MAINE INTERNATIONAL TRADE CENTER
Global Resources. Local Expertise.

International Payments When Importing

I. Documentary Collection

Think of a documentary collection as an international COD (cash on delivery): the buyer pays for goods at delivery. A documentary collection, however, is distinguished from a typical COD transaction in two ways: (1) instead of an individual, shipping company, or postal service collecting the payment, a bank handles the transaction, and (2) instead of cash on delivery for goods it is cash on delivery for a title document (bill of lading) that is then used to claim the goods from the shipping company.
Banks, therefore, act as intermediaries to collect payment from the buyer in exchange for the transfer of documents that enable the holder to take possession of the goods. The procedure is easier than a documentary credit, and the bank charges are lower. The bank, however, does not act as surety of payment but rather only as collector of funds for documents.

For the seller and buyer, a documentary collection falls between a documentary credit and open account in its desirability. Advantages, disadvantages, and issues for both buyer and seller will be discussed in the following pages.

Documentary Collections vs. Documentary Credits
In a documentary collection, the seller prepares and presents documents to the bank in much the same way as for a documentary letter of credit. However, there are two major differences between a documentary collection and a documentary credit: (1) the draft involved is not drawn by the seller (the "drawer") upon a bank for payment, but rather on the buyer itself (the "drawee"), and (2) the seller's bank has no obligation to pay upon presentation but, more simply, acts as a collecting or remitting bank on behalf of the seller, thus earning a commission for its services.

The Uniform Rules for Collections (URC)
Although documentary collections, in one form or another, have been in use for a long time, questions arose about how to effect transactions in a practical, fair, and uniform manner.
The Uniform Rules for Collections (URC) is the internationally recognized codification of rules unifying banking practice regarding collection operations for drafts and for documentary collections. The URC was developed by the International Chamber of Commerce (ICC) in Paris. It is revised and updated from time-to-time; the current valid version is ICC publication No. 322.

Introducing the Parties to a Documentary Collection

There are four main parties to a documentary collection transaction. Note below that each party has several names. This is because businesspeople and banks each have their own way of thinking about and naming each party to the transaction. For example, as far as businesspeople are concerned there are just buyers and sellers and the buyer's bank and the seller's bank. Banks, however, are not concerned with buying and selling. They are concerned with remitting (sending) documents from the principal (seller) and presenting drafts (orders to pay) to the drawee (buyer) for payment. The four main parties are:

> **THE PRINCIPAL (SELLER/EXPORTER/DRAWER)**
>
> The principal is generally the seller/exporter as well as the party that prepares documentation (collection documents) and submits (remits) them to his bank (remitting bank) with a collection order for payment from the buyer (drawee). The principal is also sometimes called the remitter.
>
> **THE REMITTING (PRINCIPAL'S / SELLER'S / EXPORTER'S) BANK**
>
> The remitting bank receives documentation (collection documents) from the seller (principal) for forwarding (remitting) to the buyer's bank (collecting/presenting bank) along with instructions for payment.
>
> **THE COLLECTING OR PRESENTING (BUYER'S) BANK**
>
> This is the bank that presents the documents to the buyer and collects cash payment (payment of a bank draft) or a promise to pay in the future (a bill of exchange) from the buyer (drawee of the draft) in exchange for the documents.
>
> **THE DRAWEE (BUYER/IMPORTER)**
>
> The drawee (buyer/importer) is the party that makes cash payment or signs a draft according to the terms of the collection order in exchange for the documents from the presenting/collecting bank and takes possession of the goods. The drawee is the one on whom a draft is drawn and who owes the indicated amount.

Basic Documentary Collection Procedure

The documentary collection procedure involves the step-by-step exchange of documents giving title to goods for either cash or a contracted promise to pay at a later time.

BUYER AND SELLER

The buyer and seller agree on the terms of sale of goods: (a) specifying a documentary collection as the means of payment, (b) naming a collecting/presenting bank (usually the buyer's bank), and (c) listing required documents.

PRINCIPAL (SELLER)

1. The seller (principal) ships the goods to the buyer (drawee) and obtains a negotiable transport document (bill of lading) from the shipping firm/agent.

