Asia Pacific Science Press

Asia Pacific Economic and Management Review
ISSN(O):3005-9275
ISSN(P):3005-9267
Vol. 2 No.5 (2025)

Clarifying Four Key Issues Regarding Letters of Credit: The Most Important International Payment Method

Yongdong Xu*

School of Economics and Management, Guangdong Technology College, Zhaoqing, 526000, China

Corresponding author: Yongdong Xu

Abstract: As one of the most significant payment methods in international trade, letters of credit have greatly facilitated the settlement of international trade transactions and promoted the development of global commerce. This paper examines four key aspects of letters of credit. Firstly, their origins and evolution: from the Roman Empire to 19th-century Britain, culminating in the implementation of UCP600 on 1st July 2007, letters of credit have undergone extensive development throughout human history. Secondly, the issuance of letters of credit is subject to stringent restrictions and requirements. Upon the applicant's submission of an application, the bank verifies their qualifications and creditworthiness. If compliant, the issuing bank issues the letter of credit upon the applicant's deposit of a security deposit. Thirdly, the fundamental principles of letters of credit are central to our profound understanding of their core and essence. Letters of credit constitute a documentary transaction, necessitating documentary consistency and documentary compliance. Finally, examining the operational procedures of letters of credit aids in comprehending how they facilitate international trade settlements.

Keywords: International Payment Methods; Letters of Credit; Origins; Fundamental Principles; Operational Procedures

Published: Oct 25, 2025

DOI: https://doi.org/10.62177/apemr.v2i5.725

1.The Origins and Development of Letters of Credit

In the mid-fifth century BC, ancient Roman law established provisions governing the property rights and obligations pertaining to commodities: written instruments of credit could be employed in the exchange of goods and currency to demonstrate the commercial credibility of both parties involved.

The letter of credit, substituting bank credit for commercial credit, was jointly devised by bankers and merchants. The earliest letters of credit emerged in 12th-century Europe. At that time, when popes, princes, and other rulers dispatched envoys on missions abroad, they would issue and sign public notices for convenience, pledging unconditional repayment to any party willing to advance funds to their envoys. This notice resembled our modern traveller's letter of credit and represents the earliest form of such instruments. Practical application can be traced back to the 14th century, with traveller's letters of credit (Traveler's Letter of Credit) used in European cities such as Venice, Genoa, and Florence in Italy. A defining characteristic of the traveller's letter of credit was that the applicant, beneficiary, and traveller were one and the same person. Historically, this type of credit document was termed the original letter of credit. Subsequently, letters of credit found commercial application. Formally, they included not only open letters of credit but also so-called special letters of credit, wherein the issuing bank required its overseas representative or a co-operator to advance funds to its dispatched agent. However, such letters of credit were all documentary letters of credit without shipping documents attached, and they were not necessarily based on a sales contract. The circulation of the letter of credit was also not tied to the movement of goods.

By the mid-19th century, the establishment of regular shipping routes, advances in marine insurance, and the subsequent development of bills of lading and insurance policies into negotiable instruments gave rise to the documentary credit – the precursor to the modern letter of credit.

In 1880s Britain, letters of credit were first employed as a means of settling payments in international trade. [1]

Following the First World War, documentary credits became the predominant method for international trade payments. In early 1920, the Bankers' Committee on Commercial Credit in New York (led by Citibank and comprising 34 financial institutions) adopted and promulgated the 'Rules for the Application of Export Credits' (RAECC). Revised provisions of the RAECC were formally signed in 1926, taking effect on 1 July. The period around the Second World War witnessed vigorous expansion in letter of credit operations.

Since the 1980s, numerous developing nations have utilised the letter of credit mechanism for foreign trade, with documentary letters of credit now extensively employed in international commerce. Particularly with the advent of standby credits, their applications have become even more widespread.

The identity of the world's first letter of credit issuer or the first bank to issue such a document remains unverifiable. However, the modern letter of credit is demonstrably an invention of the British. In the preface to the first edition of his work The Law of Bankers' Commercial Credit, the Englishman H.C. Guttreidge wrote: 'The method of financing the import and export of goods through bankers' commercial credit, in its modern form, is the creation of British commercial ingenuity.' On this basis, we may provisionally consider modern letters of credit to have originated in Britain. One point remains undeniable: modern letters of credit were indeed introduced to China from the West. Initially rendered as ' 信用状 ' (xin yong zhuang), they are now universally termed ' 信用证 ' (xin yong zheng) internationally. [2]

The emergence of letters of credit undoubtedly accompanied the development of international trade. The inherent contradiction between the socialisation of capitalist production and the private ownership of the means of production, coupled with the inherently greedy nature of merchants, rendered international trade fraught with risks and challenges. Bankruptcy, breach of contract, refusal of payment, and fraud were commonplace occurrences. Under such circumstances, traditional payment methods based on commercial credit, such as remittances and collections, could no longer accommodate the rapidly expanding international trade landscape and severely impeded its development. Consequently, a payment method emerged that detached itself from commercial credit and was entirely based on bank credit: the bank letter of credit.

