

DP06

International Trade Finance

3 APRIL 2006

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. On 27 December 2005, Bank Uno received a set of documents from the negotiating bank, Bank Deau, for a documentary credit (DC) issued by Bank Uno. The DC is for a shipment of five containers of electrical goods from Tokyo to Port Klang, which called for, among others, the presentation of a clean bill of lading (BL), an invoice and a certificate of inspection.

After checking the documents, Bank Uno refused the documents based on the following discrepancies noted:

- I. On-board notation in BL not signed.
- II. Transshipment effected although the terms of the DC prohibit it.
- III. BL not marked "clean".
- IV. Invoice not signed.
- V. Certificate of inspection not signed.

The notice of refusal of the documents was sent to Bank Deau on 29 December 2005.

However, on 30 December 2005, the applicant accepted the documents and waived the discrepancies. The applicant immediately made payment to Bank Deau. The documents were subsequently released to the applicant and the underlying goods were taken as well.

- (a) Was Bank Uno correct in each of the noted discrepancies? Explain your answer. [7]
- (b) What is the requirement of a proper notice of refusal in accordance to ICC Uniform Customs and Practice for Documentary Credits (UCP500)? [3]
- (c) Was Bank Uno correct in releasing the documents to the applicant? Explain your answer. [6]
- (d) (i) What does "confirmation of a DC with sight payment" mean? [2]
(ii) Briefly explain the liability of a confirming bank. [2]

(Total:20 marks)

2. Bank Avia received a set of collection documents for EUR50,000 from Bank Bovia on the instructions from Febthree Incorporated (Febthree) for Bank Avia's customer, Jantwo Enterprise (Jantwo). The collection is subjected to ICC Uniform Rules for Collections (URC522).

Bank Avia noted that the collection instructions contained a bill of exchange (BE) payable 30 days from date of the bill of lading but there was no instruction on the method to release the documents. There was no reply from Bank Bovia to all the tracers sent by Bank Avia requesting for further instruction on the matter.

After much persuasion from Jantwo, Bank Avia finally released the documents against a cash deposit of the BE amount. Bank Avia also demanded for the acceptance of the BE from Jantwo, who reluctantly agreed pending further instructions from Bank Bovia.

Upon clearance of the goods from the port, Jantwo realised that the goods were of inferior quality and quickly informed Bank Avia to stop payment for the collection.

- (a) Identify the following parties in the above scenario:
 - (i) The remitting bank [1]
 - (ii) The principal [1]
- (b) Explain Bank Avia's decision in releasing the documents against cash deposit and Jantwo's acceptance of the BE. [8]
- (c) The reply and further instruction from Bank Bovia arrived after the order to stop payment was received from Jantwo.

If you are an officer of Bank Avia, explain what your actions would be (in accordance to URC522 and your customer's request) if the instruction from Bank Bovia was to release the documents against:

- (i) payment. [4]
 - (ii) acceptance. [2]
 - (d) (i) What would you do if the maturity of the BE (which was accepted by Jantwo) has already lapsed for payment when the reply came from Bank Bovia? [3]
 - (ii) Explain whether Jantwo is obliged to pay under URC522. [1]
- (Total:20 marks)
3. (a) (i) Advance payment is seldom used as a means of securing payment.
Name **two** instances where advance payment is likely to be imposed on the importer. [4]
- (ii) What can an importer do to secure itself when making an advance payment to the supplier? [2]
- (b) State **two** disadvantages of a letter of credit as a method of payment from an importer's point of view. [4]
- (c) (i) What is a conditional bond? [2]
- (ii) Why are banks not in favour of issuing conditional bonds? [2]
- (d) Briefly describe the ALADI scheme under a Bilateral Payment Agreement. [4]
- (e) Briefly explain the Al-Musyarakah principle in Islamic banking. [2]
- (Total:20 marks)

PART B

4. (a) (i) Describe the Incoterms CFR and CPT. [4]
- (ii) State **one** difference between the above Incoterms. [2]
- (iii) If a shipment was in a container, which of the two Incoterms is more appropriate? Why? [2]
- (iv) What is a combined transport bill of lading? [4]
- (b) (i) What is a banker's acceptance (BA) draft? [4]
- (ii) A set of sales invoices and transport documents for the following shipments were presented to Bank Augusta for BA financing:

| Invoice amount | Shipment destination |
|----------------|----------------------|
| RM35,000 | Sarawak |
| RM5,000 | Pasir Gudang |
| USD10,000 | Singapore |
| RM5,000 | Labuan |

(USD1.00 = RM3.80)

However, the application was rejected.

