

# TRADE FINANCE INSTRUMENTS

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## WHAT ARE INTERNATIONAL CLEAN PAYMENTS?

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Anyone in Germany can effect payments or receive payments from abroad without any restrictions or official authorizations.

Outward payments (for imports) are payments denominated in EUR or a foreign currency which residents effect to non-residents for their account. This includes payments to non-residents with accounts with German banks.

Inward payments from abroad (for exports) are payments denominated in EUR or a foreign currency effected by non-residents to residents.

Residents are natural and legal entities usually residing (for over 6 months at one time) or headquartered in Germany.

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## PAYMENTS IN FOREIGN CURRENCY

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Cross-border payments may be effected in EUR and in all freely convertible currencies. Foreign currencies credited or debited to an account denominated in EUR are converted at the reference rate (buying or selling rate) fixed twice daily by HypoVereinsbank (the only bank doing so in Germany).

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## SECTION 59, FOREIGN TRADE REGULATIONS

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The Foreign Trade regulations are governed under "AWV" (German Foreign Trade Act). For example, under certain circumstances, outward payments in excess of EUR 12,500 or the equivalent in a foreign currency must be reported, but only for German residents!

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## TYPES OF ORDERS

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### **Transfer orders data transmissions**

HVB offers a broad spectrum of customized solutions – from the Basic Cross Border Credit Transfer via HVB Direct B@nking for private customers, via the HVB eFIN for corporates, and Internet-based solutions for companies via the HVB globalTRX family. This ensures that payments are made safely and rapidly to all countries throughout the world (excluding those subject to embargo).

### **Paper-based orders**

Instructions for Basic Cross Border Credit Transfers are made using the "Euro Überweisung" (IBAN-/BIC-payment) form. A special form (so-called Z1) is used for other crossborder payments or payments to non-residents.

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## FEES

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In contrast to domestic payments in Germany, customers may select from different types of fees to be paid for cross-border payments.

### SHARE

Refers to fee-sharing, i.e. the ordering party and the beneficiary share the cost of the transaction.

### BEN

Refers to all fees charged to the beneficiary. The payee's bank deducts the fee from the amount transferred.

### OUR

Refers to all fees charged to the ordering party. In addition to HVB's price, a flat rate for third-party costs is charged since HVB must pay the fees of the foreign bank. Only by using "OUR" can the ordering party be certain that the beneficiary receives the full amount.

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## HOW ARE PAYMENT INSTRUCTIONS CARRIED OUT?

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HVB effects almost all payments via the SWIFT (Society for Worldwide Interbank Financial Telecommunication) network. SWIFT developed international communication standards for customer and interbank payments as well as for money, forex and securities trading. By structuring individual transactions in precisely defined fields, SWIFT created the foundation for the electronic exchange of messages and automatic processing.

Signatures are electronically encoded and can be checked by the receiving bank for authenticity.

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## BASIC CROSS BORDER TRANSFERS

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Pursuant to the EU regulations for cross-border payments denominated in EUR effective from July 1, 2003, all European banks are required to charge the same prices for Basic Cross Border Credit Transfer as for comparable domestic payments. One of the prerequisites for this is provision of the following data:

- IBAN (International Bank Account Number) of the beneficiary
- BIC (Bank Identifier Code) = SWIFT-address of beneficiary's bank
- Amount in EUR up to 50,000
- Fees shared
- No additional instructions.

Once this information has been received, the instructions can be carried out swiftly and economically.

Prices for payments differ sharply from one European country to another.

While domestic payments in Germany only cost the price for booking an item, a payment in other countries can easily cost over EUR 10. The beneficiary's bank deducts these local prices from the amount transferred even when the Basic Cross Border Credit Transfer is used.

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## SEPA – SINGLE EURO PAYMENTS AREA

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### Transfers (SEPA transfer = credit transfer)

since 28.01.2008

This will replace the current different national and cross-border procedures and formats with harmonised standards in the long term. The standards for the SEPA transfer apply for all transfers in euros within the SEPA participating countries – irrespective of the amount. The SEPA transfer is a new instrument for euro transfers in payments transactions and is geared strongly towards the EU standard transfer introduced in 2003.