The advent of letters of credit greatly facilitated international trade settlements and powerfully propelled the growth of global commerce. By the late 19th century, documentary credit had gained considerable practical application. However, early letters of credit lacked unified international rules. Merchants in different countries interpreted credit terms based on their own national laws, regulations, judicial systems, and customs, leading to constant disputes, conflicts, and litigation. This objectively hindered the widespread adoption of letters of credit. In response, banks in numerous countries successively formulated their own letter of credit practices. Yet these remained confined to limited application, failing to gain widespread acceptance or resolve the fundamental issues.

Consequently, many nations recognised the imperative for a unified set of rules and standards governing letters of credit to address the challenges of international trade settlement. Driven by this awareness, letters of credit entered a phase of rapid development, undergoing roughly eight stages and six revisions. The final revision was designated the Uniform Customs and Practice for Documentary Credits, 2007 Revision (ICC Publication No. 600), commonly known as 'UCP 600'. It came into force on 1 July 2007. Given the significance and central role of UCP600, its revision also spurred corresponding updates to eUCP (UCP Supplement for Electronic Presentation), ISBP (International Standard Banking Practice for the Examination of Documents under Documentary Credits), SWIFT (Society for Worldwide Interbank Financial Telecommunications).[3]

2.Opening of Letters of Credit

Application for Issuance

Upon agreement between the exporter and importer to settle via documentary credit, the importer assumes responsibility for initiating the credit. The first step involves completing the application form, which establishes a legal relationship between the applicant and the issuing bank. Consequently, this application form constitutes the most critical document in the credit opening process.

Requirements for the Application

The requirements for a letter of credit application are clearly stipulated in UCP 600, and the importer must communicate these precisely to the bank. Instructions for opening the credit must be complete and unambiguous. The applicant must always bear in mind that documentary credit transactions deal with documents, not goods. Bankers are not merchants; therefore, the applicant should not expect bank staff to fully comprehend the technical terminology of every transaction. Even if the applicant incorporates all terms from the sales contract into the letter of credit, full protection cannot be guaranteed should the beneficiary (exporter) seek to defraud. This necessitates collaborative effort between the bank and applicant, employing common sense to avoid issuing letters of credit that appear cumbersome to all parties. Banks should also discourage applicants from replicating the terms of previously issued letters of credit (known as 'copy letters') when applying for new ones.

Security of Letter of Credit Issuance

Upon receiving complete instructions from the applicant, the bank must immediately issue the letter of credit accordingly. Conversely, the bank retains the right to require the applicant to deposit a specified sum of funds or assets (including assets held in other forms) as security for the bank's execution of its instructions.

Under current regulations, foreign exchange held by local authorities, departments, and enterprises in China must typically be deposited with Chinese banks. Should certain entities require importing goods or technology via documentary credit payment, Chinese banks will freeze funds equivalent to the credit amount in their accounts as a letter of credit guarantee deposit.

If the applicant lacks an account with the issuing bank, the latter may require the applicant to deposit funds equivalent to the full credit amount prior to issuance. Such security may be provided through mortgage or pledge arrangements. Banks may also provide financing secured against the goods being traded. The issuing bank must first investigate the marketability of these goods; if the goods are readily marketable, the financing amount provided to the client against the letter of credit will be significantly higher than for slow-moving commodities.

3.Principles of Letters of Credit

Principle One: Upon concluding a contract, the importer requests their local bank to act as guarantor and issue a letter of credit to the exporter. Armed with this document, the exporter may arrange for goods delivery and payment collection through the bank, with the importer prohibited from reneging or interfering mid-transaction.

Principle One indicates the eligibility criteria for accepting and operating letters of credit:

Domestic manufacturers, companies, or even individual industrial and commercial households possessing independent export rights may open a US dollar account with a bank to accept and operate letters of credit through their account-holding bank.

