

## DOCUMENTARY CREDIT AS A BANK INSTRUMENT THAT CAN PROVIDE PAYMENT ASSURANCE FOR EXPORTER

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### ABSTRACT

*This study aims to provide assurance that the secured payment procedure for exporters in export transaction activities is by using Documentary Credit as a Bank instrument (With DC Payment Method).*

*It uses descriptive qualitative research method which was obtained through collecting the observed data, interview and literature study. The results of this study can be concluded 1) DC as a banking instrument in export transactions provide payment assurance for exporters the fund to settle the export transactions payment have been secured in the Issuing Bank in addition to the availability of export financing facilities; 2) The payment assurance using DC instrument is seen more beneficial by comparing two payment procedures, they are 'With DC and Without DC', where: a) With DC, the party who undertake the promise to pay is Issuing Bank, while Without DC, the party who undertakes the promise to pay is Applicant / Importer; b) in 'With DC' there is a certainty of "conditional" payment for exporters from the bank in which the term for the payment to be paid for export transactions using DC are "complying presentation" while in 'Without DC' other than Advance Payment with 100% payment upfront, it does not provide assurance or certainty of payment for the exporter thus it still carries 'default' for the payment made is settled on trust basis alone;*

**Keywords:** Documentary Credit, Usance DC Mechanism, Sight DC Mechanism, Complying Presentation

### INTRODUCTION

In international trade transactions, there are two wishes and expectations that must be met, they are the wishes and expectations of the beneficiary / seller / exporter and the wishes and expectations of the applicant / buyer / importer. The exporter's wishes and expectations are to receive payment in accordance with the agreed contract while in the other hand the wishes and expectations of the importer is to receive the goods on time and in accordance with the agreed contract. Both interests can be achieved by minimising the potential risk if there is a third party who is capable of bridging these two interest, that is the bank. The existence of a bank in a country provides a function as a "Financial Intermediary Institution" apart from being 1) the Agent of Trust; 2) the Agent of Development as well as 3) the Agent of Services. Its existence in international trade transactions is acting as an intermediary between those two parties in terms of service and financing to smoothen global economic transactions among countries which will eventually provide a multiplier effect in the economy of the country. The Bank shall protect the interest of exporter or importer whereby both shall perform their respective obligations to obtain their rights.

The obligation of the exporter is to deliver the goods in accordance with the agreed contract which must clearly be readable in the document that the goods delivered are correct and as expected. The documents that have been complied with terms and conditions on the DC becomes the basis for the Bank to settle payments to exporters.

The documents that conform to the terms and conditions in DC becomes the basis for the Bank to settle the payments to exporters. The Bank only deals with documents, not goods. Therefore, in order to control that the goods have been complied with, it is necessary for the Importer to appoint parties in the exporting country to check the goods in which the checking evidence must be embedded on the required documents. Thus the parties who issue documents are trusted parties such as Department of Industry and Trade who will issue Certificate of Origin (of Goods), Shipping Company who will issue document of Bill of Lading, Surveyor, Customs and Excise etc where such documents required in DC and must be met by the exporter. If all the obligations required in DC have been met by the exporter by presenting all documents that are in compliance with DC terms and conditions, the Bank will settle the payment, in other words if all obligations are met the exporter will receive his right that is "to receive payment".

Similarly for the importers, the obligation is to settle the payment, therefore the requirement in executing import transactions using DC ('With DC') is that they must provide Cash Collateral or cash as a security in the bank worth 100% of the DC values to be issued. Therefore, the payment method using DC is deemed to be secured for the exporters, since the payment fund has been secured by the bank who guarantees the payment to the exporters as long as they can perform their obligation of complying presentation. If the importer's obligation has been fulfilled, he shall be entitled to receive his right, that is to receive goods on time in accordance with the agreed contract that must be readable on the document presented. In Indonesia, it is important to maintain the export transactions made to obtain the payment for there have been export transactions that did not receive payment and affected the losses for either the exporters or the country. It is, therefore, necessary for the global market players to understand on the importance of the secured international trade payment procedure.

## **LITERATURE REVIEW**

### **Credit Documentary Definition**

Based on the UCPDC the definition of Documentary Credit or referred to as "Credit" under UCP 600 Article 2 states as follows:

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 the beneficiary and pay at maturity if credit is available by acceptance.

