Overview

This part covers the following topics:

- Cash in advance
- Open account
- On consignment
- Draft or documentary collection
- Letter of Credit

Objectives

By the end of this part, you will be able to:

- Identify payment options for various trade transactions
- Recognize the risks and advantages of payment options for both buyers and sellers
- Distinguish between major categories of Letters of Credit
- Analyze the application of different types of Letters of Credit to international trade transactions
Module 2-3: Trade Payment Methods

Scenario: Will the Exporter be Paid?

You are in the import business. You need to place an order, and your supplier in Yugoslavia has asked for either cash in advance or payment “at sight” in Yugoslav Dinar by confirmed, irrevocable letter of credit with all charges for your account. Does this sound like a good deal, or will you negotiate?

Okay, now you are in the export business. You have an order from Bulgaria, and the customer offers to pay in Bulgarian Leva and billed upon 60-day open account or shipped on 60-day sight draft, documents against acceptance (SD/DA) terms. Is this acceptable, or will you negotiate?

Now that you are both importing and exporting, a firm in Bosnia offers to trade $10,000 worth of beautiful cotton blouses for industrial sewing machines of the same value. “Don’t worry about duties or quotas” the manager says. “They won’t apply because this is a barter deal”. Will you order the blouses and send the sewing machines?

This part will give you ideas about how to deal with these sorts of issues. If you don’t know how to deal with them, and don’t have a very good banker to advise you, your business will be limited to the most routine transactions. Get involved in unique or complex deals without an understanding of how to deal with money matters, or a very good advisor and you could lose your shirt, your trousers and more.

Introduction

In international commercial procedures, the dealers and buyers shall want to make the sale under the best conditions for themselves. While the buyer will vote for the cheapest and longest termed payment type in paying the cost of the goods, the dealers will prefer cash payment, which is the most advantageous payment type and the types of collection with the least risks.

The agreement of buyers and dealers on how and in which term the payment will be made is a quite critical period for both sides.

In this part, payment methods will be dealt upon in details, and their risks and superiorities for dealers and buyers will be evaluated.
The exporter that prepares the goods and gets them ready for dispatch, as agreed with the importer, has to think of the payment terms and a financing program, as he/she will experience serious difficulties if he/she is not paid. Therefore, it is necessary for the exporter to have sufficient information about the different methods of payment available to him/her.

The main payment methods in foreign trade are cash in advance, open account, on consignment, draft or documentary collection and letter of credit. In this part, the main characteristics of each payment method are explained and the advantages and risks for each one are given. Thus enabling one to choose the best method for the transaction.

Cash in Advance

The Cash in Advance or Advance Payment method allows the buyer to pay cash in advance to the seller. Paying in advance gives the greatest protection for the seller and puts the risk on the buyer. Payment does not guarantee the shipment or delivery of the goods from the seller. Therefore, the buyer will rarely pay cash up front before receiving an assurance that the goods will be shipped and that the quality and quantity of the goods ordered will be delivered.
Although this method of payment is not uncommon, the seller requiring full payment in advance may cause lost sales to a foreign or domestic competitor who is able to offer more attractive payment terms. In some cases, however, where the manufacturing process is specialized, lengthy or capital-intensive, it may be reasonable to ask for some of the full payment in advance, or with progressive payments. This method is often too expensive and risky for foreign buyers, but useful when shipping to politically unstable countries, when the buyer’s credit is unsatisfactory or when goods are custom made to the customer’s requirements (LatinTrade, 1999).

In some circumstances this payment method can be modified to a partial payment in advance with agreed upon installments or additional terms available.
Advantages and Risks of Cash in Advance Method

The cash in advance method is advantageous for the seller as there is no risk for him/her. The advantages and risks for both the buyer and seller are illustrated in Figure 2.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyer</td>
<td>Seller</td>
</tr>
<tr>
<td>None</td>
<td>No control over the goods</td>
</tr>
<tr>
<td>Goods shipped when</td>
<td>Use of funds is lost</td>
</tr>
<tr>
<td>convenient</td>
<td>Seller may refuse to ship</td>
</tr>
<tr>
<td>Use of buyer’s funds</td>
<td>Political risk in the seller country</td>
</tr>
</tbody>
</table>

Figure 2: Advantages and Risks for the Buyer and Seller in the “Cash in Advance” Method

As a buyer and a seller in which positions do you choose/accept cash in advance method?

The cash in advance may be most practical method if;

- The buyer lacks creditworthiness
- The buyer is not able to offer sufficient security for payment
- The buyer is located in a region of political and/or economic instability
- The product is so specialized that it is specifically made for the customer and cannot be easily sold to another customer

(http://www.tradeport.org/ts/trade_expert/details/payment/cash.html)
An open account transaction means that the goods are manufactured and delivered before payment is necessary (for example, payment could be due 14, 30, or 60 following shipment or delivery). The method provides great flexibility and in many countries sales are likely to be made on an open-account basis if the manufacturer has been dealing with the buyer over a long period of time and has established a secure working relationship.

The flow of the goods and payment in the open account method is illustrated in Figure 3.

**Figure 3: The Process of the “Open Account” Method**

The open account method is a preferred method of payment for the importer, since it places the risk on the exporter or seller. This method cannot be used safely unless the buyer is credit worthy and the country of destination is politically and economically stable. However, in certain instances it might be possible to discount open accounts receivable with a factoring company or other financial institution (LatinTrade, 1999).
Advantages and Risks of the Open Account Method

The Open Account method is advantageous for the buyer as there is no risk for him/her. The advantages and risks are shown in Figure 4.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control over the goods</td>
<td>None</td>
</tr>
<tr>
<td>Pays when convenient</td>
<td>None</td>
</tr>
<tr>
<td>None</td>
<td>No control over the goods or payment</td>
</tr>
<tr>
<td>Buyer</td>
<td>Buyer may refuse to pay</td>
</tr>
<tr>
<td>Seller</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4: Advantages and Risks of “Open Account” Method for the Buyer and Seller

What do you think about how the seller could decrease the risks of open account method?

