ARTICLE ON LETTER OF CREDIT (LC)
(PART-II)

A. LC discounting (i.e. LC negotiation) Vs Bill Discounting Limit

In Bill Discounting, the Bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment.

What is the role of LC now? The LC facilitate the transaction and confirms that the exporter/manufacturer do not have risk of being default. LC is as good as the cash. Even the exporter can discount the LC subject to acceptance by the importer. Hence if there is no bill discounting facility, the beneficiary gets the payment subject to deduction of margin and bank charges and approval by both banks along with the buyer.

In case of bill discounting facility the seller gets the bill discounted immediately it shows and submit the required documents to its bank. But intimation needs to send to the buyer through its (buyers) bank as the transaction is backed with Letter of Credit.

B. LC Vs Buyers Credit

Buyer opens the letter of credit (usance) in favour of seller. Now the seller on submission of required documents' can discount the LC or stays away i.e. hold the LC as it is. The seller will send the documents along with goods to the destination. The buyer will release the goods by accepting the documents at the bank. But the due date of payment has not come yet i.e. LC is not expired yet.

Suppose the buyer, due to any reason say to leverage its books, wants to postpone the payment. But extension is not possible in the same form. What is the solution now?

The buyer will take the following course of action and if accepted by all the parties, it might get the extension for some period as approved:

1. The buyer will identify overseas bank/financial institution (or a bank having its branch overseas) (say X) which give the services of buyer's credit. The buyer will request for availing the facility with all the details about transaction. On satisfaction, the bank (X bank) will generate the Offer in favour of the LC issuing bank (i.e. buyer bank or say Y bank)

2. On the basis of the Offer, the buyer approach to its bank (Y bank) for issuance a Letter of Comfort in favour of X bank against this LC. The Y bank will charge some fees for the services. Here Y bank works as a broker. But the bank will continue to hold the LC by marking the facts on its face and also continuously blocked the LC limit.

3. Now the buyer takes this Letter of Comfort and approach the X bank which will give payment to Y against this Letter of Comfort against some charges.

It is totally a secured transaction where Y bank guarantees to X bank.

The buyer gets the extension of payment period and also benefitted by getting the funds at LIBOR rate.

C. If additional credit needs of exporters arises due to firm orders/ confirmed letter of credit (and which are not taken into account while fixing regular credit limits of borrower) are to be met in full even if sanction of such additional credit limits exceeds Maximum Permissible Bank Finance (MPBF).

D. Receivables arising in domestic/inland sales by drawing bills of exchange under usance Letter of Credit and negotiated with the terms & conditions of LC are excluded while calculating minimum net working capital under MPBF (second method of lending).

In other words domestic receivables covered by bills of exchange under usance LC shall be accorded the same treatment as export receivables and no margin on such receivables will have to be brought.

E. Advising and confirming the export Letter of Credit (LC)

Advising bank does not undertake any commitment except to verify the authenticity of the message received by it at the time of advising the LC to the exporter. Advising of LC does not, therefore, involve any credit risk for the bank.

Confirmation of LC implies a definite undertaking being given by the confirming bank to the opening bank and the confirming bank is placed in the same position as that of opening bank in relation to beneficiary. But even in these cases the confirmation to the LC is added by the bank on behalf of the opening bank only and not on account of beneficiary (exporters)). This would also, therefore, not constitute a credit facility to the exporters. These services facilitate banking operations and the beneficiary of the LC need not necessarily the customers of the confirming bank.

For any query or assistance, kindly call or send a mail undersigned.

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