



Standard banking practice approved

by Donald R. Smith

In political parlance, an overwhelming majority of ICC members voted for the acceptance of the International Standard Banking Practice for the Examination of Documents under Documentary Credits (ISBP), at the recent meeting in Rome. The final tally, of 57-8 (32 committees for, 3 against) was a fitting reward for more than two years of meticulous work on the part of the task force in order to document standard practices worldwide. It is anticipated that the document, which is to be read in conjunction with the UCP 500, will be welcomed by letter of credit practitioners globally.

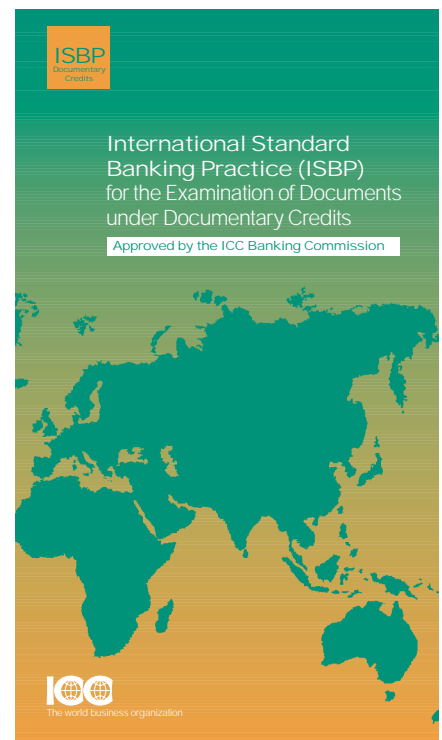
The following, from the introduction of the ISBP further clarifies the relationship to the UCP 500: "This document does not amend UCP 500. It explains how the practices articulated in the UCP are to be applied by documentary practitioners. It is, of course, recognized that the law in some countries may compel a different practice than that stated here." In other words, the authors recognize the primacy of the UCP and do not expect that credits will be written subject to both the UCP and the ISBP. They do, however, expect that ISBP will be widely used in the day-to-day practice of documentary practitioners. It is the hope of its authors, as well as the ICC, that its widespread use will greatly facilitate uniformity in the

preparation and review of documents under letters of credit – dramatically reducing the number of documents rejected for discrepancies on first presentation.

Some history

The dismal letter of credit statistics presented at the May 2000 meeting of the ICC Commission on Banking Technique and Practice delivered a clear message: it was time to heed Martin Shaw's "Call to Action," first published in the Spring 1999 issue of *DCInsight*. Shaw, a well-recognized 30-year veteran of international trade finance, defined the issue in blunt terms: "Apparent/alleged discrepancies – that's the real problem: personal opinions, different experiences amongst practitioners, different attitudes, subjective approaches, questions of interpretation." ¹

His recommended solution: further development and endorsement, by ICC, of the International Financial Services Association's (IFSA) 1996 publication "Standard Banking Practice for the Examination of Documents." In addition, Shaw encouraged incorporating applicable ICC Opinions and suggested "the ICC should itself take on the task of formulating and articulating 'international standard banking practice' in a more detailed way than UCP 500 can achieve on its own." ²



Ready soon!

Flood of queries

Indeed, with publication of UCP 500 (1993 Revision), there have been more than 600 educational queries since 2000, a clear indication of the need to address the issue voiced by Martin Shaw – and others before him. In the 1996 issue of *DCInsight*, Reinhard Langerich remarked: "Banks are not expected to know about the underlying contracts or local usage, but where does 'international standard banking practice' come into the picture? Are bankers expected to have knowledge of relevant laws? Should they look at whether the documents are filled in completely, not only with regard to the

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Editor's note

We hope you will excuse us for holding up this issue of *DCI* for a couple of weeks. We did so because the ICC Banking Commission was meeting on 30-31 October in Rome, and there were items on the agenda that were significant enough to warrant a delay in our distribution.

The first of these, of course, was the paper "International Standard Banking Practice for the Examination of Documents under Documentary Credits", or ISBP as it is more conveniently called. The strong majority vote in favour of this document, even from some ICC national committees that were originally sceptical about its usefulness, testifies to the importance the documentary credit community attaches to this text. For despite several volumes of Banking Commission Opinions – and the Decisions and clarifying papers issued by the Banking Commission over the years – the hard fact is that discrepancy rates are still far too high.

That's why the Banking Commission took on the task of "putting meat on the bones", of setting forth what constitutes international practice on letters of credit as called for in Article 13 of UCP. Time will tell if this document will have the impact the Banking Commission expects. The precedents are encouraging: a pioneering document on the subject, issued by IFSA several years ago, succeeded in dramatically reducing discrepancy rates on credits involving Mexican and US banks.

The second item concerns a review leading to a future revision of UCP. The operative word here is "review". For what the Banking Commission decided was to begin the process of reviewing existing UCP Articles to determine which of them should be changed in a future UCP. Seven of the Articles – the ones that have generated the most queries – have already been reviewed by the Commission's Technical Adviser. Now the Commission has to go through the same process for the other 42 Articles.

Only then – and that is probably a year off – would the drafting of a revision begin. So we repeat: this is a long, long process. Your UCP 500 – and the new standard banking practice paper – will still grace your desk for years to come.



Ron Katz
Editor

UCP developments

A review of UCP Articles begins

The first hesitating steps leading to a future UCP revision are underway. But Banking Commission members caution readers not to assume that a UCP 600 is around the corner. We are talking years here, not months.

At the Rome Banking Commission meeting, Gary Collyer, the Commission's Technical Adviser, laid out for members some of the questions/issues that would have to be addressed concerning the seven UCP Articles that had generated more than 55 per cent of the queries on the rules. Only a partial list follows:

Article 9

- Issues relating to difference between payment, acceptance and negotiation.
- When is a 'sight' letter of credit a deferred payment (issue of number of days pre-payment notification)?

Article 13

- What is close of business for the purposes of reasonable time?
- What are banking days? Does this include short working days (Saturdays)?

Article 14

- The issues surrounding liability of issuing bank having sought and received waiver, holding documents at disposal, clarity of discrepancies observed and the discrepancies being contained within one single advice of refusal.

Article 21

- Review of non-transport documents (i.e. those not covered by articles 23-29) under this Article.
- Dating of documents after the shipment date.

Article 23

- What is deemed to be the bill of lading date?
- Ports of loading in the L/C appearing as the place of receipt on B/L and how to make this acceptable under the UCP.

Article 37

- Use of a shortened goods description in the invoice where the credit covers more than one type of goods and only one type shipped.
- Need for address of applicant or beneficiary to be exactly as per L/C and does this include fax, phone,

email details?

Article 48

- This Article needs to consider the issues that have been raised and covered in the Transferable Credits and Article 48 paper (soon to be posted on the ICC website).

In addition to provisions currently in the UCP, the Commission will need to look closely at other ICC rules, i.e., URR 525, ISP98 and the eUCP, to see whether they should be incorporated into the revision. However, the decisions on how and whether to incorporate parts of all of these other rules will be put off until the end of the review period.

The process

The Commission has decided to proceed in stages. First, a small group will set out the issues needed to be reviewed in the remaining 42 Articles of the UCP. Once that list has been compiled – probably late in 2003 – a drafting group will review the issues and try to develop a first draft of a suggested revision. Then, and only then, will the draft be open to general comment by ICC national committees and others.

The process is intended to ensure that the basic issues are carefully articulated before the rush of comments comes in. Of course, when the time for comments arrives, all issues, including some that may not be in the list, will be considered. A consultative group – consisting of members from the transport community and several other disciplines – will also be established to react to drafts produced by the core drafting group. The aim is to make any revision a broad-based one.

If past experience is any guide, once an initial draft is produced, it will be at least 2-3 years before a final draft is approved. This means several drafts and several rounds of comments have to be considered. From the time of approval of a final draft, another six months will elapse before new rules come into force.

In short, if, as the Chinese say, a journey of a thousand miles begins with a single step, the Banking Commission is only a few steps down the road towards an eventual destination. ■

Expert commentary

Alternative financial products: the silent payment guarantee

by Arjuna Balasingham

Arjuna Balasingham is Senior Manager of Structured Trade and Commodity Finance at Bank of Tokyo Mitsubishi Ltd in London. He has spent around 21 years in trade finance and has held various positions in international operations, credit risk management, general management, marketing and business development.

Exporters have traditionally relied on the letter of credit as an instrument of choice for mitigating the risk of financial default by their buyers. This works fine when both the buyer and seller agree on contract terms that require payment by means of an L/C. However, due to changes in market or industry practice, this may not always be practical.

For example, suppose the State Procurement Company in an emerging market country seeks to import petroleum products. It would typically put out a supply contract for open tender. Here pre-qualified international oil trading companies would be invited to submit sealed bids for the supply of the required petroleum products.

But this is a highly competitive market. The successful bidder will not be chosen solely on the basis of the supply price; consideration will also be given to extended payment terms and credit terms offered by potential suppliers. Therefore, the oil trading company, in order to win the contract, may offer unsecured payment terms without the security of an L/C.

The successful oil trading company would typically prefer to have security for the transaction because it has conservative risk management policies that require it to mitigate against the risk of financial default by the buyer. The challenge here for the oil trader is to find appropriate security without the cooperation or the knowledge of the State Procurement Company.

Recent years have seen the market develop a few alternative financial products to meet this need. One such

product that has become increasingly popular is the silent payment guarantee.

What is a silent payment guarantee?

This product competes with credit risk insurance and credit derivatives.

In brief, the silent payment guarantee is a conditional financial guarantee issued by a bank in favour of the exporter to indemnify the exporter against financial default by the buyer.

The seller of the goods (the "seller") in connection with payment obligations of the buyer (the "buyer") under a commercial contract between the buyer and the seller (the "contract") requests the bank (the "issuing bank") to issue a silent payment guarantee (the "SPG") in the seller's favour.

As the name implies, the issuance of the SPG is silent, i.e., it is issued in favour of the seller without the knowledge

of the buyer. The initial commercial parties to the SPG are the seller and the issuing bank. At this stage the issuance of the SPG will not be disclosed to the buyer. It is designed to offer protection to the seller in the event the buyer defaults on payment after delivery of the goods, e.g., due to bankruptcy or a foreign debt moratorium in the country of the buyer.

The issuing bank will disclose to the buyer that it has issued the SPG only in the event the seller makes a demand under the SPG. The issuing bank's means of recovery will be primarily one of the following:

- by perfecting an assignment of the seller's right to payment from the buyer

under the contract (i.e., the rights of the seller under the contract are transferred to the issuing bank which may then pursue recovery directly against the buyer), provided, of course, it is possible under the terms of the contract and its relative governing law; or

- by subrogating under the seller's right to payment under the contract, (i.e., by virtue of its right to subrogation, the issuing bank may "stand in the shoes of" the seller and bring a recovery action against the buyer who is in default); and in addition,

- the issuing bank will have the right to direct the seller to enforce the contract against the buyer.

Buyer's payment obligation

Typically there are two ways to establish the buyer's payment obligation:

1. In some cases the buyer's payment obligation under the contract will be evidenced by a written payment undertaking from the buyer to the seller in the form of a simple payment undertaking stating the amount and due date. This is not a promissory note but rather an irrevocable signed undertaking from the buyer to the seller to effect payment upon receipt of relevant shipping documents; or

2. In other cases, there will be no separate payment undertaking; rather there will be specific conditions for payment within the terms of the contract, such as shipment of a specified quantity of a specified good within a specified time period for a specified unit price.

Any claims by the seller under the SPG will be honoured by the issuing bank after (i) clearly establishing there has been financial default by the buyer; and (ii) perfecting the issuing bank's security rights to receive payment under the contract, (e.g., assignment and/or subrogation), as mentioned above.

Limited recourse to the seller

In any event, the issuing bank only assumes the financial payment risk, including the transfer risk in connection with currency convertibility, from the buyer. The issuing bank does not assume any commercial or performance risk. In the event of the buyer subsequently refusing to pay the issuing bank because of a contractual dispute, the seller must



Balasingham: "this is a highly competitive market"

promptly repay any sums paid by the issuing bank under the SPG.

The onus is then on the seller to pursue legal action against the buyer and to obtain a legal and enforceable judgment with respect to the contract dispute against the buyer. If the buyer continues to default on its financial obligation, notwithstanding such a judgment, the seller is then entitled to claim for indemnification from the issuing bank under the SPG.

