

CHAPTER- I

INTRODUCTION

1.1 Background of the Study

In the ages when barter became impossible due to increase in demand, supply and trade, the commercial parties then invented the way to trade their goods and services across the world by the help of bank became more and more popular and trustworthy. One of the most popular and commonly used method is now termed as “Documentary Letter of Credit”.

It's users in any event rely upon commercial credit to finance the purchase of goods or devices. International trade historically has involved buyers and sellers striving to conduct trade despite differences in language, national customs, credit procedures, and accounting practices. Such variances have lead merchants to seek protective devices to minimize the effects of nationalistic diversities and at the same time to facilitate trade and payments for goods. Commercial Credits are instruments well designed to meet this international need. Within the United States purchases of goods and services between parties are far less complicated than dealing across international boundaries. The speed and simplicity of communication of shipment and of credit arrangements all have served to lessen the domestic dependency on commercial Letter of Credit as financing tool. However, whenever some firms need the special protection and can be equally useful in domestic market. “In today's world where customer is consider king the definition given by Mahatma Gandhi, A customer is the most important visitor on our premises. He does not depend on us. We are dependent on him. He is not an interruption in our business. He is purpose of it . He is part of it. We are not doing favor by serving him. He is doing us a favor by giving us an opportunity to do so”(Dahal Sarita and Bhuvan “A Hand Book to Banking” 2056: 6).

For the issuing bank, the LC is an import LC while for the advising bank it is an export LC payment by means of letter of credit involves action between two banks, one in the importer's country and other in exporter's country. Thus, a bank in the importer's country issues a letter in favor of the exporter with an undertaking that bill of exchange drawn by him upon his importer up to the amount specified therein, will be honored by its presentation.

“According to the uniform Customs and Practice for Documentary Credit, 2007 Revision ICC Publication No. 600 the expression "documentary credit" means any agreement, however named or described whereby a bank (the issuing bank) acting at the request and on the instruction of a customer (the "Applicant") or on its own behalf” (Guide to Documentary of LC & UCP 600-Article 2).

In a broad sense, a commercial letter of credit (hereafter sometimes referred to as a "Credit" or "Commercial Credit") is simply a letter of instructions issued to an exporter by a bank at the request of its customer. In its narrowest sense, it is a specialized and technical instrument used to finance a shipment of goods from one party to another. Whether a Credit is highly specialized or simple is determined usually not by its construction but rather by how well versed its users are in the language and practices of international trade.

What is Letter of Credit

An, LC is written undertaking by a Bank (issuing bank) given to the seller (the Beneficiary) at the request and in accordance with the instructions of the buyer (the applicant) to effect payment (that is by making a payment or by accepting or negotiating bills of exchange) up to a stated sum within prescribed time limits, against stipulated documents and provided that the terms and conditions of the LC are complied with.

1.2 Statement of the Problems

Letter of Credit (LC) is a widely used instrument in the field of international trade. The need for it generally arises whenever any two parties (i.e. exporter and importer) get into a contract to buy and sell something. In any international trading activity, as the parties to reside in two different countries, the issue of confident and credit worthiness of the both the parties arises. A party might be big or prestigious even then the other parties always have to think from the worst case scenario i.e. the other party might default and might renege in its obligation. It is to tide over such things that the instrument of LC invoked.

LC is a reliable instrument for international trade and in the 21st century where the market of trade is enhancing. The important of LC is in increasing trend but there are many confusion regarding LC transaction theory and practices in our country. The main focus will be towards studying the obstacles of LC business, procedure of LC transaction rolled played by NRB for LC, document necessary for the letter of credit and other rules, regulation and obstacles in the LC business.

1.3 Objectives of the Study

The primary objectives of this study is to analyze the overall LC theory and practices in Nepal however following are the specific objectives of the study:

- 1) To know the procedure for opening Letter of Credit
- 2) To find the prohibition regarding opening LC
- 3) To analyze the problem while opening LC
- 4) To examine the directive of NRB on LC activities

1.4 Significance of the Study

For the particle fulfillment of requirement of the Master of Business Studies, provided by Faculty of Management, Tribhuvan University, this field report was prepared as thesis on Letter of Credit.. Being a finance student, letter of credit transaction is taken as study subject in Nepal. As I met to managers,

staffs of the NRB , I asked necessary questions and documents which are helpful to carry out my thesis writing. Carrying out these kinds of particle mental exercise in the colleges is very good for the students. Because it saves students from being an educated illiterate. Generally, we seen or experienced that though we are a "Degree", we may not even know the simple thing regarding the operation of the organization. What we have is the theoretical knowledge, which is not sufficient for the successful career. So giving opportunities to students to know about organization and their operation is a very good work. It develops students professionally.

The main importance of this field work assignment are as follows:

To gain first hand and actual knowledge about the working style of the organization or in other words we can say that to give the student the particle knowledge about the LC.

-) To develop the business skills of the students, which may be helpful in their career path
-) To train the students for administrative and managerial functions.
-) To gain practical knowledge about the LC
-) To enable the students for accessing the source of the information required by them.
-) To gain ability to analyze the present and future market environment and also to improve the company's profitability
-) To make student capable of tackling the problems faced by them during the entire course of making thesis.
-) To find out the process and problems of LC opening.
-) To make students capable of sorting out the problem
-) To fulfilled the practical thesis work of Master of Business Studies.

1.5 Limitation of the Study

The law relating to LC was very scare and the material relating to theory and practice of LC was very difficult to find in the market. It was difficult to get various rule and regulation regarding the LC transaction, Since LC is complicated subject matter and there seems lot of fraud in LC so depth knowledge regarding LC should be provided to the man dealing in LC but due to incompetent manpower in LC department of various banks it seems difficult to get proper interpretation to LC theory and practices in Nepal.

-) The field study is costly for going and coming to the office for data collection, typing and binding of the thesis require a lot of expenses. Being a student it is very difficult to manage such expenses.
-) Most of the personnel from the banks were very co-operative in providing the necessary facts and data, at many times they were reluctant to provide certain data, which they considered was company's secrecy. Such attitude puts the question mark on the authenticity of the study.

1.6 Organization of the Study

The thesis on Letter of Credit Theory and Practices in Nepal has been divided into five chapters, viz Introduction, Meaning & Types of LC, Procedure of LC, Rule & Regulation for letter of Credit, Conclusion.

Chapter –I: Introduction

The introduction chapter describes general overview, statement of the problem, objectives of the study, limitation of the study, methodology of the study.

Chapter –II: Review of Literature

In this chapter, meaning and kinds of letter of credit, procedure of opening letter of credit, rules and regulation for letter of credit, presentation of the related studies and findings as well as review of various articles similar to this study is discussed briefly.

Chapter –III : Research Methodology

In this chapter is concerned with the methodology adopted in the research work. It contains research design helps to collect quantum of accurate data economically but there is various type of research design. Here, is applied descriptive and analytical research design.

Chapter –IV: Data Analysis and Presentation

In this chapter is concerned with Procedure of opening letter of Credit, Findings of prohibition regarding LC, Problems while opening letter of credit and Examine the directive of NRB on LC activities.

Chapter - V: Summary, Conclusion and Recommendation

The last chapter is concerned with summary of the study, conclusion of the study and various suggestions and recommendation for the improvement of LC theory and practices in Nepal.

CHAPTER- II

REVIEW OF LITERATURE

Literature review a “Stock taking” of available literature in one’s field of research. The purpose of review is thus to find out what research studies have been conducted in one’s chosen field of study and what remain to be done. Here, the review of literature is divided into two parts.

- a) Conceptual framework
- b) Review of related studies

2.1 Conceptual Framework

Under this, Meaning and concept of LC, Parties involved in LC and their rights and responsibilities, Types of LC, Example of a simple LC, Standard forms of the documentation, pre-requisites for opening LC in Nepal, Amendment and cancellation of LC, Payment settlement, Document Check lists.

2.1.1 Meaning and Concept of Letter of Credit

The earliest trade known to be done was through barter. Barter is exchange of one good with another i.e. salt with oil, wool with leather etc. Goods and property were then traded on spot and the deal was closed.

In the primitive ages when human civilization and economic development were not advanced the desired and needs were limited. With advancement in civilization and growth in economic development the desires and needs increased. This resulted in human beings of one locality moving to other localities to fulfill their unmet desired and needs a process which indicated shift “self sufficiency” to “inter dependence”. As a result “Barter Economy” came into existence.

Human needs and desire soon became unlimited and produce of a given locality or vicinity could not meet the demands. Movement of people from one place to another reduced due to increase in size of family and development of the culture of setting families in allocation. This forced people to involve in buying and selling i.e. trading of goods and produces from one place to another. By then money has already been introduced as measuring rod for goods and services.

The human desire could not be met by the goods and services produced in one locality to another and people now wanted to use produce from one country to another and from one continent to another and from one end of the globe to another end of the globe. In such a scenario it was impossible for people to move around and buy the product of their choice or demand due to geographical distance as well as risk in carrying money and then complications faced in carrying back the produces to their habitat. The LC is also popularly known as non fund loan of bank. “Non-Fund based business helps to facilitate trade/non trade transactions between parties who are unknown to each other. The bank acts as a facilitator or a middlemen and chargers commission for this business. The goodwill and reputation of the bank helps alleviate doubts and apprehension of parties” (Rakesh /Nikhil, *“How to Achieve Success in Banking Career”* Page 223).

Concurrently, technology had also advanced a lot and facilities like transportation, communication etc. had made trade easier as well as sophisticated. A person say from Nepal could get in touch with a merchant of Singapore to find out if a produce of their needs were available there or not. Deals were made to buy particular goods for payment of specified amount giving birth to concept of exporter and importer more commonly known as buyer and seller.

Through by now trading had become easier settlement of trade but transaction posed problems for the parties involved. Goods bought and sold abroad started becoming complicated transactions for number of reasons voyage time, import/export control regulations, customs formalities and the very fact the buyer and seller were widely separated geographically.

Moreover, in much of these cases the buyer and seller would not have met or seen one another and possibility of not knowing each others standing and integrity also loomed large. So the trades felt the need to safeguard and protect the interests of both buyers and sellers, the need of bankers who are widely accepted for its credibility and standings to be involved in financial transactions.

The buyer needs to know that he has paid for and getting the getting the right goods and the sellers interest is to get promptly paid for his goods. As a result the banks started arranging and extending wide use of credit instruments, which satisfied the needs of both the buyer and seller. The instrument was called the Documentary Credit or more commonly Letter of Credit handled by international banking network calling for the exporter to present to a bank documents evidencing shipment or dispatch of the required merchandise for which if the documents are in order he will be paid. The requirement for such documentary must be agreed upon in the contract of a sale.

Meaning of Letter of Credit

“Documentary Credit is an instrument facility international or national trade where in all parties to the credit deal only with the documents and not the goods. It is an instrument by which a bank undertakes to pay a seller for his goods, provided the complies with the condition laid down on the credit” (Rakesh /Nikhil, “How to Achieve Success in Banking Career”).

A Documentary Credit is a conditional Bank undertaking of payment. It is a written undertaking by a bank to a seller at the request and instruction of buyer to pay at sight or determinable future date up to a stated sum of money, within a prescribed time limit and against stipulated documents. The documentary credit is the most safe and convenient means of paying for export among all other methods of paying existing.

“The letter of credit abbreviated as LC, stands at centre of international commercial transaction, issued by a bank at the request of importers, the letter states that the bank will pay a specified sum of money to a beneficiary, normally the exporter on presentation of particular specified documents” (*Charles W. L. Hill, 1994: 431*) Similarly “ LC means letter written by one of bank to another directing the letter to accept cheque draft or hundi of specified person up to the amount specified” (NRB Act 2058) · “Credit means any arrangement however named or described where by a bank (the issuing) acting at the request and on the instruction of a customer (the applicant) or on its own behalf” (*Article of UCPDC ICC Publication No. 600*).

The letter of credit is defined as “ An arrangement by means of which a bank (Issuing Bank) acting at the request of a importer (Applicant) under takes to pay to exporter (Beneficiary) for a predetermined amount by a given according to agree stipulation and against presenting of stipulated documents”(Gartener, “*Documentary Credits*” 1999). In simple term, it is bank’s conditional undertaking of payment.

Letter of Credit is letter from a bank guaranteeing that a buyer’s payment to a seller will be received on time and for the correct amount. In the event that the buyers is unable to make payment on the purchasing, the bank is required to cover or remaining amount of the purchase. The parties to LC are usually an applicant who want to sent money, the beneficiary who will receive the money, the issuing bank and the advising bank. However, LC is not a bank guarantee.

But guarantee is issued on behalf of applicant to cover situation of its non-performance, i.e. the issuing bank agrees to make payment to beneficiary once he surrenders the requisite documents and in compliance with stipulated conditions, irrespective of the fact whether the applicant pays for such documents or not (*Bhandari, Banking and Insurance Management 2003:127*).

A letter of Credit is an instrument wherein a bank authorized another bank to debit its account for payment to the exporter upon submission of specified document and fulfillment of stipulated condition in respect of the shipment of goods or services rendered as required by the importer.

The request to open a letter of credit will be made by the importer to its bank detailing all terms and conditions upon fulfillment of which it authorized the bank to release payment to the exporter. The same terms and condition are, in turn, conveyed by the LC opening bank to the negotiating bank (Which in most cases is the exporter's banker). The negotiating bank notifies the receipt of LC to the exporter.

Therefore, a LC is quite different from that of a demand draft (Where payment is released at the discretion of the buyer irrespective of the receipt of goods or not) and documents received on collection basis (Where the buyer will have to make payment for release of delivery order). Under LC, the seller gets his payment as soon as he is able to show that the goods have been shipped and the conditions of the LC are duly complied with.

Advance Payment – Seller requests cash from buyer in advance of shipment.

Open Payment – Buyer affects payments through some method as per arrangement privately concluded with seller in an agreed future date.

On Consignment- Buyer receives the goods first and makes payment only after sales of goods. In the meantime the ownership of the goods remains with the seller.

Collection Basis- The seller ship goods. Documents covering shipment including a draft (Bill of exchange) drawn on the buyer for value of shipment through a bank. Buyer presented with the documents and must honor the draft before documents are released to him.

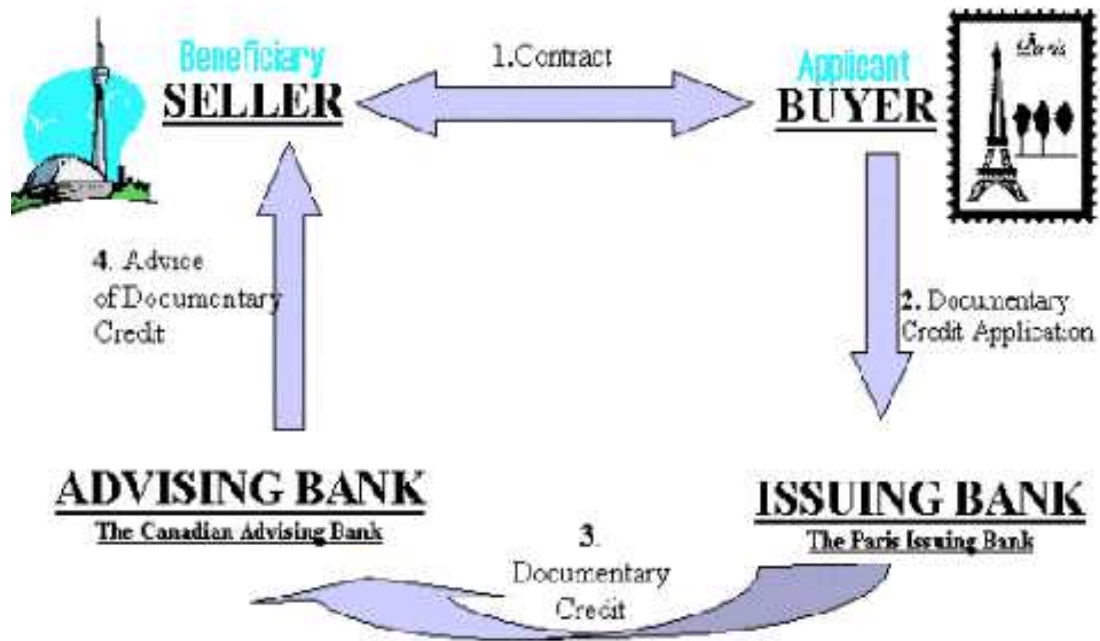
A documentary credit serve four purposes like being instrument for financing, purchase of foreign goods and equipment's assist issuing bank to grant finance to the importer and monitor its use, brings confidence and security for commercial parties involved and enables exporters to secure payments provided the clauses and conditions are not needlessly complicated.

2.1.2 Parties in Letter of Credit

There are various parties involved in LC transaction the definition of various parties involved in LC are as mentioned below:

The Documentary Credit Cycle

Letter of Credit



) **Applicant**

The applicant is the buyer/importer of the goods who ask his bank, the issuing bank, to issue him a "Letter of credit". The applicant is also called the opener. In most of the cases the applicant maintains an account relation with the issuing bank.

