

Export University – District Export Council

# *Managing Payments and Financing*

Presented: October 25, 2016

Temple University – Fox School of Business

**Fulton Bank**

LISTENING IS JUST THE BEGINNING.™

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LETTER OF CREDIT GROUP

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# What we will Cover

- \* International Payment Methods
  - \* Cash in Advance, Letters of Credit, Credit Insurance, Documentary Collections and Open Account
- \* Working Capital Financing Programs
- \* Foreign Exchange Markets.

# Why use trade products...

- \* Mitigate commercial and sovereign risks.
- \* Provide secure method for movement of shipping documents.
- \* Provide secure method for movement of funds.
- \* Obtain pre-export and post-export financing opportunities.
- \* Can be issued in many foreign currencies and under foreign contracts.
- \* Support and facilitate trade.

# Why use trade products...

- \* Low default rate.

13,444,027 Transactions, 20542 Defaulted, 0.15%

Total transactions and default rate by product, 2008-2014

Product	Total # transactions	Total # defaulted transactions	Default rate
1. Export L/C	1,847,734	121	0.01%
2. Import L/C	3,164,200	2,509	0.08%
3. Performance Guarantees	1,615,351	2,736	0.17%
4. Loans for Import/Export	6,816,742	15,176	0.22%

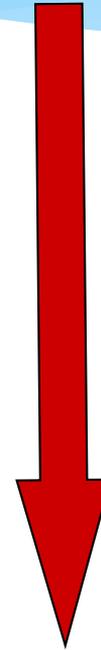
# INTERNATIONAL PAYMENT METHODS

## RISK MITIGATION TECHNIQUES

(WITH EXPORTER IN MIND... FOR IMPORTER, REVERSE...)

*More Favorable*

- \* Cash in Advance
- \* Letter of Credit
  - Confirmed
  - Unconfirmed
- \* Export Credit Insurance
  - SBA / EximBank
  - Private Export Insurance
- \* Documentary Collection
- \* Open Account



*Less Favorable*

# Cash in Advance

- \* As an exporter cash in advance is the best payment method.
- \* Works if the exporter has a unique product that is in high demand.
- \* Payments are generally made by wire transfer, check, or credit card.
- \* There are risks. International checks take time to clear. Credit cards could be subject to disputed payments.
- \* Some exporters have a separate account for incoming wires for fraud protection.

# What is a Letter of Credit?

- \* Contract between the issuing bank (on the buyer's/applicant's behalf) and the beneficiary that guarantees payment to the beneficiary, so long as they can meet the terms and conditions.
- \* Used to support international trade transactions (Commercial LC's) and contractual obligations (Standby LC's).
- \* Banks that issue letters of credit put their credit in place of the buyers credit which provides the seller more comfort.
- \* Can provide the seller with a competitive advantage by allowing them to offer terms to the buyer.

# Facts about...

## \* **Commercial Letters of Credit**

- \* Issued in support of a trade transaction.
- \* Intended to be the payment mechanism.
- \* Payment is triggered by shipment and subsequent presentation of shipping documents.
- \* When the documents are in order or accepted the issuing bank is under obligation to make the payment.
- \* Mitigates commercial risks - Issuing bank replaces the applicant's credit with its own.
- \* Can mitigate sovereign economic, political and war risks in the case of a confirmed letter of credit.
- \* Can be issued and negotiated in a foreign currency.



# Facts about...

## \* **Standby Letters of Credit**

- \* A letter of credit used to support the obligation of one company (applicant) to another (beneficiary).
- \* Not Intended to be the payment mechanism, but only there in the event of default by the applicant.
- \* In international applications they can be used for:
  - \* Bid Bonds, Advanced Payment Guarantees, Performance Bonds, For Non Payment of Invoices, Warranties
- \* Can be issued and negotiated in a foreign currency.



# Letter of Credit Strategies to Benefit Exporters

- \* Offer Terms (30, 60, 90, 120 Days From Shipment) – Banker's Acceptance
  - \* Your foreign competitors are very likely doing this.
  - \* Structuring an LC to offer terms gives your customer the flexibility to meet their needs, such as:
    - \* Receiving and re-selling the product;
    - \* Using it in their manufacturing process;
    - \* Purchasing capital equipment from you and having it running before payment is due.
  - \* Can be Discounted.
    - \* Bank will pay the Exporter at acceptance of the documents and will wait for the term payment from the issuing bank.