Excluded risks

The SPG will not cover the seller for the following risks: (i) contract disputes; or (ii) performance risks of the seller. This will be clearly stated in all documentation. The seller will not be entitled to indemnification in the event the buyer refuses to pay on the basis of a contract dispute.

Conditionality

The issuing bank's obligations under the SPG are conditional and can be separated into three stages:

1. Conditions precedent to the effectiveness of the SPG will include:

- Delivery of a certified copy of the contract; evidence that the seller has properly authorized execution of the relevant agreements;

- Valid signature authorizations.

2. Conditions that must be met to ensure a valid demand from the seller on the issuing bank will include:

- Assignment of the contract and notice of such assignment will have been executed (to enable the issuing bank to pursue a legal claim directly against the buyer);

- Signing of the demand, which must be by an authorized signatory of the seller; and

- Accompanying the demand by certified copies of the relevant invoice and other documentation required for payment under the contract, a payment undertaking if applicable, and a statement to the effect that non-payment of one of the covered risks has occurred.

Additional conditions which must be satisfied before the issuing bank makes payment include:

- The seller shall warrant that there are no contract disputes between the seller and the buyer.

- Payment of fees will have been effected.

3. Post-payment steps: after the issuing bank has made payment under the SPG to the seller it will seek to enforce its right directly against the buyer and will also ensure that the seller agrees to:

- take all reasonable actions requested by the issuing bank to assist in enforcing the issuing bank's rights against the buyer to receive payment under the contract;

- pay to the issuing bank all amounts recovered up to the amount paid by the issuing bank to the seller under the SPG;

- if the buyer disputes the payment obligation under the contract, promptly repay any sums paid by the issuing bank under the guarantee. (The issuing bank will then retain these sums unless and until it is satisfied that there has been a legal and enforceable judgment with respect to the contract dispute against the buyer.)

Credit considerations

It should be noted that the risks to the issuing bank vis-à-vis the buyer and the seller are different in each case.

■ **Buyer risk:** The primary risk to the issuing bank is (i) that the buyer may default on its payment obligation (for example, due to bankruptcy); or (ii) the buyer may be unable to effect payment due to the unavailability of foreign exchange in his country, if, for instance, there is a foreign debt moratorium. Therefore, before entering into a SPG transaction, critical criteria for the issuing bank are the track record and credit-worthiness of the buyer, as well as related

country risk considerations. Typically these will be addressed by setting up unadvised credit limits for the buyer.

■ **Seller risk:** The primary risk for the seller is (i) financial risk covering its limited recourse liability to repay funds drawn under the SPG in the event the buyer subsequently claims non-payment on account of a commercial dispute; or (ii) the need to ensure continued cooperation with the issuing bank in order to take all reasonable actions requested by the issuing bank to assist in enforcing its rights against the buyer.

Typically, therefore, this product will only be offered to sellers who are long-standing clients of the issuing bank and who are also market leaders in their sector, with strong balance sheets and a proven

track record of contract completion with the buyer.

Other considerations

For accounting purposes the SPG is treated as a financial guarantee with 100% risk weighting on the issuing bank's balance sheet. These transactions will be priced to meet requirements of the issuing bank for a fair return. In most cases, the pricing will far exceed the relevant rate for lending directly to the buyers in question on the basis of the country risk involved.

While the SPG is a specialized product, it is no more complex than other comparable products such as credit risk insurance. Banks active in this market appear to be able to market and deliver this product using their existing trade finance capability. However, the support of a competent legal department is a critical factor in ensuring its successful use. ■

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" ... this product will only be offered to sellers who are long-standing clients of the issuing bank "

Pakistan/Ex-Im Bank agree on L/Cs

Pakistan and the US Export-Import Bank (Ex-Im Bank) have signed a letter of awareness, enabling at last the bank to open its letter of credit programme in Pakistan. Ex-Im Bank's L/C insurance policies are available to cover

L/Cs issued by three banks in Pakistan – National Bank of Pakistan Ltd., United Bank of Pakistan Ltd., and Muslim Commercial Bank Ltd. According to this arrangement, the banks will receive all requisite permits to obtain the foreign exchange necessary to fulfil their dollar obligations under L/Cs. The

programme obviously aims to stimulate US exports to Pakistan. These have increased markedly since the US decided to warm to Pakistan's military regime in the wake of the 11 September attacks and the subsequent political imperative for Washington to befriend countries thought to cradle Al Qaeda cells.

Fraud journal

Crumbs of comfort in massive metals frauds

by Mark Ford

If allegations of false accounting and fraud are proven, banks caught up in apparently bogus metal trades involving London-based RBG Resources plc and New Jersey-based Allied Deals Inc. – and possibly some related companies – stand to lose as much as USD 1 billion. This exceeds the estimated USD 600 million bill faced by banks embroiled in the Solo Industries scam, aspects of which have vexed documentary credit professionals for more than three years.

Striking similarities between the two cases spring out instantly. This has prompted an immediate response from those who claim new online trade finance mechanisms are more secure than paper-based instruments, since the alleged frauds, they say, would not have happened so easily had the transactions been conducted online. Meanwhile, creditors involved in either case may find some small crumbs of comfort in recent judgments that could make it somewhat easier for banks to recover funds, even in cases where comprehensive fraud is proven.

Impact of other frauds

The scale of alleged frauds at RBG/Allied Deals and related companies might have been larger still had it not been for the current mood of concern over corporate governance and the roles and responsibilities of auditors.

PricewaterhouseCoopers (PwC) resigned as the auditors of London-based RBG Resources plc the month after Enron's collapse cast a dark shadow over its auditors and after investigations into six of RBG's specific counterparties raised concerns over the authenticity and independence of these entities. Following PwC's resignation, one of RBG's largest creditors, WestLB, engaged the services

of Arthur Andersen to discover what was going on. "What Arthur Andersen appeared to discover was that much of the business conducted by RBG Resources and the RBG group was fictitious," Mr Justice Laddie said at a UK High Court hearing.

What actually happened at RBG's London offices has yet to be revealed. Justice Laddie, however, surmised that liquidators from the accountancy firm Grant Thornton had outlined "a strong prima facie case of fraud" and decided it was right for the court to assist the hunt for the USD 400 million that he concluded had "gone walkies".

The judge added that there was probably very little left in RBG's coffers from which creditors would be able to recover funds. "There would be an enormous amount of money coming in," he said, if trades on RBG's books had not been bogus. "What is terribly noticeable is that there has not been any incoming money for nearly a month, and some has been outstanding for nearly three months," he added.

The judge's decision at the hearing to extend injunctions and freezing orders on three directors and an employee of RBG represented what a Grant Thornton spokesman described as a "landmark"

decision. The court decided in July to lend a hand in the hunt for RBG's assets that the liquidators allege are missing. They have been authorized by the court to question Virendra Rastogi and Anand Jain, directors of the RBG's London-based operation under oath.

Charges

Freezing orders were originated in May after raids on the London premises of RBG Resources plc – better known as the former Allied Deals plc – by police and

the UK's Serious Fraud Office (SFO). The company's majority shareholder, Virendra Rastogi, was arrested and then released on bail. Days later his brother and chief executive of New Jersey-based Allied Deals Inc, Narendra Kumar Rastogi, was arrested in New York along with three of his colleagues.

Prosecutors in the US have charged the four Allied Deals executives with involvement in what they say is a USD 600 million bank fraud and officials have been forthright in their accusations of what they think happened at Allied Deals. James B Comey, US attorney for the Southern District of New York, said the four metal traders had been involved in conduct that included "outright falsification of documents and a complex scheme to cover up fraud of astonishing scope and magnitude".

A complaint opened at the US attorney's office says the Allied Deals executives represented themselves as brokers to non-ferrous metals suppliers and buyers, arranging for shipments and providing financing for purchases involving parties in India, Hong Kong, Singapore and the United Arab Emirates (UAE).

According to the well-regarded metals industry news source, Metals Bulletin, metals trading companies linked to the Rastogi family continue to operate in the UAE and Singapore. In the UAE, Dubai-based Waves Metco is owned and run by Ravindra Rastogi, a brother of Virender and Narendra Rastogi. Singapore-based Allied Deals Pte Ltd apparently continues in business under the name WMC Trading – a company with no relation whatsoever to WMC Ltd, Australia's giant natural resources company. The Singapore company is understood to have been run by a fourth brother, Subhash Rastogi. The Rastogi family maintains the companies are run independently.

Similarities with Solo

Similarities between the Solo/Hamco and the RBG/Hamco cases are striking. Both were family affairs with similar global dimensions. Solo Industries was a UK-based metal trader owned by Madhav Patel. Solo, in common with RBG, had a sister organization in the UAE – Patel's was in Sharjah, Rastogi's in Dubai. Patel's father, B M Patel, owned the Bombay-listed Hamco group of companies which comprised several mining and metals

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businesses. As well as its metal trading activities, RBG had mining interests in Bolivia and Romania.

Solo's fraud was sophisticated and well-disguised by the complex variety of frauds it perpetrated. Essentially it utilized letters of credit and bank guarantees to fund cross-border metal trades. Banks involved in the RBG/Allied Deals case accepted collateral documents detailing transactions for physical metal.

Chances for recovery

Justice Laddie's decision to allow RGB executives to be questioned under oath by liquidators is not the only recent court ruling that might make the task of recovering funds lost through fraudulent trades a little easier – at least in the UK. A legal ruling by the Commercial Court in London earlier this year involving Hamco – a company related to Solo – might also help creditors looking to recover funds from RBG Resources and related companies, even if the beneficiary company has been engaged in potentially fraudulent activity.

As lead lender of a syndicate of four banks, Standard Bank London (SBL) claimed USD 10m under an on-demand guarantee issued by Indian state-owned bank Canara. Solo assigned the guarantee to SBL as security to obtain an advance to finance a metal supply contract between a Hamco company in India and Solo in the UK.

Lawyers for SBL argued that if a client goes bankrupt, the bank should look to its security, often an assigned guarantee. Provided the bank can establish the underlying contract was part of a genuine

business it should be paid – even when there are widespread allegations of fraud involving the business, they said. Canara's lawyers argued that the underlying contract was a sham.

Mr Justice Moore Bick said he was “satisfied that among the many sham transactions at Hamco, there were a significant number of genuine contracts for the import of goods that were performed in accordance with their terms”.

The judge fully agreed with SBL's arguments and ruled that although fraud between Hamco and Solo existed, the contract in question formed part of a genuine business transaction; therefore, the guarantee was enforceable and SBL was entitled to recover the amount of USD 10 million under the demand guarantee.

Canara's defence, according to the judge, depended entirely on establishing that the contract was a sham. It failed to do so, he said. This, however, may not have been the most significant part of his judgment. Justice Moore-Bick went on to say that even if Canara had shown that the underlying contract was a sham, Canara would still not have been able to shirk its obligations for two reasons.

First, a clause in the demand guarantee said it would not be adversely affected by any “invalidity, illegality, unenforceability, irregularity, frustration, or discharge by operation of law or any actual or purported illegality”. This, the judge concluded, meant that both banks had foreseen the possibility that the contract might be invalid or unenforceable and had agreed that liability should stand.

Second, while Canara had argued it

was fraudulently persuaded to issue the guarantee and therefore it was not obliged to pay, this was overridden by the fact that the two banks had been in direct contact over an amendment to the guarantee and that they agreed it should be isolated from matters arising out of the relationship between Canara, Solo and Hamco related companies.

Future implications

According to lawyers at Stephenson Harwood who represented SBL, this means that in future cases, including those involving comprehensive fraud, banks might be able to find some protection. Another significant implication in Mr Justice Moore Bick's judgment for bankers is that they will now need to consider very carefully the way inter-bank guarantees are constructed and worded.

Quick to argue that the alleged RBG/Allied Deals frauds would not so easily have happened if transactions had been conducted over a secure electronic trading platform was commercial director of bolero.net, Peter Scott. “With bolero.net you know exactly who sent what and when, whether any changes were made to the documents, and where they came from. This makes it much more difficult to circulate fake documentation through the system,” he said.

Perhaps this latest metals fraud will provide the opportunity needed by purveyors of electronic alternatives to L/Cs or online support platforms for documentary credits to prove their worth and gain the critical mass they need to make commercial sense of their operations from those seeking more secure ways to finance international trade. (See “The Insight interview” in this issue.)

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“... in future cases, including those involving comprehensive fraud, banks might be able to find some protection”

International bulletin

Country views

India

Erratic documentation is a universal phenomenon and both developed and developing countries face the problems it raises. Big or small, corporate or non-corporate,

manufacturer or merchant exporters – all kinds of exporters make mistakes in documentation. And they commit the same kind of mistakes, occasionally or repeatedly, in some or all transactions.

