

Documentary credits and the necessity of recognition of some legal and financial aspects in their use of the Albanian traders

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Abstract

In the last decade, the internationalization process included widely the Albanian businesses, which work in many parts of the world and in particular in those countries where, until a few years ago there was no commercial relationship. This process requires from businesses to have organization and sufficient financial means to meet various distant markets. This leads to the further development of the use of International Payments, namely those forms of payment in which the bank plays a fundamental role, in particular the letters of credit. Elements and concepts of the letters of credit are governed by Same Rates and Uses the of the International Chamber of Commerce in Paris (ICC), which are related to "Documentary Credits", more detailed by Publication 500, where there were underlined the principal differences of the two main instruments: letter of credit and international bank guarantees.

Regarding the review of the letter of credit and international bank guarantees the perspective of this study will be that of the exporter.

How it is created a letter of credit?

At the end of every trade agreement, as defined all terms of sale in the contract of supply (according to the instructions of the Incoterms 2000¹), and so, and ways of making payment, the exporter prepares the **pro-forma invoice**, in which one side is presented in a succinct summary way of what is defined during the time of the trade agreement, and on the other hand it is a "simulation" on all the elements that will be part of the **definitive commercial invoice**. Based on the function and legal - trade meaning, pro-forma invoice must bear the description of the delivered goods which should describe the goods, but at the same time it should be more succinct, outline disbursements, prices, delivery times, types of packaging, etc.. In relation to the exporter's bank, necessary and sufficient data are the name and bank center, Swift code and telex (if it exists); account number is irrelevant, and should not be communicated, IBAN code, which is the typical bank, coordinates of banking systems.

Normally it is sufficient to send the simple *pro-forma invoice* to the client by fax, without being necessary that one or more units should be sent in original. There are

some exceptions in some countries where the customer requires the delivery of one or more originals.

Upon receipt of *pro-forma invoice*, client is addressed to his bank and charges it with the task of opening the letter of credit in favor of the exporter at the bank required by the exporter/supplier, based on synthetic information of *pro-forma invoice*. It should be noted, that it is being presented this procedural reality in a simplified way, as not always L/C is opened in perfect synchrony with what is theoretically defined. In fact, many times there are no direct reports between importers bank so the bank that does the emission of the title of the L/C - or **issuing bank** and the bank of the exporter and therefore the documentary credit is used in another bank with which issuing bank has relations. In this situation it would be better, that at the moment of signing the contract, and whatever before preparing the pro-forma invoice, there should be provided the relationship that exists between banks, namely the Bank of exporter and importer bank, with order to avoid this situation. However, although in practice the exporter and the importer can act in perfect harmony between them, it is possible that the credit letter can arrive at a different bank from the bank agreed between the parties.

Results and Discussions

In the operation of the opening of a letter of credit enter into the "game" two separate groups of interests. On one hand

the importer client with the bank who makes the emission of the title, on the other hand the exporter supplier with the receiving bank, which is of course also the confirmer of completion the encashment.

Importer (Applicant)

Exporter (Beneficiary)

Message transmitted by ----->

to receiving, negotiating, confirming bank

Issuing bank

What are the systems of delivery of a Letter of Credit?

The bank that issues the title may use different systems to issue and send to the receiving bank the text of a letter of credit. Main systems are:

- **Swift**, easy operating instrument to be used as there is no need to be authenticated.
- **Telex**, more complex instrument than the first, which even though it is just as fast in data transmission, needs to be authenticated through decodification.
- **Papery** (delivery of documents via express courier or by registered mail, etc.). This is an instrument not very practical as it is necessary to be controlled by the receiving party to verify the documents. Fortunately this system is heading toward extinction, although some banks, for example in India, Bangladesh and Pakistan and other countries of Asia still use it as an operational tool in the notification of receipt of letters of credit.

How it is submitted a Letter of Credit?

