

Opportunity for Partnership — Letter of Credit Services Can Put Money on Your Table

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By Michael J. Scheller

A sset-based lenders, factoring and finance companies are always seeking new ways to create deals and generate additional revenues. Here's one source of enhanced revenues that many have not considered: offering letter of credit services to ABL clients.

Letters of credit have been a critical element of international trade for hundreds of years. These instruments help facilitate trade by substituting the reputation and creditworthiness of a bank or other financial institution for that of the importer, guaranteeing payment on the transaction when the conditions of the letter of credit are met.

While some importation is conducted through cash in advance or open account, a large volume of trade is conducted using letters of credit. In recent years, the demand for letters of credit from asset-based borrowers has increased substantially, as international sourcing of completed products, raw materials and components has risen dramatically. Because a sizable proportion of asset-based borrowers import products or components, ABLs can develop an incremental revenue stream by offering letters of credit to their clients.

Here are two illustrations of the link between asset-based lending and letter of credit services:

- 1) A U.S.-based wholesaler, who borrows from an ABL based on his receivables, imports novelty items from China. To make the shipment, the exporter in China requires a letter of credit from a financial institution that will guarantee payment.
- 2) An American manufacturer of small motors, who borrows from an ABL, imports components from a manufacturer in Korea. Before the company ships the goods, the Korean exporter requires a letter of credit guaranteeing payment.

Letters of Credit Explained

Letters of credit are normally used when an importer is not well known to the exporter or when the importer's creditworthiness is not considered satisfactory. A letter of credit, issued by a bank to an exporter, guarantees payment for the export transaction, thus protecting the exporter from potential credit issues with the importer.

Letters of credit also offer protection to the importer, since the bank will not make payment unless certain documents — meeting conditions requested by the importer — are presented to the bank within a specified period of time. As long as the terms of the letter of credit are met, the bank is responsible for payment, regardless of the actions or abilities of the importer. Letters of credit are subject to stringent rules and regulations set forth by the International Chamber of Commerce (ICC), a global organization that promotes world trade and seeks to facilitate business and trade practices.

ABLs, factoring and finance companies may be missing the opportunity to generate additional fee-based revenues as well as running the risk that the financial institutions may attempt to lure away their customers.

How an ABL Can Offer Letter of Credit Services

Because of the inherently riskier nature of international trade as compared with domestic transactions, as well as the complicated and detailed aspects of the documentation, working with letters of credit is a complex undertaking with which many ABLs are not comfortable. For that reason, they often prefer to avoid offering letters of credit directly, suggesting to clients that they obtain a letter of credit from a large bank that has significant experience in international trade transactions.

By going this route, however, ABLs, factoring and finance companies may be missing the opportunity to generate additional fee-based revenues as well as running the risk that the financial institutions may attempt to lure away their customers.

But there is a way for these ABLs to generate a letter of credit revenue stream from their clients' import transactions without being concerned about the complexities of these instruments or about losing business to the banks — they can partner with a financial institution that is experienced in trade finance and letter of credit documentation.

By partnering, we mean that the bank acts as a service and advice provider — offering letter of credit services through the ABL, factor or finance company — rather than working directly with the lender's clients. In this way, the lender's relationship with the client is preserved, the lender augments its revenues with letter of credit fees and the bank receives compensation for its services.

Locating the Right Partner

Many banks of all sizes offer trade finance services. When seeking a partner to provide letter of credit services to their clients, it is important that ABLs consider a number of issues and requirements.

Depth of experience in trade finance is the most critical required element. An ABL should look for a bank where the trade services department has individuals with many years of experience in trade finance, including letters of credit. At Sterling National Bank, for example, our International Trade Services department is highly experienced in all aspects of letters of credit and other international trade documentation.

Lenders should make sure they have access to senior international trade staff at the bank — those who understand the intricacies and technicalities of the import/export and documentation processes — rather than less experienced staffers.

The right bank partner is one that will provide personalized and customized letter of credit services for the lender and its clients. At Sterling, we call this “high-touch, personalized” service. The bank and its staff must be highly accessible to the lender — meaning that a specialist banker can be reached at any time when needed. It is frustrating to reach a voice mail or a call center hundreds or even thousands of miles away.