) **Issuing Bank**

The bank that issues a letter of credit or guarantee and takes ultimate responsibility for payment of the instrument it provides the document on request of the applicant.

) **Advising Bank**

The bank, normally in the exporter's country through which a letter of credit is transmitted and authenticated the exporter. There is no liability on the part of the advising bank to honor the letter of credit. The main function of the advising bank is to prove the beneficiary that the letter of credit is genuine. Since the advising bank has to satisfy itself that the letter of credit is properly authenticated by the issuing bank.

) **Confirming Bank**

When a bank "confirms" the letter of credit of another bank, it takes on obligation of the issuing bank. Such bank is known, as confirming bank will only confirm irrevocable credit. The bank, at the request of the Issuing Bank, adds its confirmation to the Letter of Credit. In doing so, the Bank undertakes to make payment to the Exporter upon presentation of documents under the Letter of Credit assuming all terms and conditions of the Letter of Credit have been met.

) **Beneficiary**

The party to whom a letter of credit is addressed and who will benefit from its issuance

) Reimbursing Bank

The bank designated in the Letter of Credit to reimburse the "available with" Bank which submits payment claims under the Letter of Credit.

In a broad sense, a commercial letter of credit (hereafter sometimes referred to as a "Credit" or "Commercial Credit") is simply a letter of instructions issued to an exporter by a bank at the request of its customer. In its narrowest sense, it is a specialized and technical instrument used to finance a shipment of goods from one party to another. Whether a Credit is highly specialized or simple is determined usually not by its construction but rather by how well versed its users are in the language and practices of international trade.

1. Is to make a payment or to the order of third party the beneficiary or is to accept and payment bill of exchange (drafts) drawn by the beneficiary.

In Letter of Credit Normally

-) The supplier is known as the beneficiary
-) The bank that opens a letter of credit is the opening or issuing bank
-) The buyer who asks the bank to issue the credit is the applicant or account.
-) The bank in the supplier's country that advises the credit to the beneficiary and checks its authenticity is the advising bank
-) When the advising bank adds confirmation on the LC to be advised to the beneficiary it is then known as confirming Bank too.
-) When certain terms and conditions of the credit are changed such change is known as amendment.
-) The generally adopted set of rules for credits is known as the Uniform Customs and Practice for Letter of Credit issued by the International Chamber of Commerce in their publication dated 2007 numbered 600

- J When an exporters takes the required documents into the banks, he is presenting them, which is known as presentation of the documents
- J If the documents are in order the credit becomes drawn
- J In a letter of credit where payment is to be made after a deferred period, correct for credit conformed documents are taken up.
- J Documents that are not in order are referred to as discrepant
- J Letter of credit are issued in a variety of ways. They come by post from the issuing bank (rarely), by telex and by SWIFT (Society for Worldwide inter bank financial Telecommunication) network. SWIFT is an industry owned cooperative supplying secure messaging services and interface software to over 7000 financial institutions in over 196 countries. SWIFT messages are preset and referred to by category numbers called MT number.

2.1.3 Types of Letter of Credit

The same Letter of Credit is Either an Import LC or Export LC. The LC for the issuing party/bank/country becomes Import LC whereas for the seller it becomes an Export LC.

Letter of Credit may be any one of the following types:

Revocable Credit

A revocable credit is one that may be amended or cancelled by the issuing bank at any moment and without prior notice and consent of the beneficiary and other involve any party. This credit gives maximum flexibility to the buyer and exposes the seller to a certain degree of risk.

Irrevocable Credit

An irrevocable letter of credit can not be amended or revoked without the agreement of ALL the parties to the letter of credit, so it provides the assurance that providing the beneficiary complies with the terms, he/she will be paid for

the goods or services. Under UCP 600, a letter of credit is deemed irrevocable unless otherwise stated.

There are many types of irrevocable credit which are widely in usage as shown hereunder:

Confirmed Credit

A confirmed irrevocable letter of credit is one to which the advising bank adds its confirmation, makes its own independent undertaking to effect payment, negotiation or acceptance, providing documents are presented which comply with the terms of the letter of credit. The advising bank, which may also be the confirming bank, assumes the country (political and economic) risk of the applicant's country as well as the credit risk, failure and default of the issuing bank and effects payment to the beneficiary without recourse.

In order for a letter of credit to be confirmed, a bank accepting this risk would have a correspondent relationship with the issuing bank. If the advising bank does not have such a relationship, the letter of credit can be confirmed by an independent bank. The negative aspect here is the cost of adding another bank to the scenario.

A seller should consider requesting a confirmed credit when

-) The credit standing of the issuing bank is unknown to the seller or viewed by the seller as questionable.
-) Exchange controls in the buyer's country may prevent local banks from honoring certain external payments.
-) The importing country is suffering economic difficulties: large external debt and/or high debt service ratios, a persistent negative balance of payments, or a record of being late or having defaulted on its international payments.

Unconfirmed

An unconfirmed irrevocable letter of credit provides a commitment by the issuing bank to pay, accept, or negotiate a letter of credit. An advising bank forwards the letter of credit to the beneficiary without responsibility or undertaking on its part except that it must use reasonable care to check the authenticity of the credit which it advised. It does not provide a commitment from the advising bank to pay, so the beneficiary is reliant upon the undertaking of the overseas bank. The beneficiary is not protected from the credit risk of the issuing bank nor the country risk.

Sight Letter of Credit

A letter of credit under which payment is made to the beneficiary upon presentation of the draft along with other documents complying terms of credit.

Time Letter of Credit

A letter of credit under which settlement of payment will be made at a fixed or determinable future date. The tenor of payment can be for 30, 60,90, 120 or 180 days.

Deferred payment Letter of Credit

A letter of credit which calls for payment under the letter of credit at a future, determinable date after presentation of specified shipping documents. The importer is extended the facility of making payments in installments and likewise the exporter is allowed the privilege of shipping goods in installments. This type of letter of credit is normally issued in cases where industrial machinery is to be imported and which need time to be prepared/fixed or installed.

Revolving Letter of Credit

A letter of credit, which allows for automatic reinstatement of the amount of the credit. The bank permits the seller to borrow from time to time up to an

agreed maximum amount with the privilege of redrawing during the life of the LC. The credit can be made revolving in relation to time, value or shipment.

This type of credit is established by buyers whose nature of requirements of goods is regular. This helps safeguard buyers maintain adequate stocks of supply and price hike.

Transferable Credit

A transferable Credit is a Credit under which the beneficiary may transfer to one or many party or all of its right to draw under the letter of credit. Such transfers can however be done only once. The credit must however stipulate the term “this credit is transferable”.

Red clause Credit

A "Red clause credit" generally authorizes the designated advising bank/negotiating bank or branch, to make clean advances to the beneficiary to finance the purchase and preparation for shipment of the relative merchandise.

This is basically a facility extended to the seller to draw up to 100% of the credit amount as a pre-shipment finance to the produce/manufacture or arrange merchandise as desired by the buyer prior to shipment. This clause is called Red Clause because the term would be typed in red ink. These credits are rare these days (Rastriya Banijya Bank, Trade Finance Manual).

Green Clause Letter of Credit

A letter of credit under which a small part of the credit amount is provided as advance to the beneficiary for the purpose of collecting goods up to the port of shipment and preparation of relative documents regarding the shipment.

Back to Back Credit

A import letter of credit issued by an account party using as collateral a previous export letter of credit issued in his favor. The two letter of credit cover

different parts of the same basic transaction. Banks are under no compulsion to issue the second letter of credit.

Under the back-to-back concept the seller as beneficiary of the first credit offers it as security for issuance of the second credit. The seller as applicant for the second credit is responsible for reimbursing the bank for payments made under the second credit regardless whether or not he himself is paid under the first credit or not.

It is necessary the second credit be worded exactly so that the documents presented (except the commercial invoice) meet all requirements of the original documentary credit as it enables the seller as beneficiary to first credit entitled to be paid within those limits.

Standby Letters of Credit

A standby letter of credit is used as support where an alternative, less secure, method of payment has been agreed. They are also used in the United States of America in place of bank guarantees. Should the exporter fail to receive payment from the importer he may claim under the standby letter of credit. Certain documents are likely to be required to obtain payment including: the standby letter of credit itself; a sight draft for the amount due; a copy of the unpaid invoice; proof of dispatch and a signed declaration from the beneficiary stating that payment has not been received by the due date and therefore reimbursement is claimed by letter of credit. The International Chamber of Commerce publishes rules for operating standby letters of credit - ISP98 International Standby Practices.

This can basically also called a performance letter of credit or a guarantee that the applicant will perform in accordance to the contract. The beneficiary will be compensated upon presentation of predetermined documents.

Acceptance Credits

It is a credit, which stipulates the drawing of term bill, which will be accepted by the issuing bank or by the customer. A beneficiary is required to present an since draft drawn at number of days from or after B/L date on the bank named as accepting bank.

Drafts and documents are later presented in conformity with the credit terms and bank will accept the draft. In doing so the bank gives an implicit understanding to pay face value at maturity. At maturity the accepting bank makes payment and claim reimbursement from the drawer.

Acceptances credits are issued to finance the buyer but if subsequently discounted they also provide a source of immediate funds to the beneficiary.

Third Country Credits

The issuing bank may request an intermediary bank in one country to confirm or advise its credit to a beneficiary in a third country. This type of credit is issued when the issuing bank does not have a correspondent bank in the beneficiary's country or due to political reasons cannot communicate directly with beneficiary's country (Rastriya Banijya Bank Trade Finance Manual).

2.1.4 Reasons for Using Letter of Credit

LC is used in national and international trade for number of reasons. Some of which are discussed below.

New Trading Relationship

It may often be advisable to use LC in new trading relationship as the security is given to the both parties, i.e. for applicant and beneficiary . The beneficiary known that he/she will get paid if he complies precisely with the LC and the importer can ensure that he/she requests all the document required by the

contract of sales and purchase and known that the beneficiary will not be paid unless he complies with LC term.

Letter of Credit Required by the Credit Insures

Credit insurer will specify the need for the seller to trade on LC terms to buyers in certain market. When exporter required trading on irrevocable LC, the underwriter will be risk in the event that documents are presented to the advising bank in compliance with the terms of LC.

Legal Reason

Some countries insist the imports are paid for under LC to help manager exchange control regulation.

Strategic Decision Made by the Exporter

The strategy of exporter as to how to sell to certain buyers in specific market should be flexible to adapt to the changing risk profile of the both country and the buyers. A strategic approach to the risk management will allow the exporter greater flexibility in protecting the payment risks and will inevitably lead to reduce bank costs because the most effective solution will be adapted.

2.1.5 Example of Simple Letter of Credit

| | |
|--------------|---|
| To: | Asian International Bank, Tokyo, Japan (the advising bank) |
| From: | Euro bank, Bruxelles, Belgium (the issuing bank) |
| Date: | DD/MM/YY |
| Test: | xxxxxxxxx we hereby our letter of credit numbered zzzzzz subject to the following terms and conditions |
| Applicant: | Belgium Import SA 123 Rue Blanche, Bruxelles, Belgium |
| Beneficiary: | Asian Exports PTY 4567 Inner Harbour, Yokohama, Japan |
| Amount: | USD 500000(US Dollars five hundred thousand only) |

| | |
|---------------------|---|
| Validity: | 31 March 1996 for shipment 21 April 1996 for presentation at our counters in Bruxelles for sight payment against presentation of the following documents |
| (aa) | Signed commercial invoices of the beneficiary |
| (bb) | Certificate of origin |
| (cc) | Full set clean "On board" ocean bills of lading evidencing Shipment of the good from yokohama to Antwerp CFR made out to order and endorsed to Euro bank SA, Burxelles branch |
| Covering: | Agriculture spare parts and machinery as per purchase order number 3409/kf/95 CFR Antwerp Incoterms 1990 |
| Special conditions: | Insurance covered by the buyers, all bank charges Belgium for account of the beneficiary |
| Reimbursement : | We hereby undertake to pay five bank working days from receipt of credit conformed document at our counters in Bruxelles |

2.1.6 Documents Under Letter of Credit

In the transaction of the letter of credit documents are very important elements to execution of order of export and it helps the bank to transact properly. The transaction of the letter of credit is done through documents, so it is called documentary credit also. Therefore both the parties specially the exporters carefully prepare the documents for the letter of credit. The principal document required for letter of credit are as mentioned below:

i) Financial Documents

- a. Bill of Exchange :** For a sight letter of credit a Bill of Exchange is not required. It is also commonly known as Draft.

“A bill of exchange is an instrument in writing containing unconditional order, signed by the maker, directing a certain person / to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument” (Kuchhal M.C. “Mercantile Law” 350).

A Bill of Exchange is a negotiable instrument required when the beneficiary would like to negotiate documents under LC. It is called a negotiable instrument because it is a document, which by endorsement and delivery passes on the full title to the instrument to the transferee.

It may be a sight draft or time draft maturing on date it falls due. A sight draft matures on the third day after the day on which it is expressed to be payable. A time draft payment is calculated and determined by excluding the day from which the time is to begin and by including the day of payment.

ii) Commercial Document

a) Performa Invoice: Basically, it is a form of quotation by the seller to a potential buyer. Normally, it shows the terms of trade and prices in addition to the description of the goods so that once the applicant has accepted the order, there is a firm contract to be performed as per terms and conditions mentioned in it. Normally, it forms the basis for all transactions.

b) Commercial Invoice: This is the accounting document by which the seller charges the goods to the buyer. It is prepared on the basis of the sales contract and in accordance with credit stipulation. A commercial invoice normally includes:

- a. Invoice no and date
- b. Name and address of buyer and seller
- c. Order or contract number, quantity and description of goods, unit price and the total price.
- d. Weight of the goods, number of packages, shipping marks and numbers.
- e. Terms of delivery and payment
- f. Shipment details
- g. Credit number

c) **Packing List** :This contain information of packing details e.g. total number of pieces, number of cartoons, number of each package. It will also state name and address of beneficiary and account besides the LC number.

d) **Certificate of Origin**: This is a signed statement providing evidence of the origin of goods. Normally certificate is authenticated by an independent official organization such as Chamber of Commerce. The certificates are usually in a mandatory form and manner.

The certificate contain detail of the shipment to which it relates, states the origin of goods and bear the signature and the seal of the certifying body.

e) **Inspection Certificate**: This is basically a certificate issued by internationally reputed inspection company or appointed parties or person acceptable to the importer. This authority checks and inspects the goods to be shipped under the letter of credit and issue a certificate that shows goods have been inspected and examined and found to be according to the requirements of the order.

iii) **Transport Documents**

This is one of the most important documents in documentary letter of credit operation. The transport document is the document that certifies and authenticates the movement of goods from the seller to the buyer destination.

The common mode of transportation and document thereof are as follows :

- a) Marine bill of lading
- b) Combined transport bill of lading
- c) Combined transport document
- d) Airway bill

- e) Truck receipt
- f) Railway receipt
- g) Post parcel receipt

a) Marine bills of Lading

This is a type of transport document normally applicable to a carriage of goods solely by sea. Unless otherwise stipulated in the credit this document must indicate that the goods have been loaded on board or shipped on a named vessel. “ A bill of lading is a document issued by the shipper or by the master or captain of the ship or other agent in exchange of Mate’s receipt after the goods have been placed on board the ship for being carried to a specific destination” (Kuchhal M.C., “Mercantile Law Page 3547).

b) Combined transport bill of Lading

This is the type of transport document normally applicable to a carriage of goods by at least two mode of transport Unless otherwise stipulated in the credit this document may indicate either dispatch or taking in charge of goods or loading on board as the case may be and undertakes liability from the place of receipt up to the place of delivery.

c) Combined transport Document

Where several modes of transport are to be employed say ocean going vessel. In-land water ways, barge and trucks than a combined transport document or through BL is used.

d) Airway Bill

The receipt issued by an airlines or its agent for the carriage of goods through air is called airway bill or air consignment note.

e) Truck Receipt

It is a transport document certifying dispatch of goods by truck when consignment is to be made from a landlocked country and for local delivery mostly a truck receipt is used.

f) Post Parcel Receipt

Goods dispatched through the postal system and documents specifying the dispatch of goods through this mode are known as post parcel receipt.

Details of Transport Documents :

-) Should indicate that it has been issued by a named carrier or his agent.
-) A description of the goods in general terms not inconsistent with that in the credit
-) Identifying marks and numbers (If any)
-) Name of the carrying vessel or the name of the intended carrying vessel in case of a combined transport bill of lading including sea transport.
-) An indication of dispatch or taking in charge of the goods or loading on board as the case may be.
-) An indication of the place of such dispatch or taking in charge or loading on board and the place of final destination
-) The name of shipper consignee (If not made out of order) and the name and address of any notifies party.
-) If freight has been paid or is still to be paid.
-) The number of originals issued to the consignor if used in more than one original.
-) Date of issuance of the transport document.

iv) Insurance Certificate / Policy

Insurance is obtaining financial protection against happening of an accidental event or loss. Sending goods from one place to another entails risk and to manage and safeguard the interest of commercial parties and transactions insurance are done.

