PREFACE

In the curricular structure introduced by this University for students of Post Graduate Diploma Programme, the opportunity to pursue a Post Graduate Diploma course in any subject introduced by this University is equally available to all learners. Instead of being guided by any presumption about ability level, it would perhaps stand to reason if receptivity of a learner is judged in the course of the learning process. That would be entirely in keeping with the objectives of open education which does not believe in artificial differentiation.

Keeping this in view, study materials of the Post Graduate Diploma level in different subjects are being prepared on the basis of a well laid-out syllabus. The course structure combines the best elements in the approved syllabi of Central and State Universities in respective subjects. It has been so designed as to be upgradable with the addition of new information as well as results of fresh thinking and analysis.

The accepted methodology of distance education has been followed in the preparation of these study materials. Co-operation in every form of experienced scholars is indispensable for a work of this kind. We, therefore, owe an enormous debt of gratitude to everyone whose tireless efforts went into the writing, editing and devising of proper lay-out of the materials. Practically speaking, their role amounts to an involvement in 'invisible teaching'. For, whoever makes use of these study materials would virtually derive the benefit of learning under their collective care without each being seen by the other.

The more a learner will seriously pursue these study materials, the easier it will be for him or her to reach out to larger horizons of a subject. Care has also been taken to make the language lucid and presentation attractive so that they may be rated as quality self-learning materials. If anything remains still obscure or difficult to follow, arrangements are there to come to terms with them through the counselling sessions regularly available at the network of study centres set up by the University.

Needless to add, a great deal of these efforts is still experimental–in fact, pioneering in certain areas. Naturally, there is every possibility of some lapse or deficiency here and there. However, these do admit of rectification and further improvement in due course. On the whole, therefore, these study materials are expected to evoke wider appreciation the more they receive serious attention of all concerned.

Professor (Dr.) Subha Sankar Sarkar
Vice-Chancellor

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Post Graduate Diploma in Export-Import Management

PAPER - 5
MODULES : I & II
Regulatory Framework for International Trade

Course Writing
Mr. Rupnarayan Bose

Editing
Dr. Nirmal Kumar Sengupta,
Dr. Anirban Ghosh

Netaji Subhas Open University

Post Graduate Diploma in Export-Import Management
Paper - 5

Module I

Unit 501 ❐ Introduction to regulatory framework for export and import

Structure

(Note: The information furnished below may not necessarily be the latest applicable. Reference should be made to the authorities/organisations concerned for the latest information before any action is initiated.)

501.0 ❒ Introduction

Creation of appropriate institutional framework and supportive environment facilitates the growth of external trade. In a developing country like India, the real barometer of sustained economic development is the growth index of exports. Sustained growth in exports can only be accelerated by conducive framework. The primary objective and emphasis of the framework is towards accelerated development with the required regulation to support the framework structure. The role of regulation is to protect the interests of consumers, obtain conditions of competition and foster the institutional framework. The present regulatory framework in India is highly supportive. The attitude of the government, a very important aspect for faster pace, is poised in that direction to make the framework achieve sustained growth, progress and development by removing the bottlenecks.

501.1 ❒ Trade policy

Trade policy is one of the many economic instruments for achieving economic growth. The basic twin objectives of the trade policy have been to promote exports and restrict imports to the level of foreign exchange available in the country. The inherent problems of the country have been non-availability/acute shortage of crucial inputs like industrial raw materials, supporting relevant technology and required capital goods. The problems can be removed by imports. But, continuous imports are neither possible nor desirable. The gap between exports and imports is financed through borrowing and foreign aid. However, imports must be financed by exports, in the long run. The basic objective of the trade policy revolves round the instruments and techniques of export promotion and import management.

501.2 ❒ Foreign trade

All over the world, foreign trade is recognized as the most significant determinant of economic development of a country. For providing, regulating and creating necessary environment for its orderly growth, several Acts have been put in place. The foreign trade of a country consists of inward and outward movement of goods and services, which results into outflow and inflow of foreign exchange. The foreign trade of India is governed by the Foreign Trade (Development & Regulation) Act, 1992 and the rules and orders issued there under. Payments for import and export transactions are governed by Foreign Exchange Management Act, 1999. Customs Act, 1962 governs the physical movement of goods and services through various modes of transportation. To make India a quality producer and exporter of goods and services, apart from projecting such image, an important Act-Exports (Quality control & inspection) Act, 1963 has been in vogue.

Developmental pace of foreign trade is dependent on the Export-Import Policy adopted by the country. The current Exim Policy lays stress to simplify procedures to further reduce transaction costs.

Today's international trade is not only highly competitive but also dynamic. Necessary responsive framework to make exports compete globally is essential. In order to harness these gains from trade, the transaction costs, in turn dependent on the framework support, involved need to be low for trading within the country and for international trade.

International trade is a vital part of development strategy and it can be an effective instrument of economic growth, employment generation and poverty alleviation. Market conditions change almost daily, requiring quick response and anticipation of the future requirements as the need of the hour.

India's recent performance in international trade:

INDIA'S TOP TEN TRADING PARTNERS

Year: 2010-2011(Apr-Sep)

(Rs. crore)

Rank	Country	Export	Import	Total Trade
1.	UNITED ARAB EMIRATES	65,469.08	58,549.30	124,018.37
2.	CHINA	25,682.21	89,927.23	115,609.44
3.	U S A	54,778.53	40,360.70	95,139.24
4.	SAUDI ARABIA	10,221.62	44,947.40	55,169.02
5.	SWITZERLAND	1,313.06	39,122.05	40,435.11
6.	HONG KONG	22,319.56	15,828.28	38,147.84
7.	SINGAPORE	21,269.73	16,227.87	37,497.60
8.	GERMANY	12,720.77	24,243.71	36,964.48
9.	AUSTRALIA	3,614.13	27,545.59	31,159.72
10.	INDONESIA	10,335.16	20,557.59	30,892.75
	Total of top 10 countries	227,723.85	377,309.72	605,033.56
	India's total	484,515.81	757,988.62	1,242,175.52

Source: Government of India, Ministry of Commerce & Industry, Department of Commerce (http://commerce.nic.in/eidb/default.asp)

(US$ million)

	2009-2010	2010-2011(Apr-Sep)
India's total export	178,751.43	105,204.40
India's total import	288,372.88	164,620.39

501.3 ❐ Export performance of the Indian service industry

An analysis of the consultancy contracts secured by Indian project in the foreign market has been carried out by Eximbank of India. As per the analysis, done during 1995-96 to 2000-01 indicates that consultancy contracts were secured largely in West Asia which accounted for 39% number wise and 46% value wise followed by South East Asia and Pacific & South Asia.

South East Asia constituted 22% both by number and by value whereas South Asia was 18% number wise and 16% value wise. According to the 2002 data of the Federation of Indian Export Organizations (FIEO), India's share in global trade in services was about 1.3%. India's share of consultancy exports is about 0.5% of global trade in services.

501.4 ❐ Export-Import Trade: Introduction to Regulatory Framework

In India, all the activities related to import are handled by the Directorate General of Foreign Trade (DGFT), a government organisation that also controls the export business in India. DGFT and all its regional offices work under the Ministry Commerce and Industries, Department of Commerce, Government of India. All the procedure and policies in matter related to the import is announced by the DGFT through its notification, appendices and forms.

To reiterate, the following are the institutions that govern import trade in India:

- Ministry of Commerce and Industry
- Directorate General of Foreign Trade (DGFT)
- Central Board of Excise and Customs (CBEC)
- The Reserve Bank of India

501.5 ❒ The Reserve Bank of India (RBI)

Under the Foreign Exchange Management Act (FEMA), the RBI issues instructions and guideline for the exporters, importers and commercial banks handling international trade. Among others, every July the RBI issues a document tilted Master Circular on Import of Goods and Services. This Master Circular (http://www.rbi.org.in) consolidates at one place the existing instructions on the subject of "Import of Goods and Services". This is revised and updated on the first day of July every year. The Master Circular covers practical, day to day issues on imports. Other circulars are also issued from time to time by the RBI on policy and operational issues.

Export of Goods and Services from India is allowed in terms of clause (a) of sub-section (1) and sub-section (3) of Section 7 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated May 3, 2000 viz. Foreign Exchange Management (Current Account) Rules, 2000, as amended from time to time.

Master Circular ref. RBI/2010-11/6, No.06/2010-11 dated July 01, 2010 issued by the RBI consolidates the existing instructions on the subject of "Export of Goods and Services from India". This circular is updated and reissued on 1 July every year.

Import of Goods and Services into India is being allowed in terms of Section 5 of the Foreign Exchange Management Act 1999 (42 of 1999), read with Notification No. G.S.R. 381(E) dated May 3, 2000 viz. Foreign Exchange Management (Current Account) Rules, 2000 as amended from time to time. The Reserve Bank of India also updates and issues Master Circulars titled Master Circular on Import of Goods and Services on 01 July every year. The currently available circular is RBI/2010-2011/4, Master Circular No. 04/2010-11 dated July 01, 2010, valid up to 30 June 2011. Check the RBI website on 01 July for the revised and updated Master Circulars on export, import and a wide range of other subjects.

501.6 ❒ Organisations Supporting to Exporters

In India there are a number of organisation and agencies that provides various types of support to the exporters from time to time. These export organisations provides market research in the area of foreign trade, dissemination of information arising from its activities relating to research and market studies.

- Export Promotion Councils (EPC)
- Commodity Boards

- Federation of Indian Export Organisations (FIEO)
- Indian Institute of Foreign Trade (IIFT)
- Indian Institution of Packaging (IIP)
- Export Inspection Council (EIC)
- Indian Council of Arbitration (ICA)
- India Trade Promotion Organisation (ITPO)
- Chamber of Commerce & Industry (CII)
- Federation of Indian Chamber of Commerce & Industry (FICCI)
- Bureau of Indian Standards (BIS)
- Marine Products Export Development Authority (MPEDA)
- India Investment Centre (IIC)
- Directorate General of Foreign Trade (DGFT)
- Director General of Commercial Intelligence Statistics (DGCIS)

501.7 ❐ Useful publications and Acts

Apart from the rules and regulations announced by the regulatory authorities as enumerated above, all exporters, importers and those who deal with international trade should also be familiar with the following:

(a) Uniform Customs and Practice for Documentary Credits (UCP 600) - effective from 1 July 2007;
(b) Uniform Rules for Demand Guarantees (URDG), ICC Publication No. 758 (effective from 1 July, 2010);
(c) Uniform Rules for Collection (URC 522);
(d) International Standard Banking Practice (ISBP), ICC Publication #681 (effective from 1 July, 2007);
(e) Uniform Rules for Bank-to-bank Reimbursement (URR-725) - from 1 October, 2009;
(f) International Standby Practices (ISP98);
(g) Incoterms 2010 (International Commercial Terms), International Chamber of Commerce, Paris, (ICC) Publication No. 715, effective from 1/1/2011
(h) Other ICC Publications (see http://www.iccindia.co.in)
(i) Negotiable Instruments Act, 1881,
(j) The Indian Contract Act, 1872,
(k) Sales of Goods Act.
(l) United Nations Convention on Contracts for the International Sale of Goods (1980) [CISG]

(m) The Carriage by Air Act, 1972 (for carriage of goods by air)

(n) For carriage of goods by land:

   (i) The Carriers Act, 1865.

   (ii) The Railways Act, 1989.

(o) In case of carriage of goods by sea:

   (i) The (Indian) Bills of Lading Act, 1856.

   (ii) The Carriage of Goods by Sea Act, 1925.

   (iii) The Merchant Shipping Act, 1958.

   (iv) The Marine Insurance Act, 1963;

501.8 ❒ Export Promotion Programmes / Measures

501.8.1 Participation in International Fairs/Exhibitions

To enable the exporters from small scale sector to exhibit their products in the international exhibitions, required assistance & support are provided. Expenditure on account of space rent, handling and clearing charges, insurance and shipment charges etc. are met by the office of the Development Commissioner (Small Scale Industries) under one of the plan schemes. Enquiries generated during such exhibitions abroad are disseminated to all SSI units through a network of field offices of this organisation. This strategy has been found to be successful for exporters from small scale sector in identifying new foreign buyers/markets.

501.9 ❒ Packaging for Exports

Role of packaging for exports has gained much significance in view of trends in the world markets. The need for better and scientific packaging for exports from small sector was recognised long back. With a view to acquaint SSI exporters of the latest packaging standards, techniques etc. training programmes on packaging for exports are organised in various parts of the country. These programmes are organised in association with Indian Institute of Packaging

501.10 ❒ Technical & Managerial Consultancy Services

Technical & managerial consultancy services to the SSI manufacturers/exporters are provided through a net work of field offices to ensure higher level of production and generation of higher exports.

501.11 ❐ National Awards for Quality Products

With a view to encourage the small scale units for producing quality goods, National Awards for Quality Products are given to the outstanding small scale units, who have made significant contribution for improving quality of their products. The scheme is being operated since 1986.

501.12 ❐ Marketing Development Assistance

Marketing Development Scheme (MDA) is operated by Ministry of Commerce. Under this, MDA is given to exporters through FIEO and Export Promotion Councils/ Commodity Boards to plan their marketing strategy for export growth. Guidelines in respect of single person sale-cum-study tours abroad and participation in fairs/ exhibition abroad have been revised with effect from 1st May, 1999. The revised scheme is as under:-

(i) Eligible activities:-

- - One person sale-cum-study tour(s) abroad
- - Participation in fairs/ exhibitions abroad.

(ii) Eligible exporters :-

- - Status Holder exporters namely Export Houses, Trading Houses etc. They would be eligible to get MDA through FIEO.
- - Small Exporters who are not status holders but are eligible to get the Special Import License (SIL) under Para 11.11 (a&b) of the Hand Book of Procedures 1997-2002. Such exporters would be eligible to get MDA through their respective EPCs/Commodity Boards.

(iii) Quantum of Assistance:-

- Sales-cum-Study Tour(s) abroad:-
- MDA would be limited to 90% of the actual fare for SSI Exporters and 75% for other than SSI exporters with upper ceiling of Rs. 60,000/- in all cases for travel in economy class.

Participation in Fairs/Exhibitions abroad :-

- MDA would be available on actual fair in economy class and space rent including decoration, electricity, water etc. Only and would be limited to 90% of the total expenditure on above mentioned items for SSI exporters and 75% for other than SSI exporters with combined upper ceiling of Rs.90,000/- in all cases.

(iv) Number of activities permissible :-

■ MDA would be provided for a maximum of 3 activities in a financial year, combined both for sale-cum-study tour abroad and participation in fairs/exhibitions abroad subject to the condition that not more than two activities would be allowed in a financial year either in sales-cum-study tour or in participation in fairs/exhibition abroad.

Second activity in a financial year of either of the activities indicated at sub-para (I) above would be permissible only to those exporters who have achieved a minimum 5% export growth in their global exports during the preceding financial year. One additional sale-cum-study tour or participation fairs/ Exhibition in Latin American Countries (LAC) Region would be permissible without any minimum export growth restriction in a financial year to Status Holder's exporters only.

NOTE: Ministry of Commerce, MDA Section may be approached for other conditions/guidelines, payment terms, documents to be submitted etc. Their Circular No. 1(3)/99-MDA dated 28/4/1999 refers. Also refer to latest updates announced from time to time by concerned authorities.

501.13 ❒ Awards to exporters

Ministry of Commerce gives awards to exporters for their outstanding export performance, under the scheme of National Export Award for export performance.

Promotional Schemes

To meet the challenges of international competition and to promote exports of SSI products, following promotional schemes are also being implemented.

(i) Technology Development and Modernization Fund Scheme

Small Industries Development Bank of India (SIDBI) has been implementing a scheme of technology development and modernisation of SSI units with effect from April, 1995. Under this scheme assistance is available for meeting the expenditure on purchase of capital equipment, acquisition of technical know-how, upgradation of process technology and products with thrust on quality improvement, improvement of packaging and cost of TQM and acquisition of ISO-9000 series certification.

(ii) Quality Awareness Scheme

Small Industries Service Institutes organising Workshop on ISO-9000 certification and awareness about quality.

(iii) Subsidy for obtaining ISO-9000 quality Certification

Under the scheme of promoting ISO-9000 certification SSIs are given financial support by way of reimbursing 75% of their expenditure to obtain ISO-9000 certification subject to a maximum of Rs.75,000/-

(iv) Other Schemes for technology improvement

Tool Rooms :
Tool rooms provide toolings, dies, moulds and fixtures to small scale units at a very low price to enable them to produce quality goods to meet the requirements of supplies of components to large units as well as produce quality goods for direct sale. This enhances their competitiveness and export potentials.

Process-cum-Product Development Centres :

These Centres take up jobs from SSIs for specific product development as well process development to improve the quality of products, reduce cost of product and enhance marketability of goods. These Centres deal with specific product groups.

UPTECH :

A new scheme for technology upgradation for industrial clusters has been started recently. 10 clusters of industries producing different groups in various parts of country have been selected. The scheme aims at diagnostic study of the clusters, identification of technological needs, technological intervention and wider dissemination of information and technology within the clusters. The expenditure involved on pilot plants etc. is to be met on 50:50 cost sharing basis by the Government and the concerned Industry Association of the clusters. The scheme is flexible and provides for smooth sourcing of technology even from abroad.

501.14 ❒ SIMPLIFICATION IN DOCUMENTATION (Developments in August, 2005)

501.14.1 DGFT Related Documentation at a Single Place

Importers and exporters have to fill multiple application forms at various stages of their business activity to meet procedural requirements of different Departments/ Ministries under different Acts. The objective of Government has been to simplify procedures and reduce documentation requirements so as to reduce the transaction costs of the exporters and thereby increase their competitiveness in international markets. With this in mind, a Committee to look into procedural simplification and reduction of transaction costs has been set up under the Chairmanship of Director General of Foreign Trade.

As a first step towards this exercise, the DGFT has devised a single common application form called 'Aayaat Niryaat Form'. This 50-page set of forms, as against the 120-page set currently in existence, provides availability of information on DGFT related Documentation at a single place. It has a web interface for on-line filing by exporters and retrieval of documents by the licensing authorities. This is a major leap towards paperless trading, in the series of initiatives in the direction of moving towards reduced paper transactions through procedural simplifications. A single common application form called "Aayaat Niryat Form" is being introduced, reducing the documentation requirements by more than 60%.

501.15 ❐ Reduction of documents for customs purposes

Government has decided to do away with a number of declarations that exporters, presently, have to file under various promotion schemes, including duty drawback and duty entitlement pass book.

The decision has been taken by the finance ministry in line with the recommendations of the sub-committee headed by the Chief Commissioner of Customs, Delhi. The panel has been formed to study the problems faced by traders under the present exports documentation procedure, following complaints from industry about cumbersome requirements that have often resulted in unnecessary delay and additional transaction costs.

The sub-committee has comprised representatives from the Customs department, the Directorate General of Foreign Trade, the Reserve Bank of India, Fieo and the Delhi Exporters Association. After a scrutiny of requirements under the electronic data interface (EDI) system, the sub-committee has concluded that there are just five documents required for customs purposes. These include commercial invoice, packing list, self-declaration form, ARE-1 (application for removal of excisable goods for export) and the declarations pertaining to various export promotion schemes.

While the identified documents can not be dispensed with, the sub-committee has stated that a number of documents being filed by exporters for various export promotion schemes have outlived their utility and do not serve any useful purpose. It has recommended that such declarations should be done away with. The revenue department, after going through the sub-committee's recommendations, has also decided not to ask for any declaration on the duty drawback scheme and the duty-free replenishment certificate scheme. The department has agreed to issue a suitable draft notice and standing order for guiding industry and staff, in this context.

[The following article, published in the Economic Times on 30 May 2011, provides an excellent overview of India's economic and export performances in recent times, as also the trend for the immediate future. Worth a read.]

501.16 ❒ Hail the emergence of a trading nation India

Hari Shankar Singhania[1]

Performance of exports in 2010-11 has been a remarkable achievement of the Indian economy. Against a target of $200 billion, actual export turnover stood at over $245 billion, exceeding the target by 22.5%.

Actually, except in 2009-10 when exports actually fell 4.7% during the global economic crisis, our exports have been doing well for quite some time. Between 2003-04 and 2008-09, average annual export growth in dollar terms has been 23.4%, and exports nearly trebled from $63.8 billion to $185.2 billion. And now we have reached $245 billion, which together with imports make a trade turnover of nearly $600 billion. This can be reasonably projected as the emergence of India as a major fast-moving trading nation.

If we can add some extra effort, and achieve average annual growth of 25%, we can exceed a turnover of $600 billion by 2014-15 in exports alone. This will firmly place us a major exporting nation, or, more significantly, a major trading nation , with a strong clout in the global economy. What is required is that we must continue to be ambitious and stay steady on the road to export competitiveness.

We may still have a negative trade balance, but that does not matter really. On the contrary, our image as an economy with more than a trillion dollar trading interests, with an open internal market, might actually be enhanced.

For a large trading nation, like the kind we would be, trade deficit is not a matter of concern really, as long as capital inflows remain vibrant. The size of trade and size of capital flows, I presume, are positively correlated. For the present, we need

1. President of JK Organisation, in The Economic Times, 30 May, 2011.

not bother about the balance of trade, not at least till our current account position is comfortable.

For the purpose of maintaining comfortable current account balance, I feel it is important for us to ensure steady high growth in export of services. A surplus on the invisibles account can finance the deficit on the merchandise account.

What we need to appreciate at the moment is the fact that finally Indian exporters have come of age and broken the barriers to entry into global markets. Now we can be confident that we are in the high league of exporting nations.

This we have been able to achieve, it may be mentioned, without pursuing the East Asian type of export-led growth model, wherein governments were highly aggressive on exports but defensive on imports. We, on the contrary, have pursued a strategy of export push while opening our domestic markets to global competition. In our case, it has been a perfect working of globalisation that allowed free mingling of competitive forces within the domestic economy.

The current export success has vindicated the benefits of trade liberalisation. It is well established that trade liberalisation helps in pushing exports on one hand and strengthening the domestic economy on the other. For us in India, this has been a perfect experiment with globalisation as a vehicle for export promotion.

One more aspect of our export performance is that, quite different from the case in China, foreign direct investment (FDI) has played little or no role in developing the export sector. There have been hardly any FDI flows in our export sector, though we have our own version of SEZs and FTZs. It is only recently that we are beginning to see a surge in exports from our FTZs and 100% Export Oriented Units (EOUs), but the observed surge is more due to new generation of entrepreneurs.

Further, unlike in many emerging market economies, export success has been achieved without India participating in a game of exchange rate manipulation. On the contrary, India's exports have grown in spite of some significant appreciation of rupee vis-à-vis dollar since 2002-03, when average exchange rate was INR48.4 to a dollar against average INR45.5 in 2010-11. Certainly, our exporters have found a way out of a situation of volatility in exchange rates movement.

At this stage, one can recall with some satisfaction how in the aftermath of liberalisation policies the Indian industry had undergone total restructuring and reorganisation, but only to come up stronger and return as global players.

The export success has much to do with that resurgence of Indian industry subsequent to liberalisation. This is very well reflected in the changing composition of our export basket, where some high-value non-traditional items such as petrochemicals, pharmaceuticals, chemicals, automobiles and so on are leading export growth.

In some traditional sectors as well, like textiles and garments, gems and jewellery, there has been a significant increase in competitiveness and a surge of confidence in our exporting community that has mastered the art of global networking. In most traditional items, there has been a noticeable upward shift across market segments. This product diversification has been yet another driving force behind the resurgence of exports.

Finally, one must talk of one more driving force at work, and that is where one has to give full credit to the government. Initially, there were lot of concerns and anxieties in our minds about implications of bilateral free trade agreements (FTAs), and there was some opposition as well. It was for the government to take the lead and push for several FTAs with countries, helping diversification of export markets in an important way.

Without such bilateral FTAs, it would have been difficult for India to diversify its export market. Today, our exports are no longer dependent on a few advanced markets only, and are poised to perform even after being subject to global economic shocks.

With the government steering the course on trade and economic relationships with our partners, a new relationship has emerged with the industry.

It is like the government giving a sort of MasterCard to the exporting community for access to global markets. Do you recall Sachin Tendulkar saying, 'MasterCard, go and get it?' It has been exactly like that in our case. With more and more FTAs, the government is showing MasterCard. It was for the exporters to go and get it. Now, they have learnt it.

Suggested Reading/references :

(i) India's shifting Trade Policy: South Asia and Beyond, by Vinod K. Aggarwal and Rahul Mukherji.

(ii) Changing face of India's External Trade, by V S Sheshadri.

(iii) SEZs in India: Analyzing Export Performance, by Aradhana Aggarwal.

(iv) SEZs: Revisiting the Policy Debates, by Aradhana Aggarwal.

(v) The New Foreign Trade Policy (2009-2014), Ministry of Commerce and Industry, Government of India.

(vi) http://exim.indiamart.com/ssi-policies/export-promotion-programs.html

Unit 502 ❐ Excise Clearance for Export

Structure

(Refer to latest applicable rules and regulations issued by the concerned authorities, and also RBI Master Circulars for up to date information.)

502.0 ❐ Introduction

As a part of further simplifications and rationalisation of excise rules announced by the Finance Minister, a set of Central Excise Rules, 2002 has come into effect from 1-3-2002. Under these new rules, central excise provisions for exports (except exports to Nepal and Bhutan) have been prescribed in Rule 18 and 19.

502.1 ❐ Procedure for Export to all countries (except Nepal and Bhutan) under Payment of Duty Conditions and Limitations

The procedure for export of excisable1 goods except Nepal and Bhutan on payment of duty under claim for rebate is governed by the provisions of Rule 18 of the Central Excise (No.2) Rules, 2001. The conditions, limitations and safeguards are separately contained in Notification No. 40/2001-CE(NT) dated 26"' June, 2001 (also check latest RBI Master Circulars for updates, if any).

Conditions and Limitations

i. that the excisable goods shall be exported after payment of duty, directly from a factory or warehouse;
ii. the excisable goods shall be exported within six months from the date on which they were, cleared for export, from the factory of manufacture or warehouse;
iii. the rebate claim by filing electronic declaration shall be allowed from such place of export and such date, as may be specified by the Board in this behalf;
iv. that the market price of the excisable goods at the time of exportation is not less than the amount of rebate of duty claimed ;
v. that the amount of rebate of duty admissible is not less than five hundred rupees.

502.2 ❐ Sealing of goods and examination at place of dispatch

(a) For the sealing of goods intended for export at the place of despatch, the exporter shall present the goods along with four copies of application in the Form ARE-I to the Superintendent or Inspector of Central Excise having jurisdiction over the factory of production or manufacture or warehouse, who will verify the identity of goods mentioned in the application and the particulars of the duty paid or payable, and if found in order, he shall seal each package or the container in the manner as may be specified by the Commissioner of Central Excise and endorse each copy of the application in token of having such examination done;
(b) The said Superintendent or Inspector of Central Excise shall return the original and duplicate copies of application to the exporter.
(c) The triplicate copy of application shall be:
   i. sent to the officer with whom rebate claim is to be filed, either by post or by handing over to the exporter in a tamper proof sealed cover after posting the particulars in official records, or
   ii. sent to the Excise Rebate Audit Section at the place of export in case rebate is to be claimed by electronic declaration on Electronic Data Interchange (EDI) system of Customs.

(d) The exporter may prepare quintuplicate copy of application for claiming any other export incentive. This copy shall be dealt in the same manner as the original copy of application.

(e) Where goods are not exported directly from the factory of manufacture or warehouse, the triplicate copy of application shall be sent by the Superintendent having jurisdiction over the factory of manufacture or warehouse who shall, after verification forward the triplicate copy in the manner specified in sub-paragraph (c) above.

502.3 ❐ Despatch of goods by self-sealing and self-certification

(a) Where the exporter desires self-sealing and self-certification for removal of goods from the factory or warehouse, the exporter or a person duly authorised by such exporter, shall certify on all the copies of the application that the goods have been sealed in his presence, and shall send the original and duplicate copies of the application along with the goods at the place of export, and shall send the triplicate and quadruplicate copies of the application to the Superintendent or Inspector of Central Excise having jurisdiction over the factory or warehouse within twenty four hours of removal of the goods.

(b) The said Superintendent or Inspector of Central Excise shall, after verifying the particulars of the duty paid or duty payable and endorsing the correctness or otherwise, of these particulars:

  (i) send to the officer with whom rebate claim is to be filed, either by post or by handing over to the exporter in a tamper proof sealed cover after posting the particulars in official records, or

  (ii) send to the Excise Rebate Audit Section at the place of export in case rebate is to be claimed by electronic declaration on Electronic Data Interchange system of Customs.

(c) The exporter may prepare quintuplicate copy of application for claiming any other export incentive. This copy shall be dealt in the same manner as the original copy of application.

502.4 ❐ Examination of goods at the place of export

(a) On arrival at the place of export, the goods shall be presented together with original, duplicate and quintuplicate (optional) copies of the application to the Commissioner of Customs or other duly appointed officer;

(b) The Commissioner of Customs or other duly appointed officer shall examine the consignments with the particulars as cited in the application and if he finds that the same are correct and exportable in accordance with the laws for the time being in force, shall allow export thereof and certify on the copies of the application that the goods have been duly exported citing the shipping bill number and date and other particulars of export,

Provided that if the Superintendent or Inspector of Central Excise has sealed packages or container at the place of despatch, the officer of customs shall inspect the packages or container with reference to declarations in the application to satisfy himself about the exportability thereof and if the seals are found intact, he shall allow export.

(c) The officer of customs shall return the original and quintuplicate (optional copy for exporter) copies of application to the exporter and forward the duplicate copy of application either by post or by handing over to the exporter in a tamper proof sealed cover to the officer specified in the application, from whom exporter wants to claim rebate,

Provided that where exporter claims rebate by electronic declaration on Electronic Data Inter-change system of Customs, the duplicate shall be sent to the Excise Rebate Audit Section at the place of export.

(d) The exporter shall use the quintuplicate copy for the purposes of claiming any other export incentive;

502.5 ❐ Presentation of claim for rebate to Central Excise

(a) Claim of the rebate of duty shall be lodged along with original copy of the application to the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise having jurisdiction over the factory of manufacture or warehouse or, as the case may be, the Maritime Commissioner;

(b) The Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise having jurisdiction over the factory of manufacture or warehouse or, as the case may be, Maritime Commissioner of Central Excise shall compare the duplicate copy of application received from the Officer of Customs with the original copy received from the exporter and with the triplicate copy received from the Central Excise Officer and if satisfied that the claim is in order, he shall sanction the rebate either in whole or in part.

502.6 ❐ Claim of rebate by electronic declaration

An exporter may enter the requisite information in the Shipping Bill filed at such place of export, as may be specified by the Board, for claiming rebate by electronic declaration on Electronic Data Inter-change system of Customs. The details of the corresponding application shall be entered in the Electronic Data Inter-change system of Customs upon arrival of the goods in the Customs area. After goods are exported or order under section 51 of the Customs Act, 1962 (52 of 1962) has been issued, the rebate of excise duty shall, if the claim is found in order, be sanctioned and disbursed by the Assistant Commissioner of Customs or the Deputy Commissioner of Customs.

502.7 ❐ Procedure for Export to all countries (except Nepal and Bhutan) without Payment of Duty Conditions

The procedure for export of all excisable goods, except to Nepal and Bhutan, without payment of duty from the factory of the production or the manufacture or warehouse or any other premises as may be approved by the Commissioner of Central Excise, is governed by the provisions of Rule 19 of the Central Excise (No. 2) Rules, 2002. The conditions, limitations and safeguards are separately contained in Notification No. 42/2001-CE(NT) dated 26th June, 2002.

Conditions :

(i) that the exporter shall furnish a General Bond (Surety/Security) to the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise having jurisdiction over the factory, warehouse or such approved premises, as the case may be, or the Maritime Commissioner or such other officer as authorised by the Board on this behalf, in a sum equal at least to the duty chargeable on the goods, with such surety or sufficient security, as such officers may approve for the due arrival thereof at the place of export and their export therefrom under Customs or as the case may be postal supervision. The manufacturer-exporter may furnish a letter of undertaking in the Form specified in lieu of a bond;

(ii) that goods shall be exported within six months from the date on which these were cleared for export from the factory of the production or the manufacture or warehouse or other approved premises within such extended period as the Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise or Maritime Commissioner may in any particular case allow;

(iii) that when the export is from a place other than registered factory or warehouse, the excisable goods are in original packed condition and identifiable as to their origin.

502.8 ❒ Procedure for removal without payment of duty

(a) After furnishing bond, a merchant-exporter shall obtain certificates in Form CT-1 issued by the Superintendent of Central Excise having jurisdiction over the factory or warehouse or approved premises or Maritime Commissioner or such other officer as may be authorised by the Board on this behalf and on the basis of such certificate he may procure excisable goods without payment of duty for export by indicating the quantity, value and duty involved therein;

(b) the exporter who has furnished bond shall ensure that the debit in bond account does not exceed the credit available therein at any point of time;

(c) the manufacturer-exporter may remove the goods without payment of duty after furnishing the letter of undertaking as specified under condition (1);

(d) such General bond or letter of undertaking shall not be discharged unless the goods are duly exported, to the satisfaction of the Assistant Commissioner of Central Excise or the Deputy Commissioner of Central Excise or Maritime Commissioner or such other officer as may be authorised by the Board on this behalf within the time allowed for such export or are otherwise accounted for to the satisfaction of such officer, or until the full duty due upon any deficiency of goods, not accounted so and interest, if any, has been paid.

502.9 ❒ Sealing of goods and examination at place of despatch

(a) For the sealing of goods intended for export at the place of despatch, the exporter shall present the goods along with four copies of application in the Form A.R.E.-l to the Superintendent or Inspector of Central Excise who will verify the identity of goods mentioned in the application and the particulars of the duty paid or payable, and if found in order, he shall seal each package or the container in the manner as may be specified by the Commissioner of Central Excise and endorse each copy of the application in token of having such examination done;

(b) The said Superintendent or Inspector of Central Excise shall return the original and duplicate copies of application to the exporter mid retain the quadruplicate copy;

(c) The triplicate copy of application shall be sent to the officer to whom bond or letter of undertaking has been furnished, either by post or by handing over to the exporter in a tamper proof sealed cover after posting the particulars in official records;

(d) The exporter may prepare quintuplicate copy of application for claiming any other export incentive. This copy shall be dealt in the same manner as the original copy of application;

(e) In case of export by parcel post after the goods intended for export has been sealed, the exporter shall affix to the duplicate application sufficient postage stamps to cover postal charges and shall present the documents, together with the package to which it refers, to the postmaster at the office of booking.

