Standby Letters of Credit

Trying to make your life and your (documentary) payments a little easier

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Our program today

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What is a standby letter of credit (SBLC)

- In short (and very simply put) ; a bank guarantee in LC format
- Once upon a time banks in the US found out that they were not allowed to issue (bank) guarantees, however they also found that if they changed the format of the guarantee slightly they could adapt a Letter of Credit in such a way it became de facto a "bank guarantee"
- What does a SBLC do; it covers the beneficiary (/seller) and offers financial compensation in case of the applicant (/buyer) defaulting on its named obligation (financial or otherwise) i.e. it guarantees financial compensation in case of a claim in conformity with the instrument and the underlying rules
- So contrary to a "normal" LC you would only draw under the SBLC in case something goes wrong

The process

- If you, as the exporter have decided that an SBLC is the appropriate instrument to be used for your transaction you will ask your counterpart to approach his bank to issue the instrument to you (either directly or through your local bank)
- The instrument is relative straight forward but requires quite a bit of trust on the side of the applicant ! N.B. the instrument is abstracts from its underlying obligation.
- Make sure the SBLC text is clear and does not contain any clauses which make a successful claim dependent on the applicant cooperating

- 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 LC

Confirming a SBLC

- A standby LC can, just like a normal LC be confirmed by your own bank, this removes the country and issuing banks risk from the transaction as you can directly claim under the SBLC by the bank adding it's confirmation
- You do need to check with your bank whether the issuing bank is acceptable to them (and against what price!) and whether the SBLC text as agreed between applicant and beneficiary is also acceptable to the confirming bank:
- Example; the SBLC text mentions that beneficiary is allowed to claim by e-mail, which is not always acceptable to the confirming bank (KYC) or the SBLC allows for transfer of the instrument without the consent of the issuing bank.

Requirements

- As the SBLC is not a “normal” LC and you would in a normal situation not expect to get a drawing, your bank might have different requirements when you want them to open a SBLC for you (or for your counter part for that matter)
- There will not be any title documentation and as the SBLC will only be drawn in a default situation the bank might perceive the instrument as “riskier” than a normal LC for which they have grip on the documents (remember the SBLC normally only gets drawn in a default situation, such as the applicant going bankrupt)

Supporting documentation

- What is usually required under SBLC to claim;
  - an invoice
  - a statement that the applicant did not fulfill his contractual obligations
  - the claim letter

- Of course you can agree with your counterpart for even less or more docs (such as a surveyors report, or another 3rd party document)

How do SBLC’s differ from normal LC’s

- As stated before a SBLC would only drawn under in case of a default scenario, whereas with the regular LC you would “always” draw
- The SBLC is usually much simpler in set up when compared to a regular L/C
- The documents required are much simpler in form and the chances for discrepancies are much less (but these chances are still there !)
- And now for the bad news; - open account payments have a tendency to get paid late
- Claims are usually presented on the last possible claim day and this carries a high risk - banks have 5 working day period to react !

When to use SBLC's

- Simply put, when you know you should actually be working with a regular LC (to cover country or counterparty risk) but when you are convinced you will never be able provide credit conform documents
- But perhaps in a more positive way, when you want to do business on an semi open account basis but need a bit of extra security to cover again the country risk of the counterpart risk
- Nowadays quite a lot of Firms use the SBLC in combination with Open Account payments and the SBLC is only there to serve as a form of insurance just in case the counterparts fails on his payment; almost the security of the Letter of Credit with the ease of open account payments

Different type of LC’s

Please note there are more sub-types but roughly they can be divided as follows

- Financial SBLC – guaranteeing a financial performance such rent, margin calls, etc.

- Performance SBLC – guaranteeing a “performance” such as performing under a contract, construction

- The end result is always the same, a financial compensation is paid out when successfully claimed

How does a SBLC differ from a Bank guarantee

- Level playing field — bank guarantees (except for those under UDRG 758) are subject to a certain law and jurisdiction, which is either that of the applicant or the beneficiary.

  When using a SBCL the underlying rules will be either UCP or ISP (perhaps with the addition of English or NY law in certain cases)
- Expiry date — a guarantee can be open ended, a SBLC can not be open ended
- Form of documents — especially under UCP 600 the scrutiny for the documents to be presented is higher than under a bank guarantee although both will be checked “on their face” under UCP they will be checked for consistency as well

The rules governing SBLC’s

- 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
- ISP98 especially designed SBLC’s however there is some hesitation by banks 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**

- In short, if a original shipping docs are required (for instance 1/3 B/L) then under a SBLC issued under UCP 600 they need to be presented within 21 days after shipment (unless otherwise indicated), under ISP there is no limitation except for the expiry date
- Consistency of documents; under ISP98 only if so indicated, under UCP 600 always (documents need to show consistency)

The rules governing SBLC’s continued

- So for example if a original shipping doc is required for presentation (for instance 1/3 original B/L) then under a SBLC issued under UCP 600 they need to be presented within 21 days after shipment (unless otherwise indicated) , under ISP98 there is no limitation except for the expiry date.
- 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 LC (UCP contains 12 sub-clauses for document examination, ISP basically states that documents on their face need to comply)

The fees

- Now please note that what is state here is indicative only and based upon my experience as a banker working for multiple banks in Europe, charges can differ and this should be seen as a rough guideline
- Approximately 1 per mille per month issuance fee
- A handling fee of approx. EUR 250 per drawing (which should normally not be charged as the SBLC should only be drawn in case of a default)
- Advising fee of 1 per mille usually with a cap to max EUR 250 – 500
- Confirmation fee, if applicable and based upon the issuing banks rating and the attached country risk

Standby LC – In Conclusion

- 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 bank guarantees the SBLC offers a level playing field to both applicant and beneficiary

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