Insurance is an agreement whereby the insure indemnifies the assured in the manner and to the extent thereby agreed against loss.

Open Policy – It is a type of insurance covering goods notice of which is not stated but has to be proven in the event of loss accruing.

Cover Note – A cover is document, which is issued in advance of the policy to grant provisional cover pending issuance of the policy. (NRB Directives)

Specific Policy – The policy granted to cover a single shipment or consignment.

Special Policy – This is issued for a period of twelve months and suitable for traders whose shipments are in regular manner. It is in the favor of the owner of the goods and the banks interest will be recorded in the policy.

An insurance policy can be for up to 300% of total consignment value and not less than for 100% Value. In banking practices it should be for minimum of 110% of CIF value of shipment, date operating CIF value of shipment, date appearing on the policy is not later than the date appearing on the B/L be in negotiable form i.e. countersigned and endorsed and be in complete form with original and duplicate.

Unless otherwise stipulated in the credit documents must be issued and signed by insurance companies or underwriters or their agents be dated on or before

the date of shipment evidenced by transport document and be for an amount at least equal to CIF value of the goods plus 10% in currency of the credit.

2.1.7 Pre-requisites for Opening of Letter of Credit

While opening letter of credit, applicant has to submit various important documents. NRB has directed that applicant have to submit various document related to the import trade. Those documents are given as follows:

1. Income Tax renewed certificate
2. Firm Registration Certificate (duly renewed)
3. Should have income certificate, PAN certificate and VAT certificate
4. The customer should be current account holder
5. The photocopies of the Proprietor/Partner/Director
6. The Proprietor/Partner/Directors name should not be registered in blacklist or defaulter list.
7. Limit approval or review period bank should collect the copy of firm's financial documents, CIB report or Board minutes.
8. Customer should be creditworthiness in the market.
9. Permission is required from the NRB in case of applicant is an individual or non registered firm.
10. In case of Private limited, minute must be presented, among those Articles of Association (AOA) and Memorandum of Association (MOA) are the must.
11. Performa Invoice / Indent / Sales Contract issued by beneficiary/ indenter:
there must be following indication details.
 -) Description of goods (name, brand and Model No. of goods)
 -) Harmonic code
 -) Country of Origin
 -) Unit price & quantity
 -) Total Price
 -) Account / Beneficiary

12. LC applicant duly filled up signed & stamped by opener / Account / Applicant
13. Bi. Bi. Ni. 3 (not required for LC opened in IRS &NRS)
14. Garment of Association Recommendation's letter (To import fabric for India only)
15. Trade and Export Promotion Committee (To import wool only)
16. Insurance Policy in case of LC opened on FOB / FOR, CFR & C&F Basis.

First Objective of my Study

Procedure of Opening Letter of Credit

-) Applicant for opening letter of credit should mandatory fill in the prescribed form Bi.Bi.Ni. NO. 3 But in case of Nepalese and Indian Currency Bi.Bi.Ni. NO. 3 is not required.
-) LC can be opened for those products only, which are mentioned in the "Customs Traffic Code" book and goods under OGL. But LC can't be opened for those products. Which are prohibited by the NG and NRB through they have Harmonic Code.
-) Letter of Credit can be opened in convertible currency even for importing certain goods from India. But clause is manufacturing industry must open the LC and the products must be directly purchased from the India manufacturer as specified by NRB
-) All import LC issued, amendments advised and confirmation added to export LC will be signed by the appropriate authorities of the Bank, depending upon the amount and type of transaction. The name of the signatories and their numbers, as appearing in the Bank's booklet of Authorized signatories, must be typed or stamped underneath the respective signatures.
-) LC can be opened only on behalf of those customers of the branch for whom such facilities have been approved. LC opened on one time basis

will need to specific approval of the lending authority concerned. For this, the credit department will also issue CFR on specific deal basis on the case to case.

- J Before an applicant for issuing an LC or an amendment is taken up for processing it must be validated by the officer in-charge of the LC department on the basis of approved lines laid down in the CFR.
- J Selection of a bank to advise / Confirm LC will be made from the list of approved correspondents for handling LC and will depends on the currency in which the credit is issued and address of the beneficiary.
- J LC should be opened only in favor of those beneficiaries who are known to the bank and not been black listed. However, depending upon the standing of the client it may be done after specific approval to the concerned authorities obtained.
- J The issue of an LC is authorized subjected to the holding of a stipulated margin the margin amount should be collected prior to the issues of the LC and held in “LC margin A/C” and a customer-wise record be maintained of such margins held.
- J When a credit is opened by full text operative telex. He must carry the clause “This credit is subject to the Uniform Customs and Practice for Documentary Credit 2007 International Chamber of Commerce Publication No. 600
- J In order to minimize exchange risk and interest on loan which can occur on large value negotiations / Payment the negotiating / Paying bank should be instructed to tele-advise the treasury department of the bank about the details of negotiations on or above USD 100,000.00
- J The original (beneficiary copy) and the advising bank’s copy must be dispatched to the advising / confirming bank or the bank nominated in the LC. Dispatch of amendments to an LC must be handled in the same way.

All the terms and condition mentioned in the LC should be fulfilled before the negotiating bank could negotiate the bill of exchange drawn by the beneficiary

(seller). If the documents contained even a single defect, it is termed carry discrepancy. In such a case the document should be forwarded on collection basis. It would be, then, the discretion of the importer to accept or reject such document and the payment is released by the bank only upon acceptance by the importer. Should there be no discrepancy; the negotiating bank will release payment upon submission of bill of exchange by the seller.

The negotiating bank pays the exporter by debiting the LC opening bank's account with itself. In this sense, the LC opening banks' fund is utilized on that date and hence it charge on such amount from that date up to the actual date of payment by the importer cover and above the interest is also liable to pay bank service charges.

While requesting the bank for opening a LC, the importer is required to deposit certain margin amount (other than collateral) as per the bank's rules. Such margin deposit amount is deductible while releasing documents. Interest is also chargeable only on amount less margin.

It is not always true that in a LC transaction; only two banks (the opener and the negotiator) are involved. Where the opening bank does not have agency relationship with any banks in the area (country) of the exporter, it is but natural that another banks come to play the linking role between the seller's and buyer's bankers.

Issuing a Letter of Credit

The following points must be take care of while issuing letter of credit otherwise conflict arises in the letter of credit.

Issuing Bank – Full Name and Address of the issuing Bank

Applicant – Full Name and Address of the applicant

Beneficiary – Full Name and Address of the Beneficiary

Date and Place of Expiry – All credit must stipulate an expiry date. All credit must stipulate City or the country where the documents have to be presented up to the expiry of the credit.

Mode of Advice – This stipulates by which means the credit is being advised by mail or telex or SWIFT. Brief telex advice evidencing issuance of credit can also be issued with full text or sent through mail.

Amount - The amount of credit in words and figures must be expressed and can be in any currency in which the parties wish to deal. Tolerance percentage must be quoted precisely. Also to be stipulated are if partial shipments allowed or not.

Form of Credit – All credit must clearly indicate the type of credit it is revocable / irrevocable. If not indicated the credit will be deemed to be irrevocable. If the credit is transferable it must be expressly designed as transferable by the issuing bank.

Advising Bank – In many cases the beneficiary gives the instruction through which bank the credit is to be advised. If there is no such instruction the issuing bank chooses the advising bank itself.

Availability of Credit- The name of the bank who can pay or accept drafts of negotiate should be indicated. If the applicant does not know in which bank the beneficiary wishes the credit to be made available he should leave it blank.

Credit Available By – How is the proceeds available by sight, deferred payment, acceptance. The credit can be freely negotiable at any bank or at restricted bank for negotiation should also indicate.

Partial Shipment – If partial are prohibited then only one shipment may be made for total quantity of goods and one payment effected under the credit must be specified.

Transshipment – If more than one mode of transportation is being used the same should be stipulated.

Transport Details – From where the shipment is being made to where it is sent, the name of the city, port of dispatch and destination may also be indicated.

Terms of Delivery- This states the basis on which the amount payable is fixed and the mode for dispatch of goods. Also known as in coterms.

Description of Goods – Description of goods to be shipped must be given.

Documents – A credit must stipulate the set of documents that must be presented and in what state and how many copies have to be presented.

Presentation and Period – Every credit which calls for transport document must stipulate the specified period of time after date of shipment within which documents must be presented for payment, acceptance or negotiation. Applicant must consider the time beneficiary may be needed to collect the documents from the issuers and time to prepare documents for presentation to the bank.

Bank Charges – The credit must stipulate clearly by whom the bank charges e.g. advising charge, postage, confirmation charge and so on have to be collected.

2.1.8 Checking Discrepancies in Letter of Credit

A letter of credit instruct the shippers to present documents to the bank. The documents are intended to show that he has shipped his goods in accordance with his agreement with the buyer.

When the bank receives these documents, the bank has to check them against the copy of letter of credit to determine whether or not the requirements of the LC have been carried out.

First the bank has to read the LC and determine what documents it required and see whether they are received. Then you have to go over the letter of credit, point to point, to make sure each requirement has been satisfied by the documents and that the documents are consistent with each other.

If any of the documents do not satisfy the requirements of the letter of credit are not consistent with each other, there are to be noted down as discrepancies. A decision in then have to be made as to what action is to be taken. Depending on the circumstances, the documents may be accepted, rejected or corrected.

Some of the most common discrepancies are :

-) Clause (Unclean) bill of lading
-) Charter party bill of lading
-) No evidence of goods actually “Shipped on board”
-) Shipment made between ports other than those stated in the credit
-) Goods shipped on deck
-) Presentation of insurance documents of a type other than that required by the credit
-) Insurance risk covered not as specified in the credit
-) Insurance cover expressed in a currency other than that of the credit.
-) Under insured
-) Insurance not effective from date on the shipping document.
-) Document inconsistent with each other
-) Description of goods on invoice differs from that in the credit
-) Weights differ between documents
-) The amount shown in the invoice and bill of exchange differ
-) Marks and numbers differ between document
-) Credit amount exceeded
-) Late shipment
-) Absence of documents called for in the credit

-) Bill of exchange drawn on a wrong party
-) Bill of exchange payable on an indeterminable date
-) Bills of lading, insurance documents or bill of exchange not indorsed correctly
-) Absence of signatures where required on documents presented
-) Bill of lading does not mark 'freight pre-paid' when so required by credit

Discrepancies that can occur in documents presented by the beneficiary may be broadly clarified into two categories viz. Those that can be corrected by the beneficiary and those cannot be corrected by the beneficiary. Discrepancies that are correctable by the beneficiary are like :

-) Number of the credit does not appear in the draft
-) Draft not signed
-) Invoice for wrong amount
-) Invoice showing incorrect cost breaking
-) Bill of lading lacking on board notations, date or signature etc.

Discrepancies that cannot be corrected by the beneficiaries are alike:

-) Wrong merchandise shipped
-) Merchandise on board after latest shipping date
-) Documents presented after expiry of letter of credit etc.

If the drawee bank discover correctable discrepancies during its examination of the documents, it may ask the beneficiary to make the necessary corrections and resubmit the documents. If the re-submitted documents are in order, the bank will then honor the draft and transmit the documents to the issuing bank.

The drawee bank could lose money by honoring a draft accompanied by documents that are not in order and uncorrectable, when the drawee bank accept or pay a draft, it is coming itself. It can not go back on its commitment

and demand that the beneficiary repay; and it cannot assure that the issuing bank will reimburse it. If the documents are not in order, the issuing bank need not pay.

2.1.9 Amendment and Cancellation of Letter of Credit

The seller after receiving letter of credit that he cannot meet one or more conditions of the credit he can request to change the conditions of letter of credit. The terms and condition of letter of credit can be changed by amendment. To amend an irrevocable letter of credit the seller must first contact his account party regarding the change. If requested change or amendment is acceptable, to the account party he should notify the issuing bank of the amendment. For the amendment to be effective the issuing bank, the confirming bank (if applicable) and the beneficiary, does not have to approve the amendment.

In case of revocable letter of credit may be amend or whole letter of credit may be cancelled by the issuing bank without prior notice to the beneficiary. But revocable letter of credit can not cancelled after the beneficiary has presented his document and had them accepted/paid.

| | Revocable LC | Irrevocable LC | Confirmed LC |
|---------------------------|---------------------|-----------------------------|--|
| Who applies for amendment | Account Party | Account Party | Account Party |
| Who approves amendment | Issuing Bank | Issuing bank Beneficiary | Issuing bank beneficiary confirming bank |

2.1.10 Incoterms

With incoterms, ICC tries to overcome the problem of conflicting national laws and interpretation by establishing a standard set of trade terms and definition that offer neutral rules and practices. Incoterms are widely used all over the world and these constitute a pre-established set of rules that can be incorporated in the sales contract. Express reference in the contract is necessary

to make the Incoterms applicable and if such reference is made in the contract, the incoterms becomes part of the contract. Of course, special provision in the individual contract will override anything provided in Incoterms. In order to standardize by the United Nations on the proposal of ICC for all trade terms covered by the United Nations on the proposal of ICC for all trade terms covered by Incoterms.

Incoterms do not provide rules for interpretation of all trade used in international commerce but concentrate on the most important ones. These start from the seller's minimum obligation where it is up to the buyer to take delivery of the goods at the seller's premises, "EXE" (Ex works), and end up with two terms, EXS, EXQ (Ex Ship, EX Quay) where the seller undertakes to deliver the goods in the buyer's country. The terms "Ex Works" implies as sales in the seller's country while under terms "Ex Ship" or " Ex Quay" the seller has not performed his obligation until the goods have arrived in the buyer's country.

At present there are 14 standardized sales terms developed by ICC. All of these terms are three letter abbreviation used to indicate the rights and obligations of each party to a transaction when it comes to transporting the goods . The incoterms and the rights and obligation of each party under trade terms are as follows:

| Shipping Terms | ICC International Abbreviation | The seller must | The Buyer must |
|-------------------------------|--------------------------------|---|--|
| Ex works | EXW | Deliver goods at his premises | Make all arrangements at his own cost and risk to take good to their destination |
| Free carrier at a named point | FRC | Provide export license and pay any export | Contract for the carriage, pay the freight and |

| | | | |
|-------------------------------|-------------------------|---|---|
| | | taxes, provide evidence of delivery of goods to the carrier | nominate the carrier, pay insurance premium |
| Free of ail, or free on truck | FOR | Deliver goods to railways, provide buyer with an invoice and transport document | Pay freight, notify seller of destination of the goods obtain export license and pay any export taxes. |
| FOB airport | FOA | Deliver of goods to airport of departure, contract for carriage or notify the buyer if he wants him to do so | Pay freight notify seller if he does not wish him to contract for carriage, pay insurance premium |
| Free alongside ship | FAS | Deliver goods alongside ship, provide an 'alongside' receipt | Nominate the carrier, contract for carriage pay freight, obtain export license and pay and export taxes pay insurance premium |
| Free on Board | FOB | Deliver goods on board and provide a clean on board receipt, provide export license, pay export taxes and loading costs if not included in the freight charge | Nominate the carrier contract for carriage and pay the freight, pay discharge costs and loading costs if included in the freight charges, pay insurance premium |
| Cost and freight | CFR (Often seen as C&F) | Contract for carriage, pay freight to named destination, deliver goods on board and | Accept delivery of goods on shipment after documents are tendered to him, pay unloading |

| | | | |
|---|-----|---|--|
| | | provide buyer with an invoice and clean on board bill of lading, obtain export license and pay export taxes, loading costs and unloading costs if included in the freight charges. | costs if not included in the freight charges, pay insurance premium. |
| Cost, Insurance and freight | CIF | As with 'cost and freight' above plus contract for the insurance of goods pay the premium and provide the buyer with the policy or certificate | Accept delivery of goods on shipment after documents are tendered to him, pay unloading costs if not included in the freight charges |
| Freight/ carriage paid to | DCP | Contract for carriage, pay freight to named destination, deliver goods to first carrier, obtain export license and pay any export taxes, provide buyer with invoice and transport document. | After tender of documents, accept delivery of goods when they are delivered to first carrier, arrange and pay insurance premium |
| Freight/ carriage and insurance paid to | CIP | As with freight/carriage paid to above , plus contract for insurance of goods and pay the | Accept delivery of the goods after documents are tendered to him |

| | | | |
|-----------------------|-----|---|--|
| | | premium, providing the buyer with a policy or certificate | |
| Ex-ship | EXS | Deliver goods on board at destination, provide buyer with documents to enable delivery to be taken from the ship | Pay discharge costs, import duties, taxes and free if any obtain import license |
| Ex-quay | EXQ | Deliver goods on to quay at destination. Provide buyer with documents to enable him to take delivery, obtain import license and pay import duties, taxes, fee unloading costs and insurance | Take delivery of goods from the quay at destination |
| Delivered at frontier | DAF | Deliver goods cleared for export at place named on the frontier, provide the buyer with documents to take delivery. | Pay for on carriage obtain import license and pay import duties, taxes and fees if any |
| Delivered duty paid | DDP | Obtain import license and pay import duties taxes and fees if any arrange and pay insurance, provide documents enable the buyer to take delivery. | Take delivery of the goods at the named place of destination. |

The 14 sales terms explained above describe situation that range from that in which everything is the responsibility of the buyer to the extreme where everything is the responsibility of the seller. If the buyer wishes to increase the seller's obligation specified under a specified sales term and if the seller agrees, that can be done by adding provision after the specified term. Sales terms are guiding factors for quoting export prices, as price quotation will clearly differ depending on the nature of the sales terms used. It should also be emphasized that terms like FRC, DCP and CIP presuppose the existence of the service of internationally recognized freight forwarders having a network of collection points in different parts of a country. This facility is yet confusion in future; it is advisable to write the word "INCOTERM" after the specific sales terms (e.g. CIP-INCOTERMS) (International Chamber of Commerce).

