

Soh Chee Seng, Technical Advisor to the Association of Banks in Singapore

Trade vs Development

What are the role and problems associated with letters of credit (LCs) and trade finance in low-income countries? Ravi Mehta talks to LC and trade finance specialist Soh Chee Seng, who is Technical Adviser to the Association of Banks in Singapore. Soh plays a vital consultancy role in trade finance management functions of banks in Asian economies.



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GTR: Economists say that for low-income countries, international trade and its financing are requisites for economic development. Should international trade finance by indigenous banks be administered by the country in order to regulate and ensure its use for planned economic development as a political objective?

SCS: Instead of being administered by the country, international trade finance by indigenous banks should be supported by the authorities with an incentive to encourage its use for planned economic development in low-income countries. One of the examples is to provide tax incentives or interest rate subsidies for export and pre-export finance.

GTR: Letters of credit (LCs) may be suitable for low-income countries for their international trade. But we see a high percentage of discrepant presentations and undue document rejections. Is an LC practically helpful in international trade promotion for economic development acceleration? How can trade documentation in low-income countries be improved?

SCS: An LC is used only when an exporter requires a financial

institution to secure a payment on behalf of the importer. It is suitable for all countries. LCs may not be required when the exporter trusts its buyer/importer's integrity and financial ability. LCs used in low-income countries are more for foreign exchange control purposes. They provide an assurance that the foreign exchange has been approved by the authority when the LC is issued.

The high percentage of discrepant presentations is mainly due to a lack of knowledge in document preparation. This has not only happened in low-income countries, but also in some high-income countries. I believe the LC is still practically helpful in international trade although the system may sometimes be abused.

To improve trade documentation, the parties concerned must be aware of the international standard banking practice for LC operations. Banks and ICC national committees, if any, may provide training for their clients or members.

GTR: Is the International Standard Banking Practice (ISBP) helping to minimise document rejection and to

minimise overdue export payments?

SCS: The ISBP may help to minimise document rejection and as a result may minimise any overdues.

GTR: How can low-income countries prevent/fix the problem of overdue export payments?

SCS: Discrepant presentation may be used as an excuse to refuse or delay payment by the importers or the issuing banks. Overdue export payments to low-income countries are mainly due to wrong shipment, or poor quality of the products exported from the low-income countries. To prevent the problem of overdue export payments, other than presentation of non-discrepant documents, exporters from low-income countries should ensure that goods are shipped in accordance with the requirements in the sales agreement.

GTR: LCs can serve the purpose of collateral. Still there is a tendency to obtain physical collateral in low-income countries for pre-shipment and post-shipment financing of international trade. Is physical collateral necessary? Physical collateralisation may be a deterrent to some exporters.

SCS: Banks may require physical collateral for pre-shipment financing but not for post-export financing. The exporter may not be able to deliver or produce the goods as required in the LC after it obtains pre-shipment financing from its banker. With the exception of standby LCs favouring the financing bank, commercial LCs cannot serve the purpose of collateral as it is good for payment only on condition that the terms and conditions of the LC are complied with.

The negotiating bank may not

be reimbursed by the issuing bank if the documents are discrepant. Banks do not require physical collateral to provide post-shipment finance if compliant documents are presented and the LC is confirmed or issued by a reputable and financially strong issuing bank.

GTR: If an LC is irrevocable and confirmed should LC-based trade finance still be credit insured? Is credit insurance a necessary evil?

SCS: It would only be fair to the export credit insurance company if all exports, including LC-based exports, from its client are insured. No one would run the credit insurance business if only exports that are considered high risk are covered.

GTR: International traders in low-income countries lack UCP knowledge. How does one promote UCP knowledge and its use in low-income countries?

SCS: Banks and ICC national committees, if any, in low-income countries play an important role to promote UCP knowledge. However, it would also depend on the education level of the people in low-income countries. As most traders in low-income countries are not well educated, banks may also have difficulty in promoting UCP knowledge or training their customers.