The open account method may be useful if:

- There is long-term relationship and confidence between the buyer and the seller
- The seller is under pressure to sell his goods
- The buyer has a very good reputation and is well-known in the market
- The buyer is solvent

The two payment methods, cash in advance and the open account, are not suitable when the buyer and the seller don’t know each other very well or the seller doesn’t want to assume the credit risk or the risk of dealing with a particular country when offering payment terms to the buyer.
On Consignment

With **consignment** sales, the seller does not receive payment until the importer sells or resells the goods. The product stays with the importer until all the terms of the sale have been satisfied. In the consignment method, the importer is called the consignee and he/she is responsible for paying for the goods when they are sold. Consignment sales are very risky and there is no control available to the exporter. Obtaining sales proceeds or return of the merchandise if it is not sold can be difficult.

(http://www.tradeport.org/ts/trade_expert/details/payment/cash.html)

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**On Consignment Method**

Seller ships goods but retains ownership

![Diagram of consignment process]

Figure 5: Process of the “On Consignment” Method
Advantages and Risks of the On Consignment Method

There are several advantages and risks of the on consignment payment method. These advantages and risks are illustrated in Figure 6.

<table>
<thead>
<tr>
<th><strong>Advantages</strong></th>
<th><strong>Risks</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Pays only when goods are sold</td>
<td>None</td>
</tr>
<tr>
<td>Retains ownership of the goods</td>
<td>Limited control of goods</td>
</tr>
<tr>
<td>Consignee is the intermediary for the sale of goods to the buyer</td>
<td>No control over the consignee’s willingness to pay for the goods</td>
</tr>
</tbody>
</table>

In your business life, have you used on consignment method? If yes, could you give examples of advantages and risks of that method from your experiences?

On Consignment payment method is useful if;

- The consignee is reliable
- The consignee has a good credit history
- The consignee’s country has economic and political stability
- The consignee is the branch office of the main company
Draft or Documentary Collection

The Draft or Documentary collection method is employed when either the cash in advance method is not acceptable to the buyer, or the open account method is not acceptable to the seller. With the **Draft or Documentary Collection Method**, the seller or exporter ships the goods and draws a draft or bill of exchange on the buyer or importer through an intermediary bank. The draft is an unconditional order to make a payment in accordance with certain terms. The documents needed are specified before the title for the goods is transferred (LatinTrade, 1999).

What do you think about the reason why the seller or the buyer may accept draft or documentary collection method instead of cash in advance or open account?

There are four parties involved in the documentary collection method: The buyer, collecting/presenting bank (buyer’s bank), the seller and the remitting bank (seller’s bank). Also, there are four main steps in the documentary collection method. The process is shown on Figure 7.

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**Draft or Documentary Collection Method**

Banks act as intermediaries between the buyer and seller and act upon instructions received

1. Seller → Remitting Bank → Collecting/Presenting Bank → Buyer
2. Seller → Remitting Bank → Collecting/Presenting Bank → Buyer
3. Seller → Remitting Bank → Collecting/Presenting Bank → Buyer

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Figure 7: The Process of the “Draft or Documentary Collection” Method
In the process of documentary collection method,

- First of all, the seller sends the draft to the remitting bank
- The remitting bank, as an intermediary, sends the draft to the collecting/presenting bank
- The collection/presenting bank, as an intermediary, makes the documents available to the buyer
- The buyer, after examining the documents, has three options:
  - to pay immediately
  - to pay at a future date
  - to refuse to pay for the draft

When the draft is paid, the title documents are released to the buyer so he/she can obtain possession of the goods. As the title to the goods is not transferred until the draft is paid or accepted, both the buyer and seller are protected. However, nothing prevents the buyer from refusing a draft for payment.

In such cases, the exporter, who has already shipped the goods, faces the problem of getting his/her merchandise back, which may involve warehousing or insuring the goods, or even disposing of the merchandise at the collection point. If the buyer refuses or defaults on payment of the draft, the seller may also have to pursue collection through the courts (or possibly, by arbitration, if such had been agreed upon between the parties). The use of drafts involves a certain level of risk; but they are less expensive for the purchaser than letters of credit.
**Sight Drafts:** If the exporter and importer have agreed that payment should be made immediately upon receipt of the draft and/or shipping documents by the buyer's bank, the draft is said to be drawn at sight (LatinTrade, 1999). A sight draft is an order signed by the seller instructing the buyer to pay a specified amount to the seller upon presentation of the draft.

The flow of the sight draft is illustrated in Figure 8.
**Time Drafts:** If the seller has provided credit terms to the buyer, thereby allowing the merchandise to be released before payment is received; it is called a time draft. The exporter will need a written promise from the buyer that payment will be made at a specified future date. When a bank receives time drafts, the bank is requested to deliver the documents only when the buyer has accepted. The buyer’s acceptance of the draft is his/her agreement to pay at an agreed upon future date (LatinTrade, 1999).

![Figure 9: The Documentary Collection Process for a Time Draft](image)

**Advantages and Risks of Draft or Documentary Collection Method**

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>May refuse to pay or accept the draft</td>
<td>Goods may not be as represented in the documentation</td>
</tr>
<tr>
<td>Gives him time to sell goods before having to pay for them</td>
<td></td>
</tr>
<tr>
<td>Low cost</td>
<td></td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Knows that title documents are controlled by the bank</td>
<td>Buyer may refuse to pay or accept the draft</td>
</tr>
<tr>
<td>Evidence of indebtedness</td>
<td>Foreign exchange risk</td>
</tr>
<tr>
<td></td>
<td>Country’s political risk</td>
</tr>
</tbody>
</table>

![Figure 10: Advantages and Risks of the “Draft or Documentary Collection” Method](image)
There are several advantages and risks of documentary collection method for the buyer and seller. These advantages and risks are illustrated in Figure 10.

**Letter of Credit**

The Letter of Credit has been a keystone of international trade for many years. It continues to play an important role in world trade today. With the various alternative payment methods available to buyers and sellers of goods or services today, why is the Letter of Credit the most common payment method? A simple answer may be that the seller will not ship without a bank's assurance of payment. While this is a major factor, the Letter of Credit offers other advantages for the buyer and seller. For any company entering the international market, the Letter of Credit is an important payment mechanism that needs to be understood.

What is a Letter of Credit?

A Letter of Credit is a document issued by a bank at the buyer's request in favor of the seller; it guarantees that the buyer will pay the agreed amount of money to the seller within a specified period of time, provided that the seller conforms to the product specifications and document requirements of the buyer. (http://internet.ggu.edu/~emilian/bankreq.html#LC).

The Letter of Credit is a specialized, technical tool that is applied when paying for a shipment of goods or services from one party to another.

