

WTC Harrisburg 17<sup>th</sup> Annual International Trade  
Conference

*Rediscovering Letters of Credit as a Trade  
Tool in the Strong Dollar Environment*

Presented: May 18, 2016  
Eden Resort, Lancaster PA

**Fulton Bank**

LISTENING IS JUST THE BEGINNING.™

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LETTER OF CREDIT GROUP

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# What we will Cover

- \* Overview of Letters of Credit and Misconceptions
- \* L/C Strategies for Exporters
- \* L/C Strategies for Importers
- \* Two Questions to Ask and Who to get Involved in an International Transaction

# What is a Letter of Credit?

- \* Contract between the issuing bank (on the buyer's/applicant's behalf) and the beneficiary that guarantees payment to the beneficiary, so long as they can meet the terms and conditions.
- \* Used to support international trade transactions (Commercial LC's) and contractual obligations (Standby LC's).
- \* Banks that issue letters of credit put their credit in place of the buyers credit which provides the seller more comfort.
- \* Can provide the seller with a competitive advantage by allowing them to offer terms to the buyer.

# Facts about...

## \* **Commercial Letters of Credit**

- \* Issued in support of a trade transaction.
- \* Intended to be the payment mechanism.
- \* Payment is triggered by shipment and subsequent presentation of shipping documents.
- \* When the documents are in order or accepted the issuing bank is under obligation to make the payment.
- \* Mitigates commercial risks - Issuing bank replaces the applicant's credit with its own.
- \* Can mitigate sovereign economic, political and war risks in the case of a confirmed letter of credit.
- \* Can be issued and negotiated in a foreign currency.



# Why use trade products...

- \* Mitigate commercial and sovereign risks.
- \* Provide secure method for movement of shipping documents.
- \* Provide secure method for movement of funds.
- \* Obtain pre-export and post-export financing opportunities.
- \* Can be issued in many foreign currencies and under foreign contracts.
- \* Support and facilitate trade.

# Why use trade products...

- \* Low default rate.

13,444,027 Transactions, 20542 Defaulted, 0.15%

Total transactions and default rate by product, 2008–2014

Product	Total # transactions	Total # defaulted transactions	Default rate
1. Export L/C	1,847,734	121	0.01%
2. Import L/C	3,164,200	2,509	0.08%
3. Performance Guarantees	1,615,351	2,736	0.17%
4. Loans for Import/Export	6,816,742	15,176	0.22%

# Letter of Credit Misconceptions

- \* “Letters of Credit are impossible to understand.”
  - L/C’s come in a standard format that your bank should help interpret for you. Once you get used to reading them, they become much easier to understand.
- \* “L/C’s cannot be complied with.”
  - With proper preparation and planning with your bank, an L/C can be an easy transaction.

# Letter of Credit Misconceptions

- \* “No one can tell me how L/Cs work.”
  - That’s the job of your bank’s L/C department. If they’re not helpful, we’ll provide a no-obligation explanation.
- \* “No one can explain the risks.”
  - Ditto as above. But keep in mind that a Letter of Credit mitigates risk but does not eliminate it. A Beneficiary must conform to the terms and conditions of the L/C in order for the issuing bank to make the payment.



# Letter of Credit Strategies for Exporters

## \* Offer Terms (30, 60, 90, 120 Days From Shipment)

- Your foreign competitors are very likely doing this.
- Structuring an LC to offer terms gives your customer the flexibility to meet their needs, such as:
  1.
    - receiving and re-selling the product;
    - using it in their manufacturing process;
    - purchasing capital equipment from you and having it running before payment is due.

# Letter of Credit Strategies for Exporters

- \* Offer Terms (30, 60, 90, 120 Days From Shipment)
    - In many foreign countries, borrowing rates are notably higher than in the U.S.
    - Offering terms helps your customer finance their purchase at a lower rate than in their country.
- Here's how ...

# Letter of Credit Strategies for Exporters (Continued)

## \* Offer Terms (30, 60, 90, 120 Days From Shipment)

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- Have the L/C Confirmed and Discount it. Confirmation takes the risk of payment from the issuing bank (your customer's bank) and puts it on a bank here (your bank). The confirming bank is obligated to make payment upon presentation of complying documents.