The right banker will also provide the infrastructure, people, technology and network (see “Look for a Winning Technology” below) to enable the ABL and its clients to input and access all transaction details while allowing the lender to control all approvals.

In short, the right banker with which to partner is one that: 1) has the right people with strong expertise in letters of credit and international trade services; 2) has been handling letters of credit for lenders and their clients for many years; 3) is extremely accessible; 4) has the right infrastructure and technology; 5) truly wants the business; and 6) is willing to go the extra mile for their ABL partner. Furthermore, the right bank will provide all of these benefits at the “right” price, one that is highly competitive in the international trade services marketplace.

In all of this, a bigger bank is not necessarily the better partner. A bank that wants the business enough will be willing and able to extend itself for its ABL partners. The most appropriate partner may actually be a smaller bank. For instance, \$10 million in letter of credit business may not mean much to a multinational financial institution, but a smaller bank will see this as a significant piece of business and will act accordingly.

Value-Added Trade Advice

Not only does a good bank partner provide immediate access to senior international trade executives, but based on its years of experience, the bank can also offer advice that helps clients avoid or resolve letter of credit issues. The following are two examples from Sterling National Bank's experience:

1) Complications for an importer can occur if an exporter requires a letter of credit that is denominated in a currency other than the U.S. dollar. Exporters of high-end merchandise that is in strong demand can often

force this requirement on U.S. importers. The exporter knows his costs, revenues, etc. in the local currency, and if he can, would rather get paid in his own currency.

For example: In one case, a high-end supplier in Italy required a letter of credit denominated in euros; this created a problem for the U.S. importer, because fluctuations in the exchange rate between the dollar and the euro could impact the importer's costs and profitability. Sterling helped the importer by advising and implementing a hedging strategy so that there was no impact on the importer's accounts due to currency fluctuations.

2) In another situation, we advised on a letter of credit in which the importer wanted to include permission for transshipment of the imported goods. Transshipment refers to the procedure under which — if the shipment is not direct to the final destination — goods that are shipped on a vessel are off-loaded at the first port of call, then loaded onto a second vessel for the next leg of the trip. The reason may be for ease and convenience of delivery to the shipment's final destination.

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Transshipment can sometimes create problems for the importer. As an example, bathing suits are shipped from an Asian port in June for final delivery in New York in early July. If weather problems delay the first leg of the trip, and transshipment is thereby delayed, the swimwear may arrive too late for sale in the summer season, thus reducing or eliminating the profitability of the shipment.

In one situation faced by a client, the exporter did not actually request permission to transship the goods and, of course, we advised the importer to eliminate permission to transship from the letter of credit, thus saving the importer potential problems and reduced profits.

Look for a Winning Technology

The best bank with which to partner will also have the most up-to-date, Web-based letter of credit technology and infrastructure, making it easier and more efficient to initiate letter of credit applications and to access specific information and detailed reports. Such a system should:

- enable a lender's customers to submit letter of credit applications, as well as request amendments to existing letters of credit electronically;
- enable real-time access to letters of credit data, from anywhere in the world, over the Internet;
- have strict, multiple security controls including a firewall, user ID and passwords;
- be easy to learn; operate with speed, convenience, accuracy and reliability;
- save time, reduce paperwork and thus help to reduce costs; and
- build the ABL's letter of credit templates and customize the information access to meet their specific needs, rather than direct the client to the bank's website.

At Sterling National Bank, our Sterlinks Web Letter of Credit system offers all of these capabilities and benefits, and is supported by our experienced International Trade Services staff.

Money on the Table

There is money on the table for the ABL who offers letters of credit to their clients. By partnering with the right bank, a lender can offer a valuable service to its clients and at the same time enhance its revenue.

When selecting a bank partner to do letter of credit work, an ABL must look for strong experience in trade finance, high accessibility, and up-to-date technology and infrastructure, along with competitive pricing. The bank should be a partner and a resource for the lender, rather than a potential competitor for the lender's clients. In the international trade arena, bigger is not necessarily better; by partnering with a smaller bank, the ABL may be making a wise decision; they may get better overall service and value than with a larger, multinational financial institution. **abfj**

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