

# Standby Letter of Credit

## What is a Standby Letter of Credit?

It is a written guarantee, issued by a bank, to pay on behalf of their customer in the event their customer does not pay.

## What if the customer fails to pay?

If the bank's customer fails to pay (or complete a project on time, or satisfy the terms of a contract), the bank would pay the beneficiary (i.e., you).

## How do I implement a Standby Letter of Credit?

Here are some basic steps you can take to implement a Standby Letter of Credit for your company.

1.

Work with your Sales and Credit Departments to establish guidelines for what kind of job or order will require a Standby Letter of Credit.

These guidelines are usually set by very high dollar amounts. From there, you can set the terms of the Standby Letter of Credit for the customer.

2.

Communicate the terms of the Standby Letter of Credit to your customer.

Make sure one of the terms in the Standby Letter of Credit is "irrevocable."

Your customer, also known as the applicant, will apply to their bank for the Standby Letter of Credit and will have to provide collateral or meet certain credit standards to compel the bank to issue the Standby Letter of Credit.

3.

Once the Standby Letter of Credit has been issued and the issuing bank is viable, orders can be fulfilled/work can be performed for the customer.

## IMPORTANT!

Make sure the total value of the goods/work is not more than the dollar amount of the protection described in the Standby Letter of Credit.

It is critical to pay attention to this, especially when multiple orders are being fulfilled.

## Why should I use a Standby Letter of Credit & what are the benefits?

Ultimately, the Standby Letter of Credit is never meant to be "used."

The goal of the Standby Letter of Credit is to show a customer's ability to repay credit. It prevents large dollar contracts from going unfulfilled if a customer does not pay or cannot pay.

If used correctly, a standby notice of credit will be payable upon demand—typically without any objection as long as the collection procedure is followed according to the Standby Letter of Credit.

The terms of the Standby Letter of Credit will detail the procedure for collection – it is required that you comply with the terms in order to be paid from the letter of credit.

## Takeaways

A Standby Letter of Credit is a guarantee from a bank to pay the debts of a customer in the event of non-payment.

It is a good business practice on both sides; shows willingness and ability to pay.

Make sure you keep track of the total value of the project or order, so the dollar amount does not exceed the amount protected by the Standby Letter of Credit.

In the event of non-payment, collection can be pursued; ensure you are in compliance with the terms of the Standby Letter of Credit

## Questions?

Contact NCS today!

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From Protection to Collection

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