

Understanding and Using Letters of Credit LC

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SPAIN, April 1, 2020 /EINPresswire.com/ -- [Letter of Credit](#) accomplish their purpose by substituting the credit of the bank for that of the customer, for the purpose of facilitating trade. There are basically two types: commercial and standby. The [commercial letter of credit](#) is the primary payment mechanism for a transaction, whereas the standby letter of credit is a secondary payment mechanism.□



Commercial Letter of Credit:

Commercial letters of credit have been used for centuries to facilitate payment in international trade. Their use will continue to increase as the global economy evolves.□

Letter of credit used in international transactions are governed by the [International Chamber of Commerce](#) Uniform Customs and Practice for Documentary Credits. The general provisions and definitions of the International Chamber of Commerce are binding on all parties. Domestic collections in the United States are governed by the Uniform Commercial Code.□

A commercial letter of credit is a contractual agreement between a bank, known as the issuing bank, on behalf of one of its customers, authorizing another bank, known as the advising or confirming bank, to make payment to the beneficiary. The issuing bank, on the request of its customer, opens the letter of credit. The issuing bank makes a commitment to honor drawings made under the credit. The beneficiary is normally the provider of goods and/or services. Essentially, the issuing bank replaces the bank's customer as the payor.□

Elements of a Letter of Credit:□

- A payment undertaking given by a bank (issuing bank)□
- On behalf of a buyer (applicant)□
- To pay a seller (beneficiary) for a given amount of money□
- On presentation of specified documents representing the supply of goods□
- Within specified time limits□
- Documents must conform to terms and conditions set out in the letter of credit□
- Documents to be presented at a specified place

Beneficiary:□The beneficiary is entitled to payment as long as he can provide the documentary evidence required by the letter of credit. The letter of credit is a distinct and separate transaction from the contract on which it is based. All parties deal in documents and not in goods. The issuing bank is not liable for performance of the underlying contract between the customer and beneficiary. The issuing bank's obligation to the buyer, is to examine all documents to insure that they meet all the terms and conditions of the credit. Upon requesting demand for payment the beneficiary warrants that all conditions of the agreement have been complied with. If the beneficiary (seller) conforms to the letter of credit, the seller must be paid by the bank.□

Issuing Bank:□The issuing bank's liability to pay and to be reimbursed from its customer becomes absolute upon the completion of the terms and conditions of the letter of credit. Under the provisions of the Uniform Customs and Practice for Documentary Credits, the bank is given a

reasonable amount of time after receipt of the documents to honor the draft.

The issuing banks' role is to provide a guarantee to the seller that if compliant documents are presented, the bank will pay the seller the amount due and to examine the documents, and only pay if these documents comply with the terms and conditions set out in the letter of credit. Typically the documents requested will include a commercial invoice, a transport document such as a bill of lading or airway bill and an insurance document; but there are many others. Letters of credit deal in documents, not goods.

Advising Bank: An advising bank, usually a foreign correspondent bank of the issuing bank will advise the beneficiary. Generally, the beneficiary would want to use a local bank to insure that the letter of credit is valid. In addition, the advising bank would be responsible for sending the documents to the issuing bank. The advising bank has no other obligation under the letter of credit. If the issuing bank does not pay the beneficiary, the advising bank is not obligated to pay.

Confirming Bank: The correspondent bank may confirm the letter of credit for the beneficiary. At the request of the issuing bank, the correspondent obligates itself to insure payment under the letter of credit. The confirming bank would not confirm the credit until it evaluated the country and bank where the letter of credit originates. The confirming bank is usually the advising bank.

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