2.1.11 Advantage of Letter of Credit

"A letter of credit is advantage to the seller in that by the terms of the contract he is given a reliable paymaster generally in his own country whom he can sue and of advantage to the buyer in that he can make arrangement with his bankers for the provision of the necessary funds" (Dr. Indira Cari, "International Trade Law" Page 182-183) The advantage of letter of credit can be classified from two point of view that is from Buyer & Seller point of view.

To the Buyer

1. Assurance his bank will refuse payment to seller unless terms and condition given by him to his bank as stipulated in the credit are met.
2. Extended terms of payments, which in any other form of payment means wouldn't be available.
3. Refinance of goods until they are marketed.

To the Seller

1. Relies more on credit extending bank than the buyer.

2. Less apprehensive that payment for goods might be delayed or jeopardize by political acts or other problems in the buyer's country
3. Enable to obtain loan from banks to prepare goods for shipment prior to making a shipment or just after making shipment.

Some More Advantage of Letter of Credit

The beneficiary is assured of payment as long as it complies with the terms and conditions of the letter of credit. The letter of credit identifies which documents must be presented and the data content of those documents. The credit risk is transferred from the applicant to the issuing bank.

The beneficiary can enjoy the advantage of mitigating the issuing bank's country risk by requiring that a bank in its own country confirm the letter of credit. That bank then takes on the country and commercial risk of the issuing bank and protects the beneficiary.

The beneficiary minimizes collection time as the letter of credit accelerates payment of the receivables.

The beneficiary's foreign exchange risk is eliminated with a letter of credit issued in the currency of the beneficiary's country.

2.1.12 Prohibition Regarding Letter of Credit

Second Objective of My Study

Opening of letter of credit for certain things are prohibited by the NRB and GoN. Opening of letter of credit for things like Tetracycline, Borin, Readymade Garments, Video Cassettes, Plastics Scraps, Titanium dioxide, Shoes, Doxycycline Raw material for Medicine, flasks, Lunch Box are prohibited. Apart from these if the applicant request the bank to open the LC for other things that don't have harmonic code, bank should open only after taking the permission of the loan Investment Department. But if the above

mentioned products are going to be used as raw material then the LC can be opened in favor of those products to be imported in the country. Similarly NRB issued various items prohibition for the purpose of issuance of LC and commercial bank should follow such rule and regulation otherwise commercial bank will be penalized.

2.1.13 Directives of Nepal Rastra Bank For Letter of Credit

Fourth Objective of My Study

1. Applicant for opening letter of credit, should mandatory fill in the prescribed form (BBN F.NO.3)
2. Where LC is opened or paid for merchandise falling under more than one group it shall be compulsory to have stated the value and quality separately for each group.
3. At the time of retirement of documents, BBN F.No.4 should be prepared in quadruplicate for distribution as follows:
 - a. First two copies to importer, for submission to customs office for clearance of goods;
 - b. Third copy to be sent to NRB
 - c. Fourth copy to be retained by the bank
4. Of the two copies handed over to the importer for submitting to the customs office. One of the same, duly certified by the customs, should be submitted back to the bank.
5. List of importers who fail to submit such certified form within 3 months from the date of retirement of the document should be intimated to NRB within 7 days after the expiry of such period.
6. A security deposit at the rate of 2% shall be obtained from the importer till such time the second copy of BBN form No.4 is submitted back to the bank
7. Letter of Credit serial number for LCs payable in Indian currency should be separated.

8. The above BBN Form No.3 and 4 should be submitted to NRB on daily basis by banks situated in Kathmandu valley and weekly (every Sunday by banks situated outside the valley)
9. Effective 2050.11.1/feb 13, 1994- BBN Form No. 4 shall also be issued for imports against USANCE facility. Further, payments made against such Usance imports shall be reported to NRB separately under BBN Form No. 4a (Circular No. 128 dated 2050.10.20/feb. 3, 1994)
10. BBN Form No. 4 should be used also for import of raw wool from Tibet without opening LC under the prevailing system. Similarly, BBN Form No. 3 & 4 should be used for imports from India against payment of foreign currency.
11. Requisite Documents to Open LC (Circular No. 101 dated: 2049/6/25 Oct 11, 1992)
 -) Firm registration certificate
 -) Income tax registration certificate
 -) Performa invoice or contract specifying value and quality of goods to be imported.
12. LCs with clauses like "All DISCREPANCIES ACCEPTABLE" shall not be opened nor shall be amended resulting in such arrangements. (Circular No. 161 dated 2056.5.20/sept.5, 1995)
13. Where LCs are opened and amendment is requested enhancing the LC amount by more than 10%, Permission to that effect from the respective Central Offices of concerned Banks, in addition to fulfillment of other obligation, shall also be obtained. However, no such permission shall be necessary where the amended amount is US\$ 1000 or less (Circular No. 161. dated 2052.5.20/sept.5, 1995).

2.2 Review of Related Studies

2.2.1 Uniform Custom and Practice for Documentary Credit (UCPDC)

“The transaction of letter and credit deals with documents only. It does not deal with goods. As the UCP stated that in credit operation all party deal with

documentary may related”¹ “As the international character of letter of credit sometime domestic and local law are not effective to solve the problem and interpret the proper term on it . So need of one international law related to letter of credit enacted by international chamber of commerce the first attempt in this field was made early 1993 and revised many times”.

Documentary credit transaction are generally operated in accordance with the Uniform Customs and Practice for Documentary Credit (UCPDC) of the ICC. Under UCP, documentary credits are separate and distinct transaction from the contract on which they are based. Banks deal with documents only and are not a party to the contractual stipulations arranged. Banks can and must make payment “Under the principle of strict compliance” if all documents are in conformity with the credit requirement.

The never ending attempt to adapt to new technologies and the simplification of rules On June 1, 2007 the new Uniform Customs and Practices for Documentary Credits, published as International Chamber of Commerce publication No 600, will take effect. The first version of the UCP was drafted at the ICC congress in Vienna in 1933 (ICC-Publication No. 82). After the first revision in 1951, the UCP were again revised in 1962, latter revision being of particular significance, since for the first time Great Britain and the Commonwealth accepted the UCP. The UCP were again revised in 1974 and 1993; the 1993 revision obtained the blessing of the UNCITRAL (United Nations Commission on International Trade Law) which recommended that the UCP be applied to all documentary credits .

The stated goal of the current revision has been identical to previous ones, i.e. - take into account developments in banking, transportation and insurance - review the wording of the UCP to avoid differing interpretations and applications. In a note to its members and the national committees the ICC

itself labeled the new revision as "the most comprehensive in the entire history of the rules." Comprehensiveness however did not lead to substantive changes.

The ICC has shortened the number of articles from 49 to 38. This change is mostly cosmetic however, since substantive changes are barely noticeable. An exception to the foregoing is the shortening of the time to examine documents from seven to five working days.

Structural Changes

The drafters of the UCP 600 unfortunately have given up the division of the text with upper case characters. The criterion of inconsistency of documents (Article 13 a sentence 3 UCP 500) was watered down to read now " Data in a document, when read in context with the credit, the document itself and international standard banking practice, need not be identical to, but must not conflict with, data in that document, any other stipulated document or the credit." (Article 14 d UCP 600). The term "to honour" has been newly introduced and obligates the issuing bank to comply with its payment obligations whether they are based on sight payment, deferred payment, acceptance, deferred payments or negotiation LC. The term to negotiate has been newly introduced (Article 2 UCP 600) and means "the purchase by the nominated bank of drafts ...by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank".

Article 12 b UCP 600 allows that a nominating bank prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank. In this context it should be remembered that individual agreements take precedence over general terms and conditions. Under this doctrine the discounting of deferred-payment L/Cs is - contrary to the wording of Article 12 b UCP 600- not allowed,. One of the most important structural changes of the UCP 600 consists of the introduction of articles regarding definitions (Article

2) and interpretation (Article 3). These new articles summarize what in the UCP 500 had been spread over various articles relating to specific documents.

The goal of the UCP 600 was to reduce redundancy . It remains doubtful however, whether these summaries, in particular article 3, are advantageous. Article 3 contains, without any numbering or division, in twelve paragraphs of completely differing content. Beginning with the concept of irrevocability of LCs, continuing to creation of originals, time related concepts like "on or about", "to", "until", "till", "from" and "between", and "beginning", "middle" and "end" of a month.

Short Review of the Most Important Changes

The most important practical change is the reduction of time to examine documents from previously seven bank working days (UCP 13 b UCP 500) to now five (Article 14b UCP 600). At this point it is not clear whether this will lead to a quicker examination of documents, as is the ICCs intention, or rather convince banks to use the entire time allotted for examination.

Article 1 - 5 Definition, Interpretation, independence of credits and underlying contracts. Article 6 - 10 Availability, expiry date and place, obligations of issuing and confirming bank, advising credits and amendments.

Article 11 - 17 Pre-Advised Credits, nominated bank, reimbursement arrangements, complying presentations and discrepant documents, waiver, original documents and notices Article 18 Commercial invoice Article 19 - 27 Transport Documents Article 28 Insurance documents Article 29 - 37 Extension of Expiry Date, tolerances, partial drawings and partial shipments, Disclaimers

Article 38 - 39 Transferability of Credits and Assignment of Proceeds. The most important substantive changes are: The criterion that documents have to

appear to comply "on their face" is only mentioned in Article 14 a UCP 600. This leaves open that one has to consult the back side of the document. The criterion of inconsistency (Article 13 a UCP 500 "Documents which appear on their face to be inconsistent with one another") was watered down to read now (see Article 14 d UCP 600): "Data in a document, when read in context ... need not be identical to, but must not conflict with..."

Criterion of Documentary Compliance

The requirement that documents have to be examined whether they appear to comply "on their face" has not changed; Article 14 a UCP 600 adds however, whether the documents appear to "constitute a complying presentation". This addition should not be interpreted as a softening of the standard of documentary compliance. This view is supported by ICC publication 645 International Standby Banking Practice for the examination of documents under documentary credits which also applies to UCP 600 . In the introduction to ICC-Publ. 645 the ICC states that the ISBP have developed into a necessary complement to the UCP which practitioners should continue to apply, also the ICC announces an amended version of the ISBP. Contrary to the ISBP, the four position papers of the ICC dated September 1994 are not applicable to the UCP 600. The decision regarding the determination of original documents however is still valid but has been incorporated into the UCP 600 (Dr. Nielsen Jens).

Collyer Gary (2008)- The article in UCP 600

It is now over one year since UCP 600 was implemented and is an opportune time to take a brief look at where we are with the implementation, issues, perceptions and usage of LC. From an ICC perspective, 2008 has seen three requests for DOCDEX decisions relating to credits issued subject to UCP 600. The first was in respect of a credit that was issued on 24 July 2007. The underlying issue related to the actions of a bank when refusing documents where that bank was not the issuing bank, but the bank to which the issuing

bank had outsourced their processing. The issues in this case would equally have arisen if the credit had been subject to UCP 500.

The second also related to whether a party had refused the documents in a timely manner. In this case, the issuer of the credit was a non-bank who took longer than the maximum of five banking days to provide their refusal. In fact, their refusal was sent on the 11th banking [business] day. Again, the issues in this case would equally have arisen under UCP 500.

The third related to a case where the issuing bank required presentation of an "arrival advising report" in relation to the vessel. The beneficiary presented a document so titled but the issuing bank refused on the basis that it should have been issued after the vessel's arrival – although this was not stated in the credit. The issuing bank also took 12 calendar days following the day of presentation to issue their refusal, whilst they waited for what they thought would be the correct document under the credit. Once again, these issues could equally have applied if the credit had been subject to UCP 500.

So, from a DOCDEX viewpoint, there has not been much activity that can be linked to the rules themselves. In addition to the three UCP 600 DOCDEX cases, so far this year there have been eight other DOCDEX cases relating to credit subject to UCP 500.

During the course of the two ICC Banking Commission meetings that have been held since the implementation date (meetings in October 2007 and April 2008), around 30 requests for opinions have been submitted, opinions drafted and then approved. Of these, 20 related to UCP 600 of which 14 could equally have applied to transactions subject to UCP 500. The content of these UCP 600 opinions has been discussed in previous newsletters. For the ICC Banking Commission in October, we have a total of 19 opinions to discuss of which 17 are in respect of UCP 600 transactions. These will be discussed in the next newsletters.

I would now like to share with you some comments that have been made during my discussions with corporate and banks from around the world. You will note that there is some commonality in the comments made by both, which in fact is a good thing as it would seem to indicate that they are on the same wave length with regard to applying the rules.

Corporate views of UCP 600

-) Easier to read, follow and apply;
-) Clearer rules that leave little room for banks to "manipulate" or interpret to their liking;
-) There is widespread adoption by banks together with greater application of the ISBP publication.
-) A recognition that there is a need for an applicant to grasp that UCP 600 does not only benefit the beneficiary;
-) The content and structure of UCP 600 should encourage more usage of the documentary credit as a means of payment ;
-) An opportune time for corporate to review their current practices and look for better documentary credit structures;
-) Use the impetus of UCP 600 to seek out new buyers and suppliers; and
-) There appears to be a reduction in discrepancy rates seen in many countries.

Bank views of UCP 600

-) Easier to read, follow and apply [*note the similar comment from the corporate*];
-) Clearer rules that leave little room for issuing banks to "manipulate" or interpret to their liking [*note the similar comment from the corporate, but in this respect banks are referring to where they are the nominated bank and are subject to the determination of compliance by the issuing bank*];

- J Increased application of the ISBP publication [This was a problem under UCP 500. Some banks took the view that they would adopt the practices outlined in ISBP publication 645; others decided they would not, and some applied the practices when it suited them and did not apply them when it worked against them. There was no common adoption globally. The cross referencing of the publications in the introductions to UCP 600 and ISBP 681 seems to be working];
- J Increased usage of documentary credits already seen in markets such as Asia and Middle East. For example, China is the number 1 issuer of documentary credits globally and various countries in the Middle East are projecting increases in volume of around 15-20% per annum;
- J Banks are now promoting documentary credits as an offering whereas in the past it was not a 'priority' product;
- J Banks have identified that this is an opportune time to review current practices and look for better documentary credit structures and guidelines; [*The introduction of UCP 600 was not just an exercise to change '500' to '600' on the LC application form or online application service. Banks are now looking to re-address their offerings and look at new offerings*];
- J Individual banks have stated that their discrepancy rates have dropped.

My view of UCP 600

- J To make the rules easier to read, follow and apply was in the top 2 or 3 goals of the drafting group;
- J It was hoped that clearer rules would leave little room for banks to "manipulate" or interpret to their liking;
- J With UCP 600 and ISBP publication 681 issued at the same time and directly linked with each other, common standards are being achieved;
- J It is an opportune time for corporate and banks to review their current practices and look for better documentary credit structures and guidelines. The world has moved on since UCP 500 was implemented and letter of

credit structures and offerings should also reflect this movement; www.coastlinesolutions.com (collier Gary).

- J A reduction in discrepancy rates has been seen in many countries. However, the rules by themselves will not have a significant impact on the percentage of refusals. Rules cannot stop a beneficiary shipping late, presenting late, adding data that creates a conflict between data on other documents, etc.
- J There has been no need to issue any form of Position Papers as was the case under UCP 500; and
- J The majority of ICC Opinions issued to date could have equally applied under UCP 500.

The UCP 600 looks to be in fairly good shape. There will always be teething problems and there has been, but hopefully the correct messages have reached or are reaching the banks that misinterpreted the rules originally. There are still individuals that have their own views on what should have been included in the rules and what should not. At the end of the day, the UCP 600 reflects the agreement of the ICC national committees as of October 2006, when the rules were approved. For the continuing benefit and success of UCP 600, it relies upon the banks to adopt the rules in the spirit and intent in which they were written and not to look at ways to circumvent the rules by trying to impose impossible or ambiguous conditions on the beneficiary nor to look to refuse documents for reasons that do not exist. www.coastlinesolutions.com (Collyer Gary).

