

THE CONTENT OF DOCUMENTARY CREDIT AS A BANK INSTRUMENT THAT CAN ENSURE SECURITY FOR BOTH BENEFICIARY AND APPLICANT

Finny Redjeki¹, Vip Paramarta², Sudi Rahayu³, Muhammad Rizki Fauzi⁴

^{1,2}Sangga Buana University Bandung, ³STIE Ekuitas Bandung,

⁴Telkom University Bandung, Jawa Barat, INDONESIA.

sudi_rahayu@ekuitas.ac.id

ABSTRACT

This study aims is to ensure security documentary credit payment method between using 'with' or 'without' DC and contents. This research is a qualitative study and data collection using literature studies. The results of this studies are the bank will honour the DC payment so long the condition of the presented document by the beneficiary have been complied with DC terms and conditions (Complying Presentation). There are 7 (seven) points contain in the Documentary Credit : 1) Promise to pay ; 2) Payment Obligation Substitution; 3) Complying Presentation; 4) Payment Tenure; 5) Parties ; 6) Time ; 7) Terms and Conditions. They can ensure security for both beneficiary and applicant and mitigate the risk as well as to give security assurance in complying their right and obligation.

Keywords: Documentary Credit, Irrevocable DC, Issuing Bank Undertaking, Content of Documentary Credit, Complying Presentation.

INTRODUCTION

There are 2(two) ways of payment methods in international trade, they are: 1) 'Without DC' and 'With DC' Payment Method. A few of Without DC Payment Methods are Advance Payment, Open Account and Consignment, Collection, etc. Usually industrialists use 'Without DC' payment method because cheaper, easier, and simpler but actually risky. The payment that solely lies on trust for both applicant and beneficiary is called the payment 'without DC' where the written undertaking is given by the applicant to the beneficiary whilst payment using DC ('with DC') is considered relatively more secured than 'without DC' for the (issuing) bank will undertake the payment. DC payment method refers to the rule of *International Chamber of Commerce (ICC) that is the Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No.600. (latest version)*. The method is subject to UCP latest version will give security to all parties involved in the transaction for it must not deviate from international custom agreed especially when dealing with dispute so that we can work out to resolve the problem for there is an agreed reference.

LITERATURE REVIEW

The Uniform Customs and Practice for Documentary Credit (UCPDC)

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No.600. ("UCP") article 1 – stated that

"The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No.600 ("UCP") are rules that apply to any documentary credit ("credit") (including, to the extent to which they may be applicable, any standby letter of credit) when the text of the credit expressly indicates that it is subject to these rules. They are binding on all parties thereto unless expressly modified or excluded by the credit."

It shows that any DC issued should clearly state that it subject to UCP, ICC Publication No.600.

2.2. Documentary Credit (DC)

Based on the *Uniform Customs and Practice for Documentary Credits, Revision 2007, Publikasi ICC No.600 ("UCP) Article 2* it is stipulated that :

“Credit means any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking of the Issuing Bank to honour a Complying Presentation.

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 Beneficiary and pay at maturity if the credit is available by acceptance.”*

According to UCP 600 article 2 and article 3, it is stipulated that :

“ A credit is irrevocable even if there is no indication to that effect”.

UCP 600 has clearly given a protection to beneficiary that every single Letter of Credit issued must be “*IRREVOCABLE*”.

The Issuing Bank and Issuing Bank Undertaking

Issuing Bank

The Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No.600. (“UCP) article 2 – stated that

Issuing bank means the bank that issues a credit at the request of an applicant or on its own behalf.

