

# FCIB Webinar Series

# DOCUMENTARY

# COLLECTIONS

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# Agenda

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- International Trade Payments and Risk Levels
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- Documentary Credits
- Parties to Documentary Credits
- Similarities and Differences Between Documentary Collections and Documentary Credits.

# International Trade Credit Risks

- **Country Risks (Political Risks):** Country risk also refers to the broader notion of the degree to which political and economic unrest affect the securities of issuers doing business in a particular country.
- **Customer Risks:** Know your customer (KYC)
- **Foreign Bank Risks:** Correspondence Relations with other banks, Credit Risk
- **Currency (FX) Risks:** Financial risk that exists when a financial transaction is denominated in a currency other than that of the base currency of the company.
- **Shipping Risks:** Timely delivery, accurate delivery, lost merchandise, fees, taxes, and insurance are some factors that should be examined.

# International Trade Payments

- Prepayment (Cash in Advance Payments): Importer must pay the exporter in cash before a shipment is made.
- Documentary Credit (Letter of Credits): Importer's bank guaranteeing to an exporter that the payment will be received on time and for the correct amount.
- Documentary Collection :Exporter hands over the task of collecting payment for goods supplied to his or her bank, against the shipping documents
- Open Accounts: An International trade is a sale where the goods are shipped and delivered before payment is due. (Term: 30-60-90 days)

# International Trade Payment Risk Levels



# Uniform Rules for Collection (URC 522) Revision 1995

- Standard international rules governing the role and responsibilities of banks in collections have been established by the International Chamber of Commerce (ICC).
- Uniform Rules for Collection (ICC publication URC 522) are internationally recognized and have been adopted by most banks world-wide.
- Any company importing or exporting on a documentary collection term should be familiar with the URC 522, as it has a direct impact on how the collection is handled and what procedures the banks follow.

# URC 522/ “Article 02”

## Documentary Collection Definition

- a) “Collection” means the handling by banks of documents as defined in Sub-ARTICLE 2 b in accordance with instructions received , in order to;
1. obtain payment and/or acceptance; or
  2. deliver documents against payment and/or against acceptance; or
  3. deliver documents on other terms and conditions.
- b) “Documents” means financial documents and/or commercial documents:
1. “Financial documents” means bills of exchange, promissory notes, cheques, or other similar instruments used for obtaining the payment of money.
  2. “Commercial documents” means invoices, transport documents, documents of title or other similar documents, or any other documents whatsoever, not being financial documents.

# URC 522/ Article 02

## Documentary Collection Definition

- c) “Clean Collection” means collection of financial documents not accompanied by commercial documents
- d) “Documentary collection” means collection of :
1. Financial documents accompanied by commercial documents.
  2. Commercial documents not accompanied by financial documents.



# Documentary Collections

- Documentary Collection; is a transaction where the exporter entrusts the collection of a payment to the remitting bank (exporter's bank) which delivers the corresponding documents to the collecting bank (importer's bank) along with the instructions for payment.
- Exporter ship the goods before payment but retain control of them until they receive payment from overseas buyer or receive a legal undertaking of future payment, such as an endorsed (signed) bill of exchange (also called a draft) or promissory note.
- Also known as “Sight Drafts and Time Drafts” or D/P (documents against payment) or D/A (Documents against Acceptance);

# Documentary Collection Types

• Documents against Payment (D/P) also known as "Sight Draft" or "Cash against Documents" (CAD). The buyer must pay before the collecting bank releases the title documents.

- Time of Payment: After shipment, but before documents are released.
- Transfer of Goods: After payment is made on sight.
- Exporter Risk: If draft is unpaid, goods may need to be disposed.

• Documents against Acceptance (D/A) The buyer accepts a time draft, promising to pay for the goods at a future date. After acceptance, the title documents are released to the buyer.

- Time of Payment: On maturity of draft at a specified future date.
- Transfer of Goods: Before payment, but upon acceptance of draft.
- Exporter Risk: Has no control of goods and may not get paid at due date.