Why did Bank Augusta reject the application?

[4]
(Total:20 marks)

5. (a) (i) What is a red clause letter of credit? [2]
(ii) Using an example, describe how a red clause letter of credit is used in international trade. [4]
(b) (i) What does the selling TT rate in a table of exchange rates for currency represent? [2]
(ii) Why is the buying OD rate of a foreign currency normally lower than the buying TT rate? [4]
(iii) Give **two** reasons why the selling TT rate of a currency is higher than the buying TT rate. [4]
(c) Briefly describe the **two** methods of financing available under the Export Credit Refinancing (ECR) pre-shipment scheme. [4]
(Total:20 marks)

6. Nilcost Sdn Bhd (Nilcost), a customer of your bank, bought 80MT of flaxseed from a seller in Europe. Nilcost wanted the shipments to be sent equally to two ports in Malaysia i.e. Port Klang and Pasir Gudang from October 2005 to January 2006 on condition that there will only be one shipment per month.

Your bank issued a transferable documentary credit (DC) for the transaction and among the details in the DC were the following:

- 80MT of flaxseed in four shipments and each shipment contains 20MT.
- Destination port(s) of shipment: Port Klang or Pasir Gudang
- Shipment schedule
 - 1st shipment : First half of October 2005
 - 2nd shipment : Beginning of November 2005
 - 3rd shipment : Second half of December 2005
 - 4th shipment : After 20 December 2005
- Expiry date: 15 January 2006

The DC is subjected to the ICC Uniform Customs and Practice for Documentary Credits (UCP500).

- (a) What is a transferable documentary credit under UCP500? [3]
- (b) What dates does "beginning of November 2005" refer to in accordance to UCP500? [2]
- (c) After receiving the 2nd shipment, Nilcost did not want the 3rd and 4th shipments and notified you accordingly.
What would be your advice to Nilcost? [3]
- (d) In another scenario, assume Nilcost wants to accept the remainder of the shipments. However, when you received the documents for the 3rd shipment, you noted that the destination port was Pasir Gudang. The first two shipments had also arrived earlier at Pasir Gudang. Nilcost rejected the documents because it was not in accordance to the agreement and asked you to refuse the documents.
What would be your advice to Nilcost and your next course of action according to UCP500? [3]
- (e) In another scenario, if the documents for the 2nd shipment were rejected earlier due to late shipment and the 3rd and 4th shipments fulfilled the shipment instalment schedule in the DC, what is your obligation as the issuing bank if Nilcost asked you to reject the 3rd and 4th shipments? [4]

- (f) When the documents were presented, you noted that the 1st shipment was on the 11 October 2005, the 2nd shipment was on 11 November 2005, the 3rd shipment was on 16 December 2005 and the 4th shipment was on the 16 January 2006.

Did the shipments fulfill the DC's and Nilcost's requirements? Explain your answer. [5]
(Total:20 marks)

7. On 1 December 2005, CBC Bank received a documentary collection from Bank Duautas for USD100,000 for presentation to Gladwind Sdn Bhd (Gladwind). The documentary collection was subjected to ICC Uniform Rules for Collections (URC522).

The collection instructions specified the following:

- Documents are to be delivered against payment.
- Partial payment for the collection is allowed.
- Payment for the collection must be made within 5 days from the date of the receipt of the documents by the collecting bank. If payment was made after the 5th working day, an interest charge of 5% per annum of the collection bill amount from the date of receipt of the documents to the actual payment date must be collected.
- Interest cannot be waived if refused.

On 4 December 2005, Gladwind approached CBC Bank and offered a partial payment of 80%. Bank CBC released the documents and remitted the payment to Bank Duautas indicating that partial payment was effected and the pending balance would be paid later.

Soon after, Gladwind faced financial difficulties and could not pay the balance payment of 20%. Gladwin asked CBC Bank to request Bank Duautas for consent to close the file and treat the 80% payment as final settlement of the collection bill.

