

DP06

International Trade Finance

7 APRIL 2003

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. (a) Against a letter of credit expiring on 30 April 2002, your bank, as the negotiating bank, paid out the full invoice value of the documents consisting of:
- a bill of exchange dated 23 February 2002;
 - an invoice dated 10 February 2002;
 - a bill of lading dated 18 April 2002; and
 - a clean report of findings dated 27 February 2002.

The documents covered a consignment of date-marked food products. According to your customer (the beneficiary) and the SGS General Superintendence Company (which issued the clean report of findings), the dates were manufacturing dates. But the letter of credit applicant regarded the dates as the expiry or "sell by" dates.

Through a letter dated 2 June 2002, the issuing bank raised the following discrepancies:

- The invoice was dated 10 February 2002 instead of 23 February 2002.
- The clean report of findings was dated 27 February 2002, whereas the goods were shipped on 18 April 2002.
- The letter of credit was cancelled via telex on 20 May 2002.

Your bank sent a telex on 10 June 2002 stating that:

- your bank did not receive the telex dated 20 May 2002; and
- the documents have been presented within the validity date of the letter of credit.

The dispute between the credit applicant and the beneficiary about the date markings on the goods continued, and your bank was not reimbursed.

Required:

As the negotiating bank, briefly explain how you can convince the issuing bank, via the Articles of Uniform Customs and Practice for Documentary Credits (UCP 500), of your right to obtain reimbursement. [15]

- (b) Under a letter of credit that calls for an air shipment of goods direct to the importer, a bank negotiated drafts with documents. The issuing bank rejected the documents stating several discrepancies. The negotiating bank refuted the discrepancies, which the negotiating bank claimed to be on baseless ground. In addition to that, the importer has taken delivery of the goods, leaving the documents unpaid at the issuing bank.

Is the negotiating bank correct in refuting the discrepancies? Explain your answer. [5]
(Total:20 marks)

2. As a Bills Officer of Bank Baru Bhd, you received during the last year a number of documentary collections from a bank in Korea, accompanied by bills of exchange drawn on your customer, Wicker Products Sdn Bhd ("Wicker Products"), at 60 days sight documents against acceptance (D/A). These bills have been paid promptly on the due date but Wicker Products has now refused to pay the latest accepted bill of exchange for USD300,000.

Required:

- (a) What actions would you take upon dishonour of payment? [7]

- (b) Wicker Products then explained to you that the reason for non-payment was due to a dispute over the quality of the goods.

Would your actions still be similar to those taken in (a) above? [4]

- (c) What would you do if Wicker Products were to offer you a part payment of USD150,000? [3]

(d) Will your bank arrange for the insurance and storage if it is a documents against payment (D/P) collection and your customer has refused to accept the documents? Briefly explain your answer. [3]

(e) Why is noting cheaper than protesting? [3]

(Total:20 marks)

3. (a) (i) Name **three** measures a bank would expect the importer to undertake if the bank wishes to afford itself the greatest protection under trust receipt. [9]

(ii) Explain why a bank would also request the importer to accept a usance bill of exchange drawn by the bank on the importer after having signed the trust receipt with the bank. [5]

(b) (i) Explain the difference between a conditional bond and an unconditional bond. [4]

(ii) Which type of bond would most banks prefer to issue? Explain your answer. [2]

(Total:20 marks)

PART B

4. (a) A letter of credit was issued to be payable according to the following schedule of terms of payment:

- 20% as advance payment against simple receipt issued by the beneficiary;
- 60% against the documents stipulated in the letter of credit; and
- 20% against the applicant's certificate stating that the consignment is in conformity with the *pro forma* invoice and is acceptable to the applicant.

The nominated bank views that the inclusion of such contractual terms cannot be incorporated in the credit and violates the very principle of which the letter of credit operates.

Do you agree with the nominated bank's view? Explain your answer. [12]

(b) Briefly explain whether an advising bank can add its confirmation to the letter of credit at the beneficiary's request without having been asked or authorised by the issuing bank. [8]

(Total:20 marks)

5. (a) Tanjung Builders Sdn Bhd ("Tanjung Builders") managed to secure a large contract they have been bidding for since January 2003. Beginning May 2003, Tanjung Builders will be supplying a wide range of building materials and products to an overseas buyer.

