

DP06

International Trade Finance

4 OCTOBER 2004

1. Time allowed : Three (3) hours
2. Total number of questions : Seven (7) questions
3. Number of questions to be answered : Five (5) questions of which at least two (2) must be from Part A [20 marks each]
4. Candidates must obtain a minimum of 16 marks in Part A as well as pass the paper as a whole.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.
7. A blank page is provided at the end of the question paper for rough work.

PART A

ANSWER AT LEAST TWO (2) QUESTIONS

1. MK Sdn Bhd (MKSB), a customer of your bank, has recently received a transferable documentary credit (DC) issued by Bank Amir in favour of MKSB for the purchase of raw sugar. Your bank, being the advising bank of the DC, was subsequently requested by MKSB to transfer the DC to two 2nd beneficiaries, i.e. Icedex Sdn Bhd and Firex Sdn Bhd.

MKSB wished to transfer only 80% of the DC amount to the two 2nd beneficiaries for the substitution of their invoices at a later date for the full DC amount once presented by the two companies. Due to the urgency of the shipment, MKSB wanted the transfer to be effected immediately; otherwise, the contract with the buyer may be terminated.

You are the trade officer-in-charge of MKSB. While processing the application, you noted the following in the DC:

- The DC was designated as “transferable”.
- No bank was mentioned as the transferring bank.
- Credit was restricted at the counter of your bank.
- Partial shipment was prohibited.

Based on what you noted, you initially refused to do the transfer. However, after further discussion with MKSB, you decided to do the transfer but restricted the transfer only to one 2nd beneficiary, i.e. Icedex Sdn Bhd. MKSB was unhappy with your decision and made a complaint to Bank Negara Malaysia about the incident. As you were the one who made the transfer, MKSB held your bank liable as the transferring bank of the DC, regardless of whether the transfer was correct as per ICC Uniform Customs and Practice for Documentary Credits (UCP500).

Required:

- (a) Were you correct in transferring the DC even though your bank was not specifically nominated as the transferring bank? Why? [4]
- (b) How would you explain to your manager of your decision to restrict the transfer to only one 2nd beneficiary? [6]
- (c) In accordance to UCP500, a DC can be transferred only on the terms and conditions specified in the original DC. However, there are exceptions to this rule whereby some items can be changed or reduced.
State any **five** items that can be changed or reduced from an original DC. [5]
- (d) If the DC is “non-transferable”, can MKSB assign the proceeds to its creditors to settle another invoice? Why? [2]
- (e) Icedex Sdn Bhd later presented the documents to you, and the substitution of invoice and bill of exchange by MKSB was done on first demand. However, you noted the invoice amount is 4% less than the DC amount even though the quantity was shipped in full and the unit price remained as per the original DC.
Will the substituted documents become discrepant when submitted to Bank Amir? Why? [3]
(Total:20 marks)

2. CHARA Sdn Bhd (CHARA), a customer of your bank, recently concluded a business deal to purchase some raw materials from a new supplier who allowed CHARA to pay via documentary collections. CHARA suggested that the collection be channelled through your bank and expected a 30-day credit term by this supplier.

When your bank received the documents from the remitting bank, you noted that the collection instruction stated that documents are to be delivered against payment 30 days from the date on the bill of lading. No bill of exchange (BE) was enclosed but the collection was subjected to ICC Uniform Rules for Collections (URC522).

When the shipment arrived at the port, CHARA did not want the unnecessary demurrage charges, and persuaded you to give the documents to them against acceptance 30 days from the shipment date. Since there was no BE for acceptance, they provided a backdated authorisation letter to pay the bill 30 days from the shipment date.

After much persuasion, you agreed on the arrangement and delivered the documents to CHARA. When the date of payment came, you contacted CHARA but were informed that CHARA had been sold and the new owner has no knowledge about the transaction. The new owner was not willing to pay for the shipment and could prove to you that he never took the goods.