Manufacturers without export rights who export through foreign trade companies may likewise request the foreign trade company to handle the letter of credit on their behalf. In such cases, however, the exporter named on the letter of credit will be the foreign trade company, which will accept and operate the letter of credit through its US dollar-denominated account bank. As with standard agency export operations, the foreign trade company handles the business while the exporter bears the risk.

Principle Two of Letters of Credit: In documentary credit transactions, the exchange involves documents.

Principle Two addresses how banks oversee exporters' shipments under this payment method.

Foreign banks only disburse funds upon the exporter's fulfilment of delivery obligations. Given the vast diversity of industries and products in international trade, and banks' limited product expertise, how can banks verify shipment compliance and ensure delivery? Consequently, banks must rely on the supporting documentation accompanying the goods.

In a sense, foreign trade exports involve the buying and selling of documents, a characteristic particularly pronounced in letters of credit. In L/C operations, banks must first ensure the exporter delivers goods on time, in the correct quantity, and of the specified quality before making payment. However, banks worldwide handling related foreign trade business process thousands of letters of credit daily, involving products ranging from Philippine pineapples and Bordeaux red wine to

Christmas trees from Yiwu, Zhejiang, China... Banks lack the time, resources, and specialised expertise to physically inspect goods. How then do they verify shipments and facilitate delivery? The solution lies in international trade's 'documentary transactions'. In foreign trade, a set of documents represents the actual goods, typically comprising:

1. Commercial Invoice. This is not a domestic tax invoice but a document prepared by the exporter detailing the goods' description, quantity, unit price, and total value.
2. Packing list. Prepared by the exporter, detailing the number of packages, external markings, net weight, gross weight, and dimensions.
3. Bill of lading. Specifically the ocean bill of lading, a document of title issued by the shipping company. This document carries internationally recognised legal title to the goods; whoever holds the bill of lading is the owner of the shipment.

These three documents constitute the fundamental set under a letter of credit. In international trade, the party holding this documentation in good faith (excluding cases of finding or theft) is entitled to collect the goods.

To verify quantity, quality, and import/export eligibility, supplementary documents may include:

4. Quality/Quantity Certificate. Issued by statutory bodies (e.g., China Commodity Inspection and Quarantine Bureau) or private agencies (e.g., SGS, the Swiss General Notary Office specialising in international goods inspection) commissioned by the exporter or importer. This document certifies that the goods meet specified quality and quantity requirements following inspection.
5. Certificate of Origin. Verifies the goods' country of origin, primarily used for claiming preferential import/export tariffs.
6. Additional documentation detailing the consignment's particulars may be required depending on industry and national regulations.

With this comprehensive set of documents, all parties involved in international trade—whether importers, exporters, or intermediaries—need not remain tied to the goods or endure the hassle of repeated shipments. Goods may be temporarily stored in warehouses while parties trade these documents among themselves. Ultimately, whoever secures the full set of documents proceeds to the warehouse to collect the goods, thereby saving substantial transportation and handling costs. This exemplifies the 'documentary transaction' characteristic of international trade.

In a letter of credit, delivering goods to the bank entails submitting this complete set of trade documents.

Principle Three of Letters of Credit: Banks process goods delivery and payment solely based on the documents. Payment is made only when the documents are in order and consistent with each other.

This principle underscores that trade documents are the lifeblood of letters of credit. In practice, submitting documents to the bank is equivalent to delivering goods. If the bank finds no issues upon examination, payment is released. The critical importance of documents in letters of credit is thus self-evident.

Given their significance, banks naturally specify in detail within the letter of credit the types of documents required, the party responsible for issuing them, and their validity periods. Occasionally, to facilitate processing, banks may even request additional documentation.

As this is a documentary transaction, banks involved in L/C operations do not concern themselves with the quality or nature of the imported or exported goods. They solely verify whether the complete set of trade documents complies with the L/C terms and is valid. Banks do not even undertake to authenticate the documents; provided the documents 'appear' to meet the L/C requirements, they accept them and make payment. It is conceivable for an exporter to fabricate the entire set of documents. This refers to a beneficiary of the letter of credit obtaining payment under the credit by fraudulently presenting forged documents that superficially match the credit requirements, thereby inducing the bank to make unconditional payment despite the goods not existing. This constitutes fraudulent activity by the exporter and is a criminal offence.[4]

Consequently, the critical importance of documents under letter of credit terms becomes readily apparent. To put it starkly, if an exporter can procure a complete set of documents conforming to the letter of credit requirements, they could receive payment even if they shipped a load of rubbish to the importer. Conversely, even if the exporter's goods are flawless, non-compliance of the documents with the letter of credit stipulations will result in non-payment. Banks adhere strictly to this principle: they recognise documents, not goods, nor individuals.