International Trade and LC (*Bineet Dhungana, Journal of ICAN 2009 Page 34*)

Letter of Credit has become one of the most widely used document in international trade. For a bank, letter of credit is linked with many revenue sources. But banks need to be cautious in LC related transaction as LCs are susceptible to many risks. When there are some unpredictable turns in

international trade or major economic movements in world market, even the transaction related to letter of credits are exposed to disputes (in between various parties to LC). Such unfavorable situations will generally result into disputes related to technical as well as practical aspects of trade executed via letter of credits. Recently, we had experienced such disputes in import LCs related with steel & palm oil. In those cases, the price of steel and palm oil had reduced drastically, due to global economic crisis, after opening of LCs but before taking the delivery of the imported goods by the importers.

| Particular | 2007/08 | 2008/09 | 2009/10P | 2009/10P | |
|---------------|---------|---------|----------|----------|---------|
| | | | | 2008/09 | 2009/10 |
| Total Exports | 529.5 | 553.4 | 622.2 | 4.5 | 12.4 |
| Total Import | 1647.1 | 2196.1 | 2554.6 | 33.3 | 16.3 |

Amount in Crore NPR P= Provisional

However, a bank has to take some calculate risk in its business. In the countries like Nepal which is heavily dependent on imports, banks have a lot of opportunities in letter of credits, especially in import LCs. Following table shows the amount of import & export for FY 2064/65 and 65/66 and also estimated amount of import/export for FY 2066/67:

With the end of internal conflict and also with the signs of political stability, many developments projects are in the pipeline. Additionally, Nepal is witnessing the rise in real estate sector, especially the housing/Multiplexes etc. With the increase in the remittance from abroad, the disposable cash in the hand of common Nepalese is increasing. All these factors will result into more imports. Banks are experiencing huge inflow of foreign exchange through remittances. Banks can take proper advantages of such forex only when they are able to increases their LC business as in LC they can sell forex to importer to derive trading income on foreign exchange.

A bank auditor (internal or external), to be able to audit the transactions related to LC, should be familiar with the entire regulatory requirement including UCPDC guidelines and bank's internal trade finance policy and should have sound technical knowledge on international trade practices. He/she should assess the adequacy of internal control system over the letter of credit transaction, should assess the technical competency of personnel responsible for LC transaction and should use appropriate substantive procedures to derive reasonable assurance on the matters related with Letter of Credits. As the bank's try to maximize the profit by taking as much LC business as possible, it's up to the auditor to ensure that, the bank is operating within the framework/boundary prescribed by the authorities so that the bank is not exposed to unnecessary and unauthorized risk.

2.2.2 Collection of Circulation Issued by Foreign Exchange Management Department, Nepal Rastra Bank, Central Bank

Nepal Rastra Bank the central bank of Nepal was established in 1995 under the Rastra Bank Act 1995 to discharge the central banking responsibilities including development of the embryonic domestic financial sector.

The foreign exchange management department being a wing of Nepal Rastra Bank which has been assigned to formulate the policy in the sector of foreign exchange currencies and international trade (export and import). Thus the department has been formulating the foreign exchange policy to stabilize consolidate the balance of payment for sustainable development of the economy of nation. Besides the department development develop secure, healthy and efficient systems of payment, appropriate supervision of the banking and financial system in order to foster its healthy development and further enhance the public confidence in Nepal entire banking and financial system as well as.

The department has been issuing the circulars to BFIS and other concerned sector to have effect for smooth operation of foreign exchange currencies, such circulation have been issued to make a healthy transaction in foreign currency appropriate supervision of the banking and financial system and to control the illegal and restricted transaction.

In F.Y. 2063/64 the department has cancelled the previous issued circulars no. 1-279 by replacing the series of new circular which is start from circular no. 38 on the same has been circulated with immediate effect from issued date to BIS such circulars have been revised and further adding by new one on time to time. At present circulation reached to 520.

In, Nepalese context, LC transaction related with foreign currency stately follows these circular. If LC transaction made without following the rules or circulars laid down by NRB shall be presented violation of NRB rules.

In this study, “Collection of Circulars issued by foreign exchange management department, NRB, central office is denoted as NRB forex policy or NRB forex guideline”.

There has been few number of thesis done in Letter of Credit. Therefore, my findings has been confined.

In this “review of related studies” section some researchers finding related to this topic are presented below :

Mishra, Sarbendra “A Study on letter of credits business in Nepal, with reference to Nabil Bank Ltd.”

From the study conducted so far, it has been found that operation of an letter of credit in Nepalese context is highly sophisticated. The reason for this is

obvious to see, our currency is not convertible and we have limited export and huge import resulting in negative balance of payment. This has prompted NRB (Central Bank) to formulate so many rules and regulations related to opening administering of L/Cs in Nepal. Most of these rules are in contravention of internationally accepted norms of UCP. This is some extent has reduced the scope of international business in Nepal. Excessive documentary works, delays and bureaucratic red tapism have discouraged multinational cooperation for doing business in our country.

It is found by this study that Letters of credit is a core business of a bank. It is major avenue for revenue generations. It has multifarious effects on balance sheets and profitability of the bank as a whole.

Chhetry (2005) has submitted a thesis entitled on “ A Study on letter of credit operation of SBI Bank Limited”. He had done analytical study of LC on joint venture commercial bank, which is operating from Kathmandu valley. His main objective of the study are :

-) To examine the NRB directive on LC operate
-) To analyze the problem while opening LC

Findings of the study are :

-) Rules laid down by NRB regarding LC transaction are inconsistent with the international practice. This has caused difficulty to business people for international trade (import and export) and decrease in the earnings of bank.
-) There should be sound coordination between NRB and SBI and other commercial bank so as to deliver credit and other supporting services smoothly. So that jointly effort can be earned out in making any decision like change in service charge, interest rate, lending criteria, credit term etc.

-) There have been a lot of fraud cases in bank by ineffective and in efficient management. Therefore to prevent future fraud cases in future, the manager must be careful and must follows the direction given by NRB, which is important for successful running of the business.
-) Training should be provided to staff of bank on letter of credit operation. Right man should be kept in right place according to their capacity and willingness to work. There must be need of defining their job, authority and responsibility so that they may provide quick service to the customers and also able to convince the people that bank is for their benefit rather than profit.

Tamang (2005) has submitted her thesis on “NRB directives towards letter of credit operation”. Her research statement of problem are :

-) How the letter of credit is being practicing in Nepal?
-) What are the major NRB directives towards letter of credit.

Objectives of the study are

-) To study about the procedures of opening LC in Nepal.
-) To examine the major NRB directives towards LC

Major findings of study are :

-) For operating letter of credit, applicant should mandatory fill the prescribed form “Bi. Bi. Ni. Form No.3”
-) At the retirement time of documents Bi. Bi. Ni. Form No.4 should be prepared in quadruplicate. First two goes to importer for submission to customer’s office and clearance of goods, third copy to NRB and fourth copy to respective bank.
-) Bi. Bi. Ni. Form No.3 and 4 should be submitted to NRB on daily basis by bank situated in Kathmandu valley and weekly in other case. A copy of Bi. Bi. Ni. Form No.3 must be sent to concern custom office.

- J Requirement for the opening LC are, Firm registration certificate, Income tax certificate, Performa invoice or contract specifying value and quantity of the goods to be imported.
- J No documentary credit shall be amended to enhance LC amount by more than 10% within prior approval of central office however such approval is not required where the amended amount is US \$ 1000 or less.
- J Documentary credit receive through correspondent bank only accepted.
- J Payment to the beneficiary must be made through correspondent bank. Direct payment to the beneficiary by the way of draft is strictly prohibited.
- J Payment of import bill more than US\$ 1000 by demand draft requires NRB approval. But the NRB circulation No. 219 has suspended this clause.
- J Commercial bank accept a transport document if that is presented to bank within 45 days of the issue.
- J All commercial bank should inform NRB within 7 days of opening letter of credit with a cash margin of 50% or more.
- J Along with Bi. Bi. Ni. Form No.4 all commercial bank should forward following documents to the concern custom office, amendment in letter of credit if any. Commercial invoice, transport document, certificate of origin, packing list.
- J No commercial bank can issue a documentary credit with red clause.
- J Performa invoice or indent must contain, description of goods, country in which have goods are produced, harmonic code, unit price, quantity, total price.
- J Half yearly internal audit report of each bank licensed to issue LC must be sent to NRB.
- J Original document do not matched with the copy documents, concern bank should inform NRB and hold the guarantee till NRB gives clearance.
- J Letter of credit can be opened for those products only, which are mentioned in the customs tariff code book and goods under OGL. But LC

cannot be opened for those products which are prohibited by the Nepal Government and NRB through their harmonic code.

- J Letter can be opened in convertible currency. But clause is product must be directly purchased from the manufacture as specified by NRB circular no. 200.
- J The bank only in favor of those beneficiaries whom it is known to the bank that the party have not been black listed should open LC. However, depending upon the standing of client in may be done after specific approval of the concerned authorities obtained.

Pradhan L (2008) has submitted a thesis entitled on “A study on letter of credit operation of Nepal credit and commercial bank Ltd.” She has done the study of LC operation in Nepal credit and commerce bank ltd. Her main objectives of the study

- J To examine the pre-requisites for opening LC
- J To evaluate the documents used in LC
- J To analyze the procedure of opening LC
- J To study the problems of LC
- J To explore the transaction of LC of sample Bank

Findings of the study

- J NCC bank has increasing trend of total loan & advances to total deposit ratio.
- J The bank has decreasing trend of non performing assets to total loan & advances ratio.
- J The bank has decreasing trend of interest income to total loan & advances to net profit ratio.
- J The bank has highly decreasing with negative trend of total loan & advances to net profit ratio

- J The bank has increasing trend of total number and total transaction value of export LC opened in Nepalese currency except the following year of study period.
- J The bank has increasing trend of total number and total transaction value of export LC opened in US dollar except the two following years of study period.

Khadka Y. (2010) has submitted a thesis entitled on “ An analysis of letter of credit operation of Nepal credit and commerce bank Ltd. He has done analysis of letter of credit operation of NCC bank and findings of his study from primary data is concerned the following conclusion have drawn.

NRB forex policy and UCPDC 600 and concerned bank requirement are considered before opening the LC bank's strictly followed the NRB forex policy UCPDC 600. The main reason of filling LC application is to collect information and execute LC operation smoothly. Bank updated its operation procedure according to periodic NRB forex policy and UCPDC 600 (Revised Version). People finds difficult to understand and filled the LC firm but still finds LC operation in NCC Bank easy and simple. NRB rules are central bank forex policy and UCPDC 600 has a positive relation where as central bank plays a coordinator for the LC operation in a commercial bank.

Objective of study

- J To study and examine the pre-requisites and required documents for opening of LC.
- J To evaluate the coordination between LC operation, NRB forex polices and international rules for LC guidelines i.e. UCPDC 600.
- J To analyze the sample banks LC transaction with the overall national volume of LC business.
- J To evaluate the LC business and profitability of the sample bank.
- J To provide recommendation to the concerned bank on the basis

- J Based on major findings of the study, some recommendations are done below hoping that these recommendation will be milestone to overcome existing issued in this field.
- J NRB forex policy and UCPDC 600 and concerned bank's requirement (pre-requisite for opening of LC in NCC Bank) should be simple and easily under stable. Since NRB forex policy and UCPDC 600 and bank's requirements are the major before opening the LC. The concerned bank must monitor whether the NRB forex policy and UCPDC 600 both are strictly followed or not.
- J LC application form should be easy and simple to fill up.
- J Concerned bank should continue updating its LC operation procedure with its dependent factors i.e. NRB forex policy and UCPDC 600.
- J Since NRB rules are sufficient to control the irregular and illegal LC transaction, the bank should focus whether it is strictly followed or not in practice.
- J Since the relation between LC dependent factors UCPDC 600 and NRB forex policy is positive, the bank should go through this both documents / policy by making sound relation.
- J Since the central bank i.e. NRB plays as a coordinator role for foreign exchange policy and monitoring the foreign trade (import and export business) the concerned bank's should timely submit the requirement and necessary reporting as guided by central bank.
- J NCC bank should adopt the sound credit collection policy. It helps to decrease loan loss provision and non performing loan of the bank. The policy should entire rapid identification of dealing with loans, immediate contact with borrower and continual follow up until a loan is recovered.
- J Training should be provided to staffs of bank about on letter of credit operation. Right man should be kept in right place according to their capacity and willingness to work. There must be need of defining their job, authority and responsibility so that they may provide quick service to

the customers and also able to convince the people that bank is for their benefit rather than profit.

Joshi Rajina, (2059) has submitted a thesis entitled on “Letter of Credit Business of Nepal Investment Bank Limited” She has done the study of LC operation in Nepal Investment Bank Ltd.

Major findings of study are:

-) Letter of Credit is a most widely used financial tool in two days International Trade and Finance.
-) NIBL has contributed a lot in the International Trade and Finance by way of providing LC facility apart from other regular banking facilities.
-) Businessmen prefer to make payment through LC while importing goods from abroad than any other instrument (Telex Draft Swift etc) because it is the safest means of payment and it also gives guarantee that the goods (as per the requirement or agreement) will be received/
-) From the study of LC Business of NIBL, we see that its import transaction is far greater than export. Hence we can say that the importer to Nepal as a whole is also in increasing trend than export.

CHAPTER- III

RESEARCH METHODOLOGY

Methodology may be defined as a systematic process that is adapted by the researcher in studying problem with certain objectives in view. In other words research methodology describe the method and process applied in the entire aspects of thesis. “A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure” (*Clair, Seltiz and others, “Research Methods in Social Science” 1962:22*).

The basic objective of this thesis is to analyze theory and practice of LC to enhance Letter of Credit theory and practice in Nepal for the improvement of business transaction. Thus in the chapter focus have been made on different law regarding letter of credit, documents require for letter of credit, rolled played by NRB for monitoring LC as well as NRB Act and Commercial Bank Act 2031 has been examined meticulously. The internationally accepted UCP 600 for LC transaction has been taken as reference along with various circular issued by NRB and directives of NRB for LC Transaction have been consider as key factor for Letter of Credit transaction.

3.1 Research Design

Research Design helps to collect quantum of accurate date economically but there is various type of research design. Here, is applied descriptive and analytical research design as it deals with the descriptive of the situation and Interpretation of data.

3.2 Source of Data

There are two methods of collecting the source of data:

1. Primary Data

2. Secondary

1. Primary Data

Those types of data, which is collected by own intellectual power, field observation, questioning etc. Primary datas are not collected and mentioned in my study.

2. Secondary

The data which are collected by the help of other peoples, professors, students, books, library, thesis, articles, report, journal etc. Economic Performance, Historical Background are collected from Nepal Stock market. The secondary datas explained here are not the actual datas because this study is based on descriptive, As the directives of NRB on LC this thesis is performed.

CHAPTER- IV

DATA ANALYSIS & PRESENTATION

4.1 Procedure of Opening Letter of Credit

For the first objective of the study, the objective is procedure of opening letter of credit.

A Letter of credit is an instrument wherein a bank authorizes another bank to debit its account for payment to the exporter upon submission of specified documents and fulfillment of stipulated condition in respect of the shipment of goods or services rendered and required by the importer.

The request to open a letter of credit will be made by the importer to its bank detailing all terms and conditions upon fulfillment of which it authorizes the bank to release payment to the exporter. The same terms and condition are, in turn, conveyed by the LC opening bank to the negotiating bank The negotiating bank notifies the receipt of LC to the exporter.

Following are the procedure of opening letter of credit.

4.1.1 Eligibility to Open LC

-)] A registered firm/company with registration updated.
-)] The party should be holding current account with the bank
-)] In case the applicant is an individual then permission from Nepal Rastra Bank is required
-)] The party shouldn't be a defaulter and blacklisted
-)] The credit worthiness of the customer should have been assessed.

4.1.2 Authority to Open LC

All the branches having LC operation can open LC remaining within the authorized Letter of Credit Limit. Letter of Credit need to be signed by the LC operation in charge of the branch and should be approved by one of Branch Manager and Assistant Manager who looks after the LC operation.

4.1.3 Documents Required to Open LC

-) Application signed by the customer. The signature should be verified by bank official with the signature in the current account specimen. LC cannot be issued on verbal request of the customer.
-) Duly filled N.R.B. Bi. Bi. Ni. 3 has to be obtained
-) Updated Firm Registration and PAN Certificate
-) Citizenship certificate of the person applying for the LC and of the person who is authorized by him
-) If applicant is Private or Public Limited Company then the following documents should be obtained for the Letter of Credit Limit:
 - a) Memorandum of Association and Articles of Association
 - b) Certificate copy of board resolution authorizing a certain person to deal in LC matters
 - c) Personal Guarantee from MD, Chairman or the shareholder holding the largest number of shares, if so stipulated in the situation
 - d) Personal guarantee can be sought from the partner(s) and Proprietor in the case of partnership and proprietorship.
-) If some person is acting on behalf of firm, company or any institution then the certificate copy of his identify card should be taken and an undertaking that the ultimate responsibility on LC is rested on the respective organization should be taken.
-) Proforma Invoice containing particulars of goods including names, quantity, price, brand and model no. should be taken. This should be signed under the seal of the importer organization.