Figure 11 shows the general flow of a Letter of Credit.
Both applicants and beneficiaries profit from the distinct uniqueness of a Letter of Credit. However, both these parties must be aware of what a Letter of Credit does not do:

- It does not provide a total assurance of payment to anyone. A Letter of Credit guarantees payment only if its terms and conditions are satisfied by presenting the necessary documents. The value of such a guarantee depends upon the stability of the bank providing its undertaking and the bank obligation to pay.
political and foreign exchange stability of the country where the bank is situated.

- It does not give a guarantee that the goods depicted in the presentation documents have been delivered. Banks don’t deal with goods and services; they deal with documents related to the Letter of Credit. The quantity and quality of the goods shipped depends upon the honesty and integrity of the seller that has manufactured or packaged the goods and organized the delivery.

The buyer may stipulate that the Letter of Credit be accompanied by laboratory test certificates, inspection certificates or other documents that confirm the quality or quantity of the goods. Generally, the buyer and seller agree in advance on which party is responsible for the sum of these services.

The buyer’s and seller’s honesty are paramount in any exchange of goods or services regardless of the payment method. When preparing a shipment covered under a letter of credit, it is important to closely follow the instructions in the letter of credit. The letter of credit will explain exactly how to prepare the draft, how the commercial invoice must be prepared, what documents must be prepared and attached to the draft for payment, and by what specified deadline the seller must ship the goods and present the documents for payment. Accurateness is extremely important.

What do you think about the advantages of the letter of credit’s instructions?
Parties and Terms in Letters of Credits

To understand Letters of Credit exactly, the parties and terms which are used in Letters of Credit should be examined.

The Parties

The parties concerned with a Letter of Credit are described below:

Applicant: The party that organizes for the Letter of Credit to be issued, usually the buyer (importer) in a commercial transaction or the borrower in a financial transaction.

Beneficiary: The party named in the Letter of Credit in whose favor the Letter of Credit is issued, it is generally the seller (exporter) in a commercial transaction or the creditor in a financial transaction.

Issuing Bank: The Applicant’s bank that issues its undertaking to the Beneficiary in the form of a Letter of Credit.

Advising Bank: The bank, usually in the Beneficiary’s country, which informs the Beneficiary that another bank has issued a Letter of Credit in their favor.

Letter of Credit Terms and Conditions

The following terms and conditions are basic to most letters of credit:

Draft – Letters of Credit usually necessitate that the Beneficiary draw a draft on the Issuing Bank. The period of time from the date on which either the complying documents are presented or the draft is drawn, to the date on which payment is payable is the “tenor” of the draft. If the draft is payable upon presentation, the draft will be drawn payable at “sight.”
Module 2-3: Trade Payment Methods

If the draft is payable, for example, 30 days after presentation of complying documents (“30 days sight”) or 30 days after the date the draft is drawn (“30 days date”), the draft is a time draft. Time drafts may be drawn for any number of days. For ease in financing, days are usually expressed in 30 day increments, i.e., 30, 60, 90, 120, 150, 180 days. The accepted draft is the unconditional obligation of the Accepting Bank to pay at maturity. When drafts are accepted by an Accepting Bank they take on special properties.

Expiration Date – A Letter of Credit should contain a stated expiry date. The Beneficiary is required to present the draft(s) and documents to the Issuing Bank or a Nominated Bank on or before that date. Under the Uniform Customs and Practice for Documentary Credits Act (UCP), published by the International Chamber of Commerce (and incorporated by reference in most commercial letters of credit), if the expiration date falls on a day when banks at the place of presentation are closed, the expiration date is extended to the next business day. Letters of Credit expire at the times and locations specified in the Letter of Credit.

Latest Shipping Date – Most Commercial Letters of Credit contain a latest shipping date. The documents confirming shipment must not be dated after that date. When “on board” transportation documents are required, the date indicated in the “on board” notation on the transport documents is considered to be the date of shipment.

Marine Bills of Lading are issued in either “Shipped on Board” or “Received for Shipment” form. When a Letter of Credit specifies marine or ocean “on board” bills of lading, “onboard” may be evidenced by:

- A bill of lading being issued using an “on board” form; or
- A bill of lading carrying an “on board” notation. This notation (often a superimposed stamp) must be dated. The “on board” date (the
shipping date) cannot be later than the “latest shipping date” specified in the Letter of Credit

Unless the Letter of Credit otherwise states, the UCP requires that marine bills of lading show that the goods are on board. This means that the Beneficiary must either provide an “on board” bill of lading or have the carrier’s “on board” notation put on the bill of lading.

**Latest Date for Presentation** – Unless the credit stipulates otherwise, the UCP requires that documents be presented within 21 days of the date of shipment or at another such period stated in the Letter of Credit. For Marine Bills of Lading, the “on board” date is seen as the shipment date.

Commercial Letters of Credit are often issued with a latest shipping date that is more than 21 days prior to the Letter of Credit expiration date. This is due to the fact that the most common amendment to a commercial Letter of Credit is to extend the shipping date. The additional period permits the shipping date to be adjusted without the expiration date being extended. The additional time is not a “cure” period for documents under discrepancy.

**Any idea about UCP?**

**UCP 500:** The letter of credit process has been standardized by a set of rules published by the International Chamber of Commerce (ICC). These rules are called the Uniform Customs and Practice for Documentary Credits (UCP) and are contained in ICC Publication No. 500.
Basic Procedures for Establishing a Letter of Credit

The basic procedure used in a letter of credit transaction is shown below. It should be noted, however, that for other specific letter of credit different procedures are used.

- The buyer and seller decide on the terms, such as the means of transport, period of credit on hand, final date of shipment and the applicable incoterm to be used.
- The buyer applies to the bank for a letter of credit to be issued.
- After assessing the buyer’s credit rating, the issuing bank sends the letter of credit to the advising bank.
- The advising bank establishes the genuineness of the letter of credit using signature books or test codes, then they send the letter of credit to the seller.

*Figure 12: Flow of the “Issuance of a Letter of Credit”*

*This figure is adopted from TD Bank Financial Group*
The seller reviews all the conditions specified in the letter of credit and, if they cannot fulfill any of the terms, they will ask the buyer to adjust the letter of credit. When the final terms are settled, the seller ships the goods to the specified port or location.

