

**ADDITIONAL MATERIAL RELATING TO THE GUIDANCE PAPER - THE USE OF
DRAFTS UNDER DOCUMENTARY CREDITS**
Prepared by the Executive Committee of the ICC Banking Commission

A major outcome of the UCP consultation on the revision of UCP 600¹ related to the statement that a greater understanding of documentary credit practices was required in the market. As such, it was agreed by the Executive Committee of the Banking Commission that more comprehensive guidance should be provided.

One aspect of the consultation revealed that a number of ICC National Committees and practitioners questioned the need for drafts to be presented under documentary credits.

With this in mind, the Executive Committee tasked David Meynell, Senior Technical Advisor, with drafting a Guidance Paper to reflect the issues.

¹ Document 470/1272 dated 15 June 2017

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1. INTRODUCTION

The following are relevant extracts from the explanatory notes that accompanied the UCP 600 consultation:

Comment:

Market feedback from a number of trade practitioners questioned the on-going requirement for drafts in a documentary credit transaction.² Furthermore, it was stated that sight drafts do not provide any benefit.

Response:

A draft under a letter of credit is, ultimately, a redundant instrument, particularly a sight draft. Removing drafts from UCP would leave the definition of 'honour' as simply 'at sight' or 'deferred payment'. However, the problem likely to be faced in this regard is that drafts, combined with documentary credits, still have enormous support from certain parts of the world. It should also not be forgotten that, whether or not drafts are required, this is not a UCP issue. Excluding drafts from the UCP would not stop this practice.

Further explanation:

It is the case that almost every bank's application form, whether in paper form or on-line, will contain a pre-set requirement for the presentation of a draft. Whether a draft is required or not is within the hands of every issuing bank and does not need a change to the UCP to achieve it. Merely deleting drafts from UCP will not stop their usage.

Statistical Data:

The latest statistics provided by SWIFT for the ICC's 2018 Global Survey³ indicate that 73.2% of credits issued by MT700 were available by negotiation in 2017 (these would, potentially, have all been accompanied by a draft – however, it is likely that a proportion did not) and 7.09% by acceptance (when a draft is required). Out-dated practices mean that drafts remain an essential aspect of bank's processes in certain regions.

Recommendation:

It is considered vital that UCP's unique characteristic of global acceptance is maintained and suggestions for non-optional changes that only benefit particular business or geographic segments of the user base are opposed. Guidance, not deletion, is the appropriate response to the issue of drafts under documentary credit transactions.

ANALYSIS

² Numerous practitioners have raised this issue over the last couple of years including at the ICC National Committee 'Networking Forum' in Rome on 8 November 2016 and the ICC National Committee 'Sharing Session' in Paris on 23 November 2016.

³ <https://iccwbo.org/publication/global-survey-2018-securing-future-growth/>

A Guidance Paper to be drafted, outlining past and current usage of drafts in relation to documentary credits.
Emphasise that drafts serve no useful commercial purpose for credits available at sight. As stated in UCP 600 article 2, for negotiation to occur under a documentary credit available by negotiation, a draft is optional.
Banks need to review their application forms for documentary credits, whether in paper format or online.

2. FORMER PRACTICE - ORIGINS

It is clear that the practice of requiring drafts under documentary credits was more commonplace in the past. As an example, the Colombia Law Review⁴ contained a chapter on Documentary Letters of Credit⁵, in which frequent reference is made to a letter of credit authorising the drawing of drafts on the issuing bank and undertaking that drafts so drawn would be honoured.

At that time, all documentary credits required a draft and an appropriate clause would be included within the terms and conditions of the credit.⁶

Extension of such practice to more modern times is the perfect example of a scenario that Bernard Wheble⁷ used to call ‘the inertia of tradition’, i.e. we have always done it this way and, therefore, see no need to change.

The first version of the UCP published in 1933⁸ stated in Article 9: ‘*When an irrevocable credit is opened in the form of a Commercial Letter of Credit, the Letter of Credit itself must include notification of the opening of an irrevocable credit and constitute the definite engagement by the issuing Bank towards the beneficiary and holder in good faith to honour all drafts issued by virtue of and in conformity with the clauses and conditions contained in the document.*’

⁴ Volume XXII No. 4 dated April 1922

⁵ https://www.istor.org/stable/1111302?seq=1#page_scan_tab_contents

⁶ For example: *We hereby agree with bona fide holders that all drafts issued by virtue of this credit and in accordance with the above stipulated terms shall meet with due honour upon presentation at the office of (the issuing bank) if drawn and negotiated on or before (the agreed date).*

⁷ CBE and former Honorary Chairman of the ICC Commission on Banking Technique and Practice

⁸ UCP 82

Article 5 of UCP 151⁹ stated: *'Irrevocable credits are definite undertakings by an Issuing Bank and constitute the engagement of that Bank to the beneficiary or as the case may be, to the beneficiary and bona fide holders of drafts drawn thereunder that the provisions for payment, acceptance or negotiation contained in the credit, will be duly fulfilled provided that the documents or as the case may be, the documents and the drafts drawn thereunder comply with the terms and conditions of the credit.'*

This would appear to be the first indication that drafts were no longer 'mandatory' and this wording continued into UCP 222¹⁰, Article 3.

UCP 290¹¹ contained the following articles:

General Provisions and Definitions:

'For the purposes of such provisions, definitions and articles the expressions "documentary credit(s)" and "credit(s)" used therein mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and in accordance with the instructions of a customer (the applicant for the credit),

i. is to make payment to or to the order of a third party (the beneficiary), or is to pay, accept or negotiate bills of exchange (drafts) drawn by the beneficiary, or
ii. authorises such payments to be made or such drafts to be paid, accepted or negotiated by another bank,
against stipulated documents, provided that the terms and conditions of the credit are complied with.'

Article 3:

'a) An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the terms and conditions of the credit are complied with:

i. to pay, or that payment will be made, if the credit provides for payment, whether against a draft or not ;

ii. to accept drafts if the credit provides for acceptance by the issuing bank or to be responsible for their acceptance and payment at maturity if the credit provides for the acceptance of drafts drawn on the applicant for the credit or any other drawee specified in the credit ;

iii. to purchase/negotiate, without recourse to drawers and/or bona fide holders, drafts drawn by the beneficiary, at sight or at a tenor, on the applicant for the credit or on any other drawee specified in the credit, or to provide for purchase/negotiation by another bank, if the credit provides for purchase/negotiation.

b) An irrevocable credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of that bank, but when an issuing bank authorises or requests another bank to confirm its irrevocable credit and the latter does so, such confirmation constitutes a definite undertaking of the confirming bank in addition to the

⁹ The 1951 revision

¹⁰ The 1962 revision

¹¹ The 1974 revision

undertaking of the issuing bank, provided that the terms and conditions of the credit are complied with:

i. to pay, if the credit is payable at its own counters, whether against a draft or not, or that payment will be made if the credit provides for payment elsewhere ;

ii. to accept drafts if the credit provides for acceptance by the confirming bank, at its own counters, or to be responsible for their acceptance and payment at maturity if the credit provides for the acceptance of drafts drawn on the applicant for the credit or any other drawee specified in the credit ;

iii. to purchase/negotiate, without recourse to drawers and/or bona fide holders, drafts drawn by the beneficiary, at sight or at a tenor, on the issuing bank, or on the applicant for the credit or on any other drawee specified in the credit, if the credit provides for purchase/negotiation.'

