

REVISITING THE ORIGINS AND REASONS FOR DISCREPANCY FEES

© 2014, Documentary Credit World, Nov./Dec. 2014, p. 23.

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As our call for reaction to discrepancy fees (Jul/Aug 2014 DCW p. 10) seems directed toward active bankers, I am happy to share the views of one who was there in early to mid-1980s when banks in the US, at least the NY banks, starting charging discrepancy fees.

First, it is important to put this time frame in perspective to understand the operational process at banks and the attitude of importers, exporters, freight forwarders, and banks. When the 1980s began, many banks, including the larger NY banks, still had a typing pool with electric typewriters and some banks were just starting to introduce stand-alone word processing machines. (At Manufacturers Hanover Trust, we converted to DEC 78 work stations.) Document examiners were divided into import and export examiners. Import document examination was considered easier since we had issued the LC, document names and data content were pretty much repetitive. Also, another bank had already examined the documents, often including the discrepancies they noted on their cover letter.

Document examiners had several levels of pay grade corresponding to their experience and approval authority. Many document examiners started in issuance before being accepted into document examination. All LC issuance and document staff might typically undergo classroom training and/or programmed instruction texts. Document examiner trainees might spend up to six months under the supervision of a senior examiner who would review and second check all their work. After that an examiner would be promoted to “first checker”, allowing them to examine and determine compliance on documents up a certain dollar value on their own. (Back in the 1970s, that amount could be as high as \$5,000.) They would also be permitted to first check documents over

that value, but those documents would be reviewed by a “second checker”. An examiner might spend years as a first checker before being considered for promotion to second checker. Many banks had even more senior levels of document examiners for higher value documents. This also allowed banks to promote, reward, and retain more experienced staff.

Separate from the document examiners was a team of telephone staff who would call or fax beneficiaries or their document preparers, usually freight forwarders, giving notice of discrepancies and requesting instructions. This had to be one of the most difficult jobs in the LC department. Imagine the call: “Good morning, my name is ... from [bank]. We received your documents and completed our examination. Unfortunately, your documents were found discrepant and you are not being paid. These are the discrepancies noted What would you like me to do with the documents?” Perhaps you can guess the reply.

Not only was this process personally challenging on the staff, but it increased the processing time and risk as documents were moved from one area to another, required follow up and tracking and often referral to more senior LC staff. Clearly, the cost to process a set of discrepant documents was higher than the cost to examine and honor a complying presentation, but that was not reflected in the fees that banks charged.

Over the next few years, banks began not only introducing more automation and computerization into LC issuance, document examination, and payment, but also into cost accounting and productivity standards in their operations. Financial and commercial markets were dealing with the Latin American debt crisis at the same time UCP400 was

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approved (1983), thus imposing increased costs on LC users. Discrepancy rates reported by banks in the NY market were still in the 60-70% range and trending upward. Clearly, processing documents with discrepancies was more costly from an operational and risk perspective. That additional cost was not reflected in the fees, whether the fees were labelled “payment”, “negotiation”, or “examination”. Banks moved to introduce a discrepancy fee on both the import and export side, assess that fee on the beneficiary and, as such was not covered by UCP, include such condition in their LCs. The thought process of the banks was to discourage beneficiaries from haphazardly preparing and submitting documents and imposing a higher processing cost and greater risk on the bank. Initially, the charge was an additional \$10 or \$20 per set of documents. The basic document payment/negotiation fees were a percentage of the dollar value, with a minimum of \$40 or \$50 per set.

The rationale was that beneficiaries would either exercise greater care or request amendments prior to submitting documents in order to avoid the additional fee or the additional fee would compensate banks for the additional processing and risk. On the import side, the rationale was to encourage importers to amend their LCs, rather than save the amendment fee and advise their beneficiary to ship and they would approve the discrepancy. The process of sending a notice of refusal, seeking waiver from applicant and bank approval was also costly, risky, and not built in to the fee for processing a compliant set of documents. Looked at another way, importers and exporters who were managing their LCs correctly, i.e., amending as necessary and preparing documents as required, were subsidizing those who were careless and frivolous.

Discrepancy processing emerged as a clear and present challenge for banks seeking to be

more productive, recover a portion of added cost, recognize and mitigate risk, and preserve customer relationships. While some banks may have been hesitant to assess such fees, once one bank charged a discrepancy fee others followed suit. Since the fee was charged to the beneficiary, i.e. deducted from proceeds, the bank’s customer, the applicant, was not charged directly and if the beneficiary complained to the applicant, the bank could simply tell them to amend the LC. In addition, banks were very judicious in assessing a discrepancy fee. Banks did not need to, nor did they look to, find discrepancies just to charge a fee. The most common discrepancies noted were late shipment, credit expired, and credit overdrawn, all easily avoided by amendments prior to shipment. For those documentary content discrepancies, it was felt that they could be avoided by the beneficiary exercising greater care and review prior to presentation. Arguing whether or not a point was indeed a discrepancy would not be worth the fee and would marginalize the bank’s integrity in defense of a “real” discrepancy.

Clearly, while discrepancy fees generated revenue for banks, they were not viewed as new products to be marketed or profit streams to be exploited. Over time, discrepancy fees have created significant revenue for banks, hopefully sufficient to offset the additional processing cost and risk assessment.

Exporters who wish to avoid discrepancy fees should take greater care in document preparation and require amendments where they anticipate non-compliance. Importers who wish to protect their suppliers from additional discrepancy fees should be willing to amend their LCs when they know changes have been made which will affect compliance of the presentation.