

## 1 Financial Documents

### 1.1 Bill of Exchange

According to Hong Kong's S3 Bills of Exchange Ordinance (cap. 19), a bill of exchange is defined as:

- (a) an unconditional order in writing;
- (b) addressed by one person (the drawer, exporter);
- (c) to another (the drawee, importer or issuing bank);
- (d) signed by the person giving it (the drawer);
- (e) requiring the person to whom it is addressed (the drawee);
- (f) to pay;
- (g) on demand, or at a fixed or determinable future date;
- (h) a certain sum of money;
- (i) to, or to the order of, a specified person, or to bearer (payee).

Hence, a bill of exchange is a means of demanding payment used in international trade. It is issued by the drawer (seller) and addressed to drawee (buyer or issuing bank).

A bill of exchange can be either a sight bill or term bill. A term bill is also known as a usance bill, or tenor bill. A sight bill is a bill against which payment must be made by the drawee at sight of the bill. A term bill, on the other hand, allows payment to be made by the drawee at a later date, which can be as few as 10 days, or as many as 365 days after sight. It is quite common to see term bills with "30 days after sight", "60 days after sight", (normally written as 30 days sight, 60 days sight) and so on.

A term bill may read as "60 days after date" which means the bill will expire 60 days after the date of issue of the bill. It is paid only at maturity date. A tenor bill, in effect, is a credit period given to the importer at the expense of the exporter.

### 1.2 Promissory Note

According to S.89(1) Bills of Exchange Ordinance (cap. 19):

"A promissory note is an unconditional promise in writing made by one person to another signed by the

issuer, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer."

A promissory note is a promise from the issuer to another that he himself will pay. Common types of promissory note are IOUs and banknotes. In international trade, a promissory note is made by the importer who engages to pay the exporter at a determinable future date a certain sum of money. Upon collection, a collecting bank may be instructed to release documents against the buyer's creation of a promissory note. It should be noted that bills of exchange are more widely used in collection.

## 2 Commercial Documents

### 2.1 Commercial Invoice

A commercial invoice is an accounting document issued by the exporter in order to demand payment for goods sold to importers. The contents of a standard commercial invoice should at least consist of:

- (a) name and address of the seller;
- (b) name and address of the buyer;
- (c) date of issue of the document;
- (d) invoice number or seller's reference number;
- (e) the description of goods, quantity, unit price (if any) and total value;
- (f) the trade terms (e.g., CIF Hong Kong, CFR Hong Kong).

Sometimes, a buyer may request the seller to add a statement in the invoice to protect his interests. For example, a D/C may contain the following requirement: "Invoice to certify that the goods shipped are in good condition". This statement serves the same function as if the D/C were calling for a "Beneficiary Certificate" to this effect. It is quite common to observe this practice in D/C issued in Hong Kong in favour of beneficiaries in China, or vice versa.

## 2.2 Pro-forma Invoice

A pro-forma invoice is different from a commercial invoice. It serves as a price quotation by a seller to a buyer. It is important to note that with the use of a pro-forma invoice, the buyer and seller have not entered into a binding contract. A pro-forma invoice serves the following functions:

- (a) The overseas buyer might need a pro-forma invoice with which to apply for an import licence or the foreign exchange to pay for the goods, in which case it serves as a price quotation.
- (b) It can be used by an exporter to tender for an export contract.

## 2.3 Consular Invoice

This is a commercial invoice prepared in a form printed in the exporter's country by the consulate of the buyer's country. It is then stamped by the consulate. The purpose of a consular invoice is to confirm the details of the shipment in order to help the government of the buyer's country to control the volume of imports (e.g., to prevent the "dumping" of goods).

In some countries, traders may prefer to use a "legalized invoice" which serves a similar function as a consular invoice. Here, the document must be legalized by the country's embassy or consulate in the seller's country for which usually a fee may be charged.

## 2.4 Packing List

The packing list provides details of the packing of the goods and increases convenience for the buyer in taking delivery. This is a useful document as regards imports of goods with different sizes and colours. Where a D/C calls for a packing list, an exporter must be careful that the weights and measurements in the packing list correspond precisely with those appeared in the bill of lading. Meanwhile, he has to ensure that all the details shown are consistent with other shipping documents.

## 2.5 Weight List (Weight Note)

This is a document issued by the exporter declaring the weight of the goods. It should be noted that this declared weight must be consistent with the weight shown on other documents. In particular, if a D/C calls for a weight list, a seller must be aware that he is expected to present a document with a declaration of weights corresponding to those entered on the bill of lading.

## 3 Transport Documents

### 3.1 Bill of Lading

A bill of lading is a transportation document for goods shipped by sea. It is issued by shipping companies or their agents, usually in the form of an ocean bill of lading (marine bill of lading). A bill of lading serves three separate functions:

- (a) It is evidence of a contract made between the shipping company and either the exporter or the foreign buyer to transport the goods by sea.
- (b) It is an official receipt for the goods taken on board the ship, and provides some details about the condition of the goods received by the shipping company, e.g., "one case broken", "shipper's load and count", "said to contain ten pallets".
- (c) A bill of lading is also a **document of title** which means that the company named on the bill of lading has the right to possess the goods. Originally, the title belongs to the shipper (i.e., exporter). When the shipper endorses the title, the negotiating bank or the issuing bank or the buyer may become entitled to the bill of lading depending on the circumstances of the case (i.e., depending on the name of the endorsee). Indeed, the goods will only be released by the shipping company at the port of destination to the party who presents a signed original of the bill of lading.

There are six types of bill of lading:

- (a) Liner bill of lading — This is a bill of lading for carriage by

vessels on scheduled journeys which have a reserved berth at their destination. Hence, scheduled departure of the ship is certain.

- (b) Marine bill of lading — This type of bill of lading is issued by a shipping company when the goods are transported from one port to another port by ship. A marine bill of lading is also known as an ocean bill of lading.
- (c) Multimodal transport bill of lading — Most consignments of goods have to be carried by more than one mode of transport, and a multimodal transport bill of lading is a transportation document for the movement of goods from start to finish. It acts as a document of title for the entire journey of the goods including every stage of that journey (e.g., one mode is by land, followed by another by sea). Formerly it was known as a combined transport bill of lading.  
The issuer of a multimodal transport bill of lading accepts responsibility for the carriage of the goods from beginning to end and accepts liability for loss or damage to the goods, on whichever stage it might occur.
- (d) Short form bill of lading — A short form bill of lading is a bill of lading which does not contain the shipping company's conditions and terms of carriage. In other words, the "small print" on the reverse side of a standard bill of lading is not shown the conditions of carriage and must be referred to elsewhere, for example, on a "master document", or a copy of the carrier's standard conditions, which are obtainable at the carrier's offices.  
A short form bill of lading is acceptable according to Article 23 a, v of UCP-600.
- (e) Charter party bill of lading — This is a bill of lading issued by the hirer of a vessel to the exporter. This arises when a trading company (known as the hirer) hires a vessel from a shipowner, and there is spare space available for the storage of extra cargo. This hirer may enter into a contract of carriage with the exporter and issue to this exporter a charter party bill of lading. The terms of the bill of lading

are subject to the contract of hire between the shipowner and the hirer. Because of the legal complexity and possible conflict of carriage terms between the two contracts, this type of bill of lading is not accepted by banks and UCP-600 unless specifically authorized otherwise.

- (f) Forwarder's bill of lading — This type of bill of lading evidences a contract of carriage and a receipt for the goods by the forwarder who will arrange to have the goods transported by a shipping company. Such a bill of lading is not accepted by UCP-600 unless the freight forwarder issuing such a bill of lading:
  - (1) acts as the carrier or multimodal transport operator and fulfils other requirements of Article 30 UCP-600;
  - (2) acts as a named agent for and on behalf of the carrier or multimodal transport operator;
  - (3) unless specifically authorized otherwise.

