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Trade Service Moves with New Regime: LC Operation of Bangladesh in contrast with Global Trade

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Abstract
Letters of credit are playing significantly to facilitate the trade. It has the ability to reduce risk in cross border transactions. Most of the LC users are based in Asia Pacific, as is Bangladesh. As our economic progress continues, usage of other trade finance products is increasing. Traders, who used Letters of Credit for decades, are now getting familiar with the use of documentary collection and other methods with the slightly relaxed state regulation of ours. LC now covers only 49% of our export. For the last three years, documentary collection is growing as fast as 10% each year against both import and export. State regulations and ICC rules are heavily in place but most of our exporters do not appear to be aware that a bank to bank maturity confirmation does not obligate the bank to pay under a DA basis collection. GFET prefers transport documents to be consigned to or to the order of a bank but this problem with DA persists when bankers are to sign on the EXP ensuring timely repatriation. URC is not prohibited and not clearly endorsed but the transaction is on with a great deal. A revision of the GFET or a separate guideline for collection and open account may well be a timely step. Open account trading is growing particularly against export. Payment in advance, which is always highly regulated, is increasing against import as well. Our trade finance mix is reshaped with the increased use of these methods along with the increased advance in foreign currency under UPAS with a lower lending rate than local. Usually, we see URDG for guarantees but ISP98 is seen used in few instances. Mix-up of payment in advance and performance guarantee is observed while our import policy directs to obtain bank guarantees to pay in advance for import. Today, we see trade card (a privately developed payment method for open account), CMT basis export and consignment sale frequently. These changes are coming in a time when USA withdraws GSP, EU is more cautious with GSP, buyers are fine tuning compliance issues and export orders are too tight. Clearly, the dominance of LC appears no more. As always, trade tends to be unbound, knows no regulation but requires to be secured to reduce the country risk.

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I. Introduction

Trade transactions are changing with changes of demand, supply & exchange rate. Bangladesh, considering the usage of LC, has the highest annual growth in import traffic being the fastest-growing exporting countries over the world in the last couple of years [1]. After 80 years of LC operation under ICC rules, trade community remains wait for a fully settled set of rules because of its uncertainty inducted by spurious discrepancies. When the construction work of UCP600 began, a number of global surveys indicated that, because of discrepancies, approximately 70% of documents presented under letters of credit were being rejected on first presentation[2]. And International Standard Banking Practice (ISBP), known as the supplementary of UCP, came under revision in 2013 when the ICC survey unfolds that spurious discrepancies are still increasing.

Payment under an LC triggers when a complying presentation is made. This compliance remains highly challenging due to illegitimate discrepancies worldwide. All it takes is just one discrepancy resulting non-payment. For example an exporter presenting 5 copies of packing lists in place of 6 is surely a discrepancy but with question 'Is it worth refusing the payment? [3]' I shall try to find the answer throughout this paper.

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[1] *ICC Global Trade and Finance survey 2013 & 2014 - our import traffic based on SWIFT MT700 was +42% in '12 & +62% in '13 and our export traffic based on SWIFT MT700 was +118% in '12 & +111% in '13. '*

[2] *Introductory words of UCP600 by Gary Collyer 2007, First UCPDC came in 1933, The Complete UCP, Uniform Customs and Practice for Documentary Credits Texts, Rules and History 1920-2007 by Dan Taylor, ICC Publication No. 683E*

[3] *Alam, Mahbubul, Formar MD, IBBL agrees that "No, It is not worth refusing the payment. But if you examine the case, there may be other considerations to refuse payment for which applicant elects not to release the consignment."*

While it is unrealistic to ever expect these illegitimate discrepancies to be completely eliminated, the revised version of the ISBP for the examination of documents helps to address these disruptive practices. The ISBP is a checklist of best practices worldwide for checking documents under the UCP; ICC's universally used rules on letters of credit. ISBP has already played a significant role in reducing discrepancies for documentary credits and is regularly consulted by a wide range of banking, logistics, insurance, legal and corporate professionals and academics worldwide. One should expect a drastic reduction in discrepancies after ISBP745 in place.

But reality seems different. 46% still reports an increase in refusal rates on the first presentation, 93% reports an increase in spurious discrepancies and only 7% reports a decrease after ISBP revision[4]. To avoid discrepancies, those handling Letters of Credits must know the UCP & ISBP properly. Industry experts raise a legitimate question 'Is the better education level responsible for hampering or delaying payments under DCs?' This paper will discuss details on this issue.

Today, Traders are exploring other avenues against the problems with LC & it's charges (+78%)[5], evident by the huge interest in the BPO project, the massive increase in short term export credit, supplier's credit, insurance, and increased use of international factoring to finance export receivables.

This paper substantiates how our exporters are gradually shifting from Letters of credit to other methods over the years whether or not there is enough support from our country regulation for those.

1.2. Milieu of the Study

This study has been put pen to paper for those people who have a-know-how of the international trade mechanism. Awareness on the usage of ICC rules[6] will be of further assistance. Practitioners of these rules will be particularly benefitted to understand the current global trade directions. We believe that this will definitely assist policy makers to reshape our preferences alongside the global trend.

This paper is coming at a time when the current world is constantly changing with high standard of living and trust among business parties, risk and challenges faced in local or international transactions are even more challenging against banking laws, policies & regulation governing foreign exchange rules under political instability mostly faced in undeveloped countries.

On the other hand, major buyers have successfully implemented transactions under contracts which are again riskier. Buyer & seller, companies & firms look for safer payment methods for their international business transactions. Between these extremes of unsafe pre-payment and open account sales has led to the use of letters of credit. But now that the letters of credit are not coming very effective, study shows the factors trimming down the use of LC in international trade payment.

1.3 Methodology & Limitation

Concentration is particularly given on Bangladeshi export rather than Bangladeshi import. The methodology for this paper is primarily based on secondary data along with a questionnaire (22 questions) to collect information and opinion and on the published sources like ICC Global Trade & Finance Survey, Balance of payment and Export Import position by Bangladesh Bank.

The datum collected by the questionnaire from the trade finance banking affiliates of the participating banking professionals from PCBs, FCBs & NCBs in Dhaka & Chittagong areas mostly trade finance desk in-charges, Head of FI units in International divisions & some officials participating from Bangladesh Bank and few legal counsels. Some of the country's highest exporters participating in this query have encouraged us as well.

[4,5] *ICC Global Trade and Finance Survey 2014*

[6] *ISBP745, UCP600, URC522, URR725, URDG, Incoterms2010 & ISP98*

The questionnaire was set for distributing countrywide trade finance experts but due to shortage of time the sample is limited to Dhaka & Chittagong. This paper is also completed on the basis of relentless study on trade, which is a reliable resource for stakeholders and policymakers.

The most members of respondents work in banks with trade finance departments of less than 50 employees while 10% are employed in large global trade finance banks including local & global regulators with more than 100 staff.

Starting with our journey, we have followed the basic formula of market research formulated by ICC/ESOMAR Code in 1976. This Code sets out the basic principles, which must guide the actions of those who carry out or use marketing research.

Phase 1:
Secondary sources like published datum from FERA, BBS, BB, EPB, Import & Export Policy Order lends a hand for writing this study.

Phase 2:
A questionnaire comprising of 22 questions distributed to 150 experts including high professionals[7].

Among them 113 respondents replied from April to September 2017. The questionnaire responses were analyzed to produce the statistical data presented in this report.

Phase 3:
Face-to-face or telephonic interviews with corporate bodies from April to August 2017. Interviews were based on a set of guideline questions and ranged from 30 minutes for phone interviews to 50 minutes for interviews in person. Interviews were conducted locally. A significant number of interviewees completed the questionnaire prior to, or during, the interview. The qualitative information gathered during the interviews was used to supplement the quantitative questionnaire data, contextualize the findings and cast further light on particular issues raised by the study.

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[7] *High professionals include*
Mr. Thierry Senechal, Former Senior Technical Manager of ICC Head Office in Paris, UK
Mr. Gary Collyer, Former Senior Technical Adviser of ICC Banking Commission & Chair, Drafting Group, UCP600, ISBP745, URBPO & many more
Mr. David Morris, Former, Relationship Director, International Trade Finance Qualifications, ifs University College, London, UK
Mr. Jack Chan, Technical Adviser, Wells Fargo Bank, Hong Kong
Mr. Moorad Choudhry, Director, ifs University College, UK, former Head of Business Treasury, Global Banking and Markets at Royal Bank of Scotland plc
Dr. Atiur Rahman, Former Governor, Bangladesh Bank
Former DG, BIBM, Mirpur, Dhaka
The Chairman, BAB
Former MD, IBBL, Int'l Division
Dr. Shah Md. Ahsan Habib, Professor [selection grade], BIBM, Mirpur, Dhaka
General Secretary, ICC Bangladesh

II. Trade Service Moves with New Era- literature review

2.1. Usage of trade finance products in Bangladesh

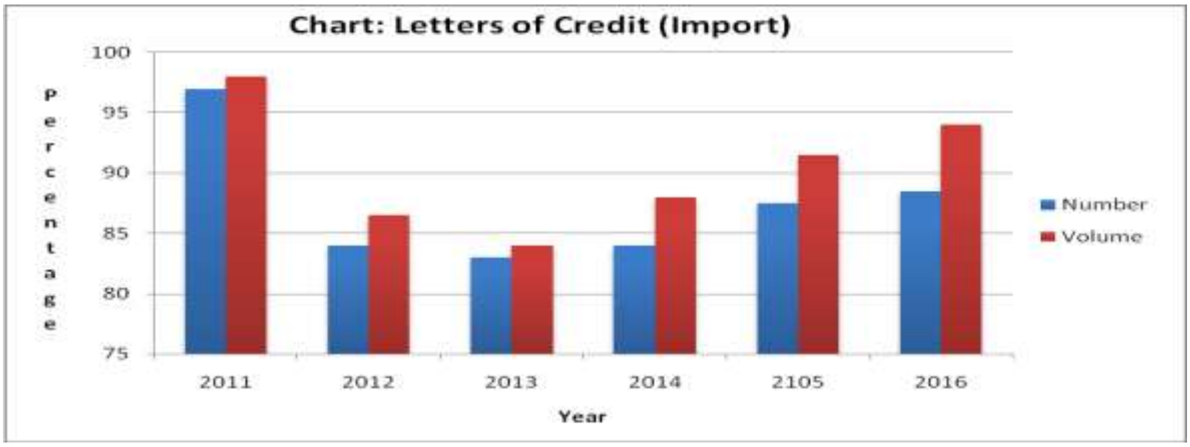
(Based on BIBM Banking Review Series & Trade services operations of banks in BD)

2.1.1. Letters of Credit (import)

Import LC operation is decreasing both by number & volume %.

Table-1

Documentary Credit (Import)	2011	2012	2013	2014	2105	2016
Number %	97	84	83	84	87.5	88.5
Volume %	98	86.5	84	88	91.5	94



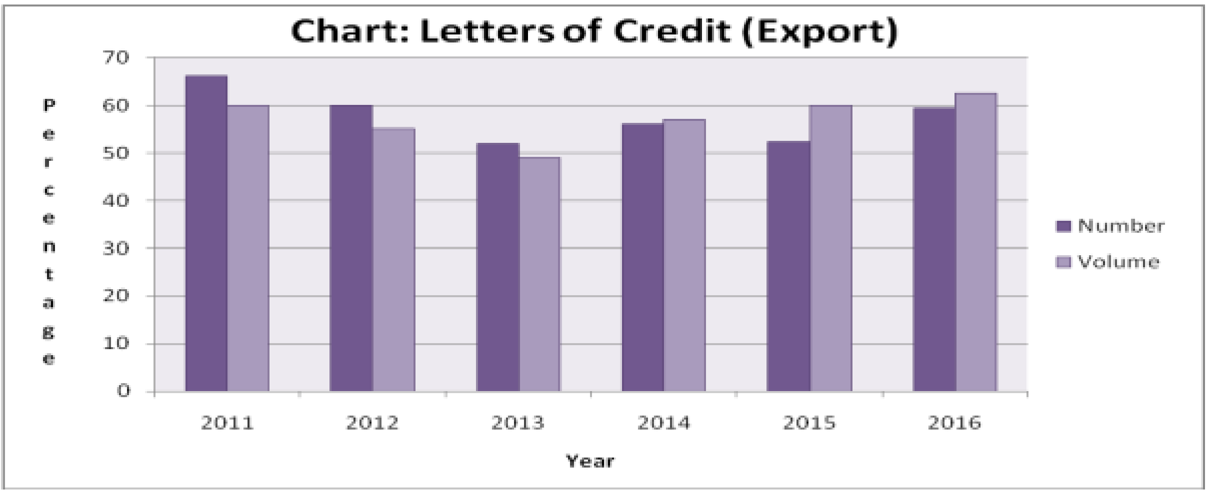
Source: BIBM Banking review series & Trade services operations of banks in BD 2017

2.1.2. Letters of Credit (export)

Export LC operation is increasing by volume but decreasing by number compare to 2011.