All the documents except the proforma invoice may be taken once in a year for the customers will LC limit unless there is any change in the any of the documents above. If any changes occur in the documents above then the changed documents need to taken from the customer.

4.1.4 Verification Process Prior to LC Opening

-) LC should be opened for the customer who is holding current account with the bank
-) The applicant should have valid LC limit with bank
-) Margin for the limit holders shall be as per the terms of the sanction. However if the issuance of the LC in question exceeds the limit of the customer then 100% margin should be taken for the exceeded amount. Unless otherwise permitted by the concerned authority. For non limit holders LC could open on 100% margin only. Unless otherwise permitted by concerned authority. Minimum margin amount in cash and balance in the form of FDR can be accepted with lien of the bank marked.
-) In case of unasked and deferred LC, it should be backed by the sufficient collateral security or the funded facility enjoyed by the customer can be earmarked to the extent of the LC amount and LC can be issued.
-) Letter of Credit cannot be issued at the request of one customer using the limit of another customer. The Letter of Credit Limit isnot transferable , unless there is group limit where such utilization is specially approved.
-) For LC with reimbursement clause custom margin is also to be recovered at the time of opening Letter of Credit.
-) LC cannot be issued for an individual. If it is requested then approval from Nepal Rastra Bank should to be obtained.
-) If guarantee has been taken from any third person then an undertaking has to be obtained that, if there is any misappropriation of the foreign exchange and or leakage in state revenue then the person applying for the LC will be responsible along with the person providing guarantee

- J Any significant amendments like changes in the LC amount should be communicated to the reimbursing bank
- J Transport document more than 21 days old will be a stale document and hence should not be accepted.
- J Generally the agreement between the buyer and the seller is not a part of Letter of Credit
- J The details of LC issued should be sent to Nepal Rastra Bank on daily basis in a specified form No. Bi. Bi. Ni 3 to NRB
- J If the imports are from third country one custom point among custom points at Kakarbhitta, Biratnagar, Birgunj, Nepalgunj, Bhairahawa, Dhangadi and TIA should be used.
- J If the custom point in a LC is to be altered then it should be authorized by Department of Commerce Government of Nepal.
- J Letter of Credit on convertible foreign exchange can be issued for the imports from India also but the beneficiary in this case should be the producer and LC cannot be issued through supplier. LC can be issued only for the import of the items certified by Nepal Rastra Bank.
- J LC can not be issued in favor of any Blacklisted person/party.
- J Customers other than from garment industry opening LC in convertible foreign exchange from India should include AR4 of AR4. A bill of export duty free goods mentioning Nepal invoice Number and the document should bear the issue date. If these conditions are not satisfied then the payment should be made in Indian Rupees.
- J Items prohibited by the Government cannot be imported through LC. Goods like, explosive, drugs, beverage containing more than 60% alcohol and used plastic items. To import liquor approval should be taken from the Inland revenue Department. Similarly, to open LC for drugs, permission should be obtained from Department of Drug Administration.

- J While importing wool, permission has to be obtained from Trade and Export Promotion Centre and only wool of standard size of length 128-4"-6" can be imported.
- J To import yarn from India industries should take permission from Department of Industries.
- J In the case of Trading Houses Income Tax registration should mention the activity as import and export
- J In case of the imports from India by importers having account on convertible foreign exchange, letter of credit can be opened on the condition that Foreign Exchange will not be expended from Banking Management under the circular No. 199
- J If a garment industry wishes to establish LC from India then the permission should be obtained from the Garment Association
- J The transaction between Nepal and Bhutan should be in Indian Currency
- J LC can not be opened for the goods to be imported from third country but to be dispatched from ~India
- J For the LC amounting to more than USD 50,000 or equivalent credibility information of the supplier/exporter should be obtained and information received once will be valid for one year. But if the importer is Government/Government Undertaking, Semi Government organization then this report is not mandatory for LCs up to value USD 500,000
- J Where ever LC is to be established for the project being finance by the bank, the bank may add reasonable condition if felt necessary
- J If Back to Back LC is to be established based on the LC received from abroad the following condition should be mandatory pressed "Negotiation of this LC is restricted to Rastriya Banijya Bank.....Branch. This clause cannot be amended without receiving prior approval from RBB." In such condition, it should be stated that the proceed from the export should be earmarked for the appropriation towards the LC settlement for imports.

- J If the LC mentions “Third Party Document Acceptable” then the payment has to be made to the party issuing invoice”.
- J Once the document arrive in the bank and go for reimbursement or negotiation before authorizing the payment in foreign exchange NRB Bi.Bi.Ni. 4 have to be issued. When the payment has already been affected by reimbursement to the negotiating bank or documents for negotiation have not been received by the bank, the bank still has to issue Bi.Bi.Ni. 4 for the concerned LC. Those issued Bi.Bi.Ni. 4 have to be kept by the Manger/ assistant Manger and handed over to the new official while hand over and take over.

The bank does not generally encourage the establishment of LC on the currencies where we do not have agency relationship. However, if the LC has to be opened on such bank then an undertaking should be taken for the customer that the settlement on USD is agreeable to the customer. Cross rates as provided by Treasury department should be applied for the settlement.

4.1.5 Steps to be Taken to Open LC

- J It should be ensure that the complete set of documents and forms are received from the applicant. Documents to be taken are as under,
 - I) Bi. Bi. Ni 3 II) P.I
- J A Signature on every document has to be verified with the specimen signature provided to the bank
- J Approval should be taken for opening of LC,
- J For limit holders: No further approval is required provided the limit is valid and can accommodate the proposed LC. (outstanding in AOC/TR Acceptance liability, if any, should also be taken as prevailing LC liability for checking the available limit)
- J In case the limit is not sufficient to accommodate the subject LC or the limit its expired or for any other thing not in order, approval from the approving authority is required even for the limit holder.

- J For non limit holders, approval from approving authority is required . The retirement arrangement should also be mentioned specifically.
- J Debit margin, commission and communication charge from the applicant's account. If the LC allows some tolerance range then the commission should be taken for the upper range. In such case the contingent liability should be booked accordingly of the higher amount.
- J LC of value more than 20 times of the paid up capital of the firms other than companies cannot be issued, unless otherwise permitted by the concerned authority
- J For back to back LC the margin can be as low as nil if it is mentioned in the sanction term.
- J Commission shall be as per the sanction terms or as approved or if nothing is specified as per the standard tariff of the bank based on the nature of items being imported and the LC validity duration.
- J For usance LC additional usance commission is also to be recovered.
- J Communicating charge shall be as per the standard tariff
- J The branch officials have to ensure that a sufficient balance is maintained in he customer's nominated account for recovery of all commission and charges as above.
- J Issue LC no. after completion of all the formalities detailed above and records the same in the LC opening register
- J The accounting entries for the marginal amount, contingent , liability, commission and the charges, foreign exchange gain, TR loan, AOC and settlement will be as prescribed in the chapter 12 of the Accounting Manual of RBB
- J Bank's field should be fill in NRB Bi.Bi.Ni 3 (only for LC in convertible foreign exchange)
- J A file has to be maintained for all the documents along with transmitted LC copies debit advice and work sheet in a systematic order

- J Segregate first copy of Bi.Bi.Ni. 3 and dispatch to NRB under covering letter (only for the LS in convertible foreign exchange)
- J Necessary information should be entered in the form provided by NRB on details of opening LC and the same should be sent to NRB regularly
- J Handover LC copy to the authorized person of the applicant
- J If LC contains direct reimbursement clause, prepare reimbursement authorization in favor of the correspondent bank and dispatch. Charge should be recovered from the customer and a copy should be retained in the file .
- J The charge of the transmission should be standard
- J LC opening registration should be maintained as prescribed in Accounting Manual of RBB .

4.2. Findings of Prohibition Regarding Opening LC

For the second objectives of the study findings of prohibition regarding LC is taken as follows :

- J All directives issued by NRB (Foreign Exchange Management Department) from time to time must be strictly complied without any expectation.
- J Letter of Credit cannot be opened putting Red Clause. Except where NRB specifically approved (NRB has allowed in some cases)
- J Unless a pre approval is obtained from NRB, LC cannot be established keeping “ Already-Shipped transport document acceptable” clause
- J A LC cannot be opened or amended putting “All discrepancy are Acceptable”
- J Vague terms Like “First Class”, “Well Known”, “Qualified”, “Independent”. “Official”, “Competent”, “Local” shall not be used in LC.
- J LC cannot be opened putting the condition that the “Transport Document Consigned to the opener or Applicant or Accountee” and if LC has to be

opened with such condition then it can be done on 100% margin only, otherwise permitted by concerned Authority

- J Clauses like , “ Documents before LC date acceptable, “Original Document to be dispatched directly to the opener”, “ LC amount can be increased” cannot be included in a LC
- J In respect of the Insurance mode it should be very clear and phrases like, usual risk and Customary Risk should not be used
- J Invoice using vague terms like “about”, “approximately”, “Circa” for value and quantity of the goods should not be accepted
- J The transport documents using the terms, “Prompt”, Immediately, “ As soon as Possible” are not acceptable
- J Transferable LC opened using the terms “Divisible”, “Fraction able”, “Assignable and Transmissible” will not be accepted
- J The branch should take the minimum margin amount in cash only and minimum margin in the form of FD in not acceptable, unless otherwise permitted by Concerned Authority
- J Transport document from Non-Conference line vessel is not allowed
- J No LC must be opened for import of merchandise specifically prohibited by NRB. Further, where ever of specific merchandise required prior approval of NRB, the same must be obtained before establishing LC for such items

4.3 Problems While Opening Letter Of Credit

Third Objective of my Research

Opening procedure of L/.C is long legal and complicated process. So parties involved in this process is faced many problems. The main problems faced by opening banks and customers may be as follows:

1. Nepal Rastra Bank (NRB) has instructed all the commercial banks to open L/C on the basis of the status of the client. Commercial banks find the term 'status' very vague. They saw how to find out ones status. They say if

someone comes to open the L/C with import license and income tax clearance certificate, then why should they be sorry about the status of the person. In the view, it should be the authority that gives import license to be responsible for giving license by checking at the person's status and not them.

2. Employees of commercial Bank involved in L/C transaction have to be responsible if anything goes wrong in the transaction. But employees of commerce Department and taxation department from where people get import license and income tax clearance certificate respectively to open LC do not have to be responsible.
3. Government has valuation for goods imported, which are undervalued NRB gives foreign currency according to their harmonic code, which is not sufficient to pay the bill. Therefore, imported are compelled to get foreign currency from back market.
4. Sometimes the client of the bank may turn out to be a fraud. In such cases bank has to face problems. If all the documents are received as per LC but the client does not come to take the documents, in that case, the bank has to pay money to the exporter although the goods will be under the bank control.
5. The new customer has to pay more than 100% margin of total amount of LC. LC process takes 15-30 days for settlements and in this period, the customer's whole amount will be blocked and he can't mobilize the amount.
6. If the party is new, Exporter does not believe on them. So they ask for advance payment's so deliver the goods. But, some commercial bank does not give permission for advance payment. NRB has provision to give the advance payment only for sample. For this purpose, they may have to use other reputed importer's account and pay them commission.
7. Problem may arise during the shipment, which may be uncertain. Difficulty in accepting state transport document of which NRB approval is essential.

8. If a firm's age does not exceed more than one year, they have to pay tax in advance of LC amount issuing bank charge 10% tax of LC amount and sends it to tax office early time businessmen do not have much ideal about the profit margin but have to pay the tax in advance. Furthermore within that one year they have to pay advance tax every time they open L/C. This amount is also blocked for whole the year.
9. The major problem of L/C is as per UCP up to 5% tolerance is allowed but as per NRB rules no specific tolerance on the value and quantity is allowed.

Discrepant Document

There are many reasons that may cause document to be incorrectly presented and Subsequently dishonored by the paying bank. If the incorrectness is found in the Document there are several possibilities for the paying bank and/or issuing bank to react:

-) To contact the beneficiary to get the document corrected, if possible.
-) The paying bank can contact the issuing bank in order to get their permission to take up documents despite the discrepancies stated.
-) The paying bank can effect payment under reserve either internal or open reserve.
-) The paying and can send document to the issuing bank for payment authorization or, in case of major discrepancies, for collection.

The largest proportion of documents is dishonored due to error in preparation and the majority of discrepancies are in the invoice.

Expiry Date and Place for Presentation Of Document

-) The last date for shipment
-) The time period available to the beneficiary from the date of issuance of the bill of lading or other shipping documents, during which the

beneficiary must present must present documents required under the credit. If this period is not stipulated it will be taken to be 21 days as per UCP

) The expiry date of the credit

In terms of section 515:1 and 515:2 respectively the maximum validity period will be one year for revolving credits. However such validity could be more and can also be amended.

Most problems result from the seller's inability to fulfill obligations stated in the letter of credit. The seller may find the terms difficult or impossible to fulfill and either tries to fulfill them and fails, or asks the buyer to amend to the letter of credit. As most letter of credit are irrevocable, amendments may at time be difficult since both the buyer and the seller must agree.

Sellers may have one or more of the following problems:

-) The shipment schedule cannot be met,
-) The stipulations concerning freight costs are unacceptable
-) The price become too low due to exchange rates fluctuations
-) The quantity of product ordered is not the expected amount
-) The stipulated documents are difficult or impossible to obtain

Even when seller accept the terms of a letter of credit, problems often arises late in the process. When this occurs, the buyer's and seller's bank will try ti negotiate any differences. In some cases, the seller can correct documents and present them within the time specified in the letter of credit. If the documents cannot be corrected, the advising bank may ask the issuing bank to accept the document despite the discrepancies found. It is important to note that, if the documents are not in accord with the specifications of the letter of credit, the buyer's issuing bank is no longer obligated to pay unless the discrepancies are acceptable to the buyer.

4.4 Examine the directive of NRB on LC activities (collections of circulars issued by Foreign Exchange Management Department, Nepal Rastra Bank, Central Office)

Fourth objective

1. Mandatory for opening import letter of credit issued by central bank foreign exchange guidelines

Documents to be submitted by the importer for opening of letters of credit for the purpose of importing any merchandise the importer has to submit.

Firm Registration Certificate Up to date Income Tax registration certificates Pro-forma Invoice or contract specifying value and quantity of goods to be imported. The eight digit Harmonic code should also be mentioned in the particulars.

It is prohibited to open or amend the letter of credit with clause like “All Discrepancies Acceptable”.

Filling in BBN Form No. 3

Importers applying for opening of import letter of credit shall fill in Bi. Bi. Ni No.3. The concerned bank officer shall certify the form after verifying that all related columns of the form have been properly filled up. In addition to that, where the LC is opened or paid for merchandise falling under more than one group arrangement shall be made to compulsorily state that value and quantity separately for each group.

Issues of BBN Form No. 4

At the time of retirement of documents. BBN Form No. 4 shall be prepared in quadruplicate for distribution as follows:

First two copies shall be given to the importer submission to the custom office for clearance of goods:

Third copy to be sent or Nepal Rastra Bank.

Fourth copy to be retained by the bank.

Of the two copies handed over to the importer for submitting to the customs office, arrangement shall be made as to returning one copy of the same, duly certified by the customs for import of goods, to the bank compulsorily.

List of importers who fail to submit such certificate form within 3 months from the date of retirement of the document (except in the case mentioned under clause 3.5 below) shall be intimated to Nepal Rastra Bank within 7 days the expiry such period.

Authorized official of the bank attest the copy of import LCs provided to the importer for purpose of clearing goods as CERTIFIED COPY of original and stamped goods as certification as such in other documents received under the LC has to be made and provided to other related parties as well.

Certified BBN form No. 4 at the time of retirement of documents shall also be issued for imports against USANCE facility for the purpose of Custom clearance.

Since the payments against such Usance facility is to made only after a fixed period from the date of entry of merchandise into the customs, an additional BBM Form No.4 (d) has been prescribed for this purpose., Accordingly particulars of payment made against such Usance facilities shall be regular submitted to Nepal Rastra Bank separately in BBN form No.4 (d)

The above BBN Form No. 3 and 4 shall be submitted to Nepal Rastra Bank, Central Office, and Foreign Exchange Department on daily basis by banks stipulated in Kathmandu valley and on weekly basis (every Sunday) by banks situated outside the valley.

Declaration of Customs Point in Import LC

All import letter of credit shall compulsorily specify the border customs point from which the goods will be brought into Nepal. Any amendment regarding such customs point will required approval from Ministry of Commerce/GON.

Custom Points

Except for import of goods by various GON offices. Project office and public corporations, other importer can bring into Nepal the merchandise imported from third countries via land route in India (truck or railway)through the following customs ports only, (1) Mechi Customs, (2) Biratnagar Customs,(3) Nepalgunj Customs, (4) Bhairahawa Customs, (5) Dhanghadi Customs, (6) Birgung Dry port.

