

DP06

International Trade Finance

11 APRIL 2005

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. Your customer, Syarikat Venture Medical (SVM), received a purchase order from a buyer in Russia for a supply of medical equipment. SVM has also received an irrevocable documentary credit (DC) for a 30-day acceptance under ICC Uniform Customs and Practice for Documentary Credits (UCP500) issued by All-State Bank. SVM came to you for advice on the documentary requirement of the DC because SVM would like to present the DC to you later for negotiation.

Upon checking the DC, you noted the following:

- Issuing bank : All-State Bank, Russia
- Advising bank: MPHI Bank Berhad, Kuala Lumpur, Malaysia
- The original DC indicated that the DC can “only be operational upon receipt by the beneficiary of a payment commitment undertaking letter from the advising bank to pay the value of the accepted bill upon presentation of compliant documents”. However, no such letter was enclosed.
- The beneficiary of the original DC was not SVM. Nevertheless, an amendment was made to change the name of the beneficiary to SVM.

You were also informed that the original DC and the amendment were given to SVM directly by Heng Medical Supply Sdn Bhd (HMS) because HMS could not fulfil the initial contract to the Russian buyer. HMS was the beneficiary of the original DC.

- (a) Briefly explain the duty and role of an advising bank as per UCP500. [4]
- (b) Is the advising bank obliged to the undertaking as required by the above DC? Why? [4]
- (c) What is the implication of SVM receiving the original DC and amendment directly from HMS instead of the advising bank? [6]
- (d) Within the context of UCP500, how would you advise SVM so that they are able to secure the payment under the DC? [6]

(Total:20 marks)

2. As a trade finance officer, you receive a number of documentary collections from a bank in Korea for your customer, Johnny Products Sdn Bhd (JPSB), for delivery of documents upon acceptance of bill of exchange at 90 days sight (D/A). These bills are subjected to ICC Uniform Rules for Collections (URC522). So far, you have not refused any collection instructions from the remitting bank because JPSB has been paying all bills promptly on the respective due dates.

However, JPSB has refused to pay the latest accepted bill of exchange for USD300,000 on its maturity because of the inferior quality of the goods received in the shipment. This is the first time JPSB has refused to pay an accepted bill on the maturity date.

JPSB, a valued customer of your bank, has also informed you that JPSB has a strong case against the seller and that legal action would be taken against the seller at a later date.

- (a) Briefly describe the following terminologies as per URC522:
- (i) Collection [4]
 - (ii) Presentation [2]
 - (iii) Commercial documents [2]
 - (iv) Clean collection [2]
- (b) Under the Bills of Exchange Act 1949, what actions would you take upon the dishonour of the bill of exchange if the collection instruction from the remitting bank specifically requires you to protest the bill for non-payment? [6]

- (c) What would you do if JPSB is willing to offer a payment of only USD150,000? [4]
(Total:20 marks)

3. JOIE Sdn Bhd (JOIE), a customer of your bank, has reorganised their business into two companies, Company Happy and Company Joy, distinguished by the goods they are manufacturing, that is, canned food products and palm oil products, among others.

JOIE has also decided that Company Happy will produce goods for the non-halal market (therefore, not eligible for Islamic financing) whereas Company Joy will produce goods for the halal market. All products are solely for the export market.

JOIE is not familiar with the availability of trade finance and has approached you for advice. The following are some of the requirements of Company Happy and Company Joy:

- They want only one type of trade finance instrument for their trade finance requirement i.e. they want a trade finance instrument that is able to finance their imports, local purchases, and exports.
- They want the lowest and most competitive interest rate available at the current market condition.
- Their tenor for purchase and sales range from sight payment to 90 days.
- They have many buyers but could not bunch the invoices for trade financing, and each invoice is not less than an equivalent of RM12,000. The usual trade term contracted is Incoterm CPT.

(a) Which trade finance instrument (that can be used in both conventional and Islamic banking) would you recommend to Company Happy and Company Joy to meet their requirements? Why? [9]

(b) Company Joy also needs some information on working capital financing under Islamic banking. Explain the term "Al-Murabahah". [3]

(c) JOIE has heard about Bilateral Payment Arrangement (BPA) and wishes to know more as they also plan to export to Third World countries.

