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A photograph showing the lower legs and feet of a person wearing a bright red jacket and black boots, walking on a frozen lake. The ice is blue and shows motion blur, suggesting the person is moving quickly. The background is a clear blue sky and distant land.

Is Turkey on thin ice?

Is Iran trade
worth the
risk?

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trade under
scrutiny

Telecoms:
emerging
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Will trade fit
the Basel II
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Demystifying China trade



Ravi Mehta speaks to Jia Hao, the financial product manager at Bank of China's Yang Zhou branch, about China's economic success and the use of letters of credit (LCs) to enhance it.

GTR: Why does China favour LCs for its international trade?

JH: From my experience of handling LC operations and frequent communications with Chinese traders, it is not difficult to find some considerations in Chinese traders' minds in choosing LCs as their mode of payment.

The first and main consideration is to seek safety and protection as Chinese traders always know that a letter of credit is a bank's credit instead of merchant's. This concept is deeply rooted in their minds. Thus, when they have a deal with a new client they usually favour an LC. China is a nation well-known for its great prudence. The second consideration is to obtain financing. A Chinese exporter with enough credit line with his bank may obtain financing in the form of a packing loan (a pre-loading short-term financing) against the LC held in



the possession of the bank, an export bill purchase against documents presented (better including a full set of negotiable transport documents as mortgage, even under collection), discounting of the drafts accepted by the issuing bank/confirming bank and forfaiting.

The different methods of financing require different levels of credit line. Among these kinds of export financing, only forfaiting operates without recourse except in the case of fraud. As to an export bill purchase against compliant documents under an LC, one thing should be mentioned: some banks distinguish it from negotiation whilst others do not, because until now there has been no legal definition of an export bill purchase under Chinese law. The controversial issue is whether payment by the nominated bank against some collateral under a mortgage or pledge agreement can be deemed as 'giving of value'. Therefore, before the concept of 'negotiation' is defined well, it is an open question whether the nominated bank making an export bill purchase under a mortgage or pledge agreement

long-established trade relationship.

However, if the importer is in a developing country and is not well known to the exporter, the exporter will be not be sure of its creditworthiness and will be reluctant to conduct business with them on OA terms. That is common sense.

However, in China OA is often mixed with advance payment, eg, upon receipt of the downpayment of 30% invoice value the exporter will get goods ready and effect shipment, then OA 30 or more days after the shipment date is used covering the left amount unpaid.

Of course there is still 100% advance payment and 100% OA with little proportion.

As a proportion of through transport (TT) payment including advance payment, OA and a mixture of advance payment and OA is the biggest, maybe 60-

Bank of China's Hao:

Some Chinese banks may be picky to find minor discrepancies for wilful document rejection where they fear non-reimbursement by the LC applicant

can be deemed as a qualified negotiating bank.

GTR: It is said that open account payment is not suitable for developing and transitional economies and that LCs are more suitable because they cover risks and that traders in low income countries may lack risk management knowledge and skills. Do you agree?

JH: Open account (OA) trading is most commonly applied in a situation where the exporter and importer trust each other with a

70%, in the export trade payment, and the remainder comprises of LC and documentary collections.

GTR: How did China acquire LC expertise when it started in international trade?

JH: As China became an open country, the need arose to acquire LC expertise by importing training services, attending LC seminars and meetings, translating LC rules, ICC opinions and authoritative books and so on.

So we can see now there are more and more Chinese bankers, scholars, lawyers, judges and traders who have acquired requisite expertise in LC operations and in LC law to keep up with the global LC process. Now I should proudly say China never lacks LC expertise.

GTR: Is LC training and learning in China trainer-assisted or computer-based?

JH: Both. In China, traders and bankers may acquire LC knowledge and expertise through online LC forums on some LC websites as well as through offline LC seminars and workshops, always organised by ICC China. Some authoritative LC experts such as Gary Collyer and Fung King Tak are often invited to give workshops.

GTR: Has LC-based international trade helped China accelerate its economic development?

JH: Yes, it has helped to provide Chinese traders with proper financing and comfortable security for payment. It is indispensable to China's booming economic development.

GTR: In low-income countries some banks take physical collateral for financing LC-based export trade. How about China: do its indigenous banks take physical collateral for issuing LCs and for financing LC-based export trade?

JH: As far as I know, an exporter who applies for trade financing under an LC must have a credit line with their bank which is enough to cover the open exposure. The credit line should be assessed and fixed by their bank in advance.

