Use of Letters of Credit

When UNDP provides a Letter of Credit (L/C)

1. On an exceptional basis, UNDP may be called upon to provide a payment guarantee, for instance, to support a micro-credit or subsidized loan program or as additional financial security to a vendor operating under extremely risky local conditions. In the first situation the usual form of guarantee is called a ‘standby’ letter of credit, effectively a backup to the local bank in case the loans are not repaid. As individual tranches of the loans are repaid, the amount of the security or deposit with the issuing bank is reduced accordingly.

2. UNDP is not authorized to borrow funds, hence UNDP will place a deposit/investment equal to the full amount of the L/C with the issuing bank. The funds for the deposit must be set aside from project funds for the duration of the LC.

3. Treasury should be informed and consulted whenever the issue of providing bank guarantees for Letters of Credit arises. Since the requirement of a payment guarantee often implies that the supplier does not accept UNDP’s credit risk, such guarantees are only given in exceptional circumstances. Otherwise there is a risk to future acceptance of UNDP’s good credit by other counterparties.

4. Information needed when UNDP is providing a L/C

Each L/C agreement is negotiated individually based on the specific needs and requirements of the program that is being supported and the financial institutions involved. However the following basic information is needed to begin the L/C process:

- The beneficiary on whose behalf L/C is opened (full name and address)
- Local (disbursing) bank (if applicable)
- Amount and currency of the obligation to be guaranteed
- Duration of contract, expiration date
- Any relevant terms and conditions to be set out in the L/C (for example, repayment schedules for loan support programs)
- Documents to be presented to bank to satisfy L/C payment criteria

5. There are fees associated with LC issuance, usually based on a percentage of the value of the L/C. These costs can usually be offset by the interest earned on the set aside (invested) funds, but must be absorbed in the project budget. Fees may be partially offset by the deposit securing the L/C.

When UNDP is the Beneficiary of L/C

6. As part of the procurement process, suppliers may be required to provide a guarantee to UNDP; in that case UNDP is the beneficiary of the L/C. Please consult the procurement site for forms and standards for accepting vendor guarantees. On rare occasions, a Standby” Letter of Credit may be offered by a donor as a cash equivalent in lieu of cash payment under a contribution agreement. Treasury should be informed and consulted when such a situation arises.

7. When UNDP is accepting a bank guarantee or Letter of Credit from a supplier, it is important to verify the reliability and creditworthiness of the bank providing the guarantee. Normally an ‘A’ rating by the established international credit-rating agencies is the minimum acceptable standard. Treasury can be contacted to verify the credit rating.
8. The Letters of Credit issued by the banks are generally subject to Uniform Customs and Practice for Documentary Credits, Publication of International Chambers of Commerce (ICC) 600 (UCPDC 600).