However, Bank Duautas demanded for the balance payment of 20% of the bill amount of USD100,000 plus the interest on the USD100,000 for the period according to the collection instruction.

- (a) State **two** advantages of a collection delivered against payment to an exporter. [4]
- (b) Did CBC Bank comply and act in accordance to URC522? Why? [4]
- (c) Was Bank Duautas' demand in accordance to URC522? Explain your answer. [6]
- (d) Will CBC Bank be liable to pay Bank Duautas if Gladwind never pays? Why? [2]
- (e) Gladwind later decided to pay USD20,000 (the remaining balance of 20% of the bill amount) to fully settle the collection bill. However, they are only willing to pay the interest portion on the balance amount of USD20,000 instead of USD100,000, claiming that only USD20,000 was paid after the fifth working day.

Do you agree with Gladwind's decision? Why? [4]
(Total:20 marks)

- **END OF QUESTION PAPER** -

OUTLINE ANSWERS

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

PART A

Question 1

- Candidates were confused over a notice of rejection under UCP500 and the methodology of rejection of documents.
- Candidates failed to understand that an invoice is not required to be signed unless otherwise indicated in the DC.
- Candidates did not know what constitutes a sight DC confirmation and the liability of a DC confirming bank.
- Candidates have difficulty in the subject matter. Thus, diligent reading of the study manual and the UCP500 articles should help candidates to answer this question and other similar questions on documentary credit.

1. (a) Not correct for items I, II, III and IV as per UCP500.
- On board notation not required to be signed, as the signature on the face of the BL is sufficient. It is not a discrepancy.
 - Even if the DC prohibits transshipment, transshipment is allowed if the shipment is shipped in containers. It is not a discrepancy.
 - A clean BL is one which bears no clause or notation which expressly declares a defective condition of the goods and/or the packaging. BL need not be marked as “clean”. It is not a discrepancy.
 - Invoice not required to be signed unless indicated in the DC. It is not a discrepancy.
 - Discrepancy is correct. All types of certification must be duly signed.
- (b) Notice of rejection as per article 14 of UCP500 must contain the following to be valid:
- The rejection or refusal must be stated.
 - The discrepancy (ies) must be stated.
 - Disposal of document must be stated, i.e. whether holding the documents at the disposal of the presenter or returning the documents to them.
- (c) Bank Uno was incorrect to release the documents to the applicant before obtaining consent from the negotiating bank as the issuing bank have already refused the documents via the notice of refusal that was sent to Bank Deau.

In a proper notice of refusal, the refused documents were being held at the disposal of the presenter, i.e. the negotiating bank, Bank Deau or would have to be returned to the Bank Deau accordingly.

Therefore after the refusal of the documents, the issuing bank and the DC applicant had ceased to have any rights over the disposal of the documents.

The negotiating bank could agree later to the acceptance of the documents by the DC issuing bank and the DC applicant despite discrepancy in documents.

Nevertheless, if Bank Deau decided to ask for the return of the documents, Bank Uno would have to comply with the instruction. Failure in this aspect may render the issuing bank payment of damages and/or claims that could be more than the DC amount.

Since the documents had already been given to the applicant and goods taken, the issuing bank had exposed itself to this unnecessary risk.

- (d) (i) A confirmation of a DC with sight payment by a bank (confirming bank) constitutes a definite undertaking of the confirming bank, in addition to that of the DC issuing bank, provided that:
- the stipulated documents are presented to the confirming bank or any other nominated bank in the DC
 - the terms and conditions of the Credit are complied with to pay at sight.
- (ii) The liability of the confirming bank under the DC is similar to the DC issuing bank and it shall be liable irrespective of whether it can eventually get reimbursement from the DC issuing bank and/or the nominated reimbursing bank for any payment paid by it under the DC.

Question 2

- Candidates could not identify the remitting bank or the principal in the collection.
- Candidates gave brief explanation although a detailed explanation was required in some parts of the question.
- Candidates did not understand drawee's obligation when the documents are handled under URC522.
- Candidates were confused between UCP500 and URC522.
- Candidates need to be aware of another important aspect of international trade which is documentary collections. Basic understanding of the URC522 via study manual and URC522 articles should ensure candidates' ability to answer this question. Documentary collections should be handled in accordance to the collection instruction and the rules in URC522. It should not be confused with any action by any party or event taken place outside of the rules of URC522 and/or collections instructions.