2. The seller (principal) prepares and presents (remits) a document package to his bank (the remitting bank) consisting of (a) a collection order specifying the terms and conditions under which the bank is to hand over documents to the buyer and receive payment, (b) the negotiable transport document (bill of lading), and (c) other documents (e.g., insurance document, certificate of origin, inspection certificate, etc.) as required by the buyer.

REMITTING BANK
3. The remitting bank sends the documentation package by mail or by courier to the designated collecting/presenting bank in the buyer's country with instructions to present them to the drawee (buyer) and collect payment.

COLLECTING BANK
4. The presenting (collecting) bank (a) reviews the documents making certain they are in conformity with the collection order, (b) notifies the buyer (drawee) about the terms and conditions of the collection order, and (c) releases the documents once the payment conditions have been met.
BUYER/DRAWEE
5. The buyer (drawee) (a) makes a cash payment (signing the draft), or if the collection order allows, signs an acceptance (promise to pay at a future date) and (b) receives the documents and takes possession of the shipment.
COLLECTING BANK
6. The collecting bank pays the remitting bank either with an immediate payment or, at the maturity date of the accepted bill of exchange.
REMITTING BANK
7. The remitting bank then pays the seller (principal).

A NOTE CONCERNING CORRESPONDENT BANKS
The remitting bank may find it necessary or desirable to use an intermediary bank (called a correspondent bank) rather than sending the collection order and documents directly to the collecting bank. For example, the collecting bank may be very small or may not have an established relationship with the remitting bank.

Three Types of Collections

There are three types of documentary collections and each relates to a buyer option for payment for the documents at presentation. The second and third, however, are dependent upon the seller's willingness to accept the option and his specific instructions in the collection order.

The three types are:

1. DOCUMENTS AGAINST PAYMENT (D/P)
In D/P terms, the collecting bank releases the documents to the buyer only upon full and immediate cash payment. D/P terms most closely resemble a traditional cash-on-delivery transaction.
Note: The buyer must pay the presenting/collecting bank the full payment in freely available funds in order to take possession of the documents.
This type of collection offers the greatest security to the seller.

2. DOCUMENTS AGAINST ACCEPTANCE (D/A)

In D/A terms the collecting bank is permitted to release the documents to the buyer against acceptance (signing) of a bill of exchange or signing of a time draft at the bank promising to pay at a later date (usually 30, 60 or 90 days).

The completed draft is held by the collecting bank and presented to the buyer for payment at maturity, after which the collecting bank sends the funds to the remitting bank, which in turn sends them to the principal/seller.

Note: The seller should be aware that he gives up title to the shipment in exchange for the signed bill of exchange that now represents his only security in the transaction.

3. ACCEPTANCE DOCUMENTS AGAINST PAYMENT

An acceptance documents against payment has features from both D/P and D/P types. It works like this: (a) the collecting bank presents a bill of exchange to the buyer for acceptance, (b) the accepted bill of exchange remains at the collecting bank together with the documents up to maturity, (c) the buyer pays the bill of exchange at maturity, (d) the collecting bank releases the documents to the buyer who takes possession of the shipment, and (e) the collecting bank sends the funds to the remitting bank, which then in turn sends them to the seller.

This gives the buyer time to pay for the shipment but gives the seller security that title to the shipment will not be handed over until payment has been made. If the buyer refuses acceptance of the bill of exchange or does not honor payment at maturity, the seller makes other arrangements to sell his goods. This type of collection is seldom used in actual practice.

PAYMENT NOTES

If the buyer draws (takes possession of) the documents against acceptance of a bill of exchange, the collecting bank sends the acceptance back to the remitting bank or retains it on a fiduciary basis up to maturity. On maturity, the collecting bank collects the bill and transfers the proceeds to the remitting bank for crediting to the seller.

General Notes and Cautions

Specific notes and cautions for sellers, buyers, and banks involved in documentary collection transactions are listed at the end of this chapter. Listed below are notes and cautions that are fundamental to the process and of importance to all parties to the transaction.

