

THE IMPACT OF ADVISING BANK'S REFUSAL TO AMEND LETTERS OF CREDIT

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ABSTRACT

The purpose of this study is to explore possible solutions banks may utilize to issue Letters of Credit (L/C) despite advising bank's refusal to grant L/C amendment to the beneficiary based on the advising bank's own decision or following the direction of State Authorities. The study find out that issuing bank is not entitled to utilize the services of another bank to grant amendment of L/C as outlined in the Uniform Customs and Practice (UCP) 600. Therefore, and as far as this Bycase is concerned, utilizing L/C amendment may result in damages to the seller and the buyer in international sales contracts. The study recommends that the International Chamber of Commerce (ICC) modify UCP 600, Article 9 to avoid damages to merchants and prevent potential international conflicts.

Keywords: ICC, Letter of Credit, Advising Bank, Issuing Bank, UCP.

INTRODUCTION

The Uniform Customs and Practice for Documentary Credits (UCP) 600 are international rules published by the International Chamber of Commerce (ICC) with the aim of standardizing international banking practice in relation to LCs. The UCP 600 is only applicable if they are expressly incorporated. The UCP 600 replaced the UCP 500 in July 2007, with the aim of reducing ambiguity and the possibility of rejecting documents (Exim News, 2022; Nordea, 2021).

An LC is a contract by which a bank agrees to pay the beneficiary upon the happening of a specific event or, in connection with the export of specific goods, against the presentation of specified documents. The use of LCs to effect payment is widespread in international trade. This is because they offer security of payment for and receipt of goods to contractual counterparties who may be in different jurisdictions to each other – and who may be contracting to buy and sell goods which are located in a third jurisdiction, or which are in transit. LCs is standalone contracts, separate from the sale contract, and banks are concerned only with the LC contract, not the sale contract.

UCP 600 sub-article 10 (a) stipulates: *“Except as otherwise provided by article 38, a credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank, if any, and the beneficiary.”*

Whether or not the issuing bank can refuse to issue an amendment to the LC depends on the agreement between the issuing bank and the applicant. Such agreement can be made before the LC is issued or obtained right at the time the applicant requests for the amendment. The

issuing bank shall issue an amendment upon the applicant's request if the agreement, which had been signed before the LC was issued, stipulates that. In the absence of such agreement, then issuing bank is not obligated to issue an amendment to the L/C. In most cases, issuing banks agree to issue an amendment even if an agreement does not exist. However, issuing banks may hesitate to issue amendments based on potential risks in situations such as the import is self-financed but the applicant has pledged his deposit l/c for less than 100% of the LC value (the rest amount is to be deposited by the time the payment is effected) or the import is partially or fully financed by the issuing bank. Whether the issuing bank agrees to issue an amendment depends on the applicant's credit worthiness and whether the applicant is willing to deposit additional funds to secure the full payment (Cambridge Dictionary, 2022).

The L/C encourages international trade by guaranteeing true performance of the international sale contract. Exporters guarantee the price while importers confirm delivery of goods through providing delivery documents to exporters (Jamaleldeen, 2000).

In addition to the issuing bank, which is usually located in the importer's country, other banks including nominated and confirming banks may engage in the transaction process. Nominated banks are the banks where the credit is available while confirming banks are those that provide added confirmation, upon issuing bank's authorization or request, of the credit (UCP 600, Article 2) and advising bank. The issuing bank provides the L/C to the importer to authenticate and also informs the exporter, L/C beneficiary, that the importer has established a L/C in the exporter's favor. In addition to the role of informing both L/C parties of the L/C status, it plays another role as indicated by UCP 600, Article 9. What options the issuing bank has to communicate with the beneficiary regarding L/C amendment when the advising bank is unable to provide L/C amendment to the beneficiary (Client Guide, 2018).

This study intends to explore options that the advising and issuing banks may utilize to communicate effectively with the beneficiary concerning the L/C amendment as indicated in UCP 600. Possible solutions may include the utilization of an additional advising bank services and/or direct communications between the beneficiary and issuing bank.

This study will take two venues to tackle the UCP 600 issues. One venue will clarify the L/C concept while the other venue will look into the advising bank's role as defined by UCP 600.

The Concept of L/C

The importance of L/C in international trade cannot be overstated. The financial and delivery of good guarantees the L/C provides to seller and buyer respectively is significant in building trust, facilitating trade deals, and in providing peace of mind to both parties. The L/C issuing bank is required to cover the full amount of the sales contract guaranteeing availability of funds to the seller regardless of the buyer's financial situation. On the other hand, bank also guarantees delivery of goods to the buyer. In a nut shell, the L/C provides a win-win situation. Several definitions are available for the L/C. It is defined as:

1. A written commitment provided by the importer's bank guaranteeing payment of a specified sum of money to the seller's bank upon receipt of specific documents (Bakhtiar, 2009).
2. A written commitment issued by a bank on behalf of the customer guaranteeing payment of a sum of money to a third party (My Accounting Course, 2021).