Briefly explain the Palm Oil Credit and Payment Arrangement (POCPA) scheme under BPA and its features. [5]

(d) (i) Briefly describe the Incoterm CPT. [2]

(ii) Who is responsible for the freight under CPT? [1]

(Total:20 marks)

PART B

4. (a) What is a standby letter of credit? [4]

(b) Illustrate **two** scenarios where a customs guarantee would be required by an importer in Malaysia. [4]

(c) (i) Name **three** functions of a bill of lading. [3]

(ii) Briefly explain why a bill of lading is regarded as "quasi-negotiable". [3]

(d) Under a bill of exchange:

(i) who is the "payee"? [3]

(ii) what is an "acceptance"? [3]

(Total:20 marks)

5. Amin Trading (AMT) is a customer of your bank. In March 2005, AMT's trade finance facility with your bank reached its limit. Due to a sudden increase in the business volume, AMT requested for an additional documentary credit (DC) facility with your bank. After careful evaluation, your bank decided to support AMT's business on an ad hoc basis for the following two DCs, which is separate from their current trade finance facility [both DCs are subjected to ICC Uniform Customs and Practice for Documentary Credits (UCP500)]:

- DC001A: A transferable irrevocable DC of USD400,000
Your bank acted as the transferring bank by transferring DC001A to a seller, Lina Trading (LNT), for the goods required. You included a condition in DC001A that "payment of DC to second beneficiary is only upon receipt of proceeds from the issuing bank".
- DC001B: An irrevocable DC of USD400,000
Your bank issued another irrevocable DC that mirrors DC001B to LNT for the goods required. This newly issued DC is also known as a back-to-back DC (BBDC), while DC001B is the master DC.

When LNT presented the documents to your bank, you checked and found that the documents were in order.

In order to obtain payment from the issuing banks of DC001A and DC001B, you replaced the respective documents with that of AMT's. After you were confident that the documents were in order, you sent out the documents to the respective issuing banks. The documents were presented within the validity period of the original DC001A and DC001B.

Unfortunately, due to political reasons, the country of the bank that issued DC001A was attacked and a war broke out. Hence, you did not receive any payment for DC001A.

As for DC001B, a discrepancy was noted by the issuing bank – the DC has expired. Upon checking, AMT told you that they had forgotten about the existence of an amendment to the DC, which has shortened the validity period of the DC.

- (a) Was it proper for your bank to set the condition in the transferred DC upon transferring the transferable DC (DC001A) to LNT? Why? [4]
 - (b) Should you pay LNT if LNT demands payment from you for both the transferred DC and the BBDC issued by your bank? Why? [8]
 - (c) Explain whether the rejection of the documents under DC001B by its issuing bank was valid and state your next course of action. [8]
- (Total:20 marks)

6. A banker's acceptance (BA) is one of the most widely used trade financing instruments in Malaysia as it can finance sales and purchases for both domestic and international trade.

- (a) As a trade finance officer of your bank, you have received the following purchase invoices together with the respective supporting documents from your customer, a trading company, for BA financing:

Item No.	Payable to	Invoice amount (RM)
I	Seller A	20,235
II	Seller B	3,100
III	Seller C	900
IV	Seller D	1,900
V	Seller E	33,400

- (i) What is the maximum BA face value allowed in accordance to the BA guidelines on bunching of invoices? Explain your answer. [8]

- (ii) Compute the discounted amount of the BA and show the workings. Assume that the BA face value amount is RM100,000 and the discounted rate is 3.5% per annum for a tenor of 120 days. [6]
- (b) Various inputs are used in the production/transformation process to produce the final goods. For example, furniture manufacturing requires wood as one of its inputs.

Under Bank Negara Malaysia's Guidelines for BAs, what are **three** inputs that are **NOT** eligible for BA financing? Give an example for each of these inputs.

[6]
(Total:20 marks)

7. Your bank received via mail a set of documentary collections with a heading "2nd mail" from HKBK Bank, Hong Kong, for your customer, ABX Trading (ABXT), which contained the following documents:

- One bill of exchange drawn at 30 days from the bill of lading date
- One invoice indicating terms of payment as 30 days from shipment date
- One original bill of lading consigned to your bank

However, not much information was stated on the collection instruction in the second mail except a notation indicating that full details are in the first mail and that the collection is subjected to ICC Uniform Rules for Collections (URC522). The instruction on the delivery of documents was not stated in the collection instruction of the second mail.

Since the goods were perishable and the shipment had arrived, and having been convinced by ABXT that the term is 30 days from the bill of lading date, you decided to release the documents to ABXT after they accepted the bill of exchange.

You later found out that your clerical staff handling collections had misplaced the documents of the first mail and the documents had yet to be found.

On the maturity of the bill, which was five days after you released the documents to ABXT, you presented the bill of exchange to ABXT for payment. However, ABXT refused to pay, claiming that the company had incurred huge losses as a large quantity of the perishable goods were rotten on arrival at the port. ABXT blamed it on the seller for sending the documents late.

