STANDBY LETTERS OF CREDIT

SBLC's – a perfect back up plan for your trade ?

- What is a SBLC
- The origins of the SBLC
- The differences with regular l/c's
- The differences with Bank guarantees
- The underlying rules and the impact of using UCP 600 vs ISP98
- In what situation should you use SBLC's
- What documents to ask for under the SBLC
- The effects of switching from a regular l/c to a SBLC in the

TODAYS PROGRAMME

- The short version; it is a bankguarantee in L/C format
- The slightly longer version; it is a conditional promise to pay i.e. a bank is guaranteeing payment against a claim, if and when such a claim complies with the conditions of the SBLC and the underlying rules
- The instrument is relative straight forward but requires quite a bit of trust on the side of the applicant ! N.b. the instrument is abstract from its underlying obligation.

WHAT IS A SBLC

- Historically Banks in the US were not allowed to issue Bankguarantees (Bonds), that task was basically only allowed for Insurance companies
- As an alternative Banks discovered that if you copy-past the guarantee text into an L/c (with a few tweaks) you could have a similar instrument as a bankguarantee which even has a few advantages over the regular Guarantee

THE ORIGINS OF THE SBLC

- The main difference is in the purpose of the instrument, the SBLC is a default instrument, i.e. you would, in most cases use the instrument in case of the client not performing under the contract. Whereas with a regular lc the instrument is a pure payment instrument and would be used to obtain payment when all is well.
- Advantage to a normal lc;
- - only need to present documents at a default situation
- - less documents needed, less chances for discrepancies
- - cheaper when compared to a documentary l/c
- Usually the SBLC will not have a tenor but will be for payment at sight, against a first demand claim
- The underlying rules for SBLC can be UCP 600 or ISP 98

DIFFERENCES TO THE REGULAR L/C

- The main difference with a “regular” Bankguarantee, in my opinion, is the level playing field it offers
- Disregarding UDRG 458, most bankguarantees will be subject to local law only which will potentially put one of the participating parties at a disadvantage
- A SBLC issued under either ISP98 or UCP 600 will offer a public set of rules which is clear to all
- Again disregarding UDRG 458, a expiry date in a SBLC is a expiry date (!)   , there are no open ended standby l/c’s

DIFFERENCES TO A BANKGUARANTEE

- UCP 600
- ISP98

- Both Rules are governed by the ICC and are quite similar in a number of ways however the latter was specifically designed for SBLC's
- Although IP98 is geared towards the SBLC there seems tom be some reluctance by parties to issue SBLC's under these rules
- UCP 600 will work almost just as well as ISP98 however its documentary requirements will apply just as hard as they would for a normal documentary presentation under a regular lc re: **original shipping documents, documents being consistent** ;

THE UNDERLYING RULES

- Consistency of documents; under ISP98 only if so indicated, under UCP 600 always , as stated above under UCP documents will be fully checked as if it was a regular presentation under an l/c (UCP contains 12 sub-clauses for document examination, ISP basically states that documents on their face need to comply)

THE RULES

- **There are a number of situations a SBLC would be a good option**
- - perhaps the "worst" reason; you have difficulty presenting credit conform documents under a regular l/c and want to make your life easier.
- Yes the SBLC will be a good alternative as claiming under a SBLC is much easier than under a documentary l/c
- However the offtaker is taking a bit of a risk here, the SBLC is a first demand payment guarantee and the exporter does not have to prove (documentary wise) that he actually shipped anything
- A perhaps better reason; you want to engage into an open account relationship and there is a certain trust level between the parties, however you want to have additional security not unlike an insurance. In such a case a SBLC is a good alternative, only in case of a default would you claim, otherwise you will just keep it on file during the performance of the contract

WHEN TO USE THE SBLC

- When you are the seller the correct answer to below question should be; at little as possible
- Standard would be an invoice + claim letter basically stating that the counterpart did fulfill his contractual obligations and therefore you would claim XXX amount
- For the buyer issuing the SBLC I would advise the opposite but I would also argue that the claim letter should mention to what particular part of the contract the applicant did not fulfil. In this way you can limit (somewhat) that the beneficiary would claim full SBLC amount for a minor issue

WHAT DOCUMENTS TO ASK FOR

- In case you will switch from documentary letters of credit to semi open account you will notice that it will have an immediate effect on your cashflow planning
- - with l/c's there will be (in most cases) a clear maturity/payment date; you present credit conform documents and the payment date is set. With a SBLC you are going back to the open account realm (for instance payment end of month, 30 days after having received the invoice, or (worst case) the guys who is supposed to sign is on holiday etc and we will pay you next week
- Therefore when switching do account for payment delays!

NOW WHAT COULD GO WRONG?

- On the back of the last point made regarding payment delays,
- - make sure the lifetime of the SBLC caters for the last maturity of your payments + a bit of extra time
- You do not want to find out that when extending payment terms and having for instance agreed a tenor of 90 days combined with a SBLC having a validity of 1 year starting January first, to have your last shipment in the year starting November 1st
- Another issue to look out for, when dealing with perhaps less scrupulous counterparts; in case you will use the SBLC in combination with an open account payment, it could happen that at payment date the funds are not in your account which you will probably only notice the first day thereafter. When contacting the buyer you will probably receive a nice excuse that something went wrong and he will pay asap. Make sure that you will actually have sufficient time to lodge a claim under the SBLC and please check (beforehand) where the SBLC expires !!

NOW WHAT COULD GO WRONG?

- Expiry date – enough time ?
- Expiry place – where does you claim need to be before 17:00 at Friday afternoon ?
- Is there any dependency on the applicant to claim (applicants certificate)
- Is there an "no claim before date" in the claim conditions ?
- What are the underlying rules, what effect does it have on claiming
- What claim format is allowed (usually no fax or e-mail claims are allowed unless the SBLC says otherwise)
- who pays the charges
- Is the SBLC confirmed, do you need confirmation ?

WHAT TO LOOK FOR IN A SBLC

- A standby lc can make your life easier, but make sure you keep track of all time lines and keep the claim process simple

- When compared to most other form of bankguarantees the SBLC offers a level playing field to both applicant and beneficiary

- Costs of a standby vs a regular l/c are usually lower but keep an eye out for late payments and missing interest as a result of this!!

IN CONCLUSION