

The Use of Payment Methods for the Settlement of International Liabilities

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Abstract

In the case of payments through a letter of credit or collection, there will be a commercial contract between the parties, in which the payment method that will be used will be clearly stipulated, and the exporter will proceed to preparing the set of documents and their transmission. If the factoring is used as a payment method, the factor will proceed to an analysis of the accounts receivable, after which the seller's accounts receivable will be taken over or not.

Keywords: letter of credit, collection, factoring, payment, bill of exchange

In order to settle international liabilities, the letter of credit, the collection (encashment), and the factoring are used as payment methods.

The letter of credit

Is a payment method through which the issuing credit institution, acting on behalf of its client, is to make the payment to the beneficiary or to accept the payment of trade bills. The issuing credit institution can also authorize another credit institution to make payments on the basis of initially stipulated documents.

The parties involved in the carrying out of a letter of credit are:

- **the principal** (the importer) is the client of the credit institution; they initiate the letter of credit and establishes the conditions for carrying it out, pursuing the deterrence of excessive clauses in the letter of credit or of references to an earlier letter of credit;

- **the issuing credit institution** (of the importer) is the one that, at the request of the principal, undertakes the settlement of the documents

issued by the exporter (the beneficiary of the letter of credit) under the conditions stipulated in the letter of credit;

- **the beneficiary of the letter of credit** (the exporter) is the one in whose favour the letter of credit was opened and who will be able to collect its equivalent value as soon as the documents attesting the execution of the contract are presented;

- **the beneficiary's credit institution** is the one that serves the beneficiary of the letter of credit.

The following two stages are necessary for the carrying out of the letter of credit:

- a. the opening of the letter of credit;
- b. the use of the letter of credit.

a. For opening a letter of credit, an economic agent which is in the position of an importer needs to submit an application, after which the credit institution will check whether the applicant has the necessary financial resources in the form of available pecuniary assets or in the form of credits obtained from the credit institution, and the two parties will establish all the necessary details and conditions.

If the economic agent does not have an account of liquid assets opened at the credit institution, then they will make use of a corresponding credit institution through which the endorsement of the letter of credit will be made and the assurance will be obtained that the payment will be made only in accordance with the content of the letter of credit.

There are situations in which, at the request of the issuing credit institution, there is also a confirming credit institution.

The notifying and confirming credit institutions will verify the authenticity and the content of the letter of credit, the solvency and reputation of the issuing credit institution, as well as the risks of the importer's country. If there are no elements of risk, then the letter of credit of the issuing credit institution can be confirmed, engagement clauses or disengagement clauses being subsequently mentioned in the letter of credit, function to its type. If it does engage, the credit institution becomes a confirming one and will assume joint liability with the issuing credit institution for completing the transaction, while if not engaging, it will only become notifying credit institution.

While the letter of credit is being carried out, partial deliveries are allowed on condition that there are clauses providing for this. Also,

the term, as well as the place and date for the payment, agreement or negotiation will need to be mentioned in the letter of credit.

The necessary documents for settling the letter of credit will also be mentioned in it, the documents most frequently necessary being:

- the documents attesting the delivery of goods or the carrying out of works or services, such as the commercial invoice issued by the beneficiary of the letter of credit;
- the transport documents (the letter of air, road or railway transport, the maritime or fluvial bill of lading or other documents for dispatch);
- the insurance documents for all the duration of transportation;
- documents certifying the quality of the goods;
- the certificate of origin for the goods;
- phyto-sanitary certificate, sanitary-veterinary certificate, etc.

As soon as the beneficiary comes into possession of the letter of credit, they will have to check its content and if it does not correspond to the initial contract, the differences will be solved in mutual agreement with the importer.

b. As soon as the exporter receives the notification of the letter of credit, after the delivery of the goods, they will send to the importer the documents necessary for encashment, which are specified in the letter of credit.

If there are inconsistencies between the documents presented to the credit institution and the ones in the letter of credit, the credit institution can deny payment to the beneficiary, but it is obliged to send a notification in this respect or will make a written invitation for the principal to present themselves for clarifying the inconsistencies. If no such problems appear, the confirming institution will credit the exporter's current account, debiting the corresponding account of the issuing credit institution by sending to the latter the related documentation directly or through a reimbursing credit institution, which corresponds both to the issuing and the confirming credit institution.