- (a) List **eight** information or items that should be in a collection instruction as per URC522. [8]
- (b) For the documentary collection under acceptance basis, are you (as the collecting bank) obliged to pay the remitting bank under URC522 if the bill of exchange is dishonoured on maturity due to the dispute over the quality of the goods? Why? [4]
- (c) When the documents from the first mail were subsequently found, you noted that the complete collection instruction did not indicate any instruction on the delivery of the documents.

Are you obliged to pay if the remitting bank demands payment from you, stating that you should have delivered the documents against payment? Why? [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 could not explain the role, function and liability of an advising bank of a DC under UCP500, including the advising bank's prerogative to advise a DC.

1. (a) An advising bank is a bank that elects to advise a DC to the beneficiary. The advising bank can choose whether or not to advise the DC if nominated by the issuing bank.

If the bank chooses to advise the DC, it shall take reasonable care to check the authenticity of the DC. If the DC cannot be authenticated but the bank still chooses to advise the DC, it can do so but it must inform the beneficiary that the authenticity of the DC cannot be established and also inform the bank from which the DC was received.

If the bank elects not to advise the DC, it must also inform the issuing bank without delay.

- (b) No. The liability and role of the advising bank is to advise the DC within the stipulation of the UCP500. It has no obligation to act and commit itself further to ensure that the DC is operational.

It is not appropriate for the issuing bank to set the condition in order for the DC to be operational unless prior arrangement and agreement has been made with the advising bank.

It is advisable for the beneficiary to check the content of the DC upon receipt from the advising bank and determine whether it is acceptable or not. Rectification of the terms can be made through an amendment to the DC.

- (c) A DC is advised either directly from the issuing bank or through a nominated advising bank. This is one way to ensure the DC is a genuine undertaking from an issuing bank.

As for the case above, it is clear that the DC is not a transferable DC, i.e. the credit cannot be transferred to a second beneficiary. It was only a change of the right of the DC from one beneficiary to another via an amendment to the original DC.

In order for any amendment to be effective, the amendment must be accepted by the issuing bank and the beneficiary of the original DC. This can be done if the original beneficiary communicates his acceptance of the amendment to the bank that advised the amendment.

Therefore, if there is no confirmation from the advising bank that the original beneficiary, i.e. HMS has accepted the amendment of the DC for the change of beneficiary of the DC, your customer cannot claim to be the new beneficiary to the DC.

- (d) It is not proper for your customer to receive the original DC and amendment directly from HMS instead of the advising bank as this does not comply with the requirement of UCP500. There will be risk involved if a dispute emerge later between HMS and SVM to the rights of the DC.

A confirmation of the acceptance of the amendment to change the beneficiary of the DC to your customer from the advising bank will also ensure that future amendments will be advised accordingly to your customer.

In short, your customer should ask HMS to acknowledge their acceptance of the amendment to the advising bank so that the advising bank can confirm to your customer the rights of the DC has been given to your customer.

Question 2

- Candidates could not explain the terms used in the collection under URC522, e.g. “presentation”.
- Candidates did not know that the handling of documents should be in accordance with the collection instruction and URC522 rules, including instruction on protest (which can be refused by the collecting bank by informing the remitting bank immediately once the collection instruction is received).

2. (a) (i) A “collection” under URC 522 means the handling by banks of financial documents and/or commercial documents in accordance with instructions received, in order to
- obtain payment and/or acceptance, or
 - deliver documents against payment and/or against acceptance, or
 - deliver documents on other terms and conditions.
- (ii) A “presentation” under URC522 is a procedure whereby the presenting bank makes the documents, i.e. financial documents and/or commercial documents, available to the drawee as instructed.
- (iii) “Commercial documents” under URC522 means invoices, transport documents, documents of title or other similar documents, or any other documents whatsoever, not being financial documents.
- (iv) “Clean collection” under URC522 means a collection of financial documents not accompanied by commercial documents.

- (b) Since you have not refused the instruction to protest the dishonour bill of exchange as stated in the collection instruction when the collections was first received, you are therefore obliged to handle the collection in accordance with the collection instruction. As instructed, you are to protest the accepted bill of exchange for dishonour of non-payment. Otherwise, you will be liable for the consequences (if any) of not protesting the bill of exchange.

Nevertheless, you could seek further clarification from the remitting bank on whether the protest can be avoided since there was a dispute between the seller and buyer. However, this may not be appropriate as it could take a long time to receive such confirmation from the remitting bank. It would not be to your favour as the procedure to preserve the right of recourse, notice of dishonour should be given and protesting should also be carried out. The date of noting must not be later than the next succeeding business day.