Through the channels mentioned in the preceding paragraph, at the bank indicated by the exporter arrives a text, normally in English or French language. Theoretically the message can arrive in any language, but the use of less popular languages of difficult interpretation is not recommended to be used for a text that is away from the English or French language. In this text there are defined the conditions that must be respected and the documents that should be prepared to be submitted by the parties. In case of using the Swift canal, the letter of credit text is divided into numbered fields - to facilitate the reading and interpretation of the letter itself, as normally a number of the field corresponds to a defined group of information. This division is made according to the specifications regulated by Same Rate and Use of the International Chamber of Commerce in Paris (ICC), and more detailed by Publication no. 500².

This text is submitted to the bank indicated by the exporter, which normally to provide a fast and efficient service to its client, sends back a fax with the received text, informing

that it is just an **inoperative warning**. This first phase does not imply any responsibility for the bank, which then has to make official the **announcement** of "Beneficiary" credit and only from then on credit will become an operational instrument. In case of the message by Swift, the arc of time that passes between the announcement and notification is necessary for the bank to check if the letter of credit provides incomplete and/or unclear instructions. If these are present, the bank must intervene at the bank that has issued it to ask from the latter to give the necessary explanations. For this initiative the bank must inform the beneficiary (exporter) considering in quick time the documentary credit as "inoperative" instrument not usable by the exporter, who must wait for clarification before sending the goods. In case it is received the letter of credit through the telex canal or mail/courier, the receiving bank must examine further the authenticity of the message and signatures.

Why it is called Letter of Credit or Documentary Credits?

This name has its origins in the fact that the commitment of the bank that issues the title to be paid, depends on the submission of the Beneficiary through his bank, the detailed documents specified in the same letter of credit, documents that **must be perfectly in conformity with what is required** by the credit title. So, the payment depends on the presentation of a series of documents that result in conformity with the requirements of the credit.

Commercial banking meaning of the word "irrevocable (non-refundable)"

One of the elements that distinguish the letter of credit from many other forms of payment is the fact that it is irrevocable. From a theoretical point of view there are revocable letters of credit, but in this case there is no practical value because of the simple fact that the bank issues it at any time in its opinion to make the cancellation of the letter. Irrevocability leads to the indisputable advantages from the commercial point of view, after the bank by the time it issues and sends an irrevocable letter of

credit, can not be turned back on its commitment without the approval of beneficiary (exporter).

From the commercial point of view this means that from the moment of receipt of the letter of credit, in the case where the exporter is unable to comply with all the agreed conditions (referring to documents and relative terms regarding the delivery deadlines *Latest Date of Shipment* and those relative to the presentation of documents *Expiry Date* also all other conditions stated in the letter of credit, which should be generally conditions defined at the time of the agreement), the exporter may quiet start producing goods without any kind of risk that can see the cancellation of the order or to change certain conditions at the time of concluding contract, as indicated in the letter of credit.

Amendment or modification

It can be verified the case in which the letter of credit that reaches to the exporter is not in conformity with what was agreed in the contract and/or presents difficult or dangerous conditions to be executed even for the exporter. It can also be verified that at the time of preparation of the order unexpected things can occur that hinder the exporter to respect the time of delivery or other conditions. In these cases, the exporter must notify the importer, in order to give his bank the order to make the change. It is very important to be underlined that it is an intervention that depends on the importers wish, who can deny and this brings a consequence for the exporter. Let us consider the case when the goods, subject to supply, are almost ready and the exporter understands not to be in time to respect *Latest Date of Shipment*, so the lack of interference of the importer at his bank puts the exporter in more serious difficulties, above all when the goods, subject to supply, are manufactured by specific order and they are not goods produced in series.

From the operational point of view it is not allowed the effort of making a partial modification by the exporter or importer! The amendment will be accepted in its entirety (there should be controlled in an integrated manner all changes that result in a single amendment) or in its alternative, the parties may exercise their right to refuse completely all modifications received in the letter of credit.

In case it is more than an amendment, the beneficiary of changes has the right to accept them all, only some of them, or none of them.

Unless the credit provides otherwise, the amendment is accepted if beneficiary (exporter) will submit documents in accordance with the amendment, then it comes here to the closing behavior. Also it should be added herein that the date of the amendment has retroactive effect on the terms of credit itself (*except the case when the letter of credit doesn't provide otherwise*).