Tanjung Builders' export manager, En Azman, called you (as Tanjung Builders' banker) to discuss the financing arrangement of the contract. During the conversation, you discovered that the goods would be bought from both local and overseas suppliers. All of Tanjung Builders' suppliers insisted upon secured methods of payment. En Azman has asked you to suggest a method that will fully protect his company. The overseas contract is expressed in Euro but one of his suppliers in Singapore is insisting to be paid in USD.

Required:

(i) Briefly describe the basic instrument which will be appropriate for Tanjung Builders. Indicate why your suggestion will cater for Tanjung Builders in overcoming their anticipated cash flow difficulties and why it would give comfort to their potential suppliers. [7]

(ii) Explain whether the method in (a)(i) would be appropriate in the case of the Singaporean supplier. [3]

- (iii) Suggest another method that would assist Tanjung Builders to comply with the Singaporean supplier's request, bearing in mind that the Singaporean supplier also requires a secured payment method. [5]
- (b) Under a letter of credit calling for on board ocean bills of lading and shipment from any port in Malaysia to Guangzhou, China, with transshipment being allowed, the issuing bank refused a set of documents because of the following reasons:
- The bill of lading shows Port Klang as place of receipt of goods and loading on board a named vessel at Singapore, and it does not indicate the name of pre-carrier and the way of the onward routing from place of receipt to the port of loading.
 - Since Singapore is not a port in Malaysia, the shipment is not in compliance with the letter of credit terms, even though the place of receipt is in Malaysia.

Required:

Explain whether the bill of lading is discrepant. [5]
(Total:20 marks)

6. (a) Under an acceptance letter of credit, a confirming bank received discrepant documents. These documents were handled on a collection basis and in due course, the issuing bank accepted the discrepancies. The confirming bank informed the beneficiary who, being cash-rich, did not ask the bank to discount or negotiate. On due date, the letter of credit remained unpaid and the issuing bank subsequently went bankrupt.

Explain whether it is possible for the confirming bank to refuse payment because the documents were handled on a collection basis. [12]

- (b) Explain whether a beneficiary is allowed to present the documents direct to the issuing bank if the letter of credit nominates another bank. [8]
(Total:20 marks)

7. Mutiara Chain Sdn Bhd ("Mutiara") has a number of outlets at holiday resorts in various parts of Malaysia. Traditionally, Mutiara has purchased fancy goods from local wholesalers but now find that the local wholesalers' prices are unattractive. Diamond Ltd ("Diamond") of Manila has offered to supply Mutiara with a whole range of products but insisted upon secured methods of payment at sight on CIF Port Klang basis. To the benefit of Mutiara's cash flow, Mutiara has in the past been able to obtain sufficient credit of 90 days from their local wholesalers to enable them to sell the goods before having to pay for them.

Required:

- (a) Briefly describe a method of payment, which would afford Diamond the protection needed, and at the same time, taking into account the cash flow requirement of Mutiara. [10]
- (b) Briefly describe the documents you would expect Diamond to provide to Mutiara. [10]
(Total:20 marks)

OUTLINE ANSWERS

PART A

Question 1

Although candidates have the correct points, they could not argue their case convincingly and consistently. Candidates also need to be more familiar with the UCP 500 Articles.

1. (a) Since there are no hard and fast rule on the issuance dates of the documents in relation to each other, the documents must be regarded as compliant. They were also presented within the lifetime of the credit.

Apparently, the negotiating bank refuted the alleged discrepancies and established as a fact that a dispute about the goods was the actual reason for the non-reimbursement under the letter of credit. Also apparently, it called attention to the UCP Article 4 principle that in credit operations all parties concerned deal in documents and not in goods.

Further observations are:

- The points raised by the issuing bank are NOT discrepancies
- When making its claims, the issuing bank obviously failed to act in accordance with the provisions of paragraph (c) and (d) of Article 14 since:
 - by not giving earlier notice within 7 working days, it did not react within reasonable time;
 - it did not give notice of its refusal claim by telecommunication (although that would not have helped the beneficiary to remedy any discrepancy, since the credit had, at time being, expired)
 - Therefore, even if it there were true discrepancies – which does appear to be the case – the issuing bank was precluded from claiming that the documents were not compliant (Article 16)
 - Disputes on goods shipped under the letter of credit are of no significance, since pursuant to Article 4, in credit operations all parties deal in documents and not goods.

