**FINANCING INTERNATIONAL TRADE**

According to the World Trade Organisation international trade, as measured as a percentage of global GDP, rose from 39% in 2000 to 50% in 2013[1]. Consequently, not only has the value and level of economic activity been supported by international trade, but that trade has become complex and fragmented with the rise of global value chains.

In 2014, the UK was a net importer, importing USD 684bn worth of merchandise trade vs. exports of USD 506bn[2]. Clearly international trade touches all our businesses, yet it is a highly specialised area of which the financing and facilitation by international banks is not well understood.

While we do not claim to have detailed expertise in this area (a knowledgeable and experienced Trade specialist is worth their weight in gold), we hope that by providing a preliminary understanding of the terms and concepts, our clients are better able to communicate their needs and have a more informed discussion with their lenders and specialist product providers.

Rather than simply define a list a terms we will endeavour to explain the purpose of each instrument and how they may assist your businesses in international trade and minimise your risk.

## Contract negotiation

When negotiating a **domestic contract** one must consider standard terms and conditions such as: the value and quantity of goods, payment, delivery, your counterparty's credit worthiness, industry norms and applicable laws.

Negotiating an **international contract** is far more complex, with additional considerations such as: international payment methods, credit terms, insurance, transport details (method, route and timing), exchange rate risk, exchange restrictions, customs regulations and most importantly when title passes.

An exporter will naturally wish to receive **payment in advance** (as early as possible) and an importer will want to pay upon receipt of the goods or at another future date (**open account**). Given the likelihood that the parties may not be well known to each other and there may be significant time between the initial order and final delivery, the use of intermediaries is common.

## Banking services and products

As part of providing the correct type of facility an experienced banker should examine your entire trade cycle to ensure that the right level of financing and protection is provided to you at the right time. This will help avoid common problems such as title having passed to you without you holding insurance or having items financed by you before you have received title.

Banks supporting **exporters** should consider your payment methods and terms, methods of shipment, which party pays freight or insurance. For **importers** the most important considerations are payment methods, which transport documents are used and when title passes.

In order to do this, internationally recognised standard trade terms are used in contracts. These are known as International Commercial Terms ('Incoterms').

[1] WTO INTERNATIONAL TRADE STATISTICS - Increased complexity of trade driving demand for good data, July 2015
[2] International Trade Statistics, October 2015

## INCOTERMS

Incoterms are global standard terms of sale that are accepted worldwide for assigning costs and responsibilities between the buyer and the seller. Proposed, updated, and copyrighted by the International Chamber of Commerce (ICC), they serve as global standards for uniform interpretation of common contract clauses in international trade.

They therefore help to prevent confusion in terms of foreign trade contracts, by helping sellers and buyers understand their obligations in any transaction. Incoterms will also differ depending on the method of shipment used.

| Incoterms - all modes of transport[3] | |
|---|---|
| **EXW** | Ex Works (named place of delivery) |
| **FCA** | Free Carrier (named place of delivery) |
| **CPT** | Carriage Paid To (named place of destination) |
| **CIP** | Carriage and Insurance Paid to (named place of destination) |
| **DAT** | Delivered At Terminal (named terminal at port or place of destination) |
| **DAP** | Delivered At Place (named place of destination) |
| **DDP** | Delivered Duty Paid (named place of destination) |
| **Incoterms - sea and inland waterway transport only** | |
| **FAS** | Free Alongside Ship (named port of shipment) |
| **FOB** | Free on Board (named port of shipment) |
| **CFR** | Cost and Freight (named port of destination) |
| **CIF** | Cost, Insurance and Freight (named port of destination) |

## Allocations of costs between Buyer and Seller[4]

| Incoterm 2010 | Export customs declaration | Carriage to port of export | Unloading of truck in port of export | Loading on vessel/airplane in port of export | Carriage (Sea/Air) to port of import | Insurance | Unloading in port of import | Loading on truck in port of import | Carriage to place of destination | Import customs clearance | Import duties and taxes |
|---|---|---|---|---|---|---|---|---|---|---|---|
| EXW | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer |
| FCA | Seller | Seller | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer |
| FAS | Seller | Seller | Seller | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer |
| FOB | Seller | Seller | Seller | Seller | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer |
| CPT | Seller | Seller | Seller | Seller | Seller | Buyer | Seller | Buyer/Seller | Seller | Buyer | Buyer |
| CFR | Seller | Seller | Seller | Seller | Seller | Buyer | Buyer/Seller | Buyer | Buyer | Buyer | Buyer |
| CIF | Seller | Seller | Seller | Seller | Seller | Seller | Buyer/Seller | Buyer | Buyer | Buyer | Buyer |
| CIP | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Buyer/Seller | Seller | Buyer | Buyer |
| DAT | Seller | Seller | Seller | Seller | Seller | Seller/Buyer | Seller | Buyer | Buyer | Buyer | Buyer |
| DAP | Seller | Seller | Seller | Seller | Seller | Seller/Buyer | Seller | Seller | Seller | Buyer | Buyer |
| DDP | Seller | Seller | Seller | Seller | Seller | Seller/Buyer | Seller | Seller | Seller | Seller | Seller |

## Banking products

**Import and export loans** use the goods that are being shipped or proof of the transaction as collateral for import or export loans. Not unlike supplier finance or invoice discounting they finance your working capital by covering the period between when you must pay for imported goods and the time when you receive payment for selling them.