### **Debits (SEPA debit = direct debit) from 01.11.2009 at the latest**

The SEPA debit represents an innovation in cross-border payments transactions as there has been no standardised procedure for this to date. A so-called “mandate” is required for the SEPA debit in future which will replace the collection authority as well as the direct debit order to date. The creditor is authorised by the debtor to collect debits. The account-holding bank is instructed to fulfill the debit instruction sent and debit the corresponding account. The debtor's bank is not obliged to check the mandate. In addition there are defined execution periods and deadlines: The creditor and his bank have to forward the debit instruction for collection in such good time that the file is available to the debtor's bank at least 5 days (TARGET days) before the due date in the case of a first or one-off debit and at least 2 days before the due date for regular debits.

A new statutory guideline is required for the SEPA debit according to current information. The question remains open, therefore, as to when the product for debits in the EURO/SEPA region currently planned can be started. The implementation date for all participating countries is 01.11.2009, though.

### **Card-supported payments transactions (debit cards = cards framework) from 31.12.2010 at the latest**

Card-supported payments transactions are also part of SEPA. “Any card at any terminal” – is SEPA's objective in respect of card payments. Card-holders are to be able to use their debit cards (ec cards) in the entire SEPA region without establishing a difference to using their card in their home country. The objective here as well is standardisation and greater transparency for the consumer.

Retailers will have the opportunity in future of accepting cards from the entire SEPA region as they also do with domestic cards.

### **SEPA transfer – the most important changes**

- Maxim period from instruction to credit entry of 3 bank working days, from 1 January 2012: 1 business day (public holiday ruling same as with TARGET)
- Transfer of the full amount, deduction of commission is not permitted
- Standard liability arrangements
- Price regulation for payments up to T€ 50

### **SEPA debit – the most important changes**

Introduction of a procedure for Europe-wide direct debits – this represents a real innovation in cross-border payments transactions.

- The condition is the granting of a mandate.
- Each direct debit includes a due date.
- There are defined execution periods and deadlines.
- Standard legal framework from national implementation of the guideline for payment instruments in the single European market
- There is no price regulation for the SEPA debit.

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## **PAYING BY CHEQUE**

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### **Paying by bank cheque**

The bank of the ordering party draws a cheque on another bank on behalf of the ordering party. The cheque can be sent directly to the beneficiary or to the ordering party. The amount is debited to the account as soon as the cheque is issued.

### **SWIFT-to-cheque**

The bank of the ordering party instructs a correspondent bank in the beneficiary's country via SWIFT to issue and send a bank cheque to the beneficiary. Here too, the amount of the cheque is debited immediately to the principal's account.

### **Personal cheque**

If the debtor himself issues a cheque and sends it to the beneficiary, this is a personal cheque. The issuer's account is only debited when the check is presented by the foreign bank.

More detailed information about international clean payments is contained in our brochures:

- Our Service in Cross-border Payments
- Basic Cross Border Credit Transfers
- IBAN
- FlashPayment.

## DOCUMENTARY COLLECTIONS

A transaction is referred to as a documentary collection when the seller (exporter) instructs his bank to deliver documents (commercial invoices, transport documents, any insurance documents, etc.) to the buyer (importer), usually through the intermediary of a bank in the importer's country, against payment of the proceeds, acceptance of a draft or other conditions. A distinction is made between the following types of collection

- a. Documents against payment (d/p).  
The documents are handed over against payment of the collection amount.
- b. Documents against acceptance (d/a).  
The documents are handed over against acceptance of a draft (a promissory note is issued).
- c. Documents against irrevocable payment order.  
The documents are handed over against the issue of an irrevocable payment order with later due date.

### Collection procedure

1. Goods shipped by seller (exporter)
2. Collection instructions + documents go to exporter's bank
3. Collection instructions with documents go to buyer's (importer's) bank
4. Importer's bank advises importer about collection
5. Importer fulfills collection instructions and receives documents
6. Transfer of collection amount to exporter's bank
7. Credit advice to exporter.

