Standby Letters of Credit: the Old, the New, and the Old with a Facelift

May 2015

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THE OLD

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SBL/c Types

ISP98 vs. UCP600

Types of trade issuances

- **Commercial or documentary Letters of Credit (LC)**
  - LC is one of the payment methods used in international and domestic trade. Banks anticipate documents to be presented for payment.

- **Standby Letter of Credit (SBL/C)**
  - This is the common instrument that acts like a guarantee from one party to another party – this is not the primary payment method. The beneficiary of SBLC relies on the SBL/C for payment only if the applicant is unable to fulfil the conditions in the sales/project contract. Banks do not anticipate a drawing under a SBL/C.
  - The SBL/C is more popular in the United States.

Common SBLC Types and Their Usage

Bid / Tender Bond	Compensates the project owner if the bidding contractor does not take up an awarded contract
Advance Payment	Compensates the project owner if the contractor fails to refund the advance payment in the event of non-performance
Performance Bond	Compensates the project owner if the contractor fails to perform in accordance with the contract
Retention / Warranty Bond	Compensates the project owner if the contractor fails to complete the installation / perform under the warranty
Commercial/Trade SBL/C	Assures the supplier of the buyer’s prompt payment for goods supplied
Financial	Assures the lender of repayment of indebtedness
Customs Bond	Allows an importer to defer payment of customs duty for goods imported or temporarily import goods into the country without payment of duty

ISP98 vs. UCP600

- **UCP 600 was drafted for documentary/commercial L/Cs.**
- **ISP 98 was created for SBL/Cs.**

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ISP98 vs. UCP 600 – Governing Rules

- **ISP98 identifies an issuer's branch or other office as a separate "person", while UCP600 does not.**
- **ISP98: Failure to make scheduled presentations DOES NOT waive right to make another timely presentation. In UCP600 the instrument CEASES TO BE AVAILABLE for that and any subsequent instalments.**
- **ISP98 provides for the expiry date AND last date for presentation and any other date relative to presentation, to be extended to next business day, if such day falls on a non-business day.**
- **ISP98 provides opportunity to present documents within 30 days of re-opening after closure caused by "force majeure". . UCP600 does not provide the beneficiary the opportunity to present documents once the bank reopens**
- **ISP98 examiner is NOT required to examine documents against each other to determine inconsistency. UCP600 requires to examine documents against each other to determine inconsistency.**
- **ISP98 provides "safe harbor" i.e notification of dishonour made within three banking days following date of presentation is deemed to be a "reasonable time". UCP600 does not have a similar provision**
- **ISP98: a standby may be transferred in its entirety, more than once and may NOT be partially transferred. UCP600 states a credit may be partially transferred but may not be transferred in its entirety more than once.**

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THE NEW

Topics of Discussion: The NEW

Channels

Know Your Customer (KYC)

Regulatory/Sanctions

Uniform Rules for Demand Guarantees (URDG)

Bank Payment Orders (BPO)

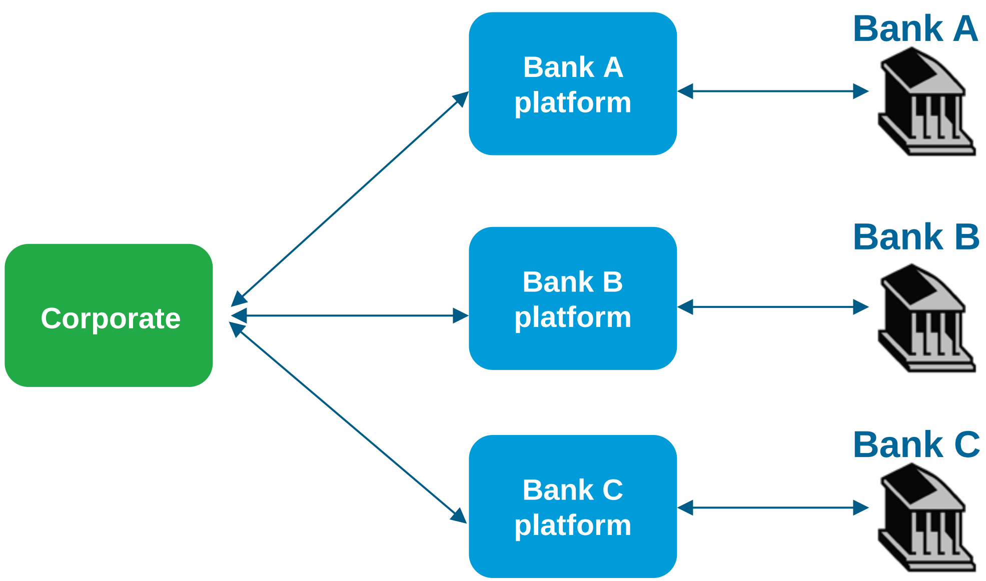
Channels: Ways to send an application to the Bank

- **Internet Banking Straight2Bank***
- **Emails**
- **Third party multibank platform**
  - **Bolero**
  - **ELCY**