### **Documentary Credit Type**

The types of Documentary Credit (DC) are distinguished by: a) The form in general, b) Payment period and, and c) Particular characteristic (Finny Redjeki, 2012).

The types of Documentary Credit are as follows:

#### **DC Type Based On Its Form in General**

In general the form of Documentary Credit is divided into 2 (two) types, these 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).

## Irrevocable DC

Irrevocable DC is the DC 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.

## Types of DC Based on Payment Term

Based on payment term the DC types are divided into 2 (two), they are:

Sight DC (DC at sight) is a DC in which the payment is made by a Bank (Nominated Bank and Issuing Bank) upon 'complying presentation documents' are received or at sight at the time specified in DC. In other words, Sight DC is a DC in which the payment is settled when draft and other required documents have been sighted and have conformed to the DC term and conditions (Complying presentation).

Usance DC is a DC which payment is settled by the Bank (Nominated Bank and Issuing Bank) upon maturity date or upon draft acceptance. The term of Usance DC is no longer than 180 days. In other words, Usance DC is a DC which payment is settled upon acceptance of the draft and or upon maturity of the draft.

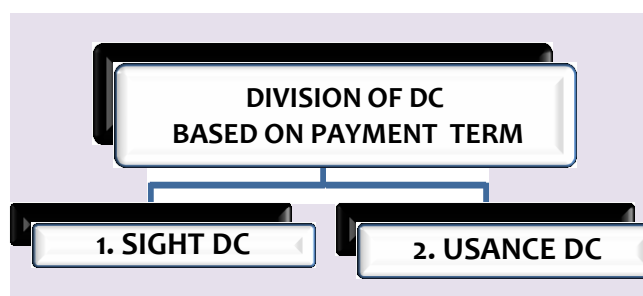


Image 1. The division of DC Types Based on Payment Term

In practice there is a DC scheme which is a combination of Usance and Sight DC type called UPAS DC (DC Usance Payable At Sight Basis), which is a term DC (USANCE DC) in which the payment can be made at SIGHT BASIS.

## Types of DC Based on its Particular Characteristic

The types of the DC based on particular characteristic varies and are a combination of some DC characteristic, for examples: Transferable DC, DC Back, Irrevocable Transferable DC, Revocable Transferable DC, Red Cluses and so on

## Documentary Credit Mechanism

The Documentary Credit Mechanism is differentiated based on payment term and consists of 2 (two) types of mechanisms, these are: a) Sight DC Mechanism, and b) Usance DC Mechanism.

Between these two mechanisms, the striking difference is that in Usance DC there is an acceptance process prior to settling the payment.

The acceptance process is a payment approval process at maturity by Issuing Bank, with a nominal value is in accordance with the value of the billed draft.

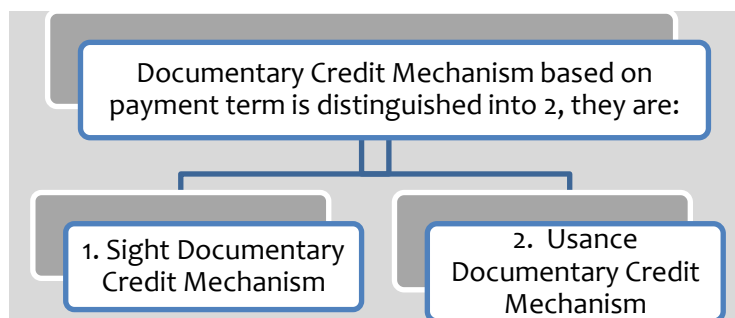


Image 2. Type of Documentary Credit Mechanism based on the Term of Payment

## METHODOLOGY

This research uses descriptive qualitative research method which is done by collecting observed data, interview and literature study.

