

**DP06**

# **International Trade Finance**

**8 MAY 2000**

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**.

## PART A

### ANSWER AT LEAST TWO (2) QUESTIONS

1. (a) Mr Chong of Chong Lee International Dealer Sdn Bhd approached your bank for trade facilities. Mr Chong has recently received an order to supply 1,000tons of fertilizers to Australia. He has made the necessary arrangement with his supplier in Brazil to ship the fertilizers to Australia, but the Brazilian supplier requires an irrevocable documentary credit in his favour.

Chong Lee International Dealer Sdn Bhd does not have a good credit standing and your bank is not prepared to extend further credit exposure to them.

**Required:**

- (i) How can this deal be completed and in what way, can a documentary credit be arranged in favour of the Brazilian supplier? [2]
- (ii) Who are the applicant(s) and beneficiary(ies) under the documentary credit(s)? [3]
- (iii) After the documentary credit(s) has/have been issued and advised, who will present the shipping documents to your bank? [3]
- (iv) Assuming the transaction consists of 1,000tons of fertilizers bought from Brazil at USD500 per ton and sold to Australia at USD550 per ton, state the amount to be advised to the various banks. [4]
- (v) What will your bank substitute upon receipt of the documents from Brazil? [4]
- (b) Define the term "clean" bill of lading. [2]
- (c) What do the terms "negotiable" and "not negotiable" on transport documents mean? [2]
- (Total:20 marks)

2. Most of the trading undertaken by Siska Trading Sdn Bhd over the years has been on an open account basis. This method of payment is however becoming unfavourable to Siska Trading Sdn Bhd's suppliers. Although Siska Trading Sdn Bhd does not mind the additional cost in issuing letters of credit, it is concerned about the problems of handling shipping documents and the delays in the movement of paperwork.

**Required:**

- (a) Name and describe alternative methods of payment Siska Trading Sdn Bhd may arrange with its suppliers, apart from documentary credit and open account. [12]
- (b) Are the methods of payment described in (a) secured? [5]
- (c) Would the methods of payment you suggested in (a), overcome the problems of handling shipping documents and the delays in the movement of paperwork? [3]
- (Total:20 marks)

3. Your customer, Antara Exports Sdn Bhd, is negotiating with an importer in Italy for the supply of raw materials. The terms of payment are "D/A 90 days sight draft through an Italian bank subject to the Uniform Rules for Collections, ICC 522". The term of shipment is CFR Italian Port.

**Required:**

- (a) Explain the terms of payment and shipment, described above. [4]
- (b) State **eight** instructions you would advise Antara Exports Sdn Bhd to include in the collection schedule accompanying the documentary collection. [8]
- (c) State **four** pertinent points you would expect to find on the bills of lading with regards to this transaction. [8]
- (Total:20 marks)

## PART B

4. Pelangi Imports Sdn Bhd, a valued customer of your bank, imports goods from South America into Malaysia on a collection basis. Documents of title are accompanied by drafts drawn at 90 days sight.

Problems have arisen in the past owing to the following reasons:

- Goods consigned to your bank without authority.
- Collection orders do not indicate whether the documents are to be released against payment (D/P) or against acceptance (D/A).
- Pelangi Imports Sdn Bhd accepts bills of exchange, examines the goods but offers partial payment of the accepted bills of exchange.
- Pelangi Imports Sdn Bhd refuses to pay the bank charges claimed by the remitting bank in their collection order.

You discuss the problems with Pelangi Imports Sdn Bhd and you explain your bank's position under the Uniform Rules for Collections, ICC 522, as all collections have been presented to you under the protection of these international rules.

### Required:

- (a) Write brief notes, indicating the responsibilities of your bank under the Uniform Rules for Collections, ICC 522, with regards to the following:
- (i) Goods consigned to your bank without authority. [4]
  - (ii) Failure to indicate the basis upon which the documents are to be released in the collection order. [4]
  - (iii) The offer of a partial payment to your bank by Pelangi Imports Sdn Bhd, after it has obtained the underlying documents by accepting the bills of exchange. [3]
  - (iv) Pelangi Imports Sdn Bhd's refusal to pay the bank charges claimed by the remitting bank. [3]
- (b) How would you deal with an offer of partial payment in accordance to the Uniform Rules for Collections, ICC 522? Explain your answer. [6]  
(Total:20 marks)

5. Central Trading is having difficulties obtaining adequate sources of supply of raw materials for their operations. Central Trading has however identified a Korean supplier to meet their needs against a secured method of payment. Central Trading has approached your bank to establish an irrevocable letter of credit in favour of the Korean supplier. Central Trading is however unclear about the implications involved.

