What is a Standby Letter of Credit (SBLC):

A legal instrument issued by a bank on behalf of an applicant ("buyer"), providing a guarantee of its commitment to pay a beneficiary ("seller") if the applicant defaults on the underlying agreement, which will be referred to in the SBLC. The SBLC is used as a payment method of last resort.

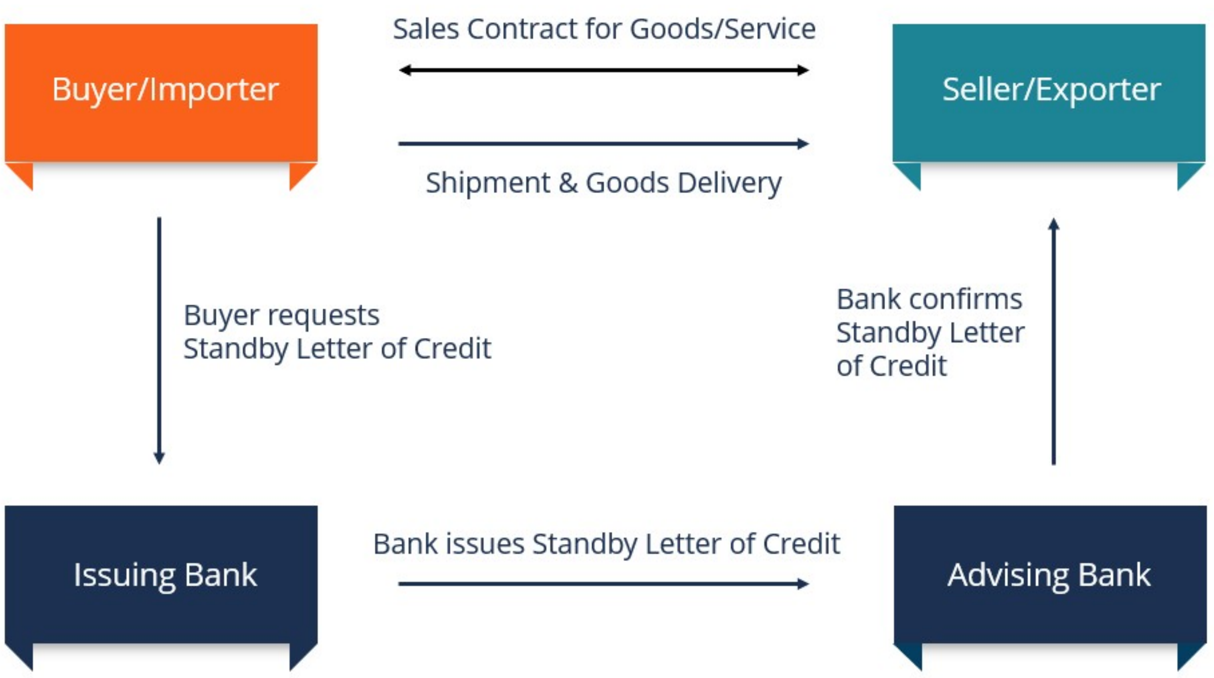
An SBLC acts as a safety net for the payment of a shipment of physical goods or completed service to the seller, in the event something unforeseen prevents the buyer from making the scheduled payments to the seller. In such a case, the SBLC ensures the required payments are made to the seller after fulfilment of the required obligations.

When is a SBLC used:

A SBLC is used in international or domestic transactions where the seller and the buyer do not know each other, and it attempts to hedge out the risks associated with such a transaction. Some of the risks include bankruptcy and insufficient cash flows on the part of the buyer, which prevents them from making payments to the seller on time.

In case of an adverse event, the bank promises to make the required payment to the seller as long as they meet the requirements of the SBLC. The bank payment to the seller is a form of credit, and the buyer is responsible for paying the principal plus interest as agreed with the bank.

How a SBLC Works:



Obtaining a SBLC from ASI:

The buyer applies for an SBLC with ASI by completing the necessary application form. ASI will perform its due diligence on the buyer and proposed transaction to assess its creditworthiness and suitability for a SBLC. ASI will use its collateral deposited with its bank and will issue the SBLC on behalf of the buyer.

The benefit for the buyer using ASI is that the buyer does not need to provide collateral to a bank for getting the SBLC issued. ASI uses its collateral and credit lines for instruments in place with its various banks.

ASI protects its collateral by staying involved in the underlying transaction and will take security in the transaction itself. The buyer will also be required to furnish ASI with information about the seller, shipping documents required for payment, the beneficiary's bank, and the period the SBLC will be valid for.

ASI will charge a service fee of 5-7% of the value of the SBLC, for each year when the SBLC remains valid. If the buyer meets its obligations in the contract before the due date, ASI will terminate the SBLC without a further charge to the buyer.

If the buyer fails to meet the terms of the contract due to various reasons, such as bankruptcy, cash flow issues, etc., the seller will be required to present all the required documentation listed in the SBLC to ASI within a specified period, and ASI will, subject to ownership of the products, make the payment due to the seller's bank.

Types of Standby Letter of Credit:

The two main types of SBLC are:

1. Financial SBLC

The financial-based SBLC guarantees payment for goods or services, as stipulated in the agreement. For example, if a crude oil company ships oil to a foreign buyer with an expectation that the buyer will pay within 30 days from the date of shipment, and the payment is not made by the required date, the crude oil seller can collect the payment for goods delivered from the buyer's bank. Since it is a credit, ASI will collect the principal plus interest from the buyer.

2. Performance SBLC

A performance-based SBLC guarantees the completion of a project within the scheduled timelines. If the contractor is unable to complete the project outlined in the contract, then ASI promises to reimburse the third party to the contract a specific sum of money.

Performance SBLCs are used in projects that are scheduled for completion within a specific timeline, such as construction projects. The payment serves as a penalty for delays in the project's completion, and it is used to compensate the customer for the inconvenience caused or to pay another contractor to take over the project.

Summary

- A SBLC refers to a legal instrument issued by ASI's bank on behalf of ASI's client, providing a guarantee of its commitment to pay the seller if ASI's client (the buyer) defaults on the underlying agreement.
- A SBLC is frequently used in international and domestic transactions where the parties to a contract do not know each other.
- A SBLC serves as a safety net by assuring the seller that the bank will make payment for the goods or services delivered if the buyer fails to make the payment on time.

ASI INTERNATIONAL
TRADE FINANCE DEPARTMENT
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