### 3.2 Air Waybill

An air waybill is a waybill for goods transported by air. It is a contract of carriage and a receipt by the airline for goods received into custody. These two functions are the same as in a bill of lading.

However, it is not a document of title. The airline will hand the goods to the consignee at the airport of destination without asking the consignee to submit the original copy of the air waybill. So, if a D/C calls for an air waybill with applicant to be shown as the consignee, the bank has lost title to the goods. The issuing bank should, therefore, take additional security from the applicant, e.g., earmark the trust receipt facility before the issue of the D/C.

It should be noted that, according to Article 37 a, iii UCP-600, the date of issuance of the air waybill is deemed to be the date of shipment. Where a D/C specifically requires an actual flight date to be shown on the air waybill, then, the flight date is deemed to be the date of shipment.

### 3.3 Sea Waybill

A sea waybill is a waybill for goods transported by sea. It differs from a bill of lading in that it is not negotiable and is therefore not a document of title. The shipping company will release the goods to the named consignee upon proof of identity. It is normally used when the seller is trading on open account terms. The importer will find a sea waybill allows for more convenience and minimum formality in taking delivery of the goods. In particular, the importer does not have to wait for the original sea waybill to be submitted to the transport company in order for him to take delivery of the goods.

### 3.4 Parcel Post (Postal Receipt)

This is a post office receipt for goods sent through the post office. The receipt provides details and evidence of the despatch of goods. It is not a document of title as is a bill of lading. The goods will be sent directly to the person named in the receipt. So, if a D/C calls for a postal receipt as a transport document, with importer as the consignee, the bank will lose control over the goods.

### 3.5 Railway Cargo Receipt

This is a transportation document which allows a railway company to release the goods to the consignee upon proof of identity. A railway cargo receipt serves similar functions as a bill of lading, e.g., (a) evidence of contract, (b) official receipt, (c) document of title.

### 3.6 Forwarder's Cargo Receipt

This is a transportation document in which the forwarding agent company is instructed to release the goods to the consignee named in the cargo receipt. In Hong Kong, even though the bank is shown as the consignee and the importer as the "notify party", some unscrupulous forwarders release the goods to the importer against the latter's indemnity. So, the bank has in effect lost control over the goods.

## 4 Insurance Documents

In order to protect against the risks of loss and damage to the goods during transit, it is necessary to arrange adequate insurance cover from the time the goods leave the factory to the time buyer takes delivery. Depending on the trade terms, either the buyer or the seller may arrange and procure insurance. For example, under CIF (cost, insurance, freight) terms, the seller must procure and pay the insurance premium. In a FOB (free on board) sale, it is the buyer who is obliged to arrange and pay the premium. A standard insurance document should contain the following details:

- (a) Name of insurer;
- (b) Name of insured (beneficiary under the insurance cover);
- (c) Types of risks and insured value;
- (d) Description of goods;
- (e) Whether claims are payable at destination or other places.

In most cases, the seller is shown as the insured party. Endorsement by the insured is necessary so that the right to claim under the policy is subsequently transferred to the buyer. Depending on each case, an insurance document can be:

- (a) Cover note — this is issued by an insurance broker to provide notice that steps are being taken to issue an insurance policy or certificate. Hence, it is not a legally valid insurance document and in D/C transactions is not acceptable by UCP-600.
- (b) Insurance policy — it gives full details of the risks covered, and is evidence of a contract of insurance between the insurance company (insurer) and the customer (insured). It is used for single consignments.
- (c) Open policy — in doing business, a seller may have to ship goods on a regular basis. To insure against damage or loss to the goods, he may have to purchase an insurance policy whenever he ships the goods. This is inconvenient for the seller. Instead of purchasing several successive insurance policies, he can take out an open policy.

An open policy allows the seller under one policy to cover all shipments (up to a limit per shipment) under the same terms and conditions in a given period of time.

Under open policy cover, the seller (the insured) must advise the insurance company of all the details of each shipment by entering the details of the goods in an Insurance Certificate. When the seller has taken out an open policy, he is authorized to issue an Insurance Certificate (a pre-printed form designed and given by the insurance company).

- (d) Insurance certificate — this shows the value and details of the shipment, and the risks covered. It is a standard form prepared by the insurance company, filled in and signed by the exporter. Then the certificate will be countersigned by the insurance company. It is normally used together with an open policy. The certificate describes, among other information, the shipping details and makes reference to the open policy.

Whatever forms of insurance document are used, it should have the following characteristics:

- (a) The cover should be effective at least from the date the journey starts (It should be noted that the issue date of a policy may not be the effective date of the policy).
- (b) The currency and amount of cover should be sufficient. The documents should be signed as required.
- (c) The goods should be described on the documents to enable such goods to be identified. The party to whom, and the place from which, claims are to be made payable should be acceptable to the seller or the buyer, depending upon who is to take out the insurance cover.<sup>[1]</sup>

Risks covered by an insurance policy are often provided on the basis of "Institute Cargo Clauses" provided by the Institute of London Underwriters. These clauses include:

- (a) Institute Cargo Clause (A), e.g., All risks;
- (b) Institute Cargo Clause (B), e.g., With Average (WA);
- (c) Institute Cargo Clause (C), e.g., Free from Particular Average (FPA).

Institute Cargo Clauses (A) is widely used in shipment of manufactured goods, new machinery, garments, electrical goods and packaged commodities. It covers the following risks:

- (a) all risks of physical loss of or damage to goods;
- (b) general average — goods sacrificed or expenditure incurred to save the entire shipment. For example, suppose there is a fire on the ship and some of the cargo is damaged by the water used to put out a fire. An insured whose goods are unharmed may be expected to contribute to that loss, and if so the insurance policy will cover this.

It should be noted that in Institute Cargo Clauses (A), the following risks are not covered:

- (a) wilful misconduct of the Insured;
- (b) ordinary leakage, loss in weight, wear and tear;
- (c) insufficiency or unsuitability of packing;
- (d) inherent vice;
- (e) delay;
- (f) insolvency or financial default of owner or charterer of vessel;
- (g) unseaworthiness of vessel if known;
- (h) war and strikes;
- (i) nuclear fission.

Institute Cargo Clauses (B) is widely used in shipment of wheat, cement, glass sheets, and used machinery. It covers the following risks:

- (a) fire or explosion;
- (b) vessel being stranded, sunk or capsized;
- (c) overturning or derailment of the land conveyance;
- (d) collision of vessel or conveyance;
- (e) general average;
- (f) jettison or washing overboard;
- (g) earthquake, volcanic eruption or lightning;
- (h) entry of sea, lake or river water into vessel or craft hold in which the goods are located;

- (i) total loss of package during loading onto or unloading from vessel or craft;
- (j) discharge of goods at port of distress.

It should be noted that in Institute Cargo Clauses (B), the risks not covered are the same as Institute Cargo (A), plus deliberate damage.

Institute Cargo Clauses (C) is widely used to cover the shipment of steel, timber, loose grains. It covers the following risks:

- (a) fire or explosion;
- (b) vessel being stranded, sunk or capsized;
- (c) overturning or derailment of land conveyance;
- (d) collision of vessel or conveyance;
- (e) general average;
- (f) jettison;
- (g) discharge of goods at port of distress.

In Institute Cargo Clauses (C), the risks not covered are the same as Institute Cargo (B).

It is worth pointing out that Institute Cargo Clauses A, B or C do not cover war or strike. To insure against the risk of loss from war or strike, an insured must cover Institute War Clauses (Cargo) and Institute Strike Clauses (Cargo) respectively as per the following:

Institute War Clauses (Cargo) — this insurance covers loss of or damage to the goods caused by war, civil commotion, revolution, rebellion, capture or detainment, mines, torpedoes or bombs.

Institute Strike Clauses (Cargo) — this insurance covers loss of or damage to the goods caused by strikers, locked-out workmen, or persons taking part in labour disturbances, terrorists, riots or civil commotions.<sup>[2]</sup>

## 5 Other Documents

- (a) If a buyer would like to see the quality of the goods up to his satisfaction or a specified standard, he may ask for an

independent party to inspect the quality of the goods before despatch. This independent person would then issue a **third party quality inspection certificate**.