After shipping the goods, the seller obtains the required documents. The documents are presented to a bank, in most cases the advising bank (prior to presenting the documents to the bank, the seller should ensure there are no inconsistencies with the letter of credit, and if there are amend the documents where necessary).

The seller’s advising bank reviews the documents. If they are in order, it will forward them to the buyer's issuing bank. If the letter of credit is confirmed, the advising bank will pay the seller (cash or a bankers' acceptance check).

Once the buyer's issuing bank takes delivery of and reviews the
documents, it either pays if there are no inconsistencies; or sends the documents to the buyer if there are discrepancies for their review and approval

After applicant reviews and accepts the documents, the beneficiary receives payment from the advising bank

The issuing bank pays for the advising bank for the goods according to the letter of credit

Finally, the applicant pays the issuing bank for the goods

**Documentary Requirements**

To ease the handling of documents presented under a Commercial Letter of Credit subject to the UCP, unless otherwise stipulated:

**Drafts should:**

- Be drawn by the Beneficiary on behalf of the parties specified in the Letter of Credit
- Not exceed the Letter of Credit amount or its remaining balance
- Not be payable or endorsed to parties other than the Beneficiary or the issuing or the nominated bank
- Be in negotiable form, endorsed by the Beneficiary as necessary
- Refer to the Letter of Credit

**Draft is drawn on whom?**

**Invoices should:**

- Be issued by the Beneficiary named in the letter of credit
- Be issued to the Applicant
- Describe the goods and show the prices and terms as detailed in the Letter of Credit
- Not exceed the Letter of Credit amount or its remaining balance, except in UCP 500
Insurance documents should:

- Cover the risks stated in the Letter of Credit
- Cover, at minimum, 110% of the cost, insurance and freight (CIF), or carriage and insurance paid (CIP) value of the shipment
- Be countersigned and if the assured is other than the Confirming, Issuing bank or buyer, be appropriately endorsed, or endorsed in blank
- Be presented in full set(s) (all relevant documents)
- Be in force as of a date not later than the date appearing on the transport document or “on board” notation

If other documents are required such as weight lists, consular invoices, certificates of quantity or quality, and the like, they must be issued and presented in accordance with the Letter of Credit. All documents must comply with the Letter of Credit and be consistent with each other. All documents, unless otherwise stated, must be original, and documents required to be certified etc. must be signed or properly authenticated.

Cover 110% of the cost, why?

Strictly complying drafts and other documents must be presented under the Letter of Credit on or before the expiry date and within the presentation period stated in the Letter of Credit. If no period is stated, documents must be presented within 21 days of the date of issuance of the bills of lading or other transport documents.

Amendment of a Letter of Credit

If the seller doesn't agree with the terms of the Letter of Credit, the buyer will normally receive a request for an amendment. Any modification to an issued Letter of Credit is known as an amendment.

For the seller to alter the terms noted on an Irrevocable Letter of Credit, it must ask for an amendment from the buyer. The amendment procedure is as follows:
The seller requests a modification or amendment of questionable terms in the letter of credit;

If the buyer and issuing bank agree to the changes, the issuing bank will change the letter of credit;

The buyer's issuing bank notifies the seller's advising bank of the change/s;

The seller's advising bank notifies the seller of the change/s.

(Credit Research Foundation)

Could you discuss the advantages and risks of amendment in a letter of credit?

The advantages and risks of the letter of credit method are illustrated in Figure 14.
Advantages and the Risks of the Letter of Credit Method

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Buyer</strong></td>
<td></td>
</tr>
<tr>
<td>Guarantee that its bank will refuse payment unless the seller complies with the terms and conditions of the letter of credit</td>
<td>Banks deal only with documents. The goods may not be the same as stated in the documents</td>
</tr>
<tr>
<td>If the seller is willing to allow the buyer extended terms, the buyer may organize the payment for a future date</td>
<td></td>
</tr>
<tr>
<td>Through the use of a Banker’s Acceptance, the buyer may finance the goods until they are marketed</td>
<td></td>
</tr>
<tr>
<td>By the documents called for, the buyer can seek to minimize the risks in not receiving the goods ordered</td>
<td></td>
</tr>
<tr>
<td><strong>Seller</strong></td>
<td></td>
</tr>
<tr>
<td>The bank’s creditworthiness must be taken into account</td>
<td>The seller’s documents must comply strictly with the terms and conditions of the LC to entitle the seller to payment</td>
</tr>
<tr>
<td>To be able to obtain financing for the purchase or manufacture of goods that will be shipped under LC</td>
<td>The seller is exposed to the commercial risk that the bank providing its undertaking is unwilling and unable to perform</td>
</tr>
<tr>
<td>The seller will receive funds shortly after presentation of shipping documents to the bank</td>
<td>The seller assume any political and foreign exchange risk affecting the issuing bank’s obligation</td>
</tr>
<tr>
<td>The seller can reduce the risk that payment for the goods might be delayed</td>
<td></td>
</tr>
</tbody>
</table>

Figure 14: Advantages and Risks of the “Letter of Credit” Method

A Case about Letter of Credit

The classic situation in which a letter of credit is used is described as follows. Company A, located in Romania, wants to purchase a piece of mining equipment from Company B, located in Croatia. Company B is unwilling to ship the equipment without being paid in advance. It is concerned that Company A might be unable to pay for the equipment, and it is not willing to trust credit
reports from Romania. It might ship on a COD basis, but that would leave them in a position that if the equipment were rejected on delivery in Romania, Company B would have to try to re-sell it in Romania or ship it back to the Croatia. In either case, it would lose money that it could only get back if it were able to win a case successfully against Company A (who may be insolvent). However, the case would take place in a foreign court system and this would cause a number of problems for Company B. Company A is not willing to pay in advance because it has similar worries. B might become insolvent, or it might not ship, leaving the buyer to try to recoup losses in a foreign legal system.

A letter of credit gives both parties some guarantee of a fair trade transaction. The buyer will get its bank to issue a letter of credit. This letter will state that the bank will honor a draft drawn against the bank to the agreed amount, if the draft is accompanied by certain specified documents, one of which will be a bill of lading showing that the goods have been loaded on a ship going to a specified Romania port and which will give the buyer the right possession of the goods upon arrival. With a guarantee from a sound, solvent establishment that it will be paid as soon as the goods are shipped, Company B can ship with minimal risk.