3. A guarantee of payment of a specified sum of money in a specified currency provided that the seller issues, and the buyer receives, specific documents including Bill of Lading, Airway Bill, Certificate of Origin, and commercial invoice within a fixed timeframe.
4. A promissory note issued by the buyer's bank guaranteeing payment of a specific amount of money to the seller's bank provided that goods meet standards and is delivered on time.

Considering the various definitions, it is reasonable to conclude that the L/C is a promissory note issued by the buyer's bank guaranteeing payment of specific amount of money to the seller as specified in the sale contract within a specific period of time provided goods meet standards and are delivered within an agreed upon timeframe, whereas the buyer guarantees to provide proof of ownership.

The Role of the Advising Bank

When all parties to of the international sale contract agree to comply with UCP 600, they will be required to ensure that the L/C language explicitly indicates that all rules, standards, and requirements of the UCP 600 are applicable (UCP 600, Article 1).

Article 9 of the UCP organizes the role and mission of the advising bank when parties decide to modify and/or amend the L/C. As such, the advising bank has six (6) main missions:

Credit and any amendment may be advised to beneficiary through an advising bank. An advising bank that is not a confirming bank advises the credit and any amendment without any undertaking to honor or negotiate. Advising bank may discuss the L/C and amendment with beneficiary but may not negotiate condition of L/C.

By advising the credit or amendment, the advising bank signifies that it has satisfied itself as per the apparent authenticity of the credit or amendment, and that the advice accurately reflects the terms and conditions of the credit or amendment received. It is apparent that the article specifies the responsibility of the advising bank is responsible for making sure that the L/C complies with the UCP terms and conditions before advising the beneficiary. An advising bank may utilize the service of another bank (second advising bank) to advise the credit and any amendment to the beneficiary. By advising the credit and any amendment, the second advising bank signifies that it has satisfied itself as to apparent authenticity of the advice it has received, and that advice accurately reflects the terms and conditions of the credit or amendment received.

It is seen that the paragraph gave the main advising bank may utilize the services of a second r advising bank to verify the accuracy of the L/C or any amendment and advise the beneficiary. Also, any L/C amendment has to be completed through the second advising bank.

A bank utilizing the service of an advising bank or second advising bank to advice of a credit must use the same bank to advice of any amendment hitherto. Issuing bank is required to use the services of the same advising bank throughout the L/C, amendment, and modification process. Issuing bank may not change advising banks. If a bank is requested to advise a credit or amendment but elects not to do so, it must inform, without delay, the bank from which the credit, amendment or advice has been received.

The advising bank is obligated to communicate immediately to the issuing bank their desire not to notify the beneficiary of L/C or amendment.

If a bank is requested to advise a credit or amendment but cannot satisfy itself as to the apparent authenticity of the credit, the amendment or advice, it must inform, without delay, the

bank from which instructions appear to have been received. If the advising bank or second advising bank is elected, nonetheless, to advise the credit or amendment, it must inform the beneficiary or second advising bank that it has not been able to satisfy itself as to the apparent authenticity of the credit, the amendment or the advice.

Advising bank is required to do two things upon notification of beneficiary of L/C amendment or modification:

1. Notify issuing bank that they are not content with the L/C or amendment.
2. Notify beneficiary that they have not verified the authenticity of the L/C or amendment.

CONCLUSION

When the issuing bank uses the services of advising banks to communicate and update the beneficiary throughout the L/C process, the advising bank mission is to provide notifications to the beneficiary.

The main advising bank may communicate directly with the beneficiary or may choose to use the services of a second advising bank to do so. Both way, direct communications with beneficiary ensures authenticity of credit and that advice reflects the terms and conditions of the credit or amendment.

The issuing bank must use the same advising bank throughout the L/C or amendment process and has not authority to change advising bank. This limited authority may put the issuing bank in a binding situation when issuing a new L/C or amendment, resulting in three (3) potentially damaging cases to the issuing bank:

1. Advising bank decides not to advise the amendment of L/C.
2. Advising bank declares bankruptcy.
3. Advising bank is ordered by State to halt conducting bank transactions effectively shutting down the bank.

In all three cases, the issuing bank has no authority to utilize the services of another advising bank; hence any amendment of credit is illegal which may push the issuing bank to ask the importer to establish a new L/C, including amendment. Doing so may add unnecessary time to complete the transaction, increase costs to the importer which may cause disagreements between the L/C parties, and may result in deducting additional cost of issuing a new L/C from the purchase price.

RECOMMENDATION

Although may require extensive coordination and the concurrence of most parties of the ICC, this study recommends that the ICC modifies UCP 600, Article 9 to authorize issuing banks the use of a new advising bank when the original advising bank fails to perform as required by UCP. This modification should not give issuing banks open authority to utilize services of new advising banks as the issuing banks see fit. The modification should limit the issuing bank's authority to utilize the services of new advising banks in certain and limited situation to prevent potential misuse and abuse.

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