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The Letter of Credit

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The Letter of Credit

A letter of credit is a document typically issued by a bank or financial institution, which authorizes the recipient of the letter (the "customer" of the bank) to draw amounts of money up to a specified total, consistent with any terms and conditions set forth in the letter. This usually occurs where the bank's customer seeks to assure a seller (the "beneficiary") that it will receive payment for any goods it sells to the customer.

For example, the bank might extend the letter of credit conditioned upon the beneficiary's providing documentation that the goods purchased with the line of credit have been shipped to the customer. The customer may use the letter of credit to assure the beneficiary that, if it satisfies the conditions set forth in the letter, it will be paid for any goods it sells and ships to the customer.

In simple terms, a letter of credit could be said to document a bank customer's line of credit, and any terms associated with its use of that line of credit. Letters of credit are most commonly used in association with long-distance and international commercial transactions.

Confirmed Letter of Credit

A letter of credit, issued by a foreign bank, which has been verified and guaranteed by a domestic bank in the event of default by the foreign bank or buyer. Typically, this form of letter of credit will be sought when a domestic exporter seeks assurance of payment from a foreign importer.

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Commercial Letter of Credit

A commercial letter of credit assures the seller that the bank will provide payment for any goods or merchandise shipped to the bank's customer, assuming the seller provides any required documentation of the transaction and its shipment of the purchased goods.

Irrevocable Letter of Credit

An irrevocable letter of credit includes a guarantee by the issuing bank that if all of the terms and conditions set forth in the letter are satisfied by the beneficiary, the letter of credit will be honored.

Revocable Letter of Credit

An revocable letter of credit may be cancelled or modified after its date of issue, by the issuing bank.

Standby Letter of Credit

In the event that the bank's customer defaults on a payment to the beneficiary, and the beneficiary documents proof of its loss consistent with any terms set forth in the letter, a standby letter of credit may be used by the beneficiary to secure payment from the issuing bank.

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