*** Standard Chartered's platform**

Why are companies moving to Multi-bank trade solutions

Point-to-point connections with multiple banks poses several challenges for corporates

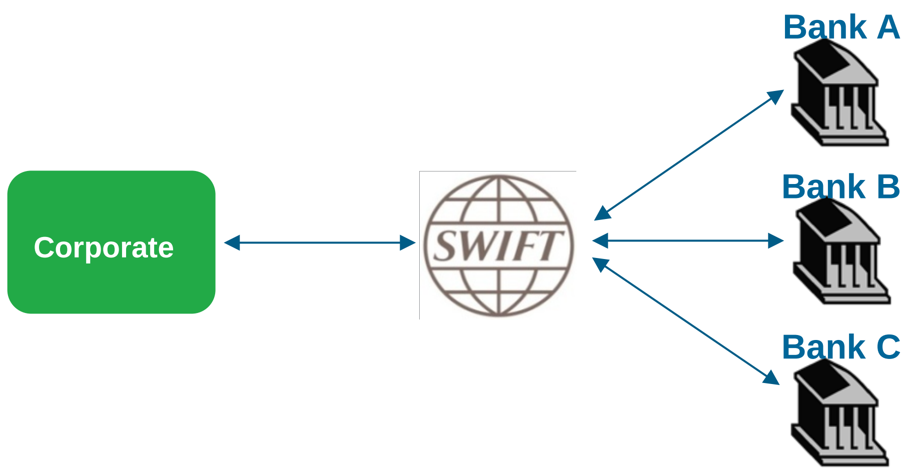


Corporate Challenges

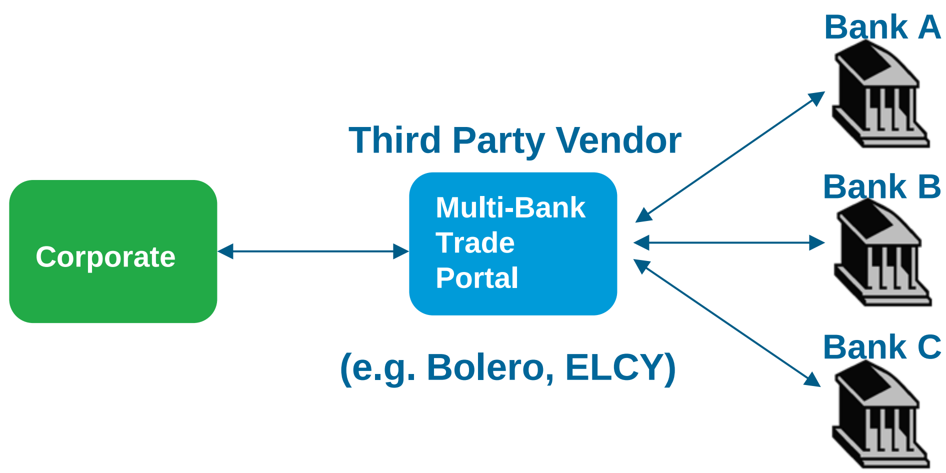
- Need to access multiple bank platforms for trade services such as LC/BG issuance, export LC advise etc.
- Lack of a consolidate view of outstanding trade transactions/limits
- Difficult to centralise/ streamline processes
- Ongoing efforts and costs for training staff and managing multiple platforms
- Not a scalable model

Multibank Trade Solutions - A single, standardized gateway to multiple banking partners for trade needs

SWIFT for Corporates



3rd Party Trade Portals



- Recent financial crisis and credit crunch forced companies to work with multiple banking partners.
- Corporate treasuries are increasingly adopting multi-bank trade finance solutions driven by the need to - standardise processes, obtain complete visibility on trade transactions and manage exposures.
- Some multibank platforms not only serve as a communication channel between a corporate and a bank, but also double as an in-house trade finance system that can be used for MIS.

Multi-banking in trade finance is now a reality

Know Your Customer

Due Diligence on Customers-A Critical Requirement for Banks

Due Diligence occurs at Inception of Customer Relationship, and throughout the life of the relationship

Basics:

Name

Address

ID Number

DOB for an individual

Expanded Due Diligence:

Nature of the business, Know Your Customer's Customers

Expected types of transactions-to and from what geographies, how many transactions monthly

Source of Funds/Source of Wealth

Ownership Structure

Sanctions

What Are Sanctions?

Sanctions are:

- Measures imposed by a country, or a group of countries
- Against target individuals, entities, organizations, or countries

COMBATTRE L'INJUSTICE

To:

- Restrict access to the targets' funds and assets ('freezing' , 'rejecting' or 'blocking')
- Bar the target from the financial system and international trade

What Lists are used to screen for Sanctions at Standard Chartered Bank?