The issuing credit institution will check the documentation, subsequently informing the credit institution from which they have received the documentation whether they will accept it or not. If the documentation is not accepted, the credit institution that made the payment will return to the issuing credit institution the amount paid, the commissions and other bank expenses.

The mechanism of an operation involving a letter of credit comprises the following stages:

1. The commercial contract between the principal and the beneficiary is concluded, as part of which the partners have agreed upon the documentary letter of credit as payment method.

2. The principal orders its credit institution to open a letter of credit in favour of its beneficiary.

3. The document regarding the opening of a letter of credit will be given to the beneficiary before they ship the commodity, but correlated to the delivery time agreed upon in the commercial contract.

4. The beneficiary is announced that the credit institution engages itself to make the payment against the documents.

5. The beneficiary of the letter of credit will proceed to the delivery of the goods in accordance with the provisions in the contract.

6. The documents attesting the shipping of the goods are presented according to contract provisions.

7. Verification of the documents against the provisions of the letter of credit takes place.

8. The documents are handed in and the reimbursement of the amount in the letter of credit is required.

9. The amount stipulated in the letter of credit is remitted according to the request received.

10. Verification of the documents on the basis of which the payment was made for the invoice belonging to the set of documents

11. The debiting of the principal's account by the credit institution serving it

The collection

The collection is a form of payment used by credit institutions with the aim of obtaining the acceptance of some documents and/or their payment or with the aim of presenting documents against acceptance and/or payment according to some instructions received from the client.

This payment method is used only when there is more trust between the business partners than in the case of the letter of credit.

It is to be noted that in the case of the collection, the credit institutions involved in the settlement of accounts do not engage to pay, they are only managers of the commercial documents mentioned by the exporter, namely: invoices, dispatch documents or any other similar

documents, but also financial documents such as: drafts/bills of exchange, promissory notes, checks or other documents of this kind.

Besides the function of making payments, in some cases the collection can also fulfil a financing function for international trade on a short-term basis, function which can be exploited both for the benefit of the importer and of the exporter, especially at present when a lot of companies complain about a lack of the capital necessary for carrying on their activity.

Like the letter of credit, the collection is regulated in a uniform manner by the International Chamber of Commerce in Paris, which, since 1956, has been regularly publishing a series of rules regarding the operations made through documentary collection. Throughout the years, the uniform rules regarding the collections acquired universal acceptance so that they have become an indispensable tool for international commercial transactions. The current version of these rules became effective in 1995 and is known as Publication 522.

Synthetically speaking, the documentary collection consists in the transmission through a bank channel of the documents attesting the delivery of a certain commodity or provision of services from the exporter to the importer and the release of these documents under certain conditions:

- against immediate payment;
- against the acceptance of drafts included in the set of documents;
- Under other conditions (for example, free of payment, the importer's debt being settled in another way).

The money is subsequently sent from the importer to the exporter through the bank channel as well. It needs to be emphasised that, if in the case of the documentary letter of credit the payment commitment to the exporter belongs to a credit institution, in the case of the collection credit institutions do not assume any payment commitment. Consequently, if they do not benefit from any guarantee, the exporter takes the risk of not being paid, or if paid, of being paid with a delay.

Although the credit institutions do not take on any payment commitment, circulating the documents through a bank channel exerts a certain psychological pressure upon the importer. If they refuse or cannot settle their debts, the importer risks worsening their relations with the credit institution serving them, which can deny them the granting of credits or other facilities, considering them a bad payer.

The parties involved in a collection payment are:

- **the principal** is the client that will entrust the credit institution with the documents in order to be cashed in; they will be in the position of the beneficiary;
- **the drawee** is the one that needs to pay the amount of money and the one to whom presentation of the documents is to be made for acceptance or payment;
- **the remitting credit institution** is the one to whom the principal has entrusted the documents for delivery and encashment;
- **the presenting credit institution** is the one presenting the documents to the drawee.

The main stages of a documentary collection in which the importer's credit institution is, at the same time, both the collecting and the presenting credit institution are the following:

1. the international commercial contract is concluded between the importer and the exporter, which provides for the payment of the goods through collection;
2. the exporter delivers the goods to the importer;
3. after the delivery of the goods, the exporter prepares the set of documents that they send to their credit institution accompanied by the collection order;
4. subsequently, the remitting credit institution sends the documents and the collection order to the presenting credit institution;
5. the presenting credit institution announces the importer about the collection, informing them about the payment conditions;
6. the importer makes the payment or accepts the bill of exchange, after which they come into possession of the documents on the basis of which they can collect the goods;
7. the presenting credit institution pays the remitting credit institution the amount of money corresponding to the value of the collection;
8. finally, the remitting credit institution credits the exporter's account.