Company A is similarly protected. It doesn't have to pay until the goods have been shipped and are out of the seller's control. The bank that issues the letter of credit can protect itself in several ways. The simplest is to have Company A put the face amount of the letter of credit in a blocked account from which the bank can withdraw funds when the letter is drawn upon. On the other hand, it can issue the letter of credit on the same basis as if it was giving Company A a loan, satisfying itself as to the applicant's credit and perhaps taking collateral. In this case, funds disbursed under the letter of credit would accumulate interest at the normal rate of loans until repaid.

If Company B is unwilling to trust the buyer's bank (of which it may never have heard) it can require that a bank which it does trust act as confirming body
of the letter of credit. The confirming body will be a bank that knows and trusts the issuer and perhaps has a correspondent banking relationship with them. The confirming body will make an obligation to honor the letter of credit. It will check the documents the beneficiary (the seller of the equipment) presents and if they are satisfactory, pay the funds to the beneficiary. It will then transmit the documents to the issuer and receive repayment. (http://www.law.utk.edu/cle/letcred/1-vb.htm)

The transaction described in above is commonly referred to as a Letter of Credit.

Types of Letter of Credit

All Letters of Credit are issued in either a "revocable" or an "irrevocable" form and "confirmed" or "unconfirmed." They should be read carefully and understood to determine the advantages and to decide which one is fitting for a particular situation.

Revocable Letter of Credit

Unless stated otherwise all credits are revocable. The term indicates that the credit is not a legally binding undertaking and can be changed or withdrawn at any time without the permission or knowledge of the beneficiary. However, it gives no assurance of payment. When the seller doesn’t need a guarantee other than the buyer’s reputation, a letter of credit serves no purpose unless it is used as a suitable means of exchanging documents and payment.

(TD Commercial Banking)

How does the seller prevent “no payment” under revocable letter of credit?
Irrevocable Letter of Credit

With this type of credit the buyer's bank has given an irrevocable promise to pay the seller, on his/her proof of compliance with the set conditions of the Letter of Credit, and the bank without the authorization of the exporter cannot change this. The buyer has no responsibility to agree to changes to the Letter of Credit. If it includes conditions that are inconsistent with the sales-purchase agreement, then this is a subject to be settled between the buyer and seller; the bank has no responsibility to involve itself with the particulars of the agreement.

Confirmed

A confirmed letter of credit is when a second guarantee is added to the document by another bank. The advising bank, the branch or the correspondent through which the issuing bank directs the letter of credit, adds its undertaking and commitment to pay the letter of credit. This confirmation means that the seller/beneficiary may also look at the credit worthiness of the confirming bank for payment guarantee (2001, Equipment).

Who is going to pay for the confirmation charges?

Unconfirmed

An unconfirmed letter of credit is when the document carries the assurance of just the issuing bank. The advising bank simply notifies the exporter of the terms and conditions of the letter of credit, without adding its obligation to pay. The exporter takes on the payment risk of the issuing bank, which is normally situated in a foreign country (2001, Equipment).

What do you think in which situations confirmed and unconfirmed Letter of Credit is acceptable?
Confirmed and Unconfirmed Credit for Importer and Exporter

As the exporter is situated in a different country from the importer, two banks are generally concerned with a documentary credit transaction. While the liability of the issuing bank always exists in the case of an irrevocable credit, the advising bank in the exporter’s country is liable only to the extent of the instructions it is given.

These instructions can direct it:

- Not to confirm the credit

When this is the case, the advising bank assumes no responsibility; it simply acts on behalf of the issuing bank, in advising the exporter of the letter of credit.

- To confirm the credit

When confirming to the credit, the advising bank takes on a secure and independent obligation to pay, as does the issuing bank. The confirming bank must make payment even if the issuing bank is not able to send the necessary cover for the payment. (http://www.chancerygroup.com.au/1to4.htm)

Could you compare all types of letter of credit’s (revocable, irrevocable, confirmed, unconfirmed) advantages and risks for the seller and the buyer?
Special Letters of Credit

A short description of some special Letters of Credit can be found below:

Red Clause Letter of Credit

Red Clause Letters of Credit supply the seller with cash before shipment so he/she can finance the production of goods. The buyer's Issuing Bank may forward some or all of the funds. In other words, the buyer offers financing to the seller and therefore sustains the risk for all advanced credits.

Deferred Payment (Usance) Letter of Credit

In Deferred Payment Letters of Credit, the buyer accepts the documents associated with the letter of credit and agrees to pay the issuing bank after a fixed period. **This credit gives the buyer a grace period for payment.**

Revolving Letter of Credit

With a Revolving Letter of Credit, the issuing bank restores the credit to its original amount once it has been used or drawn down. **Generally, these arrangements limit the number of times the buyer may draw down its line over a predetermined period.**

Back-to-Back Letter of Credit

This is a new letter of credit opened based on an already existing, nontransferable credit that is used as collateral. **Traders often use back-to-back arrangements to pay the ultimate supplier.** A trader receives a letter of credit from the buyer and then opens another letter of credit in favor of the supplier. The first letter of credit serves as collateral for the second credit.
Transferable Letter of Credit

This type of credit allows the seller to transfer all or part of the proceeds of the original letter of credit to a second beneficiary, usually the ultimate supplier of the goods. The letter of credit must state that it is transferable for it to be considered as such. This is a widespread financing method used by middlemen and is common in East Asia.

Assignment of Proceeds

The beneficiary of a Letter of Credit may allocate all or a share of the proceeds under a credit to a third party (the assignee). However, unlike a transferred credit, the beneficiary has exclusive rights to the credit and is exclusively responsible for fulfilling its terms and conditions. For the assignee, an assignment means only that the paying bank, once it obtains notice of the assignment, accepts to follow the assignment instructions, if and when payment is made. The assignee is reliant upon the beneficiary for compliance, and therefore this arrangement carries more risk than a transferred credit. Before agreeing to an assignment, the assignee should thoroughly review the original Letter of Credit (Credit Research Foundation).

