

LETTERS OF CREDIT – A SECURE FORM OF PAYMENT OFFERED BY NIGERIAN BANKS FOR INTERNATIONAL SALE TRANSACTIONS¹

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INTRODUCTION:

A letter of credit in the Nigerian context is the assurance a foreign seller receives from a Nigerian Bank that it will be paid for the goods it has made arrangements to have delivered to a Nigerian buyer or a buyer based in Nigeria once it is able to provide genuine evidence for such delivery.

Nigeria's economy is largely dependent on importation of goods from other parts of the world as a result of various socio-economic factors and right from antiquity, merchants purchased commodities like machinery and raw materials for local manufacturing from international sellers by travelling to these countries with cash to purchase the goods or by drawing out Documentary Bills and other negotiable instruments.² These modes of payment, though seemingly convenient and cheaper for the buyer are not without their downsides which may include loss/theft of cash, as well as the risk involved in carrying cash.

Banks are often involved in the operation and use of documentary bills as means of payment where the seller instructs its Bank i. e. "the remitting bank" to deliver the shipping documents or the bill of lading to the buyer's bank i.e., "the collecting bank" and ensure collection of the price from the buyer through its Bank.

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² A negotiable instrument is a document of title to money, RM Goode, COMMERCIAL LAW: 3rd ed., 2004, p. 476.

The wide network of banks and the use of correspondent/collecting banks as agents are often used in this regard.³ The rules will apply if specifically incorporated into the contract between the buyer and the seller.⁴ The use of a documentary bill is facilitated by way of a seller who sends same to a buyer before sending the bill of lading for the goods it has shipped to ensure that the buyer accepts the bill and makes payment for the goods before obtaining property to the shipped goods.⁵ The documentary bill functions as a request for the payment of the goods and the acceptance of same is an agreement to pay. If the buyer refuses to accept the bill, he is not entitled to the bill of lading and if it retains it without payment, the property in the goods will not pass to it.⁶ The disadvantages of this method of international payment grossly outweigh its advantages because there is no privity of contract between the seller and the collecting bank.⁷

RAPID GROWTH IN THE USE OF LETTERS OF CREDIT:

In the last three years, a more popular mechanism for facilitating international payments in Nigeria is through the use of letters of credit. A credit is defined as any arrangement, however named or described that is irrevocable and thereby constitutes a definite undertaking by the issuing Bank to honour a complying presentation.⁸

The use of letters of credit as an international payment mechanism for goods purchased across national and international borders has always been available but was not very popular amongst Nigerian merchants as a result of the additional costs associated with the use of the service as rendered by Nigerian Banks.

However, further to the Central Bank of Nigeria's Policy Guidelines dated November 6th 2014,⁹ for the purpose of ensuring stability of the foreign exchange market, limits have been placed on the use of Foreign Exchange to finance import contracts or other purchases. There are also existing laws which limit the amount of Foreign Exchange which can be moved by cash overseas such as Section 2(3) of the Money Laundering Prohibition Act¹⁰ which states that a

³ This is governed by the ICC's Uniform Rules for Collection (URC 522, 1995).

⁴ *Minorities Finance v. Afribank Nigeria Limited* 1 Lloyd's Rep 134 at 139, per Longmore J. (1995).

⁵ EP Ellinger and H Tjio 'UNIFORM RULES FOR COLLECTION' (1996) JBL; BENJAMINS'S SALE OF GOODS (7th ed. 2006) para. 22-067.

⁶ The United Kingdom Sale of Goods Act 1979, Section 19 (3)

⁷ *Grosvenor Casinos Ltd v National Bank of Abu Dhabi* [2008] EWHC 511 (Comm); *Bastone & Firminger Ltd v Nasima Enterprises (Nigeria) Ltd* [1996]CLC 1902 at 1908

⁸ International Chamber of Commerce, Uniform Customs and Practice 600 (2007) Article 2

⁹ Central Bank of Nigeria, 'Trade and Exchange Department's Circular dated November 6th 2014 <http://www.cbn.gov.ng/Out/2014/TED/TED.FEM.FPC.GEN.01.022.pdf> accessed 24th February 2016

¹⁰ Money Laundering Prohibition Act, Cap. M18 LFN 2004.

person must declare an amount above 10,000 dollars meant for payment outside the country to the Nigerian Customs Service Commission.

In line with these developments, Banks encourage the use of letters of credit as a payment mechanism for customers who are desirous of purchasing commodities such as raw materials, machinery and other commodities from foreign sellers.

THE MECHANISM OF LETTERS OF CREDIT:

The letter of credit is a form of documentary credit. A documentary credit represents a Bank's assurance of payment against the presentation of detailed documentation by the party required to produce such documents, which is usually the seller.

A letter of credit is useful to a seller when reliable and verifiable credit information about a foreign buyer is difficult to obtain, but he is satisfied with the creditworthiness of the buyer's bank. It has become one of the most preferred methods of payment in International Sale in Nigeria amongst merchants and Banks. Its operation is guided by the Uniform Customs and Practice for Documentary Credits (the 'UCP') 2007 which is a set of Rules governing the use of documentary credits. Its most recent edition is the 'UCP 600' which was published by the International Chamber of Commerce in July 2007.