Required:

- (a) Explain the following terms as provided under URC522:
 - (i) Documentary collections [2]
 - (ii) Commercial documents [2]
 - (b) Were you correct in handling the documents as per URC522? Why? [6]
 - (c) Was the new owner correct in refusing to pay the bill as per URC522? Why? [6]
 - (d) Will your bank be liable for the payment of the collection if the new owner still refuses to pay? Why? [4]
- (Total:20 marks)
-
- 3. (a) (i) Explain **three** key functions of a bill of lading. [6]
 - (ii) What is the major difference between a bill of lading and a waybill document? [2]
 - (b) (i) Briefly describe a liner bill of lading. [2]
 - (ii) What is the advantage of using a liner bill of lading compared with a marine bill of lading, in terms of voyage? [3]
 - (c) (i) Briefly describe the DES Incoterm. [2]
 - (ii) State the mode of transport applicable to the DES Incoterm. [1]
 - (d) The CIF and CIP Incoterms can be used for sea or inland waterway mode of transport.
 - (i) Who is responsible for the insurance coverage for both Incoterms? [2]
 - (ii) When a roll-on/roll-off technique or container is being used, which of the **two** Incoterms is more appropriate? Why? [2]
- (Total:20 marks)

PART B

- 4. (a) (i) Explain what a vostro account is, from a Malaysian bank's point of view. [3]
- (ii) If a Thai bank has a vostro account, what will be the likely currency of this account? [1]
- (b) Foreign currency trade loan (FCTL) is a financing scheme available to importers and exporters, and it involves financing via funding in a foreign currency. All foreign currency transactions involve a foreign currency exchange risk.

Since a forward foreign exchange contract cannot be used to hedge the foreign currency exchange risk under the FCTL, what are **two** circumstances that could eliminate this risk for a customer using a FCTL? [6]
- (c) (i) Briefly explain what a trust receipt is. [3]

(ii) Name **three** provisions that are expected of the customer to hold in trust for the bank and that protect the bank, which are usually contained within the trust receipt documents. [3]

(iii) Why do most banks insist on taking an accepted bill of exchange together with a trust receipt from their customers? [4]

(Total:20 marks)

5. (a) Bonds or guarantees issued by a bank can be classified as conditional or unconditional. It is normally said that banks prefer issuing unconditional bonds or guarantees.

Explain why this is so, from a bank's point of view. [5]

(b) If a customer wishes to contract a future exchange of a foreign currency with his banker, he would normally want to hedge the foreign currency exchange risk using a forward foreign exchange contract.

Explain the difference between a "fixed" and an "option" forward foreign exchange contract. [5]

(c) (i) What is an inland bill of exchange? [2]

(ii) In case of dishonour, is it necessary to note and/or protest the bill in order to preserve recourse against the drawer or indorser? Why? [3]

(d) Explain the meaning of "riba" and its application to Islamic banking. [5]

(Total:20 marks)

6. One of your bank's customers, EIRENE Sdn Bhd (EIRENE), received two documentary credits (DCs) from two different buyers as follows:

- Buyer A: An irrevocable revolving DC of USD400,000 per month on a cumulative basis for six months.
- Buyer B: An irrevocable DC of USD2,400,000 with a scheduled shipment of USD400,000 per month for six months.

EIRENE then shipped the goods to the two buyers as follows:

- 1st month : USD400,000 to both buyers.
- 2nd month : USD350,000 to buyer A and USD400,000 to buyer B.
- 3rd month : USD300,000 to buyer A and USD350,000 to buyer B.
- 4th month : USD550,000 to buyer A and USD400,000 to buyer B.

After the 4th month shipment, EIRENE informed you that due to the change in the price of the commodity involved, the buyers will definitely refuse the goods if the goods are not covered under the DC. EIRENE's 3rd month shipment was done at the end of that month and the 4th month shipment immediately at the beginning of the next month.

Required:

(a) What is the possibility of non-payment for each DC on the 3rd shipment as per UCP500 if other terms of the respective credits are in compliance? Why? [6]

(b) What is the possibility of non-payment for each DC on the 4th shipment as per UCP500 if other terms of the respective credits are in compliance? Why? [6]

(c) If EIRENE had not shipped the goods on the 4th month, what is your advice to EIRENE with regard to the 4th month shipment and also subsequent shipments, in terms of receiving the payment under the respective DCs? [4]

(d) What is the total liability of the revolving credit to buyer A and buyer B? [2]

- (e) EIRENE wanted an advance payment from another buyer and the buyer agreed, with the condition that payment will be through a DC with a requirement for a receipt and a promise to comply with the sale contract.

What is this type of credit called?