# Letter of Credit Strategies to Benefit Exporters

- \* **Confirmed Letter of Credit**
  - \* Obligation of payment is transferred from an issuing bank overseas to a bank here, generally an advising and / or negotiating bank.
- \* **Transferable Letter of Credit.**
  - \* If an exporter is purchasing from a supplier a portion of the letter of credit can be transferred to that supplier.
  - \* Documents are presented under the transfer L/C, then presented to the issuing bank overseas. When the payment is received from the issuing bank the transfer L/C gets paid and the remaining funds are placed in the exporter's account.

# Letter of Credit Strategies to Benefit Exporters

- \* Negotiate and receive the L/C in a foreign currency, but ultimately get paid in USD
  - \* Work with your bank's FX department to price your product or service in your customer's currency.
  - \* Have the L/C issued in your customer's currency.
  - \* A forward contract can be used to hedge against currency fluctuation until you are paid.
  - \* Don't equate "hedging" with taking on risk; the opposite is the case. By hedging through your bank's FX department, you lock in the equivalent U.S. dollar amount that you'll receive at maturity.
  - \* Your competitors are likely also doing this.

# Export Credit Insurance

- \* Where cargo insurance protects against loss or damage during transit credit insurance protects receivables from loss due to credit risks such as protracted default, insolvency or bankruptcy. Trade credit insurance can include a component of political risk insurance which is offered by the same insurers to insure the risk of non-payment by foreign buyers due to currency issues, political unrest, expropriation etc.
  - \* Allows for open account sales.
  - \* Opens sales opportunities in new markets.
  - \* Can back extended payment terms.
  - \* Insures payment of delinquent accounts.
  - \* May be used as Collateral on a Trade Finance Line of Credit.

# Export Credit Insurance

- \* U.S. Exim Bank ([www.exim.gov](http://www.exim.gov))
  - \* Short-Term Credit Insurance (One year policy that is renewable)
    - \* Multibuyer, Small Business, and Single-Buyer Export Credit Insurance.
  - \* Medium Term Credit Insurance (Up to five years).
- \* Private Insurance Carriers
  - \* Euler Hermes, COFACE, AIG, FCIA, Zurich , Atradius
- \* Insurance Brokers
  - \* Work with Exim and Private Carriers to offer the best solution to your needs.

# Documentary Collections

- \* Documentary Collections
  - \* Adds structure to the trade transaction by providing method for movement of documents and funds.
  - \* Intended to be the payment mechanism.
  - \* Banks take no engagement in documentary collection transactions, and therefore, very little risk is mitigated.
  - \* Offers more protection on ocean freight sight transactions than air freight transactions and transactions where terms are offered.

# Open Account

- \* Open Account Transactions
  - \* Should only be used when there is complete trust between the seller and the buyer.
  - \* The exporter ships the goods and the importer remits payment.
  - \* Payment is generally made via wire transfer: checks and credit cards are less preferred due to collection risk and timing.
  - \* Unless these transactions are backed by a Standby Letter of Credit, Credit Insurance, or one of the State / Federal Programs it is the method of payment that offers the least protection.

# Working Capital Financing Programs

- \* **Export Letters of Credit / Banker's Acceptances**
  - \* As discussed earlier. Exporter can offer terms and still be paid upon shipment.
- \* **SBA / Eximbank Working Capital Lines of Credit**
  - \* Exporters requiring financing for amounts that your bank would not agree to lend you through traditional methods.
  - \* Depending on the program they could provide the bank with up to 90% support of lines of credit used to support export activities.
- \* **Export Insurance**
  - \* Can obtain export receivable insurance through Eximbank or some independent insurers.
  - \* Bank may be willing to finance an insured receivable by taking an assignment of the insurance policy.
- \* **Direct Financing**
  - \* Short-term trade financing between the bank and the customer.
  - \* Bank lends based on the value of the trade.
  - \* The Bank would provide the principal amount minus their discount interest and commission fees on the date of financing.
  - \* Bank charges the customer back at maturity after they've been paid on the receivable.

# Foreign Exchange Markets

- \* Largest financial market in the world.
- \* Approximately \$4 trillion are traded daily.
  - \* \$ 1.5 trillion in spot and \$2.5 trillion in forwards, swaps and option strategies.
- \* Currencies traded 24-hours, six days a week.
- \* On average, exchange rates change every 4.8 seconds.
- \* Free global trading.
  - \* Clean float vs. dirty float.

# Foreign Exchange Markets

- \* Spot Settlement
  - \* 1 Day Value (CAD)
  - \* 2 Day Value (all other currencies)
  - \* Dodd Frank Spot Settlement < 7 Business Days.
    - \* Financial Institutions May Differ.
- \* Standard Market Quotes
- \* Bid/Ask
- \* Interbank Market
  - \* Trading between financial institutions in million dollar lots.