Export Letters of Credit

For example, an Importer Company in Bulgaria arranges to purchase 100 television sets from an Exporting Corporation in Greece. The transaction begins with a sales agreement which includes a requirement that the $25,000.00 purchase price be payable at "sight" under a confirmed Letter of Credit. The Importer Company then requests that its bank, Banklexport, Sofia, Bulgaria, issue an Irrevocable Letter of Credit, to be advised and confirmed by a bank in Greece.
Then the Exporting Corporation ships the goods and presents a $25,000.00 draft along with the specified documents to the bank in Greece on or before the expiration date of the Letter of Credit. Once the bank inspects the documents and concludes that they meet the terms of the Letter of Credit, payment is made to the Exporting Corporation. The bank then sends the documents to the Bulgarian bank that inspects them, reimburses the bank, and obtains payment from, and discharges the documents to, the Bulgarian importer.

What do you think about the kind of problems exporters could meet? Could you give examples from your business environment?

There are several mistakes, which exporters can make. A list of these possible mistakes is on the next page.

Export Letter of Credit – Ten Common Mistakes

1. The agreed time schedule is not followed, because of late shipment or late presentation.

2. The specified documents are not prepared as specified by the letter of credit, other than the transport document, insurance document and invoice.

3. Certificates, such as the certificate of origin and certificate of inspection, are not signed.

4. The goods description on the commercial invoice does not match the description on the letter of credit.

5. Documents are not properly endorsed.

6. Drafts (bills of exchange) are not presented as stipulated by the letter of credit or are not prepared properly.

7. The insurance document is dated after the shipment date, or does not cover the risks as required by the letter of credit. The types of risk, extent of risk coverage or currency differ from what is stated in the letter of credit.

8. The transport document is not properly signed as defined by the UCP, or it is not prepared in compliance with the letter of credit.

9. The documents are inconsistent with one another.

10. The type and number of stipulated documents and copies are not the same as those stipulated by the letter of credit.

To avoid above mistakes, here is a checklist you can use:

**Exporter’s Checklist for Analyzing a Letter of Credit**

Check the following items to verify that all terms and conditions in the Letter of Credit agree with your Price Quotation/Proforma Invoice and/or sales agreement and that you will be able to comply with the order as requested by the importer.

- **Identity of Parties** – Are the names and addresses of your company and the importer’s organization correct and complete?
- **Confirmed** – Is the L/C confirmed? If not, are there restrictions that prohibit it from being so?
- **Irrevocable** – Can terms and conditions of the L/C be changed or cancelled without your prior knowledge and consent?
- **Description of Goods** – Are goods described correctly and completely to include trademark names and model numbers?
- **Prices** – Do unit prices and total price for goods agree with the prices that you previously quoted?
- **Amount** – Will the total amount cover all costs allowed by the L/C (e.g., documentation, transportation, insurance)?
- **Currency of Payment** – Is L/C the payable at sight or at a later date? Is it drawn on your bank or importer’s bank?
- **Insurance** – Who is responsible for insurance? If the importer pays, do you have evidence of adequate coverage?
- **Shipping Terms** – Are terms correctly stated (e.g. Ex Works, FAS Port of Import, FOB Port of Export, CFR Port of Import, CIF Port of Import)?
- **Shipping Date** – Will you have adequate time to produce and have goods ready for shipment for the specified date?
- **Transportation Charges** – Are inland, ocean or airfreight charges prepaid or collect? Who pays the transportation costs?
- **Partial Shipments** – Are you allowed more than one shipment or must the complete order be contained in one shipment?
- **Transshipment** – Can goods be unloaded and transferred to another vessel between the ports of export and import?
- **Documents** – Can all documents be obtained in the exact requested form as and within the validity period of the L/C?
- **Presentation of Documents** – Is there enough time after delivery to collect and present documents to the bank for payment?
- **Expiration Date** – Can you comply with all the terms and conditions of the L/C before it automatically expires?

Source (1996, Export USA Publication)
Import Letters of Credit

For example, a bank in Macedonia is the Issuing Bank, having issued the Letter of Credit on behalf of the Macedonian importer. The same bank’s Turkish branch is the Advising Bank. The Letter of Credit is freely negotiable. The Turkish Beneficiary (exporter) of the Letter of Credit may have the draft negotiated by the bank’s Turkish branch or another bank in Turkey. As a result, the exporter receives finances (typically on a "with recourse" basis) after presenting complying documents. The Turkish Negotiating Bank will, then, send the draft and documents to the bank in Macedonia. If the documents meet the terms, the bank will charge its customer, the Macedonian importer (Applicant), for the value of the draft and at the same time pay the Turkish Negotiating Bank and discharge the documents to the Macedonian importer.

If the documents do not comply the bank may contact its customer for approval of the specific inconsistency or inconsistencies or for a general authorization to pay. If customer authorization is given and the bank itself also agrees to ignore the inconsistencies, payment is made. If the importer or the bank does not agree to ignore the inconsistencies, the Turkish Negotiating Bank will be informed of the inconsistencies and that the unpaid documents will either be returned to them or held at their disposal.

Could you compare and discuss the advantages and risks of complying and uncomplying documents for an importer?
Questions Importers Commonly Ask About Letters of Credit

**Expiry Date**

> When the Letter of Credit expiry date is established, should enough time be allowed for the goods to get to me or for payment to be made when extended payment terms have been negotiated (e.g. 60 days after sight)?

No. The expiry date should simply allow the Exporter enough time, after the latest shipping date, to present documents to the “available with” Bank. In a letter of Credit, you are not allowed the opportunity to inspect the goods prior to paying for them. Keep in mind that banks deal only with documents and not with goods.

**Cost**

> What are the costs to issue a Letter of Credit?

The fees vary based on the dollar amount of your Letter of Credit and the length of time it is outstanding. You should contact your TD branch for a Schedule of Fees and Charges.

**Quality of Goods**

> Is there any way that I can protect myself from receiving inferior quality goods by using a Letter of Credit?

Yes. This can be done by asking for appropriate third party documents to be presented under the Letter of Credit that would give proof of the shipment of the proper goods, e.g. an Inspection Certificate, Health Certificate, Agent’s Certificate, and so on.
SWIFT Transmission of the Letter of Credit

How quickly will the Exporter take delivery my Letter of Credit?

Once the Letter of Credit Application form is received by TD's International Trade Services office, normally the Letter of Credit will be issued within 24 hours. If it is sent by teletransmission as requested in the Application, the Advising Bank will receive the advice that day or next business day depending on time zones. The Advising Bank then controls how quickly the Letter of Credit is sent to the Exporter. If it is urgent that the Exporter (Beneficiary) receives advice of the Letter of Credit immediately, we recommend that you include instructions in the Application to notify the Beneficiary by phone or fax. You should include the relevant contact numbers.