Clear differentiation had now been created to clarify that payment could be made with or without drafts. If drafts were required, they were to be paid, accepted or purchased / negotiated.

UCP 400¹² introduced the term '*deferred payment undertaking*', a settlement method by which drafts would not be required.

As with UCP 290, UCP 400 again clarified that payment could be made with or without drafts.

Article 2: 'For the purposes of these articles, the expressions "documentary credit(s)" and "standby letter(s) of credit" used herein (hereinafter referred to as "credit(s)"), mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and on the instructions of a customer (the applicant for the credit),

i. is to make a payment to or to the order of a third party (the beneficiary), or is to pay or accept bills of exchange (drafts) drawn by the beneficiary,

or

ii. authorises another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts),

against stipulated documents, provided that the terms and conditions of the credit are complied with.'

The content of UCP 400 Article 10 would be very familiar to current practitioners in that it listed the various methods of settlement:

- Sight
- Deferred Payment
- Acceptance of drafts
- Negotiation against drafts

¹² The 1982 revision

UCP 500¹³ included similar provisos, albeit with minor drafting changes. The major change, in respect of drafts, was to clearly state the obligation of the confirming bank in addition to that of the issuing bank.

An accompanying publication entitled '*Standard Documentary Credit Forms for the UCP 500*'¹⁴ provided examples of standard application forms for documentary credits. With respect to drafts, the Guidance Notes stated:

- A sight payment credit may require presentation of documents without any drafts. The 'box' calling for a draft should only be X-marked if the applicant's instructions stipulate a draft. (*An additional comment was made that, at times, because of stamp duties, it is necessary in certain countries to issue credits available by sight payment without calling for drafts.*)
- A deferred payment credit will call for documents to be presented but not for any drafts.
- If the credit is to be available by acceptance, the applicant should call for drafts.
- A credit may authorise another bank to negotiate with or without the credit calling for drafts. In a negotiation credit, the 'box' calling for a draft should only be X-marked if the applicant's instructions stipulate a draft.
- For freely negotiable credits, if drafts are to be required, the drafts may be stipulated to be drawn on the issuing bank or, if the credit is to be confirmed, on the confirming bank.
- The Beneficiary's Draft 'box' must be X-marked if either of the following 'boxes' has been X-marked: 'available by acceptance' or 'available by negotiation (with drafts)'.

As can be seen, apart from acceptance credits, drafts are not considered to be mandatory for any method of settlement.

The existing rules, UCP 600¹⁵, clarify that nominated banks are authorised to accept or incur a deferred payment undertaking and that the nominated bank is authorised to prepay or purchase such a deferred payment undertaking¹⁶.

ANALYSIS

The UCP rules have evolved over the years, with drafts no longer a mandatory requirement apart from within acceptance credits, unless required for a specific commercial, regulatory or legal reason. Furthermore, the rules now allow financing via prepayment of a deferred payment undertaking.

¹³ The 1993 revision

¹⁴ ICC Publication no. 516

¹⁵ The 2007 revision

¹⁶ Sub-article 12 (b)

3. CURRENT ICC RULES AND PRACTICE

*UCP 600*¹⁷

Article 2 – definition of ‘Honour’: c. to accept a bill of exchange (“draft”) drawn by the beneficiary and pay at maturity if the credit is available by acceptance.

Article 2 – definition of ‘Negotiation’: means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, 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.

Sub-article 6 (c) - A credit must not be issued available by a draft drawn on the applicant.

Sub-article 7 (a) (iv) Issuing Bank Undertaking - acceptance with a nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;

Sub-article 8 (a) (i) (d) Confirming Bank Undertaking - acceptance with another nominated bank and that nominated bank does not accept a draft drawn on it or, having accepted a draft drawn on it, does not pay at maturity;

Sub-article 12 (b) - By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorises that nominated bank to prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank.

Sub-article 38 (h) - The first beneficiary has the right to substitute its own invoice and draft, if any, for those of a second beneficiary for an amount not in excess of that stipulated in the credit, and upon such substitution the first beneficiary can draw under the credit for the difference, if any, between its invoice and the invoice of a second beneficiary.

Sub-article 38 (i) - If the first beneficiary is to present its own invoice and draft, if any, but fails to do so on first demand, or if the invoices presented by the first beneficiary create discrepancies that did not exist in the presentation made by the second beneficiary and the first beneficiary fails to correct them on first demand, the transferring bank has the right to present the documents as received from the second beneficiary to the issuing bank, without further responsibility to the first beneficiary.

*ISBP 745*¹⁸

A7 (a) (i) - any correction of data in a document issued by the beneficiary, with the exception of drafts (see paragraph B16), need not be authenticated.

¹⁷ ICC Uniform Customs and Practice for Documentary Credits, 2007 Revision

¹⁸ ICC International Standard Banking Practice for the Examination of Documents under UCP 600, 2013

A11 (a) – Even when a credit does not expressly so require: (i) drafts are to indicate a date of issuance.

A11 (b) – A requirement that a document, other than a draft ..., be dated will be satisfied by the indication of a date of issuance ...

A19 (a) - “shipping documents” – all documents required by the credit, except drafts, teletransmission reports and courier receipts, postal receipts or certificates of posting evidencing the sending of documents.

B1 – a draft, when required, is to be drawn on the bank stated in the credit.

ANALYSIS

Neither the rules, nor the defined practice, mandate for the usage of drafts unless specifically called for under a documentary credit.

4. ICC OFFICIAL OPINIONS

ICC Opinions and DOCDEX¹⁹ refer to the usage of drafts when required by the terms and conditions of the credit.

TA703rev

For the purposes of a clause such as "all documents must be issued in English", a draft is not to be considered as one of those required documents unless the credit requires the presentation of a draft drawn on the applicant under "documents required". A draft is to be examined to the extent required by the terms and conditions of the credit, the UCP and applicable local law.

TA480 rev

It is recognised that where sight drafts are to be drawn on the issuing bank, the requirement for the presentation of such draft is often crucial for the issuing bank to obtain payment from the applicant.

R205

If an issuing bank insists on issuing a credit calling for drafts on the applicant, such drafts will be considered as an additional document. This means that the draft on the applicant will be

¹⁹ ICC Rules for Documentary Instruments Dispute Resolution Expertise, 2015

construed as being an "accommodating draft" for the use by the issuing bank and not as the "instrument" that would control payment obligations of the issuing bank under the documentary credit. It will not be treated as the primary bill of exchange demanding payment or acceptance, but just as any other document for accommodation by the issuing bank in its relationship with the applicant outside the documentary credit mandate.

TA661rev

If a draft is drawn on the issuing bank, it is for the issuing bank to accept the draft. If the draft is drawn on the issuing bank, the credit should be available with the nominated bank by negotiation and not by acceptance.

R256

The issue of whether or not the bank physically placed its acceptance on the draft is one of internal banking practices, in conjunction with any local or internationally recognised bills of exchange laws and is not an issue for the ICC or UCP. The issuing bank's obligation, according to sub-Article 9(a), is to "accept drafts" and to pay on the due date. There may be occasions where the negotiating bank requires the drafts to be accepted and returned, and, in these cases, the issuing bank may be expected to do so. This, however, is not relevant in this case, and, in any event, does not reduce the obligations of the Issuing Bank to pay. Upon the facts provided, the issuing bank has an obligation to effect settlement to the negotiating bank at maturity. Any dispute as to the requirement and manner of "physical" acceptance is between the importer and the issuing bank based upon local banking practices and law.

