

## 1. What is a letter of credit?

A letter of credit is a payment instrument issued by the Bank on behalf of its client, whereby the Bank undertakes to pay an agreed amount when the beneficiary fulfils the terms and conditions stipulated in the letter of credit and presents the required documents.

## 2. What is a guarantee?

A guarantee is security instrument issued by the Bank, representing a commitment by the bank to pay the beneficiary of the guarantee a specified amount of money if a Seller or a Buyer (depending on the type of guarantee) does not fulfil its obligations to pay or deliver goods, etc. It is not a contracted payment method but a form of “insurance” covering the risk of non-fulfilment of a contract.

## 3. What is an encashment?

Encashment is where the bank processes documents in accordance with instructions received from an exporter; they are then forwarded to the importer against payment, acceptance of a bill of exchange, or similar.

## 4. When should I use a guarantee / letter of credit / encashment?

The appropriate documentary product is selected to cover the potential risks associated with a particular transaction. For example:

- a) a seller who is not sure that the contractually agreed payment will be made can make use of a guarantee of payment. Such a guarantee can also be used as collateral against long-term delays in payment under the contract and regular deliveries.
- b) if a seller is not fully confident in the buyer's credibility but wants to be sure of receiving payment for the goods before they are delivered to the buyer, then a letter of credit will be more suitable because the buyer's bank, which is a neutral party, agrees to make the payment.
- c) if a buyer wants to be sure that goods have been sent and that all necessary documents for the goods will also be received, the best solution is encashment. In this case, the buyer's bank receives documents for its client with an instruction to forward them once the conditions (payment, acceptance, etc.) have been fulfilled.

To summarise: payment under a guarantee is made only if obligations are **not** fulfilled; payment under a letter of credit is made by the bank only if it receives the required documents; and in the case of encashment, the buyer pays first and only then receives the documents (in this case the bank has no obligations).

## 5. What is a letter of advice?

A letter of advice is an official notification made to the other party to a letter of credit / guarantee agreement regarding the transaction (opening, changing, etc.).

## 6. What is an advising (beneficiary's) bank?

The advising bank is the one that officially notifies the beneficiary of the guarantee / letter of credit that a guarantee / letter of credit has been issued on its behalf. A correspondent bank can also act as the advising bank if the counterparties' banks are not directly linked.

## 7. Which is the nominated bank?

A nominated bank (specified when opening a letter of credit) is a bank that verifies documents but has no obligations to pay (unless it also attaches a confirmation to a letter of credit). Payment may be made only if the issuing bank transfers funds.

## 8. What is a confirmation?

A confirmation is additional security that the issuing bank will fulfil its obligations under a letter of credit or a guarantee.

## **9. When is a confirmation required or used?**

Confirmation is used if the issuing bank has low credibility or if the buyer's or seller's country has high risks. If confirmation is issued, the confirming bank accepts the obligation to verify documents and make the payment.

## **10. What does "to cash a letter of credit" mean?**

This means to provide the executing bank with all required documents, which then verifies them and, if everything is in order, subsequently makes the agreed payment as per the letter of credit.

## **11. What documents are needed to cash a letter of credit?**

The letter of credit details all of the documents required for the seller and buyer to fulfil the delivery and payment conditions. The most common documents include:

- Commercial account (invoice)
- Certificates (origin, quality, etc.)
- Shipment documents (may vary depending on transport mode)
- Insurance

Shipment documents are necessary to confirm that the goods were shipped. It is preferable for the shipment documents and certificates to be provided by neutral organisations (chambers of commerce and industry, carriers, inspections) in order to prevent forgery.

## **12. How is a letter of credit payment method entered into a contract?**

You can find an example here <http://www.procreditbank.com.ua/business-clients/dealership/trade-finance/>

## **13. What is the cost of documentary products?**

The final cost depends on the contract terms and tariffs of the banks that service the documentary transactions (confirming bank, advising bank, etc.). Therefore, it is very important to state in the contract what fees and charges are to be paid and by whom. PCB's tariffs can be found here:

<http://www.procreditbank.com.ua/business-clients/teller-services/> Business Client Service Rates

## **14. Does a contract need to be pre-reviewed as to using documentary products?**

Should there be any doubt regarding the accuracy of the contract it is advisable to do this. Contracts where ProCredit Bank JSC acts as the issuing bank are subject to pre-review in all cases.

## **15. Which bank are the documents for a letter of credit submitted to?**

The seller submits the documents detailed in the letter of credit to its bank (advising bank). The documents are then forwarded to the executing bank or the issuing bank (as per the letter of credit).