- (c) If USD150,000 was considered a partial payment, you may allow such payment and pay the remitting bank accordingly. Once full payment is made later, the accepted bill of exchange can then be given to your customer. In this case, the consent of the remitting bank is not required.

However, if USD150,000 is considered a full payment, then further instruction should be obtained from the remitting bank. If the remitting bank agreed, the payment can be made as full payment and the accepted bill of exchange can be discharged.

Otherwise, any payment made to the remitting bank without their consent will be considered as partial payment and you will be liable for any discharging of the accepted bill of exchange to your customer before full payment is obtained.

Question 3

Candidates could not identify the required trade finance instrument, i.e. ECR, based on the criteria given in the question.

3. (a) Export Credit Refinancing (ECR) schemes for both pre-shipment and post-shipment financing is suitable, with the conventional ECR for Company Happy and the Islamic ECR for Company Joy. The features of the ECR scheme can be availed in accordance to their requests. This scheme is especially for promotion of export-oriented industries and for new exporters as well.

The ECR scheme under the pre-shipment financing can be used to finance JOIE's import and local purchase of inputs under the foreign purchase and domestic purchase loans, whereas their export can be financed under the post-shipment financing.

The present interest rate for the ECR scheme is 2.5% p.a. with an allowable margin of 1.0% i.e. a maximum rate of 3.5%. This is one of the lowest interest rates for trade financing product. This is similar to Islamic ECR financing cost as well.

The tenor range of at sight basis to 90 days is also within the scope of the ECR scheme.

JOIE's buyers' invoices of not less than RM12,000 is also within the requirement for ECR financing without the necessity of bunching up the invoices.

- (b) "Murabahah" refers to "purchase and sale" transactions. The fund provider buys the goods and sell them to a customer at a price which is above the paid for price, i.e. cost of goods + an agreed mark-up or "cost plus".
- (c) The POCPA Scheme under BPA is for the export of palm oil and its derivatives only. It was set up by the Malaysian Government on a revolving credit basis. The settlement period can be up to 2 years.
- (d) (i) The Incoterm "CPT" also known as Carriage paid to {a named place of destination}.
- (ii) The freight for the contract of carriage is the responsibility of the seller.

Question 4

Candidates could not illustrate the scenarios where a customs guarantee is required.

4. (a) A standby letter of credit acts as a guarantee to the beneficiary of the credit by the issuing bank on behalf of the applicant. In the event of a non-performance and/or default by the applicant, claims can be made under the standby letter of credit, which is subjected to UCP500.
- (b) Customs guarantee can be issued for the following circumstances:
- Imported goods that are brought into Malaysia, which will be re-exported later in the not too distant future, e.g. goods used in trade fair.
 - Imported goods that are pending for approval from the Ministry of Finance for waiver of import tax.
- (c) (i) **Three** functions of a bill of lading (BL):
- Acting as a receipt for the underlying goods.
 - Containing the terms and conditions of the contract of carriage.
 - Acting as documents of title for the underlying goods.
- (ii) Once a BL is made out to the order, it possesses some features of negotiable instruments where the rights and titles can be transferred by endorsement basis. This is why it is also regards as being "quasi-negotiable".

- (d) (i) The “payee” is the person in whose favour a bill of exchange has been drawn and, as such, can be considered the beneficiary. The drawer and the payee may also be the same person.
- (ii) An “acceptance” is defined as a signification by the drawee of his assent to the order of the drawer on bill of exchange that require acceptance, e.g. those payable after sight, those which stipulate for acceptance and those drawn payable elsewhere than at the residence or place of business of the drawee.

Question 5

Candidates has poor understanding of the concept and the characteristics of a transferable DC and a back-to-back DC.

5. (a) Yes, it was proper for your bank to include the condition in the transferred DC even though it may not seem fair to the second beneficiary. The transferring bank shall be under no obligation to affect such transfer except to the extent and in the manner expressly consented to by such bank. If the terms are not agreeable to the second beneficiary, then it should not commit itself to the DC and deliver the goods under the Credit.

(b) **Transferred DC**

Since it is a transferable DC and you have specifically stated that payment will be made only upon receipt of payment from the issuing bank, you have no obligation to pay even though the documents presented to you are in compliance or even when the documents were in compliance with the original DC as submitted to the issuing bank.

Back-to-back DC issued by your bank

Your bank issued this DC separately from the master DC and as such, it is a different DC. Since the documents presented to you under the BBDC issued by you are in compliance, you are obliged to pay. This is irrespective of whether you received any payment from the master DC for whatever reason.