To obtain the credit line facilitating its trade financing, the exporter may supply proper securities to his bank such as the guarantee by a competent third party or the physical collateral.

Only very big companies with high creditworthiness and good financial standing may not be asked to provide such securities.

GTR: For financing exports do Chinese exporters use: back-to-back LCs, transferable LCs, red clause LCs, or bank finance against LCs as collateral?

JH: As far as I know, China's exporters except those in Hong Kong seldom request their banks to issue back-to-back and transferable LCs in favour of the true manufacturer. However, they are not reluctant to accept back-to-backs and transferable LCs as the second beneficiary.

Chinese banks like ours will advise them of the disadvantages and risks involved in the operation of transferable LCs. With a transferable LC the exporter will be in a little more difficult position to apply for a packing loan.

As to red clause LCs, I rarely encounter them, maybe because an importer's bank is reluctant to issue or maybe China's exporters are not familiar with them.

GTR: For post-shipment financing do Chinese exporters use negotiation of compliant documents presented under LCs or assignment of LC proceeds?

JH: For post-shipment financing, our bank usually supplies an export bill purchase service for post-shipment financing. If the purchasing bank fails to receive the payment from the issuing bank, it may claim repayment from the exporter. If repayment

fails, it may have recourse to the collateral.

For example, in our bank in the contract of export bill purchase there is a condition that the bank will have recourse to the collateral in which it has acquired interest under any applicable law. I understand that in China few banks want to negotiate, as the negotiating bank in the LC, the compliant documents without acquiring any security interest in the collateral provided by the exporter/beneficiary.

GTR: If a Chinese exporter has an irrevocable confirmed LC does he still need to use credit insurance?

JH: Export credit insurance has not been very popular in China for long. But from 2001, with the establishment of China Export & Credit Insurance Corporation (Sinosure) by merging the export credit insurance departments of both PICC (People's Insurance Company of China) and The Export-Import Bank of China (China Ex-Im Bank), more and more exporters have come to realise the importance of export credit insurance and have found benefits brought by it.

As to credit insurance under LCs, there is a specific product under export credit insurance categories called LC insurance, which covers commercial and political risks under LC payment terms. As far as I know, an exporter having a confirmed LC may be reluctant to apply for LC insurance where confirmation is done by a reputed bank.

GTR: Is export financing by banks federally administered?

JH: As far as I know there is no central administration of export financing.

GTR: China is involved in so

many LC disputes. What steps is it taking to minimise documents rejection, disputes and delays?

JH: LC disputes are not due to Chinese bankers' lack of expertise of LC operations. With many seminars and training classes held by some well-known LC experts in China, Chinese bankers and traders are supplied with good opportunities to have a deeper understanding of LC operations and to be more familiar with relative international rules, ICC opinions and legal cases.

The higher rate of passing the CDCS exam than the world average rate also evidences Chinese bankers' qualifications and competence.

Disputes arise between the issuing bank and applicant when the applicant fails to reimburse and the issuing bank lacks collateral.

China's banks are now attaching more importance to reviewing applicants' financial standing and collateralisation. China has improved its document examination practice as well to reduce international disputes over discrepancies.

The ICC's International Standby Practices (ISBP) is very helpful in examination improvement and in document rejection reduction and resultant dispute reduction. However, some Chinese banks may be picky to find minor discrepancies for willful document rejection where they fear non-reimbursement by the LC applicant.

But this phenomenon is not unique to China. Where there is no dispute between the buyer and seller under the sales contract there is definitely no real dispute among the applicant, issuing bank and beneficiary.

GTR: What are the most

common discrepancies China finds in export documents received under LCs from abroad?

JH: In my experience, these are:

- Maturity cannot be established from the data in the draft itself (based on ISBP 645).
- When the LC requires a full set of insurance documents, more than one insurance document presented fails to indicate the number of originals.
- When the LC requires a certified copy of shipment advice, a copy of shipment advice presented shows no original signature, mark, stamp or label for the purpose of certification. Instead, the wording of the copy advice is "we certify that the shipment details are listed as follows...".
- When the LC requires a FCR (forwarder's cargo receipt) indicating the date of receipt of cargo, the FCR presented usually indicates the shipment date instead of the date of receipt of cargo.
- Inconsistency among documents.

GTR: What are the documents unique to China that its banks usually stipulate?