Table-2

Documentary Credit (Export)	2011	2012	2013	2014	2015	2016
Number %	66	60	52	56	52.4	59.5
Volume %	60	55	49	57	60	62.5



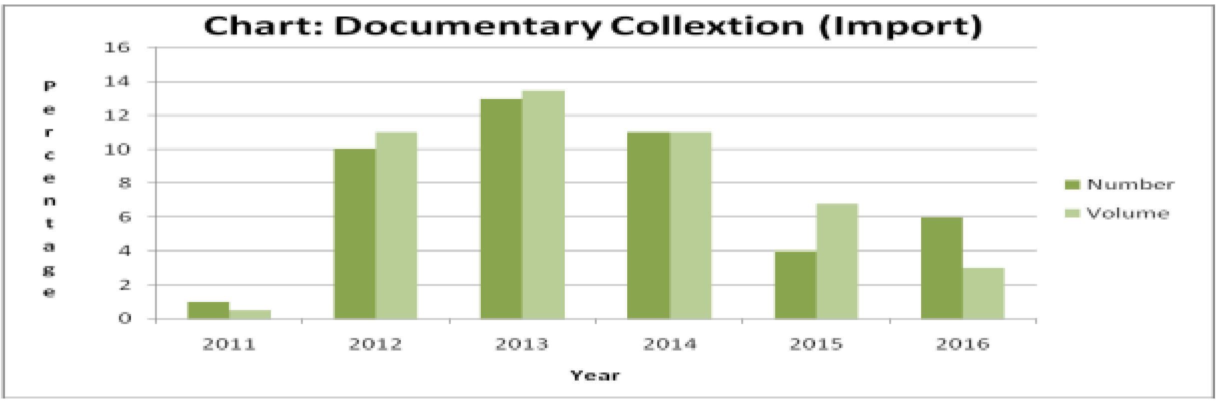
Source: Source: BIBM Banking review series & Trade services operations of banks in BD 2017

2.1.3. Documentary Collection (Import)

Documentary collection against import is increasing both by number & volume % .

Table-3

Documentary Collection (Import)	2011	2012	2013	2014	2015	2016
Number %	1	10	13	11	4	6
Volume %	0.5	11	13.5	11	6.8	3



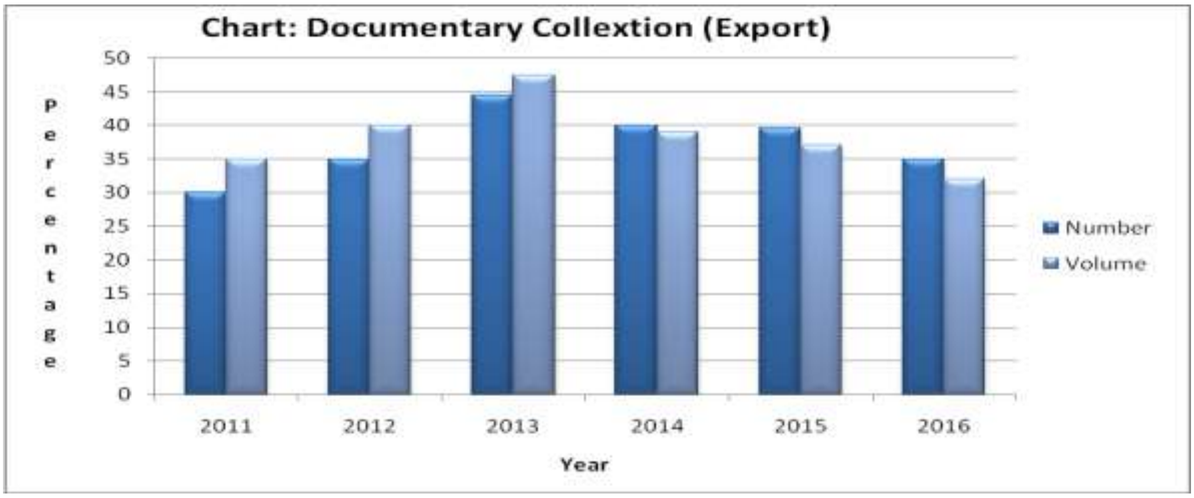
Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.1.4. Documentary collection (Export)

Documentary collection against export is increasing by number but decreasing by volume.

Table-4

Documentary Collection (Export)	2011	2012	2013	2014	2015	2016
Number %	30	35	44.5	40	39.6	35
Volume %	35	40	47.5	39	37	32



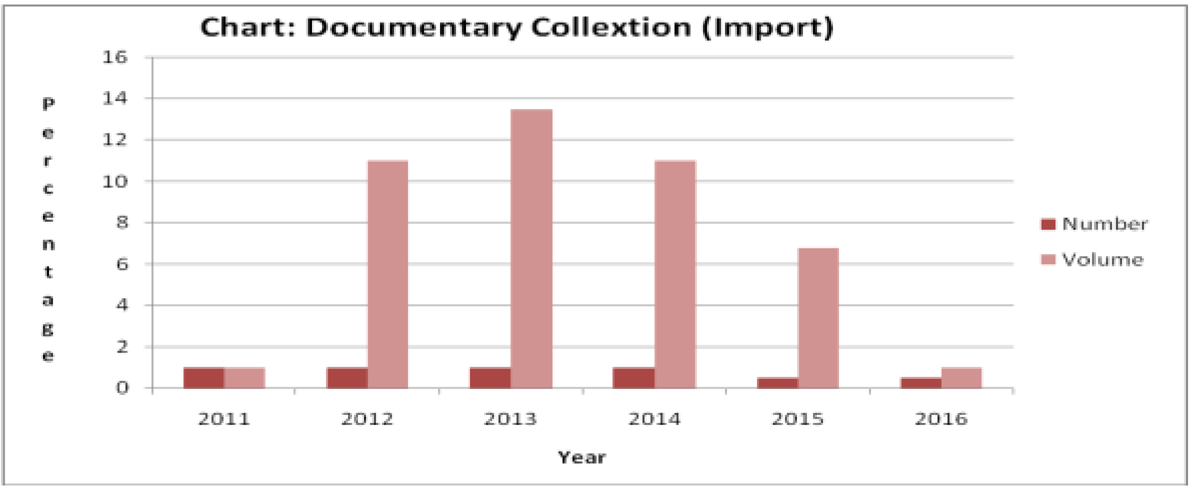
Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.1.5. Open account (Import)

Open account transactions against import shows a decline in volume in 2016.

Table-5

Open account (Import)	2011	2012	2013	2014	2015	2016
Number %	1	1	1	1	0.5	0.5
Volume %	1	11	13.5	11	6.8	1



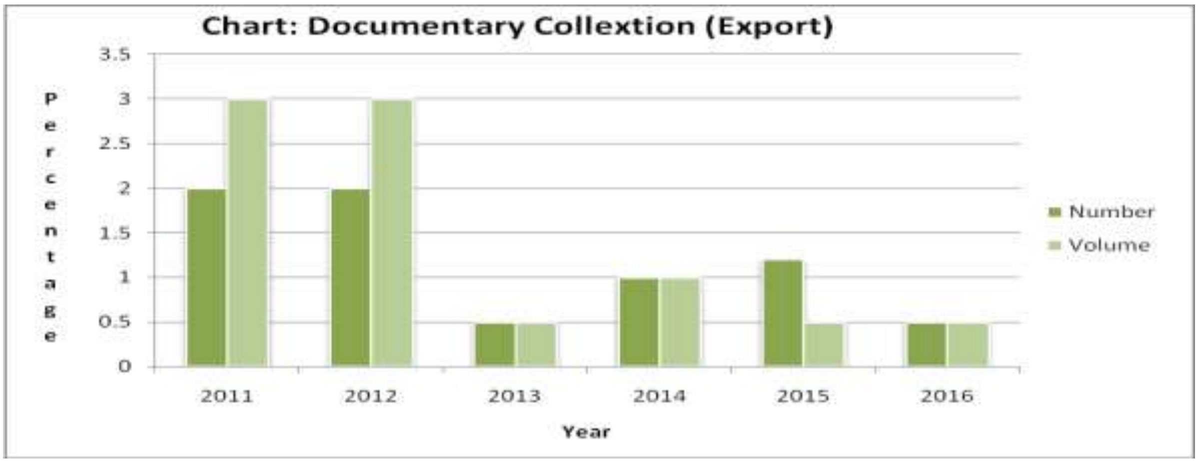
Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.1.6. Open account (Export)

Open account transactions against export shows a decline in both volume and number in 2016 compare to 2011.

Table-6

Open account (Export)	2011	2012	2013	2014	2015	2016
Number %	2	2	0.5	1	1.2	0.5
Volume %	3	3	0.5	1	0.5	0.5



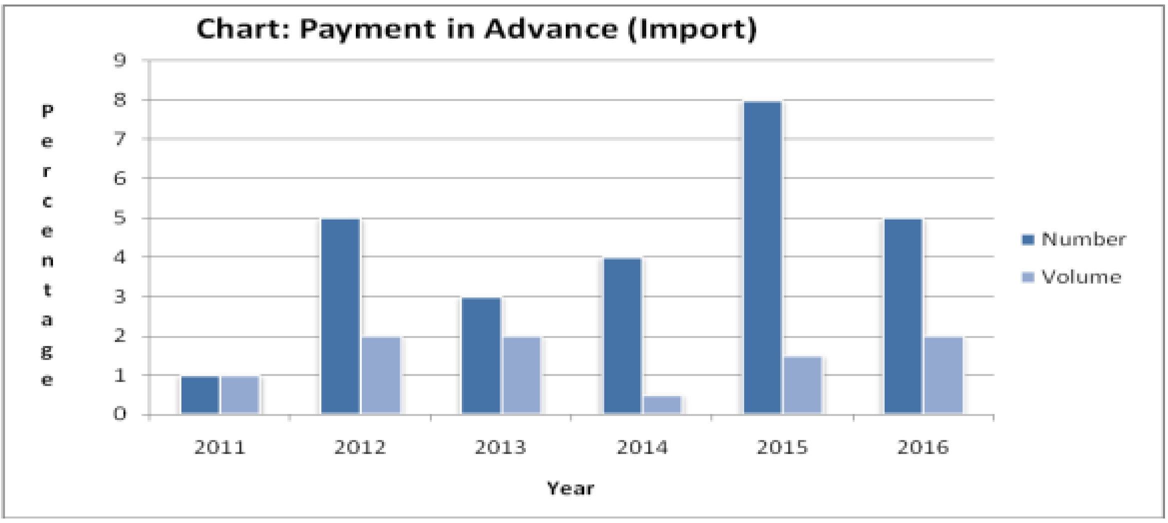
Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.1.7. Payment in advance (Import)

In 2012, payment in advance against import was much higher in number but over the period of 2011 till 2013 the value of transactions is increasing.