Publication 522 groups the documents used for the collection payment into financial and commercial documents. While the financial documents comprise bills of exchange, promissory notes, cheques, or other similar instruments used for obtaining the payment of money, the commercial documents refer to: invoices, transport documents,

documents of title or other similar documents, or any other documents whatsoever, not being financial documents.

Function to the instructions regarding the release of commercial documents, one can distinguish between:

- collections with release of documents against payment (D/P);
- collections with release of documents against acceptance (D/A).

As the name suggests, in the first case (D/P), the importer will receive the documents from the presenting credit institution against prompt payment. In the second instance (D/A), the presenting credit institution will release the documents either against acceptance of the bills of exchange payable at a future date included in the set of documents, or against signing a letter through which the importer pledges irrevocably to make the payment at the specified term.

Factoring

In accordance with the Government Emergency Ordinance no. 10 of 19.04.1997, factoring consists in the possibility of economic agents to transfer part of or all their accounts receivable to one or some institutions specialized in such operations on the basis of a factoring contract and in exchange for a commission.

From the perspective of the included services, the factoring is defined as a complex financial product or a contract relationship between the seller and a factor that combines the crediting activity, taking the risk of not cashing in the accounts receivable, services of tracking and encashment of debts, as well as book-keeping.

The coverage through factoring of the risk of not cashing in the accounts receivable is done without requiring actual guarantees. Thus, for foreign operations, one of the concerns of the institution assuring the credit through factoring is the protection against the risk of lack of payment generated by relations of foreign trade of Romanian companies, resulting from the experience of the respective institutions in the administration of client portfolios. The advantage is obvious, given the fact that recovering the accounts receivable from a foreign debtor is almost impossible, and a law suit can last several years, involving costs that may exceed the value of the damage.

Factoring is also regarded as a contract concluded between the seller, respectively the supplier of goods and services, and the factor (which can be a credit institution or a specialized financial institution through which the seller's accounts receivable resulted from sales of

goods or services are taken over in order to be later cashed in from the debtors).

The parties involved in a factoring operation are the following:

- **the seller**, which is a producer or seller of goods, provider of services or works and which, based on their contract with the factor transfers to the latter all the accounts receivable materialized in invoices, with the specification that these have been ceded and they are to be paid by the factor.

- **the factor**, which is a financial institution (a credit institution, a specialized insurance and reinsurance company or another financial institution) and which, in exchange for a commission will pay to the seller all the accepted accounts receivable, and will later encash the receivables from the seller's debtors.

- **the debtors**, which are the seller's clients, the buyers of the goods, the beneficiaries of the services or works and which are notified about the transfer of the seller's rights onto the factor, as well as about the debtor's obligation to pay the invoice directly and only to the factor.

The factoring operation involves the following stages:

1. the release of the invoice and the delivery of the goods and services;
2. invoice acceptance;
3. invoice transfer;
4. financing;
5. payment is made;
6. financing of the difference.

The elements that need to be taken into consideration for client selection are the activities that are not fit for or are excepted from factoring operations.

a. The main activities that are not fit for factoring are the following:

1. construction;
2. naval workshops;
3. production of fishing utensils and tools;
4. production of jewellery, fur, and other luxury products;
5. production of cosmetics;
6. services area, excepting international freight transport services and those services that allow for written

confirmation from the beneficiary that the service has been carried out, corresponds to their requirements and will be entirely paid for when due.

- b. The following shall be excepted from factoring:
1. reliance on one or a small number of debtors;
 2. release of invoices before the delivery of goods or provision of services;
 3. release of invoices for partial deliveries of goods;
 4. release of invoices for execution stages of a project whose completion determines the nullity of the previous invoices;
 5. release of post-dated invoices;
 6. advance payment or payment on delivery;
 7. sales through a salesperson;
 8. overdue invoices or invoices whose encashment period exceeds 180 days;
 9. release of invoices for samples (as these will not be paid if the partner does not order the respective product).

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management decision for monthly accounting reports are not sufficient but requires constant monitoring as possible (daily) certain types of

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