- (b) If a seller has not agreed in his contract to send the goods to the buyer, the seller should determine whether he wants to accept a letter of credit under which he is to do so. If he does, he should be aware of the risk he runs if his documents turn out to be discrepant. He should not try to blame the issuing bank, which is acting on the instruction of the applicant.

If the parties agreed to dispatch the goods by air, they have to be dispatched in the name of the consignee. If the credit is accepted whereby the consignee is the purchaser of the goods, then the issuing bank of the letter of credit has no power to intervene in respect of the goods.

It is for the parties to satisfy themselves that they are trustworthy, and also as a matter of common sense, to make sure that the documents presented are not to be refused because of discrepancies.

Question 2

This was the most attempted question and many candidates were able to provide the correct answers.

2. (a) Since the collection will be subject to Uniform Rules for Collection, I would first examine the collection for the following:
- whether to protest
 - the method of advice of non-payment
 - whether there is a case of need

I would strictly be guided by the instruction on the collection and immediately acted upon it.

- (b) My bank is acting as an agent of the Korean bank and our duty is to act on the Korean bank's interest. My bank would proceed as above. The reason for non-payment is irrelevant.
- (c) My bank should accept the part payment and remit it to the Korean bank in accordance with the instructions on the collection order. The Korean bank must be advised of the position. My bank will endorse the receipt of USD150,000 on the bill of exchange. If the collection order asks for protest, it will be protested for the full amount of the bill.
- (d) It is not a practice for a Malaysian bank to store and insure the goods unless a specific store and insure clause appears on the collection order. Even before doing so most Malaysian banks will seek confirmation from the remitting bank and advise them of the amount of charges to be incurred.
- (e) With noting, the Notary Public does not personally visit the drawee, but with protesting he does.

Question 3

Candidates were able to answer this question well. Some candidates were able to elaborate on their answers, which reflected good understanding of the concepts examined.

3. (a) (i) Measures for protection under trust receipts (any **three**):
- to hold trust for the following:
 - the goods and/or the documents of title relating thereto.
 - the sales proceed and, upon receipt, pay proceeds to the importers' bank.
 - among that elates to any insurance claims and upon receipt, pay the proceeds to the importer's bank.
 - to keep the goods adequately stored and insured at all times
 - if any goods are not sold following the release from the bank, to return to the bank's control
 - to provide, upon bank's request, a signed letter of indemnity.
- (ii) Besides taking the customer signed trust receipt, some banks may additionally get the importer to accept a usance bill of exchange, on which the financing bank is both the drawer and payee and the importer is the drawee. The reasons for doing so are:
- the bank may not want to solely rely on the goods as security.
 - the goods may not always be in control of the bank, e.g. if the customer holds the documents of title, or the customer places the goods in his warehouse of choice, or if the customer attends to the delivery of the goods to the onward buyer, etc.
- By taking the accepted bill of exchange, in any event of the default, the bank can present the bill of exchange to the importer on the maturity date for payment. If the importer does not pay the bill, it can be enforced under the Bill of Exchange Act. To obtain payment from the Bill of Exchange Act is much simpler than having to sue someone for repayment of debt.
- (b) (i) **Conditional Bond**
- Where a conditional bond is in issue, then the person in whose favour it has been issued, must satisfy the "conditions" imposed upon him by the bond if he is to make a successful claim on the bank. Thus, as mentioned in the performance bond section above, the condition may be that an independent person must assess the "loss" and produce a formal report supporting the claim of loss. Should the documents that are lodged to the bank satisfy the condition(s) imposed by the bond, the bank will pay. When paying out, the bank will make available the lower of the loss or the value of the bond.

Unconditional Bond

With an unconditional bond, the person in whose favour the bond has been issued merely has to make a claim and the issuing bank will pay out. The amount the issuing bank will pay out is always the value of the bond. Unconditional bond clearly leaves banks (and the customer on whose behalf the bonds has been issued) open to fraudulent claim. However, as bank merely has to pay on demand, provided it meets the respective claims, it has complied with what was expected of it under the bond. Such payments, if arise through a fraudulent claim, can tarnish the bank-customer relationship. However, there is no great deal that the issuing bank can do.