### Advantages/risks

- Cheaper than processing L/Cs.
- Exporter bears risk of taking up documents, i.e. the importer may not comply with instructions and refuse to pay.
- If documents are not taken up, the exporter risks having to find another use for the goods or send them back.
- The importer's bank is not liable for honoring the bill.
- The importer's financial risk is limited mainly to the possibility that the goods will not be delivered, will be delivered late or the shipment will be defective in some way.
- In export business, goods should never be addressed directly to the importer (except ocean transport), since importer can otherwise receive goods before taking up documents. To avoid this risk, goods should be addressed to importer's bank (but only after prior approval of this bank).

## BANK GUARANTEE

A bank guarantee is an irrevocable undertaking by a bank (guarantor) to effect payment in order to secure a certain contractually agreed service or payment obligations of the contractual parties in foreign trade transactions. The guarantee is an agreement between the bank and the beneficiary on behalf of a customer of the bank, usually the business partner of the beneficiary.

The guarantee is payable upon receipt of the first written demand of the beneficiary and the latter's statement that a certain contractually agreed service or payment obligation has not been fulfilled.

### Most important guarantees

- Tender guarantee = bid bond for 2% - 5% of contract value. Companies should maintain their offers after being awarded a contract or otherwise pay compensation (costs for new bid for tender).
- Advance payment guarantee for 100% of the amount paid in advance.
- Delivery and performance guarantee = performance bond for 10% - 20% of the contract value; compensation must be paid if contract is not fulfilled.
- Payment guarantee secures payment of purchase price by buyer.

### Recommendation

Try to agree on a direct, time-limited guarantee. Some countries insist on an indirect, unlimited guarantee. When the guarantee is indirect, the importer's bank is asked to issue a guarantee against the liability of the exporter's bank (additional costs, foreign law, sometimes problems with being released from liability).

## ACCEPTANCE

With short- and medium-term conditions, use of a bill should be considered as

- a hedging instrument, (depending on the country, if low or unknown creditworthiness, try to insist on bank aval),
- financing instrument, low-interest negotiation, forfaiting.

A draft is a bill which has been drawn but not yet accepted.

Promissory Notes are bills where drawee and drawer are identical.

Recommendation for Italy: If payments are not made punctually, we recommend the Ricevuta Bancaris = bank receipt which is customary there. It exercises relatively strong moral pressure on the debtor and avoids the high Italian stamp duty.

## LETTER OF CREDIT = L/C

A letter of credit is an irrevocable, abstract promise from the buyer's bank (the issuing bank) to pay the exporter an agreed amount under precisely stipulated conditions for the account of the buyer or to accept a draft.

Who is involved in the letter of credit:

- Applicant = Importer
- Issuing bank = bank of the importer
- Advising bank = bank of the exporter
- Beneficiary = exporter

### L/C according to security criteria

- Irrevocable unconfirmed L/C
- Irrevocable confirmed L/C.

L/C Confirmation means the additional commitment of the confirming bank to pay on behalf of the issuing bank. We recommend the L/C confirmation in cases of unknown banks and/or problematic countries.

### L/C according to types of payment

- Sight letters of credit
- Deferred payment L/C, for example 180 days after shipment date
- Tip: Forfaiting
- L/Cs with advance payment (usually linked to an advance payment guarantee).

### Procedure

1. Buyer instructs his bank to open an L/C in favor of seller.
2. L/C will be issued to the seller's bank.
3. Seller's bank advises seller about the L/C.
4. Exporter (seller) ships goods.
5. Documents are submitted to advising bank.
6. The advising bank checks the documents and if they are compliant effects immediate payment (L/C payable at advising banks counters at sight).
7. Documents are forwarded to issuing (= importer) bank.
8. The issuing bank checks the documents and has to effect payment immediately if documents are in order (L/C payable at sight at issuing banks counters).

