LOCAL ENTREPRENUERS ARE DEPRIVED OF THE BENEFITS OF TRANSFERABLE CREDITS ENJOYED BY ENTERPRENUERS OF THE FOREIGN COUNTRIES

Michael Peiris (Trade Consultant)

Overview

I would like to share one of my recent experience relating to a transferable Letter of Credit for the benefit of trade practitioners both in banks and trade enterprises. It comes to my mind a saying of late Great Mohamed Ali the black superman. He once said that if you are thinking the same way you thought when you were on thirties even after fifty years you have wasted at least twenty years of your valuable life. I hope my colleagues will not get offended for stating here that I do not see a significant change in thinking pattern of the people involved in trade currently in commercial banks from some of the people that I have associated with about twenty years ago. World has changed so much during this period and the trade too has changed over the years in an unimaginable ways to meet the need of the developing markets. Therefore no one should think in the rigid way as the people thought about twenty years ago with regard to trade settlement as the necessary provisions are already available in the regulations both local and international to create a level playing field anywhere in the world providing opportunities for seamless trade or more appropriately the supply chain.

Transferable Credits & Import Regulations

Coming back to the subject of local entrepreneurs being deprived of benefits enjoyed by the entrepreneurs of other countries, I would like to take the example from a recent transaction where the settlement was to be made via a transferable Letter of Credit. Transferable Letter of Credit is an instrument that is being used by a middleman to source commodities or services to an ultimate buyer or an employer whilst ensuring the supplier of his due payment and the middleman's payment of profit margin by the ultimate buyer's bank provided letter of credit terms and conditions are complied with.

The current Sri Lankan import regulations provides flexibility for structuring payments terms and methods to commercial banks, the importers and the suppliers so as to facilitate international trade on technically and internationally acceptable terms sans barriers. In this connection I would like to quote from the Gazette Extraordinary 1739/3 (this outlines the current Import and Payment Regulations In Sri Lanka) dated January 2, 2012 paragraph 3 (2) – "**The choice and technicalities of the payment terms to be adopted in respect of any particular import is a matter to be decided as between the person who is the supplier and the importer of the goods and relevant licensed commercial bank."** This in my view is a major breakthrough the present Sri Lankan trade bankers dealing in supply chain financing have achieved in order to facilitate payment methods acceptable to trade practitioners anywhere in the globe. Despite the above it is sometime frustrating to see commercial banks still hesitate to think out of the box and take the advantage of the relaxed regulations and provide financing solutions. That in my view has prevented local clients harnessing new potentials despite the desire and the ability to be in a level playing field with their counterparts.

Modifying Transferable Credit meeting Local Regulatory Requirements

Whilst drawing your attention to the above, I would like to take you through a scenario where a local party had to almost lose a trade contract due to a stand taken by a local bank to refuse a transfer of Transferable Letter of Credit (TLC) issued by another local bank to a Chinese supplier. This particular TLC under its special condition has stipulated that a set of invoices issued by the second beneficiary to be presented by the first beneficiary. This requirement has been stipulated by the issuing bank at the request of its applicant mainly to ensure that there would be no issues whatsoever when clearing the goods from the customs. The First Beneficiary (local middleman) has arranged with the second beneficiary to send a separate set of invoices for the full value of the credit direct to the first beneficiary in order to comply with TLC term. Although Uniform Customs and Practice for Documentary Credits 600 article 18 b. permits invoices exceeding the value of letter of credit to be presented provided the negotiation is made only within the LC value, in terms of the supplier's (second Beneficiary's) company internal policy the supplier was unable to present an invoice exceeding the value of the transferred credit. Nevertheless the supplier has agreed to send a separate set of invoices direct to the beneficiary (middleman) enabling him to secure his profit margin within the LC transaction. We all know that in a normal transferable credit according to UCP (600) article 38 h. beneficiary has the right to substitute his invoices for that of the second beneficiary. However one must understand that this requirement is only applicable unless and otherwise modified to the contrary in the letter of credit. This has been provided for in the article 1 of UCP 600 itself. On the other hand in a transferable Letter of Credit, the responsibility of the complying with original Letter of Credit remains with the first beneficiary and what a transferring bank does in an ordinary course of business is only presenting documents to the issuing bank and thereafter upon receipt of proceeds is settling the second beneficiary. In fact this letter of credit clearly stated that the first beneficiary has to present second beneficiary's invoices and therefore it is neither logical nor ethical for a bank to refuse a transfer request of a customer whose integrity is beyond any doubt; due to aforementioned reason although as per UCP the transferring bank has no obligation to transfer a credit except to the extent and in the manner expressly consented to by that bank.

Why Banks need to Support Local Entrepreneurs?

It is a known fact that International Chamber of Commerce Paris right through in its revised publications of Uniform Customs and Practice has acknowledged the legality of doing transactions via transferable credits taking into considerations the need of the trade. However we all know that under a normal circumstance if the first beneficiary and the second beneficiary are residing outside Sri Lanka an import transaction against a transferable credit will go through without any question being raised by any local bank with regard to the authenticity of invoices. In this kind of a scenario, has anyone realised that the local banks are facilitating foreign middlemen to engage in profitable transactions where not only the cost of goods but their profits are also transferred in valuable foreign exchange. On the other hand what I cannot come to terms with is, when a local beneficiary of a transferable credit engages in a similar transaction to source goods to a buyer in his own country from a foreign supplier, some of our local banks take the view that such transactions are illegal, depriving him of his profit that the country saves in foreign exchange.

Conclusion

To the best of my knowledge there are no contravening regulations that prevent local banks facilitating such transactions in Sri Lanka. I feel the officers concerned in the banks are yet reluctant to support this kind of transaction fearing they are still being restricted by local exchange control regulations. This is typically how the officers concerned thought about twenty years ago. Such contention in my view is baseless and untenable. Hence the issue needs to be addressed objectively taking a holistic view of the matter by the local banks so that our local entrepreneurs also may be able to engage in international trade and reap its full benefits.