From a banking perspective, these facilities are expressed in terms of an overall 'General Line' and a 'Cash Line', which is a sub-limit of the General Line and represents the period when your finance provider does not have control of the underlying goods (as collateral). Consequently it is more expensive and the interest rate will be higher.

[3] "Incoterms® 2010", ICC. Retrieved March 2014.
[4] Wikipedia - as per Incoterms 2010

In general, import and export loans are based on the goods being delivered and proof of the transaction agreement. Consequently the lender may place less importance on your business's credit history when considering your loan application. However, the lender will want to see that you have been in business for at least a year and have made other, similar transactions in the past.

The credibility of the specific transaction, and the ability of the receiving company to make good on payments are also considered since the loan is financing the receivables before they are collected. Therefore the most important documents the lender will need to review are the contract and/or other documentation providing proof of the transaction, as well as specific details.

Like other business loans, businesses may have some leeway in negotiating loan terms and fees and at Broadoak we specialise in ensuring our clients receive optimal terms. Loan terms will include a repayment schedule for the loan and the interest rate. Be sure to also perform some due diligence on the lender you choose. When handled properly, an import or export loan can provide the working capital you need to keep your business going and growing.

## PAYMENT METHODS

There are four main methods (in order of least/most risk for an importer/exporter): Open Account, Documentary Collections, Documentary Credits and Advance Payment.

Both Documentary Credits (Letters of Credit) and Documentary Collections are highly technical and process driven however we will provide a brief overview of the context and how they can assist your business & supply chain.

### Documentary Letters of Credit (LCs)

A Letter of Credit is a written undertaking by an issuing bank (usually the importer's bank) given to the seller/exporter (beneficiary) to make a payment once they have received a satisfactory bill of exchange or draft. The exporter now holds exposure to the Issuing Bank and the importer will reimburse their bank. Because the issuing bank holds credit exposure to their client there are in a position to most accurately price that risk. This process also offers an exporter greater protection than a documentary collection.

### Documentary collections

Under the collection method, an exporter passes the documents to their bank which is then responsible for collecting payment from the importer. Essentially and somewhat unusually one might say, the exporter receives payment from the importer in exchange for the shipping documents (as opposed to the goods), with the funds and documents channelled through their respective banks.

The seller is relying on the buyer alone for payment and the exporter's protection depends to a great extent upon controlling title to the merchandise through the transport documents used and the banks' ability to protect the exporter's interests. It offers an importer greater protection than an LC.

While this method is considered to be less complicated and cheaper than LCs, they are riskier for exporters because they do not have a verification process and offer limited recourse if the importer does not pay. They are therefore only recommended in situations where the exporter and importer have a long-standing trade relationship.

## TERMINOLOGY

### Bills of Exchange ("Bill")

A Bill is the most common document in international trade and while the terminology can be confusing, it is essentially no more than a formal legally-enforceable unconditional "you-owe-me". An exporter (or Drawer) will draw up a Bill stating that the importer (Drawee or Acceptor) owes the exporter a certain amount to be paid on a certain date in a certain place, in return for goods received. It will be signed by both parties.

The risk as to the acceptor's ability to pay at maturity may be transferred to a 3$^{rd}$ party bank which will then guarantee the payment. This bank is then said to have endorsed the Bill, for which it will charge a fee. The Payee may also endorse the Bill and which stage they will transfer their rights to another party often at a discount for immediate payment. In this way an exporter may get paid immediately.

A Bill payable 'on demand' or 'at sight' are known as a **Sight Bills**. If it is payable at a 'fixed or determinable future time', it is referred to as a term or **Usance Bill** (draft), because the buyer (drawee) is receiving a period of credit which is equal to the term (usance) of the Bill, which is the period between the Bill's acceptance and payment.

Bills Receivable (BR)

A **bill receivable** is signed for by the importer to facilitate short-term financing for the importer. This in turn allows the importer to obtain the goods without first settling the payments due under an LC arrangement.

Loan against Imports (LAI)

An **LAI** is granted to retire an import bill under a Documentary Collection if the Bank continues to hold the goods as collateral post-import. By setting up an LAI as payment for the DC, goods are released to the business under **trust receipts** (TR) although the goods belong to the bank until the loan is settled.[5]

Significantly an LAI covers the period up to the point of sale so the goods may be held as inventory or used in the manufacturing process.

Clean Import Loans (CIL)

A **CIL** is made based solely on the supplier's invoice and where an importer's Bank has never held the goods as collateral. **Pre-shipment CILs** can also be used so that payments are made directly to the nominated supplier, subject to certain criteria being met.

[5] www.hsbc.com.cn, January 2016