DOCDEX Decision No. 215

Draft made out in the name of Bank I&C, Country C. No inconsistency between the word 'and' and '&' – no discrepancy.

DOCDEX Decision No. 226

The draft presented by the beneficiary, and taken up by the Initiator, indicated the following amount in figures: "USD 447,160.59" and indicated the following amount in letters: "USD four hundred forty seventy thousand one hundred sixty 59/100". The Respondent pointed out the difference between the amount in figures and the amount in letters and accordingly rejected the draft as non-conforming. The draft should be considered as conforming to the terms of the documentary credit.

ANALYSIS

Neither ICC Opinions, nor the DOCDEX Decisions, mandate for the usage of drafts unless specifically called for under a documentary credit.

5. LEGAL PERSPECTIVE: INTERPRETATION IN THE COURTS

It should be noted that courts have observed that even though a sight draft may have no legal effect and serve no useful commercial purpose, it still has to be tendered if called for in a documentary credit.²⁰

However, there is no mandatory requirement for a draft if one is not called for by the credit. Courts are likely to reflect customs and practice as stated within UCP and ISBP.

A Federal Court in the US has ruled that “the words ‘drafts at . . . at sight’ in Field 42C of a letter of credit mean that a sight draft must be presented to obtain payment under a letter of credit. Because a draft is required, the presentation of a single draft and multiple invoices constitutes a single presentment, which must be honored or dishonored as a whole.”²¹

ANALYSIS

Courts do not mandate for the usage of drafts unless specifically called for under a documentary credit.

6. EXPERT PERSPECTIVE: REFERENCE TEXTS

As mentioned in one of the most authoritative textbooks on documentary credits, “Jack: Documentary Credits”,²² in some transactions where the credit calls for a draft, the draft may seem of little importance as, for example, where a sight draft drawn on the issuing or confirming bank is required. Even so, in these circumstances the draft must still comply with any specific requirements of the credit and the bank may not waive those requirements even if inserted for its own benefit. However, the text also suggests that bills of exchange should not be included among the documents required by a credit without reason.

In his book, “Negotiation in Letter of Credit Practice and Law: The Evolution of the Doctrine”²³, Professor James E. Byrne highlights that from playing a central role in the letter of credit process, the draft or bill of exchange has become incidental and atrophied, and goes on to state that with respect to banks nominated in the letter of credit to “negotiate,” negotiation can occur without there being a draft or bill of exchange.

²⁰ *Kydon Compania Naviera SA v National Westminster Bank Ltd (The "Lena")* 1981

²¹ Cites:

Lower Court - *SewChez Int'l Ltd. v. CIT Group*, No. CV 07-1211 SVW (JWJx), (C.D. Cal. Sept. 19, 2007) [USA]

Appellate Court - *SewChez Int'l Ltd. v. CIT Group*, 2009 US App. Lexis 25005 (9th Cir. Nov. 13, 2009) [USA]

²² Jack: Documentary Credits, Fourth Edition, Ali Malek QC & David Quest, 2009

²³ <http://www.tilj.org/content/journal/42/num3/Byrne561.pdf>

Various articles on the subject were published in the former ICC publication, DCInsight, over the years.

Reinhard Langerich²⁴ questioned why bills of exchange are used today, when the documentary credit is so well known and is accepted as a separate instrument for payment and finance. He pointed out that sight drafts are superfluous and have no value, whilst usance drafts drawn on the issuing bank are not returned to the beneficiary, but held by the issuing bank and paid at maturity.

Kim Sindberg²⁵ highlighted that the problems with a draft are related to the fact that it is one payment instrument on top of another and that, in most cases, there is no real need for a draft. His suggestion was to discourage the use of drafts in credits and to only call for them when there is a real commercial need (bearing in mind that documents can be negotiated without drafts).

Bob Ronai²⁶ expounded similar views, stating that the draft is a misunderstood and totally misused concept, which has no place in the vast majority of credits. As stated by others, he views the draft as superfluous, highlighting that comparable benefit can be obtained from a deferred payment credit.

Rupnarayan Bose expressed an alternative viewpoint²⁷ and asked why a section of users are opposed to drafts, especially where documentary credits are concerned. He has also provided comments in a number of blogs, the most recent in which he expounds that the abolition of drafts from documentary credit operations cannot be effective if our mind-set does not change²⁸.

A detailed article, published by David Meynell and Gary Collyer²⁹, is reproduced below.

“A draft is a common feature of a documentary credit. However, it is very often a cause of discrepancies due to incorrect or inadequate data being shown. For example, the absence of key information, such as a date relating to the date of shipment, or date of a document or an event from which a maturity date may be determined from the face of the draft, is an area where a discrepancy is commonly identified.

It is the issuing bank, and not the applicant, that usually specifies a requirement for a draft by the pre-printed wording on its documentary credit application form (paper or online). There are no specific rules concerning the form and issuance of a draft. However, in order to

²⁴ DCInsight Vol. 7 No. 3, July-September 2001

²⁵ DCInsight Vol. 16 No. 2, April-June 2010

²⁶ DCInsight Vol. 20 No. 1, January-March 2014

²⁷ DCInsight Vol. 19 No. 4, October-December 2013

²⁸ <https://rnbose.blogspot.co.uk/2016/04/whats-draft-got-to-do-with-it1.html>

²⁹ <https://www.tradefinance.training/blog/articles/drafts-under-documentary-credits-still-relevant/>

be considered a bill of exchange (or, more commonly, a draft), the presented document must conform to the following definition: *"A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person, or to bearer."*³⁰

When a draft is required as evidence of the amount due under a documentary credit, it must be drawn on a bank. A credit may indicate this requirement by stating the actual name of a bank, or it may indicate the applicable (drawee) bank by the role that it is performing, i.e., "Issuing Bank", "Nominated Bank", etc.

With the exception of a documentary credit that is available by acceptance, each bank should ask itself as to whether a draft is as relevant today as it was, say, 5 or 10 years ago. This is especially so when a documentary credit is available by payment or by negotiation on a sight basis, and as we try to move away from paper based transactions.

In fact, it is arguable whether a draft should ever be required under a documentary credit. Maybe the credit itself should provide the risk mitigation, financial undertaking and settlement conditions? We are aware of a growing number of advocates around the world supporting this position. UCP 600 incorporates rules defining the undertaking of the issuing and confirming bank to honour. Why utilise a credit available by acceptance when there is a perfectly acceptable alternative in making the credit available by deferred payment?"

Such argument was expanded further in a blog published by Meynell and Collyer in April 2017³¹:

"The problem likely to be faced with the removal of drafts is that drafts, combined with documentary credits, still have enormous support from certain parts of the world. It should also not be forgotten that, whether or not drafts are required, this is not a UCP issue. It is the case that almost every bank's application form, whether in paper form or on-line, will contain a pre-set requirement for the presentation of a draft. Whether a draft is required is within the hands of every issuing bank and does not need a change to the UCP to achieve it. Merely deleting drafts from UCP will not stop their usage.

As mentioned by one ICC National Committee, it is considered vital that UCP's unique characteristic of global acceptance is maintained and suggestions for non-optional changes that only benefit particular business or geographic segments of the user base are opposed. We could not agree more with this comment; changes need to focus on the entire market and not solely on particular elements.

This is not to say that we agree with the usage of drafts in documentary credits. In the main, we believe that they are a redundant requirement that is superfluous to actual needs. In

³⁰ Bills of Exchange Act 1882 (UK)

³¹ <https://www.tradefinance.training/blog/articles/drafts-ucp-700/>

essence, guidance as to the appropriate usage of drafts is the applicable response to this issue.”