# When to Use Documentary Collections.

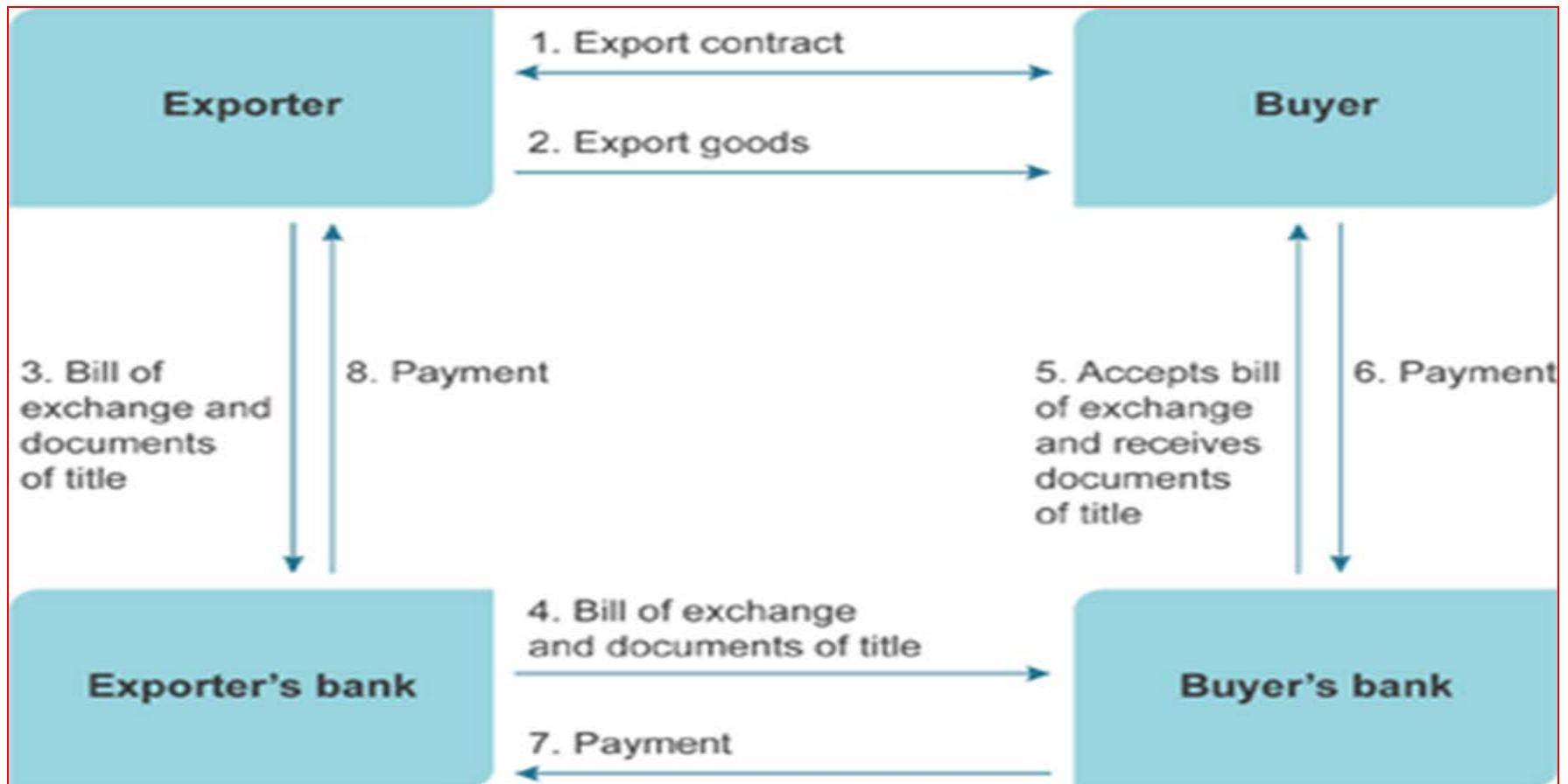
There are many criteria's when determining which payment instrument to offer as a term of sale. In general, a documentary collection would be appropriate where:

- The exporter and importer have a well established relationship.
- There is no doubt about the buyer's willingness or ability to pay.
- The political and economic conditions of the buyer's country are stable.
- The importer's country does not have restrictive foreign exchange controls.

