

ADVERTORIAL



# Reducing discrepancies in letters of credit

Letters of credit are a substantial part of the mechanics of international trade. As *Anand Pande*, Asia regional product manager, Trade Services at Citigroup, writes, up until the International Standard Banking Practices for the Examination of Documents Under Documentary Credits (ISBP) was passed, the amount of discrepancies were many. The passing of the ISBP however brings a lot of comfort and advantages for exporters and importers.

Today, an estimated 15% of world trade, worth more than US\$1 trillion, is transacted through the use of letters of credit – a time-proven risk management tool for thousands of companies that engage in global trade. Letters of credit enable these companies to grow their international business by freeing them from their reliance on the credit standings of their buyers, through an independent, financially trusted partner, in the form of a bank.

The letter of credit agreement guarantees that payment for the delivery of goods will be effected – as long as the seller's documentation complies with the terms and conditions of the letter of credit.

In order to establish a common set of standards for compliant documents under letters of credit, the International Chamber of Commerce (ICC) published the Uniform Customs and Practice for Documentary Credit (UCP 500).

First published in 1923, and

most recently updated in 1993, the document is meant to be used by all letter of credit parties, worldwide, in order to facilitate the trade cycle between sellers and buyers. The basic concept of the UCP was to transcend the complexities of local country laws, regulations, and practices, and instead follow an international set of uniform rules that would help to facilitate and grow the global trade business.

In reality, however, this utopian ideal was never achieved. In 2002, more than 60-70% of documents presented by sellers were classified as discrepant by the buyers' banks. This has led to inefficiencies across the entire value chain by tying up the sellers' working capital while their payments are unnecessarily delayed.

In addition, while the buyers, sellers, and their banks try to thrash out their differences and clarify whether the discrepancies are significant and how best to resolve them, the waiting goods are not only incurring demurrage costs, but

also becoming vulnerable to potential damage. The entire situation is driven by the need and/or the ability to interpret the practices set forth in the UCP 500, as evidenced by the hundreds of enquiries received by the ICC since the last revision. The situation is further complicated by the expansion of international trade; with the entry of new countries and inexperienced practitioners, the discrepancies in practice have compounded.

## Meeting a compelling need

In order to clearly define standard international banking practices, and significantly reduce the level of discrepancies, the ICC put together a 13-member multinational task force. Their task was to clarify the stated practices, as defined in the UCP 500, and explain how to put them into practice. More than two years in the writing, the document they produced is now known as the International Standard Banking Practices for the Examination of Documents Under Documentary Credits (ISBP).

On October 31, 2002, the official status of the ISBP was put to a vote. The national committees of the International Chamber of Commerce Banking Commission voted overwhelmingly in favour of the official adoption of the ISBP. The vote for the

adoption of the ISBP was a clear mandate to resolve the longstanding and costly ambiguities surrounding the use of documentary letters of credit, ensuring their continued prominence as a primary payment vehicle of international commerce.

## The potential impact

With global adoption, the potential impact of the ISBP will be substantial on all fronts, significantly reducing the discrepancies and confusion that currently surround letter of credit practice, speeding the flow of payments to exporters and documents to importers, and enhancing straight-through processing for the banks.

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

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

In those instances when both the importer and exporter bank with Citibank, the cycle times will be shortened further, since the transaction will go through the same backend system. In addition, documents can be examined in a more expeditious manner due to the use of a single common operating platform.

## Reducing discrepancies through analytical tools

With the ISBP providing a new framework for clarity around the document checking process, the reduction in document rejection will significantly speed up the trade cycle.

Both exporters and importers alike have begun making efforts to improve the process. As a result, more and more trade clients are requesting better analysis of the frequency, type and origin of discrepancies. Citibank corporate clients can use our web-based corporate banking platform, CitiDirect® Online Banking, to get a wide range of reports both for imports and exports, including discrepancy

analysis to improve and reduce the overall number of differences.

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

## Advantages on all sides of the transaction

Adoption of the ISBP delivers multiple advantages for both exporters and importers. Exporters (beneficiaries of letters of credit) will see improvements in cashflow and efficiency as a result of the transparency in the document preparation and presentation process. The reduced time spent on document correction as well as faster payment will help to lower costs and significantly improve working capital management. Importers (applicants of letters of credit) will benefit from faster receipt of import documents, thus avoiding demurrage charges and delays in receipt of goods and ultimately reducing the true cost of the goods.

## Are letters of credit on the way out?

To borrow the words of the great American writer, Mark Twain, on reading his own obituary, "The reports of my death are greatly exaggerated", the same may be said about the supposed demise of letters of credit. With the adoption of the ISBP, the industry has set viable new standards in order

to address the problems that add unnecessary delays and costs to the trade cycle. In addition, the banks continue to add innovative new concepts to further improve the trade flow between exporters and importers. In other words, the right steps are being made in the right direction. The result is a win/win/win situation for all – exporters, importers and banks.

## A time-proven tool of the trade

In an expanding trade scenario, fed in no small part by the entry of an increasing number of new exporters, the built-in controls of a letter of credit add a valuable layer of risk management. For this reason, letters of credit have



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played a long-running role in the history of international trade – as far back as the 15th century BC, when Phoenician traders carried them in the form of clay tablets. Their ongoing viability over so many centuries is compelling testimony to the basic integrity of their premise and their proven ability to facilitate and protect the practitioners of international trade.

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

### Abbreviations

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

### Misspellings or typing errors

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

### General issues relating to invoices

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