Confirmation

Confirmation is an absolutely essential concept. It is a necessary condition that the exporter's bank (or a third bank, in the case of the triangle between the banks) could increase its not derogated commitment for payment, and for this it is necessary that the bank that has made the issuance could have authorized also the confirmation. In the case of letter of credit opened in Swift channel, field 78 - Confirmation - will bring in writing **Confirm** in place of **Without**. Only when verified this situation, the bank (in its discretion) may add its confirmation. This should be done carefully: confirmation by the exporter's bank is not a binding commitment and it is on bank's discretion, therefore it can not be imposed to make a credit confirmation. Since the moment in which the bank adds its confirmation, and only from that moment onwards, its commitment will be added to the bank's commitment that has made the emission irrevocably, and when documents presented by the exporter are accurately in conformity with the letter of credit, based on the analysis made by the confirming bank, the exporter must be sure that when it is reached the moment of payment maturity, he will find the money in his account. In this situation it is necessary to explain better, that at the moment in which the exporter's bank will add to the credit its confirmation, it will take on the risks associated with the operation (here are meant the risks associated with the place and/or the bank that issues it). Confirmation is safe only in the moment in which the exporter shall submit the documents and they result in conformity according to the analysis of the confirming bank. If the confirming bank states that the documents are perfectly in conformity, and after that the issuing bank notices a discrepancy that invalids and/or compromises the integrity of the document and that saves the analysis of the confirming bank, in this case, the confirming bank must respond to the obtained commitment by putting the money in the account of the exporter in a timely manner.

When the confirming bank will identify discrepancies in the submitted documents and these discrepancies can not be corrected by the exporter, it will be relieved of any responsibility and will send documents for admission to the issuing bank, highlighting the found inconsistencies.

The principle of formalism, abstraction and autonomy

- a. **The principle of formalism** leads to the fact that credit title text interpretation and

preparation of documents must be made exclusively on the **letter**, meaning that in case of spelling errors in the writing of credit text in preparation of documents, will be borne errors as written in the text. For this reason it is advisable to prepare documents under the jurisdiction of the "Beneficiary" (Issued by Beneficiary), with a normal Word Office system or any other type of video-writing system, and do not use paper with the name and logo of the company, which of course should have written correctly the

name, address and other details of the company, and if there are errors in the credit text, the contrast will be even clearer.

This solution is recommended as it facilitates the procedure and above all it doesn't require any intervention of the "Beneficiary" to "applicant" importer. It should be noted that, in the case when one of the documents required by the letter of credit is a Certificate of Origin and/or any other customs document (EUR 1, ATR, EX 1, etc.), Chambers of Commerce and Customs will refuse to consider documents that bear big errors in name and/or address of the "Beneficiary". So it will be *necessary* to be addressed for possible solutions in paragraph 1, to require the credit modification.

- b. **Principle of abstraction and autonomy.** The letter of credit is an *independent* instrument

of cause (cause that gives origin), that the report and contacts of trade agreement between the exporter and importer, and in no way it isn't limited by this report. These two principles lead to an **absolute independence** of the letter of credit instrument by the commercial ratio between the banks and supplier/customer. For example customer can cancel or modify the order to the production center, but from the moment that the letter of credit is opened it will be autonomous and exporter may continue to manufacture and supply without any problem.

It should be noted that the banks can not intervene for any reason between the supplier-client and/or other, in order to not respond to the taken commitment. They must base their behavior **absolutely** on the outcome of the analysis of the documents.

Documents required by a letter of credit

Documents that must be completed by the "Beneficiary"

- Invoice of merchandise
- Packing weight list
- Declaration and various certificates

Invoice is a key document. Any operation with title of expense has no meaning without the presence of this element, which among other things, certifies also the value of the transaction.

Packing and Weight list. The list of packages and weights shall specify the content of goods for each parcel. In some countries, the customs are very prudent and "fiscal" in the regularity between Packing list and actual content of packages.

Various statements. There are considered as such all those statements with different content and issued by "Beneficiary" and that are required in letters of credit. We can mention for example the statement of quality, quantity, origin, etc.