- (b) A **supplier's quality inspection certificate** is a signed declaration by the supplier to the effect that the goods have been inspected before despatch and are of a quality in accordance with the contract of sale. As this inspection certificate is issued by the supplier, this assurance is sometimes doubtful. Hence, a third party inspection certificate gives better assurance of the quality and standard of the goods. In addition, a **Public Surveyor's Report** serves the best assurance of the quality of the goods. A Public Surveyor is deemed to be an independent party whose judgement is assumed to be impartial.

- (c) A **certificate of origin** is a document required by the authorities of the importing country. This document serves as evidence of the country from which the goods originated. The reasons for calling for a certificate of origin may include the following circumstances:

- (1) The importing country may forbid goods to be imported from some countries because of political reasons. Here, the purpose of the certificate of origin is to show that the goods imported are not from a prohibited country.
- (2) That the goods originate from a well-known country may have added value to the goods and increased the marketability of the products.
- (3) That the goods imported from friendly countries may be exempted from import duty or enjoy preferential rates of duty.

In Hong Kong, various organizations are authorized to issue certificates of origin, e.g., The Hong Kong General Chamber of Commerce, the Trade and Industry Department, Federation of Hong Kong Industries, Chinese Chamber of Commerce, Chinese Manufacturers' Association of Hong Kong and the Indian Chamber of Commerce.

- (b) obtain cargo insurance and provide insurance cover.

The buyer's responsibilities are as for CFR above, except that insurance is covered by the seller.

### 3.6 *Delivered Duty Paid (DDP.....named place of destination)*

Under this term, the exporter must obtain any export and import licences and carry out all customs formalities for the exportation and importation of the goods including payment of all costs, duties and taxes, arrange the contract for the carriage, place the goods at the disposal of the buyer, and provide the transport document.

The importer must accept the usual transport document and take delivery of the goods.

DDP, in total contrast with EXW, means maximum obligation on the part of the exporter and minimum responsibilities for the importer.

The following three Incoterms, once relatively unpopular in Hong Kong, have now become common. This is due to the increasing use of multimodal transport worldwide, with Hong Kong being no exception.

### 3.7 *Free Carrier (FCA.....named place)*

This trade term is based on air transport or multimodal transport. The separation responsibilities between the seller and buyer are similar to the situation under FOB terms (see Section 3.3).

The seller must :

- (a) obtain any export licence and carry out all customs formalities for the exportation of the goods including payment of all costs, duties and taxes;
- (b) deliver the goods into the custody of the carrier and notify the buyer;
- (c) provide the usual transport document;
- (d) he is not required to pay freight charges.

The buyer must:

- (a) obtain any import licence and carry out customs formalities for the importation of the goods;
- (b) bear all risks and pay all costs, duties and taxes;
- (c) nominate carrier and arrange contract for the carriage;
- (d) pay the freight charges;
- (e) take delivery of the goods.

### 3.8 *Carriage Paid To (CPT.....named place)*

Under CPT terms, the seller must:

- (a) obtain any export licence and carry out all official/customs formalities for the exportation of the goods including payment of all costs, duties and taxes;
- (b) contract for the carriage and pay the freight charges;
- (c) deliver the goods into the custody of the first carrier;
- (d) provide the usual transport document.

The buyer must:

- (a) obtain any import licence and carry out all customs formalities for the importation of the goods including payment of all costs, duties and taxes;
- (b) bear all risks of loss or damage to the goods when the goods have been delivered to the first carrier;
- (c) accept delivery of the goods from the carrier.

### 3.9 *Carriage and Insurance Paid To (CIP.....named place)*

Here, the seller's obligations are identical to CPT above. In addition, the seller must:

- (a) arrange cargo insurance and provide evidence of insurance cover;
- (b) pay the insurance premium.

The buyer must:

- (a) clear the goods for import;
- (b) take delivery of the goods at the named place of destination.  
(to be cancelled starting from January 2011)

#### 4 Division of Costs, Risks and Responsibilities under Incoterms

The above Incoterms with respect to the buyer's and seller's responsibilities are written in a simplified manner, as in most standard textbooks. According to International Chamber of Commerce (I.C.C.), Incoterms should allocate costs, risks and responsibilities between the seller and buyer in ten numbered articles, "A" for seller's responsibilities and "B" for the buyer's responsibilities.<sup>[2]</sup>

##### A — Seller's responsibilities

- A1 Provision of goods in conformity with the contract
- A2 Licences, authorizations and formalities
- A3 Contract of carriage and insurance
- A4 Delivery
- A5 Transfer of risks
- A6 Division of Costs
- A7 Notice to the buyer
- A8 Proof of delivery, transport document or equivalent E-message
- A9 Checking—packaging—marking
- A10 Other obligations.

##### B — Buyer's responsibilities

- B1 Payment of the price
- B2 Licences, authorizations and formalities
- B3 Contract of carriage
- B4 Taking delivery
- B5 Transfer of risks

- B6 Division of Costs
- B7 Notice to the seller
- B8 Proof of delivery, transport document or equivalent E-message
- B9 Inspection of goods
- B10 Other obligations.

#### 5 Summary of ICC Incoterms 2000

There are 13 standard Incoterms in the 2000 version as shown in the following sequences.

Group E Departure:	EXW	Ex Works
Group F Main carriage unpaid:	FCA	Free Carrier
	FAS	Free Alongside Ship
	FOB	Free on Board
Group C Main carriage paid:	CFR	Cost and Freight
	CIF	Cost, Insurance and Freight
	CPT	Carriage Paid To
	CIP	Carriage and Insurance Paid To
Group D Arrival:	DAF	Delivered At Frontier
	DES	Delivered EX Ship
	DEQ	Delivered EX Quay
	DDU	Delivered Duty Unpaid
	DDP	Delivered Duty Paid

## 6 Summary of Mode of Transport and the Appropriate Incoterms 2000<sup>[3]</sup>

Any modes of transport including multimodal	EXW	Ex Works (...named place)
	FCA	Free Carrier (...named place)
	CPT	Carriage Paid To (...named port of destination)
	CIP	Carriage and Insurance Paid To (...named port of destination)
	DAF	Delivered at Frontier (...named place)
	DDU	Delivered Duty Unpaid
	DDP	Delivered Duty Paid
Sea and inland waterway transport	FAS	Free Alongside Ship (...named port of shipment)
	FOB	Free On Board (...named port of shipment)
	CFR	Cost and Freight (...named port of destination)
	CIF	Cost, Insurance and Freight (...named port of destination)
	DES	Delivered Ex Ship (...named port of destination)
	DEQ	Delivered Ex Quay (...named port of destination)

## 7 Variants in Incoterms

The above Incoterms were designed by the International Chamber of Commerce in 2000 and are not tailor-made for every trader. Sometimes, they may be useful only when used with some variations.

For example, EX Works Loaded may be used instead of EX Works to allow a seller and a buyer more flexibility Under EX Works Loaded: in addition to making the goods available at his own premises, an exporter is required to load the goods on vehicles.

Meanwhile, under EX Works Cleared, an exporter is required to clear the goods for export. These variants may be quite useful to the buyer when he is not familiar with the customs formalities of the exporting country. EXW Cleared is used when the buyer would like the seller to clear the goods for export for him at the latter's expense. Other variants in standard terms such as FAS Cleared, DDU Cleared, DDP VAT Unpaid are also used in the market.<sup>[4]</sup>

## 8 Incoterms 2010

Incoterms 2000 have been used as the standard shipping terms in the last decade. Since its introduction, there have been some changes in the delivery process. Therefore, a new set of rules Incoterms 2010 will replace Incoterms 2000, effective from 1st January 2011.

