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### Risk of International Payment through Commercial Banks in the form of L/C Documentary Credit

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#### Abstract

Import-export payments by commercial banks increasingly account for a large proportion and have a very positive impact on the development of foreign trade activities in particular and the economy in general. Like other business fields, import-export payment activities of commercial banks, especially L/C documentary credit payment methods, contain different risks and can occur. With all relevant subjects, especially the intermediary "bank". Therefore, identifying and controlling risks in the L/C documentary credit payment method is very meaningful for import-export

payment managers as well as for working staff. Cooperate in this field, and only then can commercial banks that perform import-export payment services hope to achieve success in their professional activities. The article studies the theory of L/C documentary credit payment methods, risks in documentary credit payments for exporters, importers, issuing banks, notifying banks, banks. Nominated bank, confirming bank, document discounting bank; Analyze actual documentary credit risk cases in Vietnam and provide solutions to limit L/C documentary credit risks.

**Keywords:** Documentary Credit, Importer, Exporter, Issuing Bank, Advising Bank

#### 1. Introduction

Today, modern banks operate multi-functionally to increase income not only from traditional banking operations, but increasingly expand off-balance sheet operations such as foreign exchange trading, international payments, guarantees, etc. Off-balance sheet activities bring income to banks in the form of fees that are increasing not only in quantity but also in proportion. Among off-balance sheet operations, international payment for Vietnamese commercial banks is the most important operation, with a strong growth rate, bringing banks increasing fee income; Through international payment operations to develop other operations such as foreign currency trading, guarantees, import and export financing, expanding account and credit relationships,... Therefore, payment operations international payment in which payment by documentary credit L/C is the most popular form of international payment today can be considered a typical off-balance sheet operation for Vietnamese commercial banks today.

However, international payments in the form of L/C documentary credit as well as other off-balance sheet activities have many potential risks because of the complexity and diversity of international factors; Especially, when some people think that L/C documentary credit payment activities bring attractive income but the bank does not have to invest capital, it makes them even more subjective and negligent, despite the potential risks. Hidden can happen at any time.

Therefore, systematically researching the contents and measures to manage risks in international payment methods using L/C documentary credit to improve the efficiency of international payment activities is necessary. At the bank in accordance with the requirements of foreign economic development is an objective need and in accordance with the law.

#### 2. Theoretical basis

##### *Concept of L/C documentary credit payment method*

Is an agreement in which a Bank (the bank opening the letter of credit) at the request of the customer (the person requesting the letter of credit) will pay a certain amount of money to a third person (beneficiary). amount of the letter of credit) or accept a bill of exchange signed by this person within that amount when this person presents to the bank a set of payment documents in accordance with the provisions set out in the letter of credit.

**Risks in L/C Documentary Credit method**

Documentary credit payment method is a payment method that ensures the highest benefits for manufacturers compared to other payment methods. However, it is not an absolutely safe payment method for participating parties. There are still some risks for both exporters, importers and participating banks.

**For exporters**

Exporters may encounter many difficulties or be unable to implement the terms in the letter of credit if the importer intentionally opens a letter of credit different from the agreed content, or adds additional terms. Clause that has not been previously agreed, for example:

Delivery time is too urgent and cannot be met.

Documents required to be presented are too difficult or impossible.

Specify a freight charge that is unacceptable to the exporter.

L/C validity period is too short, exporters do not have enough time to gather documents for presentation.

The type of letter of credit is not as agreed upon.

Even when the exporter has accepted the conditions of the letter of credit, there is still a risk in the payment process: The set of documents is not suitable and the bank refuses to pay or the Issuing Bank/Confirming Bank loses its ability. Payment ability.

In the practice of trade between countries in close proximity, goods arrive at the port before the importer receives transport documents. To facilitate the receipt of goods without a bank guarantee, the person opening the letter of credit requires an original bill of lading sent with the goods or sent directly by the exporter to the importer. This original document will be received instead of the document sent to the bank. In this case, if the bank determines it is invalid, while the importer has received the goods and refuses to pay. Thus, exporters must accept risks.

The L/C issuing bank does not comply with its commitment to pay the exporter.

**For importers**

The bank will make payment to the beneficiary based on the documents presented, not based on the inspection of the goods. The bank is not responsible for the authenticity of the documents, nor is it responsible for the quantity and quality of delivered goods. Therefore, if there is forgery in presenting fake documents to receive payment, then in this case, the importer must reimburse the amount that the Bank that issued the letter of credit paid to the beneficiary.