Principle Four of Letters of Credit: Should errors occur in the export documentation, the bank may refuse payment and impose penalties on the exporter. The subsequent course of action following a bank's refusal of payment requires separate negotiation.

This principle underscores that when handling trade documents under a letter of credit, meticulous preparation is essential to avoid errors. What consequences arise if discrepancies occur? The letter of credit specifies detailed requirements for the full set of trade documents. Any aspect of the documents submitted to the bank that fails to meet these requirements is termed a 'discrepancy' (Discrepant). Upon identifying such discrepancies, the bank retains the right to withhold payment.

Subsequent handling involves the bank consulting both the importer and exporter. Should the importer accept the discrepancy, the bank may proceed with payment as normal. Should the importer object, the exporter must decide whether to withdraw the documents and recall the goods, thereby terminating the transaction; or negotiate a resolution with the importer, potentially involving price reductions, compensation, or other terms.

Regardless of the final resolution, the bank will impose a penalty on the exporter whenever discrepancies arise. This penalty is termed a forfeit. The amount of each forfeit is stipulated in advance within the letter of credit. Exporters should not entertain any notion that forfeits can be avoided by the transaction falling through, as this is impossible since the documents remain in the bank's possession. Such is the nature of international trade: the documents represent the goods, and the goods represent the payment.

Principle Five of Letters of Credit: Once a letter of credit is issued, the importer cannot unilaterally breach the contract or demand amendments. The exporter may refuse to utilise the letter of credit or request modifications before submitting the trade documents to the bank.

This principle underscores that letters of credit serve to safeguard the exporter's interests.

Given the critical importance of trade documents, exporters must exercise caution. What if the documentary requirements stipulated in the letter of credit are unfeasible for the exporter? The solution is straightforward: the exporter may request the importer to amend the relevant terms of the letter of credit. Once issued, the importer cannot breach the contract or unilaterally demand alterations, whereas the exporter retains the right to request modifications. This underscores that letters of credit fundamentally safeguard the exporter's interests. When an importer opens a letter of credit through a bank, the exporter may accept it, decline it, or request amendments to its terms until the exporter agrees. Naturally, once the exporter submits documents to the bank for payment, this is deemed acceptance of the letter of credit. At this stage, the exporter cannot request further amendments unless both parties consent.

Note that even after accepting the letter of credit, should unforeseen circumstances arise or significant changes occur in the export situation, the exporter may refrain from proceeding with the transaction before submitting documents to the bank. The letter of credit will then expire automatically. The exporter bears no liability towards the bank in such cases and may simply return the original letter of credit. The designation of the exporter as the 'beneficiary' in the letter of credit is entirely apt, as the initiative lies squarely with the exporter at this stage.

4.The Operational Process of Letters of Credit

In international trade, what constitutes the most reliable method of payment? Undoubtedly, it is cash payment – goods exchanged for money on the spot. However, this form of cash transaction proves exceedingly difficult to implement within the complexities of international commerce, encountering numerous obstacles. For instance, vast geographical distances often prevent buyers and sellers from conducting face-to-face transactions where money changes hands immediately for goods. Moreover, transaction values are often substantial, frequently reaching millions, tens of millions, or even hundreds of millions of pounds. The transportation and security of such vast sums of cash alone present significant challenges, and in some cases, are simply impracticable.

A letter of credit serves as a payment method within international trade, or alternatively, it can be understood as a means of receiving payment. In certain respects, a letter of credit offers reliability comparable to cash payment. Provided it is operated correctly and without breach, a letter of credit is as secure as cash payment. This is why the phrase 'paying for goods via letter of credit' is commonplace in the foreign trade industry. In essence, a letter of credit is a method for receiving payment in international trade. Since exporters and importers often lack mutual trust in each other's integrity, this mechanism establishes a framework of mutual confidence. It is based on trust in each party's respective banks, which also maintain cooperative relationships with one another.

Let us examine the fundamental operational process of letters of credit as an international trade payment method through a concrete case study.

China's BYD Company Limited exports 10,000 new energy vehicles to a British firm, valued at £200 million. The trade contract stipulates payment via letter of credit. How does BYD recover payment through this method?

Step One: The UK company (importer) first remits payment to its local Barclays Bank branch to apply for a letter of credit.