The new revision reflects the profound changes that have been taken place in the global trade since 2000. These include the important cargo security taken in many countries and the 2004 revision of the United States' Commercial Code, which resulted in a deletion of the former US shipment and delivery terms. The revised Incoterms rules also reflect the adoption in 2009 by the insurance markets of the revised Institute Cargo Clauses (LMA/UA) (2009). The new rules have been developed to take into account these changes and other trends in international commercial practices. The onward march of containerization and point-to-point deliveries, for example, persuaded ICC to introduce two new "Delivered" terms.<sup>[5]</sup>

Under Incoterms 2010, there are fewer terms. Delivered at Frontier (DAF), Delivered Ex Ship (DES), Delivered Ex Quay (DEQ) and Delivered Duty Unpaid (DDU) are cancelled. Delivered at Terminal (DAT) and Delivered at Place (DAP) are introduced. In other words, there are now a total of 11 standard terms instead of the 13 standard terms in Incoterms 2000.

Apart from the above changes, the new Incoterms 2010 are separated into 2 groups, those applicable to all modes of transport and those applicable to sea and inland waterway transport. The following table summarizes the 11 standard terms in Incoterms 2010:

All modes of transport:	Ex Works (EXW)
	Free Carrier (FCA)
	Carriage Paid To (CPT)
	Carriage And Insurance Paid To (CIP)
	Delivered At Terminal (DAT)*
	Delivered At Place (DAP)*
Sea and inland waterway transport:	Delivered Duty Paid (DDP)
	Free Alongside Ship (FAS)
	Free On Board (FOB)
	Cost And Freight (CFR)
	Cost, Insurance And Freight (CIF)
	* newly introduced

It is hoped that with the new incoterms, there will be a set of clearer, more precise and comprehensive rules adapted for the 21st century that offer increased legal certainty in sales transactions between and within countries, and within customs-free blocks. The rules will also help traders avoid misunderstandings by clarifying the cost, risks and responsibilities of both buyers and sellers, making it essential for professionals in international trade to clearly understand the new rules.<sup>[6]</sup>

## Notes

1. Under Incoterms 2000, the buyer has an obligation to clear the goods for import and to pay import tax, if any.
2. Jan Rambert, *Guide to Incoterms 1990*, ICC Publishing SA.
3. International Chamber of Commerce, *Incoterms 2000*.
4. Although I.C.C. does not formally recognize variants in Incoterms (this is understandable as there are many variants used in the market and more and more may be introduced by traders to suit their needs), **FAS under Incoterms 2000 is more or less the same as the variant — FAS cleared. Under FAS (the new Incoterms), sellers are required to perform export custom clearance.**
5. ICC Events, *Incoterms 2010*, by the International Chamber of Commerce
6. ICC Events, *Incoterms 2010*, by the International Chamber of Commerce

## Revision Questions

1. People's Ltd., a valuable customer, purchases goods from suppliers in the UK. They have been using documentary credits and trading under FOB terms for most of the transactions. Today, the shipping manager of People's Ltd., Mr John Wong, calls to see you and asks you what transport and insurance documents a UK exporter should produce if they wish to use the following terms:

- (a) FCA Heathrow Airport
- (b) FAS Oslo
- (c) CIF Hong Kong

Required:

- (a) State, in note form, the full name of these Incoterms and how you would deal with Mr. Wong's request.
- (b) State whether the importer or the exporter should pay for marine insurance under the following Incoterms: DAF, CFR, EXW, DDP, FOB, CIP.

\*Question from HKIB Banking Practice in Hong Kong, May 1998.

2. What do you understand by "Variants in Incoterms"?
3. What are the major differences between Incoterms 2000 and Incoterms 2010? (Hint: refer pp. 57–58 for answer)

## Further Reading

1. *Incoterms 2010*, the International Chamber of Commerce ICC publication no. 715, 2010 Edition.

direct collection, a collecting bank may be ready to present the bill if the drawee is known to him (or a good bank–customer relationship is established between the collecting bank and the drawee). However, most banks are unwilling to act as collecting banks if the documents are sent from an unknown party addressed to an unknown drawee for acceptance/payment. The norm is that, in dealing with a collection, they must at least know one party well, either the instructing party (remitting bank or principal) or the drawee (his customer).

### 3.2 Indirect Collection

For a clean collection, goods are delivered by the principal to the drawee's premises or a place as designated by the drawee. Commercial documents (including bills of lading, commercial invoice etc.) are sent direct by the principal to the drawee or accompany the goods. Financial documents (usually bills of exchange) are submitted by the principal to the remitting bank which, in turn, will forward the bills to the collecting bank for payment or acceptance.

The advantage of a clean collection over open account is that, with the help of a collecting bank, the presentation of a bill of exchange can remind the buyer to pay/accept a draft and pay upon maturity. Also, there is an additional protection under the Bills of Exchange Ordinance. Despite the fact that a principal has lost control over the goods under a clean collection, this type of term of payment may be relatively less risky than open account for the exporter.

For documentary collection, goods are delivered by the principal to the drawee's country or a place designated by the drawee. Financial documents and commercial documents are submitted by the principal to the remitting bank. Banks may be instructed to release documents against immediate payment. This type of collection is known as "document against payment" (D/P). Where a bill of exchange is the financial document, it is a sight bill. In this type of collection, the drawee must make immediate payment to the collecting bank in order to obtain shipping documents to take delivery of goods.

If the collecting bank is instructed to release documents against immediate acceptance of a bill of exchange, this type of collection is referred to as "documents against acceptance" (D/A). Where a bill of exchange is the financial document, it will be a term bill. In this type of collection, the drawee can take the shipping documents against acceptance of the draft and undertake to pay upon maturity.

## 4 Bank Considerations in Remitting Bill (Outward Collection)

A remitting bank is a bank handling outward collections (O/C). When a principal hands in an application for collection, there are many steps which a remitting bank has to take before sending an instruction to the overseas corresponding bank for collecting the proceeds. On the one hand, the remitting bank has to act strictly in accordance with the principal's instruction. On the other hand, it has to comply with the Uniform Rules for Collections and take into account the need of being practical.

Upon receipt of a set of documents for collection, the remitting bank must :

- (a) check that the customer has a bill account with it and is trustworthy;
- (b) check that the number of documents appears to be the same as listed in the collection order. Although the remitting bank has no further responsibility to examine the contents of the documents, it is recommended that in order not to delay the collection process and, in particular, to demonstrate its professional service, it should at least take the following extra steps:
  - (1) ensure that the bill of exchange is duly signed and endorsed;
  - (2) ensure that the amount of the bill of exchange is the same as the invoice and collection order;
  - (3) ensure that a full set (unless otherwise specified by the principal) of bills of lading and insurance policy (if any) are submitted and duly signed and endorsed.

- (c) exercise professionalism to remind its customers of any special documentary requirements in the drawee's country, e.g., consular invoice, certificate of origin (in practice, this may be difficult);
- (d) advise the principal the need on protest in some countries;
- (e) choose a collecting bank at its own discretion or according to the principal's special instruction.

After that, the remitting bank will issue its own "collection covering letter" in accordance with its customers' instructions and in compliance with the Uniform Rules for Collection.

## 5 Bank Considerations in Collecting Bills (Inward Collection)

A collecting bank is a bank handling inward collections (I/C). It is acting in an agency capacity for a remitting bank. As an instructed party, a collecting bank must act in accordance with the instructions of the instructing party (remitting bank). Therefore, a collecting bank must make sure that the documents received are accompanied by a collection instruction with clear instructions.

Even if a bank-customer relationship exists between the collecting bank (acting as presenting bank) and drawee, the collecting bank owes a duty of agency to the remitting bank. If there is any variation in instructions respectively given from the remitting bank and the drawee, a collecting bank should act strictly in accordance with instructions of the remitting bank. In case of any queries, a collecting bank (instructed party) should go back to the remitting bank (instructing party) to seek instruction.