Advise Central Trading on the following:

- (a) What is a confirmed irrevocable letter of credit? [8]
- (b) What are the basic documents Central Trading should call for and the details they would expect to find in those documents if your bank agrees to establish an irrevocable letter of credit? [6]
- (c) What are the precautions Central Trading should take to ensure that they receive the goods they have contracted to buy, whilst at the same time satisfying the seller's needs? [6]  
(Total:20 marks)

6. (a) Hong Lee Export Sdn Bhd is situated in Ipoh. It has recently entered into a sales contract with an importer located in Frankfurt, Germany. The Incoterms in their contract states CIF Hamburg.

**Required:**

- (i) Briefly define the purpose of Incoterms. [4]
- (ii) For which part of the journey from Ipoh, will the exporter have to pay for the transport costs? [4]
- (iii) Where will the exporter's responsibility end, with regards to the insurance of the goods? [4]
- (b) Express the following Incoterms in detail:
- (i) CFR New York [2]
- (ii) FOB Hamburg [2]
- (c) What type of bill of lading would you expect a Malaysian exporter to produce as proof of fulfillment of a contract with the term, "DDP Buyer's premises in Chicago"? [4]
- (Total:20 marks)

7. Kukup Scrap Sdn Bhd enjoys the following credit facilities from your bank:

Type of facilities	Limit (MYR)	Pricing
Overdraft	5,000,000	1.5% + Base Lending Rate (BLR)

Total combined multi-trade facilities:

Letter of credit	}	0.1% per month	Acceptance Commission 2.0%
Trust receipt		BLR + 1.5%	
Bankers' acceptances (BA)		5,000,000	
Shipping guarantee		0.1% flat	

Kukup Scrap Sdn Bhd imported scrap metal for USD500,000 from Argentina against sight payment and has requested your bank to finance the import for **90** days.

**Required:**

- (a) State the credit facilities available to finance the imports and briefly explain the features of these facilities. [6]
- (b) Based on the additional information below, which financing alternative would you advise Kukup Scrap Sdn Bhd to opt for and why? Show your workings.
- |                       |        |
|-----------------------|--------|
| BLR                   | 6.8%   |
| BA discount rate      | 6.3%   |
| USD/MYR exchange rate | 3.8005 |
- [10]
- (c) Under what circumstances is the drawer permitted to redeem the BA before maturity? [4]
- (Total:20 marks)

## OUTLINE ANSWERS

### PART A

#### Question 1

The most popular question was on documentary credit. It was a straight-forward question. A few candidates scored above 70% of the overall marks for this question. The students who failed this question had a very poor knowledge on the subject matter.

1. (a) (i) Transferable credit. A back-to-back credit is not appropriate because the bank will be involved in a liability under such arrangement.
- (ii) The Australian is the applicant; Chong Lee International Dealer is the first beneficiary; and Brazilian supplier is the second beneficiary.
- (iii) The Brazilian supplier.
- (iv) The Australian Bank advises an amount of USD500,000 to our bank. Our bank advises USD550,000 to the Brazilian bank.
- (v) Our bank will substitute Chong Lee's International Dealer's invoice for the Brazilian exporter's invoice, and will substitute a bill of exchange for the full USD550,000.
- (b) A clean bill of lading is a bill of lading that does not contain any superimposed clause on the face of it, which expressly declares the defective condition of the goods.
- (c) NEGOTIABLE means it is a document of title and NOT NEGOTIABLE means it is NOT a document of title.

#### Question 2

Only a few candidates passed this question. Here, candidates were required to explain and elaborate on the various methods of payment. The candidates who did not perform well, got carried away and went out-of-point.