Amendment of LC Amount

Where LC are opened and amendment is requested enhancing the LC amount by more than 10% permission to that effect from the respective Central Office of concerned Banks, in addition to fulfillment of other obligations shall also be obtained . However, for this purpose, such permission shall not be required where the amended amount is US\$ 1000 of less.

Monitoring by the Central Level

The Centre office of concerned Banks shall compulsorily follow up all LC opened for more than US \$ 50,000.

2. Payment Procedure of Import LC

2.1 LC opened at the request of Nepalese importer shall be sent to the foreign beneficiary as stated in threw LC through correspondent bank only

2.2 The LC issuing bank shall accept documents received through correspondent banks only

2.3 Payment to the beneficiary shall be made through correspondent banks only direct payment to the beneficiary by way of draft otherwise is prohibited

2.4 Export and import transaction through LC between Nepal and Bhutan is required to be done in Indian Currency only.

3. Security Deposit Arrangement

Following arrangements have been made in respect of obtaining deposits against import Letter of Credit opened by banks payable in convertible foreign currency.

3.1 All banks branches situated in Kathmandu valley and transacting in letter of credit are required to open a letter of credit security Deposit Account with banking office of this bank

3.2 In the of banks branches situated outside Kathmandu valley such security deposits account is required to be opened with the respective branch office of this bank situated in the region.

3.3 Separate cheques book will be issued to banks branches holding Letter of Credit security Deposit Account

3.4 Where under an import LC payable in convertible foreign currency provision as to release of payment prior to release payment to the corresponding bank , BBN Form No. 4 has to be issued only after issuing a cheques drawn on the above Security Deposit Account amounting to 10% of the value of foreign currency mentioned in the import LC favoring the concerned customs office.

However, obtaining the security deposit shall be necessary where the following document

3.5 In respect of payment of LC not being as specified in 3.4 above, but with authorization to debit the account of the Nepalese bank by the foreign correspondent bank (including advising bank, negotiating bank, reimbursing bank, confirming bank) or claim reimbursement upon

negotiation, bank shall issues, prior to issue of such LC, BBN form No. 4 only after issuing the cheque amounting to 10 % of the LC amount (including the amended amount if any) favoring the concerned customs office. In such case, the time period to resubmit the BBN Form No. 4 duly attested by the customs office is set at 120 days.

- 3.6 Where documents under LC are received on collection basis or received under negotiation against which the LC opening bank is required to remit payment only after the receipt of documents, 10% security deposit as referred to in 3.5 above shall be compulsorily obtained from the importers prior to release of payment.

Notwithstanding anything contained in clause 3.4, 3.5 and 3.6 above, banks shall compulsorily issue BBN Form No. 4 even if the importer has not come forward to retire the documents or payment is not been made to the bank. Such form shall be submitted to Nepal Rastra Bank as usual. Whether or not such form is to be delivered to the importer shall be as per the policy of the bank only.

Arrangement made by circular No. 315 dated 2060.5.19 / September 5, 2003

Obtaining the specified security deposit shall not be required for issuing BBN Form No. 4 where the following documents are enclosed.

- a. Bonded warehouse certificate issued in the name of the importer by HMG, Department of Customs. (Where such certificate requires renewal, the same should have been renewed)
 - b. Copy of the bank guarantee issued in favor of HMG, concerned Customs office for the purpose of releasing the imported merchandise.
- 3.7 In the reverse side all such cheques issued, the particulars as to (a) letter of credit number (b) the importer (c) invoice number (d) amount in foreign exchange as per the invoice (e) the exporter (f) serial number of BBN Form No. 4 are to be compulsorily mentioned

- 3.8 The cheques may be used for the purpose of payment of customs duty and other taxes payable by the importer.
- 3.9 The branches of Nepal Rastra Bank shall, upon receipt of such cheques through the concerned customs offices, immediately pay to the customs office and follow the following procedures :
- a) Where the “LC Security Deposit Account” of the cheque issuing bank exists with the branch, such account shall be debited under advice to the concerned commercial bank (through regular statements)
 - b) Where the branch does not maintain the “LC Security Deposit Account” of the cheque-issuing bank, payment to the concerned customs office shall be released by purchasing the cheque (bill). Such cheque shall be presented to the concerned branch office (holding such account) of Nepal Rastra Bank. The receiving branch office shall debit the account of the concerned commercial bank and credit the “General Account” in the name of cheque sending bank under advice to the cheque-issuing bank(through regular statements)
- 3.10 The commercial shall, at the time of issuing cheque in the name of the customs office, collect the required amount from the importer and transfer the fund into the “LC Security Deposit Account” maintained with branches of Nepal Rastra Bank. In case the balance in account, at the time of debiting the amount of the cheques, is not sufficient, the same shall be recovered by debiting the other accounts of concerned commercial bank. In case sufficient balances are also not available in other accounts, penal interest @ determine by Nepal Rastra Bank Shall be charged.
- 3.11 The issued cheque shall be *protectographed* and the name and address of the issuing bank shall be clearly mentioned. Such cheques shall be issued fulfilling all required norms. Otherwise, payment to the custom office, by debiting the concerned commercial bank’s account, shall be made irrespective of any discrepancies in the cheque and the any negative consequence that might bring by this act shall be the

responsibility of the concerned cheque-issuing commercial bank only. Further, where any bank has not mentioned its name and address in the cheque, the amount along with penal interest @ 20% per annum from the date of issue of the cheque to the date of payment to the custom office shall be levied.

3.12 If an application is received from the importer stating that the aggregate duties leviable on any imported merchandises is less than 10% and hence issue of cheque equivalent to 10% is not appropriate, cheque for the amount requested shall be issued and BBN Form No. 4 is to be issued after taking the balance in security deposit. Such deposit amount can be refunded. However, prior to refund of such deposit amount, the bank shall compulsorily receive (a) original copy of BBN Form No. 4 endorse by custom office (b) copy of custom declaration form (Pragyapan patra) and (c) custom duty payment receipt. However, in case the security deposit cheques has to be cancelled, the concerned bank itself may cancel the same after verifying the following documents.

Required Documents

- (a) Import Customs Pragyapan Patra (Custom Declaration Form)
- (b) Customs Duty payment Receipt
- (c) BBN Form No. 4 endorsed by concerned custom office

3.13 For the purpose of imports by industrial forms, the applicable rate of deposits is only 2%. If the importer industrial form so wishes, an account payee cheques equivalent to the requisite security deposit amount may be issued in the name of customs office of entry point. Other arrangements with respect to the cheques shall remain as is applicable to the commercial. Further, in case where the 2 % security deposit cheques is not issued, the amount shall be held as security deposit cheques is not issued, the amount shall be held as security deposit cheques is not issued, the amount shall be duty payment receipt

and BBN Form No. , duly attested by customs office, is submitted to the concerned bank. Such amount may be refunded by the bank itself upon receipt of such documents attested by the customs office.

3.14 The above arrangement of obtaining security deposit except for commercial firms and industrial firms. Will not apply in the case to following letters of credit :

- a. LC opened by any convertible foreign currency account holder against payment through such account.
- b. LC opened by diplomatic privileged agencies
- c. LC opened by GoN or Corporations fully owned by GoN
- d. LC opened under Foreign Loan. Assistance or Grants for which reimbursement is to received from foreign Country.

3.15 Banks are required to follow up regularly as to the timely return of BBN Form No.4 from the LC opening branches and payment of cheques issued. The particulars of cheques not in cashed within 90 days from the date of issue shall be submitted to this department within a maximum period of 15 days from the expiry of such period. Similarly, intimation as to non-receipt of any forms prescribed in this respect shall be given to this department.

Further, where the validity period of the cheques issued against the security in the name of a Customs Office has expired and request is received for extension of such validity the concerned bank may extend the validity by itself.

3.16 The arrangements of obtaining 10 % security deposit and issued of cheques shall also be applicable in the case of imports against payment through draft/TT and not by the opening of L, under approval of this bank. In respect of the particulars to be filled in the reversed side of the cheques in the place of LC number the permit number of this bank shall be mentioned.

3.17 With respect to the involvement of the private sector in the transaction of chemical fertilizers, the import letters of credit may be opened as per

the quality specification of such chemical fertilizers. One copy of such LC should be sent to GoN, Ministry of Agriculture and Cooperative chemical fertilizer section sighthadurbar where an importer wishes to import chemical fertilizer by opening letters of credit the concerned bank may open the import letters of credit under the following conditions.

- i. Import letter of credit may be opened against obtaining security deposit equivalent to 2 % of the import value of chemical fertilizer in cash savings bonds or securities acceptable to the concerned bank.
- ii. After opening of import letter of credit if the fertilizer is not imported equivalent to the amount of the letter of credit, the security as mentioned above shall be ceased and intimated to Nepal Rastra Bank Compulsorily within 7 (Seven) days.

Note: Approval of Nepal Rastra Bank shall compulsorily be obtained for import of chemical fertilizer on the basis of bank guarantee.

4. Other Mandatory provisioning Regarding Import Letter of Credit

4.1 The concerned banks may themselves acting within the UNIFORM CUSTOMS AND PRACTICE 500, amend the letter of credit for effecting the payment of letter of credit and other transaction relating to such letters of credit on the basis of transport documents issued by transporter under the following conditions.

- a. The request for amendment is received along with documentary evidence confirming that he imported explaining the particulars of the goods and that the imported merchandise has not yet arrived at the customs point and
- b. A letter is received by the bank from the concerned Customs Office from which point goods are to be imported explaining the particulars of the goods and that the particulars of the goods mentioned in such letter agrees with the particulars mentioned in the letter of credit.

- 4.2 Where the transport documents referred to in clause in 4.1 is received by the concerned bank after 45 days from the date of issue, particulars of such letters of credit shall be submitted to Nepal Rastra Bank Foreign Exchange Management Department separately on monthly basis.
- 4.3 In respect of the letter of credit opened by industrial Firm for importing the merchandise by themselves, security deposit in the form of FON securities and NRB bond any be accepted by the bank if such securities are acceptable to the bank as per circular Bi.Bi. Ni./Bitta/148/062/063 dated 2063/3/29 issued by the Bank and Financial Institution Regulation Department of NRB.
- 4.4 Upon receipt of BBN Form No. 4 from the customs office by the bank shall retain photocopy of the Custom Duty Payment Receipt duly verified with the original.
- 4.5 A copy of the BBN Form no. 3 which is required to be submitted to Nepal Rastra Bank, Foreign Exchange management department, shall also be compulsory sent to the customs point as specified in the letter of Credit.
- 4.6 Copy to the BBN Form No. 4 which is to be certified by the customs office shall be printed security for maintaining uniformity among the banks. Nepal Banker's Association will co-ordinate to maintain uniformity of such form.
- 4.7 All transaction relating to letter of credit shall be performed only. Through the accounts opened in the name of the concerned firm or company. At the time of opening of the accounts in the name of the firm or company, the signature put in by the authorized executives of the firm or company making himself personally present shall be identified and certified by the concerned bank officer.
- 4.8 Copies of requisites documents for opening the account shall be verified with the originals and certified by the bank officer.
- 4.9 Once in each fiscal year. The bank officer shall verify and certify the copies of following documents required for opening Letter of Credit.

- a. Renewed certificates of registration of firm or company
 - b. Renewed certificates of income tax registration
 - c. Citizenship Certificate of the authorized person
- 4.10 Where a firm or company authorizes any person to conduct letter of credit transactions with the bank the authorizing person eg. the proprietor or director or chief executive officer of the firm or company shall do so by signing in the authorization letter by personally presenting himself at the bank and provide detail no. and certified copy of citizenship certificates) to the bank. However, this clause as well as sub-clause 4.7 shall not be applicable to GON. Government owned corporation or public limited company in which case only the authorization letter certifies by the authorized officer would be sufficient.
- 4.11 In providing the delegation of authority per clause 4.10 a written undertaking from the authorizing person that he shall be fully responsible for he works doneby such authorized person shall also be obtained.
- 4.12 Where a LC is opened against the guarantee of any other person under the prevailing arrangements, the concerned bank shall obtain a written-undertaking along with the application for opening the LC stating that both the applicant as well as the guarantor person firm or company shall be responsible for any deflection of foreign currency by not importing the merchandise specified in the letter of credit or evasion of government revenue
- 4.13 Particulars of all LC opened by the banks with 50% or more cash margin shall be submitted to Nepal Rastra bank within 7days after the close of the month.
- 4.14 LC opened for importing merchandise from third countries cannot be used as well as make payment for importing merchandise from India.
- a. For the purpose of verification of authenticity of BBN Form No.4 returned by the custom offices. The outcome offices shall

compulsorily make available updated specimen signatures of customs officers to the banks.

- b. For the purpose of verification of authenticity of BBN Form No. 4 issued by the banks, the banks shall also compulsorily make available updated specimen signatures of banks officers to the customs office .

4.16 The concerned officers shall, while certifying the BBN Form No. 4 and other related documents, sign as provided in the specimen.

4.17 The banks shall at the time of sending the BBN Form No. 4 to the concerned customs office, also enclose the following documents duly certified.

Copy of LC Including amendments if any,

Commercial invoice

Transport document

Certificate of origin

Packing list

In addition, in the case of imports from India against payment of convertible foreign currency, certificate copy of the form AR-4/AR 4 A or Nepal invoice shall also be enclosed.

4.18 Following arrangements shall be observed while issuing and returning the BBN Form No. 4: Seal (Shellac) must be used for delivery of documents between the bank and customs office. Banks shall maintain separate file for issuing BBN Form No. 4, chronological order from such files. The custom offices shall also maintain separate file for returning the BBN Form No.4 pertaining to each bank branches and provide serial number in chronological order from such files. The custom offices shall compulsorily send copies of the record maintaining per (c) above o the concerned bank branches every 15 days and Bank shall verify the records received from the customs office with own records (serial

number and amount) an any discrepancies found shall be immediately intimated to this department.

4.19 Where in the absence of original documents, BBN Form No. 4 is to be issue on the basis of COPY documents, such form shall be issued only against collecting the equivalent amount of imported goods and endorsing the copy documents. However , payment to the exporter shall be made only on the basis of the authenticated documents received from the negotiating bank (i.e. exporter's bank)This restriction shall not be applicable for LC opened with Usance facility (Usancebill).

4.20 Generally LC cannot be opened with Red Clause. However, in respect of releasing advance payment through Import Letter of Credit, such import letter of credit with the clause of advance payment may be opened only if the advance payment is to be made by debiting the importer's own convertible foreign currency account. In such cases, the bank shall compulsorily monitor the import of the merchandise/service as per the payment release by the bank and where import of merchandise/service is not found to have been made within the stipulated period, the same shall compulsorily be notified to NRB. Foreign Exchange Management Department.

Advance Payment

Except under the condition explained above , advance payment under the letter of credit opened for the purpose of import of goods and services as per the existing arrangements may be released under the following condition.

For the purpose of release of advance payment, generally a guarantee (in the name of Nepalese Bank) equivalent to the advance amount has to be obtained from the beneficiary.

If such bank guarantee could not be obtained deposit at10% of the advance payment shall be placed with the bank. Such deposit shall not be the refunded

unless approved payment shall be placed with the bank. Such deposit shall not be the refunded unless approved in writing by this department.

The department will provide clearance for refund of the deposit on submission of documentary evidence of completion of the transaction.

A maximum period of 6 month shall be fixed for submission of documentary evidence of completion of the transaction.

In case the documentary evidence as to the completion of the transaction is not submitted within the stipulated period. Such act shall be deemed as depletion of foreign currency and shall be liable for further action as per existing law.

Consultant Note

The eligible quantum of advance payment is no spelt in the circular. Therefore, it is presume than 100 value of the LC may be paid in advance. However, the circular is silent as to required course of action if the invoice value of merchandise/services and shall be reported to NRB accordingly.

4.21 The certificate of Origin of imported merchandise shall have to be issued by concerned authorized agencies like Chamber of Commerce agencies, concerned Association. However, the Certificate of origin issued by the exporter can be approved if accepted by the importer.

4.22 In respect of other firms except companies, opening of letter of credit with cumulative outstanding liabilities exceeding 20 times.

4.23 Following particulars are required to be disclosed in the Proforma Invoice or Indent or Sales Contract (letter of LC Section No. BLC 220/061 dated 2062/1/7/April 20, 2005 has reminded banks to comply)

Name, brand and model number, if any, of the merchandise

Name of the manufacturing country

Harmonic Code Number

Unit Price

Quantity

Total amount

In Case it is practically unreasonable to list all the import in the letters of credit owing to the same being ling, the bank at the time of submitting BBN form No.3 to the concerned agencies under the existing arrangements shall enclose duly certified copy of the invoice, against which the letter of credit has been opened, indicating the letter of credit number in that invoice.

Further, in this respect, while mentioning the Harmonic Code Number the same has to be as per the 8 digits code as mentioned in the Custom Traffic Books published by GON Department of Custom. At the time of opening of letter of credit, the above-mentioned particulars shall compulsorily be mentioned in the letter of credit itself.