Upon receipt of a set of inward collection documents, a collecting bank must:

- (a) ask itself if it wishes to handle the collection. Sometimes, it may not wish to handle the collection because the collection instruction was sent from an unknown bank/exporter or the collecting bank finds it difficult to collect bank charges because of a deterioration in drawee's credit standing;
- (b) verify the signature(s) of the collecting covering letter (in

practice, most collecting banks do not need to do this) if it agrees to handle the documents, and that the documents received appear to be as listed in the collection instruction. However, it takes no further responsibility to examine the documents. If documents appear not to be as listed, a collecting bank must inform the remitting bank without delay;

- (c) examine the collection instructions. Inform the instructing party for any instructions which it cannot follow, if any;
- (d) inform the importer of the arrival of collection documents. Deliver documents against payment or acceptance according to the collection instructions. Act strictly in accordance with the instructions of the collection instruction for other terms.

## 6 Roles and Responsibilities of a Collecting Bank

A collecting bank acts as an agent of the remitting bank. Therefore, it should act strictly in accordance with the instructions given in the remitting bank's collection instruction. Its main role is to present the bill to the importer either for payment/acceptance or against other terms. However, as an instructed party, it does not guarantee payment of the bills. If the bill is paid by the buyer, it should immediately remit the proceeds to the instructing party, the remitting bank. If the bill is accepted, it should advise the fate of the bill to the remitting bank according to the collection instruction. If the bill is unpaid/unaccepted, it may have to arrange storage and insurance for the goods as instructed in the collection instruction.

Sometime, a collecting bank is instructed to protest on behalf of the remitting bank in case the bill is dishonoured. Whether protest is required depends on whether protest is specifically instructed in the remitting bank's collection instruction. Whenever a collecting bank has taken action in connection to the storage, insurance for the goods or protest, it must immediately advise the remitting bank of the details of the action taken. If there are any unclear instructions or queries in the collection instruction, it should seek further instructions from the instructing party, e.g., the remitting bank, before taking any

action. A collecting bank, in any circumstances, acts as an agent only. It must act in good faith and exercise reasonable care.

## 7 Procedures for Presenting Documents to Buyer against Payment/Acceptance/Other Terms

Upon receipt of an inward collection, a collecting bank will act in accordance with the instructions of the collection. The first and most important instruction which should be noticed is whether documents are released against payment or acceptance.

### 7.1 Documents against Payment (D/P)

If it is a D/P collection, the collecting bank should only release documents against payment of the sight draft, and the payment must be immediately available for remittance to the instructing party. If payment is refused or the drawee makes an excuse to make immediate payment, a collecting bank should not release the original documents to buyer. Even if security is deposited with the bank by the buyer against examination of original documents, the collecting bank should not release documents unless full payment is made. A collecting bank should always remember that it is responsible to the remitting bank and is an agent of that bank. Upon receipt of payment, a collecting bank should remit the proceeds to the instructing party without delay.

### 7.2 Documents against Payment with a Tenor Draft (D/P Usance)

Sometimes, the movement of documents from a remitting bank to a collecting bank is faster than the movement of goods from the seller's country to the buyer's country. It may happen if documents and goods are respectively mailed and shipped from Europe to Hong Kong. Normally, it takes one week or so for documents to arrive in Hong Kong whereas goods do not arrive by vessel for three or more weeks. A buyer may be unwilling to pay if he is required to make

payment immediately upon presentation of a draft which may be long before the arrival of goods. In that case, a buyer may ask for a D/P with a tenor draft as the term of payment, e.g., D/P 30 days. Under this term of payment, the buyer is not obliged to pay until the maturity date which is 30 days after presentation of documents. Hence, the buyer can wait for the arrival of goods during this 30 day period. However, this is not encouraged in URC-522, Article 7A.

Documents cannot be released to the buyer unless full payment is made at any time during this period of 30 days. Depending on the arrival day of the goods and the buyer's urgent need for the goods, he may make an early payment in order to take delivery of the goods. In other words, he may make payment on day one immediately after acceptance of the documents, in return for a set of shipping documents. He may make payment on, say, day 15 (assuming that this is the day when the shipment arrives) in return for a set of shipping documents. He is, however, obliged to pay on day 30 after the day of acceptance of the draft regardless of whether the goods have arrived or not. The amount collected by the presenting bank must be remitted to the instructing party without delay.

### 7.3 Documents against Acceptance (D/A)

In the case of a D/A collection, the collecting bank is instructed to release documents against the acceptance of a tenor draft. If the drawee refuses to accept the draft, the collecting bank should not release the documents and should inform the instructing party without delay. The collecting bank fulfils its obligation when it obtains the acceptance of the draft and delivers the documents to the drawee. Then, it should advise the remitting bank of the due date and retain the draft until maturity. Upon maturity, it should remit the proceeds to the remitting bank to the debit of its customer's account/cheque or cash.

Should the drawee refuse to honour payment upon maturity, a collecting bank may have to take further action in accordance with the collecting schedule such as:

- (a) advise non-payment;
- (b) protest for non-payment if requested;

- (c) contact the case-of-need if requested;
- (d) store and insure the goods if requested.

#### 7.4 Documents Released against Other Terms and Conditions

Sometimes, a collecting bank is instructed to release documents against a promissory note or letter of undertaking issued by the drawee. A promissory note is a promise issued and signed by the importer to pay at an agreed future date. In the case of a letter of undertaking, it is most probable that this document is used to replace a draft to exempt the transaction from stamp duty in some countries. The collecting bank fulfils its obligation when the documents are released to the drawee against the receipt of a promissory note or letter of undertaking or other conditions as per the collecting instruction. Sometimes, a collecting bank may be instructed to release documents against "free of payment" in which case, the collecting bank fulfils its obligation when it releases the documents against a receipt for the goods issued by the drawee. No payment will be collected in this type of collection.

### 8 Advice of Fate

In almost all collection instructions, the need for a collecting bank to advise the maturity date of a usance document for non-payment or non-acceptance is specified as one of the instructions. Therefore, a collecting bank must always keep the remitting bank informed of the progress (the Fate) of the bill. According to the instructions given in the remitting schedule, a collecting bank may have to advise the remitting bank by telex or by mail or other means.

If a D/A bill is accepted by the buyer, the collecting bank may be instructed to send an advice of fate to the remitting bank stating that the bill is accepted giving the maturity date of the bill. If the bill is dishonoured either for payment or acceptance, the collecting bank should endeavour to ascertain the reasons for this. It may be instructed to protest the bill, contact the case-of-need, warehouse and

insure the goods under advice to the remitting bank. The collecting bank is obliged to keep the remitting bank informed of the details of all action taken.

### 9 Procedures for Dealing with Goods Consigned to the Collecting Bank

Sometimes, an exporter would like to consign the goods to or to the order of a collecting bank. The exporter may feel that if the goods are consigned to a bank, the bank instead of the importer, will absolutely retain control over the goods. Unless the importer has paid for or signified his acceptance on the bills of exchange, he cannot get the documents and the possession of the goods. This is what an exporter normally thinks. As a matter of fact, it may be risky for an exporter to have this arrangement because, according to URC-522, goods should not be consigned to a collecting bank without prior agreement on the part of that bank. If a collecting bank is informed by a transportation company of the arrival of goods and asked to take delivery of them, it is up to the collecting bank to take them or not. Normally, a collecting bank should take the following action:

- (a) Inform its customer about the arrival of goods. Decide whether it would be prepared to help its customer or not. If its customer does not want the goods or if the goods do not belong to its customer, then, inform the transportation company that it is not prepared to take delivery of the goods. Meanwhile, ask the transportation company to refer the matter back to the instructing party, which is normally the remitting bank.

Even if the customer wants its assistance, there is no obligation on the collecting bank to take any steps to protect the interests of its customer and the goods which remain at the risk of the instructing party.

However, if the collecting bank decides to be involved in this transaction and in particular to help its customer, it must confirm immediately with its customer whether he really wants the bank to assist him to take delivery of the goods and then seek its customer's instructions.