1. Documents that must be completed by the consignor / vector

- CMR
- Air waybill
- Bill of lading

It is important that regarding to this should be refined the consequences that may have the procured (charged) vectors used from the buyer. Many operators, in fact, prefer to sell their goods by delivery terms E and F group of Incoterms 2000. Thereby they give the against party (seller) a choice of carriers, disregarding the risks that can be encountered: the impossibility of assessing the professionalism of the carrier, the difficulty and sometimes impossibility to have documents in conformity with the documentary credit, making it lose the strength of the instrument L/C, so that since the beginning of the transaction, the documents are inconsistent.

2. Documents that must be completed by the Chamber of Commerce and Consular Visa

Certificate of Origin is a document completed by the vector in the module required exclusively at the Chambers of Commerce, and normally it has these key elements:

- Seller
- Buyer
- Description of the goods, the number and type of packages, brands (if any).
- Gross and net weight
- Space for comments

In some geographic areas (for example Middle East) in both documents, as in the Certificate of Origin as well as in the Invoice, it may be required the consular visa of the respective countries in the exporters country. This detail is very important as for the cost of operation, as well as for the time required to obtain these visas.

3. Documents that must be completed by Customs are Eur 1 and ATR

Eur 1 and ATR are documents controlled by the customs to the exit from the territory of the European Community and have the function of allowing the extra-communitarian buyer (outside the European Community) to excise clearance, which are partially or totally removed.

It is needed more caution while using them in L/C as normally they are completed by the operators who don't see the L/C and therefore can carry a lot of mistakes that are contrary to the L/C, thus creating further problems.

Relation with banks, inconsistencies, domestic and foreign stocks

Discrepancy is a technical-bank term that is used more or less for significant errors that are present in the documents. In the banking practice, it is spoken usually **on internal and external discrepancy**. The first evidences less severe errors identified by the exporter's bank and not communicated to the bank that has made the issue of the document. The second highlights serious errors necessarily to be evidenced by the issuing bank. For their own importance, it is very dangerous to underestimate domestic discrepancies, as they can be assessed by the issuing bank as *heavy discrepancies* that invalids (devalues) the documents. It's hard to know exactly at what level "heavy" would be perceived as a sort of "not perfection." Let's think some foreign banks that have decentralized the analysis and review of documents and finding the *discrepancies of external professional studios* offering to them an amount for each *found discrepancy*!

Also it is absolutely unacceptable the behavior of some banks that in a confirmed credit find *internal discrepancies less valuable* for making accreditation with reserve money in the account – *Subject to Final Payment* - thus not engaging minimally for confirmations of documents.

Discrepancies found from the bank of the exporter or importer, should be absolutely eliminated by replacing or correcting the documents, and then appear again, always within the time limit prescribed for filing the documents. When *discrepancies* are identified by the issuing bank, it will be difficult for the exporter to reach in time to replace the documents. Replacement of one or more documents may also be made many times, provided it is done within the time given by the letter of credit for the submission of documents. In such a situation it can be very important the speed at which the "Beneficiary" prepares the documents and its bank action in the examination of documents.

Normally in practice the bank notifies in a timely manner the "beneficiary" for *discrepancies* that are present in the documents, leaving the time needed to be corrected and/or replaced, but many times, it is the "Beneficiary" that does not use the service and the availability of his bank, as for the motives of low preparation, either for being superficial. Very often banks at the time of notification for *discrepancies* hear the answer from the exporter: "Send safely the documents to the foreign bank. That client has always paid!" or "You are very precise! Whatever, send the documents to the foreign bank, they have always paid!"

Bank guarantee in export operations

Fundamental differences of the bank guarantee with the "usual" letter of credit

"Usual" instrument of the letter of credit provides the engagement of a foreign bank to pay in the first or on a specific date, a certain amount, if beneficiary submits the required documents within the stabilized time limit. These documents must be in conformity with the requirements of the bank and they should be completed by applying

respectively *Same Rates and Uses* as Publication no. 500 of 1993 International Chamber of Commerce in Paris and updates from Publications no. 600 in July 2007, which makes all L/C irrevocable. With the issuance of the L/C, the issuing bank pays after the presentation of documents only and exclusively if these documents result in conformity with its commitment and is completely autonomous with the trade rapport between exporter and importer.