### Advantages exporter

- The exporter receives an abstract and conditional promise from a bank to pay.
- Risk of payment is transferred to the issuing bank (unconfirmed L/C) or to the confirming bank (confirmed L/C).

### Risks/disadvantages exporter

- Unconfirmed L/C: bank which opens L/C could become insolvent; economic and political country risk.
- L/C conditions have to be fulfilled strictly.

### Advantages importer

- The importer is certain that payment will only be effected against documents that comply with the L/C terms. By setting the terms of the L/C, the importer forces the exporter to deliver the goods described at the agreed price by an agreed means of transport by a certain date.
- Presentation of documents required in the country of the importer.

### Risks importer

- Goods delivered do not comply with the contract and the L/C conditions.

### Solution

Checking of the goods before shipment by e.g. SGS, which is an independent inspection company and issues certificates about inspections.

### Advice

With our checklist "Request to open a Letter of Credit" you can give more detailed information about the L/C to your client in order to avoid time consuming and expensive changes of the L/C.

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## BUYER'S CREDITS

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Buyer's credits do not strain the balance sheet, because they are concluded by commercial banks or special institutions like AKA with the importer or the importer's bank. Disbursements under buyer's credits are usually made to the exporter.

### Prerequisites

EULER-HERMES credit insurance (uncovered deductible of the financing bank = 5% of the loan amount). The exporter's liabilities in connection with a buyer's credit that are balance sheet sparing compared with a supplier's credit, contain an undertaking (*vis-à-vis* EULER-HERMES and declaration of the exporter (*vis-à-vis* the financing bank).

HVB, like AKA, maintains a broad range of framework agreements with banks in importing countries whose use make granting loans fast and uncomplicated.

Since many importers consider financing a prerequisite for concluding a contract, you should contact us in an early stage of your negotiations.

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## FORFAITING

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Forfaiting is the sale of future payment obligations arising out of the sale of goods or services without recourse to the seller of those payment obligations except for defences or counterclaims with regard to the performance of the underlying commercial contract. A typical forfaiting transaction would be in the amount of at least EUR 500,000 for short and medium term supplier's credits, documented by

- Bills of Exchange or Promissory notes usually with bank aval
- Payment claims from deferred payment letters of credit
- Corporate accounts receivables (if possible with bank guarantee).

### Advantages for sellers

- Sell to riskier markets and on credit
- Removal of receivables from balance sheet
- Liquidity improvement and free credit lines
- Reduce of political, commercial and currency risk
- Quick and flexible 100% financing
- Fixed interest rate for the entire credit period

### Costs

Funding costs, risk premium covering country and debtor risk, management and commitment fees, days of grace.

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## CREDIT INSURANCE

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The pure del credere risk (credit/commercial, not political risk) is covered by private insurance companies (such as Gerling and the private-sector arm of Euler Hermes Kreditversicherungs-AG).

On behalf of the German government, Euler Hermes Kreditversicherungs-AG also covers credit/commercial and political risks of short-, medium- and long-term export transactions of German exporters as a Export Credit Agency (ECA). The most important ones are:

### Manufacturing risk

During the production phase, the importer may have financial problems or the country to which the goods are to be exported experiences financial/political difficulties. The exporter can have his prime costs insured. The premium, depending on the duration of production and the country category, which runs from 1 (least risk) to 7 (greatest risk) is between 0.33% to 2.10%. This premium also covers the embargo risk if export of the goods or performance of the service is revoked or banned by the German government. The same applies to embargo measures of any third countries involved.

### Export risks

After goods have been delivered, or service performed, importer becomes insolvent or legal measures, moratoriums, or bans on payments, bans on conversion and transfer are issued. Also secured is the loss of goods before the danger passes to the foreign debtor due to political circumstances.

The exporter's deductible for commercial risks is 15% and 5% of the amount covered for political risks.

### Prerequisites

The origin of the goods must be mainly German. At least 15% of the contract value must be paid as an advance and interim payment and the debtor and the country must be sufficiently creditworthy.

The premium depends on the contractual value, the country category, the duration of the claim and the status of the buyer (government or private) and is calculated according to special formulas.

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