- (b) When the bank assists in the delivery process, it must make it clear that once its customer has taken delivery of the goods, he cannot refuse to pay for the relevant documents which will subsequently arrive. In addition, the customer is liable to pay for all the charges and takes the risk in connection with the delivery.
- (c) In helping its customer to take delivery, a collecting bank needs to know the value of the goods and have the same amount of cash/security from its customer. It may ask for a photocopy of an invoice sent from the seller to its customer, or it may send a telex to the remitting bank enquiring the exact value of the goods. If it requests the deposit of a security simply based on the customer's declaration, it may run the risk of taking insufficient security to cover the value of the goods. Some unscrupulous customers know that they do not have enough cash balance or a Trust Receipt facility. When the goods arrive, they declare a smaller value and take delivery of the goods against T/R or deposit of cash. When documents subsequently arrive, the bank may find that the amount in the documents is many times larger than that of the declared value of the goods. Therefore, caution has to be taken to guard against unscrupulous customers.
- (d) The bank will create a suspense account (Marginal Deposit Account) pending arrival of documents for settlement.

One point to note is that as mentioned above, a collecting bank has no obligation to take any action in respect of the goods in a collection. It even does not have to take action to protect the goods, including storage and insurance, even when specific instructions are given by the sending party to do so. Besides, the collecting bank, under URC-522, is not obliged to inform the sending party about its refusal to take delivery (in practice, the collecting bank will inform the sending party). However, if the collecting bank has taken action in connection with the goods, whether instructed or not, it is obliged to inform the instructing party of all the details. But the collecting bank is not responsible for the acts of any third parties in connection with the protection of the goods. This third party may be the warehousing company.

## 10 Procedures for the Protection of Goods in the Event of Dishonour

When the remitting covering schedule requests that goods should be stored and insured in the event of dishonour, the collecting bank will only take such action if they agree to do so. A collecting bank is not obliged to do so according to URC-522. When the collecting bank takes action to protect and insure the good, it will, in most cases, choose a warehousing company and insurance company with whom it is familiar. The collecting bank must inform the remitting bank of the details in connection to warehousing and insurance. However, the collecting bank is not liable to nor responsible for any third parties entrusted with the protection and custody of the goods. If the collecting bank is unwilling or unable to take actions to protect the goods, it is not obliged to inform the remitting bank according to URC-522 (even if specific instructions are given to do so). It is, however, a customary practice for the collecting bank to advise the remitting bank that it is unable or unwilling to take action to protect the goods.

## 11 Note and Protest in the Event of Dishonour

According to the Bills of Exchange Ordinance, noting and protesting involves handing the bill to a notary public who represents the bill. If the bill is again dishonoured, the notary public notes on the bill the date, a reference to his register, the noting charges and his initial. Noting is cheaper than the formal protest and its main purpose is to extend the time in which a protest can be made. Protest is a formal declaration by a notary public at the request of the holder that the bill has been dishonoured and that the holder intends to recover all the expenses to which he may be put in consequence of it.

If a bill is dishonoured either for non-payment or non-acceptance, a collecting bank will have to protest the bills when specifically instructed to do so in the collection instruction. Regarding protest, particular care must be taken to ensure that such protest be made immediately. Usually, the in-house solicitor of the bank acts on behalf of the collecting bank in effecting protest. The bill may be

## 2 Explanation of the Operation of a Transferable Credit (see Figure 10.1)

- (1) Ultimate buyer in USA applies for a transferable credit known as original credit from his banker.
- (2) His banker, known as original L/C issuing bank, issued the L/C in USA and has it sent to its branch/ subsidiary/ corresponding bank in Hong Kong.
- (3) The advising bank in Hong Kong advises the credit to the beneficiary who is usually a middleman. This middleman is the beneficiary under the original credit as well as the applicant under the transferable credit. He is also known as a transferor or first beneficiary.
- (4) The transferor applies for a transferable credit (also known as letter of transfer) from his banker (or from the advising bank if it so happens that the advising bank is also his banker).
- (5) The transferring bank effects the transfer and sends the transferable credit through its branch/ subsidiary/ corresponding bank in China for onward advising the transferable credit to a supplier or more than one suppliers.

Note that the transferable credit is effected without payment undertaking imposed on the transferring bank in Hong Kong. It is the undertaking of the original D/C issuing bank in USA to give a payment promise to the supplier in China. In the case of a partial transfer, the transferring bank will keep the original D/C at its premises and based on its contents, issue a separate D/C to the Chinese supplier. The separate D/C is usually a certified photostatic copy of the original D/C except that a few items are changed e.g., amount of credit, quantity of goods, unit price, if any. The transferable credit can even be a full telex message prepared by the Transferring bank if it finds it more convenient to do so.

In the case of a full transfer, the original D/C will be sent to the supplier. A letter issued by the Transferring bank is accompanied with the original D/C instructing that there

- should be no substitution of documents to be followed subsequently afterwards. It can be, perhaps, said that there are physically two credits involved in partial transfer and, one credit involved in fully transfer. And in both cases, the transferring bank effect the transfers without any payment obligation.
- (6) The advising bank in China advises the transferable credit to the supplier, who is known as the transferee or second beneficiary. Note that there can be more than one "Second beneficiaries" who can be in the same country or different countries. Second beneficiaries, however, are not allowed to further transfer the credit to any third beneficiaries except in the case of retransfer back the letter of transfer to the first beneficiary. We consider supplier A only for simplicity reason.
  - (7) The supplier ships the goods to the ultimate buyer or his designated place.
  - (8) The supplier prepares documents which are submitted to his banker to have them sent to the Transferring bank for substitution of documents by the first beneficiary pending payment from DC issuing bank (in full transfer with no substitution stipulated, documents are sent direct to original D/C issuing bank for payment). Note that in most cases, unless a very good relationship has been established between the transferee and his banker, negotiation of transferee's documents will not happen.
  - (9) Transferee's banker (2nd beneficiary's banker) sends documents to the Transferring bank for substitution of documents (In case of full transfer, documents will be sent directly to original D/C issuing bank for payment, as shown in route 9A, bypassing routes 9-12).
  - (10) Transferring bank informs the first beneficiary to have documents substituted and fulfil the terms as per the original credit.
  - (11) Transferor submits substituted documents to the Transferring bank.
  - (12) Transferring bank, upon receipt of full set of documents,

will send them to the original D/C issuing bank for payment. Also, unless a good relationship has been established between the transferor and his banker, there will not be negotiation.

- (13) Issuing bank checks documents. It honours its payment undertaking if documents are found to be in order. Proceeds will be remitted to the Transferring bank.
- (14) Payment by Transferring bank of the amount drawn by the second beneficiary and the difference of the transferred amount and original L/C amount paid to the first beneficiary as profit.
- (15) Issuing bank releases documents to the ultimate buyer upon receipt of payment/against trust receipt.
- (16) Ultimate buyer takes delivery of goods upon presentation of the transport document.

### 3 Types of Transfer: Partial Transfer, Full Transfer (Total Transfer)

There are two types of transfer, namely partial transfer and full transfer. Partial transfer means transfer part of the original DC amount to the second beneficiary(ies) with substitution of his (their) documents. Full transfer means transfer the full DC value to the second beneficiary(ies) normally without substitution of his (their) own documents.

In partial transfer, a transferor transfers part of the credit amount to a beneficiary or more than one beneficiaries. The remaining amount may be left for himself. For the portion being transferred, it is expected that substitution of the middleman's invoice for that of the supplier is required. Substitution of documents means the middleman is asked by the transferring bank to present his own invoice and draft (larger amount according to original credit) to replace those issued by the supplier's which, together with other shipping documents (submitted by supplier) will be sent to issuing bank for payment. In full transfer, a transferor simply requests his

banker to have the credit wholly transferred to a supplier. This transferor may be an agent only, responsible for placing order for either the ultimate buyer or supplier. The amount in the letter of transfer is the same as that of the original credit. As such, no substitution of invoice will be followed. Also, it is expected that the transferee's banker should send documents directly to original credit issuing bank for payment, bypassing Transferring bank.