## FINDINGS

The payment procedure using DC ('with DC') is a secured payment procedure for the exporters because:

1. There is an assurance of certainty of receiving "conditional" payment. Conditional means that the exporter will receive payment as long as he implements his commitment of presenting all documents in accordance with DC terms and conditions to the Bank or so called Complying presentation.
2. The one who undertakes to pay is Issuing Bank and not applicant (importer). Therefore, in the case of DC issuance, the applicant (importer) is obliged to meet the requirements which must be fulfilled that consist of: 1) administrative requirements, 2) legal requirements and 3) financial terms. This financial condition determines whether or not the DC shall be issued for the cash collateral that must be fulfilled by the applicant (importer) to the Bank should be 100 pct of the DC value to be issued. If it is less than 100 pct of the DC value to be issued, then the remaining amount will be backed-up by the bank's financing facility. In other words, the funds to pay the exporters, relating to export transactions, have been fully secured by the Bank thus the undertaking promise to pay is given by Issuing Bank becomes the payment assurance for the exporters provided they can perform "Complying presentation".
3. The payment mechanism using Documentary Credit ('With DC') contains two types of mechanisms that are differentiated based on their payment term, ie Sight DC payment and Usance DC payment.

### Sight DC Mechanism

Sight DC Mechanism is the payment mechanism which is made by the beneficiary's Bank / exporter's Bank to the exporter (beneficiary) as soon as Beneficiary's Bank receives trade documents from the beneficiary that have been in compliance to the DC terms and conditions.

This mechanism can be globally divided into three (3) stages, as follows:

#### Stage of Sight DC Issuance

The stage of Sight DC issuance can be performed by the Issuing Bank if all requirements of either administrative, legality or financial requirements have been met by Applicant (importer).

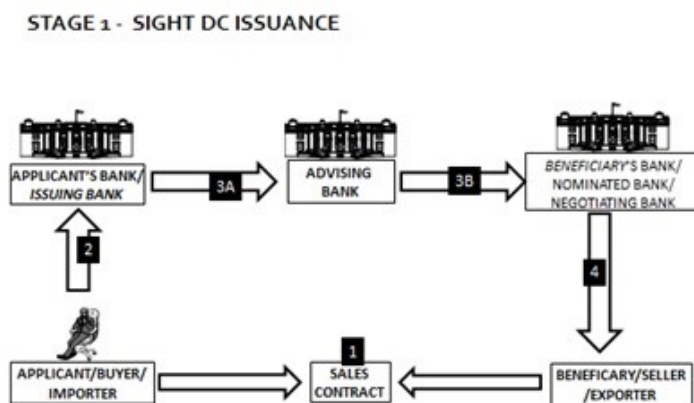


Image 3. Sight DC Issuance

Caption: Stage 1

- 1 Sales Contract
- 2 DC Opening Request
- 3 DC Issuance and DC advising through Correspondent Bank  
Advising DC to beneficiary

### Stage of Goods Delivery, Document Presentation and Payment of Sight DC

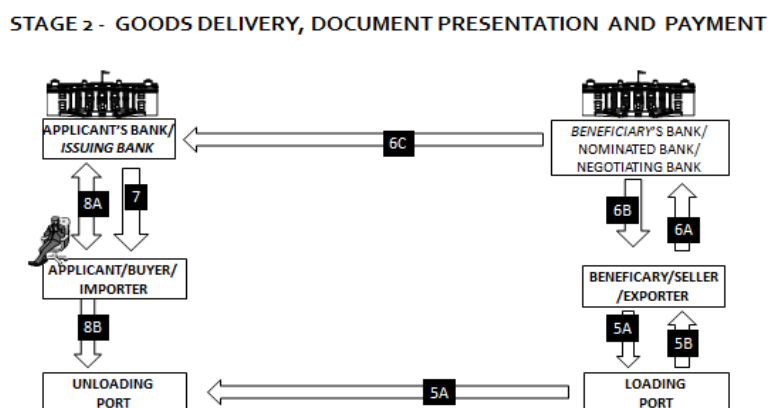


Image 4. Goods Delivery, Document Presentation and Payment of Sight DC

Caption: Stage 2

- 5A Exporter prepares and delivers goods
- 5B Exporter shall obtain a receipt of goods delivery, if by land it is transport document which is in the form of consignment note, if by air it is Air Ways Bill (AWB) and if by sea it is Bill of Lading (BL).
- 6A Prepare all agreed documents by attaching all required documents in DC, then present them to the Bank.
- 6B If there is no discrepancy in the presented document or in Complying presentation or presentation in accordance with DC terms and conditions, the Bank shall make payment to the exporter.
- 6C The documents that have been purchased by Banks are reimbursed to Issuing Bank by sending all original documents to Issuing Bank.

