

Documentary credits Documentary collections Bank guarantees

**A guide to safer
international trading**

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Credit Suisse Special Publications, Vol. 69



Preface

for

Credit Suisse The People's Construction Bank of China
Joint Documentary Credit Publication in Chinese

The rapid changes in China's financial markets in recent years have, among others, brought about an increase in the number of those banks and financial institutions entitled to engage in documentary transactions. As a result numerous institutions have been faced with the challenge of developing comprehensive documentary services within a comparably short period of time. While the topic had been covered by some related Chinese publications, Chinese experts were at the same time also looking for a practical handbook, summarizing the know-how and expertise gathered by large commercial banks in the course of their long-standing documentary experience.

It therefore gives us great pleasure and fills us with pride that Credit Suisse has the privilege of contributing to the training of young Chinese bankers through the Chinese edition of the Credit Suisse documentary brochure.

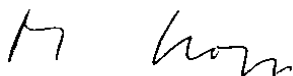
We consider the present publication a milestone in the rewarding relationship that has developed between our two banks over the years, the basis of which was laid through the joint signature of

Cooperation and Agency Agreements.

It will also serve to enhance the Sino-Swiss trade relationship that has witnessed a steady expansion ever since the early establishment of diplomatic ties between the People's Republic of China and Switzerland in January 1950.

The translated version was made possible through a joint effort of experts from The People's Construction Bank of China and Credit Suisse. It was Mr. Mao Yumin of The People's Construction Bank of China who took the initiative and organized a group of young talented experts that embarked with great enthusiasm on this very time-consuming and demanding task. They were Mr. Guo Caiming, Ms. Wang Baoya, Mr. Liu Haisheng, Mr. Ji Shenghua, Miss Wu Chuanhong, Mr. Li Biao, Ms. Yan Qingfang and Mr. Ma Jian. Ms. Pan Hong of Credit Suisse Beijing Representative Office and Miss Winnie Li of Credit suisse Hong Kong Branch also offered their advice in the process of completing the Chinese version. We would like to seize this opportunity to thank all of them for their dedicated efforts.

Allow us to extend our best wishes to those who may find this publication helpful for their daily work. May they succeed in effectively contributing to the further success of the modernization of China's financial sector.



Dr. Max Kopp
Member of the Executive Board
Credit Suisse



Zhou Daojiong
President
PCBC

Dear Reader,

In the world of business, those who supply goods or services must be paid for them. And those who make payments are entitled to expect goods or services in return. An economy based on the division of labour cannot function in any other way.

In international trade, however, the smooth operation of this process of exchange cannot be taken for granted. The movement of merchandise and the transmission of payments present difficult technical problems. Moreover, it is no easy matter to ensure that a payment or delivery, having been promised, will actually be made.

This handbook is concerned with the second of these two classes of problems. It provides an introduction to the principal instruments for achieving security of payment (documentary credits and documentary collections) and security of performance (bank guarantees). It does not, on the other hand, deal specifically with the instruments by which international payments are transmitted (bills of exchange, transfers, bankers' drafts and cheques).

Designed as a practical guide for use in commerce and industry, this book will provide the reader with useful advice and information at every stage of an international transaction. It will also appeal to students and members of the general public who wish to acquire a basic understanding of the risks of international trade and the means by which they can be contained. We make no pretensions, however, to completeness or absolute legal precision. In difficult cases, our specialists will be happy to provide further advice.