Table-7

Payment in advance (Import)	2011	2012	2013	2014	2015	2016
Number %	1	5	3	4	8	5
Volume %	1	2	2	0.5	1.5	2



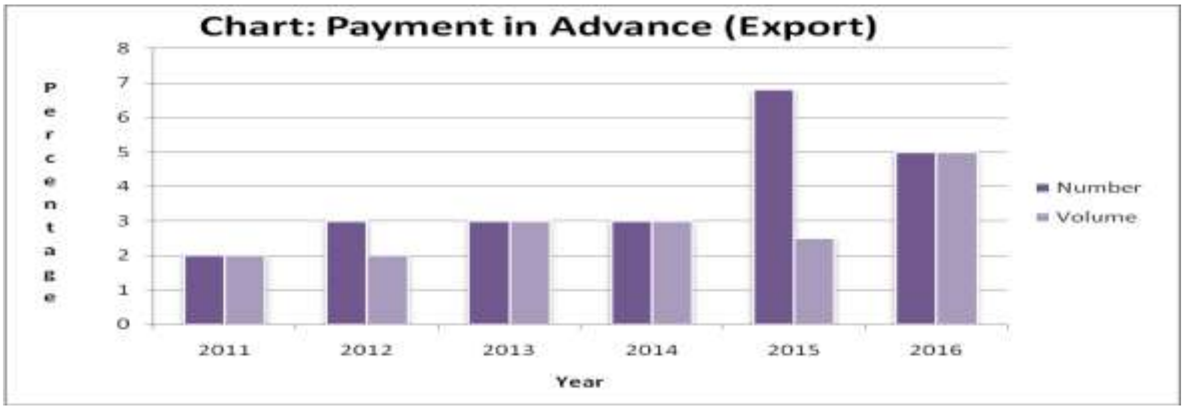
Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.1.8. Payment in advance (Export)

In 2016, the amount of payment in advance against export is up when the number of transactions are also increasing over the period of 20011 till 2016.

Table-8

Payment in advance (Export)	2011	2012	2013	2014	2015	2016
Number %	2	3	3	3	6.8	5
Volume %	2	2	3	3	2.5	5

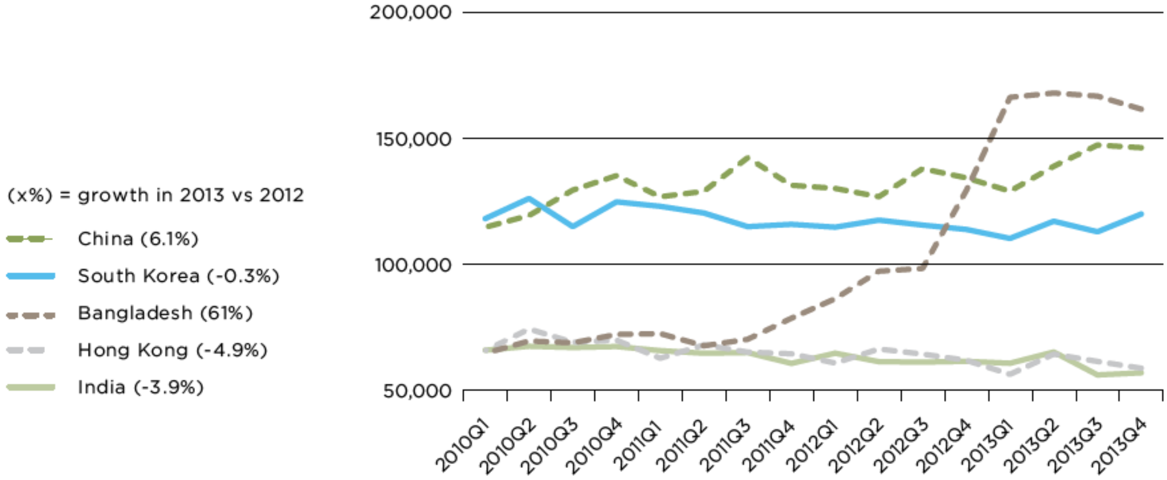


Source: BIBM Banking review series 2014 & Trade services operations of banks in BD 2017

2.2. Bangladesh Trade Vs Global Trade in ICC Global Trade and Finance

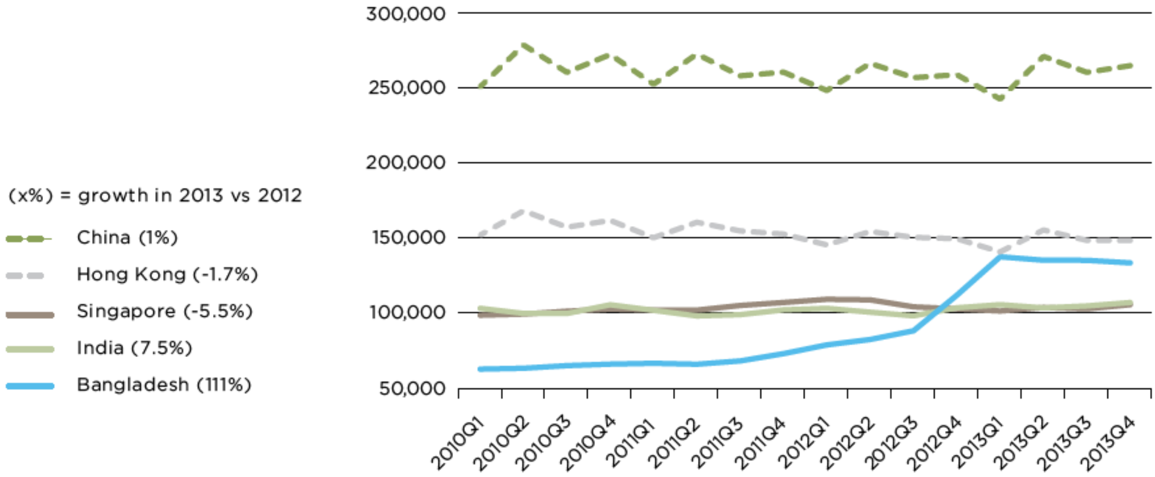
Bangladesh represents the highest importing country using letters of credit and represents the highest volume growth (based on MT700 operation) from 2012 to 2013 in both imports and exports.

Chart: Top 5 countries in volume of MT700 sent



Source: ICC Global Survey 2014

Chart: Top 5 countries in volume of MT700 received

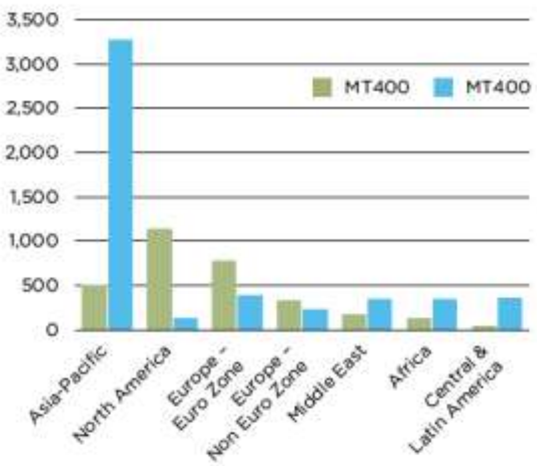


Source: ICC Global Survey 2014

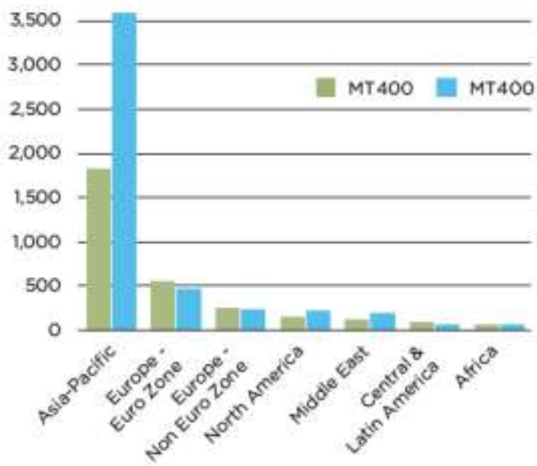
In 2013, Bangladesh was among the most active markets against ADB's Trade Finance Program (TFP) filling market gaps for trade finance by providing guarantees and loans through over 200 banks to 18 countries.
Asia-Pacific continues to register far greater volume for sent MT700 (import) with 68% of the world traffic in 2013. It is followed by Europe-Euro Zone (8%) and Middle East (7%). Looking at the figures, Asia-Pacific is the region with the highest annual increase of 6.97% in 2013 for import with LC compared to 2012. The region that shows the highest annual decrease in North America with 11.1% in 2013 for import with LC compared to 2012.
Looking at the annual figures, Asia-Pacific is the region with the highest annual increase of 5.52% in 2013 for export with L/C compared to 2012. The region that shows the highest annual decrease is North America with 5.24% in 2013 for export with L/C compared to 2012.

It is quite notable that North America's operation under letters of credit is reducing for both exports (-5.24%) and import (-11.1%). On the other hand, the Asia-Pacific region registers the highest volume of letters of credit use – covering 68% of imports and 75% of exports.