In case the exporter presents documents in accordance with the provisions of the L/C and receives payment from the bank. But the goods were not delivered according to the contract. Because banks are not involved in checking goods as analyzed above.

When there is a necessary change in the terms of the contract, the importer must amend and modify the terms in the L/C. Thus, delivery time may be delayed, unable to meet the importer's business needs promptly, and subject to correction and modification fees.

In some cases, the goods have been delivered to the destination but the importer has not yet received the payment documents and thus cannot receive the goods. If the importer urgently needs the goods or is afraid of incurring storage costs, he must arrange for the bank to issue a guarantee to the shipping company to receive the goods. The importer must bear a significant additional cost to pay to the bank.

The Confirming Bank or another nominated bank may make the mistake of paying for an erroneous set of documents and then debiting the L/C Issuing Bank. If the erroneous bank is designated by the importer, the Issuing Bank has the right to refund the amount debited. Furthermore, in some cases, the importer must accept the refund terms to the Issuing Bank even if the bank makes a mistake specified by the Issuing Bank.

In principle, the nominated bank that made a mistake must refund the debited amount to the Issuing Bank, but in practice it is very complicated and easy to refuse. This happens because, in order to receive reimbursement, the Issuing Bank must transact with a bank far away and in another country, and this bank often emphasizes its relationship and responsibility with the Bank. Domestic exporter. Even if the Issuing Bank is eventually reimbursed, it takes a long time and the cost can exceed the L/C value.

**For Issuing Bank**

The issuing bank must make payment to the beneficiary according to the provisions of the L/C even in cases where the importer intentionally does not repay or does not repay. For this reason, credit risk for the Issuing Bank is very present.

When paying a confirmed L/C, the issuing bank is often required to accept payment to the beneficiary without seeing the set of documents. In this case, without the importer's prior approval of the refund, the Issuing Bank will run the risk that the documents will be erroneous, so the importer will refuse, so the bank will not Refund money from importer. In principle, the Issuing Bank has the right to recourse to the bank to pay for the erroneous set of documents. But as mentioned above, this proved to be time-consuming and expensive.

If the Issuing Bank pays or accepts payment of a promissory note without carefully checking the documents, if the documents contain errors and the importer refuses, the Issuing Bank cannot claim money from the importer. Password.

Risks that occur during transportation and the responsibility of the shipping company does not lie, the importer does not buy insurance, or the importer is not willing to pay, the Issuing Bank may be at risk.

Risk of the importer becoming insolvent or bankrupt: This risk causes heavy losses to the Issuing Bank if the Issuing Bank finances import capital.

Risk due to fraudulent behavior by the exporter: The exporter falsifies documents, although the designated bank has checked but does not detect it, and the Issuing Bank allows the discounting bank to deduct the account. Your deposit to pay the seller or request money at a third bank. If the exporter is a "ghost" organization or goes bankrupt while the importer does not have enough financial capacity to compensate the Issuing Bank, the Issuing Bank is ultimately the one who bears the risk.

The issuing bank is not careful in paying for a set of documents without the original B/L or AWB, which means paying money abroad without proof on the basis of having reciprocal goods, causing the risk of payment not being made or the party's side. Foreign countries take advantage to present and demand money with a perfect set of documents with original B/L or AWB.

Risk due to the Issuing Bank not acting in accordance with the UCP referenced by the letter of credit: According to the UCP, the Issuing Bank is exempt from payment

responsibility if the documents contain errors. However, if the Issuing Bank does not act in accordance with the regulations, the Issuing Bank faces the risk of those erroneous documents. These are the following cases:

Notice of refusal but does not clearly and fully state the irregularities of the set of documents, or these irregularities are denied by the Discounting Bank and become invalid;

Notify the Bank of irregularities and rejection of documents beyond 5 working days; No instructions are given on the disposition of documents;

Transferred documents to the opener, or lost and failed to return a complete and intact set of documents to the presenting party, or failed to deliver documents to a third party designated by the presenting party.

#### *For Notifying Bank*

The advising bank is responsible for taking "reasonable care" to ensure that the letter of credit is genuine, including verifying signatures, encryption keys, and electronic samples before advising the exporter. The Advising Bank is responsible for deciding not to advise a letter of credit without sending notice of its decision to the Issuing Bank without delay.

