

Undertaking of the Banks

Issuing Bank Undertaking

A credit is an irrevocable undertaking of the issuing bank to honour a complying presentation. Each word of this sentence has significance in understanding documentary credits.

The word "**irrevocable**" signifies that it can neither be amended nor canceled without the consent of the beneficiary. The credit comes into force at the time the issuing bank issues the credit, not when the beneficiary actually receives the LC. As such, once the issuing bank issues the credit, it is bound to pay against a complying presentation, and the LC can neither be canceled nor amended without the consent of the beneficiary.

Credit has the **undertaking** of the issuing bank, which is a promise to pay. Any undertaking must have an expiry date.

The undertaking is to **honour**, meaning to fulfil the commitment of payment against a complying presentation according to the payment terms stated in the LC.

If the LC is available:

- **By sight payment:** Pay at sight
- **By deferred payment:** Incur a deferred payment undertaking and pay at maturity
- **By acceptance:** Accept the bill of exchange drawn by the beneficiary and pay at maturity

The issuing bank must honour a complying presentation if the LC is available with it by sight payment, deferred payment, or acceptance.

The issuing bank must also honour a complying presentation when the LC is available with a nominated bank by sight payment, deferred payment, acceptance, or negotiation, if such nominated bank does not honour or negotiate.

The word "**negotiation**" applies only to the nominated bank. In simple terms, negotiation is an advance payment by the nominated bank to the beneficiary before a due date. It is a purchase of drafts and/or documents by the nominated bank under a complying presentation by advancing or agreeing to advance funds before the due date.

In simple terms, the issuing bank honours a complying presentation, and the nominated bank may honour or negotiate a complying presentation. An LC should not be made available with the issuing bank by negotiation.

When the nominated bank acts upon its nomination and honours or negotiates a complying presentation and forwards the documents to the issuing bank, the issuing bank must provide reimbursement to the nominated bank.

As such, the issuing bank has two independent undertakings: an undertaking to the beneficiary to honour and an undertaking to reimburse a nominated bank that has

honoured/negotiated a complying presentation and forwarded the documents to the issuing bank.

If the LC is available with a named nominated bank, it is known as restricted credit. If the LC is available with any bank, it is known as freely available credit.

An LC available with a nominated bank is also available with the issuing bank. This means the beneficiary can present documents either to the nominated bank or directly to the issuing bank.

Confirming Bank Undertaking

The issuing bank may authorize or request an advising bank or a nominated bank to add confirmation to the LC. Confirmation is an undertaking of the confirming bank in addition to the issuing bank to honour or negotiate a complying presentation. While the issuing bank is obligated to honour, the confirming bank is obligated to honour or negotiate without recourse when the LC is available with it by negotiation.

If the LC is available with any other nominated bank by sight payment, deferred payment, acceptance, or negotiation and such nominated bank does not honour or negotiate, the confirming bank must honour.

The confirming bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded documents to the issuing bank.

As such, the confirming bank also has two undertakings: an undertaking to the beneficiary to honour/negotiate a complying presentation and to provide reimbursement to the nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the confirming bank.

Concept of Payment with/without Recourse

Honour by the issuing bank is always without recourse. This means that once the issuing bank pays money upon examination of documents, it cannot claim a refund.

However, if the nominated bank received reimbursement before receipt and examination of the documents by the issuing bank and the documents are subsequently found to be discrepant, the issuing bank is entitled to claim a refund with interest from that nominated bank.

Honour or negotiation by the confirming bank is always without recourse. This means that once the confirming bank pays money upon examination of documents, it cannot claim a refund.

Honour/negotiation by the nominated bank is usually with recourse because the nominated bank does not provide an undertaking to the beneficiary. This means the nominated bank can demand a refund of the amount paid to the beneficiary in the event of non-reimbursement by the issuing bank/confirming bank to the nominated bank. However, the nominated bank must have a recourse agreement with the beneficiary to this effect. This can be a general agreement with the beneficiary for all payments made to the beneficiary under any LC in the capacity of a nominated bank. There is no need to have a recourse agreement with the beneficiary against each LC.

Concept of Prepay or Purchase

When the LC is available with a nominated bank by deferred payment or acceptance, the nominated bank usually pays the beneficiary at maturity upon receipt of the money from the issuing bank or confirming bank. The issuing bank/confirming bank must arrange funds to be available with the nominated bank on the maturity date for further credit to the beneficiary. When the LC is available by deferred payment or acceptance, the beneficiary is entitled to receive payment only on the maturity date.

However, if the beneficiary needs funds before the maturity date and is willing to pay the charges and interest, the nominated bank may choose to prepay the money and collect interest and other charges from the beneficiary. In such a case, the issuing bank/confirming bank is bound to provide reimbursement to the nominated bank on the maturity date.

As such, the issuing bank authorizes the nominated bank to prepay or purchase against a complying presentation when the LC is available by deferred payment or acceptance. This arrangement is technically similar to the negotiation of documents by the nominated bank.

Documents Lost in Transit

According to Article 35 of UCP 600, if documents are lost in transit between a nominated bank and an issuing bank or confirming bank, or between the confirming bank and the issuing bank, the issuing bank and confirming bank must honour or negotiate when the nominated bank determines that the presentation is complying.