502.10 ❐ Despatch of goods by self-sealing and self-certification

(a) Where the exporter desires self-sealing and self-certification for removal of goods from the factory, warehouse or any approved premises, the exporter or a person duly authorised, shall certify on all the copies of the application that the goods have been sealed in his presence, and shall send the original and duplicate copies of the application along with the goods at the place of export, and shall send the triplicate and quadruplicate copies of the application to the Superintendent or Inspector of Central Excise having jurisdiction over the factory, warehouse, any such approved premises within twenty four hours of removal of the goods;

(b) The Superintendent or Inspector of Central Excise shall, after verifying the particulars of the bond or letter of undertaking and endorsing the correctness or otherwise, of the particulars on the application, send to the officer to whom the bond or letter of undertaking has been furnished either by post or by handing over to the exporter in a tamper proof sealed cover after recording the particulars in the official records;

(c) The exporter may prepare quintuplicate copy of application for claiming any other export incentive. This copy shall be dealt in the same manner as the original copy of application;

502.11 ❐ Examination of goods at the place of export

(a) On arrival at the place of export, the goods shall be presented together with original, duplicate and quintuplicate (optional) copies of the application to the Commissioner of Customs or other duly appointed officer;

(b) The Commissioner of Customs or other duly appointed officer shall examine the goods with the particulars as specified in the application and if he finds that the same are correct arid exportable in accordance with the laws for the time being in force, shall allow export thereof and certify on the copies of the application that the goods have been duly exported citing the shipping bill.

Reference

1. Export documentation and procedure A-Z, by Paras Ram, Ch. 22 & 26
2. http://www.indiaexim.com/excise.htm

Unit 503 ❐ Customs Clearance of Export And Import Cargo

Structure

503.1 ❐ Procedure for Clearance of Imported and Export Goods

I. Import :

Bill of Entry - Cargo Declaration:

1. Goods imported in a vessel/aircraft attract customs duty. Unless these are not meant for customs clearance at the port/airport of arrival by particular vessel/aircraft and are intended for transit by the same vessel/aircraft or transhipment to another customs station or to any place outside India, detailed customs clearance formalities of the landed goods have to be followed by the importers.

   With regard to the transit goods, so long as these are mentioned in import report/IGM for transit to any place outside India, customs allows transit without payment of duty.

   Similarly for goods brought in by particular vessel/aircraft for transhipment to another customs station, detailed customs clearance formalities at the port/airport of landing are not prescribed. Simple transhipment procedure has to be followed by the carrier and the concerned agencies. The customs clearance formalities have to be complied with by the importer after arrival of the goods at the other customs station.

   There could also be cases of transhipment of the goods after unloading to a port outside India. Here also simpler procedure for transhipment has been prescribed by regulations, and no duty is required to be paid. (Sections 52 to 56 of the Customs are relevant in this regard).

2. For other goods which are offloaded, importers have the option to clear the goods for home consumption after payment of the duties leviable or to clear them for warehousing without immediate discharge of the duties leviable in terms of the warehousing provisions built in the Customs Act. Every importer is required to file in terms of the Section 46 an entry (which is called Bill of Entry) for home consumption or warehousing in the form as prescribed by regulations.
3. If the goods are cleared through the EDI system no formal Bill of Entry is filed as it is generated in the computer system, but the importer is required to file a cargo declaration having prescribed particulars required for processing of the entry for customs clearance. The Bill of Entry, where filed, is to be submitted in a set.
4. In the non-EDI system along with the bill of entry filed by the importer or his representative the following documents are also generally required:
   - Signed invoice
   - Packing list
   - Bill of Lading or Delivery Order/Airway Bill
   - GATT declaration form duly filled in
   - Importers/CHA's declaration
   - License wherever necessary
   - Letter of Credit/Bank Draft/wherever necessary
   - Insurance document
   - Import license
   - Industrial License, if required
   - Test report in case of chemicals
   - Ad hoc exemption order
   - DEEC Book/DEPB in original
   - Catalogue, Technical write up, Literature in case of machineries, spares or chemicals as may be applicable
   - Separately split up value of spares, components machineries
   - Certificate of Origin, if preferential rate of duty is claimed
   - No Commission declaration
5. Under the EDI system, the importer does not submit documents as such for assessment but submits declarations in electronic format containing all the relevant information to the Service Centre. A signed paper copy of the declaration is taken by the service centre operator for non-repudiability of the declaration. A checklist is generated for verification of data by the importer/CHA. After

verification, the data is submitted to the system by the Service Centre Operator and system then generates a B/E Number, which is endorsed on the printed checklist and returned to the importer/CHA. No original documents are taken at this stage. Original documents are taken at the time of examination. The importer/CHA also needs to sign on the final document after Customs clearance.

6. The first stage for processing a bill of entry is what is termed the noting of the bill of entry, vis-à-vis, the IGM filed by the carrier. In the non-EDI system the importer has to get the bill of entry noted in the concerned unit which checks the consignment sought to be cleared having been manifested in the particular vessel and a bill of entry number is generated and indicated on all copies.
7. After noting the bill of entry gets sent to the appraising section of the Custom House for assessment functions, payment of duty etc. In the EDI system, the Steamer Agents get the manifest filed through EDI or by using the service centre of the Custom House and the noting aspect is checked by the system itself - which also generates bill of entry number.
8. After noting/registration of the Bill of entry, it is forwarded manually or electronically to the concerned Appraising Group in the Custom House dealing with the commodity sought to be cleared.
9. The basic function of the assessing officer in the appraising groups is to determine the duty liability taking due note of any exemptions or benefits claimed under different export promotion schemes. They have also to check whether there are any restrictions or prohibitions on the goods imported and if they require any permission/license/permit etc., and if so whether these are forthcoming.
10. On receipt of the examination report the appraising officers in the group assesses the bill of entry. He indicates the final classification and valuation in the bill of entry indicating separately the various duties such as basic, countervailing, anti-dumping, safeguard duties etc. that may be leviable. Thereafter the bill of entry goes to Assistant Commissioner/Deputy Commissioner for confirmation depending upon certain value limits and sent to a comptist who calculates the duty amount taking into account the rate of exchange at the relevant date as provided under Section 14 of the Customs Act.
11. After the assessment and calculation of the duty liability the importer's representative has to deposit the duty calculated with the treasury or the nominated banks, whereafter he can go and seek delivery of the goods from the custodians.
12. Where the goods have already been examined for finalization of classification or valuation no further examination/checking by the dock appraising staff is

required at the time of giving delivery and the goods can be taken delivery after taking appropriate orders and payment of dues to the custodians, if any.

13. In most cases, the appraising officer assesses the goods on the basis of information and details furnished to the importer in the bill of entry, invoice and other related documents including catalogue, write-up etc. He also determines whether the goods are permissible for import or there are any restriction/prohibition. He may allow payment of duty and delivery of the goods on what is called second check/ appraising basis in case there are no restriction/prohibition. If the goods are found to be as declared and no other discrepancies/mis-declarations etc., are detected, the importer or his agent can clear the goods after the shed appraiser gives out of charge order.
14. Wherever the importer is not satisfied with the classification, rate of duty or valuation as may be determined by the appraising officer, he can seek an assessment order. An appeal against the assessment order can be made to appropriate appellate authority within the time limits and in the manner prescribed. EDI Assessment:
15. In the EDI system of handling of the documents/declarations for taking import clearances as mentioned earlier the cargo declaration is transferred to the assessing officer in the groups electronically.
16. The assessing officer processes the cargo declaration on screen with regard to all the parameters as given above for manual process. However in EDI system, all the calculations are done by the system itself. In addition, the system also supplies useful information for calculation of duty.
17. After assessment, a copy of the assessed bill of entry is printed in the service centre. Under EDI, documents are normally examined at the time of examination of the goods. Final bill of entry is printed after 'out of charge' is given by the Custom Officer.
18. In EDI system, in certain cases, the facility of system appraisal is available. Under this process, the declaration of importer is taken as correct and the system itself calculates duty which is paid by the importer. In such case, no assessing officer is involved.
19. Also, a facility of tele-enquiry is provided in certain major Customs stations through which the status of documents filed through EDI systems could be ascertained through the telephone. If nay query is raised, the same may be got printed through fax in the office of importer/exporter/CHA. Examination of Goods:
20. All imported goods are required to be examined for verification of correctness

of description given in the bill of entry. However, a part of the consignment is selected on random selection basis and is examined. In case the importer does not have complete information with him at the time of import, he may request for examination of the goods before assessing the duty liability or, if the Customs Appraiser/Assistant Commissioner feels the goods are required to be examined before assessment, the goods are examined prior to assessment. This is called First Appraisement.

21. The goods can also be examined subsequent to assessment and payment of duty. This is called Second Appraisement. Most of the consignments are cleared on second appraisement basis. It is to be noted that whole of the consignment is not examined. Only those packages which are selected on random selection basis are examined in the shed.

22. Under the EDI system, the bill of entry, after assessment by the group or first appraisement, as the case may be, need to be presented at the counter for registration for examination in the import shed. A declaration for correctness of entries and genuineness of the original documents needs to be made at this stage. After registration, the B/E is passed on to the shed Appraiser for examination of the goods. Along-with the B/E, the CHA is to present all the necessary documents. After completing examination of the goods, the Shed Appraiser enters the report in System and transfers first appraisement B/E to the group and gives 'out of charge' in case of already assessed Bs/E. Thereupon, the system prints Bill of Entry and order of clearance (in triplicate). All these copies carry the examination report, order of clearance number and name of Shed Appraiser. The two copies each of B/E and the order are to be returned to the CHA/Importer, after the Appraiser signs them. One copy of the order is attached to the Customs copy of B/E and retained by the Shed Appraiser. Green Channel facility:

23. Whenever mistakes are noticed after submission of documents, amendments to the of entry is carried out with the approval of Deputy/Assistant Commissioner. The request for amendment may be submitted with the supporting documents.

24. For faster clearance of the goods, provision has been made in section 46 of the Act, to allow filing of bill of entry prior to arrival of goods. This bill of entry is valid if vessel/aircraft carrying the goods arrive within 30 days from the date of presentation of bill of entry.

25. A separate form of bill of entry is used for clearance of goods for warehousing. All documents as required to be attached with a Bill of Entry for home consumption

are also required to be filed with bill of entry for warehousing. The bill of entry is assessed in the same manner and duty payable is determined.

II. Export :

For clearance of export goods, the export or his agents have to undertake the following formalities:

Registration :

1. The exporters have to obtain PAN based Business Identification Number (BIN) from the Directorate General of Foreign Trade prior to filing of shipping bill for clearance of export goods. Under the EDI System, PAN based BIN is received by the Customs System from the DGFT online.
2. The exporters are also required to register authorised foreign exchange dealer code (through which export proceeds are expected to be realised) and open a current account in the designated bank for credit of any drawback incentive.

Registration in the case of export under export promotion schemes:

3. All the exporters intending to export under the export promotion scheme need to get their licences/DEEC book etc. registered at the customs station. For such registration, original documents are required.

Processing of Shipping Bill-Non-EDI :

4. Under manual system, shipping bills or, as the case may be, bills of export are required to be filed in format as prescribed in the Shipping Bill and Bill of Export (Form) regulations, 1991. The bills of export are being used if clearance of export goods is taken at the Land Customs Stations. Different forms of shipping bill/ bill of export have been prescribed for export of duty free goods, export of dutiable goods and export under drawback etc.
5. Shipping Bills are required to be filed along with all original documents such as invoice, AR-4, packing list etc. The assessing officer in the export department checks the value of the goods, classification under drawback schedule in case of drawback shipping bills, rate of duty/cess where applicable, exportability of goods under EXIM policy and other laws in force. T
6. he DEEC/DEPB Shipping bills are processed in the DEEC group. In case of DEEC Shipping bills, the assessing officer verifies that the description of the goods declared in the shipping bill and invoice match with the description of the resultant product as given in the DEEC book.

7. Once the shipping bill is passed by the export department, the exporter or his agent present the goods to the shed appraiser (export) in docks for examination. The shed appraiser may mark the document to a custom officer (usually an examiner) for examining the goods. The examination is carried out under the supervision of the shed appraiser (export). If the description and other particulars of the goods are found to be as declared, the shed appraiser gives a 'let export' order, after which the exporter may contact the preventive superintendent for supervising the loading of goods on to the vessel.
8. In case the examining staff in the docks finds some discrepancy in the goods, they may mark the shipping bill back to export department/DEEC group with their observations as well as sample of goods, if needed. The export department re-considers the case and decide whether export can be allowed, or amendment in description, value etc. is required before export and whether any other action is required to be taken under the Customs Act, 1962 for mis-declaration of description of value etc.

Processing of Shipping Bill-EDI :

9. Under EDI System, declarations in prescribed format are to be filed through the Service Centres of Customs. A checklist is generated for verification of data by the exporter/CHA. After verification, the data is submitted to the System by the Service Center operator and the System generates a Shipping Bill Number, which is endorsed on the printed checklist and returned to the exporter/CHA. For export items which are subject to export cess, the TR-6 challans for cess is printed and given by the Service Centre to the exporter/CHA immediately after submission of shipping bill. The cess can be paid on the strength of the challan at the designated bank. No copy of shipping bill is made available to exporter/CHA at this stage.

Octroi procedure, Quota Allocation and Other certification for Export Goods :

10. The quota allocation label is required to be pasted on the export invoice. The allocation number of AEPC is to be entered in the system at the time of shipping bill entry. The quota certification of export invoice needs to be submitted to Customs along-with other original documents at the time of examination of the export cargo. For determining the validity date of the quota, the relevant date needs to be the date on which the full consignment is presented to the Customs for examination and duly recorded in the Computer System.

11. Since the shipping bill is generated only after the 'let export order' is given by Customs, the exporter may make use of export invoice or such other document as required by the Octroi authorities for the purpose of Octroi exemption.

Arrival of Goods at Docks :

12. The goods brought for the purpose of examination and subsequent 'let export' is allowed entry to the dock on the strength of the checklist and other declarations filed by the exporter in the Service Centre. The port authorities have to endorse the quantity of goods actually received on the reverse of the check list.

System Appraisal of Shipping Bills :

13. In many cases the shipping bill is processed by the system on the basis of declarations made by the exporters without any human intervention. In other cases where the Shipping Bill is processed on screen by the Customs Officer, he may call for the samples, if required for confirming the declared value or for checking classification under the Drawback Schedule. He may also give any special instructions for examination of goods, if felt necessary.

Status of Shipping Bill :

14. The exporter/CHA can check up with the query counter at the Service Centre whether the Shipping Bill submitted by them in the system has been cleared or not, before the goods are brought into the Docks for examination and export. In case any query is raised, the same is required to be replied through the service centre or in case of CHAs having EDI connectivity through their respective terminals. The Customs officer may pass the Shipping Bill after all the queries have been satisfactorily replied to.

Customs Examination of Export Cargo :

15. After the receipt of the goods in the dock, the exporter/CHA may contact the Customs Officer designated for the purpose present the check list with the endorsement of Port Authority and other declarations as aforesaid along with all original documents such as, Invoice and Packing list, AR-4, etc. Customs Officer may verify the quantity of the goods actually received and enter into the system and thereafter mark the Electronic Shipping Bill and also hand over all original documents to the Dock Appraiser of the Dock who many assign a Customs Officer

for the examination and intimate the officers' name and the packages to be examined, if any, on the check list and return it to the exporter or his agent.

16. The Customs Officer may inspect/examine the shipment along with the Dock Appraiser. The Customs Officer enters the examination report in the system. He then marks the Electronic Bill along with all original documents and checklist to the Dock Appraiser. If the Dock Appraiser is satisfied that the particulars entered in the system conform to the description given in the original documents and as seen in the physical examination, he may proceed to allow "let export" for the shipment and inform the exporter or his agent.

Variation between the Declaration & Physical Examination :

17. The check list and the declaration along with all original documents are retained by the Appraiser concerned. In case of any variation between the declaration in the Shipping Bill and physical documents/examination report, the Appraiser may mark the Electronic Shipping Bill to the Assistant Commissioner/Deputy Commissioner of Customs (Exports). He may also forward the physical documents to Assistant Commissioner/Deputy Commissioner of Customs (Exports) and instruct the exporter or his agent to meet the Assistant Commissioner/Deputy Commissioner of Customs (Exports) for settlement of dispute. In case the exporter agrees with the views of the Department, the Shipping Bill needs to be processed accordingly. Where, however, the exporter disputes the view of the Department principles of natural justice is required to be followed before finalisation of the issue.

Stuffing / Loading of Goods in Containers

18. The exporter or his agent should hand over the exporter copy of the shipping bill duly signed by the Appraiser permitting "Let Export" to the steamer agent who may then approach the proper officer (Preventive Officer) for allowing the shipment. In case of container cargo the stuffing of container at Dock is dome under Preventive Supervision. Loading of both containerized and bulk cargo is done under Preventive Supervision. The Customs Preventive Superintendent (Docks) may enter the particulars of packages actually stuffed in to the container, the bottle seal number particulars of loading of cargo container on board into the system and endorse these details on the exporter copy of the shipping bill presented to him by the steamer agent. The Customs Preventive Officer supervising the loading of container and general cargo in to the vessel may give "Shipped on Board" endorsement on the exporters copy of the shipping bill.

Drawal of Samples

19. Where the Appraiser Dock (export) orders for samples to be drawn and tested, the Customs Officer may proceed to draw two samples from the consignment and enter the particulars thereof along with details of the testing agency in the ICES/E system. There is no separate register for recording dates of samples drawn. Three copies of the test memo are prepared by the Customs Officer and are signed by the Customs Officer and Appraising Officer on behalf of Customs and the exporter or his agent. The disposals of the three copies of the test memo are as follows: -
    (a) Original - to be sent along with the sample to the test agency.
    (b) Duplicate - Customs copy to be retained with the 2nd sample.
    (c) Triplicate - Exporter's copy.
20. The Assistant Commissioner/Deputy Commissioner if he considers necessary, may also order for sample to be drawn for purpose other than testing such as visual inspection and verification of description, market value inquiry, etc.

Amendments

21. Any correction/amendments in the checklist generated after filing of declaration can be made at the service centre, provided, the documents have not yet been submitted in the system and the shipping bill number has not been generated. Where corrections are required to be made after the generation of the shipping bill No. or after the goods have been brought into the Export Dock, amendments is carried out in the following manners.
    - If the goods have not yet been allowed "let export" amendments may be permitted by the Assistant Commissioner (Exports).
    - Where the "Let Export" order has already been given, amendments may be permitted only by the Additional/Joint Commissioner, Custom House, in charge of export section.
22. In both the cases, after the permission for amendments has been granted, the Assistant Commissioner/Deputy Commissioner (Export) may approve the amendments on the system on behalf of the Additional /Joint Commissioner. Where the print out of the Shipping Bill has already been generated, the exporter may first surrender all copies of the shipping bill to the Dock Appraiser for cancellation before amendment is approved on the system.

Export of Goods under Claim for Drawback

23. After actual export of the goods, the Drawback claim is processed through EDI system by the officers of Drawback Branch on first come first served basis. There is no need for filing separate drawback claims. The status of the shipping bills and sanction of DBK claim can be ascertained from the query counter set up at the service centre. If any query has been raised or deficiency noticed, the same is shown on the terminal. A print out of the query/deficiency may be obtained by the authorized person of the exporter from the service centre. The exporters are required to reply to such queries through the service centre. The claim will come in queue of the EDI system only after reply to queries/deficiencies are entered by the Service Centre.

24. All the claims sanctioned on a particular day are enumerated in a scroll and transferred to the Bank through the system. The bank credits the drawback amount in the respective accounts of the exporters. Bank may send a fortnightly statement to the exporters of such credits made in their accounts.

25. The Steamer Agent/Shipping Line may transfer electronically the EGM to the Customs EDI system so that the physical export of the goods is confirmed, to enable the Customs to sanction the drawback claims.

Generation of Shipping Bills

26. After the "let export" order is given on the system by the Appraiser, the Shipping Bill is generated by the system in two copies i.e., one Customs copy, one exporter's copy (E.P. copy is generated after submission of EGM). After obtaining the print out the appraiser obtains the signatures of the Customs Officer on the examination report and the representative of the CHA on both copies of the shipping bill and examination report. The Appraiser thereafter signs & stamps both the copies of the shipping bill at the specified place.

27. The Appraiser also signs and stamps the original & duplicate copy of SDF. Customs copy of shipping bill and original copy of the SDF is retained along with the original declarations by the Appraiser and forwarded to Export Department of the Custom House. He may return the exporter copy and the second copy of the SDF to the exporter or his agent.

28. As regards the AEPC quota and other certifications, these are retained along with the shipping bill in the dock after the shipping bill is generated by the

system. At the time of examination, apart from checking that the goods are covered by the quota certifications, the details of the quota entered into the system needs to be checked.

Export General Manifest

29. All the shipping lines/agents need to furnish the Export General Manifests, Shipping Bill wise, to the Customs electronically within 7 days from the date of sailing of the vessel.

30. Apart from lodging the EGM electronically the shipping lines need to continue to file manual EGMs along with the exporter copy of the shipping bills as per the present practice in the export department. The manual EGMs need to be entered in the register at the Export Department and the Shipping lines may obtain acknowledgements indicating the date and time at which the EGMs were received by the Export Department.

31. The above is the general procedure for export under EDI Systems. However special procedures exist for specified schemes, details of which may be obtained from the Public Notice/Standing Orders issued by the respective Commissionerates.

503.2 Customs Clearance of Imported Cargo Shipped by Air

The following, taken from the Chennai customs website, provides a good example of the process involved in clearing inward air cargo through the customs for import into the country. The text is reproduced verbatim for the benefit of the reader. Note that the procedure may vary in certain details from port to port within the same country.

Documents generally required

1. Delivery Order
2. Bill of Entry (in quadruplicate)
3. Airway Bill/House Airway Bill (2 copies)
4. Invoices
5. Packing list
6. Import Licence, wherever required
7. Catalogue

8. DEEC Book
9. Any other relevant documents

Filing of Bill of Entry (BE)

The Bill of Entry along with copies of Airway Bill, Delivery Order and Invoices etc. are filed with the Admission Clerk located at the Ground floor of the Air Cargo Complex where the process of 'noting' is carried out, in case of manual clearance.
In case of EDI, import Annexure-I along with invoice, packing list are to be to the Service Centre. Once the data is fed in the system a check list will be generated and given to Importer/CHA for verification and signature.
Then the system will cross verify the detail with the IGM, if found correct/tallied Bill of Entry Number is generated and the same is passed for assessment.

Appraisement

The Bill of Entry is put up to Appraisement Department for processing the same for the First or Second Appraisement(in case of Second Appraisement, 'Duty' is assessed and 'paid before' the Customs Examination.)

Open Examination order

In case of first appraisement open examination order is obtained. To obtain the Open Examination Order, the Importer/Agent is required to contact the Shed Appraiser who will (mark and make) a remark/noting for calling the packages for Examination. He shall also indicate the name of the Examining Officer on the Bill of Entry and thereafter AAI Location Counter should be approached to get the/location Slip.

Generation of location slip

The location slip is generated at the AAI location counter on the basis of the Customs open examination order on the Bill of Entry and along with other relevant documents like Delivery Order / Sub delivery order, Copies of MAWB/HAWB.

Customs Examination

Packages are forwarded for Customs Examination from the locations, based on the **Location Slip generated by AAI.**

After the Customs Examination, the packages are re-packed/sealed in the presence of Importer/Agent and returned to the AAI for storage into the location.

Out of customs charge

In case of First Appraisement, after completion of the Examination, the remaining Customs formalities will be completed on the first floor. After payment of duty, Office Superintendent in the Treasury Section will give 'Out of Customs Charge'. On completion of the Examination formalities, and also if the goods are in order, the Shed Appraiser will give 'Out of Customs Charge', in case of goods being cleared under Second Appraisement.

Issuance of Bill-Cum Gate Pass

After obtaining 'Out of Customs Charge' by the Importer/Agent is required to contact AAI Billing Counter for issue of Demurrage Charges-cum-Gate Pass after payment of AAI charges and Two copies (Green and Red) shall be issued. The green copy should be submitted to the AAI staff located in the Examination Area and Red Copy should be retained by the Importer/Agent and proceed to the Exit Gate.

Delivery

On receipt of the Green copy of the Gate Pass, the AAI staff shall make arrangements for delivery of the packages and shall direct the Importer/Agent to go to the Delivery Gate for taking delivery of the packages.

On verification of the Gate Pass and the packages by Customs Gate Officer and AAI Staff, the consignments will be released to the Importer/Agent against clear signatures.

503.3 ❐ A Summary of Procedures for Customs Clearance

The work of examination of goods (usually done on a percentage basis), classification, valuation, checking from import licence point of view and assessment of duty is attended to in the Custom House by the Groups. The work is divided among different commodity groups on functional basis and each group is placed under the charge of an Assistant Commissioner. The following documents have usually to be submitted by importers/ exporters for clearance of goods through customs :

Where some goods are imported for the first time or their tariff classification is not

Import	Export
1. Bill of Entry (see Form Nos.22,23,24)	1. Shipping Bill (See Form Nos.93 to 100). Use green coloured shipping bill if export is under claim for drawback and white in other cases.
2. Invoice and packing list	2. Invoice and packing list
3. Import licence, where necessary	3. Export licence/quota certificate where necessary
4. Country of origin certificate, where preferential rate is claimed	4. Export inspection agency's certificate, where necessary.
5. Insurance memo/policy	5. G.R.I Form/S.D.F. declaration under EDI system.
6. Bill of lading or deliver order	6. AR 4 form of central excise
7. Any other documents asked by customs officer	7. Any other documents asked by customs officer

well established, or their prices have gone down considerably, importers are advised to keep catalogue/literature regarding composition and functions of the goods and their prices ready with them before hand.

For examination of the goods, the customs officer may either follow the first check procedure, that is, getting the goods examined by customs officer in the docks before completing assessment or the second check procedure, that is, assessing the duty on the basis of records and leaving the examination of goods, if necessary, to be done at the time of their clearance after payment of duty. Examination of goods not falling in the sensitive list or not falling in the sensitive list or not falling under DEEC/Pass Book Schemes may be dispensed within the following types of cases:

i) Imports by regular actual user importers with proven track record.

ii) Import of any prime/standard goods that the assessing officers in the appraising groups or docks deem fit.

iii) Imports of non-sensitive bulk goods.

iv) Imports through single window clearance group.
v) Imports by charitable institutions for free distribution.

Green Channel Facility in EDI.

In such cases, examination shall only be carried out on the order of A.C, (Appraising) or A.C.(Docks) and reasons are to be indicated.

If the goods require to be tested, or there is dispute regarding valuation, classification or import licence requirement, there is provision to make a provisional assessment/ clearance subject to execution of bond with security (usually with bank guarantee) by the importer. Another option available to the importer for avoiding heavy demurrage on the goods pending resolution on the point of doubt or dispute is to store the goods under Section 49. Under the existing law, Port Trust/IAAI/CWC is not legally bound to waive the demurrage in full or in part even if goods remained detained for no fault of the importer/exports.

In testing of imported goods, method of testing as laid down by ISI should be followed.

In the case of manufacturer-exporter, customs will normally accept the following types of test reports, even for DEEC/Pass Book Schemes, and does not draw fresh samples for testing of export products:

(a) In house Test Reports provided the in house testing facility of the manufacturer-exporter has been recognised as follows:
   i. The manufacturer-exporter has been awarded GMP (Good Manufacturing Practices) certificate by the concerned Drug Controller; or
   ii. The in-house testing facility has been approved by ISI/CSIR/Ministry of Science or Technology or the nodal Ministry; or
   iii. The manufacturer-exporter has been awarded ISO 9002 certification.

(b) Test reports, attested by Superintendent of Central Excise, on samples drawn earlier by Central Excise authorities. Such test results shall be valid for six months from the date of their issue

Denaturing or mutilation of imported goods is permissible under Section 24 notwithstanding that rules thereunder have not been framed.

If the goods are re-exported, neither redemption fine nor duty is to be paid.

If export cargo is shut out by the vessel originally indicated in the shipping bill, exporters may amend the name of the vessel by taking approval of the Assistant Commissioner (Export) in the Custom House or of the Preventive Superintendent of Customs in the docks.

In order to assist importers and exporters, the services of Customs House Agents or clearing agents are available at international ports and airports. They are a body of professional experts duly licensed by Commissioner of Customs after screening. The role of the CHA is for the limited purpose of arranging clearances of the goods and once the goods are cleared he has no further role.

503.4 ❐ Customs Valuation

"Customs Value" means the value of goods for the purposes of levying ad valorem duties of customs.

Ad valorem duties of customs are duties levied according to the value of goods and are usually expressed as percentages of value. Such duties are distinct from specific duties that are based on specific measures of goods such as number, weight, volume, area, capacity etc. There can also be composite duties that are partly ad valorem and partly specific. Customs tariff of a country indicates what kind of duties are levied on different kinds of goods. However, barring exceptions, most countries generally levy customs duties on ad valorem basis.

An importer or an authorised agent needs to declare the value of imported goods as a part of goods declaration at the customs entry point along with a supporting invoice. Many countries also require a separate valuation declaration form to be filled either in respect of each consignment or in respect of a series of consignments imported over a period. Besides customs officials may also require additional documents and information in a particular case as in the case of related party sales etc or where they have a doubt regarding the truth and accuracy of the declaration.

As most countries require a declaration of value of all imported goods for compilation of trade statistics. Some countries may also require such a declaration for tariff quota, import licensing or exchange control purposes.

503.5 ❐ Note on Transaction Cost

A transaction cost is a cost incurred in making an economic exchange - the cost of participating in a market. For example, most people, when buying or selling a stock, must pay a commission to their broker; that commission is a transaction cost of doing the stock deal. Or consider buying a banana from a store; to purchase the banana, your costs will be not only the price of the banana itself, but also the energy and effort it requires to find out which of the various banana products you prefer, where to get them and at what price, the cost of travelling from your house to the store and back, the time waiting in line, and the effort of the paying itself; the costs above and beyond the cost of the banana are the transaction costs. When rationally evaluating a potential transaction, it is important to consider transaction costs that might prove significant. A number of kinds of transaction cost have come to be known by particular names:

- Search and information costs are costs such as those incurred in determining that the required good is available on the market, who has the lowest price, etc.
- Bargaining costs are the costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract and so on. In game theory this is analysed for instance in the game of chicken. On asset markets and in market microstructure, the transaction cost is some function of the distance between the bid and ask.
- Policing and enforcement costs are the costs of making sure the other party sticks to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.

Reference

1. http://www.dov.gov.in/newsite3/index.asp
2. http://www.eximguru.com/exim/guides/how-to-import/ch_19_custom_clearance_of_imported_goods.aspx
3. http://www.chennaicustoms.gov.in/imports.htm
4. Export Documentation and Procedure A-Z by Paras Ram.

Unit 504 ❐ Duty Drawback

Structure

Duty drawback - re-exported goods

Elements Necessary for Drawback under Section 74
Procedure to Claim Drawback under Section 74.
Supporting Documents Required for Processing Drawback Claim under Section 74
Time Limit under Section 74

Article: Duty Drawback - Customs Act, 1962

Duty drawback - re-exported goods

Elements Necessary for Drawback under Section 74 are :

1. The goods on which drawback is claimed must have been previously imported;
2. Import duty must have been paid on these goods when they were imported;
3. The goods should be entered for export within two years from the date of payment of duty on their importation (whether provisional or final duty). The period can be further extended to three years by the Commissioner of Customs on sufficient cause being shown.
4. The goods are identified as the goods imported.
5. The goods must be capable of being identified as imported goods.
6. The goods must actually be re-exported to any place outside India.
7. The market price of such goods must not be less than the amount of drawback claimed.
8. The amount of drawback should not be less than Rs. 50/- as per Section 76-(1) (c) of the Customs Act.

Procedure to Claim Drawback under Section 74

Drawback claims under Section 74 of the Customs Act are now being processed manually. To claim drawback under Section 74, the exporter should file the shipping bill under claim for drawback in the prescribed form and after assessment the goods are to be examined by the Customs officers for purposes of physical identification. After shipment, the claim is filed in the department, for sanction of drawback. The pre-receipted drawback payment order has to be forwarded to the drawback department upon which cheque is issued. If the information submitted by the exporter is insufficient to process the claim, a deficiency memo will be issued to the exporter seeking further information or documents to process the claim. On compliance the claims will be processed in the usual manner.

Supporting Documents Required for Processing Drawback Claim under Section 74

1. Triplicate copy of the Shipping Bill bearing examination report recorded by the proper officer of the customs at the time of export.
2. Copy of the Bill of entry or any other prescribed documents against which goods were cleared for importation.
3. Import invoice.
4. Evidence of payment of duty paid at the time of importation of goods.
5. Permission from the Reserve Bank of India for re-exports of goods, wherever necessary.
6. Export invoice and packing list.
7. Copy of the Bill of Lading or Airway bill.
8. Any other documents as may be specified in the deficiency Memo.

Time Limit under Section 74

In order to claim drawback under Section 74 the goods should be entered for export within two years from the date of payment of duty on the importation thereof. Provided that in any particular case the period of two years may on sufficient cause shown be extended by the by the Central Board of Customs and Central Excise by such period as it may deem fit.

The time limit have to be computed from the date of payment of duty up to the date of entry of goods for export under Sec 50 of the Customs Act for export by air or sea, under Section 77 for baggage items and Under Section 83 of the Customs Act for export by post

The claims should be filed in the manner prescribed under Rule 5 of Re-export of Imported Goods(Drawback of Customs Duties) Rules,1995, read with Public Notices issued by the Custom Houses. The time limit for filing the claim is three months from the date of let export order. If the exporter was prevented by sufficient cause from filing the claims within three months, the Asst. Commissioner of Customs can relax the time limit by three months.