MT400, MT700 sent by region, 2013

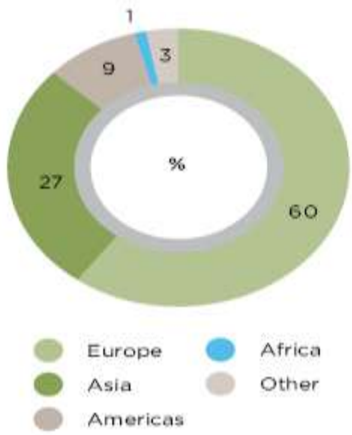


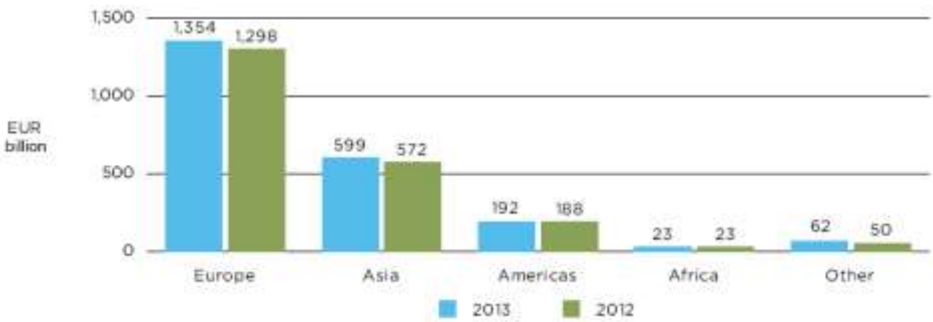
MT400, MT700 received by region, 2013



Source: ICC Global Survey 2014

2.2.1. Global Factoring industry 2013 by region

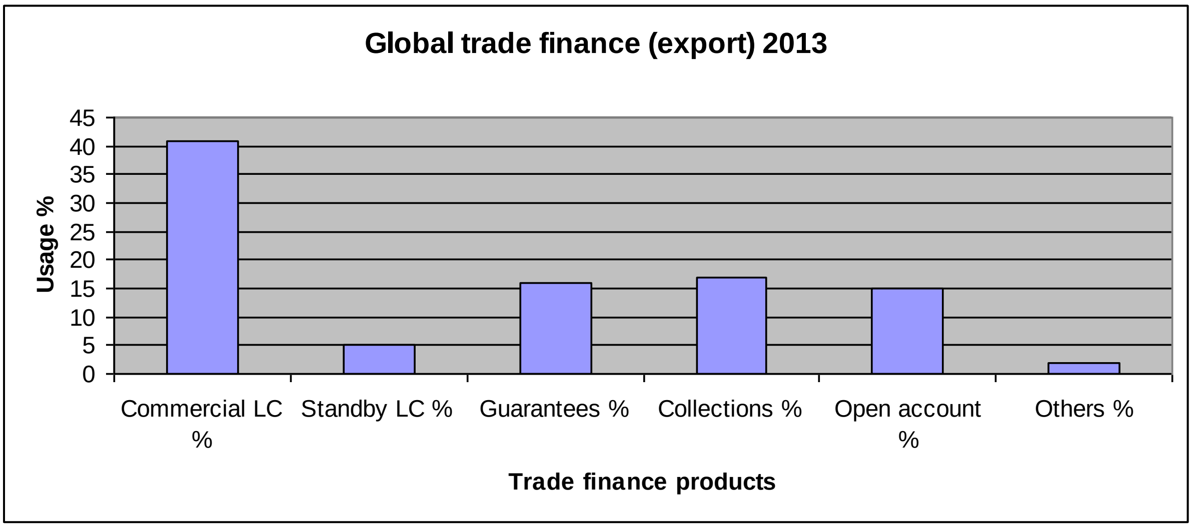




Source: ICC Global Survey 2014

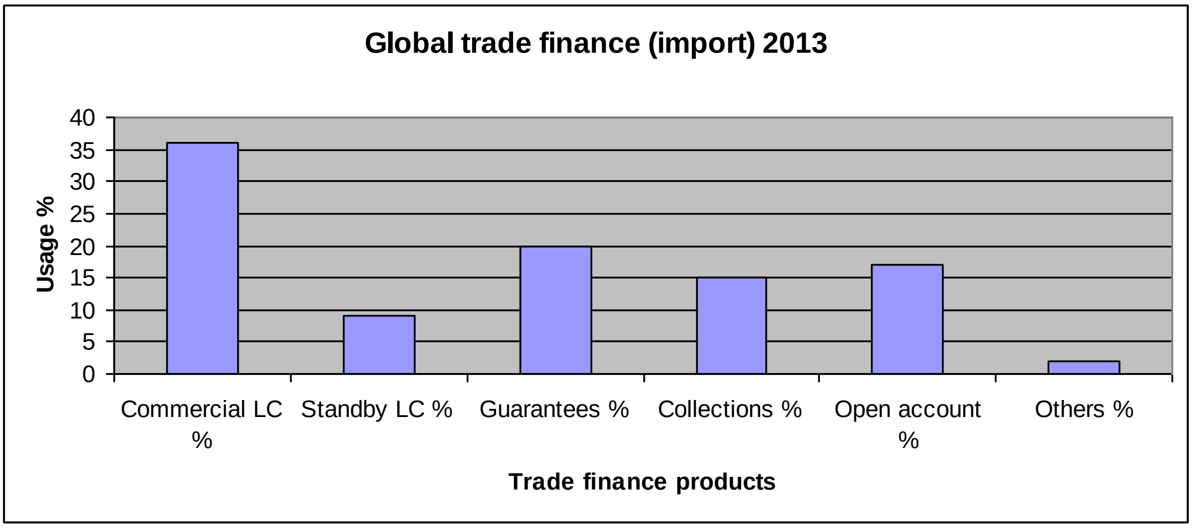
Apart from highest operation of MT700 in the Asia-Pacific, international Factoring is also taking space that is running at a pace of 15% over the last 5 years, making Asia-Pacific the second largest Factoring operator while EU remains at the top for both domestic or international**.**

2.2.2. Global trade finance mix & current trend
Export Trade Finance Global Mix 2013-2017 (%)



Source: ICC Trade finance global survey 2014-2017

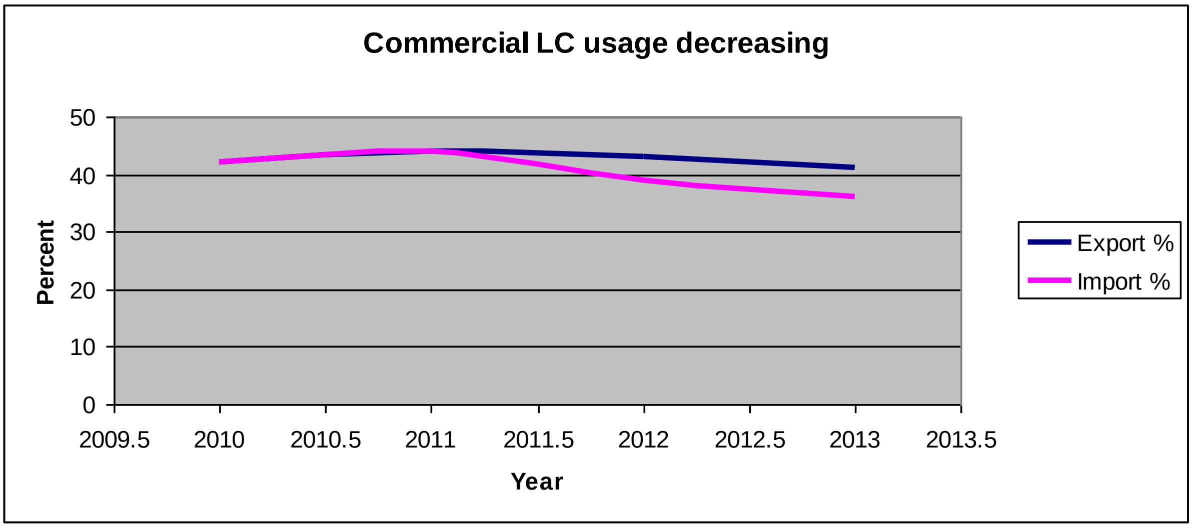
Import Trade Finance Global Mix 2013-2017 (%)



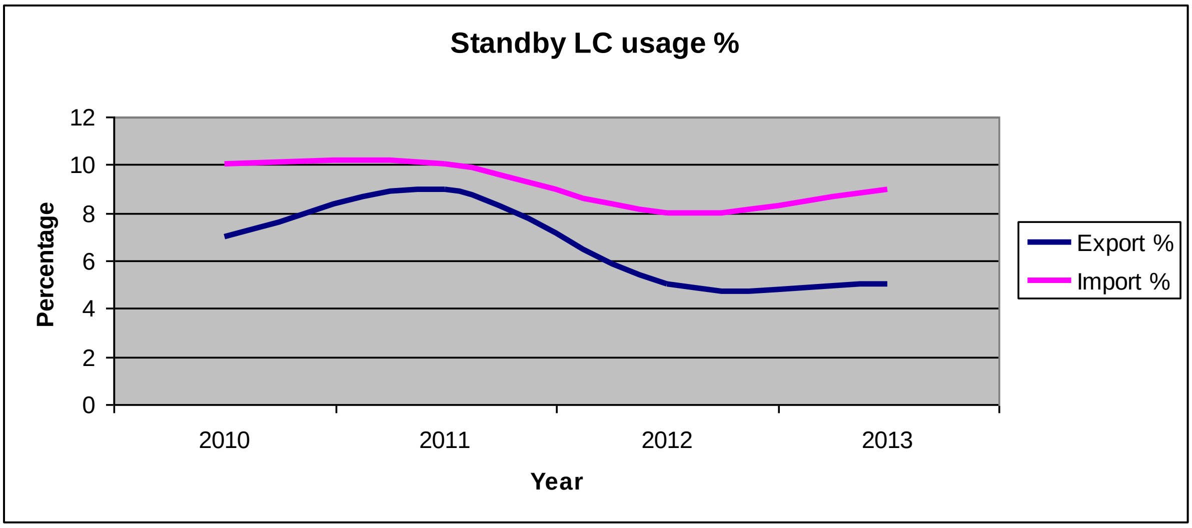
Source: ICC Trade finance global survey 2014-2017

	<u>% increase / decrease in trade methods</u>
Commercial Letters of Credit	Down by 3% in 2016
Guarantees	Up by 4% in 2016
Standby Letters of Credit	Up by 1% in 2016
Collections	No Change
Open Account Trading	17% occupied almost one sixth of total trade

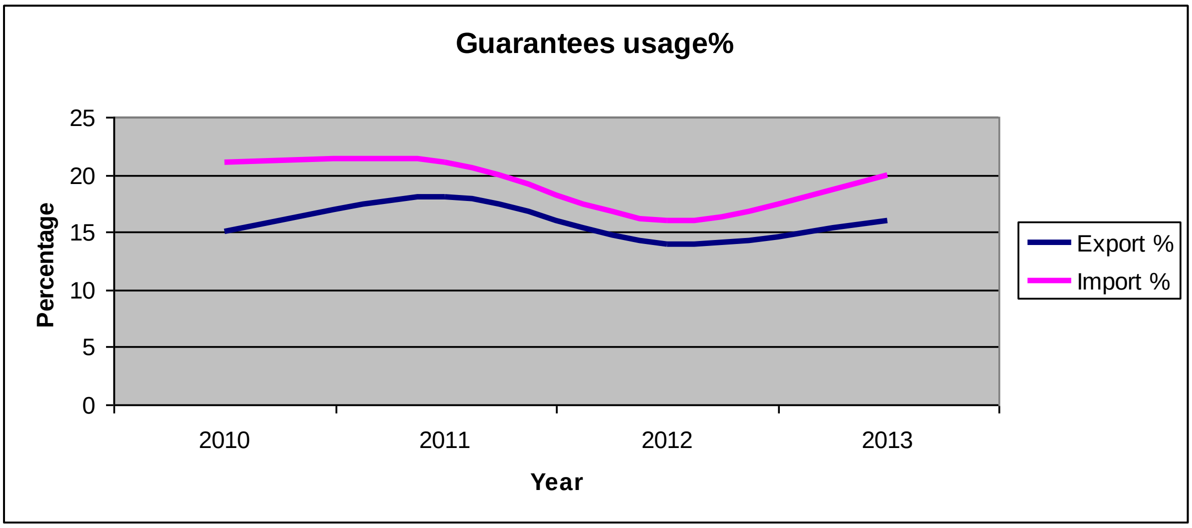
Usage of commercial letters of credit has gone down 3% at a row for consecutive 3 years. It occupied 44% in 2011 declining to 39% in 2012 and further down to 36% in 2013. The self explanatory chart below gives us an idea of current global trend.



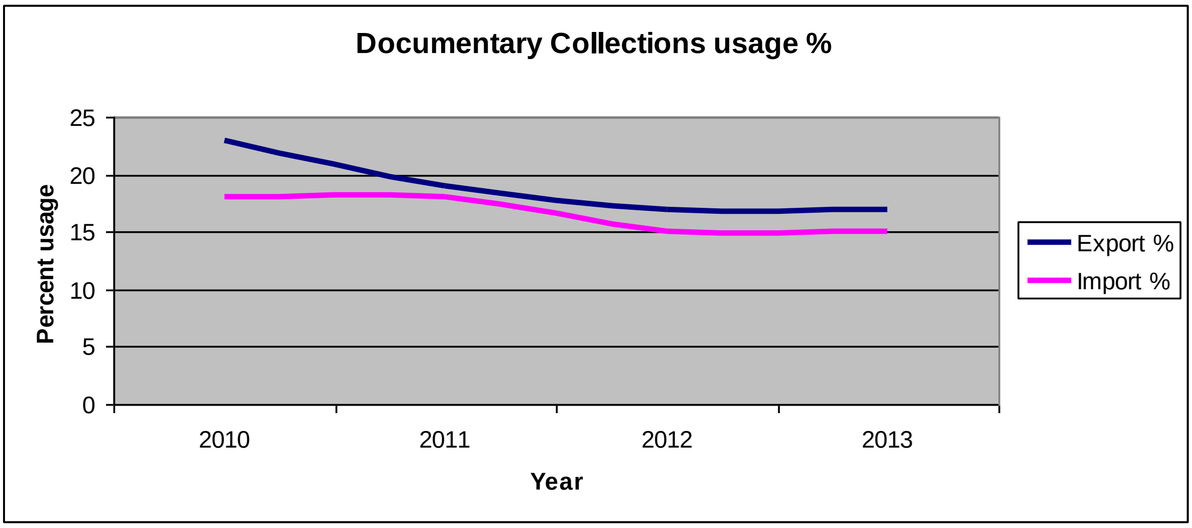
Source: ICC Global trade finance survey 2014