- (c) Most banks would prefer to issue unconditional bonds because the banks will only have to pay on demand once the claim that is made upon satisfy the terms that has been laid out in the bond. Whereas in a conditional bond, the bank is imposing of itself to ensure that the conditions laid down are met before the payment is made. There is always a possibility that after the payments has been made, it is shown that the condition has not been made, the bank will be in a loss making position. It may have to reimburse the customer for the payment wrongly made.

PART B

Question 4

Although the concept underlying the question was simple, not many candidates attempted this question.

4. (a) According to Article 4, bank deals in documents and not in goods. As such, they should not allow a customer to withhold payment even if the consignment is of inferior quality. In a situation like this, the customer should find redress either by incorporating the necessity of the performance bond in the credit or by resorting to legal action on the strength of the pro forma invoice.

If letters of credit with payment conditions as quoted are in accordance with what is agreed upon in the commercial contract, the beneficiary will have to accept the risk that the letter of credit applicant does not issue the certificate of acceptance in respect of the goods (i.e. the final 20 per cent payment).

Bank should, of course, endeavour to avoid issuing credits with similar payment conditions, but if these have been stipulated in the contracts between the commercial parties, there is not much that the bank can effectively do. The exporter should not be willing to accept a credit issued in this form, since he is entirely at risk in respect of the balance 20 percent.

- (b) The question is not covered by the UCP. Nevertheless, it appears to have become a rather common practice in certain areas that the bank – although not authorised or requested by the issuing bank to add its confirmation to the letter of credit – at the beneficiary’s request enters into an undertaking vis-à-vis the beneficiary. The essence of such an undertaking – which to a great extent is influenced by national law and the nature of each individual credit – is to provide the beneficiary with additional security that he will receive payment under the credit. The advising bank adds such confirmation at its own risk, and thereby commits itself to the beneficiary, even if cannot recover from the issuing bank.

Question 5

Many candidates were able to answer this question based on a concept that is often examined. Candidates were able to identify and describe the method of payment required by the question, and also understood transfer and back-to-back letter of credit.

5. (a) (i) The basic instrument is a transferable letter of credit. Under UCP Article 48, only credits that expressly state that they are transferable can be transferred. The overseas buyer will be the applicant, and it is the overseas buyer who must agree that the credit can be transferred. Tanjung Builders Sdn Bhd will be the first beneficiary, and

has the right to request our bank to transfer to a second beneficiary. A transferable credit can be transferred only once, but it can be split up amongst a number of second beneficiaries. The credit will be transferred on the same conditions as were originally set up, except for:

- Expiry date – earlier
- Amount – lower
- Unit prices – lower
- Insurance cover – the amount called can be whatever second beneficiary requires

The suppliers know that they have a secure method of payment, provided the credit is irrevocable. There will be no cash-flow problem for Tanjung Builders Sdn Bhd, since the only item on his bank account will be a credit for the profit (apart from bank charges).

- (ii) Under Article 48, the amount transferred by the first beneficiary's bank must be in the same currency as the original amount. Hence, transferable credits cannot be used here as the second beneficiary wants USD.
 - (iii) The only compromise available is a back-to-back credit. The original buyer is the applicant and Tanjung Builders Sdn Bhd is the first beneficiary. These are two separate credits, and we rely on the documents presented under the second credit to fulfil the requirements of the first credit. The problem is that our bank will be liable to honour the second credit if the correct documents are submitted. This applies even if the documents do not fulfil the requirements of the first credit. Hence, if we are not willing to issue the second credit on its own merits, we would be unlikely to agree purely because of the "comfort" given by the first credit. Cash-flow problems could also arise. Tanjung Builders Sdn Bhd will be debited with the full amount of the second credit and credited with the full amount of the first credit. There is an exchange risk that Tanjung Builders Sdn Bhd should cover. Suggest forward contracts or currency options as appropriate.
- (b) "Shipment" is the generic term for "loading on board, dispatch and taking in charge" (as per UCP 500); it means loading on board when used in connection with an ocean bill of lading.