- 7 The Issuing Bank receives all original documents and immediately notifies the applicant (importer) and requests the importer to settle the obligations.
- 8A Importer completes all obligations and duties that must be done.
- 8B The Issuing Bank shall submit all original documents to the importer as the basis to pick up the goods in unloading port.

**Stage of Reimbursement**

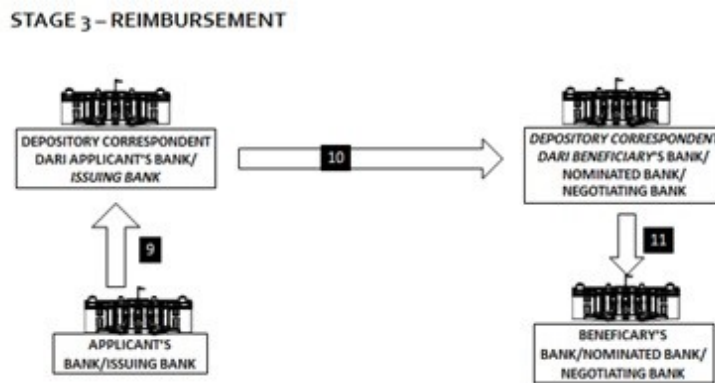


Image 5. Reimbursement

Caption: Stage 3

- 9. The Issuing Bank instructs its depository correspondent (dep-cor) to settle the payments to the beneficiary Bank's depcor.
- 10. Depcor Issuing Bank settles the payment to Beneficiary's Bank Depcor.
- 11. Beneficiary's Bank depcor credit Beneficiary's Bank account or settles the reimbursement to the Beneficiary's Bank.

**Usance DC Mechanism**

The payment mechanism made by the Beneficiary's Bank / exporter's Bank to the exporter (beneficiary) is made upon receipt of acceptance message. Payment may be made by the Beneficiary's Bank to the Beneficiary at maturity or before maturity ie by discounted. This mechanism can be globally divided into three (3) stages, as follows:

**Stage of Usance DC Issuance**

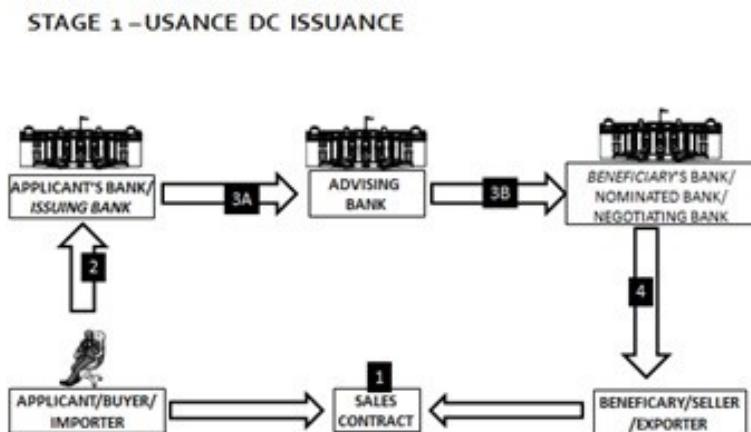


Image 6. Usance DC Issuance



Caption : Stage 1

1. Sales Contract,
2. Documentary Credit Opening Request.
3. DC Issuance and DC Advising through Correspondent Bank,
4. DC Advising to Beneficiary

