Key Differences Between A Letter Of Credit & Standby LC

Letter of credit (LC) & Standby Letter of credit (SBLC) are both the most popular, & reliable trade finance instruments used by global importers & exporters in international trade to reduce the risk of payment failure & to ensure financial stability.

A Letter of credit is a primary method of payment, while Standby LC is used when there's a risk of buyer's non-performance during a transaction. So, what is the difference between an LC and SBLC? Let's check out:

Letter of Credit Vs Standby Letter of Credit

Both the letter of credit (LC), and the Standby letter of credit (SBLC) are payment guarantee instruments used in international trade. In this article, we've discussed the key differences and usage between LC and SBLC. Take a look:

What is a Letter of Credit?

Under a letter of credit service, the issuing bank guarantees an on-time & full-fledged payment to an exporter on behalf of its client ie. importer for the ordered goods or services. But in the event, if the importer defaults in payment or is unable to fulfill the terms & conditions of the LC contract, then, the issuing bank will compensate the beneficiary ie. the exporter.

The role of the issuing bank is to make sure that the buyer pays on time and the agreement goes as planned catering to all the T&Cs being followed by both parties.

What is a Standby Letter of Credit?

On the other hand, a Standby letter of credit is a secondary payment method where the issuing bank acts as a guarantor for an on-time payment to the exporter. But the payment under SBLC will be made only when a buyer defaults in making the payment.

In other words, a Standby LC comes into action when the buyer doesn’t make the payment to the seller. As long as the seller meets the terms & conditions of the Standby LC agreement, they’re entitled to receive compensation from the issuing bank.

Standby LC V/s Letter of Credit

Both Letters of Credit and Standby LCs are issued by a legal institution like a Bank or private financial institution at the request of their applicant ie. buyer to ensure on-time payment to the exporters for the ordered goods & services.

Take a look at the key differences between LC and SBLC:

1. Definition

A letter of credit provides a legal guarantee to the exporters that they will be paid by the importers on time. On the other hand, a Standby Letter of credit assures sellers of timely payments only if the buyer defaults or is unable to fulfill the T&C of the contract.

2. Requirements of Issuing Bank

Under a **letter of credit service**, the issuing bank verifies the credibility and credit scores of the buyer to ensure their payment capabilities before granting them an LC. Moreover, there are usually cases when a buyer requests an LC from his bank in exchange for which the bank charges a certain fee. As such, the buyer may present his inability to pay which leads to insecurities in LC.

On the other hand, a Standby letter of credit brings an obligation for the bank, therefore the bank asks for collateral in the form of security before issuing an SBLC.

3. Mode of Transaction

A letter of credit is a primary mode of payment transaction while a Standby letter of credit acts as a secondary mode of payment.

4. Goal