Surveys indicate what are the common mistakes, i.e., discrepancies in documentary credit language. To prevent or correct them, checklists are often used as a preventive/ curative remedy. The exporter uses a checklist to provide error-free documentation, whilst the banker uses it to determine whether documents are compliant.

But despite the checklists discrepancies still occur. Exporters still make

mistakes. They frequently don't prevent or correct errors. Why is this the case? Some would say there are weaknesses in the exporting business itself which lead to late shipment/late or discrepant presentation.

In any case, we know the common discrepancies, but we don't know the common reasons behind them. There is, therefore, an unfortunate gap in documentary credit information which adversely affects L/C-based trade documentation.

India is not free from the epidemic of erratic documentation. Why do India's exporters commit common errors? In fact, the reasons may not be unique to India.

India has not conducted any survey on the subject. I can give you my personal experience, however, based on insights I've gained over the years. The shortcomings in India's documentation are, I believe, the result of several causes that reflect weaknesses in its exporting businesses, and particularly in export documentation.

In my view, they are the following:

- Lack of UCP knowledge management skills. India's exporters, especially the small ones, may not fully know the UCP and may not know how to apply the rules in three vital areas: 1) negotiation of suitable L/C terms and conditions during sales contract negotiations; 2) compliant document preparation; and 3) litigation, if any. The deficiency of UCP knowledge may contribute to discrepancies and can impede the exporter from defending his interests in a situation where the banker refuses to take up the documents for payment/negotiation/ acceptance.

- Lack of L/C customization. India's exporters may not negotiate for terms and conditions that suit their business requirements and capabilities. This approach could be summarized as "Send me an L/C, and I will send you the required goods." Hence they may receive an L/C containing terms and conditions with which they may not be able to comply. A customized L/C facilitates compliance.

- Lack of compliance planning. For example, there may be no plan for arranging stipulated goods and documents nor for meeting the stipulated deadlines, for monitoring and overcoming the hurdles that can delay shipment and presentation. The lack of planning may lead to further discrepancies by causing late shipment and/or late presentation.

- Lack of organization. The business may not be well organized or trained to prepare and review documentation.

- Lack of technology for use in documentation and communication.

- Lack of an adequate system for handling L/Cs. The procedure for handling L/Cs may lack one or more steps to achieve compliance. For example, the business may not follow procedures to ensure that L/Cs will be examined for accuracy before presentation. India's exporters show great concern and enthusiasm in arranging finance, stipulated products and documents when they receive L/Cs but don't appear to take much care concerning the accuracy of the L/Cs received, since they are very eager to comply with them come what may. Similarly, they may not exercise sufficient care in determining the accuracy of the documents before presentation, since they believe it is the banker's job to determine accuracy where their job is just to rectify the discrepancies, if any. India's exporters need to understand that a correct L/C leads to correct documentation, and that pre-presentation review of documents as a preventive remedy is better than post-presentation rectification as a curative remedy.

The solutions? Indian export businesses need to develop an efficient internal system for obtaining and handling L/Cs, and to acquire UCP management skills to be used in achieving the goal of getting paid. India has the necessary infrastructure of training facilities for helping its exporters acquire the necessary knowledge and skills. But it appears that the facilities are not being fully utilized.

On the other hand, India's export finance bankers are increasingly well trained. India's foreign trade could be more successful if its export managers were also well trained. Any country's success in L/C-based foreign trade lies in its acquisition and use of both compliant document preparation expertise and document examination expertise.

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"[India]
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Russian Federation

In view of the strong signs of recovery and the growth in the Russian economy, many Russian importers wonder why almost all Western exporters continue to insist on confirmation of the documentary credits issued even by the leading Russian banks which have substantial credit lines with their Western partners.

The limited number of Western banks dealing with letters of credit from different Russian banks is a basic problem for Western exporters to Russia. If the "home" bank of the exporter does not want to act as a nominated bank under a Russian

letter of credit, the exporter has to look for another bank. Since the exporter may also seek advance financing, this other bank, if and when found, may refuse to grant a credit to an unknown customer. Indeed, if his "home" bank does not agree to grant a credit against a Russian payment security, there is no alternative for the exporter except to have the letter of credit confirmed by another bank.

Take another case. Having found a nominated bank for a Russian documentary credit, the exporter may seek a payment undertaking from this bank as per sub-Article 10(c) of UCP 500. If, by any chance, this bank agrees, the agreement will be accompanied by a clause of recourse against the exporter in case reimbursement is not received from the Russian issuing bank.

This means that the exporter will bear the Russian risk during the whole life of the operation. The exporter will also be obliged, moreover, (if so required by the regulations of his country), to set aside prudential reserves to cover the risk. A confirmation eliminates these risks and problems for the exporter. But in most cases a nominated bank will refuse to make any commitment without an additional payment guarantee from the issuing bank (such as preliminary cover or an undertaking of a guaranteed reimbursement deposit from the third bank). As a rule, the issuing bank will grant these guarantees only to the confirming bank.

A third case concerns export contracts under which the related documentary credit provides for deferred payment or

acceptance of a draft, and the exporter wishes to receive the credit proceeds immediately after presentation of the documents to a nominated bank. If the exporter's "home" bank agrees to discount a deferred payment undertaking of the nominated bank or the draft accepted by the nominated bank, the exporter's problems are solved. If not, the exporter will demand a confirmation of the letter of credit, knowing that confirming banks usually discount their own payment undertakings. But, as in the previous case, a nominated bank will only agree to incur a deferred payment undertaking or to accept a draft if it confirms a letter of credit. The same logic may be applied to documentary credits available by negotiation, though this type of credit is not frequently utilized by Russian banks.

On the other hand, if a Western bank agrees to act as a nominated bank under the relevant credit (for example in a situation where presentation of documents for acceptance or issuance of a deferred payment undertaking is limited to the nominated bank), the exporter may not need confirmation of the credit. However, there may not be a very strong possibility of this happening because of two main obstacles. The first concerns the risk management requirements of Western banks, since commitments arising from the responsibilities of a nominated bank are more difficult to follow and control than those of a confirming bank. The second is connected with Russian internal regulations and the current practice of many Russian banks of transferring to the confirming bank the preliminary cover received from the applicant at the moment of the issuance of the credit.

Consequently, if Western exporters are able to obtain credit facilities from their "home" banks against direct payment guarantees issued by Russian banks, there may well be a decrease in the demand for confirmation of Russian documentary credits. This in its turn will mean that Russian commercial undertakings will

start to gain wide acceptance in Western markets.

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Recent years have seen a major shift in international trade transactions from the so-called safer haven of the letter of credit to the more risky open account trade. The bankers, with their differing and varied interpretations of the provisions of UCP, have contributed to damaging the traders' confidence in the letter of credit system and must accept the blame for this shift. These interpretations vary from country-to-country and sometimes we come across practices that are contrary, not only to the provisions of UCP, but also against international standard practices.

Sadly, standards seem to be declining worldwide. With the current UCP now in force for more than eight years, one would have thought that understanding of the rules would be much more settled. On the contrary, the number of issues raised with the ICC Banking Commission, both with respect to dispute resolution and educational queries, suggest that all is not well with the documentary credit trade.

There seems to be an urgent need for standardization of practices and definitions, especially clarification concerning what constitutes a genuine discrepancy. The ICC, for its part, is trying to promote standardization: the CDCS certification and the DC-PRO Focus discussion forum are definitely steps forward. The ICC Banking Commission is also expected to come out with a publication on ISBP (International Standard Banking Practice) in the near future. A lot of hype is being attached to this publication, as it is expected to bring in a worldwide standardization of practices and bury the myths and misconceptions associated with the trade once and for all.

However, is it all going to be enough?

Considering the realities on the ground, the answer must be in the negative. Having been associated with this trade for more than 20 years in both Pakistan and the United Arab Emirates, I can say with some authority that the general standards in these regions are well below par. This holds true for the entire Middle East, as immigrants from the Indian sub-continent constitute almost 75% of the region's work force, and have migrated whatever good or bad practices were prevalent in their respective countries to the region.

In most banks, the concept of providing formal training is non-existent; a new entrant is expected to learn on the job from his seniors. This means the incumbent will be learning the same misconceptions and myths acquired by his would-be mentor over the years. Much on-the-job training focuses on familiarization with the systems rather than on the practical understanding of the trade.

Another factor that hinders professional growth in the market is the lack of sophisticated beneficiaries. Unlike in the West, litigation related to documentary credits in the region is virtually non-existent. This allows the banks at times to get away with "dishonours" based on fabricated and frivolous discrepancies.

However, the recent introduction of the CDCS certification has generated a lot of interest, and it is fast becoming a standardization benchmark. This will hopefully lend credibility to the market and help improve sagging standards. I do feel, however, that the format of the CDCS examination needs to be reconsidered. For example, I have come across many CDCS candidates who have passed the exam because they gave the right answers, though their reasons for giving those answers were wrong. A change in exam format would help to remedy this anomaly.

All said and done, the efforts of ICC will come to naught unless the banks themselves decide to improve their employees' standards. After all, the quality of its employees has a direct bearing on an organization's reputation, especially in a service industry. ■

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"[Russian Federation] ... there may well be a decrease in the demand for confirmation of Russian documentary credits"

Queries and responses

Four recent Banking Commission Opinions

Sub-Article 14(b), 14(d)(i) and (ii), 14(d) and sub-Article 9(a)(ii)**Steps a beneficiary should take when receiving a letter of credit which does not bear the confirmation of an advising or other nominated bank**

Query

We, in the capacity of advising bank, have experienced an unpleasant event in which the issuing bank has not respected its irrevocable undertaking for payment of complying and timely presented documents under its own L/C. The L/C beneficiary would not accept our commentary on the issue. It has expressed its hope for the ICC group of experts to give their honourable opinion on the issue which would satisfy them.

The issue is as follows:

Issuing bank (Bank I) opened an irrevocable documentary letter of credit and advised it through Bank A who forwarded it to Bank B instructing it to advise the beneficiary without adding its confirmation. Payment was available with Bank A and was deferred 60 days from B/L date.

Bank B forwarded the documents in strict compliance with the L/C terms and conditions to Bank A. Bank A then sent them to Bank I, asking it to confirm receipt and the maturity date, which was March 19, 2001.

Since Bank I did not confirm receipt of the documents and maturity date, Bank B and Bank A began sending requests and enquiries to find out the fate of the documents and relevant payment. As a result they were advised by relevant postal authorities that Bank I received the documents. In spite of many enquiries and messages by SWIFT and fax, Bank I never replied.

Bank B was, some time later, informed

by the beneficiary that the applicant took over the goods on the basis of the same bank's (Bank I's) guarantee for the missing B/L. Bank B and the beneficiary constantly demanded that Bank I fulfil its obligation, but with no result. After many months Bank I finally produced a message asking Bank B for an extension of the date for payment due to a financial crisis in the applicant's country.

The beneficiary was prepared to extend the payment date only if Bank B received a reimbursement undertaking from Bank A which Bank B never received.

Seven months after the original due date, Bank I paid under its L/C, but only 15% of the documents' amount, promising to make several future partial payments to which the beneficiary agreed. Only one small partial payment followed. Since then Bank I has remained silent.

Facts:

Bank I did not act in accordance with UCP 500 to which the L/C was subject.

Bank I did not respect sub-Article 9(a)(ii)

Question:

What steps could or should the beneficiary and the advising banks take according to UCP in such cases?

Analysis

Sub-Article 14(b) states "Upon receipt of the documents the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit. If the documents appear on their face not to be in compliance with the terms and conditions of the Credit, such banks may refuse to take up the documents."

Sub-Article 14(d) states:

■ "i. If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the Beneficiary, if it received the documents directly from him.

■ ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.

■ iii. The Issuing Bank and/or Confirming Bank, if any, shall then be entitled to claim from the remitting bank refund, with interest, of any reimbursement which has been made to that bank."

Sub-Article 14(e) states:

"If the Issuing Bank and/or Confirming Bank, if any, fails to act in accordance with the provisions of this Article and/or fails to hold the documents at the disposal of, or return them to the presenter, the Issuing Bank and/or Confirming Bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit."