### 4 Checklist for the Transferring Bank in Transfer

- (a) The original credit submitted by customers must be irrevocable and transferable.
- (b) "Subject to UCP-600" must be shown in the credit.
- (c) If transferor intends to have the credit transferred to more than one "Second beneficiary", L/C should allow partial shipment.
- (d) Original credit requests third party document acceptable. Transferring bank being at the same time as the advising bank is advisable. Otherwise, ask for an amendment from credit applicant, nominating our bank (Transferring bank) as the second advising bank at the same time.
- (e) In the case of a freely negotiable credit, our bank specifically authorized in the credit as the Transferring bank is necessary.
- (f) It is advisable to add the following clause in the transferable credit to exempt our bank from payment liability clearly. "Upon receipt of fund from credit issuing bank, we shall pay to you according to your instruction".
- (g) Care must be exercised to ensure that the issuing bank is informed about the details of transfer if it is stipulated in the original credit that in case of transfer, issuing bank must be notified about the details.

## 5 Checklist for the Transferring Bank upon Receipt of Supplier's Documents

- (a) Upon receipt of supplier's documents, Transferring bank must immediately inform the first beneficiary to submit his documents for substitution as soon as possible. If this first beneficiary fails to react to the request of the Transferring bank, the Transferring bank has the right to send the supplier's documents to the issuing bank without further responsibility to the transferor.
- (b) Only in rare occasion does a Transferring bank negotiate documents presented under letter of transfer. For example, the transferring bank has no doubt about the credit standing of the transferor and the issuing bank.

## 6 Possible Risks to the Transferring Bank in Effecting a Transfer

Transferring bank effects a transfer without payment obligation to the transferee. Therefore, it is obvious that a Transferring bank will expose to less extent of risk than a back-to-back credit issuing bank. However, a Transferring bank will easily expose to the kinds of risk which an agent will normally face. In effecting a letter of transfer, it may inadvertently fail to comply with the instructions stipulated in the original credit in transfer. Therefore, it runs into danger of negligence. Action may be taken against him by issuing bank, transferor or transferee.

## 7 Rights of the Transferring Bank

- (a) A Transferring bank is not obliged to effect the transfer. Even if it is stipulated in the credit as the Transferring bank, a transferor cannot force this nominated bank to effect the transfer.

- (b) If the first beneficiary does not substitute documents on first demand, a Transferring bank has the right to send the supplier's documents to issuing bank for payment without further responsibility.

## 8 Points to Note for the Ultimate Buyer

He made a contract with the middleman but the goods are not going to be shipped by the middleman but by a third party who may be unknown to him.

The quality of the goods is not assured unless they are inspected by the ultimate buyer himself or a public surveyor before departure.

## 9 Points to Note for the Supplier

His most concern is that:

He may be unable to be paid by issuing bank even if from his point of view, he has complied strictly with credit terms and condition. This can happen in the following circumstances:

Technical errors are made by either the transferor or Transferring bank in:

- (a) Issue of letter of transfer — e.g., transferor fails to give clear instructions to Transferring bank in application. Transferring bank fails to inform issuing bank as specified in the original credit. For example, the transferring bank is required by the issuing bank to give detailed notice to it in case of transfer. However, the transferring bank fails to act as instructed.
- (b) Substitution of document — error is made by Transferring bank or transferor which makes the document unclean (even if it was a clean document sent from the supplier's banker).

### 10 Sample of a Transferable Credit

Issuing Bank (in USA): USA Bank, USA  
 Advising Bank (in Hong Kong): A Bank Limited, Hong Kong (First Advising Bank in Hong Kong; City Bank, Hong Kong (Second Advising Bank)  
 Transferring Bank (in Hong Kong): City Bank, Hong Kong  
 DC Applicant: Ultimate Buyer Limited, USA  
 Transferor: Middleman Limited, Hong Kong  
 Transferee: Transferee Limited, Beijing, China  
 D/C Number: 12345  
 Transfer Credit Number: T-67890

City Bank Limited		
Check Sheet		
Transferable Credit		
Date :		
Credit Number: 12345		
Name of Issuing Bank: USA Bank, USA		
Name of Applicant (Ultimate buyer): Ultimate Buyer Limited, USA		
Name of our Transferor (Our customer): Middleman Limited, H.K.		
Name of Transferee (Supplier): Transferee Limited, Beijing		
	With substitution of documents	Without substitution of documents
Full Transfer		
Partial Transfer	√	
	Original Credit	Transferable Credit
Amount	USD 27,000.00	USD 21,900.00
Unit Price	USD 4.5/pc	USD 3.65/pc
Latest Shipment Date	15/6/2010	30/5/2010
Expiry Date	6/7/2010	10/6/2010
Presentation Period	21 days	11 days
Trade Term	CIF New York	CIF New York
Partial Shipments	allowed/not allowed	allowed/not allowed
Transshipments	allowed/not allowed	allowed/not allowed
Items (goods)	Men's Pyjamas, 18/6519	Men's Pyjamas 18/519
Other terms and condition:		
Remarks:		
Checker	Office	Manager
Handled by: Mr/Miss _____		
Ext.: _____		

A BANK LIMITED	
HONG KONG	
To: CITY BANK LIMITED HONG KONG	DATE: 10/04/10
ATTN.: L/C ADVISING DIVISION	OUR REF. NO: 1
LETTER OF CREDIT ADVICE	
BENEFICIARY: MIDDLEMAN LIMITED, HONG KONG	
L/C NO: 12345 FOR USD 126,000.00	
ISSUING BANK: USA BANK, USA	
AT THE REQUEST OF THE ABOVE-NAMED BANK, WE FORWARD HERewith, WITHOUT ENGAGEMENT ON OUR PART THEIR IRREVOCABLE LETTER OF CREDIT AS INDICATED.	
KINDLY NOTE THAT THIS LETTER OF CREDIT MUST ACCOMPANY THE DOCUMENTS AT THE TIME OF PRESENTATION TO US FOR NEGOTIATION AND TO AVOID UNNECESSARY DELAY, PLEASE MARK YOUR COVERING LETTER OUR REFERENCE NUMBER.	
PLEASE ADVISE THE ATTACHED LETTER OF CREDIT TO BENEFICIARY AND ACKNOWLEDGE RECEIPT QUOTING OUR REFERENCE.	
BEFORE RELEASING THE L/C TO BENEFICIARY PLEASE COLLECT FROM THEM AND FAVOUR US A CHEQUE FOR 200.00 COVERING OUR POSTAGE.	
FOR AND ON BEHALF OF A BANK HONG KONG BRANCH	
AUTHORIZED SIGNATURE(S)	

This is the Covering Letter issued by the first Advising Bank in Hong Kong.

## Notes:

1. Amount of application must be smaller than that of master credit to allow for profit.
  2. Shipment route must be the same in both credits.
  3. If partial shipment is not allowed in master credit, the same stipulation must appear in application form. If partial shipment is allowed in master credit, then, partial shipment may or may not be allowed in application form.
  4. The same reason as in (3) above applies to transshipment.
  5. In application form, shipment date may be earlier than that of the master credit. However, it can show the same date as that of the master credit since it should meet the latest shipment date and shipment port stipulated in the master credit only.
  6. In application form, expiry date must be earlier than that of the master credit. Their differences are not the same in each case. In general, the following factors will be taken into account.
    - (i) The postal distance between Hong Kong and the second beneficiary's country. More time should be allowed for shipping documents under the second credit to be sent from Europe to Hong Kong (long postal distance) than documents to be sent from Asia to Hong Kong (shorter postal distance).
    - (ii) The complexity in substitution of documents.
    - (iii) The postal distance between Hong Kong and Master Credit issuing bank if the expiry place under the first credit is at the counter of issuing bank.
- In practice, it is advisable to arrange to have the first and second credits to be made payable at the counter of the B/B credit issuing bank. Then, a difference of about fifteen days is allowed for substitution of documents and onward presentation.
7. If presentation period is stipulated in both credits, application form should shorten the presentation date by at least 7 days. Again, it is not the same in each case. Presentation period can be added in application form for protection even though no such period is required by master credit.