#### *For designated banks*

Unless it is a Confirming Bank, nominated banks have no responsibility to pay the exporter before receiving funds from the Issuing Bank. However, in practice, on the basis of the presented documents, designated banks often advance money to the exporter with recourse to assist the exporter, so this bank must bear the burden. Credit risk for the Issuing Bank or exporter.

#### *For confirming bank*

If the documents are perfect, the Confirming Bank must pay the exporter regardless of whether the money can be recovered from the Issuing Bank or not. Thus, the Confirming Bank bears credit risks to the Issuing Bank, as well as political risks and institutional risks (foreign exchange restrictions) of the Issuing Bank's country.

The Confirming Bank does not understand the financial capacity of the Issuing Bank and hastily confirms according to their request so that in the end, the Confirming Bank must accept responsibility for payment to the Issuing Bank by the Issuing Bank. Lack of goodwill or insolvency, or even bankruptcy.

If the Bank confirms payment or accepts payment of a promissory note, without properly examining the documents, if the documents contain errors and the Issuing Bank does not accept them, it cannot claim Issuing Bank money.

#### *For banks to discount documents*

The Negotiating Bank can be the Confirming Bank if it is a confirmed L/C, or the Issuing Bank if the beneficiary does not want to present through a third bank, but is usually a specifically nominated Bank or Any bank if the L/C allows free negotiation (any bank negotiation). According to UCP 600, the Issuing Bank has the right to refuse to pay for a set of documents containing errors (largely depending on the goodwill of the importer). Although the discount clause allows the Discounting Bank to seek recourse against the exporter, if the exporter cannot afford to pay, the Discounting Bank is at risk.

### **3. Current status of risks in L/C documentary credit payments in Vietnam**

Since Vietnam integrated into international payments, because Vietnamese businesses are still young and are inferior to businesses in developed countries, there are actually many cases where Vietnamese businesses face disadvantages. In L/C documentary credit payment.

In August 2007, Central Pharmaceutical Company exported a shipment to India, the value of the shipment was 6,400 USD, payment method was irrevocable L/C, at sight, allowed to transship, complying with UCP600. The bank opening the L/C is Standard Chartered Bank (SCB), the notifying bank is Bank A. The L/C requires:

Complete set of 3 original B/L copies, perfect.

Shipment is carried out from any port of Vietnam to Bombay port, India.

Central Pharmaceutical Company 1 sent goods by sea from a Vietnamese port to Cutchta port, then the goods were transported by truck to Bombay port, India. After sending the goods, Central Pharmaceutical Company 1 prepares a set of documents and presents them to NH A to send to SCB to request payment. On the presented bill of lading, it is written:

Port of loading: Hai Phong Port, Vietnam

Port of discharge: Cutchta Port, India

Place of final destination: Bombay Port, India.

SCB refused to pay the above set of documents on the grounds that the B/L did not show the shipment of goods from a Vietnamese port to Bombay port, India as required by the L/C. According to article 19a UCP600, multimodal transport documents are required to clearly indicate the place of dispatch, receipt of goods for carriage or delivery and final destination as specified in the L/C.

In this case, the L/C stipulates the shipment of goods from "a Vietnamese port" to "Bombay port, India". Therefore, acceptable transport documents must clearly indicate loading at the port of Hai Phong, Vietnam and discharge at the final port of Bombay, India.

However, the presented B/L states that the port of discharge is Cutchta port, India, which is not consistent with the requirements of the L/C. Furthermore, UCP600 article 19b also defines "transshipment as unloading goods from one means of transport and reloading them onto another means of transport (whether the mode of transport is different or not) during the transport process. Moving from the place of dispatch, receipt of goods for carriage or place of delivery to the final destination stated in the credit". Meanwhile, T Pharmaceutical Company misunderstands that transshipment means switching to another mode of transportation.

Therefore, the company sent goods by sea to Calcutta port and transported them by road (truck) to Bombay port. Due to all the above errors, the bank opening the L/C refused to pay and it took a lot of time and expense for NH A to convince the partner to switch to the collection method.