# Foreign Exchange Markets

- \* What Factors Affect Exchange Rates?
  - \* Economic
    - \* Fundamental analysis
      - \* GDP, Employment, PPI, CPI, Purchasing Managers Index (PMI)
  - \* Geopolitical
    - \* Government Intervention
    - \* War, Natural Disasters, Health Scares
  - \* Market Psychology
    - \* Technical Analysis
      - \* Bollinger Bands, moving averages (50,200 day) Fibonacci Retracements.

# Foreign Exchange Markets

- \* As a Company what are your Risk Aversion Strategies?
  - \* Defining Currency Risk
  - \* Quantifying Financial Impact
    - \* Worst Case Scenario
  - \* Create Corporate Strategy
    - \* FX vs. USD
    - \* Spot vs. Forwards
    - \* Partial Cover vs. Full Cover (hedge ratio)
  - \* Use Hedging Tools

# Foreign Exchange Markets

- \* Hedging
  - \* Elimination or Reduction of Risk through the use of Forwards or Options. May sacrifice opportunity gain in order to reduce risk.
- \* Why do Companies Hedge?
  - \* Uncertainty about FX markets and forecasts.
  - \* Secure USD payable and profit margin.
  - \* Risk Aversion.
- \* Why Companies Don't Hedge?
  - \* Misperception: Hedging = Speculation
  - \* Believe currency price changes will be favorable.
  - \* Lack of understanding of risks and methods of hedging.

# Foreign Exchange Markets

- \* Hedging Tools

- \* **Forward Contract:** Contract to buy or sell a currency for a fixed rate and specific date in the future.
- \* **Window Forward:** Contract to buy or sell a currency for a fixed rate within a range of dates in the future.
- \* **Non-deliverable Forward:** A forward contract on a non-convertible foreign currency that is cash settled usually in USD using an agreed upon reference rate.
- \* **Option:** A contract that offers the right, but not the obligation to buy or sell at an agreed upon price and date.
  - \* The buyer pays a premium (insurance plan).

# Foreign Exchange Markets

- \* Why receive in in Foreign Currency?
  - \* Advantages
    - \* Offer Stable Price to Customer.
    - \* Customer Satisfaction by providing price in local currency.
    - \* Increase competitiveness and expand your market.
    - \* Risk mitigation by hedging.
    - \* Possible gains in exchange.
  - \* Disadvantages
    - \* Determining invoice rate.
    - \* Hinder the development of new relationships.
    - \* Increase the difficulty of servicing current customers.
    - \* Possible loss in exchange.

# Two Important Questions to ask when you get an International Inquiry

- \* When a potential buyer contacts you a quote to them it is much more than just how much the product costs. A proper quote cannot be given until the two following questions are addressed:
  - \* How am I getting paid? (Terms of Payment)
  - \* Cash in Advance, L/C, Documentary Collection, Open Account
  - \* Who is responsible for what part of the transportation? (Terms of Shipment/INCOTERMS)

The buyer should pay for everything; either you arrange for it and add it to the invoice or your buyer pays for it on their own.

# INCOTERMS

<b>INCOTERM® 2010 RULES***</b>											
<b>CHART OF RESPONSIBILITY</b>											
	Any Transport Mode		Sea/Inland Waterway Transport				Any Transport Mode				
	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAT	DAP	DDP
Charges/Fee	EX Works	Free Carrier	Free Alongside Ship	Free On Board	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid to	Delivered at Terminal	Delivered at Place	Delivered Duty paid
Packaging	Buyer or Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller*	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Delivery to Port/Place	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export Duty & Taxes	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Origin Terminal Charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading on Carriage	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Carriage Charges	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Insurance	**	**	**	**	**	Seller	**	Seller	**	**	**
Destination Terminal Charges	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller
Delivery to Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller
Import Duty & Taxes	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller

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\*Seller is responsible for loading charges, if the terms state FCA at seller's facility

\*\*Negotiable between Buyer and Seller

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REFER TO FULL VERSION OF INCOTERMS® 2010 RULES FOR FULL DESCRIPTION

# Whom to Involve in your Transaction

- \* In order to quote properly you need to involve all of the parties to that transaction as early as possible. That could include your:

- \* Bank
- \* Freight Company / Broker
- \* Insurance Carrier
- \* Legal, Accounting, Sales Departments, etc.

Not getting these parties involved early tends to lead to issues with your L/C transaction. Let them review a draft of the L/C before it is issued to avoid amendments and delays.

Questions?

**Fulton Bank**

LISTENING IS JUST THE BEGINNING.™

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Thank you!

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