## Parties to Documentary Collection

- Principal - is the party entrusting the handling of a collection to a bank (Exporter, Seller, Remitter, Drawer of the Draft)
- Remitting Bank - is the bank to which the principal has entrusted the handling of a collection (Exporter's Bank handling the collection)
- Collecting Bank - is any bank, other than the remitting bank, involved in processing the collection (Usually Buyer's Bank)
- Presenting Bank - is the collecting bank making presentation to the drawee.
- Drawee - is the one to whom presentation is to be made in accordance with the collection instruction (Importer, Buyer, Payee)

# Main Steps in Documentary Collection



## Pros

## &

## Cons

- Market Competitiveness
- Relatively low risk for overseas buyer and help their cash flow
- A simpler, faster and cheaper method of payment than a documentary credit
- Exporter retain title to the goods until your buyer accepts the bill of exchange
- If buyer fails to honor the bill of exchange, you can take legal action against them in accordance with laws governing the bill of exchange.
- Bank's assistance in obtaining payments.

- Risk of non-payment may be greater. If bill of exchange specifies payment at a date after delivery, exporter hands over control of the goods but run the risk of non-payment on the due date.
- Bank's role is limited and do not guarantees payment.
- The banks don't verify the shipping documents or guarantee payment by your buyer.
- May strain exporters cash flow, especially if the bill of exchange provides for extended credit terms.
- Exposed to FX risk from the date of the sale contract to the time of payment.

## Costs

Banks charge fees for their services when facilitating a documentary collection. Exporter and Importer should agree on responsible parties to pay charges.

Once the responsible party for charges are agreed both the exporter's and the importer's bank should be advised.

Generally, banks charges are less for a documentary collection compare to documentary credit transaction.

# Documentary Credits (Letters Of Credits)

- Documentary Credit (Letter of Credits) is a commitment by a bank on behalf of the buyer that payment will be made to the exporter, provided that the terms and conditions stated in the LC have been met, as verified through the presentation of all required documents. The buyer establishes credit and pays his or her bank to render this service.
- An LC is useful when reliable credit information about a foreign buyer is difficult to obtain, but the exporter is satisfied with the creditworthiness of the buyer's foreign bank. An LC also protects the buyer since no payment obligation arises until the goods have been shipped as promised.



# Documentary Credits (Letters Of Credits)

Reason's for issuing "Letters of Credit" (L/C, LOC);

- Exporter may feel insecure with the importer and his/her abilities to make payment.
- The importer may have requested the L/C to finance against it.
- The importer's country may control movement of funds with letters of credit.
- Standard way of doing business in importer's country could be via Letter of Credits.

## Parties to Documentary Credits

At least four parties involved in any transaction of LC;

- Buyer /Applicant
- Issuing bank or Applicant's Bank
- Advising Bank or Beneficiary's Bank
- Seller / Beneficiary

Other parties may be;

- Confirming Bank
- Remitting Bank
- Negotiating Bank

## Standby Letters of Credit

- The Standby LC is unlike other letters of credit is more of a bank guarantee. It is most often used as a fail safe method or guarantee for longer-term projects.
- Standby LC's promises payment only should the buyer fail to make an arranged payment or otherwise fail to meet pre-determined terms and conditions. Buyer pays on receipt of goods or services according to the credit terms arranged with the seller. Should the buyer default, the seller must then apply to the bank for payment. A relatively simple process without the burden of complicated documentation.
- It is somewhat simpler for the seller or beneficiary to comply with the terms of this instrument.
- Since the Standby LC can remain valid for years (Evergreen Clause) it eliminates the cost of separate LC's for each transaction with a regular client.

# Similarities Between Documentary Collection & Letter of Credits

- Rules devised by the ICC Banking Commission.
- Payment is not made directly by the importer, it's made through the system of correspondent banks.
- Payment is based on documentation agreed in advance between exporter and importer
- Title to the goods is usually retained by the exporter until payment has been made or settled.
- Banks are not responsible for the consequences of Force Majeure

# Differences Between Documentary Collections & Letter of Credits

- Documentary Collections Governed by URC 522 , Documentary Credits Governed by (current) UCP 600 rules.
- In Documentary Credits Issuing Bank guarantees payments as long as transaction documents comply with the agreement.
- No time limits to Documentary Collections like in Documentary Credits. (Example: Latest Date of Shipment, Expiry Date of LC...etc. )
- URC522 rules have no restrictions relating to partial or scheduled shipments.
- In Documentary collections title of the goods passes when the draft is paid off.
- Costs are usually fixed and lower then the letter of credit costs.

The URC 522 may be ordered from:  
ICC Books USA  
1212 Avenue of the America  
New York, NY 10036  
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Fax: 212-944-0012

Questions?

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