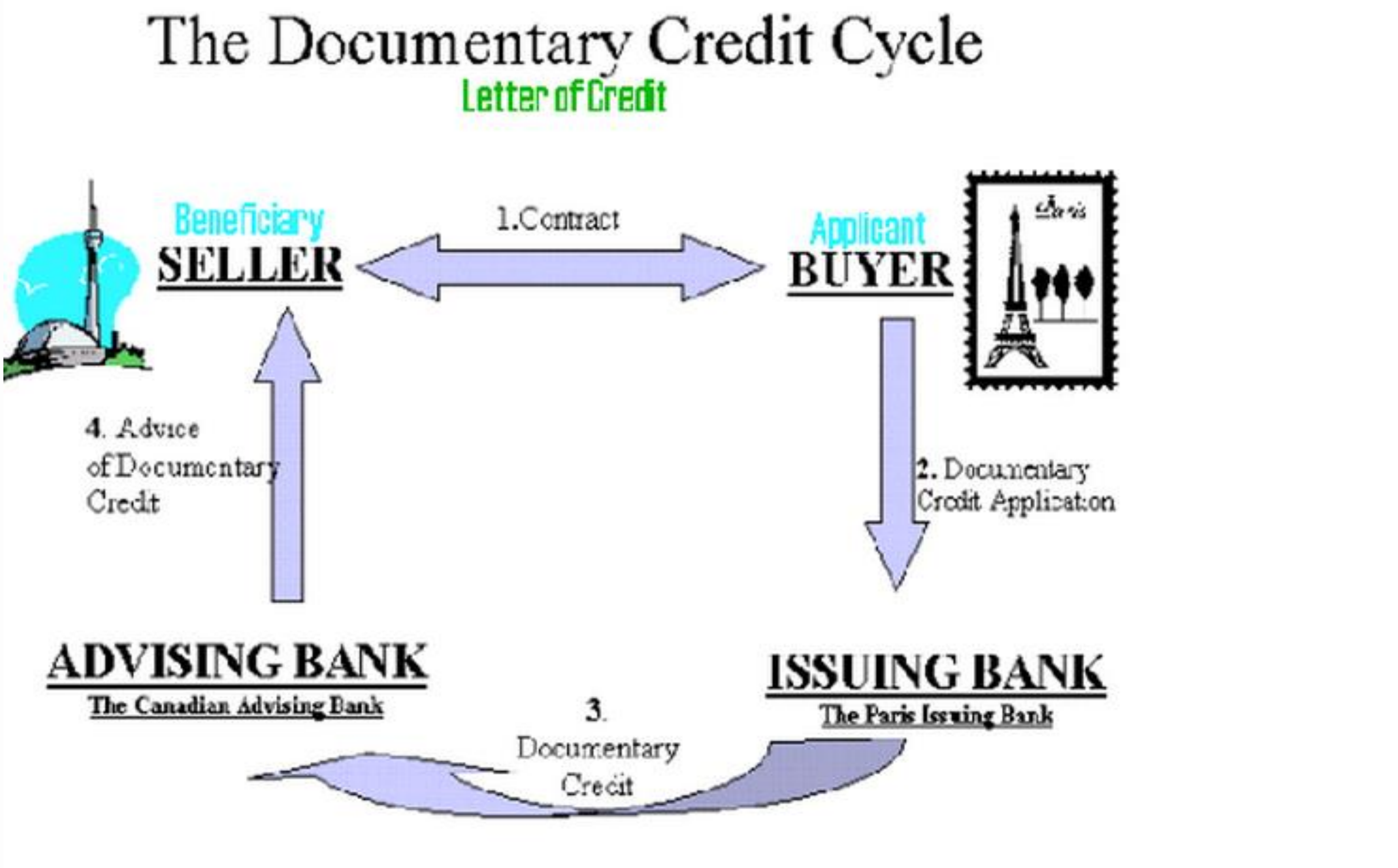
Documentary Letters of Credit (LC’s)

- What is a Letter of Credit
  - A Letter of Credit is a payment term generally used for international sales transactions. It is basically a mechanism, which allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved.
  - The technical term for Letter of credit is 'Documentary Credit'. At the very outset one must understand is that Letters of credit deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus a LC (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of the applicant i.e. the buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the LC is referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the LC to the Seller is called the Advising Bank which is generally in the country of the Seller.

Documentary Letters of Credit (LC's)

- The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the 'documents' and not the 'goods' for making payment. Thus the process works both in favor of both the buyer and the seller. The Seller gets assured that if documents are presented on time and in the way that they have been requested on the LC the payment will be made and Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and ensure that they meet the terms and conditions stipulated in the LC.

The cycle


The Documentary Credit Cycle
Letter of Credit
Beneficiary
SELLER
1.Contract
Applicant
BUYER
4. Advice of Documentary Credit
2. Documentary Credit Application
ADVISING BANK
The Canadian Advising Bank
ISSUING BANK
The Paris Issuing Bank
3. Documentary Credit

Typically the documents requested in a Letter of Credit are the following:

- Commercial invoice
- Transport document such as a Bill of lading or Airway bill,
- Insurance document;
- Inspection Certificate
- Certificate of Origin

  But there could be others too.

Documentary Letters of Credit (LC's)

- Letters of credit (LC) deal in documents, not goods. The LC could be 'irrevocable' or 'revocable'. An irrevocable LC cannot be changed unless both the buyer and seller agree. Whereas in a revocable LC changes to the LC can be made without the consent of the beneficiary. A 'sight' LC means that payment is made immediately to the beneficiary/seller/exporter upon presentation of the correct documents in the required time frame. A 'time' or 'date' LC will specify when payment will be made at a future date and upon presentation of the required documents.
- ***Deferred LC means that payment is made within a specified period acceptable between buyer and seller.

Documentary Letters of Credit (LC's)

- The letter of credit should have an expiration date that gives sufficient time to the seller to get all the tasks specified and the documents required in the LC. If the letter of credit expires, the seller is left with no protection. Most LC s fail because Sellers/Exporters/Beneficiaries were unable to perform within the specified time frame in the LC. Three dates are of importance in an LC:
  a) The date by when shipment should have occurred. The date on the Bill of Lading.
  b) The date by when documents have to be presented to the Bank
  c) The expiry date of the LC itself.
- A good source to give you an idea of the timelines would be your freight forwarding agent. As a seller check with your freight forwarding agent to see if you would be in a position to comply.

Documentary Letters of Credit (LC's)

- Letters of credit are about documents and not facts; the inability to produce a given document at the right time will nullify the letter of credit. As a Seller/Exporter/Beneficiary you should try and run the compliance issues with the various department or individuals involved within your organization to see if compliance would be a problem. And if so, have the LC amended before shipping the goods.
- Shipping terms set the parameters for international shipments, specify points of origin and destination, outline conditions under which title is transferred from seller to buyer, and determine which party is responsible for shipping costs. They also indicate which party assumes the cost if merchandise is lost or damaged during transit. To provide a common terminology for international shipping, INCOTERMS (International Commercial Terms) have been developed under the auspices of the International Chamber of Commerce.

'ALBATROSS BUILDING SOCIETY'