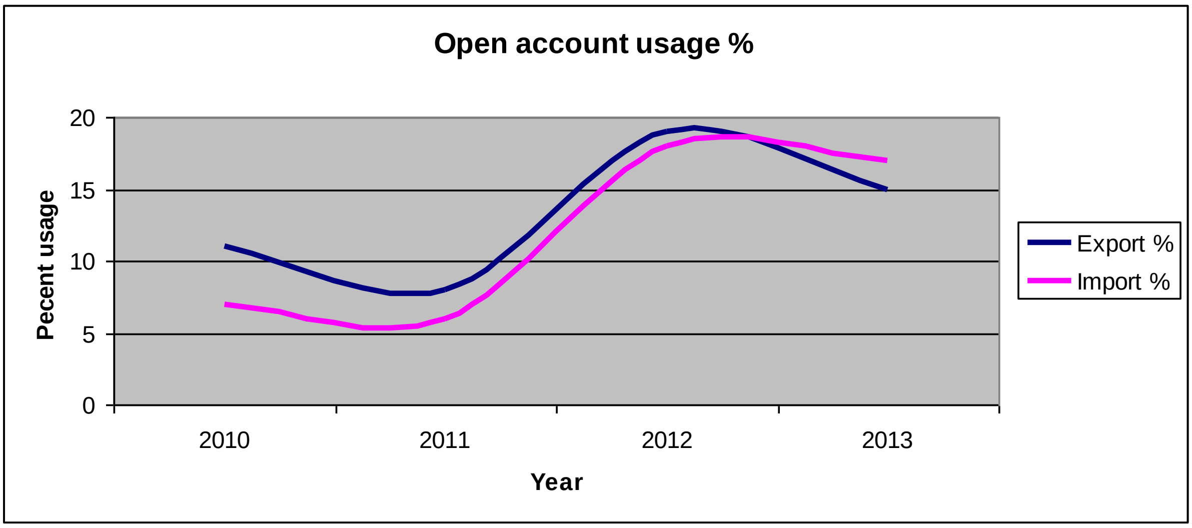
Source: ICC Global trade finance survey 2014



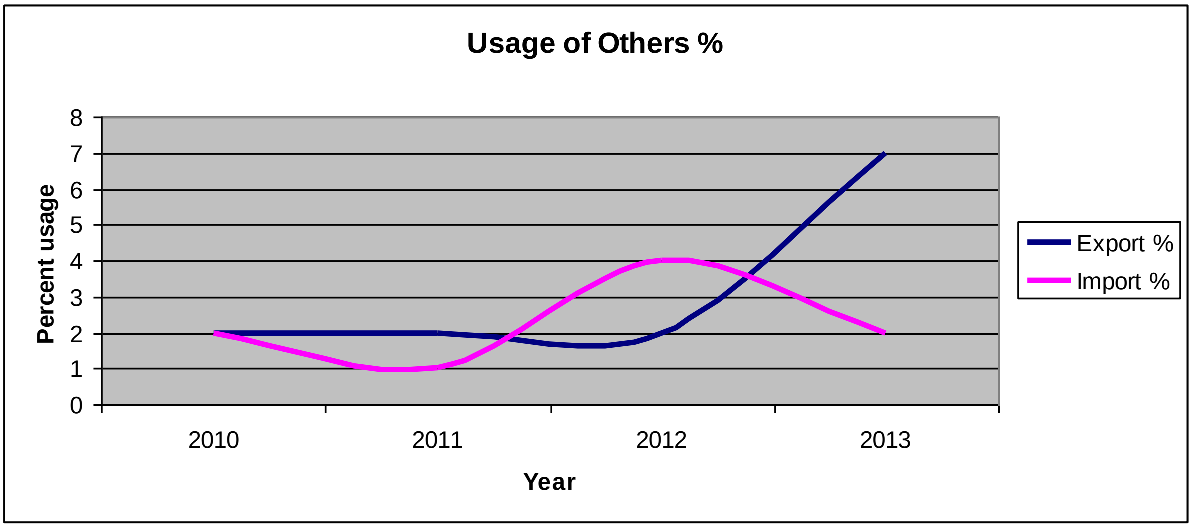
Source: ICC Global trade finance survey 2014



Source: ICC Global trade finance survey 2014



Source: ICC Global trade finance survey 2014

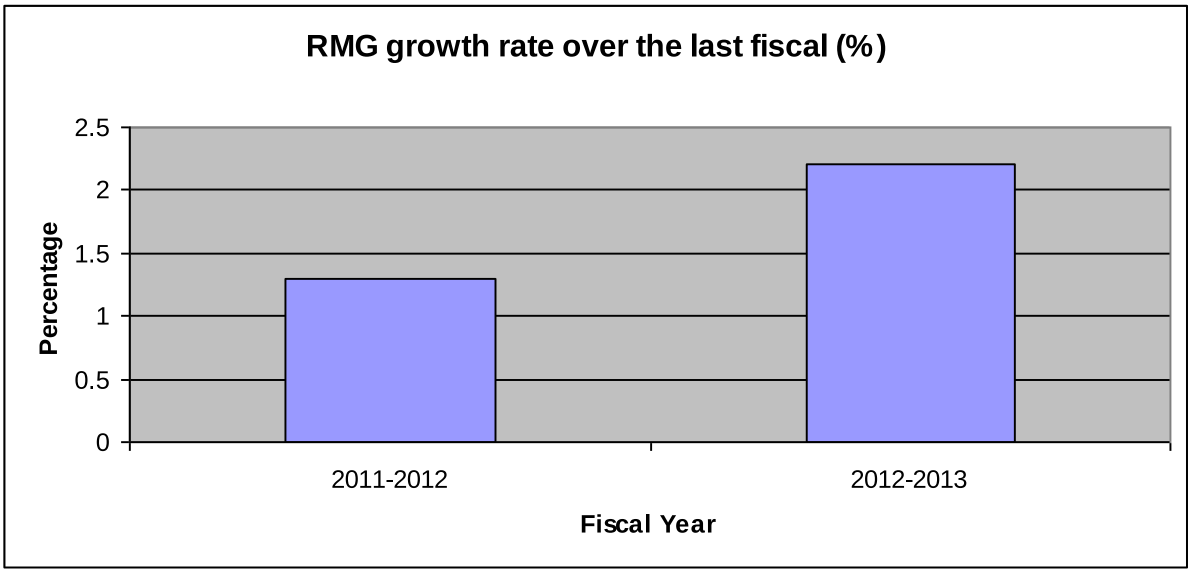


Source: ICC Global trade finance survey 2014

2.3. Export Trade scenario in Bangladesh (Based on BB data)

2.3.1. RMG sector continues to dominate our export

RMG sector continues to hold the lion share of BD export recording a 2.20% rise from 78.40% in 2011-2012 to 80.60% in 2012-2013, while it was a modest 1.3% growth from 2010-2011 to 2011-2012. This increase is recorded in a period when political turbulence and Rana Plaza led incidents hit the news box badly.

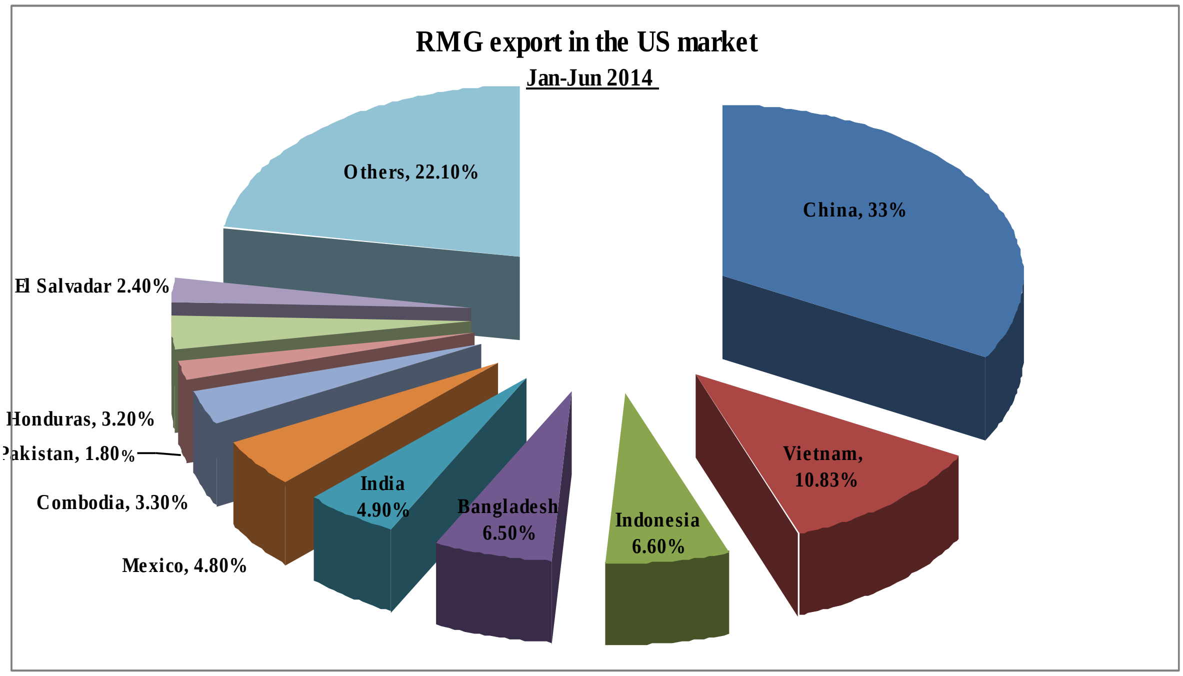


[Source: Bangladesh Bank]

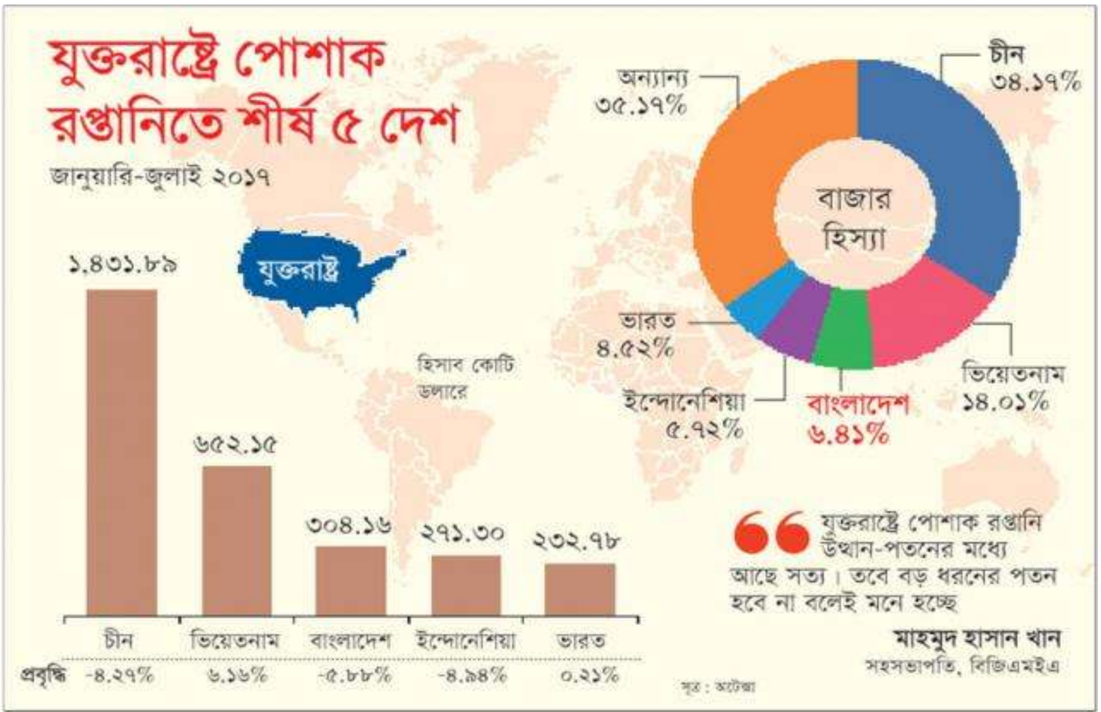
2.3.2. US remain at the top but steadily down

The United States remain at the top of the buyers list but the withdrawal of GSP has slowed down our export into the US recording 18.7% in 2012-2013 from 19.60% in 2011-2012 and 21.50% in 2010-2011.