- (c) All amendments to the original DC require the agreement of the issuing bank and the beneficiary. Even though the issuing bank is bound to the amendment once it was issued, it is different with the beneficiary. The DC amendment is only effective when the beneficiary communicates his acceptance to the bank that advised the amendment. In lieu of this, the tender of documents to the nominating bank that conform to the credit and the yet to be accepted amendment, will be deemed a notification of acceptance by the beneficiary of such amendment.

The rejection is valid if the amendment of the DC has been accepted by the beneficiary in accordance with UCP500 as stated above.

However, if no acceptance of the amendment was made earlier and if the amendment was not submitted to your bank together with the documents for submission to the issuing bank, it can be regarded as non-acceptance of the amendment. In this scenario, the validity of the credit shall remain as stated in the original DC, in which case was within the validity of the credit. Therefore, the discrepancy can then be contested as the documents were in compliance with the DC. You shall then inform the issuing bank accordingly and demand payment from them.

Question 6

- Candidates could not compute the discounted amount/proceeds of a BA transaction as well as the BA face value with the given invoice amount. The minimum invoice amount must be at least RM1,000.
- Candidates did not know the inputs that are not eligible for BA financing.

6. (a) (i) The BA guidelines allow bunching of invoices for drawing of a BA but each invoice must be a trade transaction with a minimum amount of RM1,000 per invoice.

Only items I, II, IV and V can be bunched together because they are more than RM1,000 each.

Value of invoices allowed to be bunched is RM58,635.00, i.e. RM20,235.00 + RM3,100.00 + RM1,900.00 + RM33,400.00, therefore the maximum BA face value allowed is only RM58,000.00

- (ii) The discounted amount or the proceeds from the discounting of a BA can be derived from the following formula:

$$P = fv [1 - (r \cdot t) / 36500]$$

Where,

- P = Discounted proceeds
- fv = Face value of BA, i.e. RM100,000.00
- r = Rate of discount (per annum), i.e. 3.5% p.a.
- t = Tenor (days to maturity), i.e. 120 days

The answer will be $P = RM100,000.00 \times (1 - (3.5 \times 120) / 36500)$
= RM98,849.32

- (b) The **three** inputs not eligible for BA financing are:

- Labour services/cost, e.g. employees
- Fixed asset used in the production/transformation process, e.g. machinery
- Inputs consumed completely in the production process, e.g. electricity which is necessary to the production process but are not a component of the final product.

Question 7

- Candidates did not know that if there is no instruction on the method of delivery of documents in the collection instruction, the documents must be delivered against payment.
- Candidates did not know the risk on the collecting bank for not complying with the terms of the collection instruction.

7. (a) Any **eight** of the following items:

- Details of the bank including full name, postal and swift addresses, telex, telephone, facsimile numbers and reference.
- Details of the principal including full name, postal address.
- Details of the drawee including full name, postal address or the domicile at which presentation is to be made.
- Details of presenting bank if any including full name, postal address and if applicable telex, telephone, facsimile numbers.
- Amount(s) and currency(ies) to be collected.
- List of documents enclosed and the numerical count of each document.
- Terms and condition upon which payment and/or acceptance is to be obtained.
- Terms of delivery of documents, e.g. payment and/or acceptance or other terms and conditions.
- Charges to be collected, if any, indicating whether they may be waived or not
- Interest to be collected, if any, indicating whether it may be waived or not, including the rate of interest, interest period and basis of calculation.
- Method of payment and form of payment advice.
- Instruction in case of non-payment, non-acceptance and/or non-compliance with other instructions.

- b) No, your bank is not obliged to pay. Your obligation is the fulfilment of the collection instruction only under URC522. As it is clearly an acceptance by the drawee and not your bank, non-payment by the drawee on maturity of the accepted bill of exchange will not render your bank liable. You are only required to inform the remitting bank accordingly as per the collection instruction and/or protest the bill of exchange with your consent if so stated in the collection instruction.
- c) Yes. You are obliged to pay the remitting bank as stated in article 7(b) of URC522, which state that if no specific instruction on delivery of documents in the collection instruction, you are to release the documents only against payment irrespective whether the bill of exchange enclosed is payable at sight or at a future date.

Since your bank misplaced the first mail and you released the document against acceptance, you are, therefore, liable to pay the collections for not complying with the rules of URC522.

Whether the drawee (your customer) pays you or not for the collections will strictly be settled between you and your customer. It is a risk that you have taken for delivering the documents without first sighting the full collection instruction and/or not seeking further confirmation from the remitting bank.