2. (a) Alternative Payment Terms
  - (i) Open account or documentary collection terms, supported by standby letter of credit. Alternatively, Siska Trading Sdn Bhd may be prepared to provide post shipment advances to the suppliers, possibly without recourse.
  - (ii) Documentary collection with certain variations:
    - Bills of exchange to be avalised by Siska Trading's bank either before shipment, or on presentation. These bills provide the supplier with an unconditional bank guarantee of payment, once they have been avalised. Siska Trading's bank would need to be satisfied as to the creditworthiness of Siska Trading Sdn Bhd.
    - The supplier could obtain credit insurance and could then, possibly, obtain a without recourse post-shipment finance from his bank.
    - The collection could be D/P or D/A. D/P is more secured for the supplier.
  - (iii) Payment made in advance. Siska Trading Sdn Bhd should compare the interest cost with the costs of avalisation.
- (b) Secured payment terms from the supplier's point of view is provided by:
  - (i) Open account supported by standby letter of credit, or factored invoices as long as without recourse factoring applies.

- (ii) Documentary collection with avalised bills, from the time of avalisation of the bill of exchange.
  - (iii) Credit insurance to the extent of the cover period, provided the supplier fulfils the underlying commercial conditions.
  - (iv) Without recourse post shipment against documentary collection.
  - (v) Payment in advance.
- (c) The terms which would avoid the need for handling shipping documents are:
- (i) Open account – Once the standby letter of credit has been set up, normal open account terms apply as long as payment is made. As far as factoring is concerned, the supplier is responsible for organising that aspect.
  - (ii) Documentary collection with avalised bills of exchange (prior to shipment). The supplier would be happy to use documents such as waybills once he has an avalised bills of exchange.
  - (iii) Payment in advance.

### Question 3

The question relating to the day-to-day trade operations was generally not well-answered. From the answers, it is obvious to note that only those who have practical experiences in trade operations were able to answer accordingly. The others were simply guessing although these answers can be found in the study manual (Chapter 4, Page 35; Chapter 10, Page 111).

3. (a) **Shipment term - CFR Italian Port**  
 “Cost and Freight”. This is an INCOTERM. Antara Export Sdn Bhd will be responsible for all freight or carriage costs as far as, or up to the Italian port. The importer will be responsible for the marine insurance of the sea voyage, and for all costs after the arrival of goods at the Italian port.

#### **D/A 90 days sight draft**

The seller will submit a documentary collection. Importer’s banker will be authorised to release documents against acceptance of the bill on importer. The bills of exchange will be payable 90 days after acceptance by importer. Importer will have possessions of goods once it accepts the bills of exchange. It will not need to pay until the 90<sup>th</sup> day. Antara Export Sdn Bhd is giving the importer 90 days credit from the acceptance date.

#### **Uniform Rules for Collection**

An internationally accepted set of rules governing documentary collections. All aspects of the collection will be governed by the rules unless the collection order stipulates anything to the contrary, or unless the rules contradict the laws of the land.

- (b) Instructions of the Collection Order
- (i) Release documents against acceptance
  - (ii) Whether to protest in unaccepted / unpaid
  - (iii) Remit proceeds by airmail / cable
  - (iv) Case of need and powers
  - (v) Whether to store or insure if the bills of exchange is not accepted
  - (vi) Can acceptance be delayed pending arrival of goods?
  - (vii) Charges – can they be waived?
  - (viii) Advise non-payment by airmail or cable.

- (c) (i) There should be a complete set of bills of lading or an explanation if any are missing.
- (ii) The bills of lading should be clean, shipped on board and blank endorsed by the shipper (i.e. the exporter).
- (iii) The bills of lading should show Italian port as port of destination.
- (iv) The bills of lading should be marked “freight prepaid”.

## PART B

### Question 4

Candidates performed well for the question on Uniform Rules for Collection. The majority scored above 60% of the allocated marks for this question. There were some, however, who wasted a lot of time elaborating on facts which were not asked for.

4. (a) (i) Uniform Rules for Collection (URC) states that a bank has no responsibility at all to deal with goods which have been consigned to it without authority. It could tell the local port authority to refer to the shipper (exporter) if it wished.
- (ii) Documents can only be released on payment, if the collection order does not quote “D/P” or “D/A”.
- (iii) Partial payments can be accepted in the case of clean collections, but cannot be accepted with documentary collections (unless the collection specifies so).
- (iv) Our bank will treat the collection as honored if the charges are merely stated on the collection order without any clause such as “do not waive charges”.