[2]

(Total:20 marks)

7. Your bank received three sets of documentary collections from Bank Bagus for Syarikat SK Distribution (SSKD) on 15 June 2004. The documentary collections were subjected to ICC Uniform Rules for Collections (URC522). The following are the information provided by the respective documentary collections:

Reference No.	Description on bill of exchange (BE)	Collection instruction	Principal
EX001C2004	60 days after sight	Delivery against acceptance	WSK Exports Company
EX002C2004	45 days after sight	Not stated	BST Worldwide Enterprise
EX005C2004	30 days after sight	Delivery against acceptance by drawee and presenting bank	Not stated

When approached by SSKD on 20 June 2004, you presented the respective BEs for SSKD's acceptance. At their acceptance and your further verification of their signatures, the documents were delivered to SSKD.

On the maturity date of the EX005C2004 bill, SSKD said that they were facing financial difficulty and refused to pay. SSKD also said that they would not pay for the other bills too on the respective maturity date. The remitting bank was duly informed.

However, you then received a demand for payment from the remitting bank for the three documentary collections. Your bank refused to pay, stating that you were just acting as a collecting bank without any liability and had acted according to the URC522.

Required:

- (a) In accordance to URC522, was your bank correct in refusing to pay the remitting bank for each of the **three** documentary collections? Why? [12]
- (b) Explain the proper ways to handle any of the documentary collections that were not acted on correctly as per URC522. [8]

(Total:20 marks)

OUTLINE ANSWERS

The comments given in the boxes below indicate the areas of weaknesses the examiners have identified and their advice to future candidates.

Question 1

Candidates did not know that the proceeds from a documentary credit can be assigned to any party irrespective of whether the documentary credit is transferable or not.

1. (a) Yes. Since the DC restricted to your counter, you may transfer the DC.
- (b) It is not my prerogative to transfer the DC, as I do not have any obligation to do the transfer. UCP500 allows me to transfer the DC according to my terms and conditions. I have also complied with UCP500 for only allowing transfer to one 2nd beneficiary because partial shipment was prohibited.
- (c) The following items can be changed and reduced (any **five**):
 - Amount
 - Unit price
 - Expiry date
 - Period of shipment
 - Last date of presentation
 - Percentage of insurance coverage
 - Name of 1st beneficiary
- (d) Yes, MKSB may assign the proceeds from the DC (any amount to which MKSB may be entitled to) to any other party irrespective of whether the DC was transferable or not.
- (e) No. The 1st beneficiary reserves the right to substitute the invoice and the bill of exchange. The drawing and invoice being 4% less than the DC amount is acceptable as it is within the tolerance range of 5% as provided in Article 39(c) of UCP500.

Question 2

- Candidates did not know that if the collection instructions stated the delivery terms as against payment, the document should be delivered against payment irrespective of whether it is payment against 30 days from the date on the bill of lading.
- Candidates did know that any arrangement executed out of the collection instructions is at the risk and responsibility of the party doing it.

2. (a) (i) “Documentary collections” means collections of financial documents accompanied by commercial documents, or commercial documents not accompanied by financial documents.
- (ii) “Commercial documents” include invoices, transport documents, documents of titles or other similar documents, or any other documents whatsoever, not being financial documents and instruments used for obtaining the payment of money.
- (b) No. The collection instruction clearly state that documents are to be delivered against payment irrespective of whether it is immediate or 30 days from bill of lading date. If the drawee does not pay, no documents should be released to the drawee. Anything otherwise is considered as not complying with the collection instruction and the presenting bank will be held liable for any action taken contrary to the collection instruction. The presenting bank should seek further clarification from the remitting bank if there is any unclear instruction in the collection instructions.

- (c) Yes. Previous authorised signatory is no more legally valid on the maturity date when you demand payment from the new owner and the backdated instruction letter is considered null and void. Furthermore, there was no accepted bill of exchange to prove that the company has committed itself for any payment and the new owner can prove that the goods was not taken by them.
- (d) Yes. The original customer should pay for it as he has taken the goods. Anyway, the documents were supposed to be delivered against payment and not against acceptance on the date the documents were released. It was an operational risk you (on behalf of the bank) have taken. As far as the remitting bank is concerned and as per URC522, your bank as the presenting bank is liable to pay due to non-compliance with the collection instruction. Whether you are able to recover your loss will depend on your ability to seek the original customer to pay accordingly.

Question 3

- Candidates unable to differentiate between a bill of lading and a waybill document.
- Candidates could not explain which Incoterm was more appropriate when a roll-on/roll-off technique or container is being used.