- The banks involved in a documentary collection do not guarantee payment or assume any credit risk, as they do in documentary credit transactions. The banks act merely as intermediaries to facilitate payment for a shipment.
- If the shipper/seller sends goods directly to the buyer's address, the shipment will be handed over without the buyer first making payment. The seller, therefore, will usually address the

shipment to his agent in the buyer's country or to the collecting bank if it is known to him and prior agreement has been obtained to do so.

- Goods are transported, stored, and insured at the expense and risk of the seller until payment or acceptance occurs. Generally, banks are under no obligation to protect the goods. Banks are also not responsible if the shipment is seized by customs or confiscated to cover any accrued storage costs.
- Documentary collections have one additional safeguard over transactions conducted on an open-account basis. The existence of the draft itself, which has been duly presented and accepted through a bank in the buyer's country, is an acknowledged evidence of debt. However, this may not be of great value against a purchaser who is determined not to pay.
- In D/P terms the buyer may refuse to pay, in which case the seller maintains title to the shipment. The seller may decide to negotiate new terms with the buyer, locate another buyer, or have the goods returned, incurring the cost of shipping, insurance, and bank fees. If the goods are perishable, the seller may be in a difficult position to find a new buyer quickly.
- In D/A terms the buyer may refuse to accept the draft, in which case the seller is in the same position as in D/P terms where the buyer refuses to pay the draft. (See the preceding item for details.)
- In D/A terms the buyer may accept (sign) the draft, take possession of the goods, but then refuse to pay the draft at maturity. In this case the seller has neither payment nor the goods. The seller's options are effectively reduced to trying to enforce the buyer's obligation to pay the draft through banking channels or legal action, both of which involve additional costs.
- Since the banks are under no obligation to authenticate documents, it is possible that the seller will send a short shipment, the incorrect goods, or inferior goods. The only recourse available to the buyer is through direct contact with the seller or legal action.

Transaction Documents

The documents required under a documentary collection are fundamentally the same as those in a documentary letter of credit transaction. In the original agreement between buyer and seller the buyer specifies documents that (1) make it possible to secure the shipment from the shipping company (bill of lading), (2) secure release from the customs authority (certificates of origin, commercial invoice, etc.), and (3) offer some guarantee of quality and count (inspection certificates).

Refer to Chapter 16: Documents for a full description of documents used in both documentary collection and documentary credit transactions.

The Collection Order

The collection order is the key document prepared by the seller specifying the terms and conditions of the documentary collection. It must be prepared with great care and precision as the banks are only permitted to act upon the instructions given in the order and not on instructions from past transactions or verbal understandings. On the following page is a sample collection order and below are notes for key provisions of the document.

1. The payment period as agreed with the buyer
2. The name and address of the buyer
3. The buyer's bank
4. Instructions, if any, about what to do with the accepted bill of exchange
5. Notation concerning payment of charges for the documentary collection
6. Notation/instructions for the lodging of a protest in the event of nonacceptance or nonpayment
7. Instructions for notification of agent or representative in the buyer's country

SAMPLE COLLECTION ORDER

Sender:

Mûller Ltd.
Tellstrase 26

4053 Basle

Documentary collection

Basle, 12th August 19..
Place / Date

Our Reference AK/83

We send you herewith the following documents for collection:

Registered

Swiss Bank Corporation
Schweizerischer Bankverein

Documentary collections
P.O. Box
4002 Basle

Amount	Maturity	Drawee (2)
US$ 14'300.--	90 days sight (1)	Maxwell Hammerton Inc. 12, Broadway New York, N.Y. 10014
		Drawee's bank Commercial Credit Bank (3) New York

Draft/ Receipt	Invoice: commercial	Invoice: cust.-/ consul.	Insur.-Cert.	Certif. of Orig.	Weight/ Packing List	Bill of Lading	Waybill	Postal-/ Forw.-Receipt	other documents	
1 3/3		4	2		2				2	analysis certificates

Goods: 100 barrels "Chemical products - harmless"

by: s/s CAP SAN GIORGIO from: Le Havre to: New York on: 31.7.19..