First being China, Bangladesh is down at number four (from three in 2013) among the RMG exports into the US market – as per January to June 2014 report of OTEXA (Office of Textile & Apparels, US Department of Commerce). Backed by some notable FDIs in recent days, Vietnam retains position at number two growing as fast as 15% occupying 11% of US apparel market. Vietnam remains the biggest threat for us while India, self-sufficient with 100% ingredients (raw cotton, yarn, fabrics), is knocking us from number five. Indian exporters are boost up with govt.'s incentive programs coupled with stronger Dollar against Rupees. India and Vietnam appear to be the beneficiaries of our turbulent political and labor market situation. Industry experts are concerned to retain this US market for RMG exporters. On the other hand trade practitioners are more conscious that the US market is enormously open account based (almost 90% to 95%) – as per anonymous questionnaire response from HSBC & SCB, Bangladesh who covers at least 15% of our export.



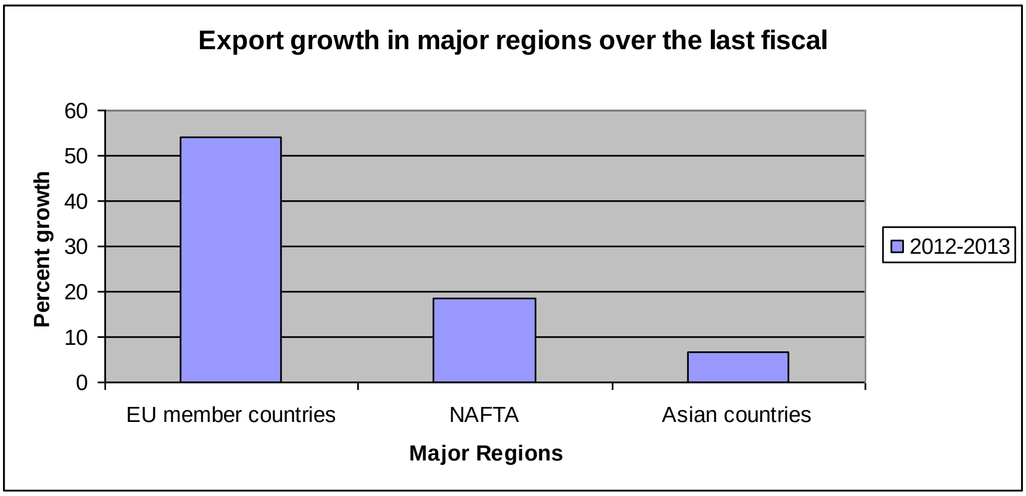
[Source: OTEXA report 29 August 2014]



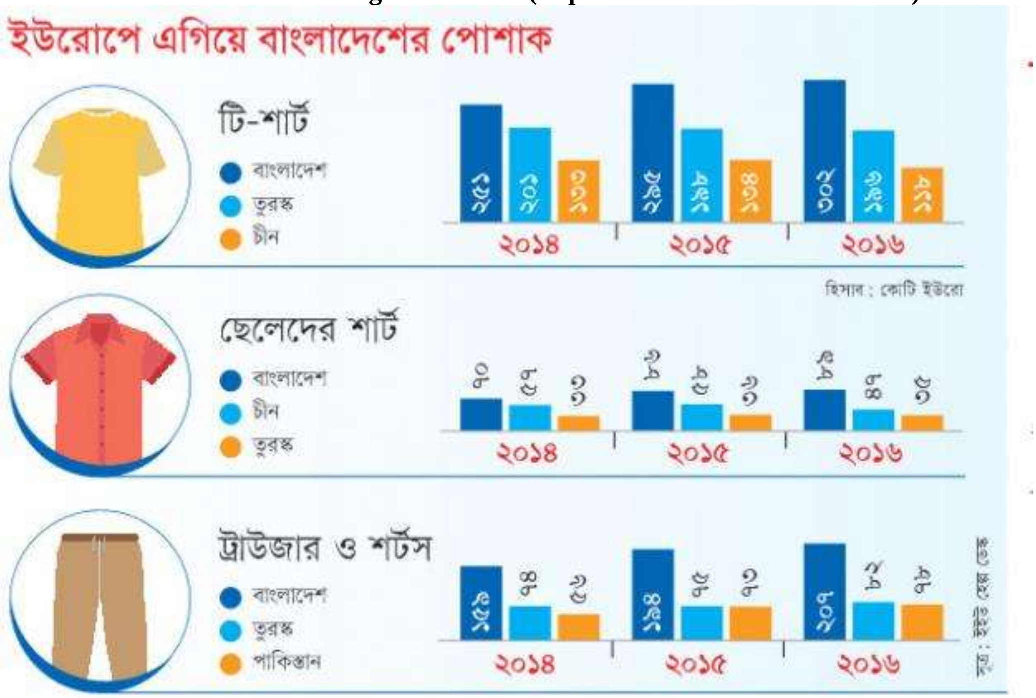
Source: The daily Prothom alo, 05 October 2017

2.4.3. EU topped at the list by region

Considering regions, EU member countries topped the list by 53.90% during 2012-2013 down from 55.60% in 2011-2012. NAFTA comes in the second (23.40%) with USA having the major share (18.7%). Asian countries show a growth of 1.1% rising from 5.40% in 2011-2012 to 6.50% in 2012-2013 [3]. Other European countries, ACU members, SAARC, OPEC, ASEAN and OIC countries either shown a growth (maximum by 1%) or was stable in 2012-2013 compared to 2011-2012. These regions are mostly under market expansion incentive program of the Government. On the other hand EU's continued GSP facility is helping the export growth.



Source: Bangladesh Bank (Export from EPZ not considered)



Source: The daily Prothom Alo, 04 November 2017

A country wise share of export shown in the below table

	2012-2013		2011-2012		2010-2011
USA	**18.7%**		**19.6%**		**21.5%**
Germany	**15.8%**		**16.4%**	`	**15.6%**
UK	**10.2%**		**10.3%**		**9.1%**
France	**6.2%**		**6.6%**		**7.5%**

Spain	**4.6%**		**4.6%**		**3.6%**
Canada	**4.3%**		**3.9%**		**4.0%**
Italy	**4.0%**		**4.4%**		**4.0%**
India	**2.7%**		**2.7%**		**2.7%**
Netherlands	**2.7%**		**3.1%**		**5.6%**
Belgium	**2.6%**		**2.9%**		**2.7%**
Turkey	**2.6%**		**2.6%**		**3.4%**
Other countries	**25.6%**		**22.9%**		**20.3%**

Source: Bangladesh Bank (Export from EPZ not considered)

Now, question to be asked, do we prefer the same trade payment method that is preferred by our biggest buyers? We will try to focus on this on the later part of the paper considering interviews and questionnaire analysis.

2.5. How the LC operation trimming down
(Based on ICC Global Trade and finance survey 2011, 2012, 2013 & 2014)
2.5.1. Claims under guarantees and court injunctions
Globally, comparing 2013 to 2012, the number of claims or demands under guarantees gone down along with the decrease of court injunctions barring payments against guarantees. This may indicate that trade finance is running smoother or people are less interested in courts for settlements.

2.5.2. Trends in documents refusal
Globally, the challenging situation concerning documentary compliance continues and the average refusal rate was 29% and 26% against Export LC and Import LC respectively[8]. To minimize their own risk, banks are in strict measures. There was some positive feedback in terms of the overall trend with discrepant documents in that approximately 75% of ICC respondents reported a drop in the overall rate of refusal of documents under commercial letters of credit[9]. Such operational problems, coupled with the relatively high cost and paper and process intensive nature of L/C transactions are propelling traders to seek out new payment alternatives. This is clearly evident in the market with the significant interest in the BPO project as reported in this year's ICC survey. Another positive trend emerged in that 69% of ICC respondents noted a decline in reported court injunctions barring payment under trade finance instruments, indicating a return to relatively normal trading conditions[10]. The increase in short-term export credit insurance and increases in the use of international factoring to finance export receivables also support the contention that traders are actively seeking out alternatives to the traditional commercial letters of credit.

2.5.3. Status of Open account, short-term credit insurance, factoring and technology driven supply chain finance globally
Open account business is rising. The SWIFT analysis in 2014 survey is comprehensive to identify Renminbi (RMB) becoming the second most used currency in trade finance overtaking the Euro. The acceleration in open account business is having the support of international factoring, which shows a five-year compound annual growth rate (CAGR) of 24.8% which is much above the domestic factoring of 13.1% CAGR[11]. Cross-border factoring volume increased at nearly double the pace compared to domestic factoring growth. Furthermore, it is worth noting that the volume of exports covered by members of the Berne Union (International Union of Credit and Investment Insurers) increased by 4%, to reach a total amount of US$1.8 trillion[12].

Out of the total business volume of Berne Union members, more than US$1.6 trillion represented short-term export credit insurance, a very significant proportion of which is open account trade. Medium and long-term export credit insurance amounted to a figure of just over US$160 billion during 2013. Supply chain finance may soon be reaching a tipping point within the bank-mediated trade finance industry, with 66% of ICC respondents underlining the increasing importance of supply chain finance within their banks. This should bode well for the ICC/SWIFT Bank Payment Obligation project where interest has been growing and take-up increasing marginally. There is a clear consensus on the need for a technology driven supply chain solution[13].

[8, 9 & 10] *ICC Global Trade and Finance Survey 2014*

[11, 12 & 13] *ICC Global Trade and Finance Survey 2014*

III. How the LC operation crunching down (Bangladesh Export Trade)

3.1. Major buyers prefer contracts over LC

A large number of interviewees, mostly exporters & bankers, reports that 90% of our major buyers prefer contracts over LC[14]. Trade practitioners (Bankers) also observed that about 80% of the BTB LCs are opened against contracts and only 20% of them are replaced onward by export LC[15]. This means that almost 60% of our export is made under contract, which is revealed through the interviewees as well. Respondents agreed that major US buyers like Walmart, K-mart, Sears, PVH, JC Penny, Oskosh & Carter prefer contracts[16]. This preference is in contrast to the decrease of USA's import through LC recording an 11.1% decline in 2013 compared to 2012.

3.2. EU concentrating more on open account trading

EU is our biggest export region. As per trade finance mix, EU is the biggest player of both domestic & international Factoring largely against open account trading. Some of the European buyers who work both under LC and contract like Carrefour (France), United Colors of Benetton (Italy), ITX Trading (Switzerland) allow discounting options usually at a LIBOR+X rate with a flavor of Factoring although not under open account trading.

3.3. B/Ls released after TT received in Bangladesh – a popular open account but safer method evolved

Some EU buyers like H&M, C&A work under contracts that look like open account trading using Trade Card payment method somewhat similar to BPO method without involving banks directly in payment. This type of contract, usually incorporating 15 to 30 days payment from shipment, is very popular to all Bangladeshi exporters. B/Ls are issued requiring further endorsement from Bangladeshi bank and Bangladeshi banks endorse only after payment being received under the contract. This is an interesting contract administration when it does not fall under LC, not under Collection, not under payment in advance and not even clearly under open account trading but with reduced uncertainty of payment. Our exporters are more interested to work with known buyers under such contracts especially bearing the risk when exporting without B/L.