ANALYSIS

Unless required for a specific commercial, regulatory or legal reason, the presentation of drafts should not be required by a credit.

Negotiation can occur without a draft or bill of exchange.

Discourage the use of drafts in credits and to only call for them when there is a real commercial need.

Drafts are superfluous and, for usance transactions, comparable benefit can be obtained from a deferred payment credit.

Drafts are a frequent, unnecessary, cause of discrepancies.

Drafts are not as relevant as they were in the past.

Merely deleting reference to drafts in the UCP will not stop their usage – as a first step, guidance is required.

Changes cannot be made that would only benefit particular business or geographic segments of the user base.

7. PREPAYMENT OF DEFERRED PAYMENT LC'S ³²

Prepayment of Deferred Payment Undertaking

- Under UCP 500, due to the 'Banco Santander v. Banque Paribas' court case in 2000, it had become unclear as to whether nominated banks were in a position to prepay deferred payment Letters of Credit and still receive reimbursement in the event of fraud.
- The court interpreted UCP 500 Articles 9, 10, and 14 as authorising the confirmer to pay at maturity, but not to prepay or discount the deferred obligation that it was obligated to incur and did incur against presentation of credit complying documents.
- This was subsequently addressed in UCP 600 by stating that the nomination of a bank included authorising a bank to prepay or purchase (included in Article 7 Issuing Bank Undertaking and Article 8 Confirming Bank Undertaking).
- And in UCP 600 Article 12 Nomination: By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorises that nominated bank to prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank.
- Provides protection for a nominated bank under credits when payment has been effected to the beneficiary, with added language to clarify the issuing bank's responsibility to a nominated bank under a credit with deferred payment terms whether or not the nominated bank has effected payment to the beneficiary prior to maturity date.

³² Article by David Meynell, November 2013

New York Court August 2010

- Fortis Bank (Nederland) N.V. v. Abu Dhabi Islamic Bank (ADIB) – in essence, reverses the ‘Santander’ decision.
- LC confirmed by ADIB and subsequently advised by Fortis to beneficiary.
 - 360 day deferred payment period.
 - Fortis apparently prepaid beneficiary.
 - At maturity, ADIB refused to pay due to fraud.
- The defence from ADIB relied on the pre-mentioned ‘Santander’ decision in which a confirming bank that incurred and then discounted its own deferred payment undertaking was held to bear the risk of beneficiary fraud established thereafter, but before the maturity date. The UK court basically decided that nominated banks were not permitted to prepay deferred payment LCs under UCP 500.
- Under the New York case, UCP 600 applied and article 12 allows prepayment.
- The New York court therefore decided that the ‘Santander’ decision had no bearing.
- In conclusion, the nominated bank had a right to reimbursement.
- A decision that should be applauded as the right way forward.

As stated in Jack³³, the UCP 600 now considerably ameliorates the risks for a bank, which discounts its own deferred payment obligation by early payment.

ANALYSIS

UCP 600 supports prepayment of a deferred payment undertaking and it is extremely unlikely that any court would oppose the rules.

³³ Jack: Documentary Credits, Fourth Edition - Ali Malek QC & David Quest, 2009

8. CONCLUSION AND RECOMMENDATIONS

Ordinarily, a UCP 600 documentary credit need not require a draft to be presented together with the stipulated documents. Accordingly:

1. It is recommended that the [longstanding] habit of requiring a draft for a documentary credit available at sight be curtailed, particularly sight drafts drawn on an issuing bank, confirming bank, or a bank nominated to pay.
2. UCP 600 article 2 allows for negotiation to occur under a documentary credit available by negotiation with or without a presentation of a draft. It is recommended that the habit of requiring a sight draft for a documentary credit available by negotiation be reviewed and that negotiating banks be encouraged to rely, not on negotiable instruments' law, but instead on specific agreements with beneficiaries evidencing negotiation and their respective recourse and other rights and remedies.
3. UCP 600 article 12 (b) supports the prepayment of a deferred payment undertaking. As such, it is recommended that banks issue usance documentary credits available by deferred payment as an alternative to availability by acceptance of a draft, unless there is specific commercial, regulatory or legal reason to create a bankers' acceptance.
4. All banks should review their UCP 600 documentary credit forms, whether in paper format and/or online, to indicate that a draft is not a standard requirement of the issuing bank and to indicate their requirements for a non-negotiable form of demand.

It is recommended that banks arrange for this Guidance Paper to be distributed throughout their network, and particularly to their legal departments. It can also be circulated to clients and, if considered appropriate, to courts and regulatory authorities. Sharing this Guidance Paper on a wider basis will help ensure amelioration of any problems.

Practitioner feedback can be found in the Annex below.

9. ACKNOWLEDGEMENTS

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DCInsight Vol. 20 No.1, Bob Ronai, January - March 2014
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ICC National Committee feedback to 'Consultation regarding a revision of the UCP' – June 2017
Documentary Credit World, Counterpoint: more evidence why practices, not UCP 600 rules, are the problem – David Meynell, January 2018
LinkedIn – Trade Finance Group & others, 2018

11. ANNEX - PRACTITIONER FEEDBACK

General Comments:

- This is the kind of technical discussions many participants of the Banking Commission are more and more missing in our meetings. Since some years the content of the 'spring' meeting is more and more shifted to "debates" (which in my humble opinion are not really debates with a conclusion) on a wide variety of high-level matters. Of course the times that discussions about traditional trade dominated the Commission from start till end are gone, and we all must broaden our view but let's not forget that the core competence of our Commission is rule making and technical discussions. The time spent on this in the Commission is becoming less and less. But for having a discussion (good or bad) on blockchain in TF etc. we all can attend seminars of Euromoney or who-ever (every day we all receive invitations for seminars in TF). I can assure you that my complaint is not only personal: many members feel the same. Again, I do not want to return to "old days" (because times changed) but let's have a sound balance between practical/technical matters and new stuff.
- Drafts have a limited usefulness in commercial credits unless the credits call for Acceptance.
- Sight drafts under commercial credits lead only to problems.
- Gives an issuing bank another opportunity to declare a discrepancy and resist payment.
- As long as they are part of the requirements ("available by your draft(s) at sight drawn on us accompanied by the following documents ...") they are a document that must be examined.
- Perhaps in our next UCP and ISBP we can actively discourage the use of drafts.
- Ban sight drafts from letters of credit, they do not provide any benefit.
- It is an issuing Bank's prerogative to decide what documents are to be called for with what contents – this will include a draft.
- The draft may serve as a financial and legal document that may also facilitate its marketability leading to financing depending on its tenor/validity.
- UCP and ISBP may continue to retain the current references to drafts and do not need to be removed.
- It would be unwise to abandon drafts in the UCP. There are certainly many advantages in using them in relation to honouring and negotiation, i.e. well established laws and practices that accommodate financing.
- The problem is not use of drafts, as such. Problems are rather related to their examination. ISBP provided a lot of clarity in this respect. However, we may go as far as saying (in the next UCP) that drafts are not examined for the purposes of determination whether the presentation is complying or not. They would be purely used as means of settlement. Today, clearly, they are to be examined (ISBP – B).
- Problem is, certainly, that the "discrepancies" re drafts maybe/are abused by some banks. In my view, we should target the question of the examination of drafts.
- Applicants are told by issuing banks what they are to say in their LC applications by way of locked data fields, which prevent variations.