Explanation: The importer submits an application to its local bank (the issuing bank), completes a letter of credit application form in accordance with the contract, and pays a credit guarantee deposit or provides other collateral to request the bank (issuing bank) to issue the credit. The credit guarantee deposit is determined by the issuing bank based on an assessment of the enterprise's qualifications, reputation, and operational status. This evaluation establishes the enterprise's creditworthiness, which in turn determines the required deposit percentage. Enterprises with stronger creditworthiness pay a lower deposit percentage, typically equivalent to the value of the letter of credit being issued. For instance, if the letter of credit is for £200 million and the bank deems the client's creditworthiness high, it may require the client to deposit a certain percentage (20%) as a guarantee, amounting to £40 million, held in a dedicated guarantee account. Naturally, this requires the applicant to maintain an account with the issuing bank. Should the client be deemed less creditworthy, the bank may require a maximum deposit of 100% of the letter of credit amount, i.e., £200 million.[5]

Step Two: Barclays Bank in the UK conducts a credit investigation and extends credit to the applicant (the importer). Upon receiving the importer's deposit and reviewing the applicant's letter of credit application, Barclays issues the letter of credit to the beneficiary following approval. The letter of credit is then transmitted via the dedicated SWIFT system to the China Construction Bank branch in Shenzhen, where BYD is located.

Explanation: Based on the application details, the issuing bank opens the letter of credit in favour of the exporter (beneficiary) and forwards it to the branch or correspondent bank in the exporter's location (collectively termed the advising bank). Once issued, the letter of credit constitutes an agreement independent of the underlying sales contract.

Step Three: Upon receiving the letter of credit, China Construction Bank (the advising bank) notifies BYD Company to collect the letter of credit.

Explanation: Upon receipt, the advising bank must immediately verify the signature or secret code on the letter of credit. Following successful verification, it must review the terms of the letter of credit. Provided the terms are complete and clear, the advising bank must promptly deliver the letter of credit to the beneficiary (exporter), retaining a duplicate or photocopy. Letters of credit are typically issued as electronic documents transmitted via telegram. The issuing bank first transmits the letter of credit details in a standardised format to the advising bank (usually a bank with which it shares a shared secret). Upon receipt, the advising bank verifies the shared secret to authenticate the letter of credit's validity, then examines the terms. If no discrepancies are found, it contacts the beneficiary to collect the original letter of credit, retaining a copy or duplicate for its records. Thus, the issuing bank issues the letter of credit to the beneficiary, not to the advising bank.

Step Four: Upon receiving the collection notice from China Construction Bank, BYD Co., Ltd. dispatches personnel to collect the letter of credit from the bank.

Step Five: After receiving the letter of credit, BYD verifies its compliance with the contract terms. It then prepares goods in accordance with contractual requirements, dispatches the shipment, obtains all relevant shipping documents, and issues a draft. Within the letter of credit's validity period, it submits these documents to the bank authorised by the issuing bank (the negotiating bank) for negotiation.

Explanation: Upon verifying compliance with the letter of credit terms, the negotiating bank advances the payment to the exporter, deducting interest from the draft amount. This process is also termed bill discounting.

The negotiating bank is typically the exporter's local bank, though the advising bank may occasionally serve this function. The negotiating bank refers to the institution authorised by the issuing bank to purchase drafts and documents presented by the beneficiary that conform to the letter of credit specifications. Pursuant to the Domestic Letter of Credit Settlement Measures: The negotiating bank must be the beneficiary's account-holding bank designated by the issuing bank. Banks not designated for negotiation, or designated negotiating banks that are not the beneficiary's account-holding bank, shall not conduct negotiation. Where a letter of credit does not expressly permit negotiation, no bank may undertake negotiation. Where negotiation is permitted, if the issuing bank designates only one negotiating bank, banks not designated as negotiating banks may not undertake negotiation; the designated negotiating bank may decide at its discretion whether to undertake negotiation.

Negotiation refers to the act whereby the negotiating bank designated under the letter of credit, upon presentation of documents in compliance with the terms, pays the beneficiary the value of the documents after deducting negotiation interest. Simply put, it constitutes the purchasing of documents by the negotiating bank. Negotiation may be either at sight or at a forward date. The beneficiary may present the documents, the original letter of credit, and the letter of credit notification to the negotiating bank during the presentation period or within the validity period of the letter of credit. They shall complete the Letter of Credit Negotiation/Collection Application Form and the Negotiation Voucher to request negotiation.

UCP600 defines negotiation as follows: Negotiation means the purchase by the nominated bank of drafts and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank.