JH: Our bank's LC calls for normal documents including commercial invoice, packing list, transport documents, insurance documents if applicable, certificate of origin, copy of shipment advice, beneficiary certificate certifying one set of non-negotiable documents have been sent to the applicant within xxx days after shipment. The document deemed a little unusual may have the requirement certified copy of shipment advice because a copy which is certified with an original signature, stamp and so on as per UCP500 article 20(d) will be deemed as an original according to ICC's policy. A little bit tricky.

GTR: What are the most common errors in LCs issued by China? What steps is China taking to improve its LC issuance and delivery practice?

JH: LCs issued by our bank

may be improved in the following ways:

- By avoiding the use of slash '/' when stipulating documents as it has an indefinite meaning.
- By stipulating presentation within xxx days after shipment date but within the LC expiry date rather than after 'presentation within xxx days after issuance date of bill of

Competition and cooperation between indigenous and foreign banks has become the hot issue in the Chinese financial community

loading or bill of lading date'.

- When to stipulate insurance documents, to mention 'full set'.
- The disclaimer clause as the similar wording: '...upon receipt of applicant's waiver prior to your contrary instructions we will release the documents to the applicant without any responsibility...' will be more watertight by emphasising that the release must be at the issuing bank's sole judgment.

GTR: What language does China use in its LC banking – Chinese or English? Does China have UCP in its native language?

JH: China has its own LC rules in Chinese for domestic trade. It is fashioned as per UCP but is quite different from the UCP. China has the Chinese version of UCP500 and other ICC rules such as ISBP and ISP.

GTR: Does China use silent confirmation?

JH: Few Chinese banks use silent confirmation, considering the great risks involved. However, with the use of it by many foreign banks China's set out to use it as a kind of financing. But they have to review the whole process of silent confirmation, especially some operational details, and assess the balance of benefits and risks involved before they have involvement in silent confirmation.

GTR: How has China mechanised its practices of LC issuance, LC delivery to foreign beneficiaries, LC advising/confirmation, LC payment/reimbursement?

JH: I think all Chinese banks use Swift and computers. The internet is not used for the conduct of LC operations.

GTR: How are costs/fees of LC services determined? Do banks have the freedom to fix costs?

JH: Cost determination depends upon a bank's internal rules. The banks have the freedom to fix costs and fees. Thus, LC service charges are competitive.

GTR: Do Chinese consumers of LC services prefer indigenous or foreign banks? How do indigenous banks compete with foreign ones?

JH: Competition and cooperation between indigenous and foreign banks has become the hot issue in the Chinese financial community. Both indigenous banks and foreign banks have their own advantages. The most important advantage of indigenous banks is their history. Many traders have a long relationship with their indigenous banks. Also, they have their credit facilities from Chinese banks, without which they find it hard to do business. Another thing that should not be ignored is that indigenous banks have so many branches which provide customers with great service and convenience. However, foreign banks have distinct advantages such as ample capital, advanced management levels, more competitive marketing skills, high level globalised services and detailed but user-friendly operational procedures. Generally though, now much

more Chinese consumers of LC services prefer indigenous banks.

GTR: Do applicants (buyers) interfere in or influence banks' document examination practices?

JH: I regret they will sometimes, but more exactly seldom. But at least in Bank of China we take efforts to avoid this bad practice and insist on the LC's independence. With the popularisation of UCP Chinese banks and courts have realised the importance of adhering to, instead of interfering in, the rules of LCs.

GTR: What currency does China mainly use in its import LCs? What methods are used to hedge foreign exchange risks in LC transactions?

JH: US dollar. Usually we select two ways to hedge foreign exchange risks. First, doing financing to advance funds so as to avoid the foreign exchange fluctuation at maturity. Second, doing a forward transaction of foreign exchange to avoid foreign exchange risks and fix foreign exchange costs.

GTR: Do Chinese exporters outsource LC documentation to freight forwarders? Do freight forwarders have a significant role in trade?

JH: Yes, in China freight forwarder services are popular, but the relative law is not good as in the US and UK. Freight forwarder services are supplied within the whole chain of international trade such as goods storage, goods package, container consolidation, goods insurance, customs clearance and so on. No doubt, they are very important.

GTR: What are the most common Incoterms on Chinese import LCs and why?

JH: Cost, insurance and freight (CIF); free on board (FOB); cost and freight (CFR), as most international trades are involved in marine transport. But among CIF, FOB and CFR it is hard for me to say which is most common.