Conclusion

As can be seen from the wording contained in sub-Article 14(b), an issuing bank is required to examine the presented documents for compliance, on their face, with the terms and conditions of the credit. In the event that it finds the documents to be discrepant, it is required to provide a notice of refusal in accordance with sub-Article 14(d) (i and ii). Failure to provide a notice of refusal within a reasonable time, not to exceed seven banking days following the day of receipt of the documents, precludes the issuing bank from claiming that the documents

"In the event that it finds the documents to be discrepant, [the issuing bank] is required to provide a notice of refusal in accordance with sub-Article 14(d) (i and ii)"

are discrepant and it must honour the drawing.

The issuing bank requested that due to financial difficulties in its country the payment date be extended. If this was agreeable, then a specific date(s) should have been determined and agreed upon. It was then suggested that an initial payment be made, with others to follow, to which the beneficiary agreed. Again, specific dates should have been agreed.

Under sub-Article 9(a)(ii) the issuing bank is required to pay on the due date, where complying documents are presented. Given the issuing bank's statement regarding the financial state within its country, the beneficiary should have sought some other form of guarantee before agreeing to any form of settlement arrangement. This may include reimbursement undertakings or a guarantee from another banking institution willing to take that issuing bank's credit risk.

When receiving a letter of credit which does not bear the confirmation of an advising or other nominated bank, a beneficiary should carefully consider the possible implications of acting under such a credit. An advising bank has no role other than to check the apparent authenticity of the letter of credit and forward it to the beneficiary. An advising bank may, if requested, act as an advisory point to the beneficiary in the determination of whether or not a confirmation of the credit is to be considered.

Article 21; sub-Article 31 (iii)

Questions concerning the words "third party documents acceptable"

Query

- *Details of the Documentary Credit:*
Issuing Bank: Bank A
Advising and Confirming Bank: Bank B
Beneficiary: Company X, London
- *Third party documents acceptable*
- *In the documentary credit, there were no specific requirements as to the issuer of the documents.*
- *Terms: FOB Rotterdam*
- *Available by payment at the counters of the confirming bank (Bank B)*
- *Documents required:*
 - Commercial invoice 3 originals
 - 3/3 bill of lading made out to the order of Bank A and marked "notify the

applicant"

- *Certificate of origin showing the goods are of European Community origin.*

The specifications of the documents that were presented by the beneficiary to Bank B (The Confirming Bank) were as follows:

- *Commercial invoice that was issued by the Company X, London (the beneficiary)*

- *B/L is issued by a shipping company and is made out to the order of Bank A, showing "the consignor" (the shipper) as Company "X", London (the beneficiary)*

- *Certificate of origin issued by the competent authorities in Rotterdam, showing that the origin of goods is EU and "the consignor" (the shipper) as Company "Y", Rotterdam (a company other than the beneficiary)*

Confirming bank (Bank B) claims that above-mentioned certificate of origin is in conformity with the terms of the documentary credit. Its argument is based on the following: "In the documentary credit, it says 'third party documents are acceptable'. The certificate of origin showing Company Y, a third party, as the shipper is in conformity with the documentary credit terms and conditions."

We – the Issuing Bank – claim that "the said certificate of origin might seem to be consistent with the documentary credit terms. But the bill of lading and the certificate of origin do not show the same names as the consignor, e.g. the two documents are not consistent with each other. Therefore, the certificate of origin must be refused."

Our argument is based on the following: "Each document may be in compliance with the documentary credit but do not comply with each other". Our argument is also based on UCP 500 sub-Article 13(a), which reads "... Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the credit."

May we also kindly ask you to refer to ICC Publication "More Queries and Responses on UCP 500, Opinions of the ICC Banking Commission 1997", Case

R277, on pages 36 and 37, especially to the phrase which reads as follows: "(3) The information quoted is not inconsistent with other documents e.g. certificate of origin shows identical shipper/consignor."

In our case, as the information/data quoted on the certificate of origin is inconsistent with the information/data on the B/L, the certificate of origin must be rejected.

Analysis and conclusion

In letter of credit operations, the words "Third party documents acceptable" have no meaning. They have no meaning to the extent that Article 21 in stating "When documents other than transport documents, insurance documents and commercial invoices are called for, the Credit should stipulate by whom such documents

are to be issued and their wording or data content. If the Credit does not so stipulate, banks will accept such documents as presented, provided that their data content is not inconsistent with any other stipulated document presented"; and sub-Article 31(iii) allowing the consignor of the goods to be a party other than the beneficiary of the credit, specifically permits the most common understanding of the term "Third party documents acceptable".

Given that the UCP permits such situations to occur, use of the term "Third party documents acceptable" can only lead to parties interpreting the clause to mean something different from the above. ICC has already stated that the use of such a term would permit the issuance of invoices and drafts in the name of a company other than the beneficiary.

Opinion R. 277, to which you refer, is a specific question based upon an ICC Case Study publication that centred on the acceptability of the beneficiary's name (in the shipper field on the bill of lading) being slightly different from the name quoted in the credit. By virtue of sub-Article 31(iii) this would be acceptable. The phrase to which you refer is one quoted in the text of the question and not part of the ICC response.

The term "Third party documents acceptable" in this credit has been given

"In letter of credit operations, the words 'Third party documents acceptable' have no meaning"

no meaning or further explanation. The certificate or origin otherwise complies apart from the fact that the shipper is shown as Company Y whereas the bill of lading shows Company X.

Based on the information provided, and the analysis shown above, the terms of the letter of credit would allow the presentation of a certificate of origin in the manner described. Banks should desist from using terminology such as "Third party documents acceptable" unless they give some meaning to what is intended by such a clause. When using this term, consideration should be given to the contents of Article 21 and sub-Article 31(iii) to determine whether such a clause is required.

Sub-Article 23(a)(v), Article 23, Sub-Article 20(b)

When B/Ls are printed via the Internet and the terms and conditions are on the front page of a blank back B/L

Query

We are a global shipping company for container transportation. Like some other major carriers, we provide printing of B/Ls via Internet service to our customers.

There are three questions (related to each other) that I would like to seek for guidance from ICC regarding bill of lading (B/L) issuance as follows:

- 1. Is there a requirement that B/L terms and conditions must be pre-printed?*
- 2. Is there a requirement that B/L terms and conditions must be pre-printed on the backside of the B/L form?*
- 3. Can we print (by system) both the B/L details and the B/L terms and conditions on the front page of blank paper with the company logo and carrier name? Also, the normal layout form of the bill of lading with B/L details (column for B/L number, shipper, consignee, notify party, also notify party, pre-carriage, vessel/voyage/flag, place of receipt, port of loading, port of discharge, place of delivery, etc.)?*

Our colleague in Country U had made an enquiry to a bank in his country as to whether it would accept the B/L printed in such a way as per 3 above. They confirmed acceptance of B/L issued by us in this manner. UCP 500 Article 23 was quoted as the basis for its acceptance. Is

the bank's understanding correct?

Will or can the other banks in Country U and other parts of the world reject a B/L as issued by us described in above question 3? Just in case some banks reject our B/L, can we explain and ask banks to accept our B/L based on the same reason as quoted by the Country U bank, i.e. UCP 500 Article 23?

We would like a formal opinion from ICC to guide us in what to do.

Analysis and conclusion

Sub-Article 23(a)(v) states: "appears to contain all of the terms and conditions of carriage, or some of such terms and conditions by reference to a source or document other than the bill of lading (short form/blank back bill of lading); banks will not examine the contents of such terms and conditions".

The sub-Article makes no distinction as to whether the terms and conditions (or reference thereto) are to appear on the front or reverse of the document. Most shipping lines currently incorporate this information on the reverse, thereby making the statement that banks will not examine the contents of such terms and conditions a straightforward one for banks to follow.

The issue may become more clouded should the terms and conditions appear on the face of the bill of lading. A bank is required to review the whole of the front of the bill of lading to ascertain information such as details of goods, journey, parties and applicable dates. In carrying out such a review, it may be difficult to distinguish letter of credit criteria from terms and conditions, unless this is clearly indicated within the layout of the text. It is not uncommon for the content of the terms and conditions to not be in compliance with the terms of a letter of credit.

The UCP provides for blank back bills of lading on the basis that the B/L refers to another source document with regard to the terms and conditions of carriage. This could be by reference to a specific document, or, in this electronic age, a segment of a web page where these conditions are stated. This may be the better option.

Any document which is produced using Internet services must conform to the requirements of Article 23 in respect of the B/L issuance and content plus the content of sub-Article 20(b) with regard to the originality and signing thereof.

Article 42

Where an L/C stipulated that negotiation must be effected seven days after the shipping date

Query

In ICC Publication No. 596, ICC strongly discourages banks from stipulating a latest date by which documents are to be presented and negotiated. We met a similar situation recently, which may be summarized as follows:

In L/C field 47A, i.e. additional conditions, the L/C stipulated that negotiation must be effected seven days after the shipping date. In the documents presented, the B/L date showed as July 14, 2001. However, the negotiating bank negotiated and sent the documents to the issuing bank on July 16, 2001, which was only two days later than the shipping date. The issuing bank, therefore, refused to take up the documents due to the discrepancy: early negotiation.

We would be very grateful if you could advise us on the following two questions:

- 1. To whom does the content of field 47A apply, the beneficiary or the negotiating bank, or put it into other words, who should follow the instructions stipulated in field 47A?*
- 2. Is early negotiation a discrepancy in this case?*

In our opinion, it is the responsibility of the issuing bank to make a payment under an irrevocable letter of credit provided the presented documents, on their face, comply with the terms and conditions of the credit. The conduct of the negotiating bank, whether

it follows the instructions of the credit or not, should not affect the right of the beneficiary to obtain payment from the issuing bank. We would like your opinion concerning this matter.

"A statement that negotiation is to be effected seven days after shipment ... must be adhered to"

Analysis and conclusion

The entire contents of a letter of credit are to be adhered to by the beneficiary AND the negotiating bank to the extent that the terms and conditions apply. A statement that negotiation is to be effected seven days after shipment, whilst not a term that would be recommended by

ICC, must be adhered to. On the basis that the advising bank has forwarded the credit to the beneficiary it must have been in agreement with that condition, and the beneficiary in effecting shipment thereunder signified its agreement to the credit terms and conditions.

As you say, the clause does not remove the obligation of the issuing bank to honour conforming documents, presented by the beneficiary, in accordance with the terms of the credit. Under this credit, the issuing bank would be obliged to honour on the seventh day after the date of shipment. ■

Point of view

“Standard banking practice” and the UCP

by Paul Turner

The terms “banking practice” and “standard banking practice” may be used broadly to describe the general conduct of a bank, *vis-à-vis* the applicant as well as the beneficiary, that issues and receives documents under a letter of credit. For example, it is “standard banking practice” for a bank to satisfy itself as to the creditworthiness of the applicant or the adequacy of collateral.

Typically, however, “banking practice” refers more narrowly to the practices of a bank in determining whether a presentation of documents complies with the requirements of the commercial letter of credit. For example, it is “standard banking practice” that an invoice need not be signed in order to be compliant. Banks and national banking associations compile these practices in detailed checklists for use by, and the training of, document examiners.

Checklists and “standard practice” – 1920 to 2002

1920 New York Regulations

An early example in the United States of a checklist for documentary examination, and perhaps the first use of the term “standard practice” in connection with documentary examination, were the “Regulations Affecting Export Commercial Credits” published in New York in 1920. They were described in their preamble as being “in accord with the standard practice adopted by the New York Bankers Commercial Credit Conference of 1920”.

UCP 500

Seventy-three years later, the drafters of the UCP included the term “international standard banking practice” in UCP 500 (1993). UCP sub-Article 13(a) states that compliance of the documents “shall be determined by international standard banking practice as reflected in these articles”. Articles 20 through 47 of UCP 500 constitute a checklist of documentary examination practices.

UCC Article 5

The 1995 revised Article 5 of the Uniform Commercial Code in the United States imported the term “standard practice” from the UCP, but Article 5 uses the term in both the broad and narrow senses. Section 5-108(e) broadly requires issuers to observe the “standard practice” of “financial institutions that regularly issue letters of credit”.

UCC Section 5-108(a) provides more narrowly that the issuer shall honour a presentation of documents that appears compliant “as determined by [that] standard practice”. In that narrow context, Official Comment 8 to UCC Section 5-108 states that the standard practice “includes (i) international practice set forth in or referenced by the Uniform Customs and Practice [UCP], (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice”.

UN Convention

The United Nations Convention on Independent Guarantees and Standby Letters of Credit, adopted by the UN in 1995, also applies the concept of standard practice in both the broad and narrow senses. The Convention requires the

issuer broadly to have due regard to “generally accepted standards of international practice” in discharging its obligations (Article 14(1)). In addition, it requires the issuer, in examining documents, to have due regard to the “applicable international standard” of independent guarantee or standby practice (Article 16(1)).