Duty Drawbac-Customs Acts, 1962

Duty Drawback is governed by a couple of sections in the Customs Act, 1962 namely Sec.74 and Sec.75. The common intention is apparently to refund the import duty borne by the importer on exporting the goods. One (Sec.74) being for duty drawback on re-export back in specie and the other (Sec.75) for duty drawback on imported Materials used in Exported product. Importing of Raw materials and manufacturing finished Goods only to export out of India is omnipotent and Sec.75 presents a heavy relief to these manufacturer-exporters. Sec.74 is an occasional phenomenon

Under Sec.75 the goods that are eligible are

1) those on which manufacturing or processing takes place and

2) those on which any operation is carried out.

The words 'on which any operation is carried out' would mean that even those non value adding activities that are incidental or ancillary to the main manufacturing process are also considered for e.g. a specific packing. If it is a packing material that is being imported, there is a choice to the exporter to avail the benefit of Sec.74 (by proving the Commissioner on the specie export under packaged condition) or Sec.75. But then the very obvious alternative is Sec.75 which gives 100% duty drawback rather than Sec.74 which gives only 98% of duty drawback with onus of proofs on assessee and many other practical difficulties.

In Sec.75, the words "being goods which have been entered for export and in respect of which an order permitting the clearance and loading thereof for exportation has been made under......" clearly require that the order for clearance of export is required as a prerequisite to make an application for Duty drawback. In USA the sale of Drawback rights is made legitimate to permit companies not exporting any goods to transfer the right to an exporter to enable him claim the drawback. This is similar to our Duty Entitlement Pass Book Scheme. But here in India we do not have such facility. Consider the case of a last sale preceding the export, where the manufacture procures imported materials and transfers the stock to an overseas distributor. There is no way the manufacturer can claim duty drawback of the import duty since the Bill of entry and hence the order permitting export clearance will be in the name of the distributor and not the manufacturer. If there had been a facility to transfer Duty drawback rights or some scheme like DEPB the manufacturer can probably claim the drawback. In this context the above words assume utmost significance.

The amount of drawback available under Sec.75 is "the duties of customs chargeable under this Act on any imported materials of a class or description used in the [manufacture or processing of such goods or carrying out any operation on such goods". Should there be a question what will happen if due to some reason there is a remission of duty from Government? The answer is cleverly replied in the subsequent clause (2a) of the section. It says that the Central Government shall make rules among various other aspects to allow drawback of the amount actually paid by the manufacturer for carrying out the purposes of the act. It is relevant to note that as per Circular No.41/2005, drawback is not to be denied when duty is paid through DEPB scheme. The duty drawback for many industries is fixed based on a trend of average import material consumption and incidence of duty which is popularly called as 'Brand Rate' fixation.

Extra Duty Deposit recovery under Customs act 1962 (Valuation Rules) is a frequent occurrence nowadays with the advent of Globalisation and off shoring. Branches of MNCs in India which import materials and components from their Parent company are very consistently demanded an Extra Duty deposit which as per law ranges from 1% - 5%. Extra Duty Deposit (EDD) is nothing but a result of investigations into the Cross border transfer pricing. EDD is collected by way of provisional assessment and depending upon the final order passed by the SVB (Special Valuation Branch which investigates the Invoicing) the deposit is either converted to Duty or refunded back to the assessee.

When a Brand rate is fixed for an Industry as per Sec.75, there could be problem for a manufacturer to claim the extra duty deposit if any paid under a provisional assessment. There are two reasons for this

1) Provisionally assessed Duty cannot be claimed as a duty drawback until the final assessment (Refer Sec.18 (5) (e)). Also the usage of words 'duties chargeable' supply adequate inference.

2) A Brand Rate fixation is claimed to be based on normal transaction value and consumption of material. Hence on a final assessment of the EDD as Duty payable, the department will argue that the EDD is a normal duty on the Normal Transaction value which is already factored in fixing the 'Brand Rate'. In which case it becomes an uphill task to claim drawback of the EDD paid.

The export proceeds have to be received in India within the time permitted by FEMA Act and FOB price of exports should not be less the value of imports. For SEZ netting of foreign currency receivables and payable is permitted.

This apart, there are powers to the Central Government conferred under this section to specify by way of rules as to how much is the percentage of a specific imported material in a particular exported product on which duty drawback is available. In doing so, it is the duty of Central Government to ensure consistency with the relevant 'Tariff reduction' agreements with other countries. This is because these agreements spell out the required percentage of 'Regional Value Content' in the exported commodity to obtain the Certificate of origin. This Certificate is the proof for claiming concessional tariffs under the agreement. If there is lack of consistency in this regard it will become a 'Catch 22' sort of situation for the exporter.

Reference :

(i) Sandeep Abuja , Duty Drawback Manual 2006

(ii) Export Documentation and Procedure A-Z by Paras Ram Ch. 48

(iii) http://www.tax4india.com/indian-laws/indian-tax-law/custom-law/duty-drawback.html

Unit 505 ❐ FEMA and RBI rules for import of goods and services

Structure

1. Introduction
2. FEMA, Chapter 7, Part A (on the import of goods)
3. RBI MC: General guidelines issued by the RBI for importers
4. Form A-1
5. Import licenses
6. Obligation of purchaser of foreign exchange
7. Time limit for settlement of import payments
8. Advance remittance
9. Interest on import bills
10. Remittances against replacement imports
11. Guarantee for replacement import
12. Receipt of import bills/documents
13. Evidence of import and issue of acknowledgement
14. Verification and preservation of evidence of import
15. Follow up for import evidence
16. Issue of bank guarantee
17. Import factoring
18. Merchanting trade

(Note: Reference to "bank" or "banks" in this document is to Authorised Dealer - Category 1 banks as classified by the RBI.)

Introduction

Import trade is regulated by the Directorate General of Foreign Trade (DGFT) under the Ministry of Commerce & Industry, Department of Commerce, Government of India. Authorised Dealer Category - I (AD Category - I) banks should ensure that the imports into India are in conformity with the Foreign Trade Policy in force and Foreign Exchange Management (Current Account Transactions) Rules, 2000, framed by the Government of India vide Notification No. G.S.R.381 (E) dated May 3, 2000 and the directions issued by Reserve Bank under Foreign Exchange Management Act, 1999 from time to time.

Banks should follow normal banking procedures and adhere to the provisions of Uniform Customs and Practices for Documentary Credits (UCPDC), etc. while opening letters of credit for import into India on behalf of their constituents.

Compliance with the provisions of Research & Development Cess Act, 1986 may be ensured for import of drawings and designs.

Banks may also advise importers to ensure compliance with the provisions of Income Tax Act, wherever applicable.

[The RBI Master Circular on imports is addressed to all commercial banks authorised to deal in foreign exchange. However, all importers should be aware of the responsibilities and compliance requirements cast on them for compliance without fail. The rest of this document provides extracts of instructions as embodied in the RBI Master Circular No. 04/2010-11 dated July 01, 2010 on import of goods and services. The Master Circular will be updated and re-issued on 01 July, as is the practice every year. It will be available on that date on the RBI website. Importers should take a note of the same.]

FEMA, Chapter 7, Part A (on the import of goods)

"7.A.(i). (ii) Authorised dealers are permitted to open letters of credit on behalf of their customers who are known to be participating in the trade. While doing so, they should follow normal banking procedures, UCPDC provisions, etc. The letter of credit should, in particular, stipulate a condition requiring that the bill of lading should indicate the name and address of the importer in India as well as the authorised dealer opening the credit. Remittances for imports under letters of credit or otherwise should be made against shipping documents/lorry/railway receipts/Exchange Control copies of bills of entry/postal/courier wrappers, etc. except where it is otherwise provided in this Chapter.

RBI MC: General guidelines issued by the RBI for importers

RBI Master Circular No. 04/2010-11 dated July 01, 2010

Section B- General Guidelines for imports

B.1. General Guidelines

Rules and regulations to be followed by the banks from the foreign exchange angle while undertaking import payment transactions on behalf of their clients are set out in the following paragraphs. Where specific regulations do not exist, Banks may be governed by normal trade practices. Banks may particularly note to adhere to "Know Your Customer" (KYC) guidelines issued by Reserve Bank (Department of Banking Operations & Development) in all their dealings.

B.2. Form A-1

Applications by persons, firms and companies for making payments, exceeding USD 500 or its equivalent, towards imports into India must be made in Form A-1.

B.3. Import Licenses

Except for goods included in the negative list which require licence under the Foreign Trade Policy in force, Banks may freely open letters of credit and allow remittances for import. While opening letters of credit, the 'For Exchange Control purposes' copy of the licence should be called for and special conditions, if any, attached to such licences should be adhered to. After effecting remittances under the licence, Banks may preserve the copies of utilised licences till they are verified by the internal auditors or inspectors.

B.4. Obligation of Purchaser of Foreign Exchange

(i) In terms of Section 10(6) of the Foreign Exchange Management Act, 1999 (FEMA), any person acquiring foreign exchange is permitted to use it either for the purpose mentioned in the declaration made by him to a bank under Section 10(5) of the Act or to use it for any other purpose for which acquisition of foreign exchange is permissible under the said Act or Rules or Regulations framed there under.

(ii) Where foreign exchange acquired has been utilised for import of goods into India, the bank should ensure that the importer furnishes evidence of import viz., Exchange Control copy of the Bill of Entry, Postal Appraisal Form or Customs Assessment Certificate, etc., and satisfy himself that goods equivalent to the value of remittance have been imported.

(iii) In addition to the permitted methods of payment for imports laid down in Notification No.FEMA14/2000-RB dated 3rd May 2000, payment for import can also be made by way of credit to non-resident account of the overseas exporter maintained with a bank in India. In such cases also Banks should ensure compliance with the instructions contained in sub-paragraphs (i) and (ii) above.

B.5. Time Limit for Settlement of Import Payments

B.5.1. Time limit for normal imports

(i) In terms of the extant regulations, remittances against imports should be completed not later than six months from the date of shipment, except in cases where amounts are withheld towards guarantee of performance, etc.

(ii) Banks may permit settlement of import dues delayed due to disputes, financial difficulties, etc. Interest in respect of delayed payments, usance bills or overdue interest for a period of less than three years from the date of shipment may be permitted in terms of the directions in para C.2 of Part III below.

B.5.2. Time limit for deferred payment arrangements

Deferred payment arrangements, including suppliers and buyers credit, providing for payments beyond a period of six months from date of shipment up to a period of less than three years, are treated as trade credits for which the procedural guidelines laid down in the Master Circular for External Commercial Borrowings and Trade Credits may be followed. (Visit the RBI website for full text.)

B.6.1. Import of foreign exchange into India

A person may -

(i) send into India without limit foreign exchange in any form other than currency notes, bank notes and travellers cheques;

(ii) bring into India from any place outside India, without limit foreign exchange (other than unissued notes), which shall be subject to the condition that such person makes, on arrival in India, a declaration to the Custom Authorities, unless the total value at any one time does not exceed USD10,000 (US Dollars ten thousand) or its equivalent and/or the aggregate value of foreign currency notes (cash portion) alone brought in by such person at any one time does not exceed USD 5,000 (US Dollars five thousand) or its equivalent.

B.6.2. Import of Indian currency and currency notes

(i) Any person resident in India who had gone out of India on a temporary visit, may bring into India at the time of his return from any place outside India (other than from Nepal and Bhutan), currency notes of Government of India and Reserve Bank notes up to an amount not exceeding Rs.7,500/- per person.

(ii) A person may bring into India from Nepal or Bhutan, currency notes of Government of India and Reserve Bank notes other than notes of denominations of above Rs.100 in either case.

Section C - Operational Guidelines for Imports

C.1. Advance Remittance

C.1.1. Advance Remittance for import of goods

(i) AD Category - I bank may allow advance remittance for import of goods without any ceiling subject to the following conditions:

(a) If the amount of advance remittance exceeds USD 100,000 or its equivalent, an unconditional, irrevocable standby Letter of Credit or a guarantee from an international bank of repute situated outside India or a guarantee of an AD Category - I bank in India, if such a guarantee is issued against the counter-guarantee of an international bank of repute situated outside India, is obtained.

(b) In cases where the importer (other than a Public Sector Company or a Department/ Undertaking of the Government of India/State Government/s) is unable to obtain bank guarantee from overseas suppliers and the AD Category - I bank is satisfied about the track record and bonafides of the importer, the requirement of the bank guarantee / standby Letter of Credit may not be insisted upon for advance remittances up to USD 5,000,000 (US Dollar five million). Banks may frame their own internal guidelines to deal with such cases as per a suitable policy framed by the bank's Board of Directors.

(c) A Public Sector Company or a Department/Undertaking of the Government of India / State Government/s which is not in a position to obtain a guarantee from an international bank of repute against an advance payment, is required to obtain a specific waiver for the bank guarantee from the Ministry of Finance, Government of India before making advance remittance exceeding USD 100, 000.

(ii) All payments towards advance remittance for imports shall be subject to the specified conditions.

C.1.2. Advance Remittance for Import of Rough Diamonds

(i) AD Category - I bank are permitted to allow advance remittance without any limit and without bank guarantee or standby Letter of Credit, by an importer (other than a Public Sector Company or a Department / Undertaking of the Government of India / State Government/s), for import of rough diamonds into India from the under noted mining companies, viz.

a) De Beers UK Ltd,

b) RIO TINTO, UK,

c) BHP Billiton, Australia,

d) ENDIAMA, E. P. Angola,

e) ALROSA, Russia,

f) GOKHARAN, Russia,

g) Rio Tinto, Belgium,

h) BHP Billiton, Belgium and

i) Namibia Diamond Trading Company (PTY) Ltd. (NDTC).

(ii) While allowing the advance remittance, AD bank may ensure the following :

(a) The importer should be a recognized processor of rough diamonds as per the list to be approved by Gems and Jewellery Export Promotion Council (GJEPC) in this regard and should have a good track record of export realisation;

(b) Bank should undertake the transaction based on their commercial judgment and after being satisfied about the bonafides of the transaction;

(c) Advance payments should be made strictly as per the terms of the sale contract and should be made directly to the account of the company concerned, that is, to the ultimate beneficiary and not through numbered accounts or otherwise. Further, due caution may be exercised to ensure that remittance is not permitted for import of conflict diamonds;

(d) KYC and due diligence exercise should be done by the AD Category - I bank for the Indian importer entity and the overseas company; and

(e) Banks should follow up submission of the Bill of Entry (BoE)/ documents evidencing import of rough diamonds into the country by the importer, in terms of FEMA / Rules / Regulations / Directions issued in this regard.

(iii) In case of an importer entity in the Public Sector or a Department / Undertaking of the Government of India / State Government/s, AD Category - I bank may permit advance remittance subject to the above conditions and a specific waiver of bank guarantee from the Ministry of Finance, Government of India where the advance payments is equivalent to or exceeds USD 100,000.

(iv) Banks are required to submit a report in the format annexed of all such advance remittances made without a bank guarantee or standby Letter of Credit, where the amount of advance payment is equivalent to or exceeds USD 5,000,000 …on a half yearly basis as at the end of September and March every year.

C.1.4. Advance Remittance for the import of services

AD Category - I bank may allow advance remittance for import of services without any ceiling subject to the following conditions:

(a) Where the amount of advance exceeds USD 500,000 or its equivalent, a guarantee from a bank of international repute situated outside India, or a guarantee from an AD Category - I bank in India, if such a guarantee is issued against the counter-guarantee of a bank of international repute situated outside India, should be obtained from the overseas beneficiary.

(b) In the case of a Public Sector Company or a Department/ Undertaking of the Government of India/ State Governments, approval from the Ministry of Finance, Government of India for advance remittance for import of services without bank guarantee for an amount exceeding USD 100,000 (USD One hundred thousand) or its equivalent would be required.

(c) Banks should also follow-up to ensure that the beneficiary of the advance remittance fulfils his obligation under the contract or agreement with the remitter in India, failing which, the amount should be repatriated to India.

C.2. Interest on Import Bills

(i) Banks may allow payment of interest on usance bills or overdue interest for a period of less than three years from the date of shipment at the rate prescribed for trade credit from time to time.

(ii) In case of pre-payment of usance import bills, remittances may be made only after reducing the proportionate interest for the unexpired portion of usance at the rate at which interest has been claimed or LIBOR of the currency in which the goods have been invoiced, whichever is applicable. Where interest is not separately claimed or expressly indicated, remittances may be allowed after deducting the proportionate interest for the unexpired portion of usance at the prevailing LIBOR of the currency of invoice.

C.3. Remittances against Replacement Imports

Where goods are short-supplied, damaged, short-landed or lost in transit and the Exchange Control copy of the import licence has already been utilised to cover the opening of a letter of credit against the original goods which have been lost, the original endorsement to the extent of the value of the lost goods may be cancelled by the bank and fresh remittance for replacement imports may be permitted without reference to

Reserve Bank, provided the insurance claim relating to the lost goods has been settled in favour of the importer. It may be ensured that the consignment being replaced is shipped within the validity period of the license.

C.4. Guarantee for Replacement Import

In case replacement goods for defective import are being sent by the overseas supplier before the defective goods imported earlier are reshipped out of India, banks may issue guarantees at the request of importer client for dispatch/return of the defective goods, according to their commercial judgment.

C.6. Receipt of Import Bills/Documents

C.6.1. Receipt of import documents by the importer directly from overseas suppliers

Import bills and documents should be received from the banker of the supplier by the banker of the importer in India. Banks should not, therefore, make remittances where import bills have been received directly by the importers from the overseas supplier, except in the following cases:

(i) Where the value of import bill does not exceed USD 300,000.

(ii) Import bills received by wholly-owned Indian subsidiaries of foreign companies from their principals.

(iii) Import bills received by Status Holder Exporters as defined in the Foreign Trade Policy, 100% Export Oriented Units / Units in Special Economic Zones, Public Sector Undertakings and Limited Companies.

(iv) Import bills received by all limited companies viz. public limited, deemed public limited and private limited companies.

C.6.2. Receipt of import documents by the importer directly from overseas suppliers in case of specified sectors

As a sector specific measure, Banks are permitted to allow remittance for imports up to USD 300,000 where the importer of rough diamonds, rough precious and semi-precious stones has received the import bills / documents directly from the overseas supplier and the documentary evidence for 13

import is submitted by the importer at the time of remittance. Banks may undertake such transactions subject to the following conditions:

(i) The import would be subject to the prevailing Foreign Trade Policy.

(ii) The transactions are based on their commercial judgment and they are satisfied about the bonafides of the transactions.

(iii) Banks should do the KYC and due diligence exercise and should be fully satisfied about the financial standing / status and track record of the importer customer. Before extending the facility, they should also obtain a report on each individual overseas supplier from the overseas banker or reputed credit rating agency overseas.

C.6.3. Receipt of import documents by the AD Category - I bank directly from overseas suppliers

(i) At the request of importer clients, AD Category - I bank may receive bills directly from the overseas supplier as above, provided the AD Category - I bank is fully satisfied about the financial standing/status and track record of the importer customer.

(ii) Before extending the facility, the AD Category - I bank should obtain a report on each individual overseas supplier from the overseas banker or a reputed credit agency. However, such credit report on the overseas supplier need not be obtained in cases where the invoice value does not exceed USD 300,000 provided the AD Category - I bank is satisfied about the bonafides of the transaction and track record of the importer constituent.

C.7. Evidence of Import

C.7.1. Physical Imports

(i) In case of all imports, where value of foreign exchange remitted/ paid for import into India exceeds USD 100,000 or its equivalent, it is obligatory on the part of the AD Category - I bank through whom the relative remittance was made, to ensure that the importer submits :-

(a) The Exchange Control copy of the Bill of Entry for home consumption, or

(b) The Exchange Control copy of the Bill of Entry for warehousing, in case of 100% Export Oriented Units, or

(c) Customs Assessment Certificate or Postal Appraisal Form, as declared by the importer to the Customs Authorities, where import has been made by post, as evidence that the goods for which the payment was made have actually been imported into India.

(ii) In respect of imports on D/A basis, banks should insist on production of evidence of import at the time of effecting remittance of import bill.

However, if importers fail to produce documentary evidence due to genuine reasons such as non-arrival of consignment, delay in delivery/ customs clearance of consignment, etc., AD bank may, if satisfied with the genuineness of request, allow reasonable time, not exceeding three months from the date of remittance, to the importer to submit the evidence of import.

C.7.2. Evidence of import in lieu of Bill of Entry

(i) AD Category - I bank may accept, in lieu of Exchange Control copy of Bill of Entry for home consumption, a certificate from the Chief Executive Officer (CEO) or auditor of the company that the goods for which remittance was made have actually been imported into India provided :-

(a) the amount of foreign exchange remitted is less than USD 1,000,000 or its equivalent,

(b) the importer is a company listed on a stock exchange in India and whose net worth is not less than Rs.100 crore as on the date of its last audited balance sheet, or the importer is a public sector company or an undertaking of the Government of India or its departments.

(ii) The above facility may also be extended to autonomous bodies, including scientific bodies/academic institutions, such as Indian Institute of Science / Indian Institute of Technology, etc. whose accounts are audited by the Comptroller and Auditor General of India (CAG). AD Category - I bank may insist on a declaration from the auditor/CEO of such institutions that their accounts are audited by CAG.

C.7.3. Non Physical Imports

(i) Where imports are made in non-physical form, i.e., software or data through internet / datacom channels and drawings and designs through e-mail/fax, a certificate from a Chartered Accountant that the software / data / drawing/ design has been received by the importer, may be obtained.

(ii) AD Category - I bank should advise importers to keep Customs Authorities informed of the imports made by them under this clause.

C.8. Issue of acknowledgement

AD Category - I bank should acknowledge receipt of evidence of import e.g. Exchange Control copy of the Bill of Entry, Postal Appraisal Form or Customs Assessment Certificate, etc., from importers by issuing acknowledgement slips containing all relevant particulars relating to the import transactions.

C.10. Follow up for Import Evidence

(i) In case an importer does not furnish any documentary evidence of import, as required under paragraph C.7. of Part III, within 3 months from the date of remittance involving foreign exchange exceeding USD 100,000, the banks should rigorously follow-up for the next 3 months, including issuing registered letters to the importer.

(ii) Banks should forward a statement on half-yearly basis as at the end of June & December of every year, in form BEF (Annex 1) furnishing details of import transactions, exceeding USD 100,000 in respect of which importers have defaulted in submission of appropriate document evidencing import within 6 months from the date of remittance, to the Regional Office of Reserve Bank under whose jurisdiction the AD Category - I bank is functioning, within 15 days from the close of the half-year to which the statement relates.

C.11. Issue of Bank Guarantee

Banks are permitted to issue guarantee on behalf of their importer customers in terms of Notification No. FEMA 8/2000-RB dated May 3, 2000, as amended from time to time.

C.16. Import factoring

(i) AD Category - I bank may enter into arrangements with international factoring companies of repute, preferably members of Factors Chain International, without the approval of Reserve Bank.

(ii) They will have to ensure compliance with the extant foreign exchange directions relating to imports, Foreign Trade Policy in force and any other guidelines/ directives issued by Reserve Bank in this regard.

C.17. Merchanting Trade

Banks may take necessary precautions in handling bonafides merchanting trade transactions or intermediary trade transactions to ensure that:

(a) Goods involved in the transactions are permitted to be imported into India and all the rules, regulations and directions applicable to export (except Export Declaration

Form) and import (except Bill of Entry) are complied with for the export leg and import leg, respectively.

(b) The entire merchant trade transaction is completed within a period of 6 months.

(c) The transactions do not involve foreign exchange outlay for a period exceeding three months.

(d) Payment is received in time for the export leg.

(e) Where the payment for export leg of the transaction precedes the payment for import leg, banks should ensure that the terms of payment are such that the liability for the import leg of the transaction is extinguished by the payment received for the export leg of the transaction, without any delay.

Banks may note that short-term credit either by way of suppliers' credit or buyers' credit is not available for merchanting trade or intermediary trade transactions.

[Note: Merchanting trade carries a much higher degree of risk than ordinary import transaction. This is because the goods never enter the country of residence of the "merchant" or the middleman who arranges the import and the export legs of the merchanting transaction. Merchanting trade should be undertaken after gaining considerable experience in international trade, after due risk analysis and taking all necessary precautions, with due observance of the RBI guidelines and KYC norms.]

Unit 506 ❐ KYC and Anti-money Laundering

Structure

506.1 Introduction

The main purpose of KYC norms was to restrict money laundering and terrorist financing when it was introduced in late the 1990s in the United States. The US government turned very strict after 9/11 and all regulations were finalised before 2002 for KYC. The US has made changes in its major legislations -- Bank Secrecy Act, USA Patriot Act, et cetera -- to make KYC norms really effective for the banking sector.

Taking a leaf out of the US book, the Reserve Bank of India too directed all banks to implement KYC guidelines for all new accounts in the 2nd half of 2002. For existing accounts, imposing KYC norms was a little difficult, so the RBI issued guidelines for the same at the end of 2004.

506.2 What is KYC ?

In order to prevent identity theft, identity fraud, money laundering, terrorist financing, etc, the RBI had directed all banks and financial institutions to put in place a policy framework to know their customers before opening any account. This involves verifying customers' identity and address by asking them to submit documents that are accepted as relevant proof. (See reference to RBI circular below).

Mandatory details required under KYC norms are proof of identity and proof of address. Passport, voter's ID card, PAN card or driving license are accepted as proof of identity, and proof of residence can be a ration card, an electricity or telephone bill or a letter from the employer or any recognised public authority certifying the address.

Some banks may even ask for verification by an existing account holder. Though the standard documents which are accepted as proof of identity and residence remain the same across various banks, some deviations are permitted, which differ from bank to bank.

So, all documents shall be checked against banks requirements to ascertain if those match or not before initiating an account opening process with any bank. Those are the basic requirements of KYC to identify a customer at the account opening stage.

506.3 Other aspects of KYC

To prevent the possible misuse of banking activities for anti-national or illegal activities, the RBI has given various directives to banks :

- Strengthening the banks' 'Internal Control System' by allocating duties and responsibilities clearly, and periodically monitoring them.
- Before giving any finance at branch level, making sure that the person has no links with notified terrorist entities and reporting any such 'suspect;' accounts to the government.
- Regular 'Internal Audit' by internal and concurrent auditors to check if the KYC guidelines are being properly adhered to or not by banks.
- Most important, banks must keep an eye out for all banking transactions and identify suspicious ones. Such transactions will be immediately reported to the

bank's head office and authorities and norms shall also be laid down for freezing of such accounts.

In 2004, the RBI had come up with more specific guidelines regarding KYC. These were divided into four parts :

1. **Customer Acceptance Policy :** All banks shall develop criteria for accepting any person as their customer to restrict any anonymous accounts and ensure documentation mentioned in KYC.
2. **Customer Identification Procedures :** Customer to be identified not only while opening the account, but also at the time when the bank has a doubt about his transactions.
3. **Monitoring of Transactions :** KYC can be effective by regular monitoring of transactions. Identifying an abnormal or unusual transaction and keeping a watch on higher risk group of the account is essential in monitoring transactions.
4. **Risk management :** This is about managing internal work to reduce the risk of any unwanted activity. Managing responsibilities, duties and various audits plus regular employee training for KYC procedures.

These guidelines also specify that KYC should be implemented for existing account holders on the basis of materiality and risk segments.

The RBI had also directed all banks to make a policy for implementing 'Know Your Customer' and anti-money laundering measures and remain fully compliant with given guidelines before December 31, 2005.

506.4 RBI Master Circular on KYC

Master Circular issued by the RBI vide RBI/2010-11/75, DBOD. AML. BC. No. 2 /14 01.001/2010-11 July 1, 2010 titled Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Csombating of Financing of Terrorism (CFT)/Obligation of banks under Prevention of Money Laundering Act, (PMLA), 2002.

[This circular is revised and updated on July 1 every year. Refer to the RBI website for the latest on the subject.]

Although addressed to banks and financial institutions, certain extracts are being reproduced here for the information of exporters and importers so that they are well prepared to comply with the regulations.

- The objective of KYC/AML/CFT guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks to know/ understand their customers and their financial dealings better which in turn help them manage their risks prudently.

- Banks are advised to follow certain customer identification procedure for opening of accounts, and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.
- For the purpose of KYC policy, a 'Customer' is defined as :
  - a person or entity that maintains an account and/or has a business relationship with the bank;
  - one on whose behalf the account is maintained (i.e. the beneficial owner). 'Beneficial Owner' means the natural person who ultimately owns or controls a client and or the person on whose behalf a transaction is being conducted, and includes a person who exercise ultimate effective control over a juridical person.
  - beneficiaries of transactions conducted by professional intermediaries, such as stock brokers, chartered accountants, solicitors etc. as permitted under the law, and
  - any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.
- Any remittance of funds by way of demand draft, mail/telegraphic transfer or any other mode and issue of travellers' cheques for value of Rupees fifty thousand and above must be effected by debit to the customer's account or against cheques and not against cash payment.
- No account is opened in anonymous or fictitious/benami name.
- Banks should not allow the opening of or keep any anonymous account or accounts in fictitious name or account on behalf of other persons whose identity has not been disclosed or cannot be verified.
- Not to open an account or close an existing account where the bank is unable to apply appropriate customer due diligence measures (say, due to non cooperation of the customer or non reliability of the data/information furnished to the bank).
- Circumstances, in which a customer is permitted to act on behalf of another person/entity, should be clearly spelt out in conformity with the established law and practice of banking;
- Necessary checks before opening a new account so as to ensure that the identity of the customer does not match with any person with known criminal background or with banned entities such as individual terrorists or terrorist organisations etc.
- Banks and financial institutions are required to verify the identity of the customers for all international money transfer operations.

- All cross-border wire transfers must be accompanied by accurate and meaningful originator information.
- In the case of non-face-to-face customers …certification of all the documents presented should be insisted upon…. In such cases, banks may also require the first payment to be effected through the customer's account with another bank which, in turn, adheres to similar KYC standards. In the case of cross-border customers the bank may have to rely on third party certification/introduction ….In such cases it must be ensured that the third party is a regulated and supervised entity and has adequate KYC systems in place.
- When the bank has knowledge or reason to believe that the client account opened by a professional intermediary is on behalf of a single client, that client must be identified.
- Accounts of proprietary concerns: Apart from following the extant guidelines on customer identification procedure as applicable to the proprietor, banks should call for and verify the following documents before opening of accounts in the name of a proprietary concern (refer to page 15, para 2.5.iv of the Master Circular for details).
- Where the bank is unable to apply appropriate KYC measures due to non-furnishing of information and/or non-cooperation by the customer, the bank should consider closing the account or terminating the banking/business relationship after issuing due notice to the customer explaining the reasons for taking such a decision.

506.5 Know Your Customer (KYC) Prevention of Money Laundering : Guidedlines (extracts)

RBI/2004-05/449, DBOD.No.BL.BC.86/22.01.001/2004-05 dated April 30, 2005 addressed to all scheduled commercial banks.

Subject: Section 23 of the Banking Regulation Act, 1949 - Door-step banking

Circular DBOD.No.BL.BC.42/C-168-83 dated May 24, 1983 advised banks not to extend any banking facilities at the premises of their customers, without obtaining the required permission from Reserve Bank of India. However, in view of requests received from Government Departments like Railways, etc. for making available banking services including collection of cash at their premises and representations from banks, a scheme for providing services at the premises of a customer within the framework of Section 23 of Banking Regulation Act, 1949, may be formulated by banks with the approval of their Boards and submitted to the Reserve Bank for approval.

RBI/2005-06/317; DNBS.PD. CC No. 64 /03.10.042/2005-06 dated March 7 , 2006 addressed to all NBFCs, Misc. NBC, and RNBCs

Subject: Know Your Customer Guidelines- Anti-Money Laundering Standards Circular DNBS.(PD). CC.48/10.42/2004-05 dated February 21, 2005. advised NBFCs to

- formulate a customer acceptance policy and customer identification procedure while opening an account on the lines of instructions issued to banks by Department of Banking Operations and Development (DBOD).
- categorize the customers into low, medium and high risk, according to risk perceived
- verify the identity and address of the customer through documents listed in Annexure II to the DBOD circular enclosed with our circular dated February 21, 2005 on 'Know Your Customer' guidelines.

To further simplify the KYC procedure for opening accounts by NBFCs for persons keeping balances not exceeding rupees fifty thousand (Rs. 50,000/-) in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees one lakh (Rs. 1,00,000/-) in a year:

In case a person who wants to open an account is not able to produce documents mentioned in Annexure II of DBOD circular enclosed with our circular dated February 21, 2005, NBFCs may open accounts as described in paragraph 2 above, subject to

a) introduction from another account holder who has been subjected to full KYC procedure.
b) introducer's account with the NBFC should be at least six month old
c) introducer's a/c should show satisfactory transactions
d) photograph of the customer who proposes to open the account and also his address needs to be certified by the introducer.

or

e) any other evidence as to the identity and address of the customer to the satisfaction of the NBFC.

If at any point of time the balances in all his/her accounts with the NBFC (taken together) exceeds rupees fifty thousand (Rs. 50,000/-) or total credit in the account exceeds rupees one lakh (Rs. 1,00,000/-),

- no further transactions will be permitted until the full KYC procedure is completed.
- the NBFC must notify the customer when the balance reaches rupees forty thousand (Rs. 40,000/-) or the total credit in a year reaches Rs. 80,000/- that appropriate documents for conducting the KYC must be submitted otherwise the operations in the account will be stopped when the total balance in all the accounts taken

together exceeds Rs. 50,000/- or the total credit in the accounts exceeds Rs. 1,00,000/- in a year.

506.6 Violation of KYC norms and misuse of IPO finance - Penal Action Press Release : 2005-2006/ 1561

The Reserve Bank of India imposed monetary penalty of Rs.15 lakh on Centurion Bank of Punjab Ltd. for violation of RBI guidelines on Know Your Customer (KYC) norms relating to opening of accounts including joint accounts, for issue of 10,200 cheque leaves to a customer during a short period of two months without complying with RBI guidelines, and also for violation of extant RBI guidelines relating to IPO financing.

