Date: 30-November-2021

GUIDANCE NOTE

DOCUMENTARY CREDITS ISSUED BY NON-BANKING ENTITIES THROUGH MT 710

A meeting of the ICC India Working Group (WG) on Banking & Finance was held to discuss the position of Indian exporters while dealing in non-bank LCs. Recently, it has been reported that Indian exporters while dealing in non-bank LCs have incurred heavy transaction charges and in some cases, have also incurred total loss for exports. Details of several such instances was further shared by FEDAI with the members of the WG. It was also reported that in many incidences buyers either defaulted or just disappeared, leaving the exporters to realise later that the LC issuing entity - a non-Bank entity - is not credit worthy. Accordingly, the ICC India WG was of the unanimous opinion that a 'check-list' be prepared to help appraise the exporters about the risk factors while dealing with non-bank LCs.

Many of the exporters, specifically MSMEs/SMEs are unable to differentiate between the different formats in which LCs are issued. Specifically, whether it is in MT 700 and 710 format. These predominantly corporate LCs are "advised" by banks on their letterhead in a SWIFT MT 700 format, and to all intents and purposes, appear to be bank issued LCs, with the requirement to present documents to the advising or transferring bank, where documents will be processed and payment made after receipt of funds from the 'issuer'. Often, in such cases the guarantee of payment is not normally by an independent third party, and, as such, the credit risk is that of the corporate entity issuing the credit. Similarly, when documents are presented under the LC for negotiation, that negotiation if any, is based on the risk of the issuing entity, i.e. is corporate, not bank risk.

Unlike India, in many countries credit can be issued subject to the UCP by a non-bank. That, however, does not mean that it is prudent for a beneficiary to accept such a credit. Issuance through an advising bank does mitigate the risk of whether the credit is authentic and presentation of documents to a bank does reduce some operational risks. There is, nonetheless, the risk of the creditworthiness of the issuer and country risk. These risks apply equally whether the issuer is or is not a bank and a beneficiary should always assess whether it is prepared to accept the credit and country risk associated with the issuer. If not, it should ask for confirmation by an entity with which it is comfortable.

MSME and SME clients lack required expertise to understand and appreciate the risks involved while dealing with LCs issued or advised through non-banking entities. It was found that the exporters/ beneficiaries on receipt of letter of credit, too eager to capture the business, ship the goods without exercising basic precautions like checking the bonafides, doing basic KYC checks on the buyer, signing a formal contract for the sale of goods. In some cases, there was no formal query or communication from the buyer and only on the basis of the LCs issued by non-banking entity, beneficiary/exporter executed the export order.

Based on discussions at the ICC India Working Group, we have listed below some check-points that exporters are encouraged to follow while dealing with new clients especially for LCs issued or advised by non-bank entities.

We wish to draw the attention of the exporters, who are receiving letters of credit issued by non-banking entities advised through another bank or another non-banking entity, to few specific aspects, SWIFT fields and information captured therein to help them better understand the risks involved. This type of letters of credit are generally transmitted in MT (Message Type) 710 format. This can be identified by checking the contents at the top of the letter of credit.

Check-list

[suggestions to the beneficiaries (exporters) to safeguard their risks]

1. Identify clearly which entity has issued this letter of credit - whether the issuing entity is a bank or a non-banking entity? This will be stated in Field No.52A. (Issuing bank)
2. Check the financial status of the issuing entity (LC issuing bank/entity) with your bank before processing the export order.
3. In some of the transactions, your buyer is in a different country and this LC issuing entity is in another country. For example: your buyer (applicant in the letter of credit) may be in the UAE. This issuing entity may be in Gambia or Ukraine.
4. Check the commercial and financial status of the buyer (importer).
5. Check for reasons why any of the banks in the buyers' (importer's) country, could not undertake its payment obligation.
6. Please read all the terms and conditions of the letter of credit before processing the order.
7. At times, the first advising bank which has transmitted the letter of credit might have added its confirmation. This can be checked by reading Field No.40A. (Irrevocable, adding our confirmation). In this case Field No.49 may state 'without'. It means that first advising bank had already confirmed the letter of credit and the second advising bank in India may advise the letter of credit 'without' confirmation.
8. First advising bank, which is incidentally the confirming bank, should be financially sound. We suggest you seek assistance of your Bank for this purpose, if you do not possess the ability to verify financial soundness of the first advising bank.
9. Please read Field No.47A (Additional conditions). Details of dispatching of documents may be stated.
10. Successful completion of your transaction depends on your alertness in checking the financial background of the buyer and the LC issuing entity's financial status.

This note is issued without any risk and responsibility either of ICC India or of FEDAI, and is solely intended to be a guidance document for the exporters, encouraging them to exercise basic due diligence and adopt appropriate precautions, whenever they receive letters of credit issued by non-banking entities and the exporter proposes to enter into any sale contract, supplying goods against future payments, initiate an export transaction against such LCs, or avail of finance, against such LCs, if any.

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