A letter of credit transaction normally operates in a sequence which is explained below:

1. Once an International seller and a Nigerian buyer have agreed in the underlying sale contract that payment shall be made by a letter of credit, the buyer (applicant), approaches his Bank in Nigeria (the issuing Bank), and requests for the opening of a documentary credit in favour of the International Seller (beneficiary). There is a prescribed Form designed by the Bank to meet general requests for letters of credit but the specifications may be amended to meet each Buyer's peculiar needs.
2. Subject to the applicant meeting all the Bank's requirements such as the official "Know Your Customer" background checks,¹¹ referencing requirements and his account being in good standing with the Bank, the issuing Bank will open an irrevocable¹² credit in favour of the beneficiary. This irrevocable credit will undertake to pay the seller in another country on the terms specified by the buyer in his instruction to his Bank, or incur a deferred payment undertaking subject to payment upon maturity provided the

¹¹ Central Bank of Nigeria (Anti-money Laundering and Combatting the Financing of Terrorism in Banks and Other financial Institutions in Nigeria) Regulations 2013, Part VII.

¹² Irrevocable by virtue of Article 3 of the ICC Uniform and Customs Practice (UCP 600) 2007.

Seller makes available the documents specified by the Buyer through his own Bank to the Buyer's Bank. Such documents may be or may include transport documents such as a bill of lading, an insurance policy, an invoice, a certificate of origin, a certificate of quality and such other documents as may be specified in the underlying contract of sale.

3. The issuing Bank will proceed to inform the seller through his Bank (the advising Bank) that a letter of credit has been opened in his favour and that he is required to tender such documents required by the buyer.
4. Upon the seller's tender of the required documents which is most likely to be after he has shipped the goods to the buyer's country, the documents will be confirmed to be adequate (this is referred to as a "complying presentation") by the seller's Bank (advising Bank), and after the confirmation, the Bank will be required to pay the seller the contract sum.
5. Upon payment of the agreed contract sum to the seller/beneficiary, the seller's Bank/advising Bank is entitled to seek reimbursement from the issuing Bank/buyers' Bank.
6. The Documents will be passed unto the buyer by his Bank and of course, he will pay the Bank the contract price in addition to any other payments for the service rendered. Sometimes, the Bank may grant the buyer/applicant an extension of time to pay the contract sum if he is not in a position to pay immediately. It depends on his relationship with the Bank and whether or not he has a credit account with the Bank. In this case, the buyer/ applicant may be allowed to sell the goods upon granting him access through the release of the documents to him and the Bank will be entitled to the proceeds of the sale up to the required amount.

The guiding principles for the operation of documentary credits can be found in the International Chamber of Commerce's UCP 600 which is the 6th Revision of the Rules since its first promulgation in 1933.¹³ The development of the UCP is the result of a desire to address the challenges faced in the facilitation of the flow of international trade and also, to address the major developments in the trade and banking world.¹⁴ Its use to a large extent ensures certainty,

¹³ The work of the International Chamber of Commerce Commission on Banking Technique and Practice.

¹⁴ Summarising the views of Gary Collyer, Corporate Director, ABN AMRO Bank, England, Technical Advisor to the ICC Commission on Banking Technique and Practice, November 2006. (Introduction to the International Chamber of Commerce, Uniform Customs and Practice 600 (2007).

predictability and a generally acceptable standard by parties involved in international transactions.

The advantages of trading with letters of credit abound for both buyer and seller. The use of the wide networks of Banks and the safety of transferring funds and documents as well as the security of a guaranteed paymaster are a few of the advantages. Nigerian courts have pronounced on documentary credits as in the case of *Akinsanya v U.B.A.*¹⁵ where the court noted that: “*The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with the control of the goods that does not permit of any dispute as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment in payment.*”¹⁶

Though a letter of credit is a guaranteed form of payment by a Bank, it is important that this assurance emanates from a “healthy” bank without any risk of insolvency. The presentation of forged documents, which is a major disadvantage, will most likely be forestalled if proper investigatory checks are carried out by the dedicated department of the advising and issuing Banks.

Despite the challenges faced in the depletion of foreign exchange available from the Central Bank of Nigeria as a result of the declining proceeds from oil revenue, the Central Bank of Nigeria and the various Commercial Banks in the country have developed stability in fulfilment of their obligations to their counterparty Banks in letters of credit transactions. This is done by channeling foreign exchange from export proceeds as well as funds provided by letters of credit applicants who source foreign exchange within the parallel market for “non-valid for forex” letters of credit.¹⁷

Payments for international business transactions are advisedly facilitated by the use of letters of credit.

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¹⁵ [1986] 4 NWLR Pt. 34, p. 278.

¹⁶ [1986] 4 NWLR Pt. 34, 278 para. 29.

¹⁷ Central Bank of Nigeria, Trade and Exchange Department’s Circular dated July 3rd 2015 <http://www.cenbank.org/Out/2015/TED/TED.FEM.FPC.GEN.01.013.pdf> accessed February 24th 2016.