3.4. China – evolved as a bigger player of open account trading

Although the Asia-pacific is predominated by LC, China has taken up their RMB as the second largest currency for trade superseding EURO in 2013. China has a large volume in Open Account Trading and other contracts. BD export in this region shows far less figures than that in the US and the EU. But because of China, one of the biggest users of BPO, one should expect that this region is not so far from applying BPO as well. Another point is made clear in ICC Survey that although Asia-pacific is the biggest user of LC, it represents the lowest average value of LC as most of the transactions are intra-regional and used even for lower value transactions[17].

3.5. Control on payment under collection through B/L endorsement

Among the contracts, some fall under Documentary Collection (DP & DA) which are mostly safe based on DP basis including Bill of Lading requiring further endorsement from the collecting bank. DA basis collections produce maturity date of payment without having any bank commitment and this has proved to be riskier than DP especially when buyer is no more interested doing business with the exporter with some of the maturities are ahead. But the refusal rate is much less than the documentary credits. This is one of the reasons that makes collection flourishing.

14, 15 & 16

Interview & Questionnaire response particularly from Md. Mahbub ul Alam, *Former MD , IBBL who said "I agree with the statement that 90 % of our major Buyers prefer to receive goods under Contract instead of L/C. Out of them around 15 to 20% replace the Contract by L/C in other cases we are to export against the Contract. After establishing a long time good and trustworthy relation the exporters accept the contract over L/C"*

[17] *ICC Global Trade and Finance Survey 2014*

3.6. Trust gap between buyer & seller reducing

Trust-Gap between buyer and seller is a key issue on Trade where Letters of Credit are primarily effective until the desired level of trust is in place[18]. This period may vary among dealers to switch to cost-effective methods. Since the global trade collapse in 2008-09, cost-effective and technology driven solutions are much appreciated for its recovery. Factoring and BPO are the kinds of product that supports the idea and being booming while letters of credits are seen misused to divert funds through 'synthetic'[19] credits. Buyers are bridging trust gap with sellers through their foreign counterparts abroad so that cost effective trade finance method may well be in place without hazard.

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[18] ***Interview & Questionnaire response particularly from*** *Md. Mahbub ul Alam, Former MD, IBBL who said "Our Exporters always try to obtain L/C instead of contract but it is the applicant who is very much reluctant to provide L/C due to high bank charges at their end. Since our Export Industry is very much buyer dominated so the Exporter has not enough choice but to accept Export against contract. In addition to this some, world class buyers, whose default rate is very low, are not providing L/C for long time like Wall mart, H & M etc. In addition, most of the exporters of Bangladesh do not find any difference between export against L/C and contract as they are unable to present complied documents against export L/C. An exporter can only obligate an opening bank by presenting complied documents. As our exporter most of the cases are unable to present complied documents so they do not differ between these two and understand the benefit of Export against L/C and risk associated with contract."*

[19] *A synthetic letter of credit differs from an ordinary standby letter of credit in that it is pre-funded by the lead or agent bank on the closing date as opposed to when the funds are drawn under the terms of the letter of credit as needed. The synthetic letter of credit funds are typically held in a credit linked deposit account until required. In the event the borrower does not pay back the funds provided by the letter of credit, the agent bank passes on any costs incurred to the other loan participants. In general, the borrower pays a rate on those funds that is based on the lender's borrowing costs under the terms of the credit agreement. Synthetic letters of credit are typically structured as assignments with the other lenders acquiring direct rights against the borrower. source: http://www.fcscfg.com/terminology/S-terms/syntheticLetter.htm*

3.7. Compliant factories better benefited through contracts

It came out that Bangladeshi compliant factories, having steady business, are dealing more with contracts while the non-compliant factories with less capacity usually work more under LC[20]. This is because buying houses prefer LCs against contracts, in case of transferable orders, so that banks find it readily transferable. Since the compliance issues are coming more, time has come to prefer contracts to support expanding our export business.

3.8. Buyers shifting from LC to Contracts

A number of our buyers, mostly American, shifted their operation from LC to open account trading among which some through Trade Card system which is again a technology driven payment mechanism. For example, PVH, Kids Headquarter, Okrosh & Carter - a few of the USA buyers, initially starting with LC, now shifted to open account trading saving at least 3% of LC operation costs as per interviewees.

Based on the comments of respondents of interview and questionnaire, a list of our major buyers along with their preferred trade payment method(s) is prepared which shows 21 out of 25 prefer contract being 11 of them already shifted fully to contract. 13 out of 25 operate under LC simultaneously with contract. Only 3 out of 25 operate solely through LC who await incorporating contract in near future. This gives us a clear message that LC may remain a good method but not any more for major/established buyers.

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[20] ***Interview & Questionnaire response***

The list of major buyers of our RMG with their preferred trade payment method is listed below[21]:

	Name of Buyer	Preferred Method
1.	H&M, Sweden	Contract
2.	C&A, Dutch	Contract
3.	Inditex (Zara, Vasca, Leftis & 3 other brand), Spain	Contract
4.	Walmart. USA (Azda, UK)	Contract
5.	K-mart, USA	Contract
6.	Target, USA (Tesco, UK)	Contract + LC

7.	Gap, USA	Contract + LC
8.	Marks & Spencer, UK	LC
9.	Primark, UK/Ireland	Contract + LC
10.	Matalon, UK	Contract + LC
11.	Carrefour, France	Contract + LC
12.	Auchan, France	LC
13.	MGB Metro	LC
14.	Aldi, Germany	Through Agent
15.	Leddle, Germany	Contract + LC
16.	United Colors of Benetton, Italy	Contract + LC
17.	We, Netherlands	Contract
18.	Charles Vogle, Switzerland	Contract + LC
19.	Sears, USA	Contract
20.	JC Penny,USA	Contract
21.	Oskosh & Carter, USA	Contract
22.	Li & Fung	Contract + LC
23.	Norwest	Contract + LC
24.	PVH, USA	Contract
25.	Kids Headquarter, USA	Contract

[Source: Several face to face interviews with trade practitioners / firms / buying house]

[21] ***Interview & Questionnaire response***

3.9. CMT basis export getting popular

Another method commonly known as CMT basis export is getting popular day by day. This is particularly safe and preferable for an RMG exporter as the fabrics (covering almost 80%) are sent Free of Charge by buyer (through nominated supplier) having a flavor of 80% payment in advance and exporter gets Cutting, Making & Trims charges through contract or LC after export. CMT basis export, involving BTB only for Trims/Accessories, is less risky for buyers minimizing risk of fabric quality. Fabric supply and production into the factory is also closely monitored through their buying agent abroad. CMT basis export is included in our EXP form by the inclusion of a field 'CMT Value'[22].

3.10. Consignment Sale is included in EXP form & 120 days bar of repatriation no more in EXP

Consignment sale is also included under recent change in EXP form from July 1, 2014 which means our central bank is trying to follow the global stream in trade. EXP form no longer has the bar of maximum 120 days for repatriation in any kind of method and 'overdue' is redefined as non repatriation beyond 'the stipulated time'. This is quite rationale and acceptable which in turn, we believe, will facilitate documentary collection and open account trading. Some respondents argue that GFET still determines 'overdue' based on 120 days[23].

[22 & 23] ***Interview & Questionnaire response particularly from*** *Md. Mahbub ul Alam, Former MD, IBBL who said* ***"****CMT value, Fob value, Insurance amount were in earlier Exp form. No new field regarding the same has been added. On the reverse side of the Exp form the undertaking of the AD has been amended. Stipulated time is mentioned in Chapter -8, para-13 it clearly mentioned that "foreign exchange proceeds of exports must be received by exporters is four months (Vide Bangladesh Bank Notification No. FE 1/77-BB dated 16th April, 1977). If the receipt of the full proceeds of any shipment is delayed beyond this period without a special or general authorization from the Bangladesh Bank, the exporter will be liable to action under the FER Act. Through F.E. Circular No. 14 Date: March 16, 2014 appendix 5/19 of GFET shall stand amended but Para 13 of volume one has not been amended. So, stipulated period for repatriation is still 120 days."*

IV. Why LC regime trimming down in BD export

4.1 Major issues from Buyer side

4.1.1. Global economic reconstruction

After the global trade collapse in 2008-09, buyers started to rethink costs, expenses and optimal process keeping the business intact with reasonable margin but under the same or in some cases reduced pricing[24]. Creative & technology driven products like Trade Card Payment System and Factoring has taken up huge space in between 2009 to 2013. Virtually the open account trading is rediscovered to overcome global trade collapse avoiding relatively unnecessary costs of other trade payment methods.

4.1.2. Cost of operation

Interview respondents pointed out that buyers are to consider almost 3% operating costs under Letters of credit when placing order to Bangladesh. It is topped to almost 5% if it ends up exceeding one quarter and very often it does go beyond 90 days as we observe late shipment very often. Add confirmation is another notable event under LC involving another 0.5% to 1% charges[25].

4.1.3. Discrepancy

Most of the export bills we forward under LC are non-compliant, attracting discrepancy charges, very often with major discrepancies like late shipment & LC expired. In almost every cases (9 out of 10) discrepancy waiver is a must that obviously delays settlement that eventually leads to delaying the trade cycle[32]. This also involves a separate management by buyers to monitor which documents under waiver and which are not and which documents to be released for immediate warehousing and which are not.

4.1.4. Credit line bar

Buyers expansion plan is often barred by LC limit even when there is a current demand of products but buyer is unable to increase the LC limit instantly due to lack of collateral or security or inability to instantly reduce contingency in hand.

4.1.5. Delayed decision making

Any decision on Letters of credit involves at least the issuing bank, the advising bank and the beneficiary leaving un-surety of its effectiveness until beneficiary consents in writing or through presentation of documents[26]. This hampers the smooth decision making process on cases like change of shipment date, mode of shipment, port of shipment, port of delivery, unit price, style etc [27].

[24 & 25] ***Interview & Questionnaire response particularly from** Md. Mahbub ul Alam, Former MD, IBBL who said **"**Yes I do agree with the statement. But alternative payment method will not help to overcome such penalty or late shipment or presentation issues. Every Importer when negotiate with the supplier desires to receive the goods in due time so that he may sell the goods in the market in due time. Most of the importers of garments have to provide guarantee to their retailers that they would supply the goods in due time. When Bangladeshi exporters fail to supply the goods in due time than the importer of the goods apply the penalty clauses on the exporters. So payment method will not overcome the issue. The problem may be overcome by*

- *Proper production schedule of the exporter*
- *Source of raw materials*
- *Strong infrastructure*
- *Stable political condition*
- *We should pay attention to solving domestic problem in garment sector.*

Contract has also a time limit to expire. After that can any payment method protect the exporter from penalty, late shipment charge or amendment charge which are on Beneficiary's cost.

[26] ***Interview & Questionnaire***

[27] *UCP600*

4.2 Major issues from Seller side

4.2.1. Spurious discrepancies & refusal of documents

93% respondents reported an increase in spurious discrepancies and 33.96% reported an increase in refusal rates[28]. Such operational problems coupled with high cost and time required in document handling contributes towards the traders seeking alternative solutions.

4.2.2. Transferred credit, no or very less control on payment

It is often imposing an uncertainty of payment when an exporter presents documents against transferred credit having a payment clause like 'payment will be made after receipt of fund from the issuing bank'. This is seen in transferred credits issued from middlemen's bank usually from India, Hong Kong, Sri Lanka & Malaysia. In such cases exporters are to rely mostly on buyer's local agent as the buyer is not generally in direct contact with seller. This problem is doubled in case of USANCE bills and of course if the documents are discrepant requiring waiver from LC applicant. Cost of operation under such credit is more expensive as usual. So, seller faces a similar situation as on open account but with the cost and complexity of LC operation.

4.2.3. Cost of operation & unreasonable deductions

As discussed earlier letters of credit involves almost 3% operating costs per quarter from the buyer side. This cost of the opener is often transferred to the seller by LC clause coupled with deduction clauses through which buyers try to avoid the cost of LC operation. Sometimes deductions out of LC clause like debit notes are brought forward as a pre-condition to waive discrepancies. Alarmingly penalty clauses sometimes exceed 30% of the invoice value[29].

