

Availability – an educational document

lcviews.com receives many questions on how LCs issued subject to UCP 600 is made available (by payment, negotiation etc.) – and the consequence in that respect.

Disclaimer:

This purpose of the document is to provide guidance. There should be no legal imputation associated with it. It should be noted that the specific LC may be structured in a way which will provide a result different from what is stated here, just as local courts of law may reach a different result – on a specific case.

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1: The LC must state how it is available

UCP 600 sub-article 6(b) reads:

A credit must state whether it is available by sight payment, deferred payment, acceptance or negotiation.

This means that there are four ways by which an LC can be made available:

1. Sight payment,
2. Deferred payment,
3. Acceptance
4. Negotiation.

In addition to the above an LC can be made available with one or more banks in 3 different ways.

1. **With the issuing bank**

In which case presentation of documents must be made to the issuing bank.

2. **With a named bank** (nominated bank).

An LC available with a nominated bank is also available with the issuing bank, in which case presentation of documents must be made to either the nominated bank or the issuing bank.

3. **With any bank** (nominated bank)

An LC available with a nominated bank is also available with the issuing bank, in which case presentation of documents must be made to either the nominated bank (which in this case may be any bank that acts upon the nomination given by the issuing bank) or the issuing bank.

2: Availability defined

UCP 600 defines “*Honour*” and “*Negotiation*” as follows:

Honour means:

- a. *to pay at sight if the credit is available by sight payment.*
- b. *to incur a deferred payment undertaking and pay at maturity if the credit is available by deferred payment.*
- c. *to accept a bill of exchange (“draft”) drawn by the beneficiary and pay at maturity if the credit is available by acceptance.*

Negotiation means *the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.*

The UCP 600 distinguishes between *Honour* and *Negotiation*. A main principle is that issuing banks do not “Negotiate” – only a bank nominated by the issuing bank to negotiate can negotiate. The issuing bank honours.

3: Nomination

The concept of nomination is important in the context of availability. UCP 600 article 2 defines a “Nominated bank” as follows:

Nominated bank means the bank with which the credit is available or any bank in the case of a credit available with any bank.

In general terms a “*nominated bank*” acting upon its nomination is “protected” by the UCP 600. This means e.g. that a negotiating bank that has advanced funds to the beneficiary – and is subsequently not reimbursed by the issuing bank e.g. due to an injunction or stop payment order – would at the outset be able to successfully file a claim against the issuing bank. This is however outside the UCP 600 – hence subject to local law.

The obligation of the nominated bank depends on the agreement made between the nominated bank and the beneficiary. UCP 600 sub-article 12(a) reads:

Unless a nominated bank is the confirming bank, an authorization to honour or negotiate does not impose any obligation on that nominated bank to honour or negotiate, except when expressly agreed to by that nominated bank and so communicated to the beneficiary.

This provision may in fact be rather wide – and it is up to the nominated bank to decide what it is willing to do. This provision does not address the issue of “with or without recourse” – and such will also be subject to the agreement made with the beneficiary.

4: Availability described

Sight payment

An LC available by “*sight payment*” with a nominated bank is one where the nominated bank pays the beneficiary when a complying presentation is made.

The “classical” LC available by sight payment will grant the nominated bank access to the funds, either via an instruction to the nominated bank to debit the account of the issuing bank – or via a reimbursement instruction.

The principle is that the nominated bank does not assume any payment risk, as payment to the beneficiary is done simultaneously with the payment from the issuing bank to the nominated bank. However, the nominated still bear the risk of document examination (provided it pays of course) – i.e. must return the funds to the issuing bank if the issuing bank refuses to honour based on valid discrepancies.

Deferred payment

An LC available by “deferred payment” with a nominated bank is one where the beneficiary will receive funds after a fixed period of time (e.g. 60 days from shipment) or on a fixed date. According to UCP600 sub-article 7(c), an issuing bank undertakes to reimburse a nominated bank that has honoured a complying presentation and forwarded the documents to the issuing bank. The reimbursement is due at maturity, whether or not the nominated bank has prepaid before maturity. No drafts (bills of exchange) are to be used in deferred payment LCs. Only the bank nominated in the LC can prepay the funds to the beneficiary. Technically this can be “any bank” but normally it will be a bank named in the LC.