#### 4 Risks to the B/B Credit Issuing Bank

- (a) Credit risk of the master credit issuing bank. Assume that no discrepancies are found in the two sets of documents. It means B/B L/C issuing bank has to pay the second beneficiary but fails to be repaid under first credit.
- (b) Country risk of the issuer of master credit prevents the movement of fund to B/B L/C issuing bank although the latter commitment remains valid.
- (c) Supplier can fulfil all the terms under the second credit and so must be paid, whereas the middleman fails to comply with some terms under the first credit and so will not get paid.
- (d) There is the possible risk that documents presented under the second credit may be delayed in the post on their way to Hong Kong so that documents cannot be presented on time for presentation under the first credit.
- (e) Payments has to be made beforehand to the supplier under the second credit and the middleman will be paid under the first credit afterwards. There may be a delay in payment under the first credit (Middleman might require financial support from the B/B L/C issuing bank until receipt of the proceeds of the first credit).
- (f) The sudden death or bankruptcy of the middleman does not allow substitution of documents.
- (g) Middleman may not submit all the subsequent amendments of the master L/C. This may result that documents presented under the first credit can never comply with master credit.
- (h) B/B L/C issuing bank may lose control over the amendments if the master credit is not advised by it.
- (i) First credit is amended and accepted by middleman, but the supplier may refuse the amendment under the second credit.
- (j) Fraudulent documents may be submitted by the supplier under the second credit.

City Bank Limited  
Hong Kong

B/B Credit

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Date and Place of issue: 15 May 2010 Hong Kong	Irrevocable Documentary Credit Number 123 Date and Place of Expiry: 30 July 2010 at issuing bank's counter
Applicant: City Import and Export Limited Des Voeux Rd Central Hong Kong	Beneficiary: USA Flexing Machine Limited, New York USA
Advising Bank: Bank of USA New York Branch New York USA	Amount: USD 4,679,000.00 (United States Dollars Four Million Six Hundred Seventy Nine Thousand only)
Partial Shipments are not allowed Transshipment is not allowed Shipment from USA Airport to Hangzhou Airport via Hong Kong Latest 19 July 2010	Credit available by negotiation against presentation of the documents detailed herein and of your draft(s) at sight drawn on our bank for full invoice value
List of documents to be presented:	
<ol style="list-style-type: none"> <li>Signed commercial invoice in duplicate.</li> <li>Clean Air Waybill consigned to Bank of Zhejiang, Hanzhou, China notifying the Applicant marked "Freight Prepaid" and indicating freight amount.</li> <li>Packing list/weight memo in 3 copies showing quantity/gross and net weight for each package.</li> <li>Certificate of quality in 3 copies issued by the manufacturer and <b>made out "To Whom It May Concern"</b>.</li> <li>Beneficiary's certified copy of telex despatched to applicant advising contract no., goods name, quantity, invoice value, packages, flight no., shipment date and place after shipment effected.</li> <li><b>Beneficiary's certificate certifying that one set of N/N documents supported by relative courier receipt has been sent to applicant within 3 days after shipment.</b></li> </ol>	
Evidencing shipment of: One set of whole shoe flexing machine Model: WFSM/338	
(continue to next page)	
We hereby issue this Documentary Credit in your favour. It is subject to the Uniform Customs and Practice for Documentary Credits (2007 Revision, International Chamber of Commerce, Paris, France, Publication N° 600) and engages us in accordance with the terms thereof, and especially in accordance with the terms of Articles 10 thereof. The number and the date of the credit and the name of our bank must be quoted on all drafts required. If the credit is available by negotiation, each presentation must be noted on the reverse of this advice by the bank where the credit is available.	
For City Bank Limited, Hong Kong	
_____ Authorized Signature(s)	

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<b>CONTINUATION OF IRREVOCABLE DOCUMENTARY CREDIT NUMBER</b>	Credit number 123
Packing: In strong wooden cases, suitable for long distance air transportation.	
Shipping mark: 12345 Hangzhou China	
CFR Hangzhou, packing charges included.	
Other terms and conditions:	
<p><b>All documents except invoice, draft and telex copy must not show this credit number, value of shipment, name and address of L/C applicant and L/C issuing bank.</b></p> <p><b>Documents must be presented within 10 days after shipment date but within credit validity.</b></p> <p>All banking charges including advising, negotiation and reimbursement charges outside Hong Kong are for account of beneficiary.</p> <p>All documents must indicate contract No. 12345.</p> <p>Insurance to be covered by ultimate buyer.</p>	
Instructions to negotiating bank:	
<p>Please forward all documents to us in one lot by speedpost or courier service.</p> <p>Upon receipt of documents in conformity with the terms of this credit we shall reimburse the negotiating bank according to their instructions.</p>	
*** END OF L/C ***	
(Bold sentences represent the changes in the B/B credit)	
(This credit consists of 2 pages)	
Yours faithfully	
For City Bank Limited Hong Kong	
_____ Authorized Signatures	

- (c) Beneficiary after obtaining the advance from the advising bank may negotiate the documents with another bank if the credit is available with any bank by negotiation.
- (d) Applicant may go into insolvency/difficulty and may not be able to honour his commitment.
- (e) Enforcement of the beneficiary's undertaking letter may be difficult and time consuming because issuing bank and beneficiary normally are in different countries.

### 3 Steps Taken by the Issuing Bank to Protect Its Own Interest

- (a) Credit should be issued nominating a bank for negotiation. It is advisable to nominate the bank giving the advance being the negotiating bank. (i.e., restrict negotiation to advising bank)
- (b) Should specifically mention the amount of the advance to be made by either specifying the percentage of the credit amount or a fixed sum.
- (c) Should specify whether the interest for the advance is for account of the beneficiary or for account of the issuing bank (normally such charges are to be borne by beneficiary).
- (d) Should specify if the advance is to be made in the currency of the credit or in the currency of the beneficiary's country (normally in the currency of the credit).
- (e) Should incorporate an undertaking clause undertaking to pay the advising bank (or the issuing bank) the amount advanced plus the interest and bank charges should the beneficiary not export the goods.
- (f) The portion of pre-shipment finance should be further supported by tangible security.

### 4 Green Clause Credit

- (a) Sometimes, it may be very risky for a bank to issue a red

clause credit for its customer as the issuing bank has no control over the goods.

- (b) In green clause credit, the advances are made by the advising bank upon the beneficiary producing a warehouse receipt, thereby overcoming the weakness of a red clause credit.
- (c) Warehouse receipts are made out in the name of the bank actually making the advance.
- (d) Advising bank retains the control over the goods.
- (e) Goods are released for shipment by the warehouse keeper on the instruction of the advising bank.
- (f) Green clause credit is rarely seen in Hong Kong

### 5 Meaning of a Revolving Credit

A revolving credit is a credit which provides for the amount of the credit to be renewed (in practice known as reinstated) automatically after use without the need to renew the credit every time.

It can revolve with respect to either:

- (a) time, or
- (b) amount (i.e., total value of the credit).

A revolving credit "with respect to time" can be cumulative or non-cumulative.

A cumulative revolving credit allows any unused credit amount of a previous period to be carried forward to the next period.

A non-cumulative revolving credit, on the other hand, provides for a maximum amount of credit to be drawn for each period. If the exporter fails to use up the maximum amount allowed to be drawn for that period, the amount in that period (full amount or any utilized balance as the cases may be ) will be forfeited automatically. "Period" is in terms of weekly, fortnightly, monthly, bi-monthly or quarterly. It is popular to see monthly revolving credit in Hong Kong. Table 12.1 is an illustration:

A revolving credit "with respect to amount" allows the credit amount to be renewed as soon as the exporter presents his shipping