4.2.4. Sight bill takes 15 to 30 days to settle payment

There is a timeframe set by UCP600 to check documents by 5 banking days but no timeframe to release payment. Let us assume a case where clean documents are presented on 'Day 0', checked & sent to issuing bank on 'Day 3', Issuing bank receives the documents on 'Day 7', issuing bank checks the documents within 'Day 12', finds that documents are clean on 'Day 12', releases payment on 'Day 15'. Notable that there is no time frame set in UCP600 for payment unless it is a bill more than 0 days' sight. Since almost all of our documents are discrepant, it requires additional time involving requesting applicant for waiver, applicant's waiver and issuing bank's discretionary decision to waive. These are not under any time frame under UCP. And issuing bank has the right not to accept applicant's waiver but applicant is the one who has requested to open the LC in the first place. As a result, sight bills are seen taking 15 to 30 days to pay and exporters finding it difficult to maintain liquidity which in turn increases the cost of operation under LC. Due to this delay, factors like exchange rate fluctuation, inflation etc may well impact the business.

4.2.5. Management of change between order placed and final delivery

Any decision on Letters of credit involves at least the issuing bank, the advising bank and finally the beneficiary leaving un-surety of its effectiveness until beneficiary consents in writing or through presentation of documents. This hampers the smooth decision making process on cases like change of shipment date, mode of shipment, port of shipment, port of delivery, unit price, style etc which are always vital and changeable. Therefore, amendments, adding cost again, are uncertain of its definite effectiveness.

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[28] ***Interview & Questionnaire response particularly from*** *Md. Mahbub ul Alam, former MD, IBBL who said "Still Letter of Credit is important and safer method of payment for our Exporter at the same time documentary credit compliance remains challenging for our exporters in pursuit of their high profit expectation they only hear to the intermediaries and do not follow the letter of credit and present documents and bear the risk of loss. Lack of training of the exporter, documentation procedure makes the documentary credit compliance more challenging. In a work paper of IMF in January 2011 it shows that in 2008 total global merchandise trade were USD15.90 Trillion. Among the trade Cash in advance was 19%-22% (USD3- USD 3.5 trillion), Bank trade finance 35%-40%(USD 5.5 to 6.4 trillion) and open account 38%-45%(USD 6.0- USD 7.2 trillion). In open account transaction ECA guaranteed transaction is USD 1.25-.50 trillion others are Arm's length non guaranteed and intra firm transaction. From the above picture we find that open account still has a high risk of loss so the same has been done via guaranteed transaction, Arm's length non guaranteed and intra firm transaction. Cash in advance is a totally depends on the Importers choice as they are aware of our exporters pre-shipment finance to procure raw materials. So I think we should patronize bank trade finance to mitigate the risk of loss by the exporters in international trade by presenting complied documents. As per our experience, inspire of tendency to raise the discrepancy on first presentation, obtaining payment rate is higher than Open Account transactions. If we see the "Non-realization of Export Proceeds "statement of different Banks, most of the non repatriated issue is related with Open Account Transactions".*

[29] ***Interview & Questionnaire***

4.2.6. Adverse and sanction clauses

Since the global trade collapse, sanctions have also increased in numbers doubling the difficulties of LC operation in terms of compliance and country risk which in turn increases the insurance cost may be in the form of add confirmation or else. There are instances of Banks being fined by millions of Dollar for non compliance.

4.2.7. Education level of trader Vs banker

Question remains whether the level of education of trader along with bankers are in optimum level[30]. There are issues where experts are also in debate. At the request of the applicant, bankers are yet helping applicant to delay the payment using spurious discrepancies as a tool. Good news is that the court injunctions against payment are reduced in 2013 compared to 2012 as per ICC survey.

V. ICC Policy Vs Reality against LC operation (considering BD Export)

5.1. Accessibility

ICC publications are not freely accessible although ICC desires uniformity among all practitioners of ICC rules.

5.2. Training & certification cost

Trade practitioners agree that training on ICC rules are not enough especially lacking frequency in Bangladesh. Online training is available but against fees. For example, CDCS & CITF qualifications each attracts a minimum fee of 500 pounds.

5.3. Dispute resolution fee

The arbitration fee of dispute resolution is particularly high due to which low or medium amount dealers do avoid arbitration.

5.4. Confusing elements

There are rules on which experts are found split. For example, tolerance, second advising, transferable LC etc are the few events evident by lots of ICC opinions over the time.

5.5. Business of ICC

Making rules on & on and amending again and again is a common feature of ICC. Critics say that ICC is making business through its publications more than to assist the business community.

5.6. ISBP745 adaptation

Much awaited ISBP745 is effective from July 2013 but ICC survey respondents did talk about an unexpected increase in spurious discrepancies after July 2013. Since inception, ISBP related training is organized by ICC Bangladesh but only twice so far and that too on payment[31].

5.7. Evolvement of 'Synthetic' letters of credit

During the crisis in 2008-09 and onwards letters of credit are used as an easy tool for money laundering producing 'Synthetic' letters of credit. The purpose of this kind of LC is to direct fund from one place to another without movement of goods or services. ISBP745 has rightly listed the phrase 'document acceptable as presented' as 'not to be used' in LCs. But this kind of fake transactions are still possible because one can always modify the rules for its own benefit.

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[30] ***Interview & Questionnaire response particularly from*** *Md. Mahbub ul Alam, Former MD, IBBL who said"No, cost of the Training and Publications are not the main reason for lake of knowledge. The reasons are:Lack of initiative by the Bank, Less scope for on the job training and Uniform practices by the bankers in pursuant of different rules and Training facility and methods of training not up to the mark".*

[31] ***Interview & Questionnaire responds***

Gary Collyer

"Feedback indicates that it has been successful in reducing discrepancies. However, no publication can account for the actions of a bank that willfully ignores established practices in its examination of documents."

ICC Banking Commission, Paris

"Yes, it is proving to be very effective based on feedback received."

LIBF [formally known as Ifs University College, UK]

"You would need to ask those engaged on a day to day basis but to my certain knowledge ISBP was written over a long consultative period with input from representatives of many countries. It certainly was not imposed top down from the ICC. It certainly should significantly assist in clarification."

VI. Regulators against contracts!

FERA, Import & Export Policy Order and circulars are put in a way that LC is the prime instrument for trade in Bangladesh. Higher education level of practitioners and regulators in LC operation sometimes proved to be dangerous for us like Hallmark, Bismilla group scandals etc. LC still may be a better instrument for import but not any more for buyer dominated export. It is now a time for regulators to think about the application of Contracts in export so that these transactions, which are already in place whether or not there is a supportive regulation, are made safer and more controlled. But bypassing the issue will bring scattered business than uniformed.

VII. Findings & insight recommendation

Along with the discussions above, we find it necessary to point out some key matters requiring more attention in order for us to continue growth in trade with a global standard and with a desired altitude towards becoming a mid-income state.

7.1. Global trade through letters of credit decline by 3% each year

Based on volume under LC and comments of ICC survey respondents, export and import trade in 2013 was 41% and 36% respectively which was 44% in 2011 for both. The usage of LC is declining year by year. Based on transactions under LC, ICC felt it necessary to point out in their survey 2012 and 2011 that 80%-85% trade are estimated to be settled on an open account basis, the rest being "traditional" trade products such as documentary and standby L/Cs, documentary collections and guarantees. Global trade is clearly standing on open account trading.

7.2. Open account trading, BPO, Factoring & Trade Card taking spaces

Apparently the LC regime is changing. Last year's (2013) robust transactions through BPO and Factoring largely contributed to global trade when both volume and amount under LC transaction going down consecutively. Traditional paper based LC operation is gradually replaced by technology driven, time bound, easy to handle solutions discarding the requirement of independent bank undertaking in settlements.

7.3. Export orders are tight

Some of our major apparel exporters complaint that orders are too tight and actually reducing but that is yet to reflect our export data due to previous orders in hand. 2013-14 data rather shows an 11.65% overall growth in export. What came out from interviewees is that buyers are under their own country policy influenced by their regional policy as well. And the news box hits (Bismillah, Rana plaza, Tajreen fashion etc) against our apparel industry made them more cautious in compliance issues. Even the compliant factories are competing highly to get orders. Some buyers moved to Vietnam. Since the demand for order went high and supply went down under increased wages to be paid, our exporters started competing badly which in turn has led the unit prices falling a little. Exporters working under contracts are staying ahead in such cases that help increase buyer's profit by 2% to 3%.

7.4. Bangladesh getting ready to address changes

With no exception, Bangladesh is also driven towards the same global direction against export, may be running slower against import. To maintain the export growth, we need to keep every payment methods in practice so that we do not loose orders for the choice of method. The policies (Guideline for Foreign Exchange Transactions, Import & Export Policy etc) are not conflicting with the evolving global solutions. Effective July 2014, we have seen positive changes in EXP form showing inclusions of CMT basis export, Consignment sale and encouragingly changing repatriation deadline from '120 days' to 'within stipulated time'. 'Import policy order 2012-2015' has allowed BTB opening against contracts. Ministry of Commerce has amended paragraph 2.5.1 of Export Policy order 2009-2012 on 04.08.2013 to support export against contract, purchase order, advance payment and consignment sale. Bangladesh Bank has developed online import export monitoring system bringing Banks and Bangladesh customs within the same platform to make such information available at any moment of time. These measures are highly proactive in nature, yet requiring straight forward guidelines and assistance from Bangladesh Bank to educate the industry in securing payments in all methods as far as possible.

7.5. Export against contract needs to be secured further

We feel it necessary for Bangladesh Bank to further emphasis contracts especially documentary collections to educate the industry promptly. It is also necessary to make the industry aware of the security measures against contracts and that the process of LC is not as secured as we might think of and that LC is not highly supportive to flourish export business and we need to explore more on alternative trade payment methods.

7.6. Technology needs more adaptation to ensure growth in export

Technology driven client to client solutions are already in place and we should expect banks involved in these transactions very soon. Bangladesh Bank is also going under full automation to support such solutions in near future. What we need to see more is to equip us with higher technology to support upcoming innovative products.

7.7. Our survival depends on Bangladesh Bank directives

Question may be asked whether the existing GFET is enough to support and secure all types of trade transactions like BPO, Trade Card System, Factoring etc. Documentary collections need to be taken care of as well. URDG (Uniform Rules for Demand Guarantee), ISP98 and URF (Uniform Rules for Forfaiting) also require due endorsement from Bangladesh Bank to promote export against guarantees that is also increasing globally. We must IMMEDIATELY start to encourage these methods but with strict security measures so to maintain export growth. Relying more on traditional methods will no longer assist the export growth, we believe.

7.8. Trade other than LC jumped to as much as 60% in 2012 and 65% in 2013

Whether or not there is a highly supportive country policy, our exporters are doing business against contracts heavily relying on buying agents and repatriation arrangements with buyer/middlemen rather than relying on the trade payment method. As per respondents of the interviews, our export against contract recorded an increase of 5% from 60% (approx.) in 2012 to almost 65% in 2013 with or without the exporters being aware of the security of payment that are mostly buyer dominated. This has also came out from the respondents that there is no significant difference for an exporter exporting against contract or LC because most of the bills against LCs are discrepant without being able to obligate the issuing bank just like contracts. The flow of operation under contract is not for us to restrict where BB has a major role to play in order to make those transactions more secured so that cases of non-repatriation against contracts be restricted instead. We need to first make the exporters aware of the problems associated with contracts and develop security measures against each of the cases of CMT basis export, Consignment sale, Sea Air export, Collection, Trade Card payments, Open account (sea, air and road shipment) etc. BB also needs to endorse URBPO immediately that ensures secured open account trading. Factoring may also be introduced initially for domestic transactions so that we can participate in the international Factoring in near future to facilitate our export. Avalisation and Forfaiting needs to be promoted as well to support these initiatives.

With all these notes, we would like to end up here with our eagerness to see changes coming in near future in order to make us unstoppable against all obstacles be it local or international.

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