SBPED

In 1996 the US Council on International Banking published a checklist called Standard Banking Practice for the Examination of Letter of Credit Documents (SBPED). The USCIB, now called the International Financial Services Organization (IFSA), is a praiseworthy successor to the laudable work of the bankers who produced the 1920 New York regulations described above. The SBPED and its Mexican counterpart supplement the UCP for commercial credit transactions between the United States and Mexico.

ISP

The 1998 International Standby Practices (ISP) include the “standard practice” concept in ISP Rule 4.01(b). The Rule states that whether a document is compliant is determined by examining it against the terms and conditions in the credit as interpreted and supplemented by the ISP Rules, “which are to be read in the context of standard standby practice”. The ISP rule is not, like the UCP and Article 5 rules, that the documents are determined to be compliant by the standard practice. Rather, the standard practice is used to interpret the ISP to determine compliance.

ISBP

A task force of the ICC Banking Com-

mission, after working for two years to compile a set of international standard practices for documentary examination, has produced a draft International Standard Banking Practice (ISBP). The draft contains 208 rules for documentary examination in checklist form. Forty-eight of the rules are general in nature, and the rest pertain to specific documents, supplementing UCP Articles 20 through 47.

The current draft was presented to the Banking Commission at its April 2002 meetings. As this article goes to press, it is expected that the ISBP will be completed and published in late 2002/early 2003. The current draft ISBP appears to be very thorough and fair. It will surely facilitate uniformity in international standard banking practice and doubtless be warmly welcomed by the international letter of credit community.

“Reflected” in the UCP

The draft ISBP seems to me to point to an ambiguity in the UCP: does sub-Article 13(a) preclude banks from looking outside of the UCP for sources of “standard banking practice”?

The sub-Article 13(a) statement that compliance “shall be determined by international standard banking practice as reflected in these articles” implies that banks may not apply practices that are not reflected in the UCP.

Boris Kozolchyk explains in the foreword to the SBPED referred to above that the sub-Article 13(a) provision was a compromise. Some of the participants in the drafting of UCP 500 urged the adoption of a “reasonable document checker” test to determine documentary compliance. Other argued for a “strict” standard. Somehow, “international standard banking practice as reflected in these articles” satisfied both camps.

I have thought that sub-Article 13(a) allows the bank to consider its own internal policies, regional or local practice, and international practices in addition to those in the UCP – so long as these do not conflict with the UCP. That interpretation seems to me consistent with the sub-Article 13(a) compromise and would more flexibly allow the bank to take into consideration evolving practice and technology. Certainly, the compilers of the SBPED thought that those practices needed only to be consistent with those of the UCP.

The current draft of the ISBP perhaps implies otherwise. It is entitled “International Standard Banking Practice (ISBP)

for the Examination of Documents, as reflected in the Articles of the UCP” (emphasis mine). The Introduction declares the opinion of the Commission that “this document states international standard banking practice as reflected in the articles of the UCP”. (emphasis mine).
 I do not know in what sense the 208 practices listed in the draft ISBP can be said to be “reflected” in the UCP. My own view is that by declaring that the ISBP practices are reflected in the UCP, the Banking Commission seems by implication to adopt the interpretation of sub-Article 13(a) that a bank examiner cannot look outside of the UCP to determine compliance with international standard banking practice. If that interpretation is narrower and less flexible than it need be, the Banking Commission might consider clarifying this issue.

“I do not know in what sense the 208 practices listed in the draft ISBP can be said to be ‘reflected’ in the UCP”

I do not know in what sense the 208 practices listed in the draft ISBP can be said to be “reflected” in the UCP. My own view is that by declaring that the ISBP practices are reflected in the UCP, the Banking Commission seems by implication to adopt the interpretation of sub-Article 13(a) that a bank examiner cannot look outside of the UCP to determine compliance with international standard banking practice. If that interpretation is narrower and less flexible than it need be, the Banking Commission might consider clarifying this issue.

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Right of response

Two views on notice of refusal

“Banks sometimes forget that documents in their possession are held by them in trust”

by Laurence Bacon

There has been some debate recently over alternatives to notices of refusal under Articles 13/14 of UCP. These Articles neither refer to nor condone such alternatives. Sub-Article 13(b) states that the bank examining documents must “examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents

accordingly”. Article 2 further states that a bank can only make payment arrangements “against stipulated document/s, provided that the terms and conditions of the Credit are complied with”.

Therefore, in cases where there are discrepancies, agreement between the parties involved in the credit is required, if payment is to be arranged. It must be noted that, under UCP, the applicant is not a party to the credit, thus necessitating agreement between the beneficiary and the bank/s. The issuing bank has a separate contract with the applicant, which, together with the UCP, may

determine the limits of its actions with regard to payment under the credit.

Thus, although the issuing bank may approach the applicant for a waiver of discrepancies (sub-Article 14(c)), this does not diminish the responsibilities of the bank (a) to find the discrepancies that exist and (b) to “... give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay...” (sub-Article 14(d)(i)). Consequently, the issuing bank is not permitted to delay dispatch of such notice of rejection for any reason, including seeking a waiver.

Holding in trust

Banks sometimes forget that documents in their possession are held by them in trust. An issuing bank should act impartially in its dual role as (a) the bank which holds documents in trust for the presenter/beneficiary and (b) the bank acting for the applicant in issuing the credit and checking the compliance of documents.

A classic example of such folly was the recent case in a UK court of CIC v CMB, where the issuing bank (CMB) failed to release documents to the presenting bank (CIC). Mr Justice Steel held that the rejection notice which read “... should the discrepancies be accepted by the applicant, we shall release the documents to them without further notice...” did not comply with UCP 500 sub-Article 14(d)(ii) as the documents were neither returned to CIC, nor held to its order. If an issuing bank releases documents upon receipt of a waiver from the applicant, without prior agreement of the beneficiary, again it commits the folly of failing to hold the documents at the disposal of the presenter/beneficiary”.

Opting out of UCP

Some banks have adopted the inimical practice of inserting clauses in L/Cs issued to opt out of their responsibilities under Article 14 of UCP. Some times these clauses are “in plain view” and sometimes inserted surreptitiously or obscured. I regard them as in plain view if they are in the main body of the L/C. However, they may be incorporated in the advising/ confirming bank’s covering letter, or within the reimbursement details of the L/C, neither of which beneficiaries tend to examine closely.

Jeremy Smith has previously written (*DCI* Vol. 8 No. 1) about the claimed disadvantages of a post-refusal granting of a waiver. If viewed solely from the viewpoint of the issuing bank, this may appear to have some validity because of: 1) the presumption of the issuing bank of an objection to the delay in advising the beneficiary of discrepancies. Such a

view may be held by the issuing bank, but is unlikely to be held by the beneficiary.

2) the presumption by the issuing bank that the beneficiary will object to the potential delay in receiving payment due to advising him as required by UCP. In my experience of acting for beneficiaries over three decades, this does not hold any credence.

3) the possibility of resolving difficulties with a nominated bank which has already taken up the documents. This, in fact, would promote negligence on the part of the nominated bank if it knew in advance that an issuing bank was likely to seek a waiver and release documents without the agreement of the beneficiary. Even without his proposal for such a change, it is known that some nominated banks already are somewhat lacking in their responsibilities to check documents, in the knowledge that the documents must ultimately be checked by the issuing bank. I have also seen documents sent by nominated banks to issuing banks without a statement as to whether or not documents have been checked, when they have been checked, or whether or not there are any discrepancies.

4) the difficulties for the applicant in the delay of release of documents of title. At the time of issue of the credit, the time scale involved was known, so either the applicant was badly advised by the issuing bank or the argument does not stand up.

5) increased costs or possible damage to the relationship with the applicant. The attitude of most bankers I know are not unlike their commercial counterparts if costs increase, charges must increase and thereby profits. The possible damage to the relationship with the applicant is entirely in the hands of the issuing bank and depends on how well or otherwise they handle the situation. Again, in this regard, they are often like many of their commercial counterparts in only considering customer relationships when a problem arises.

“One must question where the demand for contravention of Article 14 comes from”

Disadvantages to beneficiary

Jeremy’s statement that a beneficiary can recover documents at any time up to a waiver being granted is somewhat facetious if the beneficiary is not advised of discrepancies until after the waiver has been obtained. One must question where the demand for contravention of Article 14 comes from. It is so disadvantageous to beneficiaries that it could not come from them. Applicants tend to rely (too much) on the advice they receive from issuing banks and are unduly influenced by them.

Thus it is not surprising that the only party likely to benefit from this is the party demanding it, i.e., the issuing bank. If an issuing bank opts out of Article 14 by inserting a clause to this effect, it does not do so at the behest of the beneficiary. Depending on the phraseology used, this forces the beneficiary to seek an amendment removing it or possibly making a statement rescinding it. If he mistakenly assumes that it is a requirement of the applicant, he may accede to it in the interests of customer satisfaction. If long-term business is envisaged, however, the beneficiary is likely to ask the applicant to avoid using the bank which ignores its wishes.

Other issues

Jeremy’s peremptory treatment of international commercial transactions again is based on a restricted viewpoint, which may be associated with persons in a position of power, such as an issuing bank. He fails to recognize:

- 1) that the price of a commodity can change hourly;
- 2) that bankers are not meant to look beyond the credit at the underlying contract;
- 3) that where a beneficiary seeks return of documents presented under an L/C, with the intention of selling the goods to another party, this is unlikely to be a breach of an underlying contract. One simple example might be where an L/C with a three month validity is established. The beneficiary ships goods in month one and presents documents accordingly, but subsequently finds a buyer demanding immediate delivery. By retrieving the documents of title, the beneficiary can supply these goods already en route to the new buyer, but he still has a further two months to supply the applicant under the L/C;

4) that the underlying contract (about which he should not concern himself) may include penalty clauses for discrepancies. If discrepancies are observed, the beneficiary has the right to correct these within the time permitted;

5) that some applicants use the request for a waiver as a trigger to seek reductions in the price payable, regardless of the material effects or otherwise of the discrepancies. Many beneficiaries, when faced with this, would rather lose money by selling to another, than deal with characters employing such "sharp practices".

A new rule?

Incorporating a clause as suggested by Jeremy would, in the words of an ICC Opinion, "effectively create a new rule for handling the refusal of documents". In considering future versions of UCP, one should consider the implications of Article 1, which gives the potential for opting out of these Articles. To do so for some of these Articles would not alter the essential nature of the L/C, but some Articles, such as 13 and 14, are intrinsic and should be protected against exclusion. There are obviously other Articles which should also remain inviolable, but that is a topic for a future date.

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"Letter of credit practice should be fair to all parties and not just provide more convenience to banks"

by T.O. Lee

I refer to the article "Holding documents at the disposal of the presenter?" contributed by my friend Mr Martin Shaw on page 19 of DCI Volume 8 No. 2.

Whilst I admire Mr Shaw as a seasoned banker, this time I hold different views on the issues he has brought up.

1) Mr Shaw commented that the requirement for the issuing bank to ask for new instruction from the presenter on disposal of the documents after sending a refusal notice has not been a problem for the last 40 years. However, this does not automatically mean that we are precluded from raising this issue today. Perhaps practitioners in the past had never given any serious thought to this problem.

2) I do not believe that this is "a false argument based on a misunderstanding", as Mr Shaw says. It is, in fact, a new interpretation of the UCP 500 Articles using a new approach

based on legal concepts. We should always be able to look at the same issue from a new angle. Forty years ago traders did not understand the UCP in the same depth they do today. For example, I have a customer from Hong Kong whose senior finance officer has a CDCS qualification, even though he has not previously worked in the banking sector.

3) When the presenter makes his presentation, he intends and expects the issuing bank to pay him. This forms the basis of his instruction to release documents to the applicant. We may say that his instruction is a condition precedent to payment. After the refusal notice, the instruction is no longer binding, since the basis of the

instruction has not been met. By saying "holding documents at your disposal", the issuing bank has voluntarily and intentionally given up its right to dispose of the documents, including releasing them to the applicant.

4) After receipt of the refusal notice, the beneficiary has the right to sell the goods to a third party, since, as Mr Shaw admits, he still holds the title to the goods. In that case, if the issuing bank releases the documents to the applicant without asking for permission from the presenter or beneficiary, particularly after saying that the documents are held at the presenter's disposal, then if two parties claim for the same goods, the issuing bank may have trouble answering to a court of law. Indeed, it could face two lawsuits, one from the applicant (for not telling him that no permission from the presenter had been sought) and another from the presenter (for releasing documents without his permission after the refusal notice). The issuing bank would be unlikely to win on both fronts.