Therefore, it was necessary for the ocean bill of lading to evidence a Malaysian port as port of loading is in order to be in compliance with the terms of the letter of credit. This was not the case; therefore, the bill of lading was not compliant and discrepant.

The fact that the goods were received in Port Klang and forwarded to Singapore (as pre-carriage) for loading on board is irrelevant.

Question 6

Not many candidates were able to provide a good and correct explanation to the given situation. It could be that they did not fully understand the requirement of the question.

6. (a) Where faulty documents were submitted by the confirming bank to the issuing bank for approval within the framework of the documentary transaction, this action was to be regarded in effect as a request for amendment of the credit. However, the confirming bank remained bound by its obligation to effect payment in the event the documents were approved.

It should be remembered that under UCP Article 9(b) the confirming bank is only bound provided that the stipulated documents are presented and that the terms and conditions of the letter of credit are complied with. Non-compliant documents can be taken for collection.

When the confirming bank is presented with discrepancy documents, it has the option to refuse them. If it wants to use that option, it should so inform the beneficiary in a clear and unmistakable way, so as to leave no doubt that it has refused the documents and that in respect of these documents it is no longer bound by its confirmation.

If, instead the confirming agrees with the beneficiary that the documents should be forwarded for acceptance by the issuing bank, it thereby induces the beneficiary's belief that under the proviso of such acceptance, the bank is continuing its confirmation.

- (b) UCP 500 Article 14 seems to admit that under a credit advised through another bank than the issuing bank, the beneficiary could forward documents direct to the issuing bank. Taking into account that Article 10(b) requires all credit to nominate the bank authorised to pay/accept/negotiate – unless it allows free negotiation by any bank – and supposing that the credit so nominates another bank, we believe that there is a non-compliance with credit conditions if the beneficiary send the documents to the issuing bank without going through the nominated bank.

Letter of Credit is an irrevocable undertaking of the issuing bank to the beneficiary; the beneficiary is therefore entitled to presents the documents direct to the issuing bank if it so desires and if is not in contrary to the obvious payment terms of the credit. If the credit calls for a draft to be drawn on the nominated bank at a tenor to be accepted by the nominated, it would not make sense for the beneficiary to send the documents to the issuing bank.

Question 7

Candidates' performance on this question was good as they were able to identify and describe the method of payment required by the question.

7. (a) If the Diamond Ltd requires secure method of payments, documentary collections are totally inappropriate. The solution is an irrevocable documentary credit in favour of Diamond Ltd.

Notes:

- Our customer, Mutiara Sdn Bhd, must be trustworthy.
- The credit should call for drafts drawn at 90 days sight on our bank as the drawee, or on the manila bank as the drawee (nominated bank).
- Once the documents have been presented and the bill of exchange had been accepted, Diamond Ltd could discount the bill with his bank.
- Mutiara Sdn Bhd and Diamond Ltd can agree beforehand who will pay for the discount charges, and instruct the bank as part of the letter of credit condition.
- Mutiara Sdn Bhd will not be debited until 90 days after he has accepted the bill of exchange. Hence, he receives 90 days credit.
- If our bank wished to retain control over the goods after their arrival in Malaysia, a trust receipt loan could be considered.

- (b) The credit should call, among others, the following documents:

- **Bills of Lading.** A complete set of clean, shipped on board bills of lading, made out to order and blank endorsed. The bills of lading must name the vessel and must show the destinations Malaysian port agreed by the parties. The bill of lading should be marked "freight prepaid", if the invoice shows the underlying contract is CIF or CFR. The bill of lading must be dated on or before the latest permitted shipment date if one is shown in the credit. The bill of lading must describe the goods in general terms not inconsistent with the credit.
- **Invoice**, which describes the goods in exactly the same name as the credit, is made out in the name of Mutiara Sdn Bhd., and for the correct amount.
- **Insurance documents**, which covers the goods and risk as specified in the credit. The certificate will be in the same currency of the credit and must be for the CIF value of the goods plus 10%.
- **Cover** must be effective from the date of shipment.
- If the goods were to come by airfreight, an **air waybill**, as opposed to a bill of lading showing the goods consigned to our bank.