Please follow the instructions marked «x»

	Documents/goods to be delivered against:						Draft (4)		State the exact due-date		
	payment (1)	x	acceptance				to be sent back after acceptance		to be collected on due-date		
(5) x	Your charges for drawee's account; if refused					x	waive charges		do not deliver documents		
x	Your correspondent's charges are for drawee's account; if refused						waive charges	x	do not deliver documents		
(6) x	Protest in case of	x	non-payment		non-acceptance	x	Do not protest in case of		non-payment	x	non-acceptance
x	Advise	x	non-payment		non-acceptance		by airmail	x	by cable	x	giving reasons

Please credit the proceeds as follows:

☒ to our SFr account Nr. 10-326'791.0

☐ remit to

(7) Remarks:

In case of difficulties, the collecting bank is requested to inform our representatives: Messrs. Beach & Co. Inc., Broad Street 485, New York 34, who will be of assistance but who are not allowed to alter the above instructions.

Mûller Ltd

Enclosures

Signature:

E 6851 N 1/2 4.80 5000

The execution of this order is subject to the «Uniform rules for collections» issued by the International Chamber of Commerce

II. Letter of Credit (L/C)

A letter of credit is a document issued by a bank stating its commitment to pay someone (supplier/exporter/seller) a stated amount of money on behalf of a buyer (importer) so long as the seller meets very specific terms and conditions. Letters of credit are more formally called documentary letters of credit because the banks handling the transaction deal in documents as opposed to goods.

The terms and conditions listed in the credit all involve presentation of specific documents within a stated period of time, hence the formal name--documentary credits.

The documents the buyer requires in the credit may vary, but at a minimum include an invoice and a bill of lading. Other documents the buyer may specify are certificate of origin, consular invoice, insurance certificate, inspection certificate and others.

Letters of credit are the most common method of making international payments, because the risks of the transaction are shared by both the buyer and the supplier.

Documentary letters of credit are subject to the Uniform Customs and Practice for Documentary Credits (UCPDC), Brochure No. 500, of the International Chamber of Commerce (ICC) in Paris.

Basic Letters of Credit

There are two basic forms of a letter of credit: the Revocable Credit and the Irrevocable Credit. There are also two types of irrevocable credit: the Irrevocable Credit not Confirmed, and the Irrevocable Confirmed Credit. Each type of credit has advantages and disadvantages for the buyer and for the seller. Also note that the more the banks assume risk by guaranteeing payment, the more they will charge for providing the service.

(a) Revocable credit--This credit can be changed or canceled by the buyer without prior notice to the supplier. Because it offers little security to the seller, revocable credits are generally unacceptable and are rarely used.

(b) Irrevocable credit--The irrevocable credit is one which the issuing bank commits itself irrevocably to honor, provided the beneficiary complies with all stipulated conditions. This credit cannot be changed or canceled without the consent of both the buyer and the seller. As a result, this type of credit is the most widely used in international trade. Irrevocable credits are more expensive because of the issuing bank's added liability in guaranteeing the credit. There are two types of irrevocable credits:

(1) The Irrevocable credit not confirmed (Unconfirmed credit). This means that the buyer's bank which issues the credit is the only party responsible for payment to the supplier, and the supplier's bank is obliged to pay the supplier only after receiving payment from the buyer's bank. The supplier's bank merely acts on behalf of the issuing bank and therefore incurs no risk.

(2) The Irrevocable, confirmed credit. In a confirmed credit, the advising bank adds its guarantee to pay the supplier to that of the issuing bank. If the issuing bank fails to make payment, the advising bank will pay. If a supplier is unfamiliar with the buyer's bank which issues the letter of credit, he may insist on an irrevocable confirmed credit. These credits may be used when trade is conducted in a high risk area where there are fears of outbreak of war or social, political, or financial instability. Confirmed credits may also be used by the supplier to enlist the aid of a local bank to extend financing to enable him to fill the order. A confirmed credit costs more because the bank has added liability.

Special Letters of Credit

There are numerous special letters of credit designed to meet specific needs of buyers, suppliers, and intermediaries. Special letters of credit usually involve increased participation by banks, so financing and service charges are higher than those for basic letters of credit. The following is a brief description of some special letters of credit.

(a) Standby letter of credit--This credit is primarily a payment or performance guarantee. It is used primarily in the United States because U.S. banks are prevented by law from giving certain guarantees. Standby credits are often called non-performing letters of credit because they are only used as a backup payment method if the collection on a primary payment method is past due.

