

Pre-Issuance Considerations for Documentary Credits

When opening a Letter of Credit (LC), it is imperative to consider several factors to ensure compliance with internal policies, regulatory requirements, and international standards. Below are the key pre-issuance considerations classified under three main categories: Risk Management Policies of the Bank, Regulatory Requirements, and ICC Rules.

1. Risk Management Policies of the Bank

- Verify authorization by ensuring the LC application is signed by authorized signatories per bank records. For electronic forms, confirm necessary indemnities are in place.
- Check the available credit limits of the applicant and block the limit for the maximum amount under secured or unsecured limits. Credit limits are usually established by the credit/risk management team after considering various factors such as collateral (cash/assets/stocks), the customer's financial stability, credit history, and associated risks. If the bank can exercise control over the goods as per the required transport document, it may be treated under secured limits. Once the LC is issued, the issuing bank is bound to pay the beneficiary against a complying presentation. If the applicant is unable to arrange funds at the time of payment to the beneficiary, the bank can create a loan account for the applicant using this credit limit to pay the beneficiary.
- If transit insurance for the goods under shipment is the responsibility of the applicant as per the Incoterms, ensure the original insurance document, duly endorsed in favor of the bank, is surrendered to the bank. If the beneficiary is required to take transit insurance, ensure the duly endorsed insurance policy is included in the list of documents required under the LC.
- Obtain necessary internal approvals if needed for transactions involving perishable goods.
- Obtain necessary internal approvals if needed to handle special LCs such as red clause, revolving, or transferable LCs.

2. Regulatory Requirements

- The issuing bank must conduct KYC checks for beneficiaries through their correspondent banks, third-party databases, or services. This ensures compliance with regulatory requirements and mitigates the risks of fraud, money laundering, and terrorism financing in cross-border transactions.
- The goods description must be precise and detailed to determine if they qualify as dual-purpose goods (used for both civilian and military purposes, e.g., certain

chemicals used to make explosives/weapons, advanced software, telecommunication, or robotic equipment). In the case of dual-purpose goods, the bank must ensure that the necessary licenses or approvals are in place before opening the LC. Banks use various software tools to classify these goods using Harmonized System (HS) codes and Export Control Classification Numbers (ECCNs)

- Confirm that the goods are within the customer's line of business to ensure compliance with AML and KYC regulations. Unusual transactions outside the customer's normal business activities may require further scrutiny to ensure they are not facilitating money laundering, terrorism financing, or other illegal activities.
- Seek special approvals if transport documents are not included as part of the required documentation to meet AML compliance.
- Ensure compliance with sanction policies by verifying parties involved, goods origin, and routing.
- Adhere to anti-boycott regulations by avoiding participation in unsanctioned boycotts. For example, an American company cannot include clauses such as "vessel must not call at any Israeli port." Although Israel is boycotted by the Arab League, the U.S. does not impose any sanctions on Israel. Therefore, U.S. companies cannot participate in an unsanctioned boycott against Israel. However, restrictive provisions such as "goods must not be of North Korean origin" are allowed because the U.S. has imposed sanctions against North Korea.

3. ICC Rules

- Ensure compatibility of Incoterms with the required transport documents and routing.
- The issuing bank should ensure that the terms and conditions incorporated in the LC are clear and non-conflicting. Unless expressly instructed otherwise by the applicant, the issuing bank may redraft the applicant's instructions as necessary or desirable for use in the LC.
- Avoid including the copies of contract/proforma invoice as an integral part of the LC to prevent ambiguities and uphold the autonomy of the documentary credit as per article 4 of UCP 600.
- Provide pre-advice of the credit to the beneficiary if requested by the applicant. Pre-advice, which includes brief details of the LC, may be sent in case of a potential delay in issuing the full text of the documentary credit. This allows the beneficiary to arrange goods for shipment or secure pre-shipment finance from their bank. Once the issuing bank sends the pre-advice, it is irrevocably bound to open the documentary credit without delay and with terms and conditions that are consistent with the pre-advice