Or in the case where the importer is Dong Tam private enterprise, importing steel from a company in Germany. This company opened an L/C at sight at Eximbank worth USD 245,000. After that, the set of documents was presented at Eximbank and checked for irregularities:

Unauthorized partial delivery, missing delivery, delivery date of insurance documents after the delivery date. Eximbank, according to the buyer's instructions, temporarily refused to pay for the set of documents on the basis that the set of documents was invalid because the main reason was that the goods had not yet arrived in Ho Chi Minh City. On the other hand, after delivering the goods, the seller wants to receive payment immediately and requests to switch to immediate payment collection (D/P at sight). At that time, Eximbank became an intermediary bank serving customers and complied with international standards for unified collection of documents by notifying details of the set of documents received. The buyer knows that the goods have not yet arrived at the port, so he firmly refuses to accept the documents and negotiates with the seller to only receive the documents and pay when the goods arrive at the port. Because the seller sent the goods and documents for a long time but has not received the money yet, he does not have any information from the collecting bank, Eximbank. Because it has switched to collection form, the collecting bank (Eximbank). There is no obligation to notify the seller of the document status within 5 working days according to UCP600 regulations. The reseller does not trust the buyer, so he cannot trust and wait for the buyer to receive the goods before paying. Therefore, the seller through the presenting bank requesting to return the documents must not delay because the seller may have found another partner to sell at a higher price or there is a fraud that the seller has not really received. Delivery as declared to the buyer.

In 2016, several Vietnamese seafood exporters were deceived by Canadian partners, also in the case of payment by L/C. As follows:

When signing the contract, the agreed payment method is L/C, payable after 60 days. In the L/C, it is binding to give the importing party 1 of 3 bills to conduct CFIA food safety inspection samples, provided that the signature sample on the contract and the person opening the L/C along with the certification words must match each other. Short-term human resource management course.

When exporters send a set of documents to the bank to open the L/C, they give the importer the bill to pick up the goods, while returning the remaining set of documents to the exporter for the reason: The documents were invalid and refused to pay, while the importer in Canada had already picked up the goods.

In this case, our exporters and the seafood association all believe that the bank opening the L/C and the importer in Canada colluded to defraud our exporter.

Although the exporter asked for the intervention of associations, the results went nowhere and the shipment was still lost. After checking, it was discovered that the bank that opened this L/C had declared bankruptcy since 2014.

In import, Vietnamese importers are often forced to pay in advance the contract value, or in opening L/C to their disadvantage, causing delays in receiving goods, poorly presented documents...; Accepting payment for a set of documents without original documents can easily lead to claiming money on another set of documents with original documents; The importer receives the goods under a delivery guarantee issued by the bank. In export, the time limit for presentation is too short, not ensuring presentation, easily making excuses to return documents without payment; choosing an inappropriate payment method causes many risks; not having sufficient means and information to

thoroughly investigate the partner; Weak negotiation skills, vague knowledge leading to signing unclear and unfavorable contracts...

In addition, one of the current concerns related to L/C payment is the risk of litigation for breach of contract: The method of suing the party who violates the contract is very difficult and difficult. Costly due to difficult issues such as: When suing the buyer to recover unpaid debt, will the law of the buyer's country, the law of the seller's country or the law of a third country apply? Where will the lawsuit be heard? Even if the case is heard in a country other than the buyer's country and the buyer loses, there is a possibility that the judgment will not be enforced by the buyer. In addition, filing a lawsuit in a foreign court is a time-consuming and costly matter for the seller. The problem is that there needs to be a solution to minimize the risk of litigation for breach of contract.

#### 4. Recommendations

##### *For import L/C:*

##### *For the issuance of import L/C:*

Before accepting the issuance of L/C, the Bank needs to apply a strict appraisal process similar to granting credit to customers in order to control the ability to pay when the bank has paid for the completed set of documents. Perfect. This is very important and is the most effective measure to prevent risks.

Among the factors the issuing bank must consider when deciding to issue a L/C is whether the bank will recover some or all of the amount paid from the sale if the importer goes bankrupt. Product. The questions that need to be answered are:

- Will the importer definitely own the goods?
- Goods are of guaranteed quality and can be sold?
- Are the goods perishable and do prices fluctuate?
- Are the goods damaged during transportation? If damaged, is there insurance? And does the bank have the right to claim insurance money?
- Is there fraudulent collusion between the exporter and importer, the result could be that the goods will never be shipped?

If the L/C comes with a letter of guarantee for contract performance, the L/C and the contract performance guarantee must be valid together.

The description of the goods needs to have the general name of the goods (for example: Mouse, keyboard, Ram... the general name is computer accessories and components).

You should specify the quantity and type of goods for each delivery in case the L/C stipulates multiple deliveries, each delivery of different types of goods in terms of type, name, size, especially machinery equipment etc.