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Abbreviations

Art	Article
BGE	"Bundesgerichtsschied" (Judgement of the Federal Court)
CO	Code of Obligations (Swiss)
EEC	European Economic Community
EFIA	European Free Trade Association
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
L/C	Letter of credit
UCP	Uniform Customs and Practice for Documentary Credits
URC	Uniform Rules for Collections

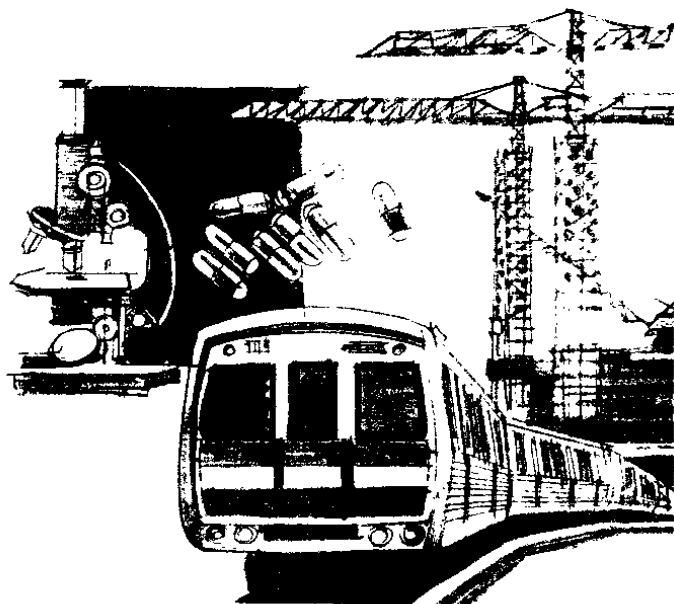
I

Risk and security in international trade

The realities of the Swiss economy – the need for imported food, the scarcity of raw materials, the high degree of industrial specialization and the relatively small size of the home market – produce a very heavy dependence on foreign trade. In 1983, imports and exports of goods and services each account-



ed for about 33 % of Switzerland's gross national product. This situation is a source of both opportunity and risk. On the one hand, Switzerland enjoys the benefits that flow from specialization and the international division of labour; on the other, this international orientation makes Switzerland increasingly dependent on political and economic developments in the rest of the world.

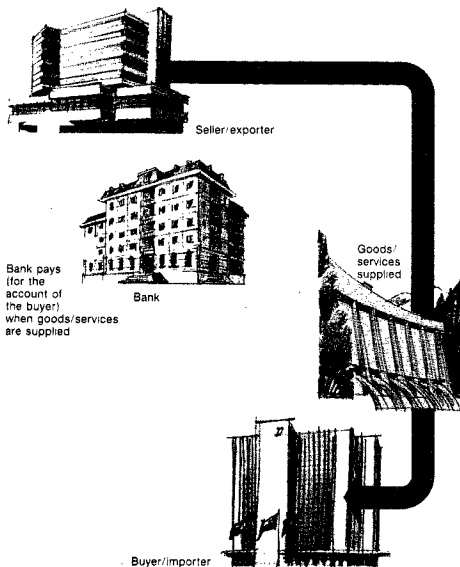


New realities

The environment in which Swiss industry and commerce operate has been transformed in recent years by a whole range of political and economic factors. Foreign trade has become more important than ever, but also more complex. The major developments have been:

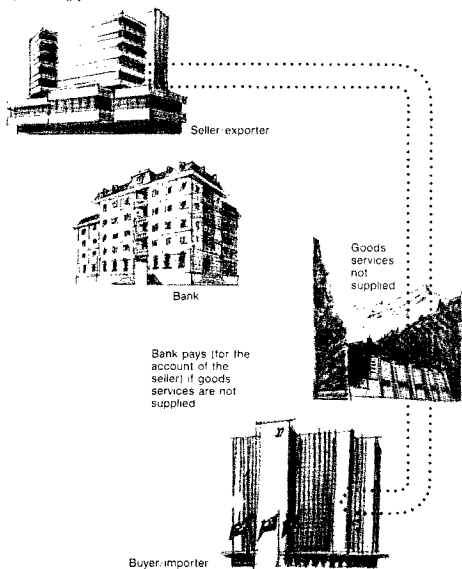
Opening-up of the Swiss market	Trade agreements (GATT, EFTA, EEC, UNCTAD)
Debt problems	Decline in exports to debtor countries
Fluctuating prices of raw materials and energy	Oil
Battle against inflation	Restrictive economic policies and high interest rates despite a general easing of inflation
Fiercer competition in quality products	Japan
Pressure of imports from the industrializing 'threshold nations'	e.g. Taiwan, Singapore, Hong Kong, Korea
Protectionist trends	especially in periods of rising unemployment
Erratic exchange rate movements	since the change-over to floating exchange rates
Fluctuating levels of economic activity	especially in the industrialized nations; recovery of the world economy since 1983, but unemployment remains high
International trade imbalances	Large shifts in balances on current account, especially in the case of OECD countries
Global political tensions	East-West relations, North-South problem
Regional political conflicts	Middle East, Gulf region
National upheavals	Central America, Lebanon