- Issuing banks put forward their "standard" wording, which often is not understood by applicants but blindly followed because it is on the form as a default requirement, no variation allowed.
- Banks do not necessarily have suitable skills.
- I am all in favour of reducing the number of documentary credits, which require drafts, but I would not recommend removing the concept entirely from UCP. There are times when they are useful. Three preliminary thoughts: 1) any move by the ICC on this topic should include standbys issued under UCP 600 and, if possible, ISP98. Drafts are totally redundant in standbys but still appear as a requirement in many standbys issued in the finance/insurance market. 2. Drafts remain a fundamental part of collections on a D/A basis since an accepted draft is the only guarantee of payment at a future date. Any guidance from ICC or amendment to standard forms will have to make it clear that drafts should continue to be used in D/A collections under URC 522. 3. ICC will have to consult with other organisations such as ITFA, since drafts are a useful tool in forfaiting operations because they are negotiable.
- Practically, the two documents, the draft and the LC, cannot be separated in any meaningful physical sense or traded separately. Regarding tradability, most practitioners are as happy with an assignment of LC rights as they are with an endorsement of a draft.
- I would not abolish drafts. They are used in the emerging markets and they give comfort, possibly irrationally, but comfort nonetheless. It would also potentially call into question past practice and acceptance L/Cs that are on banks' books. The main reasons for abolishing them appears to be the perception that they are not much used (but there are regional variations) and possibly are a little old-fashioned. On the latter point, ITFA is working to create blockchain promissory notes, which is what drafts are, so we hope to sweep away some of the cobwebs there.
- English law on drafts is set out in the Bills of Exchange Act 1882 (and a few subsequent amendments). Many common law countries have followed this model. There is also the 1930 Geneva Convention on Bills of Exchange. Article 3 of the Uniform Commercial Code I think, covers US law.
- The problem with negotiation credits is that, despite the last two revisions of UCP indicating a definition of negotiation that refers to the negotiation of drafts and/or documents, banks are reluctant to issue a negotiation credit that does not require the presentation of a draft, on a sight or usance basis (or to even act as a nominated bank, and negotiate if there were no draft). When I have questioned a number of banks over the past few years, the answer is consistent - the legal departments are unsure of how negotiation will be looked at by a court in the event of a dispute and insist upon a draft until such time as there is a clear understanding where the courts will sit.
- Acceptance credits, where a draft is necessary, only accounts for a small percentage of the volume. The beneficiaries and not the issuing banks will drive this. Beneficiaries that want an accepted draft and the ability to seek the best discount rate possible, if required.

- A concerted effort to remove drafts may need some form of acceptable legal opinion as to negotiating without a draft, as the likelihood of a bank having a court case is quite slim today.
- We should not get rid of drafts but, if we can take a first step by providing suitable 'guidance' as to the general redundancy of drafts, that would be a good thing.
- We are fully in favour of the removal of drafts/bills of exchange from documentary credit operations. Such payment instruments are not accepted/endorsed by Italian banks, as their free circulation is not permitted by Central Bank that considers this kind of instrument equivalent to currency and circulating medium. In these cases Italian banks issue their deferred payment undertaking. In Italy an important reason connected to the non-use of drafts/bills of exchange is also their relevant cost. They are subject to State duty. For the drafts connected to export transactions the stamp amounts to 9 per thousand of the face value and, for the drafts linked to import transactions, the stamp amounts to 12 per thousand of the face value, while the stamp is reduced to 6 per thousand if the draft already brings a foreign stamp. This considerable financial cost entails that, when the acceptance of a usance draft by a drawee Italian bank is requested in a documentary credit, it is replaced by an "undertaking to pay at maturity issued by the Italian Bank". Another reason in favour of non-use of drafts is the disappearance of the forfaiting market - for the cause said at the beginning - which is currently replaced by direct financing of each individual transaction. According to this situation sight drafts are totally superfluous.
- All documentary credits covering domestic trade in almost all countries in the Indian sub-continent and surrounding East-Asian group countries issue domestic/inland credits calling for 'drafts drawn on applicant' irrespective of the 'tenor/usance period' – a direct and conscious deviation of UCP 600 sub-article 6 (c).
- In many countries, because of stamp duties even on sight bills, drawing Bill of Exchange is dispensed with.

ANALYSIS

Sight drafts provide no benefit.

Legal departments are unsure of how negotiation will be looked at by a court in the event of a dispute and insist upon a draft until such time as there is a clear understanding where the courts will sit. [Note: Sharing this Guidance Paper with teams throughout the bank and providing guidance to courts can ameliorate this issue.]

Reduce the number of credits requiring a draft, but do not discontinue completely as they can be useful in certain circumstances.

In addition, feedback was received on a number of specific questions:

Why are drafts requested under documentary credits?

- A former practice that is still incorporated on letter of credit templates.
- Our local bank's documentary credit application forms continue to contain a pre-set requirement for the presentation of a tenor draft in respect of usance L/Cs available

by acceptance. Whilst there is no actual rationale for such a requirement, especially where such drafts are to be drawn on the issuing bank for acceptance, there are exporters (beneficiaries and their bankers) who insist that they require such an instrument from the importer (applicant and their bankers, the issuing bank) presumably to prepay or purchase the accepted tenor draft / bill of exchange, upon a complying presentation, notwithstanding the provisions allowed in terms of UCP 600 sub-article 12 (b) in terms of a deferred payment undertaking, or that of the Issuing or Confirming bank's undertaking(s).

- UCP does not mandate that a presentation must state an LC number so banks ask for drafts citing the LC number.
- The amount between a draft and an invoice could differ in rare cases and banks will honour the draft value.
- Some countries do not have specific documentary credit laws. Drafts tie documentary credits to negotiable instrument laws.
- The protection of the bona fide holder under B/E laws is difficult to achieve otherwise. I doubt there is such protection (for the cases of fraud or so) for any other assignees or so. So generally, drafts are to be used in cases of financing (negotiation, discounting). Otherwise, arguably, no use (except as for standbys where they can play the role of demands).
- The main reason I believe is inertia: "We've always done it this way"
- As far as I can see the vast majority of DCs calling for drafts does that out of old habits. For example I see many sight LC's calling for drafts - and these are simply archived in the file once received by the issuing banks. There are of course some cases where the draft is there in order to offer post financing.
- The requirement for a sight draft in a documentary credit is usually based on regional and historical practice. In many cases there is no legal or commercial justification for this. A draft, once accepted, provides an independent guarantee of payment, regardless of any dispute in connection with the underlying contract. However, English law (and most legal systems) recognise the independent nature of guarantee contained in an irrevocable documentary credit. If that LC is payable at sight, the requirement for a sight draft adds nothing to the beneficiary's security. The issuing or confirming bank will either pay or reject, depending upon whether the presentation is compliant. Indeed, a requirement for a sight draft adds to the beneficiary's burden in that there is one more document to be prepared and presented. There is also one more document to get lost.
- Whilst I agree a sight draft has little purpose in the UK and I think banks in the UK and many parts of the world only request drafts because it is in their standard application forms, it is still true that L/Cs from many parts of the world (where I do not know the legal implications) do require drafts which may have local implications. In the Far East there is still a great emphasis placed on the draft even sight drafts. I also recall that in many instances L/C 's used to require the drafts be drawn on the reimbursing bank and accompany the reimbursement claim, although this has little relevance now.
- We consider drafts a legal remedy easier to obtain a sum certain in money, as we are holder in due course in the transaction. A draft may be discounted in secondary

market. As per our Stamp Act 1899, all usance drafts require adhesive or impressed stamp at rate of 0.2% of the value of the bill.