2. (a) (i) Bank Bovia
(ii) Febthree Inc.
- (b) Bank Avia being the presenting bank was obliged only to the party which sent the documents in accordance to Article 4(a) (iii) of URC522 unless duly instructed otherwise in the collections instructions.

In the case above, the officer of Bank Avia was correct to refer to Bank Bovia for further instruction. Nevertheless, Bank Avia may also act in accordance to article 7 of the URC522, that is, to deliver the documents against payment.

What Bank Avia did was to assist the customer by demanding the cash deposit of the bill amount by taking a calculated risk in case the collection was indeed against payment even though this action does not conform to the rules of URC522. If the collection was to deliver the documents against acceptance, the cash margin can then be returned to Jantwo Enterprise accordingly since the BE had already been accepted.

However, the cash deposit taken was not in accordance with the collection instruction and was actually a separate arrangement/agreement between Bank Avia and Jantwo and any dispute shall be settled between the two parties only, which should not be associated directly to the collection item.

The cash margin should be taken with the understanding from Jantwo Enterprise that payment will have to be made irrespective of the condition of the goods if the actual collection instruction was to deliver the documents against payment.

Nevertheless, Bank Avia and Jantwo should also prepare for the risk that the instruction received much later from Bank Bovia demanding the payment of the collections plus interest if it was known that Bank Avia had released the documents earlier without collecting payment for the bill.

Besides this, the Foreign currency exchange risk involved should also be looked into when agreeing to the arrangement as the bill involved in a foreign currency may be volatile.

- (c) (i) Immediately make payment to Bank Bovia by liquidating the cash margin as any delay may expose Bank Avia to the element of interest claim as the documents were released earlier without payment and not in accordance/complying with the rules of URC522.

You have to explain to Jantwo Enterprise that the dispute of the goods should be settled between the buyer and the seller as you were required to comply with the collection instruction and URC522 accordingly.

There will be fewer disputes and disagreement between you and Jantwo Enterprise if the arrangement/agreement of the cash margin was properly executed.

- (ii) Immediately advise the accepted BE and maturity date to Bank Bovia and return the cash deposit to Jantwo Enterprise accordingly.

- (d) (i) Immediately advise the accepted BE and maturity date to Bank Bovia and present the accepted BE to seek instruction from Jantwo for payment of the accepted BE.

Since Jantwo has instructed Bank Avia to stop payment, it is likely that Jantwo wants the return of the cash deposit, which Bank Avia should refund accordingly.

The cash margin can be returned to Jantwo because it was a separate arrangement between Bank Avia and Jantwo and not related to any instruction of the collection bill.

The cash margin taken earlier was most likely for the purpose of ensuring payment if the instruction was to deliver the documents against payment.

- (ii) Jantwo is not obliged to pay an accepted BE if it chooses not to do so. Nevertheless Bank Avia has to inform Bank Bovia immediately regarding the non-payment of the accepted BE as per rules of URC522.

Question 3

Comprehensive reading of the study manual of DP06 should help candidates answer this question well.

3. (a) (i) Any two of the following conditions:
- The supplier holds a monopoly in the supply of the particular product either by law, capacity, or others which determine the terms of the payment if the buyers wish to purchase the particular product.
 - The product is unique and only the particular manufacturer can produce the specification of the product, where the supplier determines the terms of payment.
 - Excessive demand of the product in the market place occurs due to actual or expected shortage, calamity, new found method of usage, war, etc., where the buyers want the goods irrespective of the terms of payment.
 - The product has to be procured by cash by the supplier due to the nature of the trade or sourcing of the goods, i.e. in the interior jungle, etc.
 - Prior expenditures required by the supplier for procurement of the goods.
- (ii) An advance payment guarantee/bond can be required from the supplier for the advance payment made by the importer to the supplier. It can be in the form of a standby DC under UCP500.