If the charges are incorporated into the financial document (i.e. bills of exchange), refusal by the drawee to pay charges will amount to dishonor.

- (b) We are the presenting bank acting as agents for remitting, and under URC, our duty is to the remitting bank. We would accept the part payment, and either remit it to the overseas bank, or hold it to their order under advice. The collection is now “clean” as the commercial documents will have to be released on acceptance.

Accept receipt for the bills of exchange for the amount paid and protest for the full amount if the collection order says to protest. Tactfully, explain to our customer that we have no alternative but to protest the bills of exchange, if the instructions say protest.

### Question 5

Only a few candidates passed this question which examined candidates’ understanding on the risk associated with Letter of Credit and the various types of documents that can be used as a means to mitigate those risk. Those candidates who read Uniform Customs Practice guidelines were able to perform well for this question.

5. (a) The definition of a documentary credit is found in Uniform Customs and Practice (1993) Publication No. 500.

A ‘documentary credit’ is a guarantee by the issuing bank (ourselves) in favour of a beneficiary (the Korean supplier). The bank, guarantees payment will be made against specified documents presented within a stipulated period.

“Irrevocable” means that the credit cannot be modified or amended without the consent of all parties. From the point of view of our customer, it means that once the credit has been issued, it is committed to being debited if the conditions have been fulfilled, since we, his bank, are bound to honour the credit.

“Confirmed” means when an issuing bank authorises or request another bank to confirm its irrevocable credit, and then later added its confirmation, such confirmation constitutes as a definite undertaking of such bank (the confirming bank), in addition to that of the issuing bank, provided that the stipulated documents are presented and the terms and conditions of the credit are complied with.

(b) The credit should call for:

(i) **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 destination as a Malaysian port agreed by the parties.
- The bills of lading must be marked ‘freight prepaid’, if the invoice shows the underlying contract to be CFR or CIF.
- The bills of lading must be dated on or before the latest permitted assignment date of shipment if one is shown in the credit. The bills of lading must describe the goods in general terms not inconsistent with the credit.

(ii) **Invoice** – describes the goods in exactly the same way as the credit is made out in the name of the applicant (except for transferable credits), and is for the correct amount.

(iii) **Insurance document** – covers the same as the credit. The certificate will be in the same currency as the credit and must be the CIF value of the goods plus 10%. Cover must be effective from the date of shipment.

(iv) **Airway bill** – If the goods are to come by air freight, to show that the goods are consigned to the bank (i.e. ourselves).

(c) Precautions

(i) Our customer should stipulate that one of the documents would be a third party inspection certificate, issued by a reputable agency in Korea certifying that the materials were up to standard.

If the documents presented include such a document, our customer, can be sure that the goods are in order.

If the documents are not presented, the credit is void since the documents do not conform to the credit.

(ii) Do not establish the credit until a suitable status report is held on the general commercial integrity of the seller.

(iii) It may be possible for our customer to arrange for the amount of the credit to be set at 80% of the full value. The remaining 20% could be paid on open account after the goods have been received. This is an incentive to the seller to send materials of correct standard.

(iv) See if the seller will agree to a revocable credit. (This is unlikely in practice).

(v) The credits should, wherever possible, be arranged through the correspondent bank. This will ensure that the advising bank is trustworthy.

(vi) The credit should clearly state that the documents must be presented strictly in accordance with the credit and that banker’s indemnities are not allowed.

(vii) The credit should restrict payment or negotiation to the advising or issuing bank.

### Question 6

The question on Incoterms was generally not well-attempted by candidates. Although it was a simple and straightforward question, yet a majority of them failed to define the purpose of Incoterms and failed to express various categories of Incoterms.