- For sight L/C's I don't see any objective reason why a draft would be requested. Sight drafts are used in 2 situations: a) a draft on the applicant but this is since long time discouraged by UCP (and indeed we very rarely see that bad practice); and, b) in case of negotiation: a draft on the issuing bank in order to allow the negotiating bank to exercise a possible recourse on the beneficiary (in case the negotiating is not reimbursed by the issuing bank) : this is also not needed anymore as UCP clearly allow to negotiate such L/C based on documents only by issuing bank. Furthermore, a negotiating bank will normally negotiate within the framework of a credit agreement or other contractual arrangement with the beneficiary, making the use of a draft useless.
- Since 3 or 4 years we no longer require a draft under the (many) LC's we open available by negotiation (at sight or even at maturity) and this did not cause questions or remarks by the nominated/ negotiating banks nor by our applicants.
- I think the reasons why drafts are requested under LCs are historical. In some jurisdictions, this was a way to 'officialise' the payment obligation of the applicant towards the issuing bank. That could be one of the reasons that in the old days we saw so many requests for drafts drawn on the applicant. Fortunately these have vanished. I think that still a lot of banks have the habit to 'officialise' their payment obligation under an LC by accepting a draft - even a sight draft. This is useless, since these obligations are well incorporated in UCP 600 article 7 and others. That could also be the reason why many LCs still quote the text: 'we hereby engage with bona fide holders of all drafts ...'. Some think it is still necessary, as this text was also pre-printed in small fonts on paper letters of credit that lasted until the end of the '90's before the use of MT700 was widely spread. Old habits never die.
- In general terms, drafts provide a second line of defence in a court of law and, in certain countries, it facilitates the work of judges and court officials. No need to request a draft for an L/C available by payment at sight. In Spain the use of drafts in the import L/Cs involves the payment of taxes derived from the *Tax Law on Transfer of Property and Documented Legal Acts* (Royal Legislative Decree 1/1993, September 24). Therefore we do not request a draft and besides sometimes include wording in additional conditions discouraging its presentation. For usance L/Cs, the use of drafts allows the L/C beneficiary to easily discount it with the bank of its choice, which may not be involved in the advice/ confirmation/ negotiation of the L/C. Usually we prefer L/Cs available by deferred payment to those available by acceptance thus avoiding the tax fee issue.
- Drafts are not that important in sight LCs. However, the majority of Chinese trade practitioner's hold that, under acceptance LCs, the usance drafts are imperative in terms of legal remedies.
- It is not a practice of our customers. We do not need drafts. In any case the "draft" is not a financial document in our jurisdiction. We have "Promissory note" = "Cambiale" and "Bill of exchange" = "Tratta". The Draft is unknown in our business process.
- Issuing Bank's internal as well as regulatory and legal guidelines are the deciding factor. Where the drawings under the credit are 'sight/DP/CAD or similar, then calling

for the drafts appears unwarranted UNLESS the local/regional banking practise has certain established banking practices.

- I hardly see any LC “available by negotiation” without the request for a draft. Reason is not replicable as per UCP this is not a mandatory requirement for LC available by negotiation. I would understand for LCs “available by acceptance” but this LC type is not often issued. Drafts drawn on issuing bank the rationale might be financing reasons of the issuing bank – at least that seems the case in Asia as standard market practice but no one up to now could explained it to me so I have to take this as hear-say. But normally the issuing bank is not prepaying the beneficiary.
- We encountered drafts under credits in favor of Indian exporters only. Drafts accompanied sets of documents presented by Indian nominated banks irrespective of the fact that there was no requirement in the credits to present drafts.
- Where they are requested, we believe it is thanks to either legacy practice, which has not been reviewed, updated or revised, or to market practice by certain banks in certain countries.
- Drafts are financial instruments that are separate from the credit. Once a draft is accepted, it falls away from the credit and becomes its own payment instrument and constitutes an unconditional payment undertaking, independent of the obligation under the credit.
- Drafts can provide a beneficiary with a “negotiable” security for payment. A beneficiary may be able to get financing services from a bank;
- Drafts can be sold on the market.
- Parties that purchase drafts may achieve status of “holder in due course” which provides protection from defenses that could be asserted against the drawer; the issuing bank has an obligation to pay the holder in due course at maturity even in the event of abuse or fraud by the beneficiary;
- Using drafts with documentary credits comes from long time historical practice. Drafts are used as evidence of claim for money owed.
- Drafts are often habitually called for in the credit without any thought. It could be due to turnover in companies/banks, new staff simply copy old LC models. Often applicants don’t even know what drafts are, or why they are calling for them in their application forms. Many beneficiaries of standby LCs also don’t know what they are or how to prepare them. Often banks standby LC templates state standard language along the lines of “We will honour drafts.... presented to our above address...”. Such language is routinely included in the standby LC *even if* the standby LC doesn’t list a draft as a required document!
- Many jurisdictions do not cover risk of fraud under deferred payment credits, as there is no evidence of debt - no bill of exchange.
- In some jurisdictions, days of grace may be added to the tenor of the draft (applicants like this)
- An old explanation (back in the 1980’s) that I was given in training: *The term “Bill of Exchange” states the draft’s function i.e. it is an order to pay. The beneficiary presents the required documents along with its draft which serves to order the drawee bank to pay the payee. Thus “the bill” is presented “in exchange” of the payment under the credit.*

ANALYSIS

Requiring a draft is, in general, an out-dated practice.

The requirement for a sight draft adds nothing to the beneficiary's security.

Stamp duty / tax fees can be avoided by issuing credits available by deferred payment rather than by acceptance.

Is there any actual rationale for such a requirement?

- Apart from acceptance credits, none.
- There may have been some rationale in the 70's or 80's but LC's are now globally recognised and courts appear to understand how to treat them.
- Needed for acceptance credit to accommodate transfer, discounting, very useful for negotiation credits.
- There is no rationale and I have yet to read even one response that comprehensively mounts a case for drafts in LC transactions.
- For the vast majority - based on old habits - the answer is "no". For the small percentage where the draft is actively used, the rationale is that the draft is a well regulated instrument; i.e. may reduce the amount of documentation required.
- If the L/C is payable at a future date, i.e. a fixed time after shipment or after presentation, there are two options. A) Payment by deferred payment, i.e. without a draft, or B) Payment by acceptance, i.e. with a draft. A deferred payment undertaking will usually be acceptable to the beneficiary, particularly if the confirming bank or issuing bank is willing to discount (pre-pay) its own deferred payment undertaking and so remove any credit or country risk. However, if the confirming bank or issuing bank is not willing to discount its own deferred payment undertaking, the beneficiary may be in a better position if it holds an accepted draft from the confirming or issuing bank, as the case may be. i. Unlike a deferred payment undertaking, an accepted draft is a negotiable instrument. Once the confirming bank or issuing bank has accepted the draft, the beneficiary can raise finance by selling the draft for a discounted sum. Indeed, the draft can be sold several times. The draft becomes a finance instrument in its own right; ii. The event of a default by the accepting bank, the beneficiary or subsequent "holder in due course" has a direct legal right against the accepting bank without having to prove the terms of the credit or the acceptance of the documents. (Some form of protest may be required in accordance with the relevant legislation.); iii. The fraud exception may operate to terminate an issuing or confirming bank's obligation under a deferred payment undertaking, but it may possibly not operate to terminate the bank's obligation under an accepted draft. (NB. If you want to run this point, it would need further research.) Similarly a draft may be advantageous in a credit available by negotiation where the time for payment is later than sight. Once the confirming bank or issuing bank has accepted the draft, the negotiating bank will have rights as above.
- On sight drafts I would suggest that, unless there are identified jurisdictions where drafts are required, they might not be required. This would make the definition of

honour simpler but I consider that usance drafts are a different case, and must be included as they hold a specific place in the market and an accepted usance draft is an asset and a store of value, with legal requirements and effect. In addition I am concerned that if we remove reference to drafts from UCP and ISBP, banks will still call for drafts and, without guidance, we will get a situation where discrepancies are raised and disputed which are currently clarified within the UCP and ISBP.

