

Guarantees/Standby Letters of Credit redevelopment in ISO 20022

Demand guarantees and standby letters of credit are key financial instruments used in both international and domestic trade finance activities in order to reduce the risk being taken by each party. They are independent undertakings that provide financial assurance, to be collected on the presentation of documents that comply with its terms and conditions. When used, the guarantee/standby L/C becomes a “payment undertaking” that can be used in multiple situations; assuring performance, repayment of advance fees, in connection with bids, to assure payment for the delivery of goods, or to assure repayment of financial obligations. Their increasing use arises from the need to secure fulfilment of obligations from an independent third party i.e. a bank whose promises are dependable. At any given point in time it has been estimated that there is more than USD 1.5 trillion outstanding under these undertakings.

Guarantees are frequently subject to the laws of country where they are issued, but with increasing globalisation of trade there is a desire to adopt governance rules which are independent of both the applicant’s and the beneficiary’s national laws.–The governance rules currently published by the International Chamber of Commerce (ICC) are:

- Uniform Rules for Demand Guarantees (URDG 758) (for demand guarantees)
- International Standby Practices (ISP 98) (for standby L/Cs)
- Uniform Customs and Practice for Documentary Credits (UCP 600) (for standby L/Cs)

The SWIFT project to redevelop these instruments in ISO 20022 kicked off early November with a meeting at SWIFT Headquarters. Representatives from five major banks worked together with SWIFT Standards and started by confirming scope, business content and functional flows. The meeting in New York last week focussed on Standby Letters of Credit and in early December these will be followed by a third meeting in Hong Kong, concentrating on domestic Guarantees. Discussions cover the full end-to-end - applicant / financial services provider(s) / beneficiary - flows.

While the demand guarantee and standby are similar instruments, the practices surrounding them often differ. The scope of the new development will factor these differences into the development effort and cater for information exchanges in support of both of these instruments.

The objective of the redevelopment project is to:

- take account of updates to the relevant international governance rules, and of evolving market practice, eg the release of URDG 758 and the creation of templates under ISP 98
- provide automation improvements in related business processes
- evolve the Trade for Corporates offering
- enrich the functionality and granularity of the business flows
- push dematerialisation of trade documents
- leverage technology advancements
- allow banks to provide their corporates with integrated dematerialised flows combining structured data with attachments and supporting local language character sets.
- adopt ISO 20022 bringing a consistent messaging standard across the financial industry

The development will follow the SWIFT Standards ISO 20022 development process, with a target of submission to ISO in the second half of 2011. SWIFT expects the flows to be in use commercially in 2013, and in due time the SWIFTRReady Trade labels will be adapted accordingly.

At SWIFT HQ and in New York the experience and expertise around the table made for informed and lively discussion with solid progress. Once the three groups have validated business content and information flows, the next step will be to evaluate and confirm the new suite of draft ISO 20022 messages through testing for subsequent ISO 20022 approval, and then to take a lead role in defining ongoing market practice for their use. The banks involved will therefore be shaping the future of SWIFT messaging in this key area of Trade.