Acceptance

An LC available by “acceptance” with a nominated bank is one where the beneficiary will receive funds after a fixed period of time (e.g. 60 days from shipment) or on a fixed date. According to UCP600 sub-article 7(c), an issuing bank undertakes to reimburse a nominated bank that has honoured a complying presentation and forwarded the documents to the issuing bank. The reimbursement is due at maturity, whether or not the nominated bank has purchased before maturity.

The LC will call for a time draft presented together with the documents. Such draft will normally be drawn by the beneficiary on the nominated bank that is to accept it (a non-confirming nominated bank is not obligated to do so).

Consequently only the bank nominated in the LC can prepay the funds to the beneficiary. Technically this can be “any bank” but normally it will be a bank named in the LC.

The fact that the nominated bank does not accept the draft – does not change the issuing banks obligation to honour at maturity (see UCP 600 sub-article 7(a)(iv)).

Negotiation

An LC available by “negotiation” is one where an issuing bank nominates another bank to negotiate. Such nominated (also termed “negotiating”) bank is not obliged to negotiate unless it has confirmed the LC. When a bank negotiates then it purchases the complying documents and/or draftⁱ presented by the beneficiary from their own funds, i.e. they do not collect the funds from the account of the issuing bank before paying the beneficiary.

The “classical” negotiation LC would therefore not include any reference to claiming reimbursement from a reimbursing bank or a reference to the debiting of the issuing banks account. The LC would merely specify that the nominated bank must forward the documents to the issuing bank and upon the issuing bank ascertaining that the presentation is complying it will reimburse in accordance with the instructions received.

The UCP 600 does not distinguish between negotiation with or without recourse – except where it is a confirming bank – in which case the negotiation must be without recourse (UCP 600 sub-article 8(a)(ii)). The obligation of a non-confirming negotiating bank is based on UCP 600 sub-article 12(a) saying that:

“.. an authorization to ... negotiate does not impose any obligation on that nominated bank to ... negotiate, except when expressly agreed to by that nominated bank and so communicated to the beneficiary”

The above analysis attempts to follow the take on this by the ICC Banking Commission.

In practical terms many variations of the “*negotiation LC*” are identified. E.g. what is referred to as “*Asian negotiation*” – which normally is an LC available by negotiation, providing a reimbursing bank – i.e. allowing the negotiating bank to collect the funds from a third bank – as soon as the documents have been approved by the negotiating bank. This would mean that the negotiating bank has the option to pay the beneficiary at the same time they are collecting the funds from the issuing bank.

Although this may not be fully categorized as “advancing funds” – this is still within framework of negotiation, i.e. meaning that the issuing bank is obligated to honour a complying presentation.

On Negotiation Mr. T.O. Lee have said the following:

A generalized description of negotiation would be:

Negotiation is prompt payment against presented documents after deducting interest and negotiation commission upon the request of a beneficiary, whether authorized by the issuing bank or not (particularly in the Middle East and Asia), and against drafts and/or documents, with recourse, based on standard contract of banking services or banking facilities, except where the bank is a confirming bank, in which case it is without recourse.

*(Source: LC Monitor, Volume 6, Issue 6, November/December 2004
“Negotiation East –v– West”)*

5: Confirmation

In respect of the above one should also consider whether or not the nominated bank is also a confirming bank. In terms of the principles there is no real difference. The difference is that where a nominated (non-confirming) bank can choose not to act in accordance with its nomination – a confirming bank is bound by its confirmation, and must examine the documents presented, and if they comply must honour or negotiate (without recourse) depending on how the LC is made available.

6: Conclusion and recommendation

The above is perhaps one of the most debated and complex areas within the LC sphere. This is perhaps due to the diversity in practices that exist worldwide – not least within the regime of “local law” – where different jurisdictions will have different interpretations.

For that reason it is important that a bank that issues an LC carefully considers how such should be made available: It is highly important that the LC is very clear on the following issues:

- Where (place) is the LC available
- With whom (bank) is the LC available
- How is the LC available (*sight payment, deferred payment, acceptance or negotiation*)
- How/when is the nominated bank / reimbursed

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ⁱ The term "negotiation" is not originally an LC term - but one used for "negotiable instruments" e.g. cheques and bills of exchange. For that reason it may well be that in terms of local practices - perhaps even legalization it may be so that in order to "negotiate" one would need a negotiable instrument (e.g. draft/bill of exchange), BUT in terms of the UCP 600 you do not! You can "negotiate" the documents alone - and the position of the involved banks would (at the outset) be the same.