- Exchequer revenue of 0.2%. Accepted BE is considered as collateral.
- Not for L/C's available by negotiation (at sight or at a future date). The only rare exception I see is for L/C's available by acceptance of a term draft on a nominated bank (which is most often acting as confirming bank) if that nominated/ confirming bank is not prepared to finance (forfait) the tenor. In such case the beneficiary can request the nominated/ confirming bank to hand over the draft bearing the acceptance of that bank and ask another bank to finance that accepted draft. But such situation is extremely rare. Normal practice is that confirming banks do finance their own signature. And even in such very rare case there are alternative solutions (with an assignment of all rights in favour of the forfaiting bank, be it that such alternative is slightly more cumbersome).
- I see actually no rationale for such a requirement. Even in most jurisdictions one can discount a draft or forfait it without having the actual draft. Just based on a deferred payment undertaking of an acceptable bank, one can do this. Also, it is not common practice to request the return of accepted drafts. So if one says that they need the draft drawn on the Issuing Bank to be able to discount the proceeds with another bank than the nominated bank, I think this is not true, since you hardly ever get an accepted draft returned. But I can imagine that in some banks or some regulators a draft is compulsory to do financing. But I doubt it... Some also say that they need the draft to be able to protest it in case of non-payments. Not true. A bank never returns an accepted draft. Certainly not a bank that is in default...
- The rationale may exist from a legal point of view (second line of defence) and from a business side it is easy thing to beneficiaries for the discount on a wider ecosystem of financial institutions.
- Article 10 (letter of credit fraud) of the rule (on how to handle the disputes under LCs) circulated by Peoples Supreme Court of China says that "injunction order could be granted on condition that the fraud allegation has been duly established, with the exception that the ISSUING BANK.... HAS ALREADY ACCEPTED THE DRAFT UNDER THE LC IN GOOD FAITH". We can read from this specific rule that the attitude of the Supreme Court towards sight LCs and usance LCs is different.
- In our country there is no actual reason.
- More than rationality – it is more relevant to the eagerness to fall in line with the existing local/regional banking practice instead of trying an untested deviation.
- I am aware that drafts have a significant role to play in the issuing bank/applicant relationship in India and I have been told on a number of occasions that the draft is used as the 'proof' of debt to the applicant in order to achieve reimbursement from them. This has led to some banks requiring an additional draft (under field 46A) drawn on the applicant, for this purpose.

- As long as SWIFT field 42 exists, the request for drafts remains. Why should SWIFT eliminate drafts in a MT 700? As per my knowledge no one requested that these fields to be deleted in a MT 700.
- Work with SWIFT for the removal of field 42 variants from their standards.
- I would ask someone from India for explanation. I understood from my conversations with Indian bankers that Indian law requires drafts as a means for demand of payment. Drafts may also be an instrument for refinancing at the secondary market.
- We do not see any compelling reason for requiring drafts to be drawn in a documentary credit, or to issue credits available by acceptance. However, there could be reasons that are beyond the normal scope of trade finance, e.g. if banks have use of accepted drafts in secondary markets for liquidity purposes.
- The applicant does not require the draft and as the credit itself already represents the issuing bank's undertaking, the draft doesn't appear to serve any purpose.
- Nevertheless, since drafts are independent instruments, they can be used as the basis for legal action. If the credit does not require presentation of drafts, the beneficiary or holder of the documents must rely only on UCP 600 and may not have all the advantages that can follow from the use of a bill of exchange such as for example, the provisions of the Bill of Exchange Act.
- From the issuing bank's perspective, some issuing banks require the drafts to serve as added protection in their reimbursement rights against the applicant. Some banks' application forms include terms and conditions that allow the issuing bank to enforce reimbursement from the applicant in the event the issuing bank refuses to honour a drawing under the credit and subsequently gets sued on the basis of the draft.

ANALYSIS

Deferred payment undertakings are usually acceptable in the market.

If a bank is unwilling to discount its own deferred payment undertaking, the beneficiary may be in a better position if it holds an accepted draft.

Removal of reference to drafts in UCP will not stop banks still calling for drafts.

What are the alternatives?

- Majority of LCs routed from the Asia are available by negotiation.
- Do we need any? Simply have a credit state that the invoice must state the credit number and the amount being drawn under the credit. The only time a draft is needed is when the credit is available by acceptance.
- Simply that presentations are payable "at sight" or by "deferred payment."
- There are many. Of course it is possible to offer financing without a draft.
- Bear in mind that it is the documentary credit that is the primary instrument determining the undertaking of the involved banks - i.e. (as far as I can see) the only reason to use a draft is financing.
- A deferred payment undertaking will often be acceptable on the basis that the relevant bank is willing to discount its own undertaking. One other option is an

assignment of proceeds, but from a legal perspective, the assignee's position against the issuer or confirmer is not as strong as that of the holder of an accepted draft.

- We have stopped calling draft under sight payment LC.
- Forfeiting can be obtained from a bank other than the nominated bank through the technique of assignment. I admit that, depending on the region and jurisdiction, such alternative may not always offer the same safety as a draft accepted by a bank offers. But, again, such situation occurs extremely rare.
- The alternatives are the UCP articles that fix the obligations of the Issuing Bank, Confirming Bank or Nominated Bank. If an LC refers to the UCP (which they all do) a draft has no added value - certainly not a sight draft. I think that ICC has an educational role to play. There have been opinions stating that wrong data on drafts are not to be considered as a discrepancy. But one should make it stronger by issuing, for example, a position paper to emphasise the complete uselessness of the requirement of a draft under an LC, and, on top of that, that a mistake on such a draft could never be the cause for any discrepancy whatsoever. Except, perhaps, the amount and the maturity date ... and still then...
- From my point of view there are no actual alternatives in what the use of negotiable instruments is concerned. Strictly relying on the L/C commitments is feasible but not recommendable in certain countries or markets, since it is necessary to reword the L/C or get a separate commitment to obtain the same legal advantages.
- Pre-pay a bank deferred payment undertaking.
- UCP 600 sub-article 6 (c) already compelled the banks to adapt alternatives of making their own drafts/bills of exchange or any other relevant, legally competent document to establish their recourse through applicant's commitment.
- Post-financing and discounting without drafts.
- Except for credits available by acceptance, we do not see an issue with credits not calling for drafts.
- Sometimes drafts are intentionally not called for under credits to avoid stamp duty/taxes. As a result LCs are issued available by payment or by deferred payment, or by negotiation against documents (no drafts). If drafts were removed from the UCP there would surely be an increase in deferred payment credits and negotiation credits without drafts. The danger is that the exporters and banks might start inventing new devices or schemes in a misguided effort to obtain added security in relation to the credit. These new inventions will be "new" and therefore no known standard practice to support them. This could be detrimental to either of the parties to the credit.