- United Nations (UN)
- European Union (EU)
- United States (Office of Foreign Assets Control (OFAC)
- United Kingdom (H.M. Treasury; HMT)
- Group GPSAN (GPSAN) / Local Internal List
- Bureau of industry and Security (BIS)

Sanctions Policy Wordings

- **To comply with regulatory requirements, banks will insert the following sanction clause (or something similar) in all LCs issued:**
  - "All Parties to this transaction are advised that the U.S. and other government and /or regulatory authorities impose specific sanctions against certain countries, entities and individuals. Banks may be unable to process a transaction that involves a breach of sanctions, and authorities may require disclosure of information. We are not liable if it, or any other person, fails or delays to perform the transaction, or discloses information as a result of actual or apparent breach of such sanctions.
  - Shipment, transshipment or transit is prohibited to, from or through Iran, Cuba, North Korea, Sudan, and Syria, and no party in any of those countries (which includes any vessel flagged in, or owned or operated by a party in, such country) is to be involved in the transaction in any manner.
  - No party which is sanctioned by the United Nations, United States or the European Union, or United Kingdom, is to be involved in the transaction in any manner. We may not complete a transaction which involves such party, or any party in the above countries"

Challenges in today’s environment

- Various different sanctions programs (e.g., UN, EU, U.K., and U.S.)
- Each program imposes different restrictions on different countries, organizations, and individuals
- Even within each program, the restrictions can be different on the targeted countries, organizations and individuals
- Constantly changing as political factors change
- Sanctions targets continuously look to develop new methods to evade sanctions
- Costs associated with sanctions regulatory compliance continue to rise and become challenging
- Regulatory expectations constantly rising causing higher volumes and increased scrutiny
- Aligning sanctions screening processes to ensure compliance and meet multiple regulatory requirements

Uniform Rules for Demand Guarantees (URDG)

URDG uniform Rules for Demand Guarantees, ICC Publication No.758

Two and a half years of intensive work and extensive consultation – more than 600 sets of comments received from 52 countries

Effective 1 July 2010, succeeding URDG 458

Points of interest:

1) Can not be confirmed

2) Drawings must contain a statement of default even if the same is silent

Bank Payment Order (BPO)

A BPO is an irrevocable undertaking given by a bank to another bank that payment will be made on a specified date after a successful electronic matching of data according to a defined set of rules.

Uniform Rules for Bank Payment Obligation (URBPO) went live as of July 1, 2013

The Old with a facelift

Assignable/Transferrable

Advance Payment

Governing Law

Auto Renewal and Open Ended

Assignable/Transferable Clause

SBL/C is assignable and/or transferable

SBL/C must state (or something similar): "The proceeds payable or the transferability of this SBL/C may be assigned/transferred with our prior written consent, which consent shall not be unreasonably withheld"..

Advance Payment Clause or non operative

- **In order to protect the Applicant as well as the Beneficiary, banks will require a statement or similar wordings in the SBL/C as follows:**

  "This L/C shall become effective upon receipt by the issuer of a confirmation from the Applicant via an authenticated swift or similar confirming that the Applicant has received the advance payment thru their Banker indicating our ref. no…."

- **If there is no confirmation received and Beneficiary claims on the bank, the bank will have no obligation to pay because the SBL/C is not operative.**

Governing Law and Jurisdiction

- **Standby L/Cs must expressly state to be subject to UCP600 or ISP98**
- **In the absence of an express choice of law, the governing law of a SBL/C is the law of the location of the branch or office that issued the SBL/C.**
- **If applicable, the governing law of a counter-guarantee is the law of the location of the counter-guarantor's branch or office that issued the counter-guarantee.**
- **<u>APPROVED ARBITRAL BODY & ARBITRAL RULES for Standard Chartered Bank*</u>:**
  - London-The London Court of Intl. Arbitration; LCIA Rules
  - Singapore-Singapore Intl Arbitration Centre
  - Hong Kong- Hong Kong Intl. Arbitration Centre; HKIAC
  - New York- American Arbitration Assoc./Intl.

***SCB only. This will vary according to the issuing bank**

Auto Extension vs. Open Ended

- **Auto Extension Clause: Banks prefer to issue SBL/C's up to one year maturities. If the SBL/C expiry has to go beyond one year, it may include an Auto- extension clause with an opt out provision. This clause allows the SBL/C to automatically rollover at each anniversary for a pre-stated period of time.**
- **This Standby shall be automatically extended for an additional period of (insert period), without amendment, from the present or each future expiration date unless at least (insert number of days, usually 30 days more) prior to such expiration date, we notify you by authenticated SWIFT or courier that this Standby Letter Of Credit will not be extended beyond the current expiration date. . Upon receipt by you of such notice, you shall be entitled to the remaining balance of this Standby Letter of Credit amount against your authenticated SWIFT or signed letter, certificating that you have not been released from your Standby Letter Of Credit issued on our behalf or the underlining contract still remains in affect and the monies are still owed to us.**
- **Open Ended: Governing Law of certain countries do not recognize expiry dates. A Guarantee or Standby LC only becomes "null and void" when the original instrument is returned to the Issuer or when the Issuing Bank has been released by the Beneficiary, even with a stipulated expiry date in the instrument.**
- **In addition even with a stated expiry date, some country local laws allow the beneficiary to claim for a stated period after the expiry date**