



Export Finance Solutions

~~~~~

## **Reducing the Financial Risk of International Sales**

~~~~~

Exporting 101 Workshop

Gaylord


May 24, 2010



What 1st Time Exporters Need to Know

- Who is your buyer?
- How did you “meet”?
- How are you communicating? (method / language)
- What is your buyer asking you to do?
- How does he/she propose to pay?
- How do you propose to deliver?

Comparing Methods of Payment



Exporter's
uncertainty
increases

Cash in Advance
[with counter guaranty]

Letter of Credit
Advised // Confirmed

Documentary Collections

Open Account

Importer's
uncertainty
increases





Identifying Risks in Cross-Border Sales

What might go wrong?

- Commercial risks
- Political risks
- Transfer/economic risks
- Foreign exchange rate fluctuation risks

Identifying Risks in Cross-Border Sales

Slow payment/default	Financing risk	Commercial risk
Bankruptcy		
Contract repudiation	Contract risk	
Contract dispute		
Abusive bond drawing		
Foreign exchange control legislation	Political risk	Country risk
Discharge of debt legislation		
Government repudiation of debt		
Payment moratorium		
Insurrection/overthrow/domestic turmoil		
Non-payment due to war		
Non-payment due to natural disasters	Transfer/economic risk	
Currency inconvertibility		
Currency fluctuation/devaluation	FX risk	



Letter of Credit: Terminology

The Letter of Credit (L/C) is a well-established financial instrument, used in international trade for many years, offering security to both buyer and seller.

Commercial L/Cs are governed by Int'l Chamber of Commerce rules (UCP 600, latest revision)
Standby L/Cs are different, and will be discussed later.

“Import L/C”: The buyer is the importer.

The Issuing Bank issues the LC on behalf of the buyer (extending credit to buyer) and promises to pay on the presentation of documents/drafts, if they comply with L/C terms.

“Export L/C”: The seller is exporting and is named the “Beneficiary” of the L/C issued.

The **Advising Bank** represents the interests of the buyer, advises the L/C to the buyer, without any financial obligation.

The **Confirming Bank** is adding its “promise to pay” to that of the issuing bank, reducing the credit risk associated with the issuing bank.

Commercial L/Cs are based on the presentation of documents

When to Use Letters of Credit

To mitigate risk – credit risk, economic risk, political risk

- New or less-established trade relationships (potential credit/performance risk)
- Buyer is in an unstable country – (economic / political risk) *today's credit environment is a concern for many international transactions.*

To facilitate a “fair transaction” - risk is reduced for both seller and buyer

- Seller knows he/she will get paid, provided he delivers the order
- Buyer knows he/she will get the goods, per the order, or he does not pay

In some countries, buyer can only get FX (US\$), if he has L/C to document purchase

Facilitates payment – upon or after shipment (payment terms)

Strict rules apply (to protect all parties)



Characteristics of a Letter of Credit

A Letter of Credit (L/C) is an “irrevocable” contractual agreement in which the issuing bank, acting on behalf of its customer (the buyer, or importer), agrees to make payment to the beneficiary (the seller or exporter) upon the receipt of specifically stipulated documents.

The L/C is a separate contract from the sales contract on which it is based, so the bank is not concerned whether each party fulfills the terms of the sales contract.

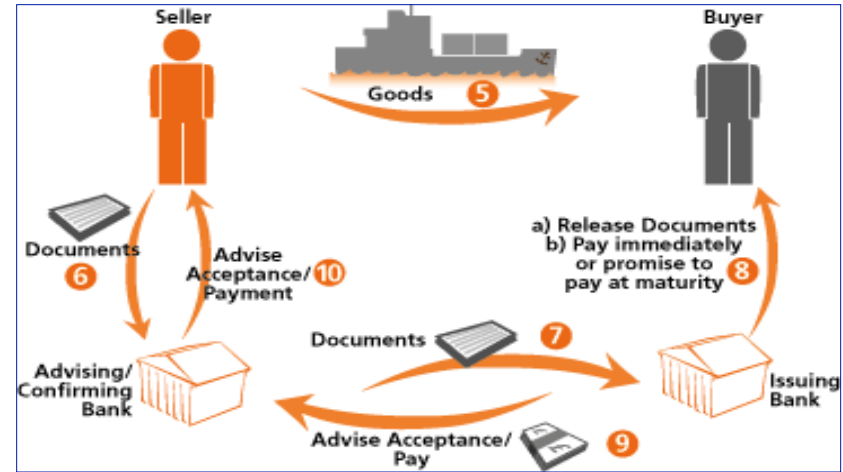
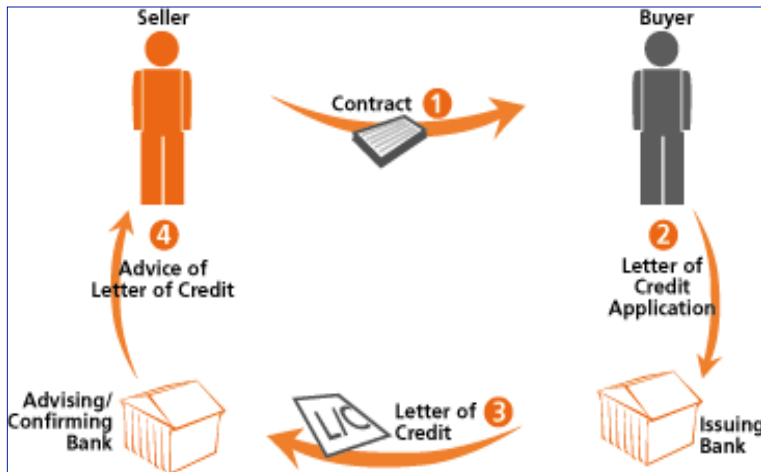
The bank’s obligation to pay is conditional upon the seller’s compliance with the terms and conditions of the L/C.