With respect to the import of Machinery and Tools by industrial firms, companies where mentioning of the particulars of merchandise in the letter of credit would not be practical owing the long list, the pro-forma Invoice containing all particulars as above, duly attested by the bank and invoice along with the particulars of letter of credit may be send at time of sending the Bi.Bi.Ni Form No.3 and particulars of letter of credit to the respective agencies.

4.24 Where the bank is transacting for the first time in letters of credit with any firm/company, detail information as to the firm's financial standing experience, address phone number fax number as well as confidentiality of the owner has to be obtained.

4.25 Each bank has to perform internal audit of its branches transacting in letter of credit on half yearly basis and submit the report to this department.

4.26 Banks has to maintain a panel of clearing and forwarding agents and transport companies for the purpose of clearing goods from Indian customs, forwarding and transporting, and that all such transaction shall be made only through such enlisted agent or companies.

5. Other Arrangements

Arrangements Regarding Deferred Payment

At the time of opening LC the payment term of the letters of credit shall be AT SIGHT BASIS only. However, usance letter of credit opened on deferred payment or suppliers credit basis may be for any time period. The concerned bank, if willing may even discount the documents of such letter of credit.

Import of Goods under Bonded Ware House

Usance facilities are to be provided to Readymade Garment Industries established as per the existing law for import of raw material from foreign countries for self consumption. This facility may be provided only for the import of goods eligible under bonded warehouse.

Documents Received in Excess of LC Amount

Where the documents under an import Letter of Credit payable in convertible foreign currency is received as for the amounting excess of the amount mentioned in the letter of credit the concerned bank itself may acting within the Terms and conditions of the concerned Letter of Credit, accept such documents regardless of the amount

Role of Judiciary on Regulating Letter of Credit

As mentioned above, LC business in Nepal has been regulated, monitored and controlled from the very beginning. In spite of this, however, misappropriation of foreign exchange has been occurring more or less on a regular basis.

The government has formed various high power age commission to investigate the matter and give suggestion also. Based on the report of that commission, certain regulatory measures were introduced. The main thrust of these new measures were how to stop any future LC scam from taking place. Some of these new measures are as follows:

- A. While opening LC, the concerned commercial bank has to make sure that the utilized LC has been sanctioned in the name of the importer himself. In other words, the practice of obtaining LC limit in one company's name while using some unknown firm / Company for actually opening the LC, has been made illegal.
- B. If any LC has opened under the guarantee of any third party, that guarantor also has been made equally responsible with regard to any misappropriation of foreign exchange.
- C. While sending payments under any import LC, the concerned bank has to make sure that transport documents received should be date only after LC has been opened. No transport documents which carriers a date before the LC has been opened. No transport documents which carries a date before the LC date can be entertained.

4.5 Critically analysis the NRB Directives

-) Mandatory for opening letter of credit issued by the central bank foreign exchange guideline are simple and more burden are up upon the shoulder of the bank. There is no any guarantee that importer who have firm registration certificate and up to date Income tax registration are loyal to the bank. The bank should take the risk but the government bodies are burden less
-) Importer has to fill BBN No. 3 and bank certify and verifying that all related column of the form have been properly filled up.
-) At the retirement of document BBN form No. 4 shall be prepared is quadruplicating for distribution.

- J The Bi.Bi.Ni. No. 3 and 4 shall be submitted to NRB central office and foreign exchange department on daily basis by bank situated in the Kathmandu on weekly basis by banks situated outside the valley.
- J The directive of NRB on LC shall compulsorily specify the border custom point. Any amendment regarding custom point will required approval from Ministry of Commerce.
- J When I go through the payment procedure it is simple and easy for the importer due to which the fraudulent activities may take place recently be have heard through media that millions of the dollar are remitted to hongkong for which material never landed in Nepal. To avoid such fraud NRB can set a rule that the original signature of the concerned officer form concerned custom point should be verified so that the concerned custom officer can be responsible for his all authorizing activities.
- J The NRB or Nepal government can set up the computerized system which will automatically show the goods entered in Nepal's territory in the bank's own computer via internet. The details of the concern pragyapanpatra can be accessed in the custom's website.
- J Security deposit arrangement is confusing, bank is required to remit payment only after the receipt of document, 10% shall be compulsorily obtained from the importers. The 10% amount as security deposit seems lower it should be increased appropriately.
- J In case of the mandatory provision regarding import letter of credit the concerned bank should act within the UCPDC 600 which is hard for the staff involved in LC department to have all knowledge about rules and regulation imposed by the NRB and UCPDC. They don't have proper time and bank didn't give them training earlier.
- J In case of the mandatory provision regarding import letter of credit a letter is required from the concern custom office to the concerned bank explaining the details of goods that should match with the details in LC. This provision is unnecessarily will be creating the problems to the importer because the custom will automatically check the details of the

goods of the amendent LC at the time of clearing the custom formalities. So such duplication of the work should be avoided to save the time and cost of all three parties concerned i.e, custom office itself, importer and the concerned bank.

-) Some of the provision are not clear and easily understandable. The process of payment can be simplified considering the accuracy of import form the concerned custom office.
-) Letter of Credit serial number for LC payable in Indian currency should be separated.

4.6 Major findings

-) Letter of credit is widely used instrument in the field of International trade. The issues of confident and credit worthiness of the both parties arises. Letter of credit is tide over such things that the instrument of LC invoked.
-) The important of LC is in increasing trend but there are many confusion regarding LC transaction theory and practice in our country.
-) The LC is also popularly known as non fund loan of bank. The bank act as a facilitator a middleman and chargers commission for this business.
-) Documentary credit is an instrument facility international or national trade where in all parties to the credit deals only with the documents and not the goods.
-) LC means letter written by one of bank to another directing the letter to accept cheque draft or hundi of specific person up to the amount specified.
-) Letter of credit are issued in various of ways. They come by post from the issuing bank by telex and by SWIFT (Society for worldwide inter bank financial telecommunication) network.
-) Letter of credit may be any one of following types

- Revocable : That may be amended or cancelled by the issuing bank at any time. The credit given maximum flexibility to buyer and exposes the seller to certain degree of risk
- Irrevocable : Irrevocable LC cannot be revoked without the agreement of all the parties. There are many types of irrevocable LC
- Red Clause Credit : This clause is called Red clause because the term would be type in red ink and to make clean advances to the beneficiary to finance the purchase and preparation for shipment of the relative merchandise. These credit are rare these days.
- Green clause LC is small part of the credit amount is provided as advance to the beneficiary.
- Back to Back LC is a import LC issued by an account party using as collateral a previous export LC.

) Letter of credit are used in new trading relationship as the security in given to the both parties i.e. for applicant and beneficiary.

) Some countries insist the imports are paid for under LC to help manager exchange control regulation.

) The principle documents required for LC are as follows

) Financial Document

) Commercial Document

) Insurance Certificate / Policy

According to the first objectives procedure of opening LC of my study following findings are taken into consideration :

) A registered firm/Company holding current account with the bank and credit worthiness of the customer should have been assessed for an individual or non registered firm permission from NRB is required and should not be defaulter and blacklisted.

) In case of bank all the branch having LC operation can open LC remaining within the authorized LC Limit.

-) The main documents are according to my findings is :
1. Application signed by the customer.
 2. Duly filled NRB Bi.Bi.Ni. No. 3 has to be obtained
 3. Updated Firm Registration and PAN/VAT certificate, citizenship certificate of the person.
 4. If applicant is Private or Public Ltd.
 - a. Memorandum of Association/Minutes
 - b. Article of Association
 5. Performa Invoice /Indent/ Sales contract issued by beneficiary
 6. Indenter
 7. If the issuance of the LC in question exceeds the limit of the customer than 100% margin should to taken for the exceeded amount.
 8. Custom point in a LC is to be alerted then it should be authorized by DOC.
 9. The detail of LC issued is sent to NRB on daily basis in a specified form of Bi.Bi.Ni.No. 3 to NRB.
 10. LC cannot be opened for the goods to be imported from third country but to be dispatched from India.

Second objectives prohibition regarding LC of my findings :

-) All directives issued by NRB must be strictly followed
-) Letter of credit cannot be opened putting Red clause (NRB has allowed in some cases)
-) LC cannot be opened or amended putting “All discrepancies are Acceptable”
-) Vague terms like “First Class” well known qualified Independent official competent local shall not be used in LC.

Third objectives Problem while opening LC of my findings :

-) Letter of Credit cannot be opened putting Red Clause. Except where NRB specifically approved (NRB has allowed in some cases)

- J No LC must be opened for import of merchandise specifically prohibited by NRB. Further, where ever of specific merchandise required prior approval of NRB, the same must be obtained before establishing LC for such items
- J The branch should take the minimum margin amount in cash only and minimum margin in the form of FD in not acceptable, unless otherwise permitted by Concerned Authority
- J All directives issued by NRB (Foreign Exchange Management Department) from time to time must be strictly complied without any expectation.
- J If the applicant request the bank to open the LC for other things that don't have harmonic code, bank should open only after taking the permission of the loan Investment Department.
- J NRB issued various items prohibition for the purpose of issuance of LC and commercial bank should follow such rule and regulation otherwise commercial bank will be penalized.
- J The NRB has not made any complication to open the letter of credit. Bank only see the credit worthiness of the customer and they should not be blacklisted. Branch Manager assistance and branch manger have the authority to open LC.
- J All the documents expect the proforma invoice may be taken once in a year for the customer with LC Limit unless there is any change in the any of the documents.
- J Verification process prior to opening LC is very much complicated and lingering for the customer. There is very much complication on the margin. The bank ask for sufficient collateral using the limit of another customer. The letter of credit limit is not transferable.
- J The NRB directives seems vague are the staff of commercial banks has to go through it which may be difficult for them. They have to go through each and every points carefully.

- J Sometimes the client of the bank may turn out to be fraud. If all the documents are received but the client does not come to take the documents in that case, the bank has to pay money to the exporter in this case the goods will be under the banks control.
- J If the party is view, exporter does not believe on them so they ask for advance payment's to deliver the goods. But some commercial bank does not give permission for advance payments to delivery the goods. But some commercial bank does not give permission for advance payment only for sample.
- J If a firm's age does not exceed more than one year, they have to pay tax in advance of LC amount issuing bank charge 10% tax of LC amount and sends it to tax office early time businessmen do not have much ideal about the profit margin but have to pay the tax in advance. Furthermore within that one year they have to pay advance tax every time they open L/C. This amount is also blocked for whole the year.

CHAPTER- V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

International trade is a key to worldwide prosperity. It can stimulate gross domestic product of the country. While international trade continue to grow as a part of global economy, more attention and emphasis have been focused on understanding the key aspects of trade finance transactions. International trade is obviously very important for global economic growth. The growth of international trade and financing can offer new opportunities for buyers and sellers between two countries or more. It is impossible for a country to produce domestically everything for its citizens need or demand. The great benefit of exporting is that large revenue and profit opportunities are to be found in foreign markets. Many of the world's largest companies derive over half of their sales from outside their home countries.

Letter of Credit has played a great role in the development of international trade. The terms and condition used in the letter of credit vary from country to country and also from one bank to another bank. It is advised that bank in Nepal should follow directives of Nepal Rastra Bank as well as UCP 600 guidelines set by ICC for regulating letter of credit. The efficient and effective management and modern technology by the introduce of SWIFT, Reuters has enhanced LC transaction in the country due to which there seems drastic improvement in letter of credit transaction. In today's era of globalization and in this phenomenon letter of credit seems to be the reliable source for enhancing business. The increasing number of commercial bank including joint venture bank after the restoration of democracy has definitely played the position role towards LC transaction with the new technology and modern facilities.

First chapter of the study paper deals about the basic concept and plan of the study. This chapter basically presented research issues, basis objectives, limitations of the study and the brief introduction of the study.

The second chapter deals with literature review helped the researcher to provide knowledge about the development and progress made by the earlier scholars on the concerned field of study. It also helped the research work, undertaken by him. It discussed about some related concept used in this study. It also summarized the findings of previous literature to provide knowledge about the background of work done by earlier research work and to step duplicate of the previous work.

The third chapter deals with the research methodology. My thesis is analytical so there no data to present. It deals with the theory that's why I have used limited methodology tools to analyze my topic.

The forth chapter deals with objective of my study which basically focus on the procedure for opening letter of credit, prohibition regarding opening letter of credit, problem while opening letter of credit and examine the directive of NRB on LC activities.

5.2 Conclusion

So far from findings of the study from primary data is concerned the following conclusion have been drawn.

NRB Forex Policy and UCPDC 600 and concern banks requirement are considered before opening the LC, Bank's strictly followed the NRB Forex Policy UCPDC 600. The main reason for filling LC Application is to collect information and to execute LC operation smoothly. Bank updated its operation procedure according to periodic NRB Forex Policy and UCPDC 600 (revised version). Peoples finds difficult to understand and filled the LC. NRB rules are

central bank's Forex Policy and UCPDC 600 has a positive relation where as central banks plays as coordinator for the LC operation in a commercial bank.

Prior to the issuance of the letter of credit, the exporters must be serious in negotiating with the importers and be sure that excessive requirements and conditions are not included in the letter of credit. During this stage of negotiation, it is easier to work out details in the letter of credit to avoid future discrepancies. The exporters can bring many incentives to the table for negotiation. For instance, the exporter may motivate the importers to make the deal easier by offering an incentive plan on the unit price, quality of merchandise, or cost of transportation. Once the letter of credit is issued, however, it becomes much more difficult to negotiate. In the case of shipping terms such as free on board (FOB) and Cost and Freight (CFR), the required documents should be an invoice, transport document, and beneficiary's certificate. The insurance certificate is needed in the case of CIF (cost, insurance, and freight) only. Exporters, importers, and bankers agree that the language of each article of the Uniform Customs and Practice 500 is difficult to understand (*International Chamber of Commerce, 2005 ; 1*). The fact is that each article contains ambiguous language with interpretive phrasing that can be seen from the following example: Article 31, unless otherwise stipulated in the credit, banks will accept a transport document which does not indicate, in the case of carriage by sea or by more than one means of conveyance including carriage by sea, that the goods are or will be loaded on deck. Nevertheless, banks will accept a transport document which contains a provision that the goods may be carried on deck, provided that it does not specifically state that they are or will be loaded on deck (*ICC Uniform Customs and Practice 500, 1994: 5*).

The language and context about loading or shipping on deck in article 31 is ambiguous. It is very difficult to understand if loading or shipping on deck is acceptable or not. This article should have stated clearly that unless otherwise

stipulated in the letter of credit, loading on deck or shipping on deck is not acceptable. It is recommended that the International Chamber of Commerce must use a clearer language on each article. Inappropriate contexts of the Uniform Customs and Practice must be changed. Each article should be written in clear and concise language that can be understood easily for practice. Additionally, the International Chamber of Commerce should provide a practical example for each article so that the personnel who work in export and import businesses would be able to follow the guidelines easily.

5.3 Recommendations

On the basis of the analysis made above the following recommendation is made:

- J NRB Forex Policy and UCPDC 600 and concerned bank's requirement should be simple and easily understandable. Since NRB Forex Policy and UCPDC 600 and bank's requirements are the major before opening the LC. The concerned bank must monitor whether the NRB Forex Policy and UCPDC 600 both are strictly followed or not.
- J LC application form should be easy and simple to fill up.
- J Since NRB rules are sufficient to control the irregular and illegal LC transaction, the bank should focus whether it is strictly followed or not in practice.
- J Since the relation between LC dependent factors UCPDC 600 and NRB Forex Policy is positive, the bank should go through this both documents/policy be making sound relation.
- J Since the central bank i.e. NRB plays as a coordinator role for Foreign Exchange Policy and monitoring the foreign trade (import and export business) the concerned bank's should timely submit the required and necessary reporting as guided by central bank.
- J There has been a lot of fraud cases in LC transaction has been increasing yearly. Therefore, to prevent further fraud cases in the future, the manager

must be careful and must follow the directives given by the Nepal Rastra Bank which is important for successful running of the business.

- J Training and promotion should be provided to the staffs. Right man should be kept in the right place according to their capacity and willingness to work and there is need of defining their job, their authority and their responsibility. So that they make provided quicker service to the customers and also to convince the people that is for their benefit rather than the profit.
- J There should be sound co-ordination between NRB and Commercial. So as to deliver credit and other supporting services smoothly. So that joint effort can be carried out in making any decision like change in the interest rate, lending policy etc.
- J Commercial Bank should attract more customers by providing different services and facilities to collect more Negotiations, so that transaction through Hundi is discourage.
- J Commercial Bank should focuses on development of modern technology and studying the problems and obstacles of customers, so that there is easy in LC transaction.
- J Rules laid down by NRB regarding Letter of Credit transactions are inconsistent with the international practice. This has caused difficulty to business people for international trade (import and export) and decrease in the earnings of banks. So NRB should set rules according to international trends and practices.

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