

Guarantees in international trade.
Documentary Credits

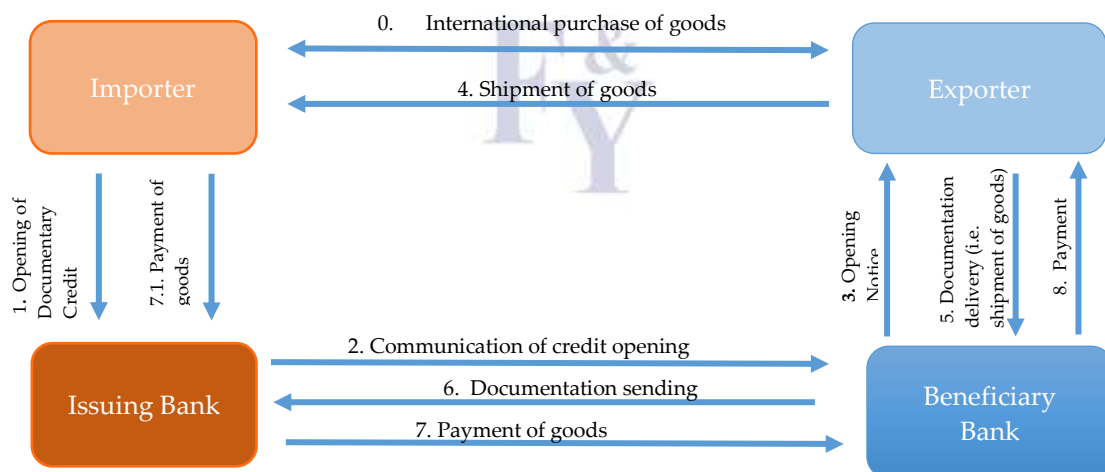
What is a documentary credit?

Documentary credit is the most efficient method of payment used in international trade of goods to secure payment for the goods.

How does it work?

Documentary credit involves 4 parties: (1) the buyer/importer; (2) the seller/exporter; (3) the issuing bank; and (4) the beneficiary bank.

The procedure is very simple. What makes the transaction secure is the fact that both parties (exporter and importer) use a bank to intermediate for them, as explained graphically.



First, there is an underlying buying and selling relationship between exporter/seller and importer/buyer.

The importer opens the documentary credit at the issuing bank in favor of the beneficiary bank (the exporter's bank).

When this situation is known and accepted by all parties, the exporter sends the goods and presents to the beneficiary bank a document (or several) agreed in advance (i.e. bill of lading) which, if in order, will be forwarded to the issuing bank.

The latter, **in view of such documentation, cannot refuse to make the transfer in favor**



of the beneficiary bank (the exporter's bank).

What are the advantages?

As main advantages of this method, we find:

- (1) it is an **irrevocable** mandate, therefore, the issuing bank (which has the payment obligation) cannot refuse to perform its payment obligation;
- (2) it is **abstract**, since the payment obligation depends exclusively on the delivery of certain documentation, the payment of the goods is not affected by any commercial risk between the parties; and
- (3) its **legal certainty**, this figure is regulated by the International Chamber of Commerce (ICC) which standardizes international legal traffic.

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