GTR: LCs issued from low-income countries, for imports for economic development purposes, may be erratic, restrictive and bulky with so many documentary conditions, some of which may be the requirements of statutory trade regulations. Delivery of LCs to beneficiaries may not be expeditious. How can one improve LC practice in the low-income countries in terms of efficiency, error-elimination and

Interview

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documentary conditions reduction?

SCS: I don't think we can help to solve the problem if it is the requirement of a government authority. It may help to improve the conditions if importers in low-income countries agree that these bulky documents are to be forwarded directly by exporters to importers outside LC terms.

GTR: Are low-income countries artful in finding or fabricating

import training. I agree that training should be part of development programmes in low-income countries. In most, the government provides grants or skills development funds to subsidise training costs.

GTR: Should low-income countries set up indigenous ombudsmen for resolving LC payment disputes in a more cost-effective manner? Is Docdex suitable for low-income countries?

are from high-income countries or low-income countries. UCP revision will take care of the needs, aspirations and problems of all countries in LC operations, if possible. I always believe that any requirement in the UCP can still be specified as part of the terms and conditions in the LC from low-income countries. The objective of UCP revision is to make the rules more up to date and easy to understand.

more suitable for developing economies: indigenous LC specialists or immigrant ones?

SCS: Whether the approach is right or wrong, it all depends on the actual problem faced by the developing economy. If the country is really lacking LC specialists, it would be right for the country to import LC specialists. However, the country must also have a policy or plan to train its own local specialists.

GTR: In developing economies foreign trade finance banks may also operate. Are these banks easily accessible and affordable to indigenous small exporters in particular? Do they show real concern for local economic development or are they manifestly concerned with only repatriation of profit? If there is competition between indigenous banks and foreign banks in a developing economy, is the competitive environment conducive to indigenous economic development?

SCS: Although foreign banks may operate in developing economies, there are often restrictions imposed by the central bank for foreign banks to deal with small enterprise. But in some developing countries, ie, Malaysia, foreign banks are easily accessible and affordable to indigenous small exporters. Foreign banks may be concerned with only repatriation of profit, but their contribution to local economic development must also be recognised. They bring in expertise and also create employment. If there is competition between indigenous banks and foreign banks, it will force indigenous banks to improve their services and staff quality to compete with foreign banks.

In Southeast Asia, most senior management staff including LC specialists are trained in foreign banks and subsequently employed by indigenous banks. The competition is conducive to indigenous economic development.



discrepancies? How do you improve document examination practices?

SCS: No. If this is the case, documents from low-income countries would have fewer discrepancies. I have seen similar problems from banks in high-income countries; the banks just find fault with documents to refuse payment, as their applicant-customer has financial problems. The problem in low-income countries is mainly a lack of UCP knowledge.

GTR: Should low-income countries develop indigenous LC/trade finance training skills or outsource or import training? Should training be a part of government trade promotion policy and be funded by state grants?

SCS: If they have the resources, they can develop their own training skills but I am doubtful. They may also find it too costly to outsource or

SCS: They may not have the resources to set up indigenous ombudsmen for resolving LC disputes. Docdex is more cost-effective and suitable for them.

GTR: Low-income countries are seen as the main users of LCs, but in UCP formulation, developed countries are more involved, which use more open account methods. Hence some say that developed countries' advice in UCP formulation may not be in the interest of developing countries. What is the objective of UCP revision? Should low-income countries have a national law for LCs?

SCS: Although the UCP drafting group members are mainly from developed countries, members will consider comments and views received from members of the Consultative Group and all national committees. There will not be any discrimination as members will not differentiate whether the views or comments

I don't really think that banks in Asia prefer 'negotiation' credits. If this is true, why is it that more than 80% of banks in Asia do not actually negotiate a 'negotiation' credit? They effect payment to the beneficiary only after they receive payment from the issuing bank. For what I know, lawyers from the west prefer to keep 'negotiation' in the new UCP revision. Some developed countries do not have a separate national law for LCs. I don't think it is necessary to have that in low-income countries. LCs could be viewed as an agreement and all parties concerned are bound by the terms and conditions specified therein.

GTR: Some developing economies, the Middle East for example, may import LC specialists, possibly as part of a trade development policy. Is this approach right for economic development purposes? What is ultimately