Issuing Bank Undertaking

Based on the *Uniform Customs and Practice for Documentary Credits, Revision 2007, Publikasi ICC No.600 (“UCP) Article 7* it is stipulated that :

- a. *Provided that the stipulated documents are presented to the nominated bank or to the issuing bank and that they constitute a complying presentation, the issuing bank must honor if the credit is available by :*
 - i. *Sight payment, deferred payment or acceptance with the issuing bank;*
 - ii. *Sight payment with nominated bank and the nominated bank does not pay ;*
 - iii. *Deferred payment with a nominated bank and that nominated bank does not incur its deferred payment undertaking or having incurred its deferred payment undertaking does not pay at maturity ;*
 - iv. *Acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted draft drawn on it, does not pay at maturity ;*
- v. *Negotiation with a nominated bank and that nominated bank does not negotiate.*

- b. *An issuing bank is irrevocably bound to honour as of the time it issues the credit.*
- c. *An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank, reimbursement for the amount of a complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity. An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary.*

Irrevocable Documentary Credit (DC)

There are two types of DC according to its form, they are:

Revocable DC

Revocable DC is the DC that can be cancelled anytime by one party without having approval of the parties involved (*beneficiary, applicant, issuing bank and or confirming bank if any*) (Finny Redjeki, 2012).

Irrevocable DC

Irrevocable DC is the LC which cannot be cancelled by one party. Cancellation, however, can be proceeded so long there has been an approval either from *beneficiary, applicant, issuing bank and or confirming bank if any* (Finny Redjeki, 2012).

Complying Presentation

According to *Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No.600 ("UCP")*, the understanding of Complying Presentation can be found in the article 2 stating as follow:

Complying Presentation means a presentation that is in accordance with the terms and conditions of the credit, the applicable provisions of these rules and international standard banking practice.

The UCP article relating to Complying presentation other than article 2 is article 15 stating that: *Complying Presentation,*

- a. *When an issuing bank determines that a presentation is complying. It must honour.*
- b. *When a confirming bank determines that a presentation is complying. It must honour or negotiate and forward the documents to the issuing bank.*
- c. *When nominated bank determines that a presentation is complying and honours or negotiates, it must forward the documents to the confirming bank or issuing bank.*

METHODOLOGY

This study is a qualitative study with data collection using literature studies about Documentary Credit.

FINDING

Documentary Credit is "a conditional written undertaking" issued by issuing bank of the applicant request to the beneficiary through correspondent bank, to effect payment on the

agreed period of time and is payable with the following condition that “beneficiary is obliged to complying presentation”.

In the Payment method with DC, there are 7 (seven) points contained in the Documentary Credit, they are:

Promise to Pay

When payment without *Documentary Credit* is effected, the *applicant* is the party responsible to settle payment, however, when payment involving *Documentary Credit* is effected, the *Issuing Bank* will be the party responsible to settle payment. With DC payment method, The issuing Bank is held responsible to effect payment as of the time so long beneficiary is able to Complying Presentation. With DC payment method, beneficiary can procure his right (the right of beneficiary is getting payment while beneficiary’s obligation is delivering goods timely). Promise to pay from Issuing bank give a definite payment to beneficiary with a definite reason.

Payment Obligation Substitution

With DC payment method, there is a payment obligation substitution which is normally done by the *applicant* and is now transferred and effected by *Issuing Bank*. Therefore by using DC as a payment method will release the *applicant* from settling the payment directly as this is now effected by the *Issuing Bank*. Payment Obligation substitution can ensure security for beneficiary and getting beneficiary’s right (getting payment).

Complying Presentation

Documentary Credit also describes how the payment can be effected so long the beneficiary is able to comply presentation (*Complying Presentation*). It is the payable condition that payment can be effected using *Documentary Credit* by bank. *Beneficiary* is obliged to comply presentation to get the payment.

Payment Tenure

Other content of the DC is explaining the term of payment available. The payment in the DC can be divided into 2 (two), they are :

Sight Basis as a sight DC

Sight Basis as a sight DC is a DC that is payable as soon as the required documents have been presented (complying presentation)

Usance Basis as a time DC

Usance Basis as a time DC is a DC that is paid a fixed number of days after shipment or presentation of documents.

DC payment method, provide the term of payment as applicant’s capability.

Parties

The payment method using DC involve several parties, such as : 1) Applicant; 2) Beneficiary; 3) Insurance Company ; 4) Transportation and shipping company ; 5) Government Bodies involved; 6) Bank, There are several banks involved when DC is used in the trade, they are 6.1) Issuing Bank; 6.2) Advising Bank; 6.3) Nominated Bank; 6.4) Confirming Bank; 6.5) Negotiating Bank; 6.6) Reimbursing Bank ; 6.7) Drawee Bank; etc.