5) The beneficiary as a presenter always has the right to sell the same goods to a third party if the issuing bank refuses to pay him. This is common sense. Commercial law supports this concept, and sound commercial practice is built on such cases, particularly with regard to perishables that cannot wait for clearance from customs. The demurrage charged by the carrier would be heavy if the beneficiary did not try to sell the goods without delay.

6) Letter of credit practice should be fair to all parties and not just provide more convenience to banks. I hope Mr Shaw will give this matter second thoughts, taking into account the position of the presenter or beneficiary. ■

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"After receipt of the refusal notice, the beneficiary has the right to sell the goods to a third party"

FIMBank looks to Africa

A Maltese bank is looking to do more trade finance business in Africa in response to what it sees as a declining market for letters of credit in developed US and European markets. First International Merchants Bank plc (FIM-Bank) is reportedly planning to expand the

reach and penetration of its trade finance operations into Africa, where the bank wants to establish a comprehensive network of partnerships to serve clients in several import and export sectors. "FIMBank's bread and butter is L/Cs, and their use is gradually decreasing in mature markets such as Europe and North

America," a FIMBank official said. A typical example where letters of credit are no longer used is in EU countries, he said. "Businesses operating in EU countries trust each other and operate without L/Cs as financial information is available and they no longer have any currency risk problems since the Euro,".

The Insight interview: Jacob Katsman

A time for realism in electronic trade

Prior to founding CCEWeb Corp., Jacob Katsman was the Director of Finance of a multinational steel trading company. He also managed trading companies in Asia, Europe and North America. His book 'How To Make Money Without Money, The Art of Transferable Letters of Credit and Assignments of Proceeds,' www.cceweb.com/book/ is regarded by the international banking community as a standard guide to the practical use of letters of credit in trade finance. Katsman also serves as Executive Director of the International Trade & Banking Institute www.itbi.net.

DCI *We now have a number of online trading systems – @GlobalTrade, Trade-Card, Bolero and so forth – and yet from what we hear global trade is still largely paper-based and e-Trade Services account for less than 1% of the total market. Why has the take-up been so slow?*

Katsman Primarily, it has to do with the practices that the market has been used to. It is very difficult to change overnight from being paper-based to, all of a sudden, not having the reliance and the legal backing that paper provides, because local law as well as the UCP has been based on paper documents.

Another reason is that if you would want achieve straight through processing of electronic documents all parties would have to be using the same system, meaning that you have to have importers, exporters, banks and all other trade service providers registered on one platform. Be it a neutral multi-bank platform or a single bank solution, they have to be registered and they have to be authenticated.

If system access is protected by digital certificates, the software is fairly new and to manage it properly takes quite a bit of resources. There are parts of the world where there is no legal infrastructure to deal with digital certificates. There are other parts of the world where digital certificates cannot be used because of export restrictions. Such restrictions pose challenges to adoption and building

critical mass. Taking all of this into account, if you think about any platform that would need the buyer and seller on it plus parties in their respective trade chains on board before any transaction could start, that becomes a very challenging task

DCI *Yet, it has always been said that online processing would save money, that it would be cheaper in the long run. But in fact, what you are saying is that start up expenses are quite considerable.*

Katsman Most of the start up expenses for the platforms that are out there have been taken care of. The major challenges now are deployment costs. You have to consider that the business models that were put in place initially – for instance, with Bolero – made participation prohibitive for most middle- and small-sized companies. The initial targets for Bolero were the large corporations who would have the human resources and the money to pay for the connectivity to the Core Messaging Platform. The question then was what would one need in addition to that in order to have usable a product. And in the case of Bolero you would need to purchase additional interface software from a variety of vendors and have at least the importer and the exporter connected to the Bolero network.

Now with Bolero Surf the model has changed somewhat but it is still rather complicated and costly. The argument that using Bolero XML standards, having system interoperability and achieving straight through processing creates efficiencies throughout the transaction chain only works when you have a critical mass of people using the system.

As long as trade remains largely paper-based and there are no adoption of standards, such an approach remains academic. @GlobalTrade has adopted a much more pragmatic approach that is less fancy but can work today with paper and electronic documents and be a stepping stone towards eUCP credits. To

answer your question, you will certainly achieve more efficiencies when all parties are using the same platform. What we can do today is create significant efficiencies for exporters, their freight forwarders, carriers and other trade service providers, and create additional revenue for participating banks.

DCI *Is it also the case that there is ignorance on the part of the banking and trading community as to the advantages and how to use these particular systems?*

Katsman I would not say ignorance, but there is insufficient knowledge about the differences between various solutions. Another important element in today's economic environment is that the focus of companies is very much on their day-to-day operations. Banks and companies

in today's economy want to cut costs. Even if we give systems away for free, we have to make it clear to them what is the value proposition. It is very difficult to sell it to them in the present market climate if we cannot quantify where the efficiencies of the systems are and when they will come. Immediate quantifiable benefits must be shown.

That is why we have had to rethink our business model as well as the technology in

view of today's business environment in order to bring to market a service that people could use today, not five years from today. That means a system that can be used without having all trading parties necessarily registered from day one. It should also be a system that could create efficiencies for the exporter, the advising/negotiating bank and the trade service providers and lead to eUCP and paperless trade later connecting the issuing bank and importer.

In short, we really have to look anew at what the market needs and how we can give the market in gradual steps what it is ready for. When a baby is born, it does not walk and run right away. It goes through various growth stages until



Katsman: "I think that there will be a second wave of the e-commerce boom"

it becomes a person who can walk and talk. We are taking something that is completely new and it has to have a staged approach to the market and a good understanding as to who is really going to be the driving force behind the move towards the paperless cross-border trade.

Not enough thought or pilot studies were made to find out and understand who would be the main driving force towards the paperless trade. Is it the importer, the exporter, the bank or the trade service providers? From our own pilot studies, we are convinced that the driver behind e-trade services solutions is going to be the exporter.

DCI *So all of us more or less overestimated the facility with which people would move from paper to electronic and we're now in the second stage where we all have to rethink what has to be done to make this work.*

Katsman You are absolutely right. If you take yourself back two years ago, when we had the NASDAQ over 5000 points and when the word "Web" was very sexy, you had a flood of B2B market places and open account resolutions. There was a tremendous excitement in the market about everything that had to do with the Internet. We were all blinded by what we wanted to see and the market rally created more fog that clouded our judgment.

Now we are going through a second stage of consolidation where companies that are going to survive will have to find the right approach to the market. These are the companies that will listen and adapt. If they have enough flexibility, and if they have the funding in order to survive and get going, then they will be the drivers in the market.

DCI *Let's now look at letters of credit, specifically with regard to the recent adoption of the eUCP. A number of online platforms, such as Bolero and @GlobalTrade, say that they are now "eUCP compliant". I have never quite understood what that means.*

Katsman I can talk to you about our experience with the eUCP. Perhaps Bolero can speak for themselves as to what they mean by "eUCP compliant". But in terms

of @GlobalTrade we have built our solution in line with the eUCP rules. That means, when we were building the solution, we have incorporated features dealing with a "Notice of Completeness" that is called for in the eUCP.

Another issue involved in the eUCP compliance revolves around certain rules for authentication of parties and documents. What does that mean? Can you sign a document with a facsimile signature or with a digital certificate? What we have done is to provide a solution that deals with these issues for letters of credit according to the eUCP and the UCP.

DCI *Would it be right to say, however, that other online traders, such as TradeCard, would not take that route, that they would want to bypass the letter of credit entirely?*

Katsman That is correct. This approach makes many trade finance bankers worried and causes them to ask the question "What rules are we playing by?". The bankers, as we all know, are very conservative. They are used to dealing within the UCP. And they say that if a letter of credit calls for a bus ticket, we will accept the bus ticket. If a letter of credit calls for a negotiable bill of lading, we will accept a negotiable bill of lading. They are used to these rules, they are comfortable with these rules. So when a product like TradeCard comes along and says: "We are not a letter of credit, we are something different", the bankers need to understand the risks and liabilities before they establish a level of comfort.

What we have done is to ask the question: "Why do we need to replace the rules? Why not make letters of credit simpler, using the UCP as the backbone?" Following this philosophy we created a simplified electronic documentary credit, that we call "FastTrack eDC" which essentially works within the UCP or eUCP and could be priced competitively by the banks.

DCI *So, you would not agree to what some people say that with online trading*

the use of letters of credit would diminish and in time would fade away?

Katsman I do not think that that is true because of human nature. You can go back in history and think about various payment methods we have had that are based on trust, starting from these nice graphs in the trade textbooks about maximum risk/minimum risk for the buyer or maximum risk/minimum risk for the seller and going through cash in advance, escrow, confirmed documentary credits, unconfirmed documentary credits, guarantees/standbys, documentary collections, and open account.

It is my personal view that as long as human nature is what it is, there will be a variety of payment instruments to meet the needs of a buyer and a seller in a trade transaction. Whether they do it electronically or in paper form, these instruments will remain. The preference for a particular type of instrument will depend on the economy and market conditions. That is how I look at it. I do not see technology or another solution replacing the trust that these payment methods provide to the trading community.

DCI *Looking to the future, when do you see this new realism creating a truly viable market place so that electronic trade can live up to its promise?*

Katsman I think that there will be a second wave of the e-commerce boom. This wave will help to speed up market penetration for the solutions that were created and have survived after the first wave.

It could be three years from today that we will see a meaningful market penetration. I believe there will be a gradual penetration starting from the middle of next year with the companies that survive and can find the right business model that is appropriate to the present market conditions.

The real benefit will come when there is a certain critical mass on any platform, and when a certain number of other providers – like ocean carriers, freight forwarders, insurance companies and government agencies – are also participating. ■

"It could be three years from today that we will see a meaningful market penetration"

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eUCP

Designing a course to teach the eUCP

by Leo Cullen

It is a perilous task to predict the future and yet we all, regardless of industry, must be ready for it.

The letter of credit industry, which for many years experienced relatively little change, has evolved significantly over the past 10 years.

Traders can agree upon contract/letter of credit terms via e-mail or online; importers may apply for L/Cs online; banks can transfer credits and payment electronically; and exporters can use document-processing systems that can automatically generate the documentation required.

The recent introduction of the *Supplement to the Uniform Customs and Practice for Documentary Credits for Electronic Presentation (eUCP)* sees the L/C industry poised for further change. eUCP accommodates the presentation of electronic records under letters of credit; eUCP provides a global standard for the examination of electronic records; eUCP essentially opens the door for technology to reshape existing L/C processes.

e-learning

The letter of credit industry is not alone in facing enormous, technology-driven changes. The training industry too has experienced seismic alterations. Training has been released from the confines of the classroom; virtual classrooms, chat-rooms, online training courses and online reference materials have come to the fore to supplement and, in some cases, to replace traditional training techniques.

Technology is allowing the development of flexible, cost-effective and convenient online training in an ever-expanding range of subjects.

eUCP and e-Learning.

ICC recognized that the L/C industry needed a training course for eUCP that would be:

- Available globally – letters of credit are used worldwide;
- Standardized – consistency amongst document and electronic record checkers

is vital to the letter of credit industry;

- Visual – new concepts are most easily explained graphically; new types of documents/records must be seen to be appreciated;

- Dynamic – eUCP governs a process that will evolve rapidly in its first few years so the training needed the ability to encompass change.

So, ICC assigned the DC-PRO team with the task of developing e-learning for eUCP.

Challenges

The task of developing the training for eUCP threw up its own unique challenges. First, this was virgin territory. eUCP was written to be the standard for the presentation of electronic records under L/Cs. However, at the time of developing the training course this procedure had never been carried out in practice. How could we provide training for the rules of a procedure that had not yet been put into practice?

The solution lay with the source of the rules, the Working Group that had developed eUCP. The Working Group wrote the rules as a forward-looking document – influenced by current technology but flexible enough to allow scope for advances in technology. It achieved this through the diversity of background and viewpoints of its members – the banking, shipping, insurance and technology industries were represented. Working closely with René Müller of Switzerland, the Working Group's Co-Chair, the DC-PRO team was able to harness the Working Group's breadth of knowledge and keep the training true to the spirit of the rules.