Standby letters of credit can be used, for example, to guarantee the following types of payment and performance: repayment of loans, fulfillment by subcontractors, securing the payment for goods delivered by third parties.

The beneficiary to a standby letter of credit can draw from it on demand, so the buyer assumes added risk.

(b) Revolving letter of credit-- This credit is a commitment on the part of the issuing bank to restore the credit to the original amount after it has been used or drawn down. The number of times it can be utilized and the period of validity is stated in the credit. The credit can be cumulative or noncumulative. Cumulative means that unutilized sums can be added to the next installment, whereas noncumulative means that partial amounts not utilized in time expire.

(c) Deferred payment letter of credit-- In this credit the buyer takes delivery of the shipped goods by accepting the documents and agreeing to pay the bank after a fixed period of time. This credit gives the buyer a grace period for payment.

(d) Red clause letter of credit--This is used to provide the supplier with some funds prior to shipment to finance production of the goods. The credit may be advanced in part or in full, and the buyer's bank finances the advance payment. The buyer, in essence, extends financing to the seller and incurs ultimate risk for all advanced credits.

(e) Transferable Letter of Credit--This credit allows the supplier to transfer all or part of the proceeds of the letter of credit to a second beneficiary, usually the ultimate supplier of the goods. This is a common financing tactic for middlemen and is used extensively in the Far East.

(f) Back-to-Back Letter of Credit--This is a new credit opened on the basis of an already existing, nontransferable credit. It is used by traders to make payment to the ultimate supplier. A trader receives a letter of credit from the buyer and then opens another letter of credit in favor of the supplier. The first letter of credit is used as collateral for the second credit. The second credit makes price adjustments from which come the trader's profit. See Guide to Letters of Credit Appendix.

Limitations of Letters of Credit

Although documentary credits provide good protection and are the preferred means of payment in many international transactions, they do have limitations. They do not, for example, ensure that the goods actually shipped are as ordered nor do they insulate buyers and sellers from other disagreements or complaints arising from their relationship. It is up to the parties to settle questions of this nature between themselves.

Advantages, disadvantages, and issues for both buyer and seller will be discussed later in this section. Please note that these issues can have a significant impact on a given transaction. An incomplete understanding of the subject can be more dangerous than no knowledge at all.

III. Notes, Tips, and Cautions for Buyers

1. A buyer should only agree to documentary collection payment terms if there is trust that the seller will ship the goods as specified in accordance with the agreement between buyer and seller.
2. The buyer should be aware of any documentation, certifications, or authorizations that may be required for customs clearance or for eventual sale of the goods in his own country.
3. The buyer should specify all documentation required of the seller in his agreement with the seller.
4. Upon presentation by the presenting bank the buyer must carefully inspect the documents to make certain they meet all specifications for customs clearance and for eventual sale of the goods in his own country.
5. As a special favor, the collecting bank may allow the buyer to take temporary possession of the documents for inspection before payment. The collecting bank, however, assumes responsibility for the documents until redemption.

6. In the above case, the buyer should immediately return the entire set of documents to the collecting bank if he is unwilling or unable to meet the agreed upon payment procedure.
7. In a documentary collection the buyer is generally in a secure position because ownership or responsibility for goods does not have to be assumed until documents have been paid for or a time draft signed.
8. The buyer may not sample or inspect the goods before accepting and paying for the documents unless authorized to do so by the seller. The buyer may, however, specify a certificate of inspection from a reliable third party as part of the required documentation package.
9. Unless bound by a separate contract, the buyer assumes no liability for goods if he refuses to take possession of the documents.
10. Partial payment in exchange for the documents is not allowed unless specifically authorized in the seller's collection order.
11. With D/A terms, the buyer may receive the goods and resell them for profit before the time draft matures, thereby using the proceeds of the sale to pay for the goods. The buyer is responsible for payment, however, even if the goods cannot be sold.
12. The main risk for buyers is that goods shipped might not conform to the goods specified. Because banks deal only in documents and not in goods, the buyer's only recourse is with the seller.