In the bank guarantee, the bank that issues the bank guarantee (importers bank) commits **irrevocably** to pay, without any exception the beneficiary (exporter) in direct connection with the introduction by the beneficiary of a simple statement. Normally this statement, but not necessarily is transmitted to the foreign bank through the bank of the exporter. In that it is declared the lack of payment within the time limit set by the principal obligor (primary obligor: client-importer). This operation is considered as an enforcement (*called at the trial or investigation*) of the bank guarantee by beneficiary. The difference between these two forms of payment lies in the fact that in the first case the commitment of the bank is "just" limited to documents that have been found in conformity, in the second case the bank intervention (hence its enforcement) is made only and exclusively in the case when obligor (importer) doesn't face his commitment to pay in a timely manner. This situation is not checked when the enforcement (*called at trial or investigation*) is done **fraudulently** and benefited by the exporter. In this case, the creditor, even though might be paying for the full or partial amount from the primary obligor, declares falsely to the foreign bank that he has not received the due amount, forcing the bank to make the payment. This becomes possible because the bank's commitment is autonomous, as by the ratio of debt, as well as from the contractual relationship between the parties. Finally, it can be said that the bank guarantee is a payment form with wider use in the European Community Countries, while the letter of credit finds a wider use at the international level.

Conclusions

Entry of Albanian businesses in the market economy, the process of internationalization, the growth of new trade relations with more distant places makes necessary knowing the *Same Rates and Uses* of the International Chamber of Commerce in Paris (ICC) and the Letters of Credit as main forms of International Payments. Knowing some of the practical aspects discussed in this study, it becomes even more necessary as a result of the presence and fundamental role of the Bank, and the manner of storage of information from the latter; contacts and trade exchanges with countries that have financial means and organizations, legislation and different norms in this field; using different languages, etc.. In Albania, there is a lack of information and data from relevant institutions on international trade exchanges of the Albanian businesses and details of forms of payment. Albanian businesses

currently are not informed and prepared, as well as Albanian banks due to their relatively short experience in these last two decades. Probably in the future these forms of payment will have a much wider use and it requires an increase of knowing and using them carefully to avoid many problems that these payments carry itself, and not to be prey of speculations and commercial frauds.

1. Incoterms were developed by the International Chamber of Commerce in Paris

(ICC) for the first time in 1936, and they were designed to ensure common understanding and uniform application of certain conditions of delivery used in different countries. In this way, operators of different countries with different legal aspects can be supported in the same, unique and authentic interpretive resources for the fair and equitable sharing of costs and risks arising in the delivery of goods. Current edition is that of the year 2000: "Incoterms 2000". Conditions were revised in 2000 (hence the name Incoterms 2000), while the last revision of the agreement was made in 2010 and entered into force on January 01st, 2011.

- 1.1. The purpose of Incoterms is to provide a set of international rules for the

interpretation of trade terms of the delivery of goods approved by operators around the world in order to eliminate the uncertainties due to different interpretations of such terms in different countries and to be applicable to

sales trade relations must necessarily be stated explicitly in the contractual agreement.

- 1.2. ICC publications are the work of joint committees and individual experts, covering the main

aspects of international business activities. Generally they relate to the guidelines and rules of the ICC, updated regularly to take account of technical developments and trends in international trade and banking practices.

2. It is the duty of the Albanian state to develop and adopt legal norms in order that

Albanian businessmen do not feel alone and unprotected, which together with the increase of financial means will make it even safe to use these new forms of payment.

3. Albanian businessmen need not only more transparent information from the

Albanian banks, but also direct assistance. A good cooperation between them will make them strongly determinant contractual partners.

4. Albanian Chamber of Commerce must provide as much updated information on

Incoterms 2000 and forms of payment, not only through various publications and direct training preparation of the Albanian business managers, but also from the operators of these businesses that have direct relationship with foreign markets.

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