The next challenge was to design the course. How should the information be pieced together? We decided to deliver the training from the perspective of a bank worker. So rather than addressing each Article in turn, e1 to e12, we looked

at the sequence of events that would take place during the life of an eUCP credit and visually illustrate each step. The following five lessons took shape:

Lesson 1 – “Introduction” & Lesson 2 – “Scope of eUCP”

eUCP was written to accommodate the presentation of electronic records under L/Cs. It was written as a supplement to UCP that would allow the further evolution of the letter of credit industry. We examine the need for and the scope of eUCP first.

Lesson 3 – “Electronic records”

eUCP introduced the electronic record to the world of L/Cs. The main function of eUCP is to accommodate the presentation of electronic records. But what is an electronic record? How do you know if the electronic record complies with the credit? In this lesson we review the electronic record itself.

Lesson 4 – “Presentation” & Lesson 5 – “Examination”

eUCP, for the most part, concentrates on the presentation and examination of electronic records. This knowledge is key to allowing the trade finance worker to use eUCP credits. Where and how do you present electronic records? Must all electronic records be presented at once? How do you know if a presentation is complete? What should you do if an electronic record contains a virus? These are the final pieces of the jigsaw that we put in place.

Another challenge: eUCP was written to be “technology-neutral”. This was necessary to accommodate the accelerating pace of change in the technology underlying the creation and presentation of

electronic records. That being the case, no effective course could concentrate on explaining existing systems if it were to remain relevant for long and encompass new technologies as they came online. The solution was to provide context-sensitive examples of electronic records

“training has been released from the confines of the classroom”


created using existing technology to reinforce understanding of the rules. As new technologies become available, new examples can be simply added to the existing store.

Conclusion

On schedule, DC-PRO released the eUCP online training course in April to coincide with the coming into force of the eUCP. The course now enjoys widespread use.

Many people are taking the course to understand the issues in advance of using eUCP credits. After all, it is impossible to predict the future but it is possible to be ready for it.

Although we have overcome our obstacles, challenges remain for the L/C community as highlighted by Canadian expert Bill Cameron to the attendees at an eUCP Conference in Paris in May of this year. Cameron said banks have no

divine right to be the intermediaries in international trade transactions – his challenge was for banks to adopt advances in technology now or risk losing their profitable intermediary role. This challenge stands. 

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For further information on the eUCP online training course go to <http://www.dcpprofessional.com>

The UCP in court

Original documents and the signature requirement

by Chang-Soon Thomas Song

Korean Supreme Court Ruling dated June 28, 2002, Case No. 2000 Da 63691 Sales Proceeds, Korean Supreme Court, 3rd Division, Korea First Bank v. Korea Export Insurance Corporation, Seoul District Court Judgment Oct. 10, 2000, Case No. 99 Na 71619.

The case involved the Korea First Bank as the negotiating bank and the Korea Export Insurance Corporation which had provided the export insurance regarding the shipping documents negotiated by the negotiating bank. In the event that the issuing bank refused payment on the shipping documents unjustifiably, the export insurance would pay the proceeds of the negotiation to the negotiating bank.

The focus of the trial was on the discrepancies noted by the issuing bank. The District Court ruled that the discrepancies were justified and that since the refusal was due to the fault of the negotiating bank in not having checked the documents in good order, the export insurance payment need not be made to the negotiating bank.

The Supreme Court reversed this decision, saying that the discrepancies noted by the issuing bank were not justified.

What the courts said

The details of the case are as follows: In 1996, Citic Industrial Bank opened a letter of credit for USD 57,802.08 in favour of Sang Woon Moon for the account of

Weihai Imp. & Exp. Corp. with the following required documents for the import of textile raw material:

1. Signed commercial invoice: 3 copies
2. Packing list/weight memo: 3 copies
3. Inspection certificate issued by Mr Liu Yue Hong of Weihai Imp. & Exp. Corp. stamped by Weihai Imp. & Exp. Corp. One original.

The letter of credit was subject to the *Uniform Customs and Practice for Documentary Credits* (1993 Revision) ICC Publication No. 500.

On December 21, 1996, the beneficiary presented the required documents for USD 57,802.08 to Korea First Bank, and the documents were negotiated and sent to the issuing bank. After examination of the documents, the issuing bank sent the following discrepancy notice:

1. There is no Original Mark on the commercial invoice, packing list and inspection certificate.
2. The inspection certificate does not have the stamp of Weihai Imp. & Exp. Corp.

The documents presented did not have the “original” stamp on them and the commercial invoice and the packing list were prepared by a typewriter. The inspection certificate was signed by Liu Yue Hong with his personal seal stamped and the words “of Weihai Imp. & Exp. Corp. Huatai Branch” were stated beside the said signature.

The District Court ruled as follows: “The refusal notice by the issuing bank based on the lack of the ‘original’ stamp

on the commercial invoice and packing list is not justified since according to UCP 500 and its relevant provisions, these documents having been prepared by a typewriter, are original documents and as such they did not need to have the ‘original’ stamp on them. However, the inspection certificate has been prepared by a word processor and therefore is not an original and needs to have the ‘original’ stamp on it, but it does not and the stamp of the Weihai Imp. & Exp. Corp. required in the credit is missing. Therefore the document is not in compliance with the terms and conditions of the credit and the refusal by the issuing bank is consequently justified.”

The Supreme Court ruled as follows: “*The Uniform Customs and Practice for Documentary Credits*, 1993 Revision, ICC Publication No. 500, Article 20(b) states that: ‘Unless otherwise stipulated in the Credit, banks will also accept as an original document(s), a document(s) produced or appearing to have been produced: i. by reprographic, automated or computerized systems; ii. as carbon copies; provided that it is marked as original and, where necessary, appears to be signed.’”

“In interpreting above provision, the ICC Commission on Banking Technique and Practice (referred to as the Banking Commission) issued the Policy Statement regarding ‘The determination of an Original document in the context of UCP 500 sub-Article 20(b)’ on July 12, 1999.

“In light of the reason behind the above policy statement by the ICC Banking Commission and the meaning of the word ‘also’ in UCP 500 sub-Article 20(b), this provision cannot be seen as a comprehensive nor an exclusive provision to distinguish originals from copies. Therefore, when determining the originality of documents under the UCP 500 in letter of credit transactions, the question of whether the issuer of the document intended the said document to be treated as an original should control and if such intention is indicated on the face of the document, regardless of the UCP 500 sub-Article 20(b), it is not necessary to show the word ‘original’ on the document.

“If, for example, the document has been hand-signed by the issuer, or there is a facsimile signature which is treated the same as a hand signature, or there are other marks, or stamp which are treated as signatures, or the document has the label of the issuer, or his letterhead and there is the issuer’s signature or it is hand marked indicating the document as an original, this document should be considered as an original document in letter of credit transactions

and the word ‘original’ required in sub-Article 20(b) need not be shown on the document itself.

“In this case, the commercial invoice and the packing list have been prepared by a typewriter and have the issuer’s signature and stamp. The inspection certificate is not prepared by a typewriter but with a word processor and it is prepared on a document with the letterhead of Weihai Imp. & Exp. Corp., with manual signature of Liu Yue Hong who is nominated in the credit to issue the said document and his personal seal is also shown.

“Therefore, it is evident that the issuer intended to produce an original document and as such, an additional mark of ‘original’ is not necessary on the face of the document.

“The requirement of the Weihai Imp. & Exp. Corp. stamp on the inspection certificate was included to make it clear to the document checker that this inspection certificate was truly prepared by an individual representing the said company. The inspection certificate shows the letterhead of the Weihai Imp. & Exp. Corp. and in addition to the signature of Liu Yue Hong and his personal seal, just

behind the signature the words ‘of Weihai Imp. & Exp. Corp.’ are shown. This indicates that Liu Yue Hong had signed the document, not as an individual, but as representing the company. Therefore, under international standard banking practice, although the inspection certificate does not have the company stamp as required in the credit, the proper review of documents shows that this inspection certificate was prepared by an individual representing the company in a lawful manner and the lack of the company stamp cannot be seen as violating the requirement of the credit.”

Conclusion

This Korean Supreme Court ruling reflects its adoption of the Decision issued by the ICC Banking Commission on sub-Article 20(b) as well as the application of international standard banking practice to letter of credit transactions. It is a welcome sign that courts will take account of Banking Commission interpretations of the UCP, and it serves as a reminder to the banking community that it is well to stay up-to-date with regard to Banking Commission Opinions and Decisions. ■

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“ ... [this is] a welcome sign that courts will take account of Banking Commission interpretations of the UCP ”

Spotlight on Latin America

How the Argentine crisis impacts L/Cs

by Jorge Luis Riva

During past months Argentina’s exchange policy has gone through profound changes. For many years Argentina had an absolutely free exchange market and the guarantee that one Argentinian peso was worth one dollar. This was termed the “Law of Convertibility”.

But on 6 January 2002, President Duhalde devalued the currency. This basically created a free market, though the possibility of intervention by the Central Bank of the Republic of Argentina remained.

Moreover, operations must be registered, and there are some restrictions on certain banking exchange operations that require prior authorization by the Central Bank. (Examples are repayment of financial loans and financial standby instruments.) Following these moves, Argentinian exporters are once again obliged to sell the foreign currency received in payment for goods exported, and to receive Argentinian pesos in exchange. In addition, their import and export deals must include provisions for payment to be made within prescribed periods.

Impact on L/Cs

How does this new environment affect letters of credit (documentary credits) and standbys?

As far as Argentinian exports are concerned, the new regulations require exporters to sell the foreign currency they receive within prescribed time limits, and the applicable time limit depends on the product that is being exported. Also, a deferred payment documentary credit may be issued in favour of an Argentinian exporter only if it complies with this requirement. Therefore, an L/C issuing bank in the importer’s country will be able

to give a deferred payment undertaking only if it at least conforms with the minimum conditions laid down by the regulations.

The importer has unlimited access to the exchange market for the purpose of buying foreign currency for the amount of the documentary credit so that the issuing bank can remit the funds to the confirming or negotiating bank. But depending on the product the time allowed for paying the L/C will have variations. In this sense, there are some restrictions for the issuing of an L/C in Argentina with a "red ink clause" (it is only possible in some cases to anticipate payment). Moreover, in a deferred payment L/C it is necessary to respect the obligatory time that the Central Bank imposes for paying for an international sale.

Difficulties

In spite of the points mentioned above, some deferred payment documentary credits issued before the new regulations came into force are currently creating a difficult situation in the relationship between the issuing bank and the applicant. The difficulties arise in cases where the documents presented comply with the credit terms and conditions, and the expiry date of the credit is later than the date on which the new regulations came into force.

The problem arises from Decree no. 214/02 issued in February 2002. This regulation converted all foreign currency debts of all types whatsoever into the local currency – namely Argentinian pesos. (In Spanish the verb "pesificar" is used to describe this conversion.) Moreover, the conversion has to take place at the rate of 1 peso to the dollar (US). However, in the free market, 1 US dollar is worth more than 3 pesos.

At the same time, the banks are saying that documentary credit applicants must pay issuing banks at the free market exchange rate. If they have to do this, many importers with high international trade payment obligations to meet could go bankrupt. Issuing banks argue in support of their claim that they have to pay the negotiating or confirming bank

in the relevant foreign currency at the free market price.

A later government regulation (Decree 410/02) aims at excluding international trade payments from the general 1 to 1 conversion rule. However, the rules are unclear so far as deferred payment documentary credits issued in the circumstances described above are concerned. Importers in this situation argue that they are entitled to pay their debts in foreign currency at the 1 to 1 conversion rate under the old "convertibility law". A number of cases on this point are being litigated.

A similar solution has been urged by importers who have arranged for the issue of a standby letter of credit to guarantee payment for goods under international sales contracts. It may be noted that before devaluation it was a common practice in Argentina to issue standby L/Cs to guarantee payment of the price under international sales deals.

Financing arrangements

Similar conflicts have appeared in connection with financing arrangements (commercial loans) for imports and exports. In some cases of this type Argentinian loans covered by a standby L/C issued by a bank in a foreign country have been converted into pesos on a 1 to 1 basis. This situation gives rise to the following question: can the beneficiary demand payment in the original currency in accordance with the principle of independence of the documentary credit, or could such a demand amount to a fraud in respect of which injunctive relief of some kind may be sought?

Another question has started to emerge since a number of banks inside Argentina now find themselves in a financial crisis. It is accordingly being asked whether credit applicants in some of these cases may be entitled to make direct payment of the credit sum to the confirming or

negotiating bank or to the beneficiary.