6. (a) (i) Incoterms, which were drawn up by the ICC, provides an internationally accepted set of standardised terms which sets where the exporter's responsibility ends with regards to insurance and transport of goods. It details the main obligations of the seller and the buyer in an international contract of sales. The main elements are delivery, costs and transfer of risk. The main categories of costs are:
- Dispatch, carriage and delivery.
  - Customs clearance for export and import.
  - Service assistance rendered by one party to the other in addition to what the assisting party is required to do under the trade term.
  - Insurance.
- (ii) The exporter must pay the transport costs as far as Hamburg. Any extra cost incurred in unloading the goods from the ship at Hamburg and further transportation to Frankfurt will be at the importer's expense.
- (iii) The exporter's responsibility with regards to insurance, ends when the goods cross the ship rail at Hamburg.
- (b) CRF New York
- Cost and Freight New York.
  - Exporter delivers when the goods pass ship's rail in port of shipment.
  - Seller must pay for the cost and freight to bring goods to the named port of destination. In this case, New York.
  - The risk of loss or damage to goods, as well as any additional cost due to events occurring after the time of delivery, are transferred to from the exporter to the importer.
  - Exporter is not required to clear the goods for exports at the importer's end.
  - Used only for sea and inland waterway transport. If parties intend to deliver goods across ship's rail, CPT term should be used.
- FOB Hamburg
- Free on Board Hamburg
  - Exporter delivers when goods pass the ship's rail at the named port of shipment (in this case Hamburg).
  - Importer has to bear all costs and risk of loss or damage to the goods from that point.
  - Exporter is required to clear the goods for export.
  - FOB can only be used for sea and inland waterway transport.
  - If parties do not intent to deliver goods across the ship rail, then FCA term should be used.
- (c) The document required would be a combined transport bill of lading, which shows the ultimate destination at the buyer's premises in Chicago. It would be marked freight prepaid.

### Question 7

Another popular question amongst candidates was in calculating financing alternatives. Here, candidates had to apply the correct formula. Many, however, lost marks because they made simple calculation errors which led to them suggesting the wrong financial alternative.

7. (a) Types of facilities available:

- (i) **Overdraft facilities** – This is a working capital facility, which allows the importer to draw in excess of the current account balance, up to the limit that has been approved. The exporter can choose to utilise their overdraft facilities for the purpose of payment for the import by authorising your bank to debit their account.
- (ii) **Trust Receipt (TR) facilities** – This is a short term financing facility, whereby the bank (entrustors) releases the goods to the buyer (trustee) who acknowledges his undertaking to hold the documents, or the goods or any proceeds therefrom in trust for the bank. Goods must be properly stored in buyer's warehouse and insured if not yet sold. **Buyers' position** – able to dispose of the goods and receive payment before he is called upon to pay the bill. **Bank's position** – legal owner of the goods.
- (iii) **Bankers' Acceptance facilities** – A very popular and cheap way of financing purchases/imports. It is a usance bill of exchange drawn by the customer on the bank and accepted by the bank. BA may be discounted with the accepting bank and the proceeds utilised to pay for sight or import bills. The rate which it is discounted is normally based on the money market rate which is normally much lower than the OD or TR rate. This is because BA can be sold down in the secondary market to the other financial institution.

(b) Value of import – USD500,000 x 3.8005 = MYR1,900,250

TR Financing

Rate: 6.8 + 1.5 = 8.3%

Interest Amount

$$\frac{90 \times 1,900,250 \times 8.3\%}{365}$$

= RM38,890.05

BA Financing

BA Rate = 6.3%

Acceptance Rate = 2.0%

Interest amount

$$1,900,000 - \frac{1,900,000 \times 365}{365 + (6.3 \times 90)}$$

$$1,900,000 - \frac{1,900,000 \times 365}{365 + (0.063 \times 90)}$$

$$1,900,000 - \frac{693,500,000}{370.67}$$

$$1,900,000 - 1,870,936.41$$

RM29,063.58

Acceptance Comm:  $\frac{1,900,000 \times 90 \times 2.0\%}{365}$

= RM9,369.86

Total Cost: 29,063.58 + 9,369.86

= RM38,433.44

Even though the total cost for BA is cheaper for the customer by RM456.61, it would be advisable for Kukup Scrap Sdn Bhd to choose TR financing for the following reasons:

- (i) Daily TR interest rate is RM432.11. If they choose to settle the TR earlier, they are able to save the interest amount.

On the other hand, BA does not allow you to settle earlier, unless the BA is still not discounted into the secondary market.

- (ii) In case the BLR were to move downwards, their interest amount will be adjusted accordingly.
  - (iii) They can obtain 100% financing from TR whereas BA financing is rounded to the nearest thousand downwards.
- (c) The drawer is permitted to redeem the BA before maturity if the BA so discounted has not been sold or rediscounted by the accepting bank to the secondary market.