

## Letters of Credit in a Digital Age

Credit professionals have many tools at their disposal. These tools range from information and knowledge to something that can be physically held in their hands. The benefit of learning something new about a potential customer from an industry trade group is invaluable as is a calculable ratio based on a set of numbers from a financial document or a risk score on a new customer. Sometimes, this information can be a tangible asset while other times it is not. These tools can fall into what can be considered hybrid as well. Such is the case in Asia, where two banks are breaking ground in cross-border transactions.

City Bank announced earlier this month that it became the first Bangladeshi bank to execute a cross-border letter of credit (LC) under Shariah-based financing using blockchain. The transaction between a Bangladeshi garments business and a Hong Kong-based exporter was conducted on Contour's network. The LC, from draft initiation to issuance and advising, took 38 minutes, as compared to the typical up to three days for regular cross-border LCs.

"Blockchain technology allows parties to manage their own data while transacting and viewing shared information seamlessly and securely with their trading partners and service providers," states the release from City Bank. "This results in transparency in transactions, reducing the scope for forgery and fraud significantly."

Meanwhile, HDBank announced it became the first Vietnamese bank to conduct such a transaction—between a fiber importer and a Taiwanese yarn manufacturer. According to BTCManager, the use of blockchain in letters of credit transactions is increasing. "Blockchain offers better security and faster processing of transactions," the news outlet reported. "It also minimizes errors that are common with paperwork and saves time. Blockchain as a distributed ledger enables the storage of huge data of statistics, management data, and historical transactions between customers."

The use of this technology is not without its complications and challenges. In many ways, digitizing and securitizing the documents with encryptions is the easy part compared to the navigation of international regulations. "The product can be crossing all kinds of borders; it can be in three or four countries over the course of the shipment, so whose laws apply?" asked Chris Pilkington, international banking relationship manager with First National Bank, which is headquartered in Pittsburgh. There has been an electronic uniform customs and practices (eUCP) process governed by the International Chamber of Commerce (ICC) for several years, noted Pilkington, yet each sovereignty has its own digital document laws and some don't have any.

"There are different regulations and levels of digital sophistication around the world," added Yenner Karto, senior vice president and head of international banking at FNB. Not every bank around the world will have the same technological expertise. Not even every country is using the same technology within its borders. On the positive side, commodity shipments with LCs can be done totally digitally because the entire vessel of product is going from one seller to one buyer—not all different products belonging to multiple shippers, noted Pilkington. However, this is not the norm at all yet.

While the buyer applies for the LC at their bank and they tell the bank what the LC will say, the seller should also provide an LC sample of what they are expecting, said Pilkington.

“What goes into the letter of credit should be dictated as much as possible by the seller,” said Karto. “So, when a sales contract is signed, it’s part of the contract to state what the seller wants in the LC. Establish the terms and conditions to influence the LC as much as possible. Where we see the seller go wrong is when the seller says, ‘We want a letter of credit,’ but they don’t specify further.”

What Pilkington and Karto have seen is that buyers can and will use the LC as a sort of safeguard, including multiple different requirements to use as reasons to not release payment on time to the seller. “Even though the buyer issues the LC through their bank, the terms and conditions of the LC should be strongly influenced by the needs of both parties,” Karto said.

*The first webinar of a four-part LC series hosted by FCIB begins Thursday, Feb. 4. LC expert Richard “Chip” Thomas will present a different aspect of LCs in each session. Find out more and [register here](#).*

-Michael Miller, NACM managing editor