3. (a) (i) The three functions of the bill of lading are:
- It acts as a receipt for the underlying goods.
 - It contains the terms and conditions of the contract of carriage.
 - It acts as a document of title for the underlying goods.
- (ii) The difference between a bill of lading and a waybill document is that a waybill is not a document of title.
- (b) (i) Liners are vessels designed to transport individuals on their holidays. Liner bill of lading is bill of lading issued by these liners when transporting goods in their holds.
- (ii) The advantage of using a liner vessel compare with the standard cargo vessel is liners have a pre-determined itinerary that obliges it to be at certain locations on stated dates. Therefore, the unloading date is certain at a particular destination and will be fully aware by both the exporter and importer. This is in contrast with a standard cargo vessel with a marine bill of lading.
- (c) (i) The incoterm DES stands for Delivered Ex-ship at named port of destination.
- (ii) It is applicable to transport by sea and inland waterway.
- (d) (i) The seller is responsible for the insurance coverage.
- (ii) The CIP Incoterm should be more appropriate, as the term “ship’s rails” the point where the obligations of the seller are completed is less meaningful.

Question 4

- Candidates could not show understanding of vostro account when the question asked about the account from a foreign bank’s perspective.
- Candidates could not state the circumstances that could eliminate the forward foreign exchange risk under the FCTL.

4. (a) (i) From the view point of a Malaysian bank, a vostro account is a local denominated currency account of a foreign bank with them, e.g. a bank in Hong Kong maintaining a Ringgit account with a Malaysian bank.

- (ii) The likely currency of a vostro account of a Thailand bank is the local currency of Thailand, i.e. Thai-baht.
- (b) Two circumstances that eliminate foreign exchange risk of a FCTL:
 - The customer is expecting proceeds from overseas in the same currency of the loan.
 - Where the authority pegs a currency, e.g. USD to MYR is pegged at 3.8000.
- (c) (i) A trust receipt is a document that provides evidence that the goods and the proceeds of the sale from those goods are bank's security. The bank is financing the customer's purchase against the goods as its security. The proceeds from the sales of the goods will be used to settle the customer's indebtedness to the bank under the trust receipt.
 - (ii) The provisions to hold in trust including the following (any **three**):
 - the underlying goods and/or documents of title relating thereto,
 - the sale proceeds (to settle the loan via designated account)
 - insurance claim amount (to settle the loan via designated account)
 - keeping the goods adequately stored and insured at all times
 - returning unsold goods (if any) to the bank
 - providing, upon request by the bank, a signed letter of authority
 - (iii) Besides the security of the goods for the trust receipt loan from the importer, a bank ask for an accepted bill of exchange as a mean of an additional security. The reason being it is difficult to determine the whereabouts of the actual goods while in transit, which was pledged as security and also the bank may elect not to solely rely on goods as security for the trust receipt loan. In the event of a default, it is simpler to obtain repayment by enforcing the bill of exchange via the provision of the Bills of Exchange Act 1949.

Question 5

- Candidates could not explain the reasons why an issuing bank prefers unconditional bank guarantees.
- Candidates did not know that a dishonoured inland bill of exchange does not need to be noted or protested to preserve recourse against the drawer or indorser.
- Candidates could not explain the meaning of "riba" and its application to Islamic banking.

- 5. (a) When a claim is entered, the interpretation of the conditions of the claim may differ from individual to individual, and is open for dispute. Therefore, an unconditional bond/guarantee is preferred, as the claim is clean and not subjected to misinterpretation, and the bank can make payments immediately.
- (b) In a fixed forward foreign exchange contract, the date of the currency transfer is known and fixed, whereas in an option forward foreign exchange contract, the exact date of the transfer is not known but is given a time period.
- (c) (i) An inland bill of exchange is defined as a bill which, on the face of it, purports to be:
 - both drawn and payable within Malaysia; or
 - drawn within Malaysia upon some person resident therein.
- (ii) When an inland bill of exchange has been dishonoured it may, if the holder thinks fit, be noted for non-acceptance or non payment, as the case may be; but, it shall not be necessary to note or protest any such bill in order to preserve recourse against the drawer or indorser.
- (d) The literal translation of the word "riba" is "increase" or "excess", which is forbidden under the Syariah law. Islamic banking is governed under the Syariah law, hence any accrued

interest for deposit and/or loan that is predetermined is prohibited, which is considered as an “increase” or “excess”. Nevertheless, any profit from business activity that involves a certain risk where the profit can not be determined is allowed since it depends on the relative success of the businesses or entrepreneurial activities. The element of sharing the profit that cannot be determined is allowed and does not contravene the Islamic principles and acceptable in the Islamic banking.