- (b) Any two of the following:
- The DC cannot be cancelled or amended once issued without the consent of the issuing bank, the DC confirming bank (if any) and the beneficiary.
 - Payment and liability of the DC depends on the compliance of documents with regards to the terms and condition of the DC only and not the actual goods. DC deals with documents and not goods.
 - Charges, fees and other expenditures that are usually borne by the instructing party, i.e. the DC applicant, could be substantial especially if it involves DC confirmation and adds to the cost of the goods purchased.
 - DC issuance requires a DC facility to be available with a Bank, which normally involves cost and pledging of security by the DC applicant with the Bank.
- (c) (i) A conditional bond is a bond/guarantee where the person in whose favour it has been issued by the beneficiary of the bond, must satisfy the “condition” imposed upon the person by the bond if it is to make a successful claim on the issuing bank of the bond.
- (ii) Banks are less favourable towards conditional bonds because there is always the possibility that the condition perceived by the bank as satisfied may be shown to be otherwise later outside or inside the court. A risk can put the bank in a loss making position especially when a claim was paid and a refund have to be made to the customer who applied for the bond.
- (d) The ALADI scheme in a bilateral payment arrangement (BPA) involves credit lines between two central banks in USD, where only designated banks are authorised to issue or negotiate DC, which are subjected to the BPA. The exporter will be paid by its central bank while the central bank of the importer will claim from it. Hence, the settlement of the trade will be done between the trader and their respective central bank in the first instance. The affected central banks will later settle their indebtedness at a designated point of time on a net basis.
- (e) Al-Musyarakah in Islamic banking relates to what is a partnership. The relationship is created where the entrepreneur and the investor jointly provide and manage the funds for a business venture. Profit from the business venture will be shared by the two parties in a pre-agreed ration. In the event of losses, the loss will be shared according to the proportion of their contributions of capital in the business venture.

PART B

Question 4

- Candidates could not answer questions related to BA draft which actually is drawn by the customer in his own favour i.e. the drawer is also the payee and accepted by a bank.
- Comprehensive reading of the study manual of DP06 could ensure maximum marks for this question.

4. (a) (i) Incoterm CFR means cost and freight to a named port of destination and is applicable to transport by either sea or inland waterway. Incoterm CPT means carriage paid to a named place of destination and is applicable to any mode of transport.
- (ii) Any one of the following:
- CFR for transport via sea or inland waterway where else CPT is for all mode of transport.
 - CFR: Seller pays and arranges for contract of carriage to the named port of destination, where else CPT to named place of destination.
 - CFR: goods delivered by seller on board vessel in port of loading where else CPT: goods delivered to carrier.
- (iii) When shipment is in container basis, Incoterm CPT is more appropriate than Incoterm. CFR as the term “ship’s rails” (i.e. the point where the obligations of the

seller are completed) used in CFR incoterm is less meaningful for container shipment.

- (iv) A combined transport bill of lading is a bill of lading issued by the shipping company, where the goods are transported using different modes of transportation by two or more carriers. However, the shipping company that issues the bill of lading, assumes liability for the goods while in transit even when they are not under its control. In addition to details in a standard bill of lading, it also contain where the goods are to be taken in charge, the name of the port of loading and discharged, and the place where the goods are to be delivered to.
- (b) (i) A banker's acceptance draft is a usance bill of exchange drawn payable in the future which,
- has been drawn by a drawer in his own favour, i.e. the drawer is also the payee.
 - has been accepted by a bank.
 - is payable on a specified future date without any additional days of grace.
- (ii) The invoices can be bunched according to similar category of transaction as follows:
- Sales to residents: RM35,000 + RM5,000 + RM5,000 = RM45,000
 - Sales to non-residents: USD10,000 = RM38,000

Both categories of transaction bunched were less than the minimum amount required for BA financing, i.e. RM50,000, therefore the application was refused by the bank.

Question 5

- Candidates could not give the two methods of financing available for ECR Pre-shipment scheme, i.e. via the order-based method and the certificate of performance method.
- Comprehensive reading of the study manual of DP06 should help candidates attain better marks.

5. (a) (i) A red clause DC is a DC that allows the beneficiary of the DC to draw on the DC before the shipment of the underlying goods, i.e. it allows for advance payment to the beneficiary of the DC. Historically, the provision mentioned in the DC was typed in red, which was how its name came about.
- (ii) An example is the timber trade, as the beneficiary requires the advance in cash to go to the up-country to purchase the timber that the DC applicant requires.

The advance payment was to facilitate the beneficiary to use it to buy the goods, prepare the goods for shipment, ship the goods, submit the documents to the encashing bank/negotiating bank and draw down the balance of the DC to which he is entitled to.

