

# Letter of Credit (LC)

**Meaning:** LC is **Written Document** issued by the **Importer Bank** on behalf of Importer Assures the seller will received his funds upon fulfillment of terms of the Trade A agreement. A guiding principle of an LC is that the issuing bank will make the payment based solely on the documents presented, and they are not required to physically ensure the shipping of the goods. If **the documents presented** are in accord with the terms and conditions of the LC. the bank has no reason to deny the payment.



## LC Documents:

- 1). Commercial Invoice
- 2). Packing List
- 3). Shipping Bill of Lading
- 4). Airway bill
- 5). Certificate of Origin
- 6). Insurance Certificate
- 7). Certificate of inspection.

**LC Costs:** Opening Charges, commitment fees, upfront fees, retirement charges, advise fees, confirming bank fees, bank charges etc., Cost will be 0.25% to 2% of LC value.

**LC-Process:** Trade Agree between buyer and seller and use of LC >>> Buyer applies to Issuing bank to issue an LC in favor of the seller >>> Issuing bank sent LC to the advising bank >>> Advising bank verifies the authenticity of the LC and forward it to the seller >>> Seller Verify LC and Initiate the goods shipping process >>> After the goods are shipped, seller presents LC documents to Advising bank >>> Advising bank send LC documents to Issuing bank and the amount is paid , accepted >>> Issuing bank verify documents and obtain payment from Buyer >>> Issuing bank send documents to buyer >>> Buyer use these documents to get possession of the shipped goods.

**Bank Guarantee (BG):** BG is an Assurance given bank for a non performing activity, if any activity fails, BG pay dues. BG involve three parties: Applicant, Beneficiary and the Banker. LC is commitment document. It Guarantee for payment to seller. Involve four parties: Buyer, Seller, issuing bank & advising bank.

## LC Types:

**1.Revocable LC:** LC can be Modified or revoked or cancelled by Issuing Bank 'or' Buyer without any notice. The concept of a Revocable Credit was withdrawn in 2007.

**2.Irrevocable LC:** LC Cannot be revoked or modified or cancelled without the consent of issuing bank, seller and confirming bank.

**3.Confirmed- Irrevocable LC:** An arrangement where another Bank or Financial institution adds its Guarantee to the LC. It is used when seller do not trust the Buyer' bank or issuing bank.

## LC Parties:

Terms	Means	Remarks
Applicant	Buyer / Importer	Buyer
Beneficiary	Seller / Exporter	Seller
Issuing / Opening Bank	Buyer Bank	Buyer
Advising bank	Seller Bank	Seller
Confirming bank	Additional Guarantee to issuing bank	Buyer
Negotiating bank	Make payment to seller subject to completeness of documents	Seller
Reimbursing bank	Bank between Issuing and negotiating bank	**
Second Beneficiary	One who represent the original beneficiary in their absence	**

**4. Unconfirmed - Irrevocable LC:** No Added Guarantee as above. It involves only Seller, Buyer, issuing bank and Buyer bank.

**5. LC at Sight:** Requires the advising bank or seller bank to make payment at sight, on demand or upon presentation of documents.

**6. Usance LC 'or' Deferred Payment LC:** This type of LC wherein the buyer is allowed to make the payment after the delivery, within a stipulated grace period.

**8. Transferable LC:** Used when there is a Middleman involved. First beneficiary requests the bank to transfer the entire/part payment to the second beneficiary. First Beneficiary is Middleman.

**9. Un-transferable LC:** Used when there is no a Middleman involved. LC cannot be used to pay any other party.

**11. Free Negotiable LC:** This LC not restricted to any Bank for negotiation or it can be negotiated in any bank

**7.Back to Back LC:** When a transaction takes place between a buyer and a seller keeping an intermediary in the loop. A broker or trader acts as an intermediary between the seller and the buyer. Instead of issuing an LC to the Seller, the buyer issues it to the intermediary. The intermediary then submits the primary LC as collateral at a bank and asks it to issue another LC to be given to the end seller in exchange for the shipment. The second LC that is issued keeping the primary LC as collateral is known as a 'back to back letter of credit'.

**10. Standby LC (SBLC):** Similar to Bank Guarantee. Seller can obtain payment from the bank even in the case of the buyer failure to perform as per the agreement.

**12.Revolving LC:** Single LC that cover Multiple transactions over a long period. It is used for Regular transactions of the same commodity between same buyer & same seller.

**13.Red Clause LC:** Seller is paid an Advance before the goods are shipped. LC acts an aid to the seller for his working capital requirements for Purchase of Raw materials, Packing and processing of goods.

**14. Green Clause LC:** Same as above (13) additions to Raw materials, packing and processing cost but also for cost incurred for Pre-shipment, warehousing and insurance.