**Stage of Good Delivery, Document Presentation and Acceptance of Usance DC**

STAGE 2 – GOODS DELIVERY , DOCUMENT PRESENTATION AND ACCEPTANCE

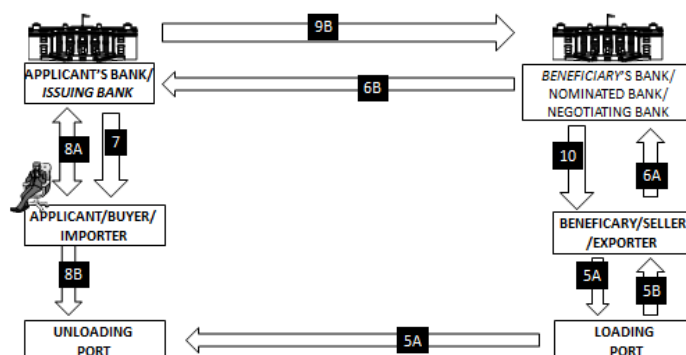


Image 7. Goods Delivery, Document Presentation and Acceptance of Usance DC

Caption: Stage 2

- 5A Exporter prepares and undertakes delivery of goods
- 5B Exporters shall obtain receipt of goods delivery, if by land it is transport document which is in the form of consignment note, if by air it is Air Ways Bill (AWB) and if by sea it is Bill of Lading (BL).
- 6A Prepare all agreed documents by attaching all required documents in DC, then presenting them to the bank.
- 6B All required original documents are sent to the Issuing bank for an acceptance.
- 7 Issuing Bank receives all original documents and immediately notifies the applicant (importer) and requests the importer to settle all obligations.
- 8A Importers complete all obligations and provide acceptance.
- 8B Issuing Bank shall submit all original documents to the importer to pick up the goods in the unloading port.
- 9A Issuing Bank sends acceptance message to the beneficiary's Bank.
- 10 Based on the acceptance message, the Beneficiary's Bank offers two alternative payment options to the exporter:
  1. The exporter will receive payment at the agreed maturity date.
  2. Exporter disburses payment before maturity date (export draft discounted)

### Stage of Reimbursement

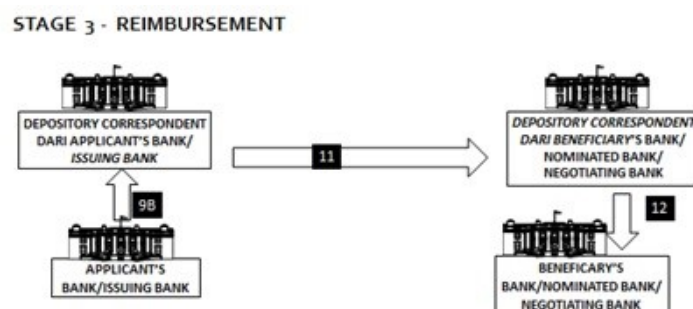


Image 8. Reimbursement

Caption : Stage 3

- 9B Issuing Bank instructs the depository correspondence (depcor) to Bank to settle the payment at maturity to the beneficiary Bank's depcor.
- 11 Depository Correspondence of Issuing Bank will settle the payment to Beneficiary Bank's depcor upon maturity.
- 12 Beneficiary's Bank receives payment from Issuing Bank through Correspondent Bank upon maturity of payment.

### The difference between Payment Procedure using DC ('With DC') and without using DC (Without DC)

The international procedure of trade transaction payment using Documentary Credit provides assurance for both exporter and importer as can be seen in the table below:

**Table 1. Difference between Payment Procedure 'With DC' and 'Without DC'**

Remarks	With DC	Without DC
1. Protection for Seller/ Beneficiary/ Exporter	There is a certainty of assurance protection of payment condition from Issuing Bank to the seller (Beneficiary/Exporter) as long as he can provide Complying Presentation.	There is no protection of payment assurance from Issuing Bank to Beneficiary.
2. Protection for Buyer/ Applicant/ Importer	There is an assurance protection of goods received on time for the Applicant/Importer because payment will not be settled by Issuing Bank to Beneficiary / Exporter if the required documents have not been complied, one of which is transport document as an evidence of goods delivery that must be met in accordance with the DC terms.	There is no assurance protection of goods receipt. The transaction is conducted on trust basis.
3. Payment Condition	Since DC is an Unconditional Undertaking Payment, the Complying Presentation made by the seller becomes the payment made for the seller by the Bank	There is no payment condition. Transaction is conducted in trust basis.
4. Buyer (Applicant /Importer) & Seller (Beneficiary)	Buyers and Sellers are the Bank's customers whose financial securities are guaranteed / no doubt because to become	The Buyer and Seller financial condition is uncertain, depending on