Judicial precedents

We have some very interesting judicial precedents in Argentina that may provide appropriate solutions to these issues. In Banco Federal Argentino s/ quiebra - Incidente entrega de fondos depositados por Quimica Kalciyan SA (National Commercial Judge no. 23), the applicant, Quimica Kalciyan SA, deposited the funds on the order of the Judge in the Bankruptcy of Banco Federal Argentino SA. The confirming bank, Banca Commerciale Italiana, claimed that it was entitled to be paid from these deposited funds (thereby preventing the funds from becoming part of the assets in the bankruptcy). The judge at first instance rejected the claim but the Commercial Appeal Court decided on December 30 1998 in favor of Banca Commerciale Italiana.

In Banco Mayo CL s/ quiebra s/ incidente por Arbeland Trade SA (Nacional Commercial Judge no. 5, Secretary no. 9), Refrigeracion Goldman SA had delivered promissory notes to Banco Mayo CL in order to guarantee its undertaking as the applicant for the issue of a documentary credit. Banco Mayo CL went into bankruptcy after the amounts due under the promissory notes had already been paid to it. The credit beneficiary, Arbeland Trade SA, and Refrigeracion Goldman SA, made a joint application to the judge aimed at recovering the funds and having them paid over to Arbeland Trade SA.

In 2001, the judge decided to allow the claim and released the funds to Arbeland Trade SA. In another case – Banco Mayo CL s/ quiebra s/ incidente por KIMPO SA – the same judge allowed the credit applicant (the buyer) to pay directly to the credit beneficiary (the seller). ■

"the new regulations require exporters to sell the foreign currency they receive within prescribed time limits"

Jorge Luis Riva

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Surety bonds

After Enron, surety bonds and letters of credit

by Diane B. Wunnicke

The unfolding drama of Enron in the financial news included much information about current trends in structured finance, including charts explaining Special Purpose Entities – SPEs. Of interest to *DCI* readers, these structured finance arrangements included the uses of letters of credit and surety bonds. The SPE structure is a valid alternative for finance and risk transfer.

Fraudulent inducement?

J.P. Morgan (acting for Mahonia, an entity offshore of the USA) thought that USD 1.1 billion of surety bonds were securing Enron's performance of some oil and gas derivative contracts. The insurance companies allege that the contracts may have been loans disguised to hide debt at Enron and related SPEs. Despite language such as "absolute and unconditional, irrespective of the value, validity or enforceability of the obligations", the standardized documentation of the International Swaps and Derivatives Association (ISDA) may be preferred for a finance contract such as a credit derivative.

Fraud in the transaction?

J.P. Morgan also fights for payment on letters of credit securing Enron's performance of gas swap contracts. The issuers use the same logic as the surety bond issuers: possibly fraudulent transactions. So, investigation is pending through the

bankruptcy court. (This issue is further summarized in *The Economist* 26.01.02 "Unsurety Bonds".)

Letters of credit vs. surety bond

As the Enron details continued to unfold, the financial press alluded to the difference between a surety bond and a letter of credit. Holders of payment and performance collateral in structured finance transactions decided they might prefer letters of credit. A surety bond is a form of guarantee and thus represents only the secondary obligation of the surety.

The primary obligation of the issuer under a letter of credit is subject to the independence principle, but the obligations of a surety are not independent of the underlying transaction. Thus the surety may raise defences to payment under the contract, but the L/C issuer cannot do so. Payment under the surety bond is not made until the dispute is ultimately resolved.

Even if no defences to the contract are available to the surety, payment under the surety bond may be far from swift. The surety will first need to assess the facts and then definitively determine that the principal obligor has defaulted. The provisions of surety bonds do not typically include time constraints on payment by the surety. The letter of credit mechanism,

by contrast, is simple and immediate and also cost effective. Other than in cases of fraud or wrongful dishonour by the issuer, prompt payment under the letter of credit is reasonably assured. (From Chapter 2, *Standby and Commercial Letters of Credit*, Brooke and Diane B. Wunnicke and Paul S. Turner, 3rd Ed.)

Capacity for issuing letters of credit

Letters of credit and surety bonds totalling USD billions secure many types of structured finance transactions. For example, in the United States, clean letters of credit are used to secure various States' statutory reserve requirements for insurance ceded by USA-admitted companies to reinsurance companies offshore of the USA. Surety bonds are issued by insurance companies, and most letters of credit are issued by banks. If the demand for letters of credit for structured finance transactions significantly re-

places the demand for surety bonds, the issuing capacity of the banking system, and the pricing, may be strained. A more visible role for non-bank issuers of letters of credit is a possible future trend. ■

"The SPE structure is a valid alternative for finance and risk transfer"

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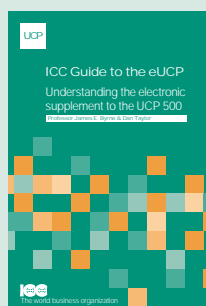
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ment checkers should follow in reviewing
documents under a documentary credit.

Standard banking practice cont'd from page 1

documentary credit, but according to the document itself?"³

Bernard Wheble, then Honorary Chairman of the ICC Banking Commission, drew on several works in his response, saying in summary: "the introduction of this international standard banking practice does not limit a bank's duty to exercise reasonable care when checking a document ... the basic fact remains that the letter of credit is a payment instrument: banks are expected to pay and not to look for technical excuses not to pay, although they are not expected to disregard obvious discrepancies that warrant dishonour."⁴

In 1997, Dr. Boris Kozolchyk, commenting on international standard banking practice, found it "... a good alternative, among other reasons, because it would encourage the harmonization of a larger number of international practices in future revisions of the UCP. And such a harmonization would have to be based on standard practices, i.e., neither above nor below the industry's norm."⁵

The task force

Attendees at the 2000 Spring meeting of the ICC Banking Commission recognized the need for clear and definitive answers to these issues. A task force was formed and their charge was clear: to document international standard banking practices as defined in the articles of UCP 500, but not to create practice; to neither alter nor amend UCP 500; but rather to determine the meaning of stated practices and how those practices are put into application.

At first, the project appeared straightforward – gather and compile checklists from around the world, used by practitioners in the examination of documents. Where different practices existed, it was surmised that a "best practice" could be identified and documented as well.

The first meeting was held in Paris immediately following appointment of members to the task force, where it was decided that the ICC Banking Commission would ask ICC national committees to contact members and solicit the checklists and publications they used to determine documentary compliance. With some 45 different responses received, the task proved to be substantially greater than anticipated.

Sub-committees

As a result, several sub-committees were formed to focus on the most frequently mentioned groups of practices. These included, among others:

- Alterations: what constitutes an "alteration" or "addition" to a document, when and how should these be authenticated?;
- Certificates of origin: particularly regarding consular invoices as well as all "other documents";
- Drafts: practices regarding endorsements, usance drafts, when "sighting" occurs if documents are discrepant, how to handle alterations;
- Signing of documents: if not explicitly stated in the credit;
- Beneficiary and applicant addresses on documents: how to handle typing errors on documents regarding name and address, different addresses of same company, etc.;
- Trade terms: Must trade terms, such as Incoterms, appear on the invoice?;
- Mathematical calculations: on invoices and other documents;
- Combining documents: Can a beneficiary's certificate appear on the invoice or must it be a separate document?;
- Transport documents: What is the "face," and should a practitioner examine the reverse side to determine the name of carrier, description of the journey, etc.?
- Insurance documents: What is a full set, a copy vs. an original, endorsements, and effective date?;

There were also numerous requests to define good, bad, and best practices regarding transfers.

Review materials

The task force decided to review official publications of the Banking Commission to ensure consistency and incorporate reference to applicable ICC Opinions. Opinions were carefully reviewed in order to avoid construing individual responses to unique queries as statements of general international practice.

In early discussions on the "target

audience" for this publication, the Committee quickly discovered that with so many technical aspects to every point under discussion, this document would be relevant to all users of documentary letters

of credit. What to call the publication was discussed numerous times, particularly with regard to the use of "documentary credits" vs. "commercial credits", which some practitioners use to distinguish those instruments used to facilitate the movement of goods, from "standby" or "clean" credits, used in many countries instead of bank guarantees. Among the suggestions for a stylistic approach was strong support for an

illustrated publication featuring "by the numbers" references with emphasis on best practices. While there is a need for such a publication, the task force felt that the scope of such a project was beyond their resources at this time.

Result

At the end of the day, a substantive and thoughtful document was produced and distributed to ICC National Committees for consideration at the Fall 2002 meeting of the Banking Commission. The successful vote to approve it as an official publication of the ICC Banking Commission is a strong first step towards resolving the ambiguities that currently hobble the entire community of letter of credit practitioners. ■

Donald R. Smith was a Co-Chairman of the task force charged with drafting the ISBP. He is Vice President, Global Trade Finance and Services, Global Product Management at Citibank, N.A. in the USA. His e-mail is Donald.R.Smith@citigroup.com

"The successful vote to approve [this document] is a strong first step ... "

1. DCInsight, *ICC Pub, Volume 5, No 2, Spring 1999.*

2. *Ibid.*

3. DCInsight, *Volume 2, No 4, Autumn 1996.*

4. *Ibid.*

5. DCInsight, *Volume 3, No 4, Autumn 1997.*

The ISBP document is expected to be available in January from ICC national committees and on the ICC bookstore website, www.iccbooks.com. Attractive discounts will be granted on bulk orders.

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In brief

World Bank backs URDG

The World Bank has given a boost to ICC's Uniform Rules for Demand Guarantees (URDG) by recommending that the rules be used in conjunction with its forms for unconditional guarantees. This is likely to give rise to several more thousands of guarantees governed by the URDG, because users of guarantees under World Bank finance contracts will have the rules incorporated in them.

After a slow start, the World Bank endorsement caps a period of increasing recognition of the URDG. The United Nations through UNCITRAL cited the URDG as the example of generally accepted international rules and usages of independent guarantees. In 1999, the International Federation of Consulting Engineers also incorporated the URDG in their model unconditional guarantees. A new African uniform law on security interests, whose chapter on guarantees copies the URDG, is now in effect in 15 African countries. In addition, the new Egyptian commercial code, in a specific chapter on demand guarantees, cited the URDG as an example of international usage.

ICC guest speakers on the URDG have appeared at seminars held in a number of different countries – including Sweden, Spain, Portugal, Czechoslovakia, the UK and France. Countries wishing to have speakers for their URDG seminars are requested to contact the ICC secretariat in Paris (rkz@iccwbo.org).

New Bolero programmes

Bolero, the electronic platform on which various types of trade transactions can be conducted in a secure online environment, has announced two new solutions that aim to cut documentary credit processing costs by replacing procedures hitherto executed by mail or fax with alternative electronic systems. The solutions offer fully automated translation capability between SWIFT MT700 and boleroXML standards and can be provided in generic or customized, bank-branded versions.

BoleroAdvise claims to offer banks cost savings and quality improvements in their existing documentary credit advice services to exporters through the provision of a Bolero's web-based XML messaging solution.

BoleroApply claims to provide a solution for banks to improve the quality of services they offer to importers in the opening of documentary credit transactions. It also includes a pre-advice capability to exporters.

A group of French institutions – including BNP Paribas, Societe Generale, Natexis Banque Populaire, Credit Agricole Indosuez and HSBC/CCF – have already planned a rollout of the new BoleroAdvise solution according to a statement issued by Bolero.

Fraud award for Bank of China
State-owned Bank of China says a US court has awarded it USD 110 million in a lawsuit against a borrower who the bank said had fraudulently obtained letters of credit (L/Cs) from its New York branch. The case emerged as a result of irregular banking practices discovered at the New York branch of Bank of China.

Under US law, the USD 35 million damage award was been trebled at the request of the bank, which along with attorneys fees and costs awarded by the court brings the total award to USD 110 million, the bank said in a statement.

Prosecutors said that the conspirators had used fraudulent trade transactions and fake and forged documents systematically to defraud the bank over a 10-year period.

A statement posted on the web site of the bank's New York law firm, Coudert Brothers, identified the defendants as a Chinese-born New Jersey couple – John Chou and his wife, Sherry Liu – as well as a former Bank of China employee whom it did not name.

Spring Banking Commission dates
The ICC Banking Commission will hold its spring 2003 meeting on 21-22 May in Paris. The day before, on 20 May, it will sponsor a conference concerning the new document on international standard banking practice. Persons wishing to attend one or both meetings should contact Audrey Di Russo at e-mail ado@iccwbo.org

in the coming issues of DCI

- Can one ignore terms and conditions on the bill of lading?
- Reactions to the international standard banking practice document
- The theory behind a new guide to the eUCP
- Queries from the Rome Banking Commission meeting
- And more