

# Types of Letters of Credit

different needs, different usage

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# Commercial Letters of Credit

- Commercial letters of credit are primary payment method in international trade.
- Commercial credits are used mainly in exporting and importing business.
- Majority of commercial letters of credit are issued subject to the latest version of UCP (Uniform Customs and Practice for Documentary Credits).
- UCP (Uniform Customs and Practice for Documentary Credits) are the set of rules that governs the commercial letters of credit procedures.

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# Standby Letters of Credit

- Standby letters of credit are secondary payment method in international trade.
- Standby credits are used mainly in construction projects as well as export and import business.
- Majority of commercial letters of credit are issued subject to the latest version of ISP (International Standby Practices).
- ISP (International Standby Practices) are the set of rules that governs the Standby letters of credit procedures.

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# Irrevocable Letter of Credit

- **Irrevocable means** not to be revoked or recalled; unalterable according to Kernerman Webster's College Dictionary.
- Irrevocable Letter of Credit is a type of letter of credit which can not be cancelled or amended without the written agreement of the credit parties.
  - If credit is unconfirmed than beneficiary and issuing bank must reach an agreement on the amendments.
  - If credit is confirmed than beneficiary, issuing bank and confirming bank must reach an agreement on the amendments.
- All credits issued subject to UCP 600 are irrevocable unless otherwise specified.

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# Revocable Letter of Credit

- **Revocable** means capable of being revoked; able to be cancelled according to Kernerman Webster's College Dictionary.
- Irrevocable Letter of Credit is a type of letter of credit which can be cancelled at any time without prior notification to the beneficiary.
  - Revocable credits can not be confirmed. So all revocable credits are need to be unconfirmed.
  - Unconfirmed credits can be amended or cancelled by the issuing bank at any time without prior agreement of the beneficiary.
- All credits issued subject to UCP 600 are irrevocable unless otherwise specified. Revocable credits can still be issued subject to UCP 500.

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# Transferable Letter of Credit

- Transferable Letters of Credit are suitable for triangle trade. Triangle trade is a trade where a middleman exist between the buyer (importer) and the seller (exporter).
- Transferable letter of credit issued in favor of the middleman. Then middleman transfers part of the credit to the ultimate supplier of the goods.
- Middleman's commission is the difference of these two credit amounts. (issued amount-transferred amount=commission of the middleman)
- Transferable Letters of Credit can be issued subject to UCP 600.
- Transferable credit can be transferred more than one beneficiary. (partial transfer is allowed)
- Transferred credits can not be transferred to another second beneficiary once more.

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# Back-to-Back Letter of Credit

- Back-to-Back Letters of Credit are suitable for triangle trade. Triangle trade is a trade where a middleman located between the buyer (importer) and the seller (exporter).
- There are two separate letters of credit exist in a back-to-back letter of credit transaction.
  - Buyer issues 1st. letter of credit in favor of the middleman.
  - Middleman issues 2nd. letter of credit in favor of the ultimate supplier of the goods.
- As back-to-back letters of credit contain two independent credits, issuing bank of the 2nd letter of credit has to bear substantial amount of payment risk. For this reason back-to-back letters of credit are rarely used in international trade.

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# Revolving Letter of Credit

- If buyer and seller are trading the same commodity regularly on a certain period of time than they may choose to work with a revolving letter of credit instead of issuing a new LC every shipment.
- Buyer's bank (issuing bank) issues a letter of credit that replenishes either in value or in time.
  - Revolves by value : Letter of credit is reissued automatically when credit amount is utilized.
  - Revolves by time : an amount is available in fixed installments over a period

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