Parties in the DC payment method which give protection for delivering appropriate goods by beneficiary to applicant as sales contract and give an easiness payment.

Time

Time in this context is limitation of time (date) determined in the DC issued which should be obeyed by the related party(ies) involved. There are 4 (four) time/ dates in the DC that become a reference, they are:

1. Issuance Date is the date of DC is issued.
2. Expiry Date is the date of DC expires
3. Latest Shipment Date.
4. Latest Presentation Date is the date of the latest presentation of documents by *Beneficiary Bank* to *Negotiating Bank/ Nominated Bank* and the latest presentation date is determined by Presentation Period, that is the delivery of documents pre-requisites in the DC terms that should be fulfilled.

Time in the DC ensure security to beneficiary on preparing shipment and doing shipment as the sales contract. Time is not only for beneficiary but also available for applicant to accommodate time limits that have to be fulfilled.

Terms and Conditions

The comprehension of terms and conditions here is that any DC issued must be subject to Uniform Customs and Practice for Documentary Credits, Revision 2007, Publication ICC No.600 (“UCP”). UCP 600 article 1 clearly explains that any Documentary Credit issued should clearly indicate that the credit is subject to UCP and should bind all parties in accordance to regulation of the valid UCP.

The Credit that is subject to UCP latest version will give security to all parties involved in the transaction for it must not deviate from international custom agreed especially when dealing with dispute so that we can work out to resolve the problem for there is an agreed reference.

CONCLUSION AND LIMITATION

The 7 (seven) Content of DC on DC Payment Method minimized potential risk at the international trade transaction. There are: 1) Promise to Pay; 2) Payment Obligation Substitution; 3) Complying Presentation; 4) Payment Tenure; 5) Parties; 6) Time ; 7) Terms and Conditions that can ensure security for both beneficiary and applicant.

To ensure security for both beneficiary and applicant, they must fulfill their obligations to reach their rights.

REFERENCE

- [1]. Business Dictionary. *Deferred Payment Letter of Credit (L/C)* [Online]. <http://www.businessdictionary.com/definition/deferred-payment-letter-of-credit-L-C.html#ixzz3wBEYbMae> [29 December 2015].
- [2]. International Chamber of Commerce. (2007). *The Uniform Customs and Practice for Documentary Credits (UCPDC) 2007 Revision*. Jakarta: ICC Indonesia.
- [3]. Investopedia. *Sight Letter of Credit* [Online]. <http://www.investopedia.com/terms/s/sightletterofcredit.asp> [29 December 2015].
- [4]. Letter of Credit. *At Sight Letter of Credit*[Online]. http://www.letterofcredit.biz/at_sight_letter_of_credit.html [29 December 2015].
- [5]. Letter of Credit. *International Standard Banking Practice - 2013 Edition* [Online]. http://www.letterofcredit.biz/isbp_2013.html [29 Desember 2015].
- [6]. Letter of Credit. *Parties to Letter of Credit* [Online]. [http://www.letterofcredit.biz/Parties to Letters of Credit.html](http://www.letterofcredit.biz/Parties_to_Letters_of_Credit.html)[29 December 2015].
- [7]. Letter of Credit. *Risks in Letter of Credit* [Online]. [http://www.letterofcredit.biz/Risks in Letters of Credit.html](http://www.letterofcredit.biz/Risks_in_Letters_of_Credit.html) [29 December 2015].
- [8]. Letter of Credit. *URC 522 - ICC Uniform Rules for Collections*[Online].[http://www.letterofcredit.biz/URC 522.html](http://www.letterofcredit.biz/URC_522.html) [29 December 2015].
- [9]. Letter of Credit. *URR 725 - The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits - ICC Publication No. 725* [Online]. [http://www.letterofcredit.biz/URR 725.html](http://www.letterofcredit.biz/URR_725.html) [29 December 2015].
- [10]. Redjeki, Finny. (2012). *Surat Kredit Berdokumen Dalam Negeri (Local DC)*. Bandung: CV. Septatech.