- If you discount a confirmed L/C with terms you get paid upon presentation. Here's what that means in layman's terms.

- Even if a L/C is not confirmed, it can be discounted after acceptance from the issuing bank.

- Work the fees for the above in your quote to your customer.

- Confirmation can drop your DSO (Days Settlement Outstanding) to 10 days or less from shipment.

# Letter of Credit Strategies for Exporters (Continued)

- \* Negotiate and receive the L/C in a foreign currency, but ultimately get paid in USD
  - Work with your bank's FX department to price your product or service in your customer's currency.
  - Have the L/C issued in your customer's currency.
  - A forward contract can be used to hedge against currency fluctuation until you are paid.
  - Don't equate "hedging" with taking on risk; the opposite is the case. By hedging through your bank's FX department, you lock in the equivalent U.S. dollar amount that you'll receive at maturity.
  - Your competitors are likely also doing this.

# Letter of Credit Strategies for Importers

- \* A strong U.S. Dollar makes the pricing of foreign goods lower and possibly more attractive.
- \* An L/C protects an Importer's interest in the transaction and mitigates risk.
- \* If you offer to pay with a letter of credit, seek terms from your supplier. They can use the flip side of what we described earlier, namely, discounting the transaction and get paid upon shipment.
- \* You can further enhance your negotiations by offering the L/C in your supplier's currency.
  - \* - An FX forward contract (hedging) can also be used to protect against the currency's fluctuation until you make the payment.

# Letter of Credit Strategies for Importers (Continued)

- \* Your bank will have to underwrite the credit risk before issuing an import L/C.
  - \* It could be a one-off L/C, secured with cash or other assets.
  - \* Your bank could instead provide a line of credit, under which L/C's are issued and availability is reduced by your aggregate L/C issuances (no interest is charged on the carved-out amount unless the line is used to make the payment).
- \* A new foreign supplier will likely request cash in advance. That's obviously not an acceptable risk for your company, so consider offering an import L/C instead.

# Letter of Credit Strategies for Importers (Continued)

- \* With the strong USD, capital equipment from foreign suppliers can become more attractive. Your bank should be able to combine FX, L/C's, and leasing alternatives to reduce your risk and optimize your cash flow.

# Two Important Questions to ask when you get an International Inquiry

\* When a potential buyer contacts you a quote to them it is much more than just how much the product costs. A proper quote cannot be given until the two following questions are addressed:

- How am I getting paid? (Terms of Payment)  
Open Account, L/C, Documentary Collection
- Who is responsible for what part of the transportation?  
(Terms of Shipment/INCOTERMS)

The buyer should pay for everything; either you arrange for it and add it to the invoice or your buyer pays for it on their own.



# INCOTERMS

<b>INCOTERM® 2010 RULES***</b>											
<b>CHART OF RESPONSIBILITY</b>											
	Any Transport Mode		Sea/Inland Waterway Transport				Any Transport Mode				
	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAT	DAP	DDP
Charges/Fee	EX Works	Free Carrier	Free Alongside Ship	Free On Board	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid to	Delivered at Terminal	Delivered at Place	Delivered Duty paid
Packaging	Buyer or Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller*	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Delivery to Port/Place	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export Duty & Taxes	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Origin Terminal Charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading on Carriage	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Carriage Charges	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Insurance	**	**	**	**	**	Seller	**	Seller	**	**	**
Destination Terminal Charges	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller
Delivery to Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller
Import Duty & Taxes	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller

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\*Seller is responsible for loading charges, if the terms state FCA at seller's facility  
 \*\*Negotiable between Buyer and Seller

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 REFER TO FULL VERSION OF INCOTERMS® 2010 RULES FOR FULL DESCRIPTION

# Whom to Involve in your Transaction

\* In order to quote properly you need to involve all of the parties to that transaction as early as possible. That could include your:

- Bank
- Freight Company / Broker
- Insurance Carrier
- Legal, Accounting, Sales Departments, etc.

Not getting these parties involved early tends to lead to issues with your L/C transaction. Let them review a draft of the L/C before it is issued to avoid amendments and delays.

Questions?

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**Thank you!**

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