506.7 All About Money Laundering & Prevention

506.7.1 What is Money Laundering ?

Illegal arms sales, smuggling, organised crime, drug trafficking and prostitution rings can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and create the incentive to "legitimise" the ill-gotten gains through money laundering.

When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds without attracting attention to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention.

Money laundering is the processing of criminal proceeds to disguise their illegal origin and to enjoy these profits without jeopardising their source.

506.7.2 How much money is laundered per year?

The International Monetary Fund, for example, has stated in 1996 that the aggregate size of money laundering in the world could be somewhere between two and five percent of the world's GDP.

Using 1996 statistics, these percentages would indicate that money laundering ranged between US Dollar (USD) 590 billion and USD 1.5 trillion. The lower figure is roughly equivalent to the value of the total output of an economy the size of Spain.

However it must be said that overall it is absolutely impossible to produce a reliable estimate of the amount of money laundered and therefore the FATF does not publish any figures in this regard.

506.7.3 How is money laundered?

Placement stage of money laundering: the launderer introduces his illegal profits into the financial system.

Done by breaking up large amounts of cash into less conspicuous smaller sums that are then deposited directly into a bank account, or by purchasing a series of monetary instruments (cheques, money orders, etc.) that are then collected and deposited into accounts at another location.

After entering the financial system, the second or layering stage takes place. In this phase, the launderer engages in a series of conversions or movements of the funds to distance them from their source. The funds might be channelled through the purchase and sales of investment instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the globe. In some instances, the launderer might disguise the transfers as payments for goods or services, thus giving them a legitimate appearance.

The launderer then moves them to the third stage - integration - in which the funds re-enter the legitimate economy. The launderer might choose to invest the funds into real estate, luxury assets, or business ventures.

506.7.4 Where does money laundering occur?

Generally, money launderers tend to seek out countries or sectors in which there is a low risk of detection due to weak or ineffective anti-money laundering programmes. Because the objective of money laundering is to get the illegal funds back to the individual who generated them, launderers usually prefer to move funds through stable financial systems.

Money laundering activity may also be concentrated geographically according to the stage the laundered funds have reached. At the placement stage, for example, the funds are usually processed relatively close to the under-lying activity; often, but not in every case, in the country where the funds originate.

With the layering phase, the launderer might choose an offshore financial centre, a large regional business centre, or a world banking centre - any location that provides an adequate financial or business infrastructure. At this stage, the laundered funds may also only transit bank accounts at various locations where this can be done without leaving traces of their source or ultimate destination.

Finally, at the integration phase, launderers might choose to invest laundered funds in still other locations if they were generated in unstable economies or locations offering limited investment opportunities.

506.7.5 How does money laundering affect business?

Evidence of complicity will have a damaging effect on the attitudes of other financial intermediaries and of regulatory authorities, as well as ordinary customers.

Potential negative macroeconomic consequences of unchecked money laundering: Inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.

As it rewards corruption and crime, successful money laundering damages the integrity of the entire society and undermines democracy and the rule of the law.

506.7.6 What influence does money laundering have on economic development?

Economies with growing or developing financial centres, but inadequate controls are particularly vulnerable as established financial centre countries implement comprehensive anti-money laundering regimes.

Launderers tend to move their networks to countries and financial systems with weak or ineffective countermeasures.

Postponing action is dangerous. The more it is deferred, the more entrenched organised crime can become.

As with the damaged integrity of an individual financial institution, there is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organised crime.

506.7.7 What is the connection with society at large?

The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. Organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments.

The economic and political influence of criminal organisations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society.

In countries transitioning to democratic systems, this criminal influence can undermine the transition.

Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue.

506.7.8 How does fighting money laundering help fight crime?

It can be the Achilles heel of criminal activity.

In law enforcement investigations into organised criminal activity, it is often the connections made through financial transaction records that allow hidden assets to be located and that establish the identity of the criminals and the criminal organisation responsible.

When criminal funds are derived from robbery, extortion, embezzlement or fraud, a money laundering investigation is frequently the only way to locate the stolen funds and restore them to the victims.

Most importantly, however, targeting the money laundering aspect of criminal activity and depriving the criminal of his ill-gotten gains means hitting him where he is vulnerable. Without a usable profit, the criminal activity will not continue.

506.8 US GUIDELINES : Know Your Customer Guidance US Department of Commerce, Bureau of Industry and Security

Certain provisions in the Export Administration Regulations (EAR) require an exporter to submit an individual validated license application if the exporter "knows" that an export that is otherwise exempt from the validated licensing requirements is for end-uses involving nuclear, chemical, and biological weapons (CBW), or related missile delivery systems, in named destinations listed in the regulations.

BIS has issued the following guidance on how individuals and firms should act under this knowledge standard. This guidance does not change or revise the EAR.

1. Decide whether there are "red flags."

   Any abnormal circumstances that indicate the export may be destined for an inappropriate end-use, end-user, or destination (circumstances referred to as "red flags.")

   Examples: orders for items inconsistent with the needs of the purchaser, a customer's declining installation and testing when included in the sales price or when normally requested, requests for equipment configurations which are incompatible with the stated destination (e.g.--120 volts in a country with a standard of 220 volts).

2. If there are "red flags."
   A duty to check out the suspicious circumstances. Enquire about the end-use, end-user, or ultimate country of destination.
3. Do not self-blind.
   Do not cut off the flow of information in the normal course of business. For example, do not instruct to tell potential customers to refrain from discussing the actual end-use, end-user and ultimate country of destination for the product your firm is seeking to sell.
   Do not put on blinders that prevent the learning of relevant information. (An affirmative policy of steps to avoid "bad" information would not insulate a company from liability, and it would usually be considered an aggravating factor in an enforcement proceeding.)
   Knowledge possessed by an employee of a company can be imputed to a firm so as to make it liable for a violation. This makes it important for firms to establish clear policies and effective compliance procedures to ensure that such knowledge about transactions can be evaluated by responsible senior officials. Failure to do so could be regarded as a form of self-blinding.
4. Re-evaluate all the information after the inquiry
   The purpose of this inquiry and re-evaluation is to determine whether the "red flags" can be explained or justified. If they can, you may proceed with the transaction. If the "red flags" cannot be explained or justified and you proceed, you run the risk of having had "knowledge" that would make your action a violation of the EAR.
5. Refrain from the transaction, disclose the information to BIS and wait.
   If you continue to have reason for concern after your inquiry, then you should either refrain from the transaction or submit all the relevant information to BIS in the form of an application for a validated license or in such other form as BIS may specify.

References

As cited above at appropriate place.

Unit 507 ❒ FEMA and RBI Rules for Guarantees

Structure

507.1 Introduction

After a gap of 18 years, International Chamber of Commerce (ICC), Paris, has come out with a completely revised set of rules on demand guarantees. These rules, which have come into force from 1 July, 2010, are called the Uniform Rules for Demand Guarantees (URDG), ICC Publication no. 758 - commonly referred to as URDG 758. Its earlier version was known as URDG 458.

Before we set ourselves on the course to a better understanding of the new rules and how they are going to affect us, a few words about guarantees themselves may be in order.

507.2 Types of guarantees

Guarantees are basically of two types, viz., performance and financial. Performance guarantees offer the security of performance. The guarantor (generally the manufacturer or the service provider) undertakes an obligation to repair the defect or replace the offending item, thus ensuring uninterrupted service to the user. (This guarantee may also be provided to the buyer by a third party.) As far as performance guarantees are concerned, the important identifier is that the main purpose is not to compensate with money any failure in performance. A performance guarantee is meant to assure continuity in performance. A financial guarantee, as the term suggests, on the other hand is designed to compensate with money against a defect, default, failure of performance or breach in promise.

Let's take an example. If X buys a camera from Y, under a performance guarantee the manufacturer Y (or Z, a guarantor) guarantees performance of the camera. If the camera malfunctions within the guarantee period, Y or Z must repair it immediately free of cost or provide a replacement. However, if Z had offered a financial guarantee to X, Z's responsibility would have been limited to compensating X only with money to the extent of the guarantee cover, not by performance. Thus, even if a bank guarantee covers performance, the mode of redressal or compensation is in terms of money alone.

Banks invariably issue financial guarantees, never performance guarantees. The reason is simple. Banks are neither equipped or qualified to repair, replace or recompense a breach in performance or promise with a similar, compensatory performance or service. (Can you imagine a bank providing an alternate for Lata Mangeshkar or Lionel Messi!) Hence, when a bank issues a guarantee, it undertakes to compensate a breach of performance in terms of money. For this reason such guarantees are called financial guarantees.

Anyone may issue financial or performance guarantee. Financial guarantees issued by commercial banks are commonly referred to as bank guarantees (BG). The formats of guarantees differ across issuers, transactions, and countries, as do the texts of such guarantees depending on the purpose they are meant to serve. The applicable laws also differ, depending on the jurisdiction.

507.3 BGs and LCs compared

While speaking about payment options in general and BGs in particular, letters of credit (LC) come to our mind. Both are issued by commercial banks, but they differ in the manner of their application. In the case of an LC, the LC issuing bank takes over direct responsibility of payment to the beneficiary (the seller of goods or services). The seller must claim payment only from the LC issuing bank, irrespective of the status of the buyer.

For BGs, this is not the case. Unlike an LC, for the seller the guarantee-issuing bank (guarantor) forms the second line of defence - not the first. The BG is invoked by the seller through a simple demand, and the issuing bank is called upon to pay, only if the buyer fails to perform. As has also been pointed out, unlike performance guarantees, BGs cannot be used to ensure or guarantee continuity of performance - only receive financial compensation for any breach or failure of performance. The point of similarity between a BG and an LC is that both the instruments ultimately represent the commitment and undertaking of a bank to the seller, to pay.

Do note that guarantees and letters of credit are used for a wide variety of purposes, not only in the course of buying and selling of goods and services.

507.4 Standard rules for BGs

As is well known, letters of credit are governed by a widely accepted set of rules known as the Uniform Customs and Practice for Documentary Credits (UCP), issued by the International Chamber of Commerce (ICC), Paris. The currently operative rules are set out in ICC's Publication no. 600 (UCP 600).

Uniform Rules for Demand Guarantees (URDG) apply to bank guarantees. These rules replace URDG 458, which came into operation 18 years ago. URDG 758 apply to all guarantees - whether domestic or international - issued after 1 July, 2010 where the guarantee or counter-guarantee expressly subscribe to these rules.

The immediate question that arises in our minds is why should guarantees or LCs be made subject to the aforementioned rules? There are several reasons for doing so. The reasons essentially revolve around the use of globally accepted, standard set of rules, norms and procedures vis-à-vis non-standard, arbitrary, regional structures and practices. Remember that the URDG was formulated after extensive exercises spanning several years. While drafting these rules, every section of the stakeholders from various nations was consulted and requested to take part in the drafting process. For example, the fourth draft brought together comments received from national committees representing 43 countries, plus observations made by ICC members and observers during the article-by-article discussion sessions that the ICC Banking Commission and the Commercial Law and Practice Commission (CLP) each conducted in 2010 in Dubai and Helsinki respectively. The practices, procedures and standards obtaining in the concerned industries were also taken into account. The URDG revision process has been highly representative, both from a geographical and a sectoral standpoint. Thus, the final product represented a collection of well-defined best practices acceptable globally to most, if not all, the stakeholders.

Similar exercise was undertaken by the ICC while developing UCP 600 for LCs. Therefore, these standardised rules like the UCP, the URDG et al serve as vitally important, common points of reference, being especially useful in international trade where norms and practices, laws, cultures, interpretations, terminologies etc. vary from region to region, country to country. The availability of such standard reference points help greatly to set up transparent systems and procedures, reduce misinterpretations, misunderstanding and disputes, improve the chances of successful closure of transactions thereby promoting the cause of international trade.

507.5 ICC Rules for guarantees

The new set of rules on guarantees, called URDG 758, comprise of 35 articles in all. To those who are familiar with the UCP, a casual reading of the URDG would immediately ring a bell. They would find the articles strangely familiar. The reason is that the URDG has been modelled and structured on the lines of the UCP. Some of the URDG articles too use almost the same words or expressions as used in the articles of the UCP. The end result? The article of the URDG are now so very easy to interpret and understand.

As in the case of the UCP, the URDG contains a set of definitions (Article 3). In it, the other provisions also appear in the order of the key stages in the life cycle of a guarantee, starting from instructions for issue, the actual issuance, amendments, presentations, demands, post-payment duties, its termination and so on. Particularly important is the new concept of 'complying presentation', which clarifies the process according to which a presentation will be checked for conformity. This was absent in the earlier URDG. The three stages to determine 'complying presentation are:

1. comparison with the terms of the guarantee itself;
2. comparison with the URDG rules to the extent they are not varied in the guarantee; and lastly (but only in the absence of a relevant term in the guarantee or the rules),
3. comparison against international standard demand guarantee practice.

507.6 Major changes

Other major changes have also been introduced. Important practices like the advice of a guarantee, amendments, standards for examination of presentations, partial and multiple demands, linkage of documents, incomplete demands and transfer of guarantees were left out of the scope of the current URDG 458. These have been covered in the new URDG.

All imprecise standards have been removed from the revised rules to generate certainty and predictability. Standards that could be subject to differing interpretations have been defined more precisely. This is particularly the case for the standard of "reasonable time" in URDG 458, Articles 10 and 26. Article 20 stipulates that a demand must be examined within a maximum period of five business days (an echo of the UCP here?).

The new URDG corrects an unfair situation if its expiry coincided with the interruption of the guarantor's business as a result of force majeure. In the new rules, force majeure triggers an extension of the guarantee for 30 days (Article 28). A complying 'extend or pay' demand allows the guarantor to suspend payment for a maximum of 20 business days (Article 31).

Several other major changes have been introduced in the new rules that are sure to benefit all users of URDG 758. I am tempted to highlight one of the several important features in the new URDG that should be of interest to all. It is about the renew/extend or pay guarantees. Certain types of beneficiaries - mostly government or semi-government entities - impose on the hapless applicants and guarantors '(either) extend/renew or pay' demands, thus perpetually extending the guarantee even though there may be no real default or reason for doing so.

This unfortunate practice may now cease, for two reasons. The first reason is the introduction of Article 25(c), which reads as follows:

> "If the guarantee or the counter-guarantee states neither an expiry date nor an expiry event, the guarantee shall terminate after the lapse of three years from the date of issue and the counter-guarantee shall terminate 30 calendar days after the guarantee terminates."

The more important reason, however, is in Article 15(a) :

"A demand under the guarantee shall be supported by such other documents as the guarantee specifies, and in any event by a statement, by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship. This statement may be in the demand or in a separate signed document accompanying or identifying the demand." (Emphasis mine.)

Unless this sub-article is specifically excluded in a guarantee document, for any demand or claim for payment under guarantees issued subject to URDG 758, the beneficiary would have to produce a supporting statement citing reasons as to why a guarantee is being called up, why a demand for payment is being made by the beneficiary. This article is expected to strongly discourage frivolous demands on the guarantor to either "extend or pay".

507.7 Summing up

To sum up, the new URDG:

1) introduces significant changes, new articles and definitions to cover modern day practices and procedures;
2) aligns, as far as possible, the URDG with UCP 600 to create a uniformity of

approach and a better understanding of the basic concepts of the new rules;

3) brings together definitions in a distinct article (article 2), and rules of interpretation (article 3);
4) presents the other provisions in the order of the key stages in the life cycle of the demand guarantee;
5) offers the most reasonable balance of the interests of the parties, and innovate in ways not yet covered in any other set of ICC rules;
6) provides comprehensive coverage of counter-guarantees, not available till now;
7) introduces default provisions concerning governing laws and jurisdiction in the event of legal challenges;
8) expresses in stronger, clearer, and in exclusively documentary terms the guarantor's independent role;
9) helps reduce fraud by defaulting to a rule requiring that each demand clearly reflect the grounds for its drawing;
10) provides a default in the event an issuer/guarantor is either prohibited from, or unable to pay in the currency of the guarantee;
11) removes ambiguities, imprecise standards in URDG 458 - prescribes precise parameters;
12) introduces the concept of "complying presentation", thus clarifying the process according to which a presentation will be checked for conformity;
13) takes account of industry practices, covers critically important practices and procedures that were left out of the scope of URDG 458. To name a few:
    (i) the advice of a guarantee,
    (ii) transfer of guarantees
    (iii) amendments,
    (iv) standards for examination of presentations,
    (v) partial and multiple demands,
    (vi) linkage of documents,
    (vii) incomplete demands,
    (viii) when payment in the currency specified in the guarantee becomes impossible,
    (ix) situation when the guarantee states neither an expiry date nor an expiry event,
    (x) a guarantor using its own records to automatically reduce a guarantee balance.
14) provides clearly defined rules for 'extend or pay' drawing requests and, unlike other rules, imposes time limits (a maximum of 30 calendar days) on issuers/ guarantors to make the decision to extend or pay;

15) acknowledges possible distinction between the applicant and the instructing party - a common practice whereby an independent undertaking's stated applicant may differ from the instructing party that requested and then assured the applicant's obligation to the guarantor in the guarantor's application agreement;
16) defines what constitutes paper and electronic documents and provides a practical, single set of rules for both;
17) provides protection to the beneficiary when there is a force majeure event (unlike the UCP) while avoiding open-ended extension lengths, similar to ISP98;
18) imposes a duty to provide information to applicants/instructing parties;
19) bases the date of expiration on a full banking day rather than on the hours the issuer/guarantor is at work;
20) ensures payment or rejection of the guarantee within five business days from its receipt;
21) features both the rules and the model guarantee and counter-guarantee forms (replaces separate publications 458 and 503);

Owing to the vastly improved and user-friendly set of rules having come into effect from 1 July, 2010, the all new URDG 758 is expected to gain a much wider acceptance among users of demand guarantees. The users are sure to derive greater benefits from the use of URDG 758 than they had done earlier. A close study of the new provisions of URDG 758 by everyone who uses guarantees in domestic or international trade is, therefore, strongly recommended. The model forms appended to URDG 758 should prove to be useful to the trading community.

507.8 Guarantees : RBI Guidelines

The following are some of the instructions issued by the Reserve Bank of India to commercial banks in India on letters of credit and guarantees. Although addressed to banks, these are quoted here for reference by the exporters and importers, since these have direct bearing on them. The exporters and importers would be required by the banks to comply with the requirements stipulated by the RBI. It is advisable for them to take note of the RBI instructions so that they can prepare themselves accordingly.

The guidelines:

1. As a general rule, the banks should confine themselves to the provision of financial guarantees and exercise due caution with regard to performance guarantee business.
2. As regards maturity, as a rule, banks should guarantee shorter maturities and leave longer maturities to be guaranteed by other institutions.

3. As a rule, banks should avoid giving unsecured guarantees in large amounts and for medium and long-term periods.
4. For performance guarantee, banks should exercise due caution and …satisfy themselves that the customer has the necessary experience, capacity and means to perform the obligations under the contract, and is not likely to commit any default.
5. Banks should refrain from issuing guarantees on behalf of customers who do not enjoy credit facilities with them.
6. Extracts from the DBOD. No. Dir. BC.12/13.03.00/2010-11 July 1, 2010, Master Circular titled "Guarantees and Co-acceptances" issued by the RBI :

"2.2.7 Bank Guarantee Scheme of Government of India

22.2.7.2 (extracts)

iii. The initial period of the bank guarantee issued by banks as a means of security in Directorate General of Supplies and Disposal contract administration would be for a period of six months beyond the original delivery period. Banks may incorporate a suitable clause in their bank guarantee, providing automatic extension of the validity period of the guarantee by 6 months, and also obtain suitable undertaking from the customer at the time of establishing the guarantee to avoid any possible complication later.

iv. A clause would be incorporated by Directorate General of Supplies and Disposal (DGS&D) in the tender forms of Directorate General of Supplies and Disposal 229 (Instruction to the tenderers) to the effect that whenever a firm fails to supply the stores within the delivery period of the contract wherein bank guarantee has been furnished, the request for extension for delivery period will automatically be taken as an agreement for getting the bank guarantee extended. Banks should make similar provisions in the bank guarantees for automatic extension of the guarantee period.

v. The Public Notice issued by the Customs Department stipulates, inter alia, that all bank guarantees furnished by an importer should contain a self-renewal clause inbuilt in the guarantee itself. As the stipulation in the Public Notice issued by the Customs Department is akin to the notice in the tender form floated by the DGS&D, the provision for automatic extension of the guarantee period in the bank guarantees issued to DGS&D, as at sub-paragraph (iv) above, should also be made applicable to bank guarantees issued favouring the Customs Houses."

7. Bid bonds and performance bonds or guarantees for exports:
   (a) In terms of Notification No.FEMA.8/2000-RB dated May 3, 2000, AD banks have the permission to give performance bond or guarantee in favour

of overseas buyers on account of bona fide exports from India.

(b) AD (authorised dealer) banks, should also…. issue counter-guarantees in favour of their branches/correspondents abroad in cover of guarantees required to be issued by the latter on behalf of Indian exporters, in cases where guarantees of only resident banks are acceptable to overseas buyers in accordance with local laws/ regulations.

8. Issue of bank guarantee on behalf of service importers: AD Category-I banks are now permitted to issue guarantee for amount not exceeding USD 500,000 or its equivalent in favour of a non-resident service provider, on behalf of a resident customer who is a service importer on certain conditions (refer to the Master Circular for details).
9. Export Credit & Guarantee Corporation (ECGC) would provide (up to) 90 percent cover for bid bonds, provided the banks give an undertaking not to insist on cash margins.
10. Refer to Section 2.3.5 of the MC on certain precautions in case of project exports.
11. On guarantees for export advance (extracts from Section 2.3.6):
    a. Banks should be careful while extending guarantees against export advances so as to ensure that no violation of FEMA regulations takes place and banks are not exposed to various risks.
    b. Banks should also ensure that the export advances received by the exporters are in compliance with the regulations/ directions issued under the Foreign Exchange Management Act, 1999.
12. Minor guarantees: Authorised Dealer banks may freely give on behalf of their customers and overseas branches and correspondents, guarantees in the ordinary course of business in respect of missing or defective documents, authenticity of signatures and for other similar purposes.

507.9 FEMA, Chapter 7
Issue of Bank Guarantee

7B.5 Issue of guarantees in favour of foreign lenders or suppliers (in the case of Supplier's Credits) requires approval of Reserve Bank. While granting approval for raising the foreign currency loan/credit, Reserve Bank will grant the required permission to the concerned authorised dealer. In the event of invocation of the guarantee, the concerned authorised dealer may make the necessary remittance without reference to Reserve Bank. A report should, however, be sent to Reserve Bank giving full details citing reference to the approval for furnishing the guarantee. A copy of the claim received from the overseas party should be enclosed with such report.

Exercise

1. What are the major differences between LCs and BGs?
2. Discuss the recent changes in the practice of "extend or pay" brought about by the URDG.
3. What are the types of guarantees in common use? What are perpetual guarantees?
4. List some of the major changes recently brought about by the ICC on guarantees.

References :

1) RBI Master Circular on Guarantees and Co-acceptances, RBI/2010-11/67, DBOD. No. Dir. BC.12/13.03.00/2010-11 July 1, 2010. (Note that the Master Circulars are revised and released afresh by the RBI on 1 July every year.)
2) FEMA, Chapter 7, import of goods, currency etc., merchanting trade and other related matters.
3) Uniform Rules for Demand Guarantees, ICC Publication No. 758 (URDG 758).

Unit 508 ❐ Relating To ICC Rules & Procedure

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508.0 Introduction to ICC Rules

For those engaged in international trade, it would never be sufficient to study only the rules and guidelines as set out in FEMA and by the Reserve Bank of India. An extremely important part of the study pertains to a good understanding of the rules framed by the International Chamber of Commerce (ICC), Paris on international trade related issues. These rules are embodied in the following publications:

(a) Uniform Customs and Practice for Documentary Credits (UCP 600): On rules for the operation of letters of credit;

(b) Uniform Rules for Demand Guarantees (URDG), ICC Publication No. 758 (effective from 1 July, 2010): On bank guarantees and counter-guarantees;

(c) International Standard Banking Practice (ISBP) for the Examination of Documents under Documentary Credits, 2007 Revision for UCP 600, ICC Publication #681 (effective from 1 July, 2007): This is a companion to the UCP, sets some standards and guidelines for the preparation of error free export documents;

(d) International Standby Practices (ISP98): A comprehensive set of rules applicable to Standby Letters of Credit.

(e) INCOTERMS 2010, ICC Publication No.715: Created by the ICC, this document prescribes three-letter trade terms that offer standard definitions to define the sharing of risk and responsibility in international trade transactions. Every contracting party should be familiar with the terms and their implications, and use them in their contracts.

(f) Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR), ICC Publication No. 725: An essential tool for the commercial banks and bankers, it incorporates rules, regulations and procedures for inter-bank reimbursements and settlement of claims under UCP 600.

(g) Uniform Rules for Collection (URC), ICC Publication No. 522: This document prescribes the rules and regulations for handling of documents that are not under letters of credit (i.e., non-LC bills). All LC bills are governed by the UCP; all non-LC bills are regulated by URC 522.

The following pages provide an overview of each of the above. To gain a minimum expertise in international trade, a detailed study and an in-depth understanding of the above are strongly advised.

508.1 The International Chamber of Commerce (ICC)[1]

It is necessary to know about the rules that govern documentary credit operations worldwide and the organisation that is responsible for framing these rules. That organisation is the International Chamber of Commerce (ICC)[1] , founded in 1919 and based in Paris, France. It is a non-governmental organisation serving world business. Within a year of the creation of the United Nations, the ICC was granted consultative status at the highest level with the UN and its specialised agencies.

ICC members in 130 countries represent tens of thousands of companies and business organisations. ICC National Committees or Councils in some 60 countries coordinate activities at the national level and work with their members to address concerns of business in their countries. ICC's fundamental mission is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalisation. ICC provides essential services that include the ICC International Court of Arbitration, the world's leading arbitral institution, and the World Chamber Federation, ICC's worldwide network of chambers of commerce. Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on technical and sectoral subjects. These include financial services, information technology, telecommunication, marketing ethics, the environment, transportation, competition law and intellectual property.

Briefly stated, the ICC

- represents the world business community at national and international levels;
- promotes world trade and investment based on free and far competition;
- harmonises trade practices and formulates terminology and guidelines for importers and exporters;
- provides a growing range of practical services to business.

It is also the originator of a large number of useful, informative and widely used publications like the UCP, the ISBP, the Incoterms and the URR.[3]

508.2 The UCP

508.2.1 Background

Commercial letters of credit are the lifeblood of international trade. For more than 75

1 Information on the ICC extracted from ICC Publication No. 600.

2 Websites for ICC India : www.Iccindiaonline.org ; ICC, Paris: www.iccwbo.org.

3 The current list of ICC Publications and their prices should be obtained from the website of the ICC, Paris or its office in India.

years the Uniform Customs and Practice for Documentary Credits (UCP)[4] - the International Chamber of Commerce rules on documentary credits - have governed letter of credit transactions worldwide. The UCP (in certain regions it is also called the UCPDC) is a universally recognised set of rules governing the use of documentary credits in international commerce. It was first published by the ICC in 1933. Subsequent revised versions were issued in 1951, 1962, 1974 and 1983 (UCP 400). ICC Publication no. 500 was adopted by the ICC in April 1993, first published in May 1993 and came into effect from January 1, 1994.

Banking associations and individual banks in more than 160 countries and territories throughout the world have adopted the UCP. Although the revisions to the UCP have taken place at approximate intervals of about 10 to 12 years, the UCP has kept pace with the modern practices of trade and commerce. ICC has also been proactive in modifying the Rules in tune with the changing times and change in technology.

508.2.2 From UCP 500 to UCP 600

After more than a decade in operation, UCP 500 underwent complete revision some years ago. The purpose was to take into account all the developments since its introduction in January 1994. The revised draft was approved by the ICC Banking Commission on 25-October-2006 at its meeting in Paris. The version of the UCP currently in operation, first published on 1-November-2006, is formally known as The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600. It is commonly referred to as UCP 600 or simply the UCP. It came into effect from 1 July, 2007.[5]

508.2.3 Revision of the UCP

The revision exercise broke new grounds. During this revision what the ICC did was to move away completely from its earlier practice of making changes line by line, article by article. Instead, the emphasis was on total revamp and on making technical changes to the UCP as a whole. The issues were, therefore, tackled in a more holistic manner. The process began by taking into account all the developments since the implementation

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4. The current version is ICC Publication No. 600.
5. The evolution of UCP 600, the revision process, the key issues discussed, the manner of their resolution, and detailed analysis of the articles of UCP 600 are available in All About UCP 600, Rupnarayan Bose (Macmillan, 2007).

of UCP 500 in 1994. For example, URR 525 and ISP 98[6] had been published and implemented much after UCP 500 came into operation. Opinions and decisions expressed by the ICC, disputes referred to it for disposal, and results of court actions were the other developments of note during this period that also demanded attention.

Further, just seven of the 49 articles of UCP 500 had given rise to 58 per cent of all the ICC opinions, views and clarifications. Since they were the cause of maximum doubts and debates, there was an urgent need to examine these seven 'problem' articles. The revision process also provided an opportunity to examine and take a view on several other issues - some major ones, and others not exactly so but serious nonetheless - that required attention and a decision from the ICC.

The purpose of these changes was to make the UCP more robust, stand-alone set of rules, with an ability to meet the needs of the future. 'Stand alone', since the UCP had otherwise become dependent on a wide range of ICC opinions, decisions and Position Papers for the correct interpretation of its articles. This situation had to end some day. A perusal of the revised version of the UCP, namely, UCP 600 shows that the ICC has succeeded to some extent (though, miles to go, yet) in its stated objectives.

508.2.4 From UCP 500 to UCP 600, what has changed?[7]

(i) The Changes According to the ICC

Since UCP 500 was revised and introduced, this has been the most frequently asked question. The ICC, of course, has its own take by way of its response to this question. The major changes in the current revised edition, as proclaimed by the ICC, are said to be as follows:

(a) a leaner set of rules, with 39 articles rather than 49 articles of UCP 500;
(b) a new section of 'definitions', containing terms such as 'honour' and 'negotiation';
(c) a replacement of the expression 'reasonable time' with a definite number of days for examining and determining compliance of documents;
(d) a new provision concerning addresses of the beneficiary and the applicant;
(e) an expanded discussion of 'original documents';

6. Uniform Rules for Bank-to-Bank Reimbursement under Documentary Credits (URR), Publication No. 525, and, International Standby Practices (ISP 98) are ICC publications. With effect from 1 October 2008 URR 725 has replaced URR 525. ISP 98 is a set of rules designed to facilitate the domestic and international use of standby letters of credit. ISP 98 addresses several topics that were not addressed at all by the UCP or that were addressed only generally by UCP. In addition, ISP 98 contains several rules crafted for standby letters of credit that differ from their UCP 500 counterparts. ISP 98 came into operation from 1 January 1999.

7. Source: Preface to All About UCP 600, Rupnarayan Bose (Macmillan, 2008).

(f) redrafted transport articles aimed at resolving confusion over the identification of carriers and agents.

This list provides a ready answer to the frequently asked question, 'From UCP 500 to UCP 600, what has changed?' To those who have been closely associated over the years with documentary credits in general and UCP 500 in particular, this list can do little to satisfy their curiosity about the real changes that the latest 'revision' has brought about. For them to be satisfied with this response would be to miss the wood for the trees. For, from UCP 500 to UCP 600, the changes are several, primarily subtle, and are very significant.

(ii) The Real Changes in UCP 600

The changes in UCP 600 (as compared to UCP 500 and its earlier versions) are briefly stated as follows :[8]

(1) The articles are fewer in number: 39 articles in place of 49 in UCP 500 (for reasons that will become apparent shortly).

(2) A whole new section of 'Definitions' under Article 2 has been added.

(3) Another new, useful section under Article 3 called 'Interpretations' has been added to the UCP.

(4) New terms such as 'honour' and 'complying presentation' have been introduced. Their introduction has greatly helped to do away with the same sets of clauses being repeated ad infinitum. Consequently, the overall length of the UCP stands considerably reduced.

(5) Interpretations of terms that lay scattered all over UCP 500 have now been collated, rearranged and brought together under a common article. The interpretations are now conveniently located right at the beginning of the UCP under Article 3 titled 'Interpretations'. In the process, all the other articles have been spruced up, restructured and reduced in length.

(6) In UCP 500 several topics were often included under a single article carrying a misleading title, incorrectly grouped, placed or classified. The issue has been sorted out in UCP 600.

(7) The topics and the articles are now far better organised. They are sensibly arranged, appearing in a more logical sequence.

8. *Refer to All About UCP 600,* Rupnarayan Bose (Macmillan, 2008), for the complete story about the revision process and article-by-article comparison between UCP 500 and UCP 600.

(8) Legalese has been abolished. Plain English is now more the norm. Longwinded, complex sentences have been done away with. The articles have been redrafted to make the sentences short and simple, the language easy to understand.

(9) Irritants in the UCP have been removed. Unbridled use of 'and/or' and uncalled for capitalisations have been discontinued. The practice of a single article leading to never-ending, multiple sub-articles has been reduced to the barest minimum.

(10) Articles with a negative stance have been turned into positive statements and rules. The stipulations are more direct and specific in nature. The thrust is on what must be complied with, not on what should not be done.

(11) UCP 600 is a stand-alone, independent document. All important issues and developments since the introduction of UCP 500 have been taken into account in this version of the UCP. Therefore, there is no further need to refer to a host of external documents to get a proper and correct understanding of its articles and provisions.

(12) Certain rules, responsibilities and liabilities, practices and procedures under the UCP, obvious but never clearly spelt out, have been framed to clear the air.

(13) Existing articles have been redrafted, new articles introduced, to remove ambiguities, clarify or reiterate certain key issues or to fill up gaps remaining in the earlier versions of the UCP.

(14) Overall, the UCP is now more user-friendly.

For the laymen and the uninitiated, problems still remain. The problems are more to do with correct interpretation and application of the articles of the UCP and related rules than the UCP itself. Some of the articles, too, require further modification.