As with any advance payment, the higher the percentage allowed for advance payment, the higher the risk to the DC applicant/buyer.

A red clause DC may be issued on either a conditional or unconditional basis.

It can also be issued as a mechanism for a possible pre-shipment financing where the cost of advancement can be passed over to the beneficiary on the strength of the DC.

- (b) (i) The selling TT rate in a table of exchange rates for currency is the exchange rate which the bank will apply when selling foreign currency to a customer or non-customer and the remittance will be via telegraphic transfer (alternatively payment via the SWIFT system).

- (ii) The buying OD and TT rate of a foreign currency is the exchange rate which the bank will apply for buying foreign currency from a customer or non-customer of the bank.

The TT rate is used for foreign currency funds that had already been cleared or came into and received by the bank concerned, whereas the OD rate is applicable for foreign currency funds for the underlying financial instrument that have not been cleared yet.

The buying OD rate is normally lower than the buying TT rate because of the element of cost that is reflective of the bank's lending role or advancement.

- (iii) Any two of the following reasons the selling TT rate of a currency is higher than the buying TT rate:
- Profitability of trading in foreign currency. Profit is higher if the spread/margin/differences are bigger.
 - Transactional cost involved includes brokerage fees.
 - Buffer against risk in the foreign exchange rate movement in the international foreign exchange market. The more volatile the currency the bigger the spread/margin/difference.

- (c) Under the Export Credit Refinancing (ECR) Preshipment scheme, two methods of financing available:
- The order based method
 - The certificate of performance method (CP)

The order-based method is available for direct and indirect exporters via submission of either a purchase order (PO), sales contract or evidence of a foreign issued DC. The eligible amount for financing is the extent of 80% of the value of the export order.

The CP method is only available to the direct exporters based on recommendation of the respective bank to EXIM Bank. The eligible amount of financing will be determined accordingly by EXIM Bank for a period of 4 months and can be renewed.

Question 6

- Candidates could not grasp nor understand the implication that once a DC is issued, the issuing bank is bound by its obligation to honour payment in accordance with the DC under UCP500.
- Many candidates did not know that the beginning of the month is from the 1st to the 10th of the month, both dates inclusive.
- DC is a contract between the DC issuing bank and the beneficiary and is separated from the sales/purchase contract of the buyer and seller. If the DC is issued wrongly, the DC issuing bank and/or the applicant/buyer is obliged to honour the DC undertaking if compliance documents are presented under the DC.

6. (a) A transferable credit is a credit under which the beneficiary (first beneficiary) may request the bank authorised to pay, incur a deferred payment undertaking, accept or negotiate (the transferring bank), or in the case of a freely negotiable DC, the bank specifically authorised as a transferring bank, to make the credit available in whole or in part to one or more other beneficiary (ies) [second beneficiary (ies)].
- (b) 1 to 10 November 2005, all dates inclusive.
- (c) You may advise Nilcost to inform the supplier to stop the shipments and subsequently, apply for the cancellation of the DC. However, for the cancellation of the DC to be effective, it will require the agreement or consent of the supplier, being the beneficiary of the DC.

If the beneficiary would not agree to the cancellation of the DC and still ships the goods under the 3rd and 4th shipments, any rejection of the shipment(s) via the presentation of the documents under the DC will depend upon whether the documents presented later are discrepant. If documents are in compliance with the terms and condition of the DC, payments would have to be made accordingly as per UCP500 and Nilcost would have to accept the documents and the underlying goods.

DC only deals with documents and not the goods.

- (d) The third shipment did not comply with the arrangement/agreement between the two trading parties.

Nevertheless, it still fulfilled the requirement of the DC as the DC was issued mentioning that the destination of the shipment can be to Port Klang or Pasir Gudang without other details or specification.

Therefore, the customer should be notified that documents could not be rejected as it was complying with the terms of the DC and your bank has to pay to fulfil the undertaking and obligation of the DC.

It is clear that the DC issued was inconsistent with the requirement of the arrangement/agreement of both the trading parties.

- (e) The 2nd shipment was rejected due to late shipment, which did not comply with the instalment shipment schedule of the DC. When any instalment mentioned in the documentary credit is not met, the documentary credit will cease to be available for that and any subsequent instalments.