In L/C transactions, banks deal in documents only, not goods.



FIFTH THIRD BANK™

Mechanics of a Commercial Letter of Credit



1. Applicant (buyer) completes a contract with seller (P.O., Pro-forma invoice, etc.)
2. Applicant then submits a completed Letter of Credit (L/C) application to Issuing Bank for approval.
3. Issuing Bank approves the application, then sends the L/C to the Advising Bank (the seller's bank).
- 4a. Advising Bank authenticates L/C and sends a true copy of the L/C to the Beneficiary (seller) by courier or fax.
- 4b. Beneficiary (seller) examines the details of the L/C to make sure that all L/C conditions can be met. [If need be, seller contacts the buyer to ask for amendment (s).]
5. (Right-hand Diagram) Beneficiary, once satisfied with the terms and conditions of the letter of credit (L/C), ships the goods and presents the documents to the Advising Bank.
6. Advising Bank examines the documents against the L/C terms. If the details are correct, Advising Bank sends the docs to the Issuing Bank for acceptance/payment. [If details are not correct, the Advising Bank tells seller. Seller can correct the docs, or instruct the Advising Bank to send documents on, "as is".]
7. Issuing Bank examines documents received from the advising bank. If the documents are in order, Issuing Bank pays the L/C as promised; "at sight", or at a future date. [If documents are received but not correct, Applicant (buyer) may accept documents, "as is", authorizing L/C payment as/when promised. If buyer rejects, Issuing Bank notifies the Advising Bank.]
8. Issuing Bank send documents to buyer, with debit/settlement advice.
9. Issuing Bank sends payment (or promise of future payment) to Advising Bank.
10. Advising Bank notifies seller of payment, or "acceptance" of documents for payment on the agreed future date.



Tips for those who are new to L/Cs

Make sure the L/C terms (the description of product and quantity, price, latest allowed shipping date, and the shipping terms~*Incoterms*~) are clearly written and consistent with the terms of the purchase order and/or invoice.

The “Amount” of the L/C can be flexible (e.g., “+/-10%”, or “up to...” for bulk goods). Does the seller want to include shipping or insurance charges in the L/C?

“Partial shipment” and “partial payment” allow for orders to be filled in segments, under one L/C. A payment schedule can be stated.

Confirmation (~a guaranty~) is an extra expense (normally paid by the seller).

Discrepancies cause delays: Good communication between buyer and seller is important. If circumstances change, the L/C can (and should) be amended. All parties must agree to any amendment.



Other Considerations

“Sight” versus “Time”

A *Sight* Letter of Credit is a credit in which the seller obtains payment upon presentation of documents (assuming they are in compliance).

A *Time Draft*, or *Usance* Letter of Credit is a credit in which the seller will be paid at a stated or determinable future time.

Documents

A single transaction can require many different kinds of documents. Most L/C transactions involve a draft, an invoice, an insurance certificate, and a bill of lading. If a Certificate of Origin, or other certificate is required to import a certain product, the buyer should inform the seller, to avoid delays in clearing Customs.

Make sure your buyer (and issuing bank) put your correct terms in the L/C.



Standby Letter of Credit

As the name implies, the Credit is “Standing By”. It is a ‘guarantee’ of the Issuing Bank to pay the buyer (of goods or services), if there is a default (e.g., undelivered service, failure of warranty, non-payment). Like a “guaranty”, the issuing party does not expect to have it called (drawn upon).

A Standby L/C is typically used to guarantee the return of a deposit, in the event of non-delivery, or to pay the value of a warranty commitment that is not honored.

Standby L/Cs are governed by different rules -ISP 98.

[Foreign banks can issue “Bank Guarantees”, U.S. banks must issue a Standby L/C, however, the text of the Standby L/C can say, “This bank guarantee...”.]



Collections – Discounting Documents

Documentary Collections

- A more basic transaction, used when there is a well established relationship, assures payment by using banks to control documents.
- Negotiable documents are not transferred to the buyer until the agreement to pay has been conveyed to seller.

Discounting Documents/Drafts

- Documents that have been accepted for payment at a future date can be purchased by Fifth Third, at a discount price
- Discount price is based on current interest rates (Libor for the period of discount, plus 2% to 4% p.a.), plus a small arrangement fee (½% - 1%, \$150 minimum)



FIFTH THIRD BANK™

Credit Insurance

What does it cover?

Non-payment of trade obligations for

- Political Risks (foreign transactions):
 - Government acts/political events that restrict payment
 - Currency inconvertibility (aka, Foreign Exchange or “transfer” risk)
 - War, riot, insurrection or civil disorder
 - Embargo
- Commercial Risks (foreign and domestic)
 - Commercial bankruptcy or legally protected reorganization
 - Protracted default (aka, slow pay)
- Exclusions include disputed payment obligations until resolved



Recap

Don't be afraid to negotiate reasonable selling terms with foreign buyers.

There are tools available to mitigate unknown factors such as credit risk and foreign currency risk.

You can extend reasonable deferred payment terms to overseas customers.



Contact

Bruce Brogan
Vice President
International Trade Finance

Offices in Southfield & Grand Rapids
248-603-0412 – Southfield
616-653-5191 – Grand Rapids
Bruce.Brogan@53.com