508.2.5 The legal status of the UCP

Note that the articles in the UCP are not laws. Hence, they have no legal sanctity or validity. The UCP, as also the other rules created by the ICC, are best practices or codes of conduct which have evolved through usage and industry participation for more than 75 years. It has helped the international trade to grow, bridge the differences between countries through standardisation of procedures and practices. The UCP has received worldwide acceptance, its rules have been tested in courts of law and in arbitration procedures, case laws and judicial pronouncements are available that refer to the articles of the UCP. Thus, over the years, the rules of the UCP have grown to acquire some sort of quasi-legal status. Yet, like a contract accepting the UCP is not a must; the parties concerned may subject themselves to it purely at their option. A country's laws would always prevail over whatever the UCP may happen to stipulate.

508.2.6 Can the articles be modified?

According to Article 1 of UCP 600, the rules are 'binding on all parties unless expressly modified or excluded by the credit'. The modification or exclusion can be effected not by making inoperative any article or sub-article of the UCP. Any condition in a credit that changes a provision of the UCP effectively modifies the application of the UCP as far as that particular credit is concerned. An applicant may, thus, specify a period of presentation that goes beyond that stipulated in sub-article 14(c). In a credit issued through SWIFT, for example, Field 48 need only be completed with the number of days i.e., 30, 40 etc. and this will override and modify the UCP rule in sub-article 14(c).

Regarding the modifications or exclusions to the articles of the UCP, made possible through Article 1A, a few important issues are worth noting.

(a) If the wording of a credit gives a different outcome to that which a particular UCP 600 article would otherwise give, then the rule is modified rather than excluded.

(b) Exclusion happens where the entire article is deemed to be inapplicable to the credit and no alternative wording is inserted. In this circumstance, the credit should state that 'article x or xx is excluded'.

(c) Where a term or condition in the credit is to be applied differently to that envisaged in the UCP 600, the wording of the credit will supersede that of the UCP and no further reference is required to be made to the UCP article or sub-article that is being modified.

(d) If exclusions or modifications are made that worsen the position of the beneficiary or the nominated bank then it is for those parties to determine whether or not to act under those conditions. If not, an amendment should be sought.

It is often the case that modifications and, in particular, exclusions are made due to a misunderstanding of the meaning and intent of the rule. What we tend to forget is that the articles of the UCP have been arrived at after a very lengthy process involving years of deliberations, and a huge number of stakeholders spread over a large number of countries. Exclusions or modifications to any of the provisions should, therefore, be attempted after careful application of mind about their implications.

Caution: The wording used in a credit to modify or exclude certain provisions of the UCP should be selected with great care, and so structured as to ensure that such actions do not lead to unintended or undesirable consequences.

508.3 Uniform Rules For Demand Guarantees (URDG 758)

508.3.1 Introduction

ICC Publication No. 758, Uniform Rules for Demand Guarantees (URDG), applies to bank guarantees. These rules replace URDG 458, which came into operation 18 years ago. URDG 758 applies to all guarantees - whether domestic or international - issued after 1 July, 2010 where the guarantee or counter-guarantee expressly subscribes to these rules.

The URDG 758 (Uniform Rules for Demand Guarantees) is a set of contractual rules that apply to demand guarantees and counter-guarantees. As the URDG is contractual by nature, it applies only if the parties to a demand guarantee or counter-guarantee so choose.

508.3.2 The structure of the URDG

The new set of rules on guarantees, called URDG 758, comprise of 35 articles in all. The URDG has been modelled and structured on the lines of the UCP. Some of the URDG articles too use almost the same words or expressions as used in the articles of the UCP. Consequently, the articles of the URDG are now easy to interpret and understand. In it, the other provisions also appear in the order of the key stages in the life cycle of a guarantee, starting from instructions for issue, the actual issuance, amendments, presentations, demands, post-payment duties, its termination and so on. Particularly important is the new concept of 'complying presentation', which clarifies the process according to which a presentation will be checked for conformity. This was absent in the earlier URDG. The three stages to determine 'complying presentation' are:

1. comparison with the terms of the guarantee itself;
2. comparison with the URDG rules to the extent they are not varied in the guarantee; and lastly (but only in the absence of a relevant term in the guarantee or the rules),
3. comparison against international standard demand guarantee practice.

508.3.3 Features

Other major changes have also been introduced. Important practices like the advice of a guarantee, amendments, standards for examination of presentations, partial and multiple demands, linkage of documents, incomplete demands and transfer of guarantees were left out of the scope of the current URDG 458. These have been covered in the new

URDG.

The URDG can adequately provide an operational framework for any situation where a demand guarantee is required, whatever the situation is in the public or the governmental sector involved.

Agreeing to issue a guarantee according to URDG spares the parties the effort of drafting extensive clauses to describe the independence of the guarantee, its irrevocability, its non-assign ability and the guarantor's duties and more.

The most popular articles in URDG from a banker's point of view are:

Article 8: Content of instructions and guarantees

Article 8 works as a checklist, very useful both for the guarantor as well as the applicant when they negotiating the guarantee.

Article 10: Advising of a guarantee or amendment

A new article containing information and instructions for the advising bank/party when receiving instruction only to advise the guarantee without any representation from their own.

Article 11: Amendments

A new article containing instructions how to handle an amendment.

Article 14: Presentation and Article 1, examination

The articles have been rewritten and are now very clear about how the guarantors shall treat a presentation and how they shall examine the documents presented.

Article 20: Time for examination of demand; payment

Reasonable time has been prolonged from 3 days to 5 days following the day of presentation.

Article 23: Extend or pay

Where a complying demand have been presented, as a request to extend the expiry date, the guarantor is now allowed to suspend payment for a period not exceeding 30 calendar days following its receipt of the demand (instead of 3 days).

Article 24: Non-Complying demand, waiver and notice

It's a new article dealing with the situation when a demand has been rejected by the guarantor.

Guarantors deal with documents and not with goods, services or performance in general. This means that even if the applicant states that he has performed and consider that the guarantor should not pay, the guarantor should pay if the documents presented are in conformity. The only circumstance in which not to pay is if the applicant has strong proof that it is an unfair calling.

508.3.4 Benefits from using URDG 758

Once the URDG are incorporated in the guarantee or counter-guarantee text by contractual reference to the URDG, they are deemed to be entirely incorporated, unless specific article(s) are expressly excluded or amended.

When drafting a URDG guarantee or counter-guarantee, it is important to make a choice and avoid conditions whose occurrence can only be determined through an examination of the underlying transactions. Guarantors and applicants should avoid using ambiguous terms in the guarantee. It is in no one's interest that the guarantee terms could only be understood through lengthy and costly litigation. Clear wording requires no judicial interpretation; therefore applicants can save considerable negotiating time and the cost of specialized legal assistance by benefiting from ready-to-use standard conditions in the model guarantee forms appended to the text of the URDG.

A URDG guarantee and counter-guarantee are irrevocable undertakings; this protects the beneficiary against the risk of revocation of the guarantee at a time when the guaranteed obligation is still to be completed.

A URDG guarantee and counter-guarantee enter into effect as from the date they are issued, unless their terms expressly postpone their entry into effect to agree with a later date or the occurrence of an agreed event. Accordingly, no demand for payment can be presented until the guarantee enters into effect following the occurrence of a specified date or event indicated in the guarantee.

The essential characteristic of a demand guarantee is that it is independent of the underlying transaction between the applicant and the beneficiary that prompted the issuance of the guarantee. Further, a demand guarantee is also independent of the instruction relationship pursuant to the applicant having requested the guarantor to issue the guarantee in favour of the beneficiary.

Those who are familiar with the UCP would find many similarities between the two documents.

508.3.5 Highlights of URDG 758

The new URDG 758:

- introduces significant changes, new articles and definitions to cover modern day practices and procedures
- aligns, as far as possible, the URDG with UCP 600 to create a uniformity of approach and a better understanding of the basic concepts of the new rules
- brings together definitions in a distinct article (article 2), and rules of interpretation (article 3).

- presents the other provisions in the order of the key stages in the life cycle of the demand guarantee
- offers the most reasonable balance of the interests of the parties, and innovate in ways not yet covered in any other set of ICC rules
- provides comprehensive coverage of counter-guarantees, not available till now
- introduces default provisions concerning governing laws and jurisdiction in the event of legal challenges
- expresses in stronger, clearer, and in exclusively documentary terms the guarantor's independent role
- helps reduce fraud by defaulting to a rule requiring that each demand clearly reflect the grounds for its drawing
- provides a default in the event an issuer/guarantor is either prohibited from, or unable to pay in the currency of the guarantee
- removes ambiguities, imprecise standards in URDG 458 - prescribes precise parameters
- introduces the concept of "complying presentation", thus clarifying the process according to which a presentation will be checked for conformity;
- takes account of industry practices, covers critically important practices and procedures that were left out of the scope of URDG 458. To name a few:
  - the advice of a guarantee,
  - transfer of guarantees
  - amendments,
  - standards for examination of presentations,
  - partial and multiple demands,
  - linkage of documents,
  - incomplete demands,
  - when payment in the currency specified in the guarantee becomes impossible,
  - situation when the guarantee states neither an expiry date nor an expiry event,
  - a guarantor using its own records to automatically reduce a guarantee balance.
- acknowledges possible distinction between the applicant and the instructing party - a common practice whereby an independent undertaking's stated applicant may differ from the instructing party that requested and then assured the applicant's obligation to the guarantor in the guarantor's application agreement;
- defines what constitutes paper and electronic documents and provides a practical, single set of rules for both;
- provides protection to the beneficiary when there is a force majeure event (unlike the UCP) while avoiding open-ended extension lengths, similar to ISP98;

- imposes a duty to provide information to applicants/instructing parties;
- bases the date of expiration on a full banking day rather than on the hours the issuer/guarantor is at work;
- features both the rules and the model guarantee and counter-guarantee forms (replaces separate publications 458 and 503).
- ensures payment or rejection of the guarantee within five business days from its receipt;
- provides clearly defined rules for 'extend or pay' drawing requests and, unlike other rules, imposes time limits (a maximum of 30 calendar days) on issuers/guarantors to make the decision to extend or pay (also see below);

Certain types of beneficiaries impose on the applicants '(either) extend/renew or pay' demands - often without citing any reason - thus perpetually extending the guarantee even though there may be no real default or reason for doing so. This unfortunate practice may now cease, for two reasons. The first reason is the introduction of Article 25(c), which reads as follows:

> "If the guarantee or the counter-guarantee states neither an expiry date nor an expiry event, the guarantee shall terminate after the lapse of three years from the date of issue and the counter-guarantee shall terminate 30 calendar days after the guarantee terminates."

The more important reason, however, is in Article 15(a):

> "A demand under the guarantee shall be supported by such other documents as the guarantee specifies, and in any event by a statement, by the beneficiary, indicating in what respect the applicant is in breach of its obligations under the underlying relationship. This statement may be in the demand or in a separate signed document accompanying or identifying the demand." (Emphasis mine.)

Unless this sub-article is specifically excluded in a guarantee document, for any demand or claim for payment under guarantees issued subject to URDG 758, the beneficiary would have to produce a supporting statement citing reasons as to why a guarantee is being called up, why a demand for payment is being made by the beneficiary. This article is expected to strongly discourage frivolous demands on the guarantor to either "extend or pay".

Readers are strongly advised to read the full text of the ICC Publication, URDG 758, in its entirety for better appreciation of the latest innovations and advantages offered by this document.

Exercise

1. What are the stages to determine a 'complying presentation'?
2. When was URDG 758 implemented?
3. What are the main features of URDG 758?
4. Does URDG apply to (a) domestic guarantees, (b) international guarantees, or (c) both?
5. Comment on the "extend or pay" scenario and the new URDG.
6. Is URDG concerned with counter-guarantees?
7. "Guarantors deal with documents and not with goods, services or performance in general." What do you understand by this statement?

508.4 The ISBP

508.4.1 Introduction

Another important publication of the ICC worthy of note is (to give its formal name) the 'International Standard Banking Practices for the Examination of Documents under Documentary Credits (ISBP), ICC Publication No. 681'. Prior to the implementation of UCP 600, the first version of the ISBP, called the ICC Publication no. 645, was in operation. This version was later revised and updated to keep pace with the changes made to the UCP. The currently operative version of the ISBP, ICC Publication no. 681, came into effect on 1 July, 2007 simultaneously with the implementation of UCP 600. The ISBP acts as a supplement to the UCP. While the UCP lays down the rules, the ISBP provides the procedures (say, how to dot the 'i's and cross the 't's) and a certain degree of standardisation. It has brought into one place some of the common areas of confusion, has codified them, and has framed some practical standards for use in documentary credit operations. The ISBP goes a long way in reducing discrepancies in documents. It should prove to be extremely useful to the exporters, bankers and those who are directly or indirectly involved with the preparation, presentation and examination of documents.

508.4.2 Background of ISBP

In May 2000, a request was made for the International Chamber of Commerce to undertake a project on a global scale. As a result, a working group was established to collect and document global banking practices that were not included in the UCP. The result of their work was the publication in January 2003 of the International Standard Banking Practice for the Examination of Documents under Documentary Credits ('ISBP').

As stated previously, this publication was updated in 2007 (and implemented with effect from 1 July 2007) to bring it in line with the latest revision of the UCP, UCP 600.'

The ISBP was originally created to help reduce the large percentage of documents refused for discrepancies on first presentation. This objective has been attained to some extent. The ISBP has laid down standards where necessary, stipulated norms where none existed, reduced grey areas, and has addressed a large number of frequently occurring areas of confusion in documentary credit operations. Though refusals remain a serious problem with letters of credit, their numbers appear to be declining, in part because of the effectiveness of the check list contained in the ISBP. Bankers, exporters, importers and everyone who deals with documents, their preparation and processing, examination and scrutiny are advised to be guided by the provisions of the ISBP to reduce errors and confusion. They are also urged to refer to this publication whenever doubts arise as to how to structure and check documents against credits under UCP 600. The ISBP is undergoing further revision at this very moment.

508.4.3 ISBP 681

Article 14 of UCP 600 enumerates the standard for the examination of documents. It also lays down certain rules for compliance by the examining banks. The articles of the UCP, however, do not cover the entire gamut of rules, norms, standards and procedures that are required to be observed and complied with by the concerned banks or the beneficiary.

These are available in a document published by the ICC and called 'International Standard Banking Practice, ICC Publication No. 681' (ISBP 681). This ICC publication does not amend UCP 600. It explains how the practices articulated in UCP 600 are to be applied by documentary credit practitioners. The ISBP provides detailed guidance about the correct manner for the preparation of documents and the norms that should be applied for the examination of documents. It goes beyond the mere postulation of rules, to the extent of explaining the norms with appropriate examples. The articles of the ISBP are, therefore, of great help to the exporters in the correct compilation of documents, and go a long way in reducing errors in documentation. They also provide guidance to the bankers about the scrutiny of documents against a letter of credit. The ISBP and the UCP, therefore, should be read in their entirety and not in isolation. Apart from mastering the articles of UCP 600, all bankers and exporters should make it a point to be up to date with the provisions of the ISBP.

ISBP 681 contains 185 articles[9] . The UCP too lays down certain rules and standards for the examination of documents. But they are fewer in number. It is strongly suggested that a copy each of these two publications be kept near at hand at all times. There can be no better solution than a quick reference to the actual articles as and when issues come up for clarification.

508.4.4 Issues addressed by the ISBP

Discrepancy occurs when two parties interpret the same fact differently. If left to individual opinion, the possibility of discrepancies occurring can never be ruled out. This can cause problems and delays in international trade, especially when documents are processed under letters of credit. ISBP provides a common platform and a standard interpretation to many of the practical issues that confront the parties to documentary credits. ISBP complements UCP 600, it does not replace the UCP. The articles of the ISBP provide valuable guidance to the exporter and the examining banker with regard to correct documentation and standard interpretations. The following provides an overview of the issues that the ISBP strives to resolve :

(1) Is transhipment permissible even if LC prohibits transhipment?
(2) If the LC uses 'Industry', 'manufacturer', or 'metric tons', would the use of abbreviations such as 'Ind', 'mfr' or 'mt' (instead of the complete words used in the credit) in invoices and other documents make these documents discrepant?
(3) Can corrections or alteration in a document be authenticated by a party other than the issuer of the document? If yes, under what circumstances?
(4) Do corrections and alterations in documents issued by the beneficiary itself require authentication?
(5) Where a document contains more than one correction or alteration, what should be the correct manner of authentication? For example, must each correction be authenticated separately, or all at one go would suffice?
(6) Must all documents be dated, even if the LC does not expressly require that some documents show their respective dates? Would the absence of date in a shipping certificate that states 'date as per bill of lading number xxxx' be considered a discrepancy?
(7) Can a document (for example, a certificate of analysis, inspection certificate or pre-shipment inspection certificate), be dated after the date of shipment?

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9. ICC Publication No. 645, its earlier version, contained 200 articles. The change is actually in the removal of sections from ISBP 645 where the rules were incorporated in UCP 600, technical adjustments made in capitalization, substitution of UCP 600 article references for those of UCP 500, date changes (from 2006 to 2007), and changes in ISBP paragraphs necessary to bring the wording in line with the wording in UCP 600.

(8) When a document shows a date of preparation and a later date of signing, which should be taken as the date of issue of such a document?

(9) Which of these date formats are acceptable: 12th of November 2007 (for example) being expressed as 12 Nov 07, 12Nov07, 12.11.2007, 12.11.07, 11.12.07, 2007.11.12 or 121107?

(10) Are copies of transport documents to be treated (and processed in the same manner as) as original transport documents (under the UCP)?

(11) Do the articles in the UCP define the terms shipping documents, stale documents, third party documents and exporting country?

(12) Can documents under a credit be presented by the beneficiary in a language other than that of the credit?

(13) If the mathematical calculations in documents (especially the invoice) carry mistakes, would the concerned document be discrepant?

(14) Are the banks required to check the detailed mathematical calculations in documents presented under a letter of credit?

(15) Typing errors resulted in the description of the merchandise being stated as 'mashine' instead of 'machine', 'fountan pen' instead of 'fountain pen', 'modle' instead of 'model', 'model 123' instead of 'model 132'. Are these discrepancies?

(16) If a signature or endorsement is required on a document consisting of more than one page, where should the signature(s) appear - on the first, on the last page, or on all pages of the document? Can the signature or endorsement appear anywhere on the document?

(17) If the LC calls for a signed document, must the signature be handwritten (i.e. manual)? Would facsimile signatures, perforated signatures, stamps, or any electronic or mechanical means of authentication be sufficient and acceptable instead?

(18) Continuing with the aforesaid, can a photocopy of a signed document qualify as a signed original document?

(19) Where documents are marked as 'original', 'duplicate', 'triplicate', 'first original', and 'second original', which of these would be acceptable as an original document?

(20) Where the credit stipulates the following, how many originals/copies are required in each of the following instances:

- 'Invoice', 'One Invoice' or 'Invoice in 1 copy';
- 'Invoice in 4 copies';
- 'One copy of Invoice'.

(21) If a credit specifies the details of a shipping mark, the documents mentioning the marks must, of course, show those details. But would additional information/ marks be acceptable?

(22) Shipping marks contained in some documents often include information in excess of what would normally be considered 'shipping marks' and could include information such as the type of goods, warnings as to the handling of fragile goods, net and/or gross weight of the goods, etc. Would the fact that some documents show such additional information while others do not constitute a discrepancy?

(23) Must every document carry a signature? Even if not stated in the credit, which are the documents and declarations that would not be acceptable without a signature?

(24) A credit requires a 'Packing List'. If document is submitted that contains the packing details, but is titled 'Packing Note', 'Packing and Weight List', etc., or is untitled - which if these would be acceptable?

(25) If a credit requires a packing list and a weight list, would such requirement be satisfied by presentation of:
- two original copies (an oxymoron?) of a combined packing and weight list? or
- a single document, the upper half being titled 'packing list' the lower portion carrying the title 'weight list'? or
- two separate documents - one marked 'packing list' and another marked 'weight list'?

(26) If the tenor of a time draft refers to xx days after the bill of lading date, and the on board date is (i) prior to, (ii) same as, or (iii) later than the date of issuance of the bill of lading, which of these should be deemed to be the bill of lading date?

(27) Ten days after or from March 1 is…. March 09, March 10, March 11, or March 12?

(28) If a bill of lading showing more than one 'on board' notation is presented under a credit, which of these (the earliest or the latest) 'on board' dates should be considered as the "shipment date", or used for calculation of the maturity date of a tenor draft?

(29) If a credit requires drafts to be drawn, for example, at 60 days after or from bill of lading date, and more than one set of bills of lading is presented under one draft, which of these bills of lading should be used for the calculation of the maturity date, the earliest or the latest?

(30) For documents containing discrepancies, where the draft is not accepted on presentation but after approval of the discrepancies, how should the maturity date be arrived at?

(31) Must all drafts be drawn by the beneficiary? Can anyone else draw a draft under a letter of credit?

(32) Can an LC be issued 'available by draft drawn on the applicant'?

(33) Where a credit requires an 'invoice' without further definition, which of these would be acceptable: commercial invoice, customs invoice, tax invoice, final invoice, consular invoice, 'provisional invoice', 'pro-forma invoice', a document simply titled 'invoice'.

(34) Credit term stipulates 'CIF Singapore Incoterms 2000'; document presented states 'CIF Singapore Incoterms'. Would this be considered as a discrepancy?

(35) Can an invoice show merchandise not called for in the credit (such as samples, advertising materials, etc.) where such items are being shipped free of charge?

(36) Are the terms 'shipped in apparent good order', 'laden on board', 'clean on board' same as 'shipped on board'?

(37) If a credit states 'any European port', as the place of taking in charge, dispatch, loading on board and destination, must a transport document indicate the actual place of taking in charge, dispatch, shipped on board and destination, even if the actual port of shipment or destination is within the geographical area or range stated in the credit?

(38) The word 'clean' appeared on a transport document but was later deleted. Is the transport document still acceptable? Would the transport document not be 'clean' any longer? In other words, would the deletion (duly authenticated) of the specified term constitute a discrepancy?

(39) Must a certificate of origin always be issued by the party stated in the credit? Is any variation/deviation permissible?

(40) If LC requires 'insurance for 110%', should 'sum insured' be exactly 100% CIF value, or does this requirement represents only the minimum amount?

A reference to the articles of the ISBP would provide clear guidance as to how the above are to be resolved.

Exercise

1. Refer to ISBP 681, and make an attempt to find solutions for the 40 questions in the preceding section.

508.5 INCOTERMS 2010

Introduction[10]

Incoterms®[11] rules explain a set of three-letter trade terms reflecting business-to business practice in contracts for the sale of goods. Incoterms rules describe mainly the tasks, costs and risks involved in the delivery of goods from sellers to buyers.

How to use the Incoterms® 2010 rules

1. *Incorporate the Incoterms® 2010 rules into your contract of sale*

   If you want the Incoterms® 2010 rules to apply to your contract, you should make this clear in your contract, through such words as, "[the chosen Incoterms rule including the named place, followed by] Incoterms® 2010" See item 3 below.

2. *Choose the appropriate Incoterms rule*

   The chosen Incoterms rule needs to be appropriate to the goods, to the means of their transport, and above all to whether the parties intend to put additional obligations, for example such as the obligation to organise carriage or insurance, on the seller or on the buyer. The Guidance Notes to each Incoterms rule contain information that is particularly helpful when making this choice. Whichever Incoterms rule is chosen, the parties should be aware that the interpretation of their contract may well be influenced by customs particular to the port or place being used.

3. *Specify your place or port as precisely as possible*

   The chosen Incoterms rule can work only if the parties name a place or port, and will work best if the parties specify the place or port as precisely as possible. A good example of such precision would be:

   "FCA 38 Cours Albert 1er, Paris, France Incoterms® 2010".

   Under the Incoterms rules Ex Works (EXW), Free Carrier (FCA), Delivered at Terminal (DAT), Delivered at Place (DAP), Delivered Duty Paid (DDP), Free Alongside Ship (FAS), and Free on Board (FOB), the named place is the place where delivery takes place and where risk passes from the seller to the buyer. Under the Incoterms rules Carriage Paid To (CPT), Carriage and Insurance Paid To (CIP), Cost and Freight (CFR) and Cost, Insurance and Freight (CIF), the

10. Source: Incoterms 2010, ICC Publication.
11. "Incoterms" is a registered trademark of the International Chamber of Commerce, Paris.

named place differs from the place of delivery. Under these four Incoterms rules, the named place is the place of destination to which carriage is paid. Indications as to place or destination can helpfully be further specified by stating a precise point in that place or destination in order to avoid doubt or argument.

4. *Remember that Incoterms rules do not give you a complete contract of sale*
   Incoterms rules do say which party to the sales contract has the obligation to make carriage or insurance arrangements, when the seller delivers the goods to the buyer, and which costs each party is responsible for. Incoterms rules, however, say nothing about the price to be paid or the method of its payment. Neither do they deal with the transfer of ownership of the goods, or the consequences of a breach of contract. These matters are normally dealt with through express terms in the contract of sale or in the law governing that contract. The parties should be aware that mandatory local law may override any aspect of the sale contract including the chosen Incoterms rule.

Main features of the Incoterms® 2010 rules

1 Two new Incoterms rules: DAT and DAP -have replaced the Incoterms 2000 rules DAF, DES, DEQ and DDU

The number of Incoterms rules has been reduced from 13 to 11. This has been achieved by substituting two new rules that may be used irrespective of the agreed mode of transport, DAT (Delivered at Terminal), and DAP (Delivered at Place), for the Incoterms 2000 rules DAF, DES, DEQ and DDU.

Under both new rules, delivery occurs at a named destination: in DAT, at buyer's disposal unloaded from the arriving vehicle (as under the former DEQ rule); in DAP, likewise at the buyer's disposal, but ready for unloading (as under the former DAF, DES and DDU rules).

The new rules make the Incoterms 2000 rules DES and DEQ superfluous. The named terminal in DAT may well be in a port and therefore DAT can safely be used in cases where the Incoterms 2000 rule DEQ once was. Likewise, the arriving "vehicle" in DAP may well be a ship; and the named place of destination may well be a port: consequently, DAP can safely be used in cases where the Incoterms 2000 rule DES once was. These new rules, like their predecessors, are "delivered", with the seller bearing all the costs (other than those related to import clearance, where applicable) and risks involved in bringing the goods to the named place of destination.

2 Classification of the eleven Incoterms® 2010 rules

The eleven Incoterms® 2010 rules are presented in two distinct classes:

(a) Rules for any mode of transport

EXW	EX WORKS
FCA	FREE CARRIER
CPT	CARRIAGE PAID TO
CIP	CARRIAGE AND INSURANCE PAID TO
DAT	DELIVERED AT TERMINAL
DAP	DELIVERED AT PLACE
DDP	DELIVERED DUTY PAID

(b) Rules for sea and inland waterway transport

FAS	FREE ALONGSIDE SHIP
FOB	FREE ON BOARD
CFR	COST AND FREIGHT
CIF	COST INSURANCE AND FREIGHT

The first class includes the seven Incoterms 2010 rules that can be used irrespective of the mode of transport selected and irrespective of whether one or more than one mode of transport is employed. EXW, FCA, CPT, CIP, DAT, DAP and DDP belong to this class. These can be used even when there is no maritime transport at all. It is important to remember, however, that these rules can be used where a ship is used for part of the carriage.

In the second class of Incoterms® 2010 rules, the point of delivery and the place to which the goods are carried to the buyer are both ports, hence the label "sea and inland waterway" rules. FAS, FOB, CFR, and CIF belong to this class. In the last three Incoterms rules, all mention of the ship's rail as the point of delivery has been omitted in preference for the goods being delivered when they are "on board" the vessel. This more closely reflects modern commercial reality and avoids the rather dated image of risk swinging to and fro across an imaginary perpendicular line.

3 Rules for domestic and international trade

Incoterms rules have traditionally been used in international sale contracts where goods pass across national borders. In various areas of the world, however, trade blocs, like the European Union, have made border formalities between different countries less significant. Consequently, the subtitle of the Incoterms® 2010 rules formally recognises

that they are available for application both to international and domestic sale contracts. As a result, the Incoterms® 2010 rules clearly state in a number of places that the obligation to comply with export/import formalities exists only where applicable.
Two developments have persuaded ICC that a movement in this direction is timely. Firstly, traders commonly use Incoterms rules for purely domestic sale contracts. The second reason is the greater willingness in the United States to use Incoterms rules in domestic trade rather than the former Uniform Commercial Code shipment and delivery terms.

4 Guidance Notes

Before each of the Incoterms® 2010 rules you will find a Guidance Note. The Guidance Notes explain the fundamentals of each Incoterms rule, such as when it should be used; when risk passes; and how costs are allocated between seller and buyer. The Guidance Notes are not part of the actual Incoterms® 2010 rules, but are intended to help the user accurately and efficiently steer towards the appropriate Incoterms rule for a particular transaction.

5 Electronic communication

Previous versions of Incoterms rules have specified those documents that could be replaced by EDI messages. Articles A1/B1 of the Incoterms® 2010 rules, however, now give electronic means of communication the same effect as paper communication so long as the parties so agree or where customary. This formulation facilitates the evolution of new electronic procedures throughout the lifetime of the Incoterms® 2010 rules.

6. Insurance cover

The Incoterms ® 2010 rules are the first version of Incoterms rules since the revision of the Institute Cargo Clauses and take account of alterations made to those Clauses. The Incoterms® 2010 rules have placed information duties relating to insurance in articles A3/B3,which deal with contracts of carriage and insurance. These provisions have now been moved from the more generic articles found in articles A10/B10 of the Incoterms 2000 rules. The language in articles A3/B3 relating to insurance has also been altered with a view to clarifying the parties' obligations in this regard.

7. Security-related clearances and information required for such clearances

There is heightened concern nowadays about security in the movement of goods, requiring verification that the goods do not pose a threat to life or property for reasons other than their inherent nature. Therefore, the Incoterms® 2010 rules have allocated obligations between the buyer and seller to obtain or to render assistance in obtaining security-related clearances, such as chain-of-custody information, in articles A2/B2 and A10/B10 of various Incoterms rules.

8 Terminal handling charges

Under Incoterms rules CPT, CIP, CFR, CIF,DAT, DAP and DDP, the seller must make arrangements for the carriage of the goods to the agreed destination. While the freight is paid by the seller, it is actually paid for by the buyer as freight costs are normally included by the seller in the total selling price. The carriage costs will sometimes include the costs of handling and moving the goods within port or container terminal facilities and the carrier or terminal operator may well charge these costs to the buyer who receives the goods. In these circumstances, the buyer will want to avoid paying for the same service twice, once to the seller as part of the total selling price and once independently to the carrier or the terminal operator. The Incoterms® 2010 rules seek to avoid this happening by clearly allocating such costs in articles A6/B6 of the relevant Incoterms rules.

9. String sales

In the sale of commodities, as opposed to the sale of manufactured goods, cargo is frequently sold several times during transit "down a string". When this happens, a seller in the middle of the string does not "ship" the goods because these have already been shipped by the first seller in the string. The seller in the middle of the string therefore performs its obligations towards its buyer not by shipping the goods, but by "procuring" goods that have been shipped. For clarification purposes, Incoterms® 2010 rules include the obligation to "procure goods shipped" as an alternative to the obligation to ship goods in the relevant Incoterms rules.

Variants of Incoterms rules

Sometimes the parties want to alter an Incoterms rule. The Incoterms® 2010 rules do not prohibit such alteration but there are dangers in so doing. In order to avoid any unwelcome surprises, the parties would need to make the intended effect of such alterations extremely clear in their contract. Thus, for example, if the allocation of costs in the Incoterms® 2010 rules is altered in the contract, the parties should also clearly state whether they intend to vary the point at which the risk passes from seller to buyer.

Explanation of terms used in the Incoterms® 2010 rules

As in the Incoterms 2000 rules, the seller's and buyer's obligations are presented in mirror fashion, reflecting under column A the sellers' obligations and under column B the buyers' obligations. These obligations can be carried out personally by the seller or the buyer or sometimes, subject to terms in the contract or the applicable law, through intermediaries such as carriers, freight forwarders or other persons nominated by the seller or the buyer for a specific purpose.

The text of the Incoterms® 2010 rules is meant to be self- explanatory. However, in order to assist users the following text sets out guidance as to the sense in which selected terms are used throughout the document.

Carrier: For the purposes of the Incoterms® 2010 rules, the carrier is the party with whom carriage is contracted.

Customs formalities: These are requirements to be met in order to comply with any applicable customs regulations and may include documentary, security, information or physical inspection obligations.

Delivery: This concept has multiple meanings in trade law and practice, but in the Incoterms® 2010 rules, it is used to indicate where the risk of loss of or damage to the goods passes from the seller to the buyer.

Delivery document: This phrase is now used as the heading to Article A8. It means a document used to prove that delivery has occurred. For many of the Incoterms® 2010 rules, the delivery document is a transport document or corresponding electronic record. However with EXW, FCA, FAS and FOB, the delivery document may simply be a receipt. A delivery document may also have other functions, for example as part of the mechanism for payment.

Electronic record or procedure: A set of information constituted of one or more electronic messages and, where applicable, being functionally equivalent with the corresponding paper document.

Packaging: This word is used for different purposes:

1. The packaging of the goods to comply with any requirements under the contract of sale.
2. The packaging of the goods so that they are fit for transportation.
3. The stowage of the packaged goods within a container or other means of transport.

In the Incoterms® 2010 rules, packaging means both the first and second of the above. The Incoterms® 2010 rules do not deal with the parties' obligations for stowage within a container and therefore where relevant the parties should deal with this in the sale of contract.

Structure of Incoterms

The respective responsibilities and obligations of the buyer and the seller, including allocation of costs, have been spelt out under ten distinct heads, as shown below:

(A) THE SELLER'S OBLIGATIONS	(B) THE BUYER'S OBLIGATIONS
A1 General obligations of the seller	B1 General obligations of the buyer
A2 Licences, authorizations, security clearances and other formalities	B2 Licences, authorizations, security clearances and other formalities
A3 Contracts of carriage and insurance	B3 Contracts of carriage and insurance
A4 Delivery	B4 Taking delivery
A5 Transfer of risks	B5 Transfer of risks
B6 Allocation of costs	B6 Allocation of costs
B7 Notices to the buyer	B7 Notices to the seller
A8 Delivery document	B8 Proof of delivery
A9 Checking - packaging - marking	B9 Inspection of goods
A10 Assistance with information and related costs	B10 Assistance with information and related costs

Incoterms Faqs - Issued By Icc, Paris

The 11 Incoterms® 2010 rules - FAQs about the basics

(Some of the following are repeats of those in the official "Introduction" to Incoterms, quoted in the immediately preceding section.)