a) Securing payment



The aim is to ensure prompt payment for goods or services. Thus instruments for securing payment are chiefly for the protection of the seller-exporter.

b) Securing performance



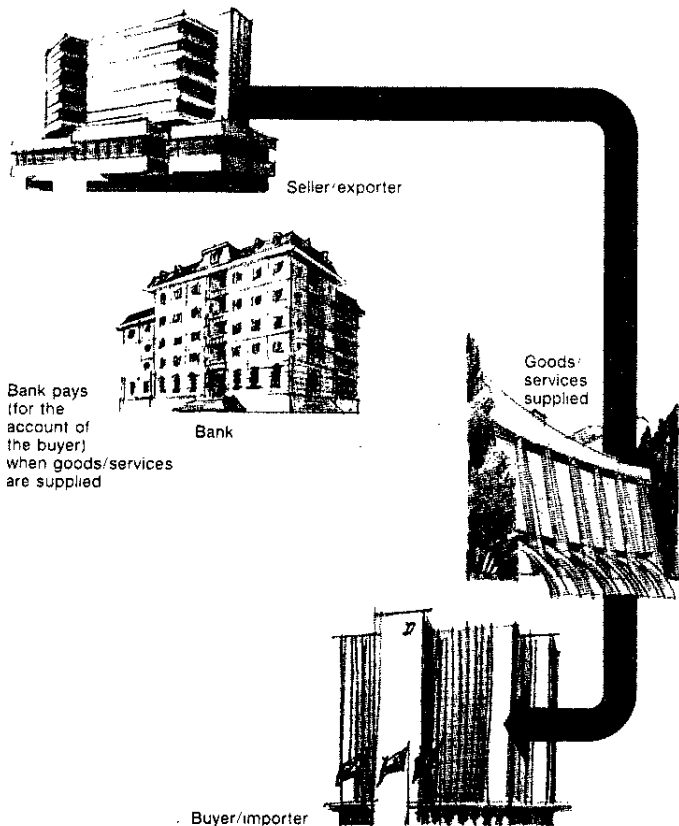
The aim is to ensure performance of the contract by the seller. Thus instruments for securing performance protect the interests of the buyer-importer.

The need for security

The risks involved in international business must be carefully weighed. Clearly, this is no easy matter, especially when capital goods with lengthy periods of manufacture or assembly are involved and the transaction is going to take many years to complete. Thanks to their extensive experience in this field, the banks can make an important contribution to the smooth operation of this type of business, whether the transaction involved is simple or complex. When planning and negotiating large projects, it is therefore advisable to call in a competent bank at an early stage.

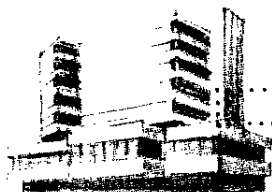
A contract concluded between Swiss parties normally provides adequate assurance that both the buyer and the seller will meet their obligations. Such transactions are subject to Swiss law, and it is an easy matter to check up on the creditworthiness and business reputation of the other party. Any legal proceedings or debt-collection measures will come within the jurisdiction of the courts and authorities of Switzerland. In the home market, settlement is therefore usually on 'open account'; the seller presents his invoice only after the goods or service have been supplied. By contrast, a simple contract with a foreign party does not provide adequate security unless the participants have a long-standing relationship of trust or a strong common interest (e.g. financial ties). Moreover, the political, economic and legal situation in the country of the foreign party must be stable. If these conditions are not met, additional security is required.