Question 6

Candidates showed poor overall understanding of the concept examined.

6. (a) Shipment to buyer A: For a revolving documentary credit, there is no discrepancy on the shipment amount and it is in compliance with the requirement of the documentary credit. Payment should be forthcoming.

Shipment to buyer B: There was a short shipment of USD50,000 which was a discrepancy. If the documents were rejected by the issuing bank, then payment may not be received under the shipment and this is a likely outcome as the buyer will definitely not accept the goods in the above scenario.

- (b) Shipment to buyer A: It is still within the revolving credit amount and in compliance. Therefore, payment should be forthcoming as the issuing bank is obliged to pay under UCP500.

Shipment to buyer B: Although the requirement of the shipment for the specific month in the documentary credit is met, the shipment will be considered discrepant as per UCP500 Article 41 and can be rejected by the issuing bank. This is because if any instalment mentioned in the documentary credit is not met, the documentary credit will be ceased to be available for that and any subsequent instalments. The documents will be rejected and no payment will be received from the issuing bank in the above scenario.

- (c) For buyer A: For revolving credit, EIRENE can still make further shipment including the 4th month shipment provided the shipment amount is within the stipulated amount of the documentary credit and other terms and conditions of the credit are in compliance. Payment should be forthcoming.

For buyer B: EIRENE should not make the 4th month shipment and also the other subsequent shipments thereafter at all or risk the refusal of all the documents presented and non-payment under the documentary credit.

- (d) USD2,400,000

- (e) A red clause letter of credit with condition for the advancement under the documentary credit.

Question 7

- Candidates did not know that if no instructions on the method of delivery of documents are given in the collection instructions, the documents must be delivered against payment.
- Candidates were unaware that if a bank accepted a bill of exchange, it would also have accepted the liability to pay the bill on maturity.

7.

Reference no.	(a) Whether your bank was correct in refusing to pay the remitting bank	(b) The correct way of handling the documentary collection, if it was wrongly handled
EX001C2004	Your bank is not obliged to pay as you have acted in accordance to the collection instruction and also rules in URC522.	Delivery of the documents to the customer was correct. Documents presented to the drawee and upon acceptance of the bill of exchange, documents were released to the drawee accordingly.
EX002C2004	Your bank is liable to pay. Instead of delivering the documents against payment, you have delivered the documents under acceptance, an error that your bank will be held responsible. Your bank is liable to pay if the drawee did not make payment as your bank had not act in accordance to the rules in URC522 specifically Article 7b. Your bank also did not seek further clarification from the remitting bank and have elected to handle the collections.	Delivery of documents to the customer was incorrect. In the absent of such instruction in the collection instruction, documents should be delivered against payment (Article 7b, URC522). This rule applies even though the enclosed bill of exchange was a usance bill of exchange with "At 45 days after sight...". Alternately you may seek further clarification from the remitting bank and upon their instruction you may act accordingly. You would not be responsible for any delay and consequences from the delay since there is no instruction on delivery of the documents while waiting for further instruction from the remitting bank.
EX005C2004	Documents should be released to customer against acceptance of the bill of exchange by both the customer and your bank. Therefore the remitting bank expects the bill of exchange to be accepted by both your bank and the drawee. If the documents had been released to the customer, the remitting bank has a right to demand payment from you accordingly and your bank is liable to pay. Any delay and refusal from your bank to pay may possibly incur further demand in delay interest. Even if your bank had not accepted the bill for whatever reason, your bank is still liable to pay as it can be construed that you have not act in accordance to the collection instruction.	Documents are to be released to drawee against acceptance of both to drawee and your bank. If the drawee or your bank does not acceptance the bill of exchange, documents should not be delivered to the drawee. Whether your bank wish to accept the bill of exchange will depend on your bank's willingness to take the liability that comes from accepting the bill of exchange, including possible demand to pay the bill of exchange if call for by the principal/ remitting bank at maturity in the event of non-payment from your customer. Similar to other collections, if your bank did not want to handle the documentary collections and/or any of the instruction, you must advise the party from whom you received the collection accordingly without delay for their further instruction.