Recourse In Case of Non-Fulfillment of Contract

Under a Letter of Credit, what kind of recourse available to me if the goods arrive and they are not the quantity or quality agreed upon?

Since banks deal only with documents and not with goods, all disputes can be referred to the International Chamber of Commerce Arbitration or handled through legal proceedings.

Goods Preceding Documents

What happens if my ocean shipment arrives before my transportation documents?

You have two choices. You can either wait for the transportation documents and pay for storage of the goods or you can request TD to issue on your behalf a Bond of Indemnity under your line of credit in favor of the carrier. The Bond of Indemnity allows you to obtain the goods without producing the transportation documents. When the transportation documents do arrive, you must forward them to the carrier in order to have your Bond of Indemnity returned to you and you, in turn, must return it to the TD branch.

Source TD Bank Financial Grup
Problems that may be Encountered and Tips

- Often a bank rejects the seller’s documents

The banks use limited discretion in matching the terms and conditions of the letter of credit against the documents presented. There is often little room for judgement.

For example, imagine that a letter of credit describes goods as “cocoa butter with a maximum fat content of 15%”. However, the exporter presents a commercial invoice referring to the goods as “cocoa butter with 12% fat content”.

Tip: Exporters must check the wording of all documents before submission, using the same criteria that the banks apply. Ensuring that all the terms used correspond.

- Often the letter of credit fails to anticipate an aspect of the transaction

For example, a common requirement on a Letter of Credit is for a “Clean On – board Bill of Lading” – documents supplied by the shipping company confirming that the goods were received in good condition, and were loaded in the ship’s hold. However, if the goods are hazardous or flammable, they will be put on the deck of the ship instead of the hold meaning that the bank could reject the documents.

Tip: To avoid such problems, exporters need an understanding of the different types of commercial document (transport document, insurance document etc.) and the things on each document that may be important to a bank in the context of presentation under a letter of credit.
Time limits can be missed when presenting required documents

Tip: You have to be aware of up to three time limits – the expiry date of credit, the latest shipping date and the maximum time allowed between dispatch and presentation. When you get advice of the Letter of Credit, check that all its terms and conditions can be fulfilled, within the set time frames. If the Letter of Credit asks for documents to be given by third parties, make reasonable allowance for the time this may take to arrange. After dispatch of the goods, check all the documents both against the terms of the Letter of Credit and against each other for internal consistency.

(OTAL).

Comparison of Various Methods of Payment

The five explained payment methods are used for different situations and each has some advantages and risks. A comparison of these methods is illustrated on Table 1. To be able to choose the right method, you should carefully examine the table.
### Table 1: Comparison of Various Methods of Payment

<table>
<thead>
<tr>
<th>Method</th>
<th>Goods Available to Buyer</th>
<th>Usual Time of Payment</th>
<th>Risk to Exporter</th>
<th>Risk to Importer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash In Advance</td>
<td>After payment</td>
<td>Before shipment</td>
<td>Very low</td>
<td>Maximum - Relies on exporter to ship goods as ordered</td>
</tr>
<tr>
<td>Open Account</td>
<td>Before payment</td>
<td>As agreed</td>
<td>Relies on importer to pay account as agreed - takes complete risk</td>
<td>Very low</td>
</tr>
<tr>
<td>Consignment</td>
<td>Before payment, exporter retains title until goods are sold or used</td>
<td>After use; inventory and warehousing costs to exporter</td>
<td>Substantial risk unless through foreign branch of subsidiary</td>
<td>Very low</td>
</tr>
<tr>
<td>Documentary Collection/ Sight Draft /Documents against Payment</td>
<td>After payment</td>
<td>On presentation or draft to importer</td>
<td>If draft unpaid, goods must be returned or disposed of, usually at loss</td>
<td>Assured of quantity, also quality, if goods are inspected before shipment</td>
</tr>
<tr>
<td>Documentary Collection/ Time Draft/ Documents against Acceptance</td>
<td>Before Payment</td>
<td>On maturity of draft</td>
<td>Relies as importer to pay draft</td>
<td>Minimal - Can check shipment for quantity and quality before payment</td>
</tr>
<tr>
<td>Letter of Credit Confirmed Unconfirmed</td>
<td>After Payment</td>
<td>When documents are available at shipment</td>
<td>Very low</td>
<td>Assured of quantity and also quality at shipment if inspection report is required</td>
</tr>
</tbody>
</table>
Case Study: Fruit Juice For Europe

A South American factory is well known for its fruit juices. They have sold 2 containers of product to a French trader at a price 20% off the wholesale.

Now the trader wants exclusive sales rights for the whole Europe, promising 20 containers the first year on open account payment terms.

At the same time, extensive research has been made for marketing the juice via a stock-keeping importer in Germany.

Importer’s selection is underway and the trade fair results have been positive.

1. What would you suggest for the management to do?
2. What kind of risks has the company got?
3. Discussion on the channels. What kind of channels can they use for entering the European market?
4. Conditions for “Exclusivity”. How should the South American factory react?
Case Study: Be Careful with the Contract

A manufacturer concluded a sizable contract for the FAS Antwerp supply of heavy duty machinery. Payment was to be by irrevocable confirmed documentary credit, stipulating a commercial invoice and the buyer’s certificate that he had taken delivery of the material at Antwerp.

In due course, the material was ready for shipment but on arrival at Antwerp, it was not taken over by the buyer and as the supplier did not receive the buyer’s certificate, he was unable to get paid under the credit. After a year of lengthy negotiations, the supplier received as compensation but still suffered a substantial loss.

Before concluding the contract, the supplier had consulted his bank, whose reply had been: “The documentary credit is a safe instrument of payment both for the buyer and for the supplier”. And he had also consulted authors on documentary credit, whose words he quoted as:

“The exporter will not be fully protected unless he has an irrevocable and confirmed documentary credit”.

The supplier was sure that by obtaining an irrevocable confirmed credit he had taken all the necessary precautions to get full payment security.

So, where is the problem?
Case Study: Real Documentary Credits

The importer applied for a credit for the full CFR value of the goods. This credit contained as term of payment:

- 40% of the value payable at sight against presentation of compliant documents
- 60% to be settled by draft at 90 day’s sight on credit applicant without responsibility or engagement on our part (meaning the issuing bank)

Compliant documents were prepared by the exporter and presented to the bank and the 40% payment was effected. The 90 days’ sight draft for the remaining 60% was duly accepted by the credit applicant.