ANALYSIS

Financing can be provided without a draft.

Prepayment of a deferred payment undertaking is allowed under UCP 600.

*Is it possible to pre-pay a deferred payment commitment in your jurisdiction?*³⁴

- UCP 600 has incorporated appropriate provisions in response to the Santander court case under UCP 500. This provision is yet to appear before court. Therefore, the outcome should be positive but not yet tested. In almost all jurisdictions, financing under acceptance credit is well understood and outcome is almost certain.
- To prepay a deferred payment commitment is possible in practice in my jurisdiction, but not sure of legal effect.
- It is possible to pre-pay a deferred payment commitment in our jurisdiction, however the view remains that a "bill of exchange" can withstand a possible fraud defence.
- Yes, however, the Santander case spooked many US banks and almost all are requiring separate agreements from the beneficiaries before they would consider it. While they may be protected under US law, there is no guarantee that a case would end up under US laws and jurisdiction.
- It has not been tested under Czech Law. But, generally, I think that it should work well. Basically, a bank has a deferred payment obligation to pay the beneficiary. They should have a possibility to agree that the payment would be done before that previously determined due date. Certainly subject to their mutual agreement, so I think that the bank cannot do it unilaterally.
- Absolutely no problem for Australian banks, we operate in a very deregulated system. This is seen as simply a commercial decision.
- In my jurisdiction(s) (i.e. the Nordics) the answer is "yes".
- Yes, under English law.
- It is possible to pre-pay a deferred payment in the UK, and accepted as possible in all jurisdictions from which L/Cs I have handled have originated.
- Very rare. Only for well-known customers against indemnity.
- Yes, this is possible in Belgium, be it that such action can be classified in 2 different ways as the legal framework differs whether my bank (= the nominated bank which has taken up complying docs) has added its confirmation (open or silent doesn't matter) or not. If I've added my confirmation to the credit I simply pay "early / in advance" my own commitment. This is in fact very simple. A debtor may always pay his debt early (in exchange of a reduction). Please note that in certain jurisdictions it cannot be excluded that a nominated bank which forfeits would be better "protected" if it is "bona fide holder" of a draft in case of legal disputes/fraud etc., despite that since the 600 revision the nominated bank is allowed to finance such deferred payment. There are not sufficient numbers of court cases to draw conclusion on this aspect. If I did not add my confirmation the beneficiary will have to assign his rights on the issuing bank to me.
- Yes, in our jurisdiction it is possible. And I can recall very little occasions where we really needed a draft. Our bank has written policies to finance without drafts, just on basis of deferred payment undertakings.
- Yes, it is in Spain. We would request a statement from the beneficiary waiving their rights to receive the payment under the L/C (partially or for the whole amount).
- Yes, in our jurisdiction.

³⁴ This has also been covered in the 'Prepayment of Deferred Payment' section of this paper.

- Yes - it is very much possible to pre-pay a deferred payment commitment in our jurisdiction and I firmly believe that there need not be any restrictions whatsoever prohibiting this.
- Yes, it is, subject to agreement between parties involved. Similar to EU.
- It is quite a widespread practice in Asia where a bank may pre-pay after receipt of 'acceptance' from the issuing bank – we tend to do this only when we are a nominated bank in a credit available by negotiation. In Europe, we also pre-pay deferred payments to beneficiaries providing that the L/Cs are confirmed or, in some specific cases, not confirmed but where documents have been duly accepted by issuing bank.
- Yes.

ANALYSIS

As prepayment allowed by UCP 600, there should not be a problem, but not yet tested in all jurisdictions.

In view of the fact that many bank's documentary credit application forms contain a pre-set requirement for the presentation of a draft, do you see a need to revise / update the ICC publication 'Standard Documentary Credit Forms for UCP 500'?

- Yes
- A guidance paper would suffice.
- That would be helpful. Of course the challenge is that today many application forms are online; i.e. updating those is an IT task. Meaning that it is a bigger task than simply updating a Word or PDF template.
- In principle I would be in favour of a form that makes it clear that a draft is to be required under the LC only if the LC is available by acceptance or by negotiation at a date later than sight.
- We will only change the draft as sight for our LC application form.
- If the majority of banks would have more or less the same opinion as I do I would certainly do this. But it's more important to have first a technical debate within our Banking Commission about the pros and cons of using drafts. I assume an agreement is achievable for getting rid of sight drafts; term drafts less black or white.
- I think those Standard Documentary Credit Forms are not used that often. Perhaps a position paper, such as the "On Board" paper or the one about sanction clauses, will have more impact, and will certainly spark a discussion about this topic.
- The publication should have been updated when the UCP 600 was approved, but I think it would be good to go over it.
- No, I don't think it's necessary.
- Yes.
- I do not see a need.
- My view is that drafts are not exactly part of a documentary credit. Since their use around the world is very limited we should not include draft related provisions into

standard application forms leaving it to banks using them to adapt standard forms to local requirements.

- We believe this would be useful, and that any such publication should be made easily and freely accessible.
- Obviously not if only for the reason to remove references to drafts. ICC Publication 516 is 25 years old and is based on UCP500 and Incoterms 1990. URR 525 did not yet exist at the time. If Pub. 516 were to be updated/revised, it would certainly be an opportunity to update the forms to align them with the current UCP rules and standard practices. BTW, Pub. No. 515 also has samples of credits indicating requirements for drafts. Publication 516 is quite helpful on how to complete the forms and related advices. It also contains good educational information vis a vis the UCP rules pretty much in line with what we see in international standard banking practice. However, I think it would be a major endeavor, which will have many extended impacts. Is the time and cost worth it? Other existing ICC publications, banks' systems, corporates' systems will be impacted. Consider that:
- Over the decades the industry has moved significantly towards electronic instructions. Banks have different front-end systems with different screen layouts and information fields for inputting the credit requirements.
- 2018 SWIFT Release for Documentary Credits include field tags for draft requirements in the MT700, 710, 707, 767 etc. and usage rules. 2019 SWIFT Release for Guarantees/Standby Letters of Credit will also include those field tags.
- ISP98 Rule 4.16 (c) specifically allows for a demand to be in the form of a draft. Rule 2.01 recognizes availability "by acceptance" and the use of drafts. The ISP98 Official Commentary also addresses the usage of drafts.
- URR 725 sub-articles 6(e), 9(c) and 10 (b) set out specific requirements for time drafts. There are no specific references to availability "by deferred payment".
- Excluding drafts would narrow the definition of honour in UCP600, but other UCP 600 articles like articles 6, 7, 8 and 12 b. still provide for acceptance of drafts.
- ISBP 745 has extensive guidance for examination of drafts and calculations of maturity dates.
- Banks' front end systems have pre-set module screens for applicants to input availability terms which include the option "by acceptance" and "drafts drawn on..."
- Not only do banks' application forms (issuance & amendment) have pre-printed optional fields for drafts, their notification advices also have pre-printed fields to indicate the credit availability terms.

ANALYSIS

To be considered at a later date.

Recent surveys on the LinkedIn 'Trade Finance' group have also revealed some interesting facts:

What does your bank, if it is the LC issuing bank, do with drafts sent to you with documents in a presentation?

The overwhelming response was that most banks do nothing and attach the draft to the presenting bank's schedule for filing.

Can anybody quote a country law, regulation or central bank instruction that LC's must require presentation of the beneficiary's draft drawn on the issuing bank?

Not one response could reference such a law or regulation.

ANALYSIS

The surveys do not indicate a legal or regulatory requirement for a draft.