To limit the fact that the documents arrive before the goods that Eximbank must pay for when the documents are perfect, it is necessary to calculate the time it takes to transport the goods on the road as usual, the time to prepare the seller's documents and the working time. The bank's job is to negotiate the time of sending documents by post to determine the exact time of presentation of documents.

Sometimes to reduce import costs, importers request in the application to open L/C that the import conditions are FOB or CFR prices. Under these conditions, all risks after the goods have been loaded onto the ship belong to the importer. If risks occur during the transportation process, the



responsibility does not belong to the shipping company, so the risk is completely borne by the importer. If the importer is not in good faith or deliberately avoids responsibility, as the issuing bank, it is forced to make payment according to the commitment to the foreign country when the documents are valid. Therefore, the bank should clearly stipulate that for L/Cs with less than 100% deposit (the rest is financed by the bank), the importer is required to add insurance documents when opening the L/C.

*For processing documents and payment of import L/C:*

Customers who refuse to pay when the documents are incorrect, in any case must keep all documents in the same state as when received to notify and wait for instructions from the negotiating bank.

Absolutely do not accept a set of documents lacking the entire original bill of lading (only a copy of the bill of lading) even if the customer accepts payment and transfers the entire amount necessary to pay the L/C.

Comply with the provisions of UCP as referenced by the Issuing Bank:

The Issuing Bank must notify the remitting bank (or the negotiating bank) of all irregularities in the set of documents within 5 banking days from the date the Issuing Bank receives the set of documents. The content of the notice clearly states all detected irregularities because these are complete and final irregularities and cannot be added later.

In case of endorsing a bill of lading or guaranteeing the customer to receive the goods without receiving a set of negotiable documents, the customer must present to the issuing bank an unconditional written acceptance of payment, even in In case the set of documents has errors, even the documents do not have the original bill of lading.

For L/C at sight: Before the Issuing Bank endorses the bill of lading or issues a delivery guarantee, the customer must sign a debt agreement with the Issuing Bank (if the customer borrows money from the bank), or Transfer an amount of money equivalent to the value of the shipment to be paid into the foreign payment account to wait for payment (if the customer pays with own capital).

For deferred payment L/C: Before signing the bill of lading, the issuing bank must request the customer to mortgage collateral (in case of payment with equity capital) or sign a credit contract or receipt. Debt (in case of borrowing capital from the Issuing Bank), the Issuing Bank will proactively debit the customer's loan account and calculate interest from the date of payment to the bank sending the documents.

In case after the Issuing Bank has issued the goods receipt guarantee without the original bill of lading, the Issuing Bank will only give the bill of lading to the customer on the condition that the customer must return the original goods receipt guarantee letter within 30 days (according to the validity period of the letter of guarantee) and the issuing bank cancels this letter of guarantee to avoid loss and abuse.

For air, road, and rail bills of lading, the issuing bank should not endorse directly to the customer but must sign an authorization to receive the goods for the customer. Because they are not documents of ownership of goods. If the customer still requests to sign the air, rail, or road bill of lading, the Issuing Bank must request the customer to provide an endorsement commitment with the condition of exempting the Issuing Bank from liability.

*For export L/C:*

In payment by documentary credit method, the Issuing Bank with a long history in documentary credit business and

always taking the motto of serving customers to the maximum should advise export customers: When the department If the documents are invalid, the beneficiary should request to transfer the documents on the basis of acceptance of payment and clearly state that UCP 600 applies and should not be sent on a collection basis.

The issuing bank advises the exporter to request that the L/C be issued by a reputable bank in international trade (preferably banks that have an agency and payment relationship with the bank serving the seller). Choose a bank with extensive experience in international payments to serve and collect money; Follow the instructions of the serving bank when requested to edit documents to comply with the L/C. Advise exporters to sell goods at CFR or CIF prices so that they can ask the carrier to re-issue a new B/L without them demanding harsh material guarantees, causing additional damage and difficulties in shipping. Business for the seller.

Do not discount sending documents to claim money for sets of export documents for goods that the state prohibits from exporting.

Do not discount documents for customers that Eximbank does not understand clearly about that customer.

Do not advise a letter of credit when there is no common name of the goods.

## 5. Conclusion

Risk analysis of L/C documentary credit payment methods is extremely necessary. This is not a new issue, but in the context of competitive integration, risks are "various", requiring judgments and assessments to propose solutions more suitable to the situation in order to manage the situation. Manage those risks more effectively.

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