At maturity, it remained unpaid and the issuing bank took refuge in the wording. “without responsibility or engagement on our part”.

The beneficiary is in the opinion that a bank issuing a credit for the full value of the goods should accept responsibility for the beneficiary also to be paid in full.

1. What do you think about this kind of credit?
2. What is wrong with the terms of payment in the credit?
3. Do you think the beneficiary has made his objection on time?
Two questions often arise in international trade. The first, for sellers, is: “If I ship the goods, am I certain to be paid for them?” The second, for buyers, is: “If I send the money, will I be certain to receive the goods?” No transaction should take place unless the answers are definitely “yes”. Yet the two seem to contradict each other.

The seller can answer “yes” if the seller receives payment in advance, and the buyer can answer “yes” if the buyer makes payment after delivery, but both of these solutions fail to protect the other party from nonperformance.

Therefore, importers and exporters are well advised to arrange their contractual terms to avoid court litigation. They have to use fully discussed payment terms and select the one that satisfies both parties.

According to the transaction, the most convenient payment terms should be chosen but in general we conclude that the most popular ones are a letter of credit and documents against payment.
### Key Terms

<table>
<thead>
<tr>
<th>Accepted Time Draft</th>
<th>Deferred Payment Letter of Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advance Payment</td>
<td>Expiration Date</td>
</tr>
<tr>
<td>Advising Bank</td>
<td>Irrevocable Letter of Credit</td>
</tr>
<tr>
<td>Amendment of a Letter of Credit</td>
<td>Issuing Bank</td>
</tr>
<tr>
<td>Applicant</td>
<td>Latest Date for Presentation</td>
</tr>
<tr>
<td>Assignment on Proceeds</td>
<td>Latest Shipping Date</td>
</tr>
<tr>
<td>Back to Back Letter of Credit</td>
<td>Letter of Credit</td>
</tr>
<tr>
<td>Beneficiary</td>
<td>On Consignment</td>
</tr>
<tr>
<td>Cash in Advance</td>
<td>Open Account</td>
</tr>
<tr>
<td>Collecting/Presenting Bank</td>
<td>Red Clause Letter of Credit</td>
</tr>
<tr>
<td>Confirmed Letter of Credit</td>
<td>Remitting Bank</td>
</tr>
<tr>
<td>Confirming Bank</td>
<td>Revocable Letter of Credit</td>
</tr>
<tr>
<td>Consignee</td>
<td>Revolving Letter of Credit</td>
</tr>
<tr>
<td>Draft</td>
<td>Sight Draft</td>
</tr>
<tr>
<td>Documentary Collection</td>
<td>Time Draft</td>
</tr>
<tr>
<td></td>
<td>Transferable Letter of Credit</td>
</tr>
</tbody>
</table>
Progress Check

1. In a documentary collection, the banks;
   a. Evaluate the quality of the goods before shipment
   b. Act as intermediaries in the collection process
   c. Finance the buyer and the seller
   d. Dictate the terms
   e. Only check the drafts

2. An exporter receives a P/O (purchase order) and payment for 100 kg. of knitting yarn. This is an example of which type of payment option?
   a. Cash in advance
   b. On consignment
   c. Open account
   d. Letter of credit
   e. Draft or documentary collection

3. If the bank holds shipping documents in custody and delivers them to the buyer upon receipt of payment, what type of document of payment term is this?
   a. Letter of credit
   b. Cash in advance
   c. Cash against goods
   d. Documents against collection
   e. Open account
4. An exporter receives a P/O (purchase order) for 1000 pullovers and ships the goods and the documents directly to the buyer before receiving payment for the goods. Which payment option is this?

   a. Cash against documents
   b. On consignment
   c. Time draft
   d. Cash in advance
   e. Open account

5. An “open account” transaction gives all of the advantages to the;

   a. Consignee
   b. Seller
   c. Bank
   d. Forwarder
   e. Buyer

6. Identify the payment option(s) which place(s) the seller in the risky position of nonpayment by the buyer (select all that apply)?

   I. Cash in advance   III. Irrevocable letter of credit at sight
   II. Open account    IV. On consignment

   a. I and II
   b. Only II
   c. II and IV
   d. Only I
   e. Only III
7. What kind of payment option(s) should the seller consider when his/her products are in low demand (select all that apply)?

I. Cash in advance  III. Open account
II. Letter of credit  IV. Documents against payment

a. Only II  b. II and III  c. Only III  d. III and IV  e. Only IV

8. Identify the risk(s) faced by the seller when collecting payment from an overseas buyer (select all that apply).

I. Country  III. Industrial
II. Political  IV. Foreign exchange

a. Only I  b. Only III  c. II and III  d. III and IV  e. I and IV

9. What payment option(s) should the seller consider when he/she is willing to extend credit to the buyer?

a. Cash in advance  b. Letter of credit at sight  c. Draft or documentary collection  d. Documents against payment  e. Documents against acceptance
10. The seller is best protected by which of the following payment terms:
   
a. Open account
b. Revolving letter of credit
c. Confirmed, irrevocable letter of credit
d. Red clause letter of credit
e. Transferable letter of credit

11. In a letter of credit transaction, the bank deals;
   
a. Only with goods, not with documents
b. Only with documents, not with goods
c. With documents and goods
d. With quantity and quality of goods
e. Only with payment

12. The exporter is about to close a deal with the importer but he/she does not know the issuing bank well. So what kind of letter of credit should be opened to satisfy the exporter and minimize the risk?
   
a. Confirmed
b. Avalized
c. Straight
d. Red – clause
e. Back – to – back
13. In some cases the seller may need some advance payment in order to make the deal possible. A L/C may assure that certain sums be paid in advance of the presentation of documents and any advance paid will be deducted from the total credit available when the credit is paid. What sort of L/C is this?

a. Back – to – back
b. Confirmed
c. Red clause
d. Straight
e. Transferable

14. If you are an intermediary purchasing materials under L/C for resale to a final purchaser and you do not want to disclose your source to the buyer, what kind of L/C should you use?

a. Back – to – back
b. Red clause
c. Back – to - back
d. Revolving
e. Confirmed