/Exporter) Condition.	Financial	a bank customer they are required to meet certain requirements where financial condition and their identity can be justified.	the transaction historical data.
5. Parties to Pay	Undertaking	Issuing Bank	Applicant/Importer/ Buyer
6. Risk Mitigation		There is a brisk mitigation thus minimising potential risk for either Buyer or Seller.	There is no risk mitigation and risk is relatively big for one party depending on the payment procedure opted.
7. Bank's Role Involvement		Bank besides acting as payment guarantor with particular condition is also providing credit facilities / financing import export and also other financial service.	Bank is acting as service provider.
8. Bank's Product Used		<ol style="list-style-type: none"> <li>1. Export Negotiation Document</li> <li>2. Discounted</li> <li>3. DC Issuance</li> <li>4. Acceptance</li> <li>5. Shipping Guarantee</li> <li>6. Import Export Credit Facility</li> </ol>	<ol style="list-style-type: none"> <li>1. Documentary Collection, including inward DP and outward DP</li> <li>2. Clean Collection</li> <li>3. Transfer</li> </ol>
Remarks		<i>With DC</i>	<i>Without DC</i>
9. Regulation That Protects The Transactions		<p>Uniform Customs and Practice for Documentary Credits, Revision 2007, Publikasi ICC No.600 (UCP), The International Standard and Banking Practice (ISBP), The Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits ("rules"), ICC Publication No. 725 (URR) and Uniform Rules for Collections No. 722 Latest Version, ICC No.722 (URC) serta International Commercial Terms 2010 (INCOTERM) ICC Publication.</p> <ol style="list-style-type: none"> <li>1. Beneficiary</li> <li>2. Applicant</li> <li>3. Issuing Bank</li> <li>4. Advising Bank</li> <li>5. Negotiating Bank</li> <li>6. Confirming Bank</li> <li>7. Accepting Bank</li> <li>8. Paying Bank</li> <li>9. Other related Banks</li> <li>10. Insurance Companies</li> <li>11. Transport companies (Land, Sea and Air)</li> <li>12. Related Government Bodies i.e Custom, Dept of Industry and Trade etc.</li> </ol>	<p>Uniform Rules for Collections No. 722 Latest Version, ICC No.722 (URC) and International Commercial Terms 2010 (INCOTERM) ICC Publication.</p> <ol style="list-style-type: none"> <li>1. Beneficiary</li> <li>2. Applicant</li> <li>3. Remitting Bank;</li> <li>4. Beneficiary Bank</li> <li>5. Paying Bank;</li> <li>6. Correspondent Bank</li> </ol>
10. Parties Involved			

## CONCLUSION

1. Export transactions using DC AS A banking instrument provide payment assurance for exporters as fund to settle the export transactions payment has been secured in the Issuing Bank, in addition to availability of export financing facilities.
2. The payment mechanisms using DC as banking instruments are divided into two they are Sight DC and Usance DC Mechanism, where both of them payment assurance for exporters.
3. The fundamental difference between the two payment procedures of 'With DC' and 'Without DC' are: a) With DC, the party who undertake the promise to pay is Issuing Bank, while Without DC, the party who undertakes the promise to pay is Applicant / Importer; b) in 'With DC' there is a certainty of "conditional" payment for exporters from the bank in which the term for the payment to be paid for export transactions using DC are "complying presentation" while in 'Without DC' other than Advance Payment with 100% payment upfront, it does not provide assurance or certainty of payment for the exporter thus it still carries 'default' for the payment made is settled on trust basis alone;
4. The result of data reduction questioner 60% out of 50 international companies run their export transactions without using Documentary Credit ('Without DC'), however this is still deemed in secure area for the 'Without DC' selected is the Advance Payment. Nevertheless, the default possibilities made by exporters should be avoided therefore the use of DC in international trade transactions is relatively secured for exporters and importers.
5. From 60% out of 50 international companies being sampled, 76% of them use Advance Payment. 16% still use Open Account and 8% use Collection. The largest possibilities for non-payment of export transactions are within the 16% (Open Account) and 8% (Collection) areas, in which the exporters still need to be educated.

The benefits of payment procedure using DC for exporters are:

- a) There is an export payment assurance as long as exporters perform complying presentation.
- b) The availability of export financing facilities when exporters need them.

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