Negotiation under a letter of credit: Whilst the issuing bank or the paying bank (confirming bank) is the entity that ultimately pays the beneficiary, the exporter (beneficiary) typically presents documents to a local bank (negotiating bank). Upon verifying the documents' compliance, this bank may advance the letter of credit amount to the exporter. The negotiating bank then presents the documents to the paying bank to claim payment. Should the paying bank honour the payment, no issues arise. Should the paying bank refuse payment, the negotiating bank retains the right to seek recourse from the exporter. This form of financing under a letter of credit with recourse is termed export discounting, which corresponds to the textbook definition of negotiation (export discounting constitutes a method of financing that may operate under either letters of credit or collections).

However, in practical operations, the concept of domestic negotiation predominantly refers to the exporter submitting documents to the exporting bank (the negotiating bank). This bank assists with document examination and forwards them to the paying bank without providing the exporter with financing. The negotiating bank acts as an agent. Should the paying bank refuse payment, it notifies the exporter, who must then negotiate with their customer to resolve the issue. Should the paying bank honour the payment, the negotiating bank informs the exporter that funds have been received and credited. This arrangement appears virtually risk-free for the bank, though termed "negotiation", it essentially constitutes document submission by proxy. [6]

Step Six: China Construction Bank presents the documents submitted by BYD to Barclays Bank in the UK for payment.

Explanation: The negotiating bank forwards the draft and shipping documents to the issuing bank (or its designated paying bank) for payment.

Step Seven: Upon verifying the accuracy of the documents submitted by China Construction Bank, Barclays Bank in the UK transfers the funds to China Construction Bank.

Explanation: The issuing bank typically pays the paying bank after deducting any margin deposited by the applicant (with overpayments refunded and shortfalls collected), provided the documents are verified as correct by the issuing bank (or its designated paying bank).

Step 8: Upon receiving funds from Barclays Bank UK, China Construction Bank notifies BYD Company Limited to process the foreign exchange settlement at the bank. At this point, BYD receives payment for the exported new energy vehicles.

Explanation: As mentioned earlier regarding negotiation, in actual practice, the negotiating bank acts solely as an agent and does not advance funds to the exporter. Upon successfully obtaining payment from the issuing bank, it notifies the exporter to process the settlement. Naturally, the negotiating bank earns a commission. Should the negotiating bank advance funds to the exporter, this constitutes export discounting.

Step Nine: Barclays Bank notifies the UK importer to make payment to redeem the documents.

Explanation: This essentially means the issuing bank instructs the importer to settle the full remaining balance of the goods, excluding any initial deposit. Unless a 100% deposit was paid upfront, the issuing bank will only release all documents to the importer upon full payment. These documents are essential for the importer to complete customs clearance and collect the goods. Should the importer fail to make payment for the documents, they naturally cannot obtain the documents from the issuing bank and thus cannot collect the goods. Given this incentive, the issuing bank can naturally recover the payment from the importer.

Step Ten: After the UK importer makes payment to Barclays Bank and obtains the shipping documents, they can then present these to the carrier to collect the goods.

Conclusion

As a vital payment method in international trade, the development of letters of credit is intrinsically linked to global trade demands. Originating from medieval European merchants' need to mitigate risks in cross-border transactions, it has evolved over time into a globalised, standardised system, becoming the core mechanism for circumventing credit risks between buyers and sellers. During the application phase, the applicant must submit documentation and provide a security deposit to the issuing bank. This step ensures the bank's risk remains manageable while establishing a foundation of trust for subsequent transactions.

Fundamentally, letters of credit substitute commercial credit with bank credit, achieving risk isolation through the principle of 'documentary exchange'. Provided the beneficiary submits documents conforming to the terms, the issuing bank is obligated to make payment, effectively resolving the core issue of mutual distrust between buyers and sellers. Operationally, the process from opening and advising the letter of credit to presenting, examining, and paying documents forms an interlinked chain. Clear roles are assigned to entities such as the issuing bank, advising bank, and negotiating bank, ensuring transactional efficiency while mitigating fraud risk through rigorous documentary scrutiny.

In summary, through its clear origin logic, standardised application mechanism, reliable underlying principles, and rigorous operational procedures, the letter of credit has become a pivotal instrument for stabilising international trade order. It safeguards the interests of both buyers and sellers while propelling the secure and efficient development of global commerce.

Funding

No

Conflict of Interests

The authors declare that there is no conflict of interest regarding the publication of this paper.

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