a) Securing payment



The aim is to ensure prompt payment for goods or services. Thus instruments for securing payment are chiefly for the protection of the seller-exporter.

b) Securing performance



Seller exporter

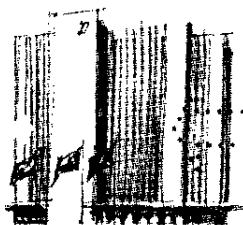


Bank

Bank pays (for the account of the seller) if goods services are not supplied



Goods
services
not
supplied



Buyer importer

The aim is to ensure performance of the contract by the seller. Thus instruments for securing performance protect the interests of the buyer importer.

In order to meet the need for security of payment and performance, the banks offer a wide range of instruments designed to cover the differing requirements of buyers and sellers. Each case must be carefully examined in order to ascertain which instruments are necessary and appropriate. The following summary outlines the main features of the various instruments available

Summary of instruments for securing payment

Banks provide two classic instruments for achieving security of payment in foreign trade transactions: the **documentary credit** and the **documentary collection**. Exporters can also avail themselves of a 'non-recourse' financing facility: **forfaiting**. Being primarily a financing technique, this facility does not come within the scope of this book, but it is mentioned here because to a certain extent it also has a payment-securing effect. Nor shall we consider state-run schemes for insurance cover against trading risks (Export Risk Guarantee).

Forfaiting described in the booklet "Forfaiting" in the CS Special Publications Series

Documentary credit

A documentary credit is basically an undertaking given by a bank at the request of a customer to pay a particular amount in an agreed currency to a beneficiary on condition that the beneficiary presents stipulated documents within a prescribed time limit.

Thus the bank acts as an intermediary between the buyer and the seller. Settlement is effected through the bank by means of a direct exchange: the beneficiary presents the required documents to the bank and receives in return the amount specified in the **credit** (in the form of cash, an accepted bill of exchange or an undertaking to pay depending on the terms agreed). Under a documentary credit, the beneficiary no longer has to rely on the buyer's ability or willingness to pay and can obtain liquid funds shortly after dispatching the goods.

As an instrument for securing payment, a documentary credit is particularly well suited to reconciling the conflicting interests of the buyer and the seller.

- The **seller** wants to be sure that the amount owed to him for the goods he has delivered will be paid in the correct currency and as soon as possible
- The **buyer** does not want to have to pay for the goods before they have actually been dispatched to him.

Documentary collection

A documentary collection is an operation whereby a bank collects a payment for a customer by delivering documents to the buyer.

Here again the bank acts as an intermediary between the buyer and the seller. In this case, however, the seller does not receive payment until after the documents have been handed over to the buyer. He therefore has to wait longer for his money than he would if he were being paid under a documentary credit. Moreover, his risk is less fully covered: at the moment when he sends off the goods he still has no assurance that the buyer or the buyer's bank will pay. He has to trust in their ability and willingness to do so. **Documentary collections** are therefore normally used only when the buyer and seller already know each other to be reliable.

Documentary credits and documentary collections each have their specific advantages:

Documentary credit

Can be used to secure payment for transactions with virtually every country in the world.

Amount due is available to the seller at an early stage.

Flexibility in respect of the terms of payment with no impairment of security.

Suitable as an instrument for short-term financing.

Rapid and trouble-free settlement, possibly enabling the seller to offer attractive discounts.

Exceptionally high degree of legal security throughout the world.

Documentary collection

Offers substantially higher security than settlement on open account.

Settlement usually faster than on open account (thanks to the presentation of documents through a bank).

Seller can request an official confirmation of non-payment (protest), which speeds up the recovery of the debt and simplifies the collection of interest on arrears.

Large measure of flexibility for both buyers and sellers thanks to few formal requirements.

Low cost.