The obligations of your bank, being the DC issuing bank had also ceased. All documents pertaining to the future shipments, i.e. the 3rd and 4th shipments if any can be rejected and no payment need to be made from your bank, being the issuing bank in the above scenario. This apply even though the 3rd and 4th shipments subsequently fulfil the shipment instalment schedule in the DC as it will still be considered discrepant documents as per UCP500 Art.41 and can be rejected by the issuing bank.

- (f) No. The shipments did not fulfil both the requirements of the customer and the DC.

The requirements of the customer were fulfilled as there was one shipment for each month from October 2005 to January 2006.

Nevertheless. the conditions of the DC were not complied with for two reasons:

- The second shipment in 11 November 2005 was not in the beginning of November.
- The fourth shipment of 16 January 2006 was after the expiry of the DC even though it complies with the period as required for the fourth shipment.

Question 7

- Candidates failed to show understanding of the responsibility and rights of a collecting bank in discharging its role in relation to collections under URC522.
- Candidates did not understand that the collection bank has a right not to execute any instruction if it elects not to by merely informing the remitting bank/principal. If the collection bank is silent, then it is obliged to follow the collection instruction accordingly. Otherwise, it will be held responsible for any loss due to its negligence and/or non-compliance of the collection instruction.
- This question requires a basic understanding of handling a documentary collection under URC522. A comprehensive reading of the study manual of DP06 and URC522 should help candidates attain better marks.

7. (a) Any two of the following:
- Only upon payment can the importer obtain the shipping documents for clearance of the goods. Otherwise if the buyer/importer defaults, the goods can be sold to other buyers in the same market or elsewhere or even bringing them back to his own country.
 - Routing the shipping documents via the banking system is more secure, reliable to obtain payment.
 - Other instruction can also be given including, i.e. noting, protest for non-payment, collection of interest, etc.
 - Basis for requesting for bank financing.

- (b) No. CBC Bank did not comply nor acted in accordance with the rules of URC522.

The collection instruction was to deliver the documents against payment. The collection instruction did not mention that delivery of documents with partial payment was allowed. Therefore as per the rules of URC522, documents must only be delivered when full payment is made even though partial payments are allowed as per Art.19b of URC522.

Non-compliance with the collection instruction had made CBC Bank liable for the full payment of the collection to the remitting bank, Bank Duautas. Besides this, CBC Bank is also liable to other claims if any that relates to the non-compliance of the collection instruction including those contained in the collection instruction and the rules of URC522.

- (c) Yes. The demand of Bank Duautas is consistent with the rules of URC522 because CBC Bank failed to act in accordance with the collection instruction to collect full payment before releasing the documents.

Anyway, CBC Bank upon receipt of the collection did not refuse to handle the collection or any related instruction received by it including those in the collection instruction.

The demand of interest on USD100,000.00 by Bank Duautas is consistent with the collection instruction since the full payment has not been made within the 5 days from the date of receipt of documents by the collecting bank. Since the balance of 20% has yet to be made, Gladwin is still liable for the interest charges of 5% p.a. from the date of receipt of the documents to the actual payment date, which must be collected on the collection bill amount, i.e. USD100,000. The interest cannot be waived even if refused by Gladwin Sdn Bhd.

The balance of 20% of the collection bill amount and the interest charges should be collected from Gladwin Sdn Bhd.

It is now the onus for CBC bank to ensure full payment as well as the payment of the interest as claimed by Bank Duautas as per the collection instruction and rules of URC522. The longer the payment, the higher the interest charges to be made will be.

- (d) Yes. CBC Bank will be responsible to pay in the event that the balance of the collection bill amount and the interest portion could not be collected from Gladwin Sdn Bhd for whatever reason.
- (e) No. The collection of interest charges must be as per the collection instruction and the rules of URC 522. Since the interest charges cannot be waived, it must be collected. The principal amount of the interest is the collection bill amount, i.e. USD100,000, which was clearly stated. The argument of Gladwin may seem reasonable and logical but it is still inconsistent with the collection instruction and the rules of URC522.

Nevertheless, CBCB Bank can still approach Bank Duautas to negotiate the interest claims to reach a compromise. However if the principal disagrees, then Gladwin Sdn Bhd and/or CBCB Bank would have to pay accordingly as per the collection instruction.