

LOAN WORKSHEET #9 – LETTERS OF CREDIT

There are two primary forms of letters of credit: trade or documentary letters of credit which eliminate the beneficiary’s risk of nonpayment under a contract for sale of goods to a bank’s customer; and standby letters of credit which eliminate the financial risks resulting from nonperformance of bank customers under contracts with third parties. A trade/documentary letter of credit is issued by a bank for the account of its customer, generally to enable international trade. It permits the beneficiary to draw funds for the payment of goods shipped by the beneficiary to the bank’s customer, provided the beneficiary complies with the documentary terms and conditions stipulated in the letter of credit. A standby letter of credit is an irrevocable instrument issued by the bank for the account of its customer to provide assurance to the beneficiary that the bank will “stand by” to honor complying documents in the event of the customer’s nonperformance under the terms of the an agreement between the customer and beneficiary. Trade/documentary letters of credit are normally funded as a transaction is completed. Standby letters of credit are usually not funded unless the bank’s customer has failed to meet an obligation with a third party. While not typically evidenced on the bank’s general ledger, letters of credit represent extensions of credit which expose the bank to potential loss if not managed properly.

Evaluate	Comments
<p>_____ 1. Review reconcilements of all categories of letters of credit, and balance amounts as of the exam date to the general ledger if applicable, or subledger if not carried on the GL.</p> <p style="padding-left: 40px;">A. Check compliance with 12 CFR 337.2 (d) which requires banks to maintain adequate controls and subsidiary records of standbys.</p> <p>_____ 2. Verify accuracy of call report schedule RC-L.</p> <p>_____ 3. Evaluate the section in the loan policy covering letters of credit.</p> <p style="padding-left: 40px;">A. Are there established procedures for monitoring the value and status of outstanding letters of credit?</p>	

LOAN WORKSHEET #9 – LETTERS OF CREDIT (continued)

Evaluate	Comments
<p data-bbox="358 283 800 457">B. Have minimum standards of documentation been established in accordance with the Uniform Commercial Code?</p> <p data-bbox="358 533 784 636">C. Are letters of credit approved in the same manner as other extensions of credit?</p> <p data-bbox="358 711 781 814">D. Does the board receive adequate reports to supervise activity?</p> <p data-bbox="207 890 735 953">_____ 4. Review a sample of letters of credit.</p> <p data-bbox="358 1029 764 1134">A. Check for primary elements that a letter of credit should contain:</p> <ul data-bbox="407 1209 812 1560" style="list-style-type: none">• A conspicuous statement that the document is a letter of credit.• A specific expiration date.• A limitation in the amount of the bank's obligation.	

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Evaluate	Comments
<ul style="list-style-type: none"> • A specific action which creates the bank’s obligation to pay, such as presentation of a draft. A bank should not be called upon to determine questions of fact or law at issue between the account party and the beneficiary. <p>_____ 5. Review financial information on a sample of letters of credit. Ensure that the bank has protected its position by evaluating the capacity of the customer to perform under the terms of the contract being covered, and taking collateral positions as appropriate.</p>	