What are Incoterms® rules?

The Incoterms® rules are the International Chamber of Commerce (ICC) rules for the use of domestic and international trade terms

Incoterms® rules are key commercial tools developed and maintained by ICC and used in certain contracts for the sale of goods all over the world. They define the responsibilities of buyers and sellers for the delivery of goods under sales contracts and determine how costs and risks are allocated.

What do they cover?

Incoterms® rules describe mainly the tasks, costs and risks involved in the delivery of goods - excluding intangibles -- from sellers to buyers.

Why Incoterms® rules? Why are Incoterms® rules successful worldwide?

Incoterms® rules are international rules that are accepted by governments, legal authorities and practitioners worldwide for the interpretation of the most commonly used terms in domestic and international trade. They facilitate business transactions globally by helping traders avoid uncertainties arising from differing interpretations of such terms in different countries.

Do Incoterms® rules apply to international or domestic contracts of sales?

Incoterms® rules apply to both domestic and international sale contracts.

How are Incoterms® rules correctly used?

ICC recommends that Incoterms® 2010 be referred to specifically whenever the terms are used, together with a location. For example, the term "Free Carrier (FCA)" should always be accompanied by a reference to an exact place to which delivery is to be made. To prevent misunderstandings, parties need to make the intended effect of any variants of the three-letter Incoterms® rules extremely clear in their contract. Incorrect use of Incoterms® 2010 rules has the potential to lead to legal consequences.

Only the version of Incoterms® rules published by ICC is official. Misuses can lead to expensive court cases.

Why do Incoterms® rules need revising periodically?

Incoterms® rules are revised periodically to adapt them to contemporary commercial practice. For instance in the 2000 version, increased use of FCA (Free Carrier) prompted ICC to simplify delivery obligations under this rule. Technological changes and developments in electronic communication have influenced contemporary trade and shaped the revision of Incoterms® rules.

Can you name some of the main innovations in Incoterms® 2010?

Two major innovations are the number of rules and their classification. There are 11 rules instead of 13. In addition, the new rules are classified according to the mode of transport (maritime vs. any other mode), reflecting a consolidation and updating of the delivered rules, replacing the precedent categorization into families of rules. In addition it includes the importance of cargo security and the 2004 revision of the United States' Uniform Commercial Code, which resulted in a deletion of the former US shipment and delivery terms. The revised Incoterms® rules also reflect the adoption in 2009 by insurance markets of the revised Institute Cargo Clauses (LMA/IUA) (2009).

The most recent revision presents practitioners with comprehensible and useful Guidance Notes to facilitate their correct choice of Incoterms® rules.

How can I find out which Incoterms® rule is the right one for my contract of sale?

When agreeing on a contract of sale, the parties should choose an Incoterms® rule that is appropriate to the goods and means of transport. Detailed Guidance Notes in each of the Incoterms® 2010 rules help buyers and sellers decide which rule is appropriate for their contract of sale.

I keep reading about "E"-terms and "C"-terms. What does that mean?

The 2000 version grouped Incoterms® rules into four term categories. Please note that Incoterms® 2010 rules are not divided this way anymore. The current version is classified in two categories according to the mode of transport (maritime vs. any other mode),

Where can I get detailed information on Incoterms® 2010 rules?

Refer to Publication No. 715E Incoterms® 2010 or No. 720E Guide to Incoterms® 2010 for a thorough explanation on the scope and the use of Incoterms® rules. These are the only recognized publications on the Incoterms® 2010 rules.

When is the risk of loss or damage to the goods transferred from the seller to the buyer?

The risk of loss or damage of the goods is generally transferred when the seller has fulfilled its delivery obligation in accordance with A4 (Delivery) of the particular Incoterms® rule. Refer to the publication No. 720E Guide to Incoterms® 2010 for a detailed explanation of A4.

Incoterms® rules and transfer of title and/or ownership

Incoterms® rules do not deal with the transfer of title to ownership of the goods.

EXW benefits for the seller

In comparison with other Incoterms® rules EXW represents the minimum obligation for the seller. However, when opting for this rule the seller has to take into consideration that under EXW the buyer is not obliged to provide any information regarding the export of the goods (if applicable) to the seller. The seller might require such information for tax or other purposes for instance thus consideration of this fact is crucial. In many cases, the parties are well advised to choose FCA instead.

Exercises

1. Does Incoterms deal with (name the correct one)

(a) Contract of sale?

(b) Ownership or title to the goods?

(c) Transfer of ownership of the goods?

(d) Issues like who bears the freight cost and up to what point?

(e) Payment obligations, viz., when, how, against what documents?

2. Which of the following is exclusively for transport by sea & inland waterway?

(a) FCA,

(b) CIP,

(c) FOB..

(d) DDP,

3. FOB, (Incoterms 2010) requires the seller to…

(a) Pass the goods across the ship's rail?

(b) Clear the goods for export (if applicable)?

(c) Clear the goods for import (at the receiver's end)?

(d) Pay any import duty? or

(e) Pay for any customs formalities?

4. Rearrange the following in the increasing order of risk & responsibility for the seller/exporter:

(1) FOB (free on board),

2) DAP (delivery at place),

(3) DAT (delivered at terminal)`

(4) EXW (ex-works),

(5) CIF (cost, insurance, freight),

(6) FAS (free alongside ship),

5. Pick the expression that is correct (as prescribed by Incoterms 2010):

(1) $ 999,999 CIF,

(2) $ 999,999 CIF Rotterdam Incoterms 2010,

(3) $ 999.999 CIF Incoterms 2010,

(4) $ 999,999 CIF Heathrow,

(5) $ 999,999 CIF Rotterdam,

(6) $ 999,999 CIF Heathrow Incoterms 2010

(7) $ 999,999 CIF Rotterdam Incoterms.

508.6 Methods of Setlement in international trade

Shipping documents

The term 'shipping document' may be used to define all documents, including a transport document but excluding a bill of exchange, that accompany a shipment.

Almost all trade transactions, with the possible exceptions of those conducted across the counter or on an ex-works basis, require the seller to provide the buyer two essential shipping documents. The first is the transport document. This is generated when the seller hands over the consignment to a carrier or a transport operator for being carried from the place of the seller to that of the buyer. The transport operator provides to the consignor a receipt in the nature of an undertaking, agreement, or contract indicating the details of carriage. If the transportation is by ship the consignor receives what is called a bill of lading (B/L), if by air the carrier or its agent produces an air waybill (AWB); if by surface transport, possibly a railway receipt or a truck receipt.

Since it is the seller who generally hands over the goods for carriage or transportation, it's called the consignor. The buyer, or whoever the goods are consigned to as shown in the transport document, is called the consignee. Most often, the consignee is required to produce the original transport receipt at destination to the carrier or its agent in order to claim possession of the consignment. The purpose of a trade transaction being the due receipt of a consignment, the transport document could be said to be the most important shipping document

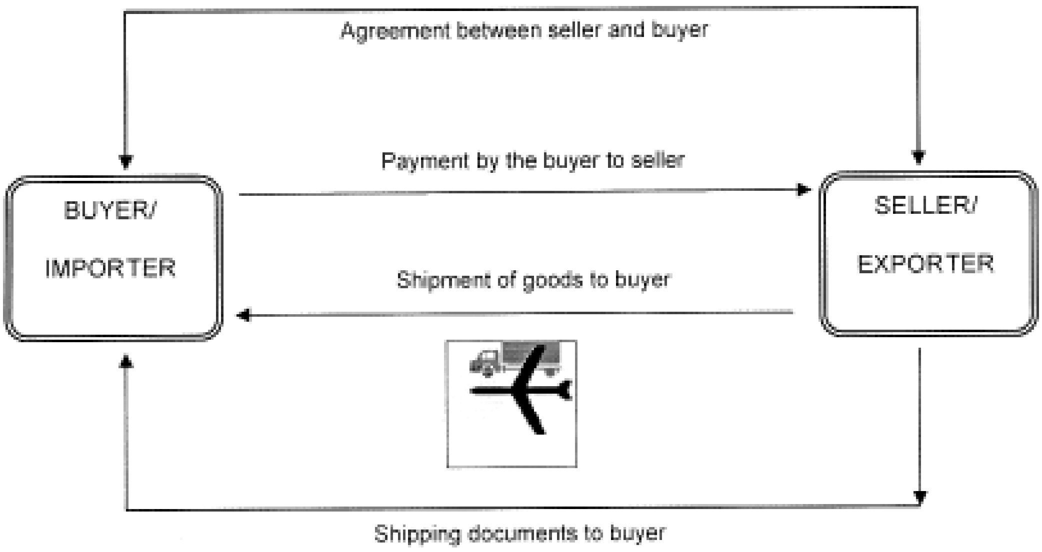
Commercial invoice and other shipping documents

The second important shipping document is a commercial invoice. This document shows the full details of a particular transaction. Besides the commercial invoice, other documents (like quality certificate, certificate of origin, weight list, packing list, legalised invoice and so on), may be added depending on whether they are required by the buyer, the buyer's country, are statutory requirements in the country of the buyer or seller, required by law for export from or import into a country etc.

When the commercial banking system is not used, the shipping documents are despatched direct by the seller to the buyer. The goods are also consigned directly to the buyer. The buyer uses the transport document to take delivery of the consignment. The commercial banking system may still be used, but only for the limited purpose of the transfer of funds.

Figure 1 is a simple illustration of a domestic or international trade transaction. The transaction begins with a sale or purchase agreement between the two parties, viz., the seller and the buyer.

Figure 1: A trade transaction



The best way for settlement

One of the key issues during any negotiation is the term of settlement. Simply put, the issue is whether

(a) payment by the buyer to the seller should precede shipment of goods to the buyer?

or

(b) shipment of goods to the buyer be made first, before payment is released by the buyer?

Remember that either of these two contains elements of risk for either party. The dilemma for the buyer and the seller in any trade transaction may be summed up as follows.

Buyer's dilemma:

- How to make sure that I get exactly the goods that I pay for?
- Why should I pay before I have an opportunity to examine the goods?
- Why should risk paying if I do not receive goods or they are not as per specifications, whatever the reason?

Seller's dilemma:

The seller's main concern is about payment. His typical question is something like, "What is the guarantee that the buyer will pay once I have effected delivery?" Putting this in other ways, the seller could ask:

- How do I know that (after having received the consignment) the buyer will not find (invent?) excuses to delay payment, demand a discount or avoid paying for the goods?
- How can I make sure that I get my payment if, after having received the goods, the buyer is not available to pay (viz., goes bankrupt, closes business, account is frozen)?
- How can I be assured of receiving the proceeds even if some problem with the buyer's country, exchange control or any statutory incident intervenes?
- Irrespective of the various risks in international trade, once I have honoured my part of the contract (say despatched or delivered the goods) how can I be sure that I will get my money?

The expectations of the buyer, as can be seen from the questions posed, are diametrically opposite to those of the seller. In international trade, where the risks are often beyond the parties' control, these questions are very natural indeed. There is no simple or single solution to these issues.

Payment method : Guiding factors

The method of settlement that the seller/exporter and the buyer/importer agrees between themselves, therefore, depends on one or a combination of the factors as outlined here. The compulsions or reasons include:

(i) The levels of mutual trust, confidence and comfort;

(ii) The credit worthiness of the counterparty, track record and past experience;

(iii) Market conditions, market practice;

(iv) Exigencies, urgency for the product or service;

(v) Bargaining power to secure the most favourable terms;

(vi) Conditions imposed by a third party (viz. insurance agency, exchange control regulations);

(vii) Insurance cover or guarantee by third party (including a bank) against risk of non-payment by principal;

(viii) Import/export regulations.

Methods of payment

In an ideal scenario, a buyer would like to pay only when the goods have been received and examined. The seller, on the other hand, (as the best option) would prefer to have the entire amount paid in advance. Unfortunately, the best option for the seller is often the worst option for the buyer, the risks being the highest. Similarly, the best option for the buyer carries the greatest risk for the seller. The parties, therefore, stand at the opposite end of the spectrum. How do we reconcile the two, so that a successful trade can result?

In a trade transaction, for reasons referred to earlier, if we leave out advance payment terms, the seller generally is in a relatively more vulnerable position than the buyer. This is because, most often, the seller's performance is expected to precede that of the buyer. The seller is expected make the goods ready for delivery (EXW), to physical delivery (DDP) thereby losing physical possession or effective control - before being paid. Of course, if the buyer had his way, all the way, he would like to take delivery of the goods, examine and sell them, and pay the supplier thereafter (ideally, from the sale proceeds). If the seller is prepared to give further time (over and above the normal transit time) to the buyer, say 30, 90, 120 days or more, for payment (e.g. on DA terms or deferred payment basis), so much the better. (The seller, then, would effectively be financing the buyer's operation - but that is another story.)

Apart from advance payment and payment after receipt and sale of the consignment, several other payment options are available to the seller and the buyer. As can be easily understood, every choice comes with it its own pluses and minuses. The commonly used payment options are as follows:

- Advance payment
- Open account/Consignment basis
- Collection Bills (DP, DA or under deferred payment)
- Banker's Acceptance
- Bank Guarantee (BG), Payment Guarantee
- Standby Credit
- Letter of Credit available by :
  - Negotiation
  - Sight payment
  - Acceptance or
  - Deferred Payment

The next few pages provide an overview of some of the above.

Advance Management

The stages

1. Agreement or sales contract: Buyer and seller come to agreement regarding the terms of sale, execute agreement, sales/purchase contract or sign pro forma invoice. The terms of sale stipulate (part or full) payment in advance of the invoice value. The schedule of payment of balance amount (if any) is also mutually agreed and stipulated in the agreement. The agreement also records, among others, the carriage, period and terms and mode of shipment.
2. Advance remittance: In accordance with the agreement, the buyer/importer remits (part or full) invoice value to the seller/exporter.
3. Shipment of goods: Seller/exporter ships goods as per terms of sale, the shipment being made direct to the buyer/importer. The goods are consigned direct to the buyer. The transport document is drawn up accordingly.
4. Despatch of documents: Documents relating to the shipment are sent direct to the buyer's address. The set of documents includes transport documents which, on receipt by the buyer, are used to take delivery of the consignment from the transport operator.
5. Part payment (if any): If pending, is effected at as mutually agreed and as per agreement.

   The buyer has the maximum risk exposure, the seller the least (actually none whatsoever).

Open Account

Features

Sale on 'open account' basis - also called 'consignment basis' - is usually between a principal and his agent, or between parties having close business relationships. Sale on consignment basis traces virtually the same stages as 'advance payment'. The change occurs where the payment to the seller follows shipment to the buyer. As in the instance of trading on 'advance payment' basis, under 'open account' (or sale on consignment basis) the seller sends the goods and relevant documents directly to the buyer or the agent. The latter would have agreed to pay the seller (or the principal) upon arrival of the goods, or within a certain period of time after (say)

(a) the shipment of goods, or
(b) the receipt of documents, or
(c) the invoice date, or

(d) on the basis of a pre-arranged schedule, say, at the end of every month.

The seller may have agreed with the consignee to allow him to sell a part or the total consignment and pay on realisation of the sale proceeds. The arrangement is mutually agreed in advance of the shipment/sale. No third party is involved. Remittance of proceeds to the seller/exporter is normally made using banking channels.

Settlement Through Escrow

The following is a general description of how an escrow system works in international trade.

(i) The buyer and the seller agree on terms. The settlement is agreed through escrow.

(ii) The seller or the buyer advises the terms of the transaction and also provides information about the merchandise to the company providing the escrow service (the 'escrow'). This information includes items such as the address of the counterparty, length of inspection period, party responsible for paying the escrow's fees, delivery options and shipping costs, and related issues as stipulated by the escrow.

(iii) The buyer is required to pay the escrow before shipment is made by the seller. After payment is received by the escrow, the seller is notified by it of this fact to enable him effect shipment.

(iv) The seller ships the merchandise direct to the buyer. Irrespective of the terms of shipment (e.g. CIF, C&F), the seller must initially pay the full freight charges for the shipment effected. As per the terms of sale, if the buyer is responsible for paying the freight charges, the seller is supposed to be reimbursed with the same when the transaction is concluded.

(v) When the buyer effectively accepts the merchandise the process of disbursement begins. Payment that is held by the escrow is then remitted to the seller after deduction of shipping and other incidental costs, as applicable and determined by the escrow company.

(vi) If the buyer rejects the consignment the seller is informed accordingly. The buyer is then responsible for re-shipment of the goods at cost to the seller.

(vii) If the seller accepts the rejected and returned goods and informs the escrow company accordingly, the latter settles the final accounts from the funds already held by it.

(viii) If the seller rejects the goods that have been returned to him, the transaction will be considered as one in dispute. The funds earlier paid to the escrow by the buyer will be withheld till the dispute is resolved.

The escrow may put conditions for accepting payment in terms of amount, the mode, the payment instrument, or even the originating or the beneficiary country. It may also impose conditions with regard to the its scale of charges, time for execution of a particular stage of operation including time period allowed for acceptance of goods, its rejection, verification of payment and so on.

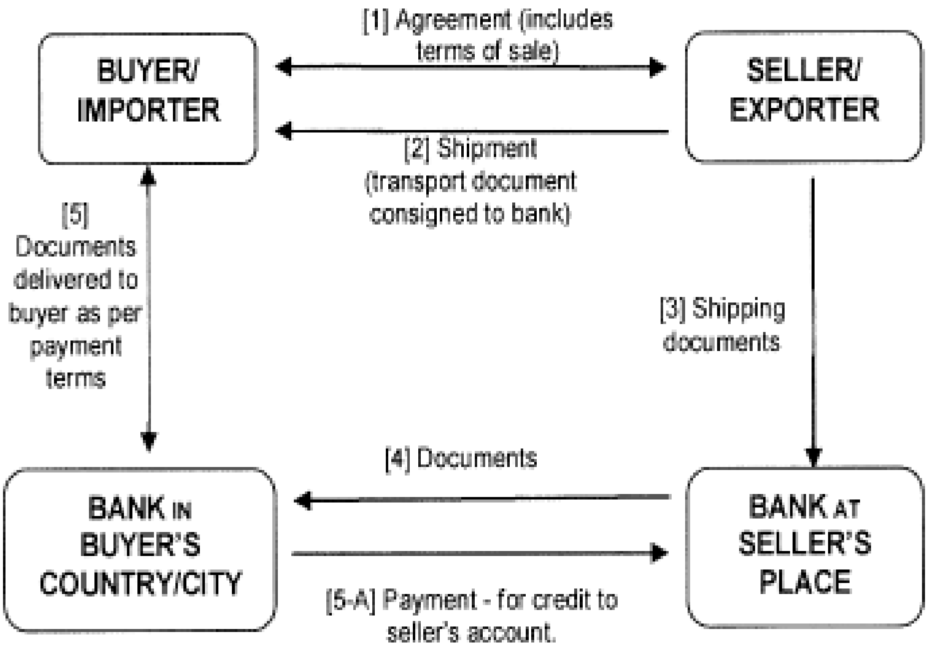
Here, there is no guarantee that the goods, once shipped, will be accepted by the buyer, or that payment will be forthcoming once shipment has been effected. The escrow acts only as an independent third party, as a custodian of the buyer's funds till the goods are accepted by the buyer. The unique selling proposition (USP) of this method is that the buyer gets an opportunity to inspect the consignment and decide whether to accept or reject the goods. If rejected, the funds get locked up till the disputes are resolved.

Transaction Through Commercial Banks

The following are some of the standard methods of settlement where banks act as intermediaries to facilitate domestic and international trade. Figure 2 depicts a simplified version of the transaction flow that takes place in a trade transaction. The payment options are:

1) Bills for collection (sight basis)
2) Bills for collection (acceptance basis)
3) Banker's Acceptance
4) Deferred Payment
5) Letter of Credit (LC)
6) Bank Guarantee (BG) or payment guarantee
7) Standby Credit

Figure 2: Documents through bank



508.7 Bills Under Lc, Collection (non-LC) Bills

Rules of the game

All bills - irrespective of their nature, purpose and content, covering domestic, export or import trade - fall under one of the following two groups:

(a) Non-LC bills: These are shipping bills (clean or documentary) routed through banks without the accompaniment of letters of credit (LC);

(b) LC bills: These are shipping bills (clean or documentary) presented to banks under cover of letters of credit.

The rules applicable[12] to these two groups of bills are as follows:

1. Non-LC bills: These are governed by Uniform Rules for Collection (URC), published by the International Chamber of Commerce, Paris. At present, ICC

12. Provided the text of the document expressly indicates that ist is subject to these rules.

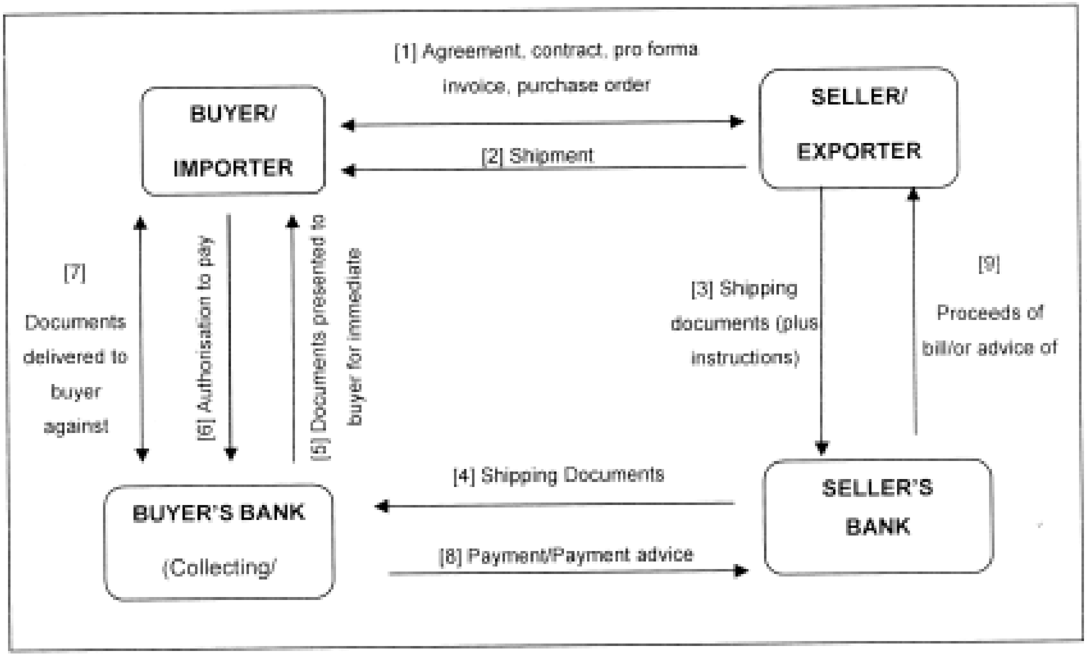
Publication No. 522 (1995 Revision), also known as URC 522 or ICC 522, is in operation.

2. LC bills: These are governed by the Uniform Customs and Practice for Documentary Credits (UCP), another ICC Publication. Presently the 2007 Revision of the UCP, International Chamber of Commerce Publication No. 600, commonly referred as UCP 600, is in operation. It came into effect from 1 July, 2007.

   To reiterate, URC applies to all bills that are not presented under letters of credit. If the bills/documents are instead presented to a bank under a letter of credit, the UCP applies[13]. These two sets of rules can be said to cover the entire gamut of operations relating to all documents that are routed through the banking system.

   Figure 3: Sight Documentary Collection - Flow Chart

Figure 3: Sight Documentary Collection – Flow Chart



The Collection Process (Figure 3)

1. Contract between parties: The buyer and seller arrive at an agreement regarding the terms of sale; execute agreement through a pro forma invoice, sales/purchase

13. In addition to the UCP, there are a few other rules that apply to documents under letters of credit. Among these are Uniform Rules for Bank-to-Bank Reimbursement (URR), the International Standard Banking Practices (ISBP) which supplement the UCP.

contract or firm order. Payment terms stipulate presentation of documents payable 'on demand' or 'at sight' to buyer, i.e., settlement against draft drawn on D/P or CAD basis.

2. Shipment of goods: The seller/exporter ships goods to the buyer/importer as per agreed schedule and mode of transport. The goods are consigned to the order of the shipper, the remitting bank or the collecting bank.

3. Documents through bank: The transport documents, along with other shipping documents as required under the sales agreement and as per buyer's requirement (viz., sight draft, commercial invoice, packing list, quality certificate etc.), are submitted by the shipper to his bank (the remitting bank). The submission includes instructions (collection instructions) for the remitting bank. (Refer to Article 4 of the URC for contents of 'collection instructions'.)

4. Despatch of documents: The shipping documents along with the 'collection instructions' issued by the remitting bank, are despatched by the latter to the collecting bank in the buyer's country/city. The presenting bank may be the same as the collecting bank, or may be a different bank. The presenting bank is usually selected by the remitting bank, unless named by the buyer or the seller (refer to Article 11 of URC 522).

5. Presentation of documents: On receipt of the documents by the collecting bank or the presenting bank (usually located in the buyer's place of operation), they are 'presented' to the buyer by the collecting/presenting bank for payment.

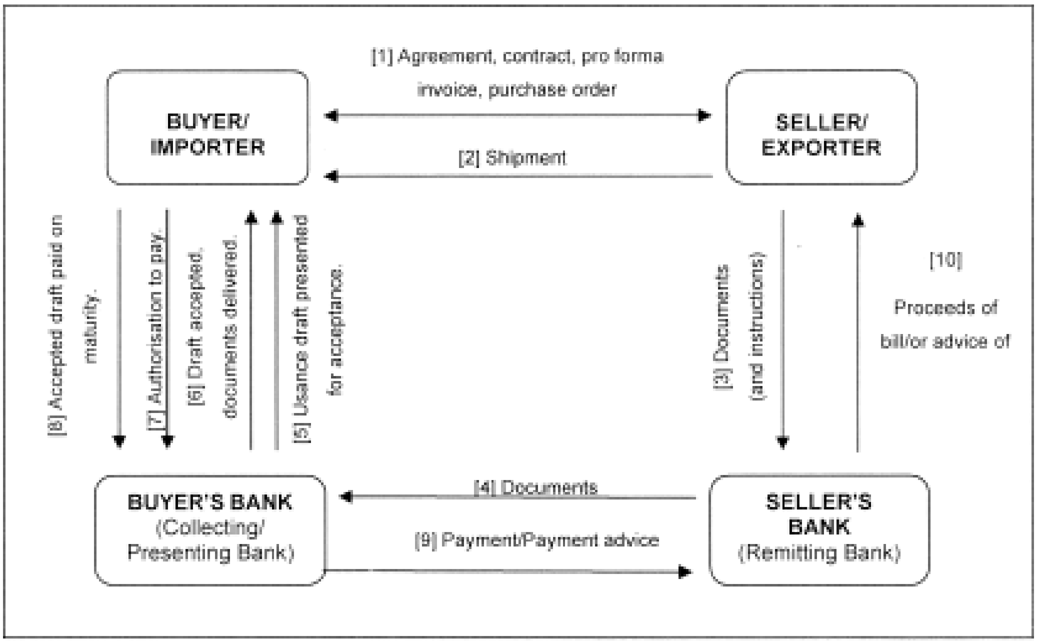
6. Authorisation to pay: If the drawee (buyer/importer) is willing to pay, authorises payment in favour of the seller.

7. Documents against payment: On payment by the buyer to the collecting/presenting bank, the documents are delivered to the buyer or to his banker. The transport document is endorsed in favour of the drawee, and/or a delivery order issued. The transport documents (duly endorsed if required), or delivery orders, are used to take delivery of the consignment from the shipping company.

8. Remittance to seller's bank: The sales proceeds (including all interests and charges, less adjustments) are remitted by the collecting bank to the seller's bank (Article 26.c.i, URC 522).

9. Credit to seller's a/c: The proceeds are credited to the exporter's account with the remitting bank. The exporter is advised accordingly.

Figure 4: Documentary Collection (on DA basis)



Acceptance Bill

Transaction Cycle (Figure 4)

1. Purchase contract: The buyer and the seller come to a mutual agreement regarding the terms of sale; executes agreement by way of a pro forma invoice, sales or purchase contract or a firm order. The payment terms stipulate presentation and delivery of documents through bank, against usance draft of 30/45/60/90/180 days' maturity (or as agreed between the parties concerned).
2. Shipment of goods: The seller/exporter ships the goods to the buyer/importer as per agreement. The shipping documents are blank endorsed, or endorsed to 'self or order', or consigned to his 'bank or order'.
3. Documents through bank: The shipping documents, along with other documents as required under the sales agreement and per buyer's requirement, are submitted by the shipper to his bank. The submission includes handling instructions for the remitting bank and the presenting bank.
4. Despatch of documents: All the documents, along with the instructions from the

remitting bank for the handling of the documents (collection instructions), are despatched by the remitting bank to the collecting bank in the buyer's country/ city.

5. Presentation of documents: On receipt of the documents from the remitting bank, the collecting bank 'presents' the usance draft to the buyer for his 'acceptance'. Acceptance and maturity date should be advised by the presenting/collecting bank to the remitting bank (refer to URC, Article 26.c).
6. Documents against acceptance: After 'acceptance' of the usance draft by the buyer, the bank retains the 'accepted' drafts. The shipping documents are delivered to the buyer. The transport documents are used to take delivery of the consignment from the carrier.
7. Authorisation to pay: On due date (maturity date of 'accepted' usance draft) the bank is authorised by the buyer/importer to effect payment.
8. Payment by buyer: The buyer's account is debited by his bank.
9. Payment advice to seller's bank: The sales proceeds are remitted by the collecting bank to the seller's bank (a/c seller). (Article 26.c.i of URC 522)
10. Credit afforded to seller's a/c: The sales proceeds, less bank charges, are credited to the exporter's account with the remitting bank. The exporter is advised accordingly.

Banker's Acceptance

This is an extension of a collection bills on usance basis. If the draft is accepted by third parties - for example by the buyer, as in a D/A bill - the buyer's bank is requested to guarantee the eventual payment of the draft on maturity by way of co-acceptance. If the time draft (as a part of the set of bills) is drawn on and accepted by a bank, the document is said to carry a 'Banker's Acceptance' (avalised).

Deferred Payment

Deferred Payment Undertaking

Sale or export on 'Deferred Payment Undertaking' (DPU) basis differs only marginally from bills on D/A terms. The main difference is generally - but not necessarily - the lack of a draft. Payment is spread over a longer period, usually over five to seven years or longer. This arrangement is suitable for transactions that involve capital goods, setting up of large plants or infrastructure, commissioning of factories, and very large sums by way of payment. Payment is made in instalments, usually on half-yearly or on annual basis. The supplier(s) may also draw time drafts on the buyer and/or his bank, duly accepted by the drawee, made payable on nominated future dates covering the full tenure of the period of the performance contract, loan, advance or deferred payment. These are usually accepted by the buyer (and/or co-accepted by his bank) and honoured as and when they fall due. The respective drafts are then cancelled by the drawer with an endorsement stating 'received payment', dated and returned to the drawee or his bank, signifying due discharge of obligations.

Deferred Payment Guarantee

At the buyer's request banks may issue Deferred Payment Guarantees (DPG) in favour of the seller, guaranteeing payment over the pre-arranged contracted period. DPGs are mostly used for purchase of capital goods, large plants and machinery where the amount involved is too large to be paid at one shot or within a very short time. It comes into play only if the principals fail to perform as per contract or agreement.

Deferred Payment Credit

Under a Deferred Payment (letter of) Credit (DPC) payment is made in instalments generally over a period of three to seven years or more. The safety for the seller is the availability of a Deferred Payment letter of credit from a bank. The issuing bank's undertaking to meet payment obligations on their respective due dates is the main distinguishing feature. The LC may expire after complying presentation of documents is made. However, the commitment of the issuing bank continues over the life of the contractual payment period.

Letter of Credit (LC)

In our analysis of the various options available for settlement of international trade, we dealt with bills for collection. These are documents that are not processed under letters of credit. Accordingly, we had termed them as 'non-LC bills'.

A Documentary Letter of Credit (also called Letter of Credit or LC for short) is a written undertaking issued by a bank on behalf of a buyer (or, in the case of international trade - an importer) that payment will be made by the bank for goods and services supplied by the seller (an exporter- in the case of overseas transactions), provided the seller (exporter) complies strictly with all the terms and conditions of the documentary credit. In a letter of credit (LC) transaction, the bank that issues the LC offers its own undertaking to pay against due presentation of documents (provided they strictly conform to LC terms) irrespective of whether its own customer (the buyer or the importer - also called the 'applicant') is capable of paying or not.

An LC replaces the buyer's promise to pay with that of a bank's, and is a direct undertaking by the (issuing) bank to the seller or the exporter. The subjects of primary concern to the seller should, therefore, be the quality of the bank that issues the credit and the beneficiary's compliance with the terms of the credit. over the years, the mechanism of documentary letters of credit has proved to be the most preferred instrument for settlement of managing risks in international trade. Knowledge about this instrument and of the applicable rules, procedures and practices are necessary to get the most out of a letter of credit.

Guarantee

Performance guarantee

Guarantees may be issued by any entity. An individual, a corporation, institutions of various kind, the government or its agencies, manufacturers or financial institutions may issue guarantees provided the beneficiary is agreeable to accept the same. Guarantees are basically of two types, viz., performance and financial. Performance guarantees offer the security of performance. The issuer of the guarantee, the guarantor (say, the manufacturer or the service provider) undertakes an obligation to repair the defect or replace the offending item, thus ensuring uninterrupted service to the user. (This guarantee may also be provided to the buyer by a third party.) As far as performance guarantees are concerned, the important identifier is that the main purpose is not to compensate with money any failure in performance. A performance guarantee is meant to assure continuity in performance.

Financial guarantee

A financial guarantee, as the term suggests, is designed to compensate with money against a defect, default, failure of performance or breach in promise. Commercial banks invariably issue financial guarantees, never performance guarantees. The reason is simple. Banks are neither equipped nor qualified to repair, replace or recompense a breach in performance or promise with a similar, compensatory performance or service. When a bank issues a guarantee, it undertakes to compensate a breach of performance only in terms of money. For this reason such guarantees are called financial guarantees. Financial guarantees issued by commercial banks are commonly referred to as bank guarantees (BG).

Uses of financial guarantees

Bank guarantees are widely used in domestic and international trade. A payment guarantee or a bank guarantee (BG) works like an insurance. It is the promise of a bank (the issuer) to pay on first demand made by the seller (the beneficiary), if the latter presents a statement or a simple claim to the bank stating that he has not been paid for the goods or services supplied. It is often used:

- in conjunction with the 'open account' term of settlement
- as 'insurance' against failure to pay against delivery of goods or services,
- for guaranteeing the safety of an advance paid in lieu of subsequent delivery of goods or performance, or
- to secure an advance to a beneficiary under a red clause or a green clause credit.

Standby Credit

A Standby Credit is essentially a substitute for a payment guarantee (i.e. guarantee of payment issued by a bank). It is not a letter of credit in its usual interpretation. It works like a BG or a payment guarantee. As a rule, payment under a standby credit is made against a statement from the exporter (seller) confirming that payment has not been made by the importer (the buyer) or that there is a failure in performance. Although not advisable, the terms sometimes stipulate presentation of (unpaid) sight drafts or invoices, copies of shipping. This type of credit is in the nature of a guarantee and is used primarily in the USA, where granting of European type bank guarantee is not permitted by law. A standby letter of credit has the protection of the rules framed by the International Chamber of Commerce (ICC), Paris. Standby letters of credit are subject to the Uniform Customs and Practice for Documentary Credits (UCP 600) to the extent applicable. However, a separate, specific set of rules, called International Standby Practices (ISP 98), ICC Publication No. 590, has been framed exclusively to govern the use and operations of standby letters of credit.

ISP 98: Overview

ISP98 reflects generally accepted practice, custom, and usage of standby letters of credit. January 1, 1999, was the date when the International Standby Practices (ISP98) was implemented. ISP98 is a set of rules designed to facilitate the domestic and international use of standby letters of credit. ISP98 is the product of more than five years of drafting under the auspices of the Institute of International Banking Law & Practice, Inc. Both bankers and lawyers were involved in the drafting process, as were rating agencies, beneficiaries, and applicants.

The latest version of the UCP, the 2007 revision, International Chamber of Commerce Publication No. 600 (UCP 600), provides in Article 1 that UCP 600 "shall apply to all Documentary Credits (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules." These rules which are currently most often used for letters of credit, the Uniform Customs and Practice for Documentary Credits (UCP), mostly reflect the usage of letter of credit in practice. UCP 600 primarily emphasizes and focuses on commercial letters of credit and the documents typically presented under commercial letters of credit (such as transport documents, insurance documents, and commercial invoices), whereas ISP98 is devoted to standbys, akin to guarantees. The UCP rules are designed to be applied domestically and internationally relatively less for standby letters of credit and rather much more for commercial letters of credit.

ISP98 streamlines the process of preparing and negotiating standby letters of credit. It has resulted in changes in forms of standby letters of credit and reimbursement agreements and applications as well as changes in certain practices. ISP98's detailed rules now lead some parties to focus on issues they had previously overlooked. In some cases the parties will opt for ISP98's default rules; in other cases they may want to limit or vary particular ISP98 rules, just as parties today often limit or vary particular UCP 600 rules in particular letters of credit. Many of ISP98's provisions specify detailed rules and the consequences of complying or failing to comply with the rules.

Perhaps the most fundamental issue facing letter of credit users is whether to choose to be governed by ISP98 or by UCP 600, in whole or in part. In order to make an informed decision, it is necessary to compare the rules and applicable law (such as the Uniform Commercial Code or the United Nations Convention on Independent Guaranties and Stand-by Letters of Credit) and to consider their impact on proposed transactions.

ISP98 addresses several topics that are not addressed at all by UCP 600 or that are addressed only generally by UCP 600. In addition, ISP98 contains several rules crafted for standby letters of credit that differ from their UCP 600 counterparts.

ISP 98 analysed

The Documentary Letter of Credit is conditioned on performance by the supplier, whose acceptable and satisfactory performance makes him the beneficiary of the credit.
The Standby Letter of Credit is conditioned on default or non-performance by the account party or applicant who opened the standby letter of credit.

A documentary letter of credit is issued with the expectation that it would be drawn on by the beneficiary. A standby letter of credit is issued with the expectation that it will not be drawn on by the beneficiary.

Standby letters of credit are sometimes referred to as "sui generis" (of their own kind, or "beasts unto themselves"). They are flexible and their versatility is virtually limitless. The premise or the essence of a standby letter of credit is that the issuer will "stand by" to perform in the event of the account party's non-performance or default.

One distinguishing characteristic with standby letters of credit is that documentation of non-performance or default is required for the beneficiary to obtain payment. This documentation must be precise and strict adherence to the language of the credit and satisfying whatever is called for in the credit indicating non-performance by the issuer. This could include, submitting drafts and perhaps a statement indicating that the account party has defaulted in accordance with the text of the credit. (Strict Compliance Rule).

Standby letters of credit are a type of IOU, more closely related to a co-signer on a loan. That is to say, if you default or don't perform in accordance with your agreement with the lender, the "co-signer" is responsible for you and your debt and pays on your behalf. In reality, he is standing by for you.

Exercise

1. Name the ICC rules that govern Standby Letters of Credit (SBLC).
2. A SBLC is said to be more in the nature of a guarantee. Give reasons.
3. What are the major differences between an LC and a guarantee?
4. What is the difference between a performance guarantee and a financial guarantee?

Table 1: Payment Terms and Options

	Applicable rule(s)	Bills payable 'on demand'	Acceptance bills
Bills for collection (Non-LC bills, i.e. bills *not* presented under LC).	URC 522.	Also called sight bills, bills payable 'at sight', D/P bill, demand bill, bills on CAD/COD basis etc.	Also called 'after sight' bill (or payable after sight), D/A bill.
Bills presented under letter of credit (LC), documentary credit, or simply a 'credit'.	The UCP (presently it is UCP 600), plus URR 725, ISBP 681.	Should be presented under 'Sight LC', credit or LC available by sight payment, or LC available by negotiation (refer to Article 6(b) of UCP 600).	Documents to be presented under credit available by acceptance, under acceptance credits/LCs, or credit available by deferred payment.

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508.8 Letters of Credit

Introduction

Documentary credits (LCs) go a long way to reduce some of the major risks in international trade. Since letters of credit operate on the basis that they are undertakings by commercial banks which are third parties to these transactions, LCs offer better security to both the buyers and sellers. LCs' operations are guided by well defined, internationally recognised, and widely accepted sets of rules, practices and procedures. These are further backed by innumerable case studies, ICC Opinions, decisions, and court judgments. Over the years documentary credits have, inevitably, emerged as one of the most popular, if not the most preferred, instrument worldwide for the settlement of domestic and international trade transactions.

Documentary credits provide significant protection to both the buyer and the seller. An LC assures the importer that payment will be released only if the seller (beneficiary) presents the documents specified in the credit. It guarantees the exporter that payment will be made if documents presented are exactly as per the terms of the credit. A variety of letters of credit are available to meet the specific needs of the contracting parties from the simplest to the most complex situations.

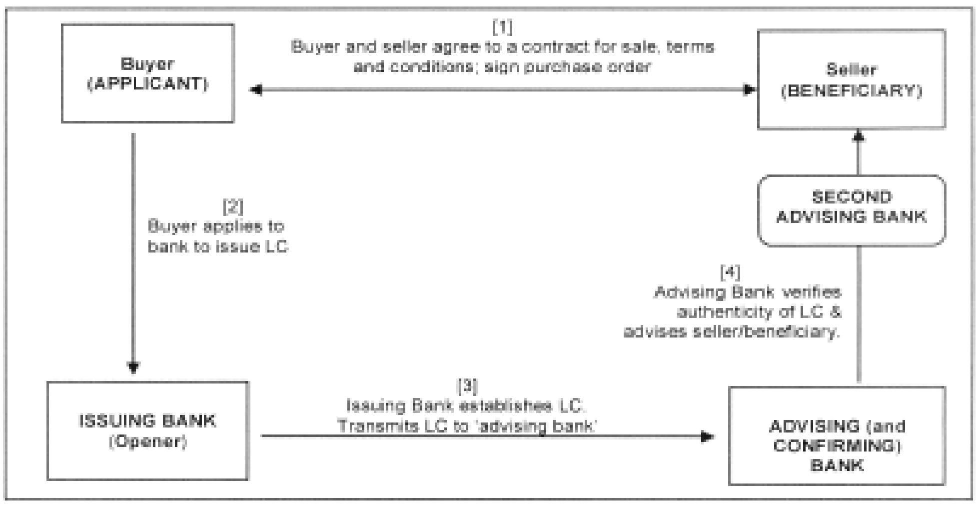
Letter of credit: Definition

A letter of credit could be defined in various ways. One of the definitions, preferred by this author, is as follows:

"A documentary letter of credit (LC) is an irrevocable, written undertaking by a bank, issued at the request of the buyer in favour of the seller, to effect payment for certain goods or services, against presentation of a specified set of documents in strict compliance with the terms of the credit."

Article 2 of UCP 600 defines a (letter of) credit as any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.[14]

Figure 5: Issue of a letter of credit



The documentary credit life cycle

The stages for the issue of a letter of credit are illustrated in Figure 5. In domestic trade transactions, the buyer and the issuing bank are generally located in the same country or city as that of the seller/beneficiary and the advising bank. In international trade, the buyer and the issuing bank would be separated by international borders, operating in a

14. 'Complying presentation' is a term that has been introduced for the very first time in the UCP (Article 2 of UCP 600) and in documentary credit operations. It encapsulates and replaces the repetitive use, till recently, of the otherwise longer expression, viz., 'presentation within the validity of the credit to the issuing, confirming or to any other nominated bank, of documents that, on their face, comply strictly with the terms and conditions of the credit' or words to that effect.

different country far away from that of the seller and his banker. The basic rules and principles, however, remain the same. These points should be kept in mind while viewing the flow charts.

The important milestones in the life cycle of a documentary credit are furnished below by way of an introduction to the subject. It should be noted that operating rules for almost every (but not all) stages mentioned in this section are described in general terms and are guided by the provisions of UCP 600. References to applicable articles of the UCP have been cited in brackets against the relevant items.

(1) Agreement Between Buyer and Seller (Article 4.a)

(a) Buyer and seller agree on the sale of goods or services.

(b) Both mutually agree to the trade terms viz., specification of goods, quality, quantity, rate, terms of payment, packing, carriage, insurance, quality inspection, documentation, name of seller's banker, delivery schedule etc. as applicable. Terms of payment should state that payment would be settled through documentary letter of credit.

(c) The parties execute agreement, sales contract, pro forma invoice or firm order describing the terms and all relevant conditions.

(2) Buyer Applies for Issue of a Documentary Letter of Credit (LC)

(a) Buyer submits duly filled in application form for issue of the LC, along with copy of sales contract and other documents to his bank as per its requirement. Issue of LCs is at the discretion of the bank concerned. Applicant should have financial facility with the opening bank already in place for issue of LC. If not, he is usually required to complete necessary formalities in advance for the same. Necessary credit limit (general or for the specific issue of a letter of credit) would only be approved subject to the norms of respective banks, and made available to the applicant on completion of formalities.

(3) Buyer's Bank Issues LC

(a) Buyer's bank issues LC, transmits the same through another bank (the advising bank) for being advised to the beneficiary (Article 9). (Note that on certain instances the issuing bank may also be the advising bank.) A non-negotiable copy of the LC is furnished to the applicant.

(b) If the LC is to be confirmed, advising bank is requested and authorised by the issuing bank to add its confirmation to the credit prior to it being advised to the beneficiary. (Article 9)

(c) Issuing bank may itself reimburse on presentation of documents, or set up reimbursement arrangement through a third bank. (Article 13)

(4) The Issuing Bank Furnishes a Copy of the LC to Buyer/Applicant.

(a) Applicant is required to go through the LC copy to ensure that all terms in the LC are as per his requirement and reflect the trade agreements with the seller. If not satisfied, he should arrange to issue amendment to the LC. (Article 10)

(b) If so desired by the beneficiary, the applicant may need to advise direct to seller about establishment of the LC; and essential details (no., date of issue, amount, issuing bank's name) for seller's advance information.

(c) Buyer is to ensure that transit risk is covered by suitable insurance cover obtained either by the seller or by himself.

(d) At some stage the seller or the buyer may choose to obtain suitable exchange cover to reduce exchange rate risks.

(5) Advising Bank Communicates Issue of LC to Beneficiary (Article 9)

(a) Advising bank establishes 'apparent authenticity' of the LC, advises beneficiary.

(b) Advising bank adds confirmation to the LC only if (i) it has been requested by the Issuing Bank to do so, and (ii) it agrees to do comply with such request. (Article 9(e))

(c) If the LC is not to be confirmed, advising Bank communicates establishment of LC without or with engagement (expressly agreeing to negotiate). (Article 9(f))

(6) Beneficiary Receives LC

(a) Immediately on receipt of LC, beneficiary must examine terms and conditions in it to ensure that they are as mutually agreed with the buyer and are acceptable to him.[15]

(b) If some of the terms are not acceptable to the beneficiary, or if changes are required for any reason whatsoever, beneficiary contacts applicant with a request for the amendment of the LC.

(7) Applicant Requests Issuing Bank for Amendment

(a) Applicant submits request to the issuing bank for issuing amendment.

(b) Issuing bank takes a view on the request and, on approval, issues amendment.

(8) Amendment Communicated to Advising Bank (Articles 9)

(a) Amendment communicated to the beneficiary through the advising bank.

(b) Amendment also communicated to the bank nominated as the 'reimbursing bank'.

(9) If Confirming Bank Communicates Amendment (Article 10.b)

(a) Confirming bank determines whether to extend its confirmation to this amendment.

(b) If agreeable to do so, advising bank extends confirmation to cover amendment, communicates amendment to beneficiary. Otherwise, LC is advised without extending its confirmation to cover the amendment.

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15. Check list is appended.

(10) Beneficiary Confirms Acceptance of Amendment (Article 10.c)

(a) Beneficiary communicates acceptance of amendment(s) to the advising/confirming bank. (Amendment not operative till formally accepted by the beneficiary, and communicated accordingly to the advising bank.)

If not so communicated by beneficiary to the advising bank, but if the beneficiary acts on the amendment(s), and presents documents conforming to the amendment(s), it is deemed to have accepted the amendment(s).

(11) Presentation of Document to Bank

(a) Beneficiary presents documents to the nominated bank for negotiation, acceptance or payment as per the LC terms.

(b) The presentation may be made to the bank that has 'confirmed' the credit (to take advantage of a 'confirmed' credit), the bank to which negotiation is 'restricted' by the issuing bank or the issuing bank direct - but within the validity of the credit.

(c) If a credit allows free negotiation, documents may be presented to a bank of beneficiary's choice for negotiation (usually submitted to the beneficiary's banker where credit lines are available and already in place).

(12) Scrutiny of Documents (Article 14)

(a) Prior to negotiation, acceptance or payment, documents are examined by the negotiating bank to ensure strict conformity with the terms of the credit. The bank concerned has five banking days after the date of presentation for the examination of documents and to decide whether the documents are as per the terms of the credit.[16]

(13) Discrepancies in Documents (Article 16)

(a) If documents contain discrepancies, the negotiating bank communicates the details to the beneficiary for rectification within the validity of the credit.

(b) If documents (still) not entirely in order, then the nominated bank may reject the presentation altogether (Article 16.a). Else, while complying with the provisions of Article 16 of UCP 600, it may act as per instructions of the beneficiary, to (a) seek amendment of the credit, or (b) pay 'under reserve', or (c) request issuing bank for waiver of discrepancies, or (d) send documents on 'approval basis'.

(14) Negotiation, Acceptance, Payment (Article 15)

(a) Nominated bank accepts, negotiates or pays against documents as per credit terms, if documents are complying, or receives approval or acceptance advice from issuing bank.

16. Check list for the examination of export documents by a beneficiary before submission to a nominated bank, and for use of the scrutinising banks, is appended.

(b) Upon negotiation, despatches documents to the issuing bank by courier (in one or two lots) or as required in the credit, under forwarding letter. The negotiating bank may also have to comply with additional instructions, if any, contained in the LC.

(15) Reimbursement to Negotiating Bank (URR, ICC 725)
Negotiating bank claims reimbursement as per credit terms.

(16) Examination by Issuing Bank (Article 16)

(a) On receipt of documents, issuing bank examines documents for strict conformity with the terms of the credit.

(b) Issuing bank decides on the basis of documents alone whether documents comply with LC terms, whether to accept or reject documents.

(c) Issuing bank presents documents to the importer/buyer/applicant for acceptance or for payment.

(d) If documents contain discrepancies, the issuing bank may, in its sole judgment, approach applicant with full details of discrepancies for waiver (Article 16.b). If applicant is willing to accept discrepant documents, the rules prescribed in Article 16.c to be complied with.

(17) Delivery of Documents to Buyer
Documents released to applicant against immediate payment or against acceptance of time drafts (if bills are payable on maturity).

(18) LC Utilized, Liability Reduced
On payment by the applicant/buyer, his liability to the bank extinguished to the extent of the amount utilised in the LC; LC liability is reduced.

(19) Charges Paid
All charges - including that of the negotiating bank, other intermediary banks, the reimbursing bank - incurred towards issue, amendment(s), advice of discrepancy, acceptance, confirmation, negotiation, out of pocket expenses etc. - paid as per credit terms. (The charges may be paid by the applicant, the beneficiary or shared as per mutual agreement; the arrangement should be reflected in the LC.).

LC : A better option

We now examine the advantages offered by documentary credits in international trade, first from the perspective of the buyer - since it is he who applies for an LC, and later from that of the seller (the beneficiary). While perusing them, the reader may keep in view the risks in international trade reviewed elsewhere.

Buyer Controls LC's Operation

An LC comes into being when an application is made to a bank by a buyer for its issue. In the application, the applicant specifies the terms and conditions that are to be included in the credit. These terms (based on the agreement negotiated earlier with the seller) form the core of the letter of credit that is finally issued and advised to the seller (the beneficiary). Through the LC mechanism, the applicant controls a transaction with his counterpart (the beneficiary) in the following manner:

(a) Buyer stipulates the terms of an LC

Since the buyer is the one who applies to the bank for the issue of the credit, he determines the type of LC to be issued, the terms and conditions to be inserted, the terms of payment and so on. Above all, the applicant specifies the documents that must be presented by the beneficiary in compliance with the credit terms, if the beneficiary is to utilise the credit.

(b) Specifies issuer and data content of documents

While stipulating the documents to be presented by the beneficiary, the buyer (applicant) also specifies

(i) the issuer of the documents (except the transport document, commercial invoice and insurance), and

(ii) what a document should contain, state or certify, i.e. its data content.

This is a major advantage for the buyer. By stipulating the documents to be presented, their issuer and their data content, the buyer controls some of the most critical aspects of a credit transaction.

(c) LC mechanism ensures payment only on compliance with terms

The LC mechanism protects the buyer from not being called upon to pay the seller unless the documents presented by the beneficiary comply strictly with the terms of the letter of credit. The applicant is thus assured that payment will be made on his behalf only if the beneficiary complies strictly with the conditions stipulated by him, not otherwise.

If some of the documents are discrepant, obviously they do not conform to the terms of the credit. Once again, until and unless these discrepancies are approved or accepted by the issuing bank, payment would still not be made to the beneficiary. The applicant's interests continue to be protected thereby.

(d) Improves bargaining position

The furnishing of a letter of credit by the buyer signals to the seller that the buyer has the ability to obtain credit lines from his bank. Thus, he signals his creditworthiness and the ability to pay for the goods. His ability to procure LCs when required indicates his good standing with a bank.

The availability of credit offers the seller security of payment. The applicant can, therefore, negotiate better terms with the seller and thus improve his competitiveness.

Through the mechanism of the letter of credit, the applicant exercises control over the quality and quantity of the goods he buys, the shipment terms, documentation and payment. The applicant thus exercises effective control over the significant aspects of a transaction through document definitions and the terms stipulated. Through this route, the applicant also reduces the counterparty risks to a significant extent.

Advantages to Beneficiary

Admittedly, the LC is an instrument created by the applicant and his bank (the issuing bank). Yet, in domestic or international trade, it also offers significant advantages to the seller (the beneficiary). These are as under:

(a) Certainty of payment

The operation of a letter of credit is based on the sole premise that the nominated bank will pay under a credit provided the beneficiary presents documents that comply with the terms of the credit. Through the mechanism of the LC, the beneficiary is offered the certainty of payment on compliance with the credit terms.

(b) LC transfers payment risk to the issuing bank

In a separate study material the risks in international trade were examined in depth. The primary risk in any trade is the risk of non-payment. The failure to pay could arise for a number of reasons. Through the mechanism of an LC, the integrity and creditworthiness of the buyer are replaced by an independent third party - those of the LC issuing bank. Counterparty risks are reduced thereby (though not eliminated altogether).

(c) Transparency for the seller

A letter of credit offers total transparency and safety to the seller/beneficiary. The credit is usually received in advance, on occasions before the start of the manufacturing process, invariably well before the intended date of shipment. This provides the beneficiary ample time to examine the terms and conditions of a credit, and decide whether these are acceptable to him. The beneficiary is also in a position to decide whether the terms allow him ample time and opportunity to procure all the documents called for and be able to present them to the nominated bank within the time stipulated in the credit.

The beneficiary should, at all times, remember that payment under an LC will only be made if the beneficiary is able to present every document called for in the credit, when the documents are presented for negotiation - within the validity of the credit. This is irrespective of whosoever the issuer may be.

(d) Beneficiary's option to accept or reject LC terms

In the opinion of the beneficiary, if certain terms are onerous, dangerous, or impossible to perform, he is free to request the applicant for modification to such terms in the credit. The process is known as 'amendment' to the letter of credit.

An LC can be amended only at the request of the applicant to the issuing bank. Therefore, all requests for amendments should be routed through the applicant/ buyer.

(e) The right to accept or reject amendments

Under the UCP, all credits are irrevocable in nature unless specified otherwise (Articles 2 and 3 of UCP 600). Article 10(a) states that 'a credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary.' This means that that the terms of a credit cannot be changed arbitrarily, or without the consent of all the parties to a credit. Consequently, for any change or amendment to the terms or conditions of a credit to take effect, it must also be accepted by the beneficiary (Article 10.c).

An amendment is not effective until and unless the beneficiary communicates his acceptance of the amendment to the bank that advises the amendment. The beneficiary thus retains the right and the privilege to accept or reject an amendment after it is advised to him by the advising bank. (UCP 600, Article 10.c)

(f) The irrevocability of the terms of an LC

An issuing bank is irrevocably bound to honour a complying presentation under its LC as of the time it issues the credit (Article 7.b). A confirming bank is irrevocably bound to honour or negotiate without recourse as of the time it adds its confirmation to a credit (Article 8.b). An issuing bank is also irrevocably bound by an amendment as of the time it issues the amendment. Yet, the amendment does not take effect till the beneficiary accepts the same. If the beneficiary does not, he still retains the option to make a complying presentation under the original credit or a credit incorporating previously accepted amendment(s).

Compare the above with the risks against collection bills, and under 'counterparty risks'. Special reference of the reader is invited also to industry risks under. The advantage with an LC is that, after an LC is issued and advised, its terms cannot be changed arbitrarily. Therefore, once a credit has been advised to the beneficiary (and the terms are found acceptable by him), he can go ahead with the production and supply secure in the knowledge that

(i) no term in the LC can be modified without his consent, and that

(ii) payment is assured if the credit terms are complied with.

These facts alone provide tremendous assurance and stability to the beneficiary. He can proceed with his part of the arrangement with certainty, without the fear of unpleasant surprises somewhere down the line.

(g) Beneficiary's option to ship or not to ship

Even after receiving the LC, the beneficiary cannot be forced to ship a consignment if he does not wish to. No action can be taken by the applicant or the issuing bank under the letter of credit for his failure to effect shipment or present documents for negotiation under a credit. (However, the buyer retains the option of legal action for breach of contract.)

(h) Export finance on more convenient terms

Banks are more willing to finance exporters or trade transactions since the risk of non-payment is significantly reduced, and the terms of contract are clearly defined.

These are some of the major advantages that LCs offer to the beneficiary. From the aspect of risk management, there are a few other points worthy of note. These are as follows:

(a) LC reduces credit investigation on the buyer

Since the commitment by the buyer is replaced by the undertaking of the issuing bank, an LC helps the seller to reduce extensive investigations regarding the integrity, reputation, track record and credit worthiness of the buyer. The risks are on the LC issuing bank.

(b) LC reduces transit risk

Whether in a DP or a DA transaction, the seller would not be paid if the consignment does not reach the buyer. (The buyer usually decides to pay or accept only after confirming from the transport operator that the goods have arrived at the destination port.) Even then, problems can crop up delaying payment by the buyer. These risks are eliminated if the transaction is under a letter of credit. The beneficiary is entitled to get paid upon making a complying presentation. The transit risks, incidentally, are covered under the terms of shipment and as per the direction of the buyer.

(c) Reduces country risks

Apart from counterparty risks, a seller must be aware of the country risks that could stand in the way of successful conclusion of an international trade transaction. Some of these risks can be reduced or eliminated by making the LC available for negotiation in the country of the beneficiary. A reimbursing bank in a country other than that of the buyer or the LC issuing bank can also reduce country risks to a considerable extent. If the LC is confirmed by a bank at the place of the beneficiary, it eliminates country risks and several other risks) altogether.

(d) If confirmed, LC localises performance

If the credit has been confirmed by a bank in his country or city, the performance under the credit is said to be 'localised'. In simple terms, it means that once a confirming bank has negotiated documents presented to it under a confirmed credit, and has paid the beneficiary, such payment is without recourse. Thereafter, nothing can compel the beneficiary to refund or repay the money paid to him by the confirming bank.

If the credit is confirmed by a bank that is known to the beneficiary or is located in his own country, the credibility, integrity, reputation or ability of the issuing bank overseas no longer remain a factor. A confirmed credit eliminates counterparty risks, country risks, and a few other risks. At an additional fee, by asking for a confirmation of the credit, the beneficiary can avail itself of the reduction of a number of risks associated with international trade.

Risks in LC Transactions

Risks for the buyer:

(a) The beneficiary may never ship the goods.

(b) The seller may present perfect documentation as required by the LC, but not the goods as described therein.

Risks for the seller:

(a) The most important factor to be considered is that an LC is as only as good as the bank that issues it. If the issuing bank is not known to the seller, then the LC issued by it may not offer the protection that the beneficiary expects it to provide.

(b) The issuing bank may refuse to pay against the documents presented (citing discrepancies).

(c) After the shipment has been made, the documents presented and negotiated, and before the issuing bank can honour or pay against them, it (the issuing bank) may suspend operation or close altogether. (If the LC is not a confirmed LC, payment to the beneficiary by a nominated bank is with recourse.)

(d) The nominated bank, including a confirming bank, may not negotiate or honour the documents, leaving it to the issuing bank to ultimately to do so.

(e) The buyer may obtain a court order to stop payment by the issuing bank. Under acceptance LCs, such a step translates into additional costs, loss of goods, delay or non-payment on the part of the issuing bank.

Risks for the issuing bank:

(a) The applicant may not be in a position to provide funds to the issuing bank to honour his commitment against the credit (credit risk).

What Letters of Credit Cannot Do

Let us now summarise what an LC cannot do. It cannot, for example:

(i) substitute for the integrity of the seller or make credit verifications totally redundant.

(ii) prevent fraud.

(iii) lend soundness to transactions which were not basically sound to start with. For example, it cannot guarantee with final authority or certainty about the quality, quantity and the specifications of the actual goods shipped.

(iv) absolve the seller, or buyer from contractual liability.

(v) remove other risks like exchange risk and transit risks.

(vi) provide guarantee that shipment will be made by the seller.

(vii) (in the case of unconfirmed credit) ensure payment if the issuing bank fails or closes down after the goods have been shipped, the documents have been negotiated and despatched;

and last, but by any measure, not the least

(viii) substitute for lack of knowledge or understanding of its operation.

It would serve the reader well if he spends some time to go through these points with due care and understanding. The implications are of great importance to those who are involved in documentary credit operation, whether in domestic or in international trade. It must be clearly understood that documentary credit is not a panacea for all problems or risks inherent in international trade. Even with an LC in hand, there are risk areas (not related to an LC operation or covered by a documentary credit) that one ought to be conscious about and attempt to mitigate.

508.9 Types of Letters of Credit

General classification

The identification and understanding of various types of credits begin with their being classified into two broad categories. All credits could be segregated into:

(1) Commercial Credits and

(2) Standby Credits.

A commercial letter of credit is a direct instrument of payment. A standby letter of credit, on the other hand, is more in the nature of a guarantee, and comes into play only when there is a default in the primary settlement process or performance, including the failure to pay. In specialised situations letters of guarantee are sometimes required and not standby credits. However, it is rare when a standby credit cannot meet the requirements of a guarantee.

The various types of credits

The various types of commercial credits may be listed as follows:

(1) Revocable Documentary Credit
(2) Irrevocable, Unconfirmed Documentary Credit
(3) Irrevocable, Confirmed Documentary Credit
(4) Direct Credit
(5) Transit Credit
(6) Restricted Credits
(7) Unrestricted (freely negotiable) Credit
(8) Sight Credit (credit available by sight payment)
(9) Acceptance Credit (credit available by acceptance)
(10) Deferred Payment Credit (credit available by deferred payment)
(11) Negotiation Credit (credit available by negotiation)
(12) Instalment Credit
(13) Red Clause Credit
(14) Green Clause Credit
(15) Usance Paid at Sight (UPAS) Credit
(16) Revolving Credit
(17) Evergreen Credit
(18) Back-to-Back Credit
(19) Transferable Credit
(20) Standby Credit

Note that the various types of credits listed here may not necessarily be mutually exclusive. The list is also not exhaustive. Beyond the types included here, we should go a step forward and also discuss a few other types (if we may call them so) of credits, viz., flawed credits, credits with problem terms and credits that are potentially dangerous for the exporter/seller. However, owing to constraints of space these are excluded from this document, but may be discussed if and when opportunity arises. (Reference to text books on LCs is recommended for further information.)

Credits described or defined by the UCP

The credits listed in the preceding section are a representative description of their types. There is no procedure, norm or standard laid down to define a particular type of documentary credit. The UCP does not, as such, offer standardised definitions for the types of credits as we would normally come across in text books or through general use. As will be evident from a few instances cited in this section, the definitions and characteristics of certain types of credits have to be derived from the articles in the UCP.

For example, although UCP 600 contains a separate article (Article 2 titled Definition) introduced for the first time ever in any UCP, this article does not include a formal definition of any type of documentary credit - save and except one. The UCP being all about documentary letters of credit (or simply 'credit', as the UCP calls it nowadays) Article 2 does define a 'credit'. It is defined as an arrangement that is irrevocable in nature. However, what makes a credit irrevocable, the features that characterises an 'irrevocable' credit, are available not under Article 2 (devoted to 'definitions') but elsewhere in the UCP.

Similarly, Article 8 describes the liabilities and responsibilities of a confirming bank. A close study of this article informs us about the special characteristics of a credit that has been confirmed by another bank. Thereby, we get to learn all about a confirmed credit. By extension of this logic, credits that are not covered by Article 8 are unconfirmed credits.

Article 6 calls on the issuing bank to state with which bank a credit is made available. The UCP provides a clue as to how a credit could be distinguished according to its availability, but the UCP -being about rules rather than procedure - does not define 'availability' in clear terms.

Proceeding further, Article 32 deals with 'instalment drawing or shipment', and outlines the characteristics of a credit available by instalment. This article, therefore, helps us to categorise such credits as one of the types of credit that we should know about. Finally, Article 38 of UCP 600 devotes itself exclusively to transferable credits. Sub-article 38(b) also defines a transferable credit.

Thus the UCP, through its various articles, helps us to define and profile certain types of credits. But the list does not end here. The list about the types of credits extends beyond those available in the UCP.

20.4 Other types of credits

Beyond those defined in or described by the UCP, there are others that are defined in text books and publications on documentary credits. Most of these definitions of documentary credits have evolved through the use to which a credit is put, or according to the function they perform. Detailed review of each type is not possible here owing to constraints of space. We embark on our analysis of some of these documentary credits with one that has faded into oblivion along with UCP 500, namely, a revocable credit.

Revocable Documentary Credit

This type of credit is now only of academic interest. Till the era covering UCP 500, revocable documentary credit found a mention in the UCP as an instrument in use in international trade. It was, however, realised that the use of revocable credit had diminished worldwide owing to its uncertain nature and was on its way to extinction. A revocable documentary credit could be amended or cancelled by the issuing bank at any time without prior notice to the beneficiary. The bank issuing advice of revocable credit was not under legal obligation to give notice of cancellation or modification except as a matter of courtesy. The only redeeming feature of a revocable credit was that the bank negotiating documents on the strength of the revocable credit was entitled to be reimbursed in respect of all negotiations prior to the receipt of advice of cancellation or modification.

Irrevocable Documentary Credit

Henceforth, all credits issued subject to UCP 600 would always be irrevocable - by definition and by their nature. While Article 2 defines a credit, its other characteristics and peculiarities have to be gleaned from the various articles of the UCP. We may collate them here as follows:

1. An irrevocable documentary credit (or simply, a credit) binds the issuing bank to its irrevocable undertaking from the time it issues the credit (Article 7.b).
2. The irrevocable undertaking is to honour a presentation that complies strictly with the terms of the credit (Article 7.i).
3. An irrevocable credit cannot be amended or cancelled without the specific agreement and consent of all the parties to the credit.
4. Amendment, once issued, binds the issuing bank. The amendment, once it has been confirmed and advised to the beneficiary, binds the confirming bank.
5. Irrespective of the above, no amendment will become effective and operational unless the beneficiary has communicated his acceptance of the amendment to the bank that advised that amendment. Thus, even if the issuing bank issues an amendment, and the confirming bank adds its confirmation to it, that amendment will remain inoperative and infructuous till it has been accepted by the beneficiary

(Article 10.c). This illustrates the very essence of an irrevocable credit.

For these reasons, once issued, such credits remain a definite undertaking, an irrevocable and a firm commitment on the part of the issuing bank to the beneficiary to negotiate or to honour (pay). A 'certainty' - given that the issuing bank remains solvent - is substituted for a 'chance'. With a credit in hand, a beneficiary can proceed with confidence with his side of the contract of sale (i.e. procurement of raw material, the process of manufacturing, or purchase of finished goods from other manufacturers for packing and export, arrangement for shipment) knowing that if he performs his part in accordance with the requirements of the credit, payment is reasonably assured. No arbitrary change in its term or condition will be permissible as per rules of the UCP or be considered as valid without his consent. Hence, the raison d'etre of a commercial credit is found primarily when the credit is 'irrevocable', as it is now by its very definition.

Recourse and Without Recourse

Recourse essentially means to resort or go back to or fall back on. In documentary credit operations the term 'recourse' is used with reference to payment made to the presenter. A bank may pay the beneficiary with or without recourse (to the beneficiary or the presenter on his behalf). Negotiation or payment done without recourse means that the bank that has effected payment against presentation and negotiation of documents cannot resort to, or fall back on, the beneficiary (the one who has received the funds) for recovery of payment made earlier. Without recourse, therefore, signifies the irreversibility of the process of payment. With recourse means the bank that negotiates and pays reserves the right, or is entitled, to fall back on the beneficiary for recompense or recovery of the amount paid earlier, should circumstances so warrant. An understanding of these terms is important if the main difference between an unconfirmed LC and a confirmed LC is to be appreciated.

Unconfirmed Credit

An unconfirmed, irrevocable, documentary letters of credit is one that bears no confirmation from another bank. It has the following features:

(a) The 'chance' of payment being eventually made by the buyer is replaced with the certainty of payment - of course, assuming that the issuing bank remains solvent till its commitment under its credit has been fully met.

(b) It is a straight commitment from the issuing bank to the beneficiary.

(c) No intermediary bank is involved.

(d) The advising bank merely establishes the 'apparent authenticity' of the credit it advises 'without obligation' to honour or to negotiate. (Article 9.a)

(e) The credit reflects the integrity and financial standing of the bank issuing the credit (the one which has given the written undertaking).

(f) It makes no difference even if the documents presented are approved by the negotiating bank as having fully complied with the terms of the credit. Under an unconfirmed credit, the final decision as to whether a presentation complies fully with the terms of a credit remains the prerogative of the issuing bank. Therefore, unconfirmed credits do not localise performance.

(g) Consequently, the quality of an LC must be judged solely by the integrity, standing, reputation and track record of the issuing bank.

(h) It follows from the above that if the issuing bank is not an institution of repute, or is of doubtful integrity, track record or standing, the credit should be viewed similarly.

(i) Unconfirmed credits are cheaper than confirmed credits.

Confirmed Credit

Description

After an LC is issued it is transmitted to the advising bank for being 'advised'[17] to the beneficiary. This is the usual process adopted for the issue of all credits. For a credit to be termed as a confirmed credit the following points should be noted:

(a) The issuing bank is required to authorise or request the advising bank to confirm the credit it issues. (Sub-article 8.d)

(b) The bank thus requested by the issuing bank to confirm the credit may confirm or to refuse to confirm a credit - at its own discretion.

If the advising bank is not prepared to confirm the credit, it may advise the credit to the beneficiary without adding its confirmation. However, the advising should, simultaneously, advise the issuing bank about its inability to confirm the credit. (Article 8.d)

(c) If the advising bank decides to confirm a credit, the process may be completed by a simple endorsement (viz., 'we confirm this credit' or 'the credit is hereby confirmed' etc.)[18] to that effect on the face of the credit instrument over the

17. UCP 600, Article 9 deals with advising of credit and amendments.

18. The confirming bank should be clear about the obligations it assumes as a confirming bank under every credit on occasions, a simple endorsement may not serve its purpose.

bank's seal, authorised signature and date. The credit, thereafter, stands confirmed. Once the advising bank has confirmed the credit, it is termed as the confirming bank.

(d) Charges are recovered by the confirming bank for adding its confirmation to a credit. This charge or fee covers the entire period of the validity of the credit, this being the period during which the risk is borne by the confirming bank. Unless otherwise stipulated, the confirmation charges are usually collected from the beneficiary. The seller and the buyer would have to arrange among themselves in advance as to who should bear these charges. The applicant may agree to pay both the banks' charges. Alternately, each may agree to bear charges of their respective banks. The LC normally indicates the arrangement about payment of charges.

Effect of Confirming a Credit

When an advising bank confirms a credit, it virtually steps into the shoes of the issuing bank. Consequently, when a bank 'confirms' a credit, the confirming bank assumes exactly the same commitment as that of the issuing bank. In other words, when a bank confirms a letter of credit,

(a) it assumes all rights and responsibilities of the issuing bank;

(b) it takes on the responsibility of the issuing bank to pay or honour (both being without recourse);

(c) if it determines that the documents presented to it conform to the terms of the credit and so decides to negotiate, the negotiation of the documents is irrevocable and binding on the issuing bank.

Thus, when a confirming bank negotiates, honours, accepts and pays, it does so without recourse to the beneficiary. This is the key difference between a confirmed credit and an unconfirmed credit. This feature about a confirmed credit has significant practical application and utility as would be evident in due course.

Confirmed credits : Key points

These are as follows:

(i) An issuing bank cannot confirm its own credit. Credit issued by a bank must be confirmed by another bank.

(ii) Adding confirmation to the credit is at the discretion of the advising bank. Even if it has been requested to add confirmation, the advising bank may decline to confirm a credit, or clearly state the nature of its obligations against its confirmation. Of course, it may choose to advise the credit without adding its confirmation to it.

(iii) The same applies to amendments. A bank that has confirmed a credit or an amendment to the credit already advised, may not extend the confirmation to cover an amendment or a further amendment to the credit.

(iv) Therefore, a beneficiary should not take a 'confirmation' as a matter of routine or for granted. If a beneficiary desires a confirmed credit, he should first make that clear to the applicant before the issue of the credit. Second, when the credit reaches his hands he should verify that it has indeed been 'confirmed' by the advising bank. Same applies to amendments.

(v) Negotiation of documents by a bank that has confirmed the credit is without recourse to the beneficiary. This is a vital element in all confirmed credits and has significant implications in credit operations.

(vi) Since a credit is irrevocable in nature, once a bank has confirmed a credit it cannot arbitrarily withdraw the confirmation. If any modification (including revocation) to the confirmation is to be effected, all parties must first agree to it. Till then, the status obtaining immediately before continues. If confirmation has been extended to cover any amendment(s) to the credit, the confirming bank would be irrevocably bound by such confirmation covering the amendment also. The irrevocable nature of the credit thus gives a safety net to the beneficiary who can then proceed with his production plans without any apprehension about subsequent change in terms and conditions.

(vii) Confirmation localises performance. If used properly, this feature brings great advantage to the beneficiary/exporter, especially where the credibility of the buyer or the issuing bank is doubtful or not satisfactorily established.

(viii) Since confirmation localises performance, it provides the seller with cover against 'del credere' and 'sovereign' risks. (Sovereign risk is expressed as the risk that moneys due to a foreign country cannot be repatriated because of events, that may be caused or influenced at least partly, by the government concerned but over which privately owned companies or individual persons have absolutely no influence. The sovereign risk includes political and transfer risks).

508.10 Documents and Documentation

Introduction

In documentary credit operations, what distinguishes the commercial banks from the other parties engaged in international trade is the fact that, unlike the other parties, 'banks deal with documents and not with goods, services or performance to which the documents may relate' (Article 5 of UCP 600). For reasons stated, banks can do no better than limit themselves to the examination of the documents placed before them, use their experience and expertise in documentary credit operations to ensure implementation of the UCP - especially to verify compliance with the credit terms, and decide whether to accept, negotiate or pay against the documents presented.

The applicant's tasks are, therefore, specific. Where banks are involved, anything and everything that the buyer expects of the seller, must necessarily be specified in terms of documents. The performance of the beneficiary must be translated to, and stated in terms of, documents and documents alone - in such form and shape that lend themselves to scrutiny and verification by the intermediary banks. Stating a condition, without calling for supporting documents in evidence thereof, is termed a non-documentary condition. Such conditions may be ignored by the examining banks, at the risk of the buyer/applicant.

As is evident from the foregoing, documents form the backbone that links the stages of a letter of credit transaction from start to finish. The success of all credit operations is critically dependent on appropriate documents being called for by the applicant, presentation of complying documents by the beneficiary, and adherence to the terms of the credit and the UCP by all concerned. Sub-article 14(a) requires that, 'a nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank must examine a presentation to determine, on the basis of the documents alone (emphasis added) whether or not the documents appear on their face to constitute a complying presentation.' For the banks, it's documents, documents, and documents all the way. In the discharge of their responsibilities, banks are neither expected nor required to go beyond the documents presented under a credit.

Buyer's responsibilities

The buyer should, accordingly, stipulate in the credit,

(a) the name of the agency/organisation entrusted with the process of verification and certification;

(b) the nature of the document or certificate to be issued by the agency/organisation;

(c) what exactly the document is required to contain or certify (i.e. the data content). If necessary, the text of the certificate, the benchmark, criteria or parameters to be tested, may also be clearly spelt out for inclusion in the stipulated document or test certificate.

Failure to do implement the foregoing invites the risks outlined in sub-article 14(f) of UCP 600. It states, "If a credit requires presentation of a document other than a transport document, insurance document or commercial invoice, without stipulating by whom the document is to be issued or its data content, banks will accept the document as presented if its content appears to fulfil the function of the required document…".

These maybe summarised as follows:

(1) The first step is for the buyer/importer (the applicant) to decide on the specific performances from the seller/exporter (the beneficiary). These are his intentions or expectations (with respect to the supplier).

(2) The second is for the buyer/importer to give physical shape to his intentions or expectations. He converts his expectations, the specific performance that he desires of the seller, defining them in terms of (supporting) documents. The documents are physical representations of the performance of the seller.

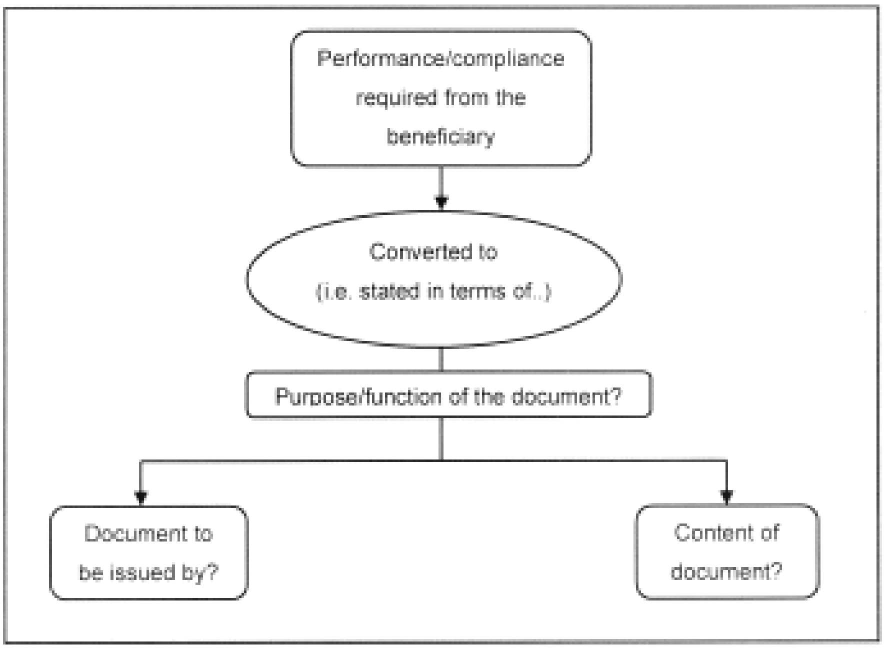
(3) The final stage is where the buyer/importer takes the previous steps a little further. Having specified the documents required, the following should also be included in the credit:

(a) the names of the issuer of the respective documents, and

(b) what the respective documents must describe, contain, specify or certify; in other words, their data content.

If a buyer/importer is to ensure that an LC works for him, he must go through the above three stages with due care. Only then his interests will be protected.

Figure 6: Translating intentions to documents



Documentation rules summarised

The thumb rules regarding documents required to be noted by the applicant are summarised as under:

(i) Copies of pro forma invoices, agreements or contracts should not be attached to LCs, or made a part of any LC. However, a reference in the LC to the underlying contract, the agreement or the pro forma invoice number and date is acceptable.

(ii) If certain terms (which are in the agreement, contract or the pro forma invoice) are to be included as a condition in an LC, those terms should be independently stated in the body of the letter of credit. These conditions should form a part of the terms and conditions of the LC itself. The idea is that a letter of credit should, as far as possible, be able to stand on its own as an independent instrument of international trade.

(iii) In LC operations, banks deal only with documents, not with facts. Banks are not concerned with the underlying contract or agreement between the parties, or the parties with their respective banks. All performances, conditions and stipulations must be stated in terms of documents. Else, they are likely to be ignored by the banks.

(iv) Non-documentary conditions should be converted to documents evidencing support to such conditions. However, even if no document is called for in the credit in support of such conditions, scrutinising banks should apply the provisions of sub-article 14(d) of UCP 600.

(v) When a credit calls for the presentation of a document, it should also state (a) by whom such a document is to be issued (that is, who is to be the author of that document), and (b) what that document is to contain, state or certify (ref.: UCP 600, Article 14.f). For example, there is no point asking for the presentation of a certificate if the credit does not stipulate (i) who is to issue that certificate and (ii) what exactly that certificate is supposed to certify.

(vi) Documents should not be presented by the beneficiary as an afterthought - even if not required by the credit. All documents required by the applicant should be carefully decided in advance and included in the credit. Failure to do so may defeat the purpose a document is meant to serve. For, according to Article 14(g) of the UCP, if a document that has not been called for in the credit is presented, it is not required to be examined by the bank to which the document is presented for negotiation. The document will be disregarded and may either be returned to the presenter or passed on to the issuing bank without comment or responsibility (A bank may even charge the presenter for this additional work!)

What comes out clearly from the above is that in international and domestic trade a little bit of application of mind on the part of the issuing bank (and of course, the applicant/buyer) can go a long way in making a letter of credit a very useful and friendly instrument for the buyer.

On his turn, the beneficiary should also examine the LC immediately on receipt. He should be careful to ensure that the conditions in the letter of credit are possible of performance. If not, or if the conditions are not clear enough, immediate steps should be taken to get them clarified or amended, as necessary. The exporter should remember that only when he submits the documents as stipulated in the letter of credit would he be entitled to receive payment under the LC, not otherwise.

508.11 LC Amendment

Meaning of amendment

Amendment to a credit essentially means modification in the original terms and conditions of a credit. A letter of credit being irrevocable in nature, none of its clauses can be changed unless all parties to the credit agree to the change.

An amendment is called for when either the beneficiary or the issuer discovers that one or more term(s) of the credit is not acceptable, cannot be complied with, or is unsuitable to his purpose. The issuer or the beneficiary may also initiate amendment(s) if there is a change in the circumstance that may come to light after the credit is issued and advised, delay in the anticipated arrival of the ship at the port of loading and its departures thereafter, change in the requirement for goods (viz., quantity, specifications), unforeseen delay in procurement or manufacture and so on. The original credit would then have to undergo modification and change in its terms.

Who can amend a credit?

Only the bank that has issued the original letter of credit can amend that credit. It may initiate an amendment on its own, or only at the request of the applicant to the credit. The applicant would be required to provide the details of the amendment(s) required. The issuing bank will advise the amendment through a 'letter of amendment' or 'amendment advice' - using a standard printed format, electronically (say, by telex), or through SWIFT MT707. The 'letter of amendment' would be addressed to the bank through which the original credit was advised. The (first) advising bank would advise the amendment direct to the beneficiary (or through the second advising bank, if any) for information and acceptance of the amendment. The charges for amendments would be paid in accordance with the terms of the credit.
The rules regarding amendment to a credit are furnished in Article 10 of UCP 600.

Partial acceptance not permitted

If a single amendment advice received from the issuing bank contains more than one amendment (say amendments covering amount, validity and shipment date), the beneficiary does not have the option to pick and choose which of these amendments to accept. For example, from the same amendment advice, he is not permitted to accept amendments only to the amount and validity, but reject amendment to the shipment date. If it's a single advice containing multiple amendment(s), the beneficiary must accept all or none contained in that single advice (UCP 600, sub-article 10.e). If the beneficiary is unable to accept all the amendments in that single advice, he should contact the applicant and get the 'amendment' amended once again.

508.12 Check List for the Beneficiary of a Documentary Credit

(Indicative check list for examination of an LC immediately on its receipt by the beneficiary.)

1. Has the beneficiary's name and address been correctly mentioned in the documentary credit instrument? Unless otherwise advised, banks will later be looking for exactly the same name to appear in at least the letterhead of the commercial invoice. (Refer to Article 14.j, UCP 600).
2. Is the applicant's (buyer's) name and address correct in all respects? Unless otherwise advised, banks will expect the commercial invoice to be addressed to this party only. (Refer to Article 14.j, UCP 600).
3. Is the tenor of any time draft - as stated in the credit - correct, i.e. the number of days from sight or date (of invoice, transport document etc.)? (Refer to Article 43, 44, ISBP 681).
4. Is the currency in which invoices to be drawn, and payment to be received, correct? If there are exchange control regulations that affect methods of payment, that should be kept in mind while drawing up a sales / purchase contract. (Refer to Article 18.a, UCP 600).
5. Do the shipment, presentation and expiry dates provide sufficient time to the beneficiary to procure raw materials, manufacture the goods, arrange any pre-shipment inspection, shipment/dispatch and the production, certification, legalisation and presentation of documents? Does the interval between the expiration of shipment date and that of the credit give sufficient time to the exporter to prepare and submit the completed set of documents within the stipulated time?
6. Are the place of expiry and availability of the credit satisfactory (both should preferably be at beneficiary's place of business.)?
7. Is shipment permitted from the place the beneficiary intends to effect shipment?
8. Are the ports of loading and discharge as desired by the beneficiary and/or the importer? Shipment to a place other than that agreed to by the beneficiary may entail delay in delivery, additional and avoidable expenses. (Refer to ISBP 681, Articles 98-100 under "Ports of Loading and Ports of Discharge" and corresponding Articles for other modes of transport.)
9. If the credit has not been confirmed, is an unconfirmed credit acceptable?
10. Is the confirming bank located at the place of the beneficiary? If not, is this aspect of the credit acceptable to the beneficiary?
11. If the credit is lacks a free negotiation clause, is a credit restricted to another bank acceptable?

12. Can the documents required as per the terms of the credit be obtained by the beneficiary in the normal course of business (refer to ISBP, Article 4)? If not, is the beneficiary prepared to go to the trouble, possible expense and risk of obtaining them? Or, should these requirements be amended before the documents become due for submission?
13. Is the description of the merchandise in the credit accurate but brief enough to copy from document to document without giving room for errors? What transport charges or (additional) customs duties will this particular description subject the transaction to? Does the credit allow for variation in the quantity or amount of the merchandise to be shipped? Does the buyer or seller need a licence to trade this merchandise? Do take care to satisfy that the item is not included in the list of sensitive, licensed, restricted or banned goods of the exporting as well as the importing country.
14. Are the delivery terms correct? Do they refer to the correct ports or points of origin and destination? Do both the parties understand which standard or reference can be used to interpret the delivery terms? Do such delivery terms usually result in the production of the transport documents (if any) called for by the credit as proof of delivery? (Refer to INCOTERMS 2010)
15. Are the unit prices correct? Do they match the description of goods exactly?
16. If special instructions are included, are they acceptable? Do they conform to the beneficiary's requests for special financing features, shipment schedules, methods of modifications etc.? Are the special instructions excessive?
17. If transhipment has been prohibited, can transhipment actually be avoided? If not, should an amendment be sought? (Refer to concerned sub-Article in UCP 600 viz., 20.c, 21.c. 23.c etc. on 'transhipment' against relevant shipping document).
18. If partial shipments have been prohibited, can the entire consignment be shipped in one shipment? Or, should partial shipment be insisted on as a term of the credit? (Refer to UCP 600, Article 31).
19. If the goods are hazardous and likely to require shipment on deck, has this been explicitly allowed by the credit? Does the insurance policy, under CIF terms, cover 'on deck' shipment? Also, does the LC allow 'on deck' shipment?
20. If non-negotiable transport documents are specified, is the beneficiary willing to submit these?
21. If a transport, insurance or inspection firm is named, is this firm acceptable to the beneficiary?
22. Are freight charges ascribed to the proper party?
23. If the seller is required to obtain insurance on behalf of the buyer, can he obtain it? Has the cost of insurance been included in amount payable?

24. Are bank charges ascribed to the proper party(ies)? If the beneficiary is to absorb these, how much will they amount to, and are they acceptable?
25. Do the letter of credit terms satisfy local laws pertaining to such transactions?
26. Do the letter of credit terms contain unacceptable clauses (any clause calling for action by the beneficiary that is impossible to fulfil) for the beneficiary?
27. Are the reimbursement clauses in the LC in your favour; could they have been improved further? Are they subject to URR 725?
28. Is the credit subject to the currently operative UCP (presently, UCP 600)?

508.13 Check-list for the Examination of Export Documents (by the beneficiary and the scrutinising banks)

Comparison with the Terms of The Documentary Credit

(i) The credit is irrevocable and either confirmed or otherwise, and that it has not been restricted to (available with) another bank for negotiation.

(ii) The place of expiry is not at the issuing bank's place; or, the credit is not available only with the issuing bank.

(iii) The documents are presented for negotiation within the validity of the credit and within the period stipulated after the date of shipment. Note that if the credit expires on a holiday, it is automatically valid up to the next working day as per the UCP (Article 29.a).

(iv) The amount of the invoice/draft does not exceed the amount for which the credit has been issued and available under it. (Ref. UCP 600, Articles 18.b, Article 30, ISBP 50-51 and 65-66)

Care should be taken to ensure that in case of part shipment, the aggregate drawing does not exceed the amount specified in the credit. According to Article 30 the word 'about' is to be construed as allowing a difference not exceeding 10% either way. It should be verified whether the word 'about' is applicable to quantity of goods, amount of the credit, or unit price.

Unless a credit stipulates that the quantity of the specified goods should not be exceeded or reduced, a tolerance of 5% either way is permissible in respect of the quantity of the merchandise to be shipped provided the total amount of the drawing does not exceed the amount of the credit.

(v) All the documents stipulated in the credit are submitted.

(vi) If any prior approval is required for the export of such goods, that it has been obtained.

(vii) Is reimbursement subject to ICC Publication No. 725 (URR 725)? Are the reimbursement clauses favourable to the beneficiary and the negotiating bank?

(viii) The mode of drawing bills and the method of reimbursement of the value of the bills negotiated under the credit are properly spelt out, and complied with while negotiating the bills.

Examination of the Bill of Exchange

The draft/bill of exchange should be closely examined to ensure that it fulfils the following conditions:

(a) The draft must be dated and drawn or endorsed to the order of the bank and should be within the prescribed period mentioned in the credit. (Refer to ISBP, Article 49).

(b) It must be drawn by the party indicated as the beneficiary of the credit (Refer to ISBP, Article 53), duly signed by the authorized signatory(ies). The signature(s) should be verified. In case the bills are submitted by the drawer's banker, this is not necessary.

(c) It must be drawn on the party or bank as specified in the credit. (Refer to ISBP, Article 52).

(d) It must be marked as drawn under the proper LC and referenced by quoting the LC number and other details as called for in the credit.

(e) The tenor should be in conformity with that stipulated in the credit. (Refer to ISBP, Article 43).

(f) The amount of draft must be identical with the net amount mentioned in the invoice or the correct proportion thereof in terms of the credit. For drafts that do not cover 100% of the invoice value, it should be ensured that the balance is realized within the period stipulated as per exchange control regulations of the country concerned. If necessary, declaration/undertaking from the exporter to that effect should be obtained and placed on record.

(g) The amount in figures must correspond exactly with the amount in words. (Refer to ISBP, Article 50).

(h) All corrections and alterations must be properly authenticated. (Refer ISBP, Articles 55 & 56).

(i) In respect of usance bills of exchange it must be ensured that the requisite stamps have been affixed on the drafts as per the stamp act applicable to the country of origin.

(j) The draft should bear interest clause wherever necessary.

(k) It must not be drawn or endorsed 'without recourse' unless the credit authorizes accordingly.

(l) The relevant number of copies of the draft/bill of exchange of the same tenor and conditions as required in the credit are submitted.

Examination of The Invoice (refer To UCP 600, Article 18 And ISBP, Articles 58 To 67)

The commercial invoice should be scrutinized to ensure that:

(a) The merchandise is invoiced to the importer mentioned in the credit at the proper address. (Refer to Article 14.j, UCP 600)

(b) The description of the merchandise corresponds (but need not be a mirror image) with the description mentioned in the credit. (UCP 600, Article 18.c; ISBP Article 58).

(c) The price and the quantity indicated in the invoice correspond to the price and the quantity indicated in the credit. (Ref.: ISBP Articles 60, 63, 64)

(d) No charges other than those pertaining to the merchandise are included in the invoice and that these charges are permitted in the credit.

(e) If the credit stipulates customs or consular invoices, such invoices are furnished. The beneficiary's invoice can be simultaneously accepted in this case as an additional document.

(f) The amount of the invoice tallies with the amount of the draft unless part payment is stipulated under the credit.

(g) The marking and numbering on the packages shown in the bill of lading are identical with those given in the invoice. They must be identical in all documents. This is because the shipper may arrange shipment of similar lots of the same commodity to different buyers in the same country. If the shipping marks are identical it can be considered that the B/L has been correctly attached to the relevant documents.

(h) The total amount in the invoice is correct on the basis of the unit price and the quantity(ies) stated in the invoice. (ISBP, Article 60).

(i) The number of copies of the invoice tendered with the bill is as specified in the credit.

(j) If any certification on the invoice by the manufacturer / exporter is required, such certification has been given in the invoice.

(k) When agency commission is deducted from the invoice value, such amount has been specifically / generally approved by the exchange control regulations of the country concerned.

[Important: Some LCs, while describing the goods, mention (description of goods) "as per pro forma invoice" or "as per details contained in pro forma invoice no. ___ dated ___ ". Should a bank check the details of a commercial invoice against those of a pro forma invoice?

This depends on the circumstances. If the pro forma invoice is attached to the credit (a practice that should be actively discouraged - refer UCP 600, Article 4.b, ISBP 681, Article 1), it forms part of the credit, and must be observed when the documents are examined.

If it is not attached to the credit, and the credit states "….. goods as per pro forma invoice no. xxx dated yyy" banks are not required to consider the contents of the pro forma invoice in any way. The responsibility is limited to seeing that any invoice presented makes correct reference to the pro forma invoice.

Examination of Transport Documents/ Post Parcel/courier Receipts.

This should be undertaken to ensure that :[19]

(a) A full set of originals B/L or in as many negotiable (Refer to ISBP Articles titled "Full set originals) copies as stipulated in the credit are submitted (Refer to UCP 600, Articles 19.a.iv, 20.a.iv, 21.a.iv, 22.a.iv). It is necessary that all the negotiable copies as issued by the shipping company are submitted to avoid delivery of goods at the destination against the remaining copy (if any) to any unauthorized third party.

(b) 'Received for shipment' B/L is not acceptable unless marked 'on board' with date and duly signed by the master of the ship.

(c) If transhipment of the merchandise is not permitted under the credit, B/L does not indicate that the goods will be transhipped.

(d) B/L is made out to the order of the consignor and endorsed in blank or to the order of the bank or to any other party mentioned in the credit. It should not, however, be made out to the order of the consignee at the destination in which case it is difficult for the bank to claim any ownership for the cargo in case of necessity.

(e) The general description of the goods given in the B/L such as type, quantity, weight, number of packages etc. agrees with that given in the invoice.

(f) The port of shipment, port of discharge, the names of the consignee and the shipper, the notified party (if any) given in the B/L correspond with those indicated

19. On B/L, refer to ISBP 681, Articles 91-114 and UCP 600, article 20.

in the credit. (Refer to ISBP, Articles 98-100 and other Articles therein titled 'Ports of loading and ports of discharge'.)

(g) All endorsements in the B/L correspond with the endorsements stipulated in the credit. (ISBP, Article 102)

(h) The B/L is duly (manually) signed by the shipping company or by its authorized agent and is properly stamped.

(i) The B/L is 'clean' and not 'claused'. A clean bill is one that bears no clause or notation indicating any defect in the quality of merchandise or in its packing which could affect the condition of the merchandise during transit.

(j) The marking on the B/L should, inter se, agree with those given in the other documents such as invoices, certificate of origin, insurance policy/certificate etc.

(k) In the case of CIF and C&F contracts, the B/L is marked 'freight paid'.

(l) B/L does not evidence 'on deck' shipment. B/L evidencing 'on deck' shipment is not acceptable unless specifically permitted in the credit. It is, however, not considered a defect if the 'intention to carry on deck' is only mentioned in the B/L as per Article 26.a of the UCP 600.

(m) The B/L is not 'stale' or 'unacceptable'. The words 'stale' or 'unacceptable' are not part of the UCP. 'Stale' has been defined in ISBP (ICC Publication No. 681), Article 21.b.

Examination of Insurance Documents[20]

(a) The insurance policy should be in negotiable form, issued and signed by insurance companies or underwriters or their agents or proxies.

(b) It should be in the bank's name or endorsed in favour of the bank. (This may not be the case always, as the LC term may stand in the way. However, in order to protect the negotiating or the issuing bank's interest in case of losses in transit, it is advisable to have LCs that permit acceptance of insurance policies to be in a negotiable form).

(c) It should be stamped as required by the laws of the country concerned.

(d) If insurance policies are required under the credit terms, certificates of insurance companies or brokers, cover notes etc. are not acceptable as substitutes. Cover notes have been made unacceptable in UCP 600.

(e) The amount of cover should be for a minimum of 10% (or as specified in the credit) over the invoice value of the merchandise or the amount stipulated by the

20. Refer UCP 600, Article 28 and ISBP 681, articles 170 to 180 on insurance documents and coverage

importer. The value of the policy should be quoted in the same currency as that of the credit amount.

(f) The date of the insurance document must be no later than the date of shipment, unless it appears from the insurance document that the cover is effective from a date no later than the date of shipment.

(g) If warehouse to warehouse policy is required, such a policy (cover) should be specifically sought and obtained.

(h) The name of the ship, shipping marks and description of the merchandise, number of packages etc. incorporated in the insurance policy must be identical to those given in the transport document and the invoice(s). The description of the goods may be in general terms not inconsistent with the description given in the invoice.

(i) There should not be any qualifying clause that may adversely or negatively affect the interest of the bank.

(j) If the insurance cover is under a blanket policy, a certificate of insurance clearly indicating the amount up to which the shipment relating to the bill tendered and the risks specifically have been covered must accompany the documents. In such cases it is necessary that the credit should cover insurance certificates forming part of the blanket policy(ies).

(k) If the Bill of Lading is claused to the effect 'shipment on deck', the policy must also cover such risks inherent in deck shipment.

(l) If transhipment is indicated the transport document, the policy must also cover transhipment risks.

(m) The beneficiary must take out the policy with himself as the 'assured'. A third party policy must not be accepted unless stipulated in the credit.

(n) Policy must state the name of the vessel and the number of the voyage as indicated in the B/L. The same goes for any transport document.

(o) Ports of shipment and destination given in the policy must be identical with those given in the transport document.

(p) If the credit terms stipulate specific risks that are required to be covered, the insurance policy should clearly and specifically indicate that such risks have indeed been covered.

(q) If the credit stipulates that the insurance to contain 'All Risks' clause, a policy that does not cover this clause should not be accepted. If a credit requires "all risks" coverage, this is satisfied by the presentation of an insurance document evidencing any "all risks" clause or notation, even if it is stated that certain risks are excluded. An insurance document indicating that it covers Institute Cargo Clauses (A) satisfies a condition in a credit calling for an "all risks" clause or notation. (Ref.: UCP 600, Article 28(g) & 28(h) and ISBP Articles 173 and 174.)

Examination of other Documents[21]

Certificate of origin is a document that certifies the country of origin of the goods and is generally issued by the chambers of commerce of the country or other specified authorities. Occasionally the credit calls for a certificate even by the shipper/exporter. The description of the merchandise in the certificate of origin should be the same (in general terms) as in the invoice. Unless stated otherwise, it should invariably be issued by the authority indicated in the credit. (Refer to ISBP, ICC Publication No. 681, Articles 181 to 185)

Exercise

1. What is a "non-documentary" condition? Can you give an example?
2. Explain the meaning of this statement, "Banks deal with documents, and not with goods or services etc. …(UCP 600, Article 5)"
3. Of what benefit is a confirmed LC (over an unconfirmed LC) to an exporter?
4. Explain why letters of credit are better options for settlement of trade - for both the exporter and the importer.
5. Can LCs take care of exchange risks?
6. Can an LC be amended unilaterally by the applicant (buyer)? Does he need to consult the exporter before amending a credit? Give reasons for your answer.

Reference

1. An introduction to documentary credits, by Rupnarayan Bose, Macmillan (2006)
2. Fundamentals of international banking, by Rupnarayan Bose, Macmillan (2007)
3. All about UCP 600, by Rupnarayan Bose, Macmillan (2008)
4. ICC Publications: UCP 600, ISBP 681, Incoterms 2010, URR 725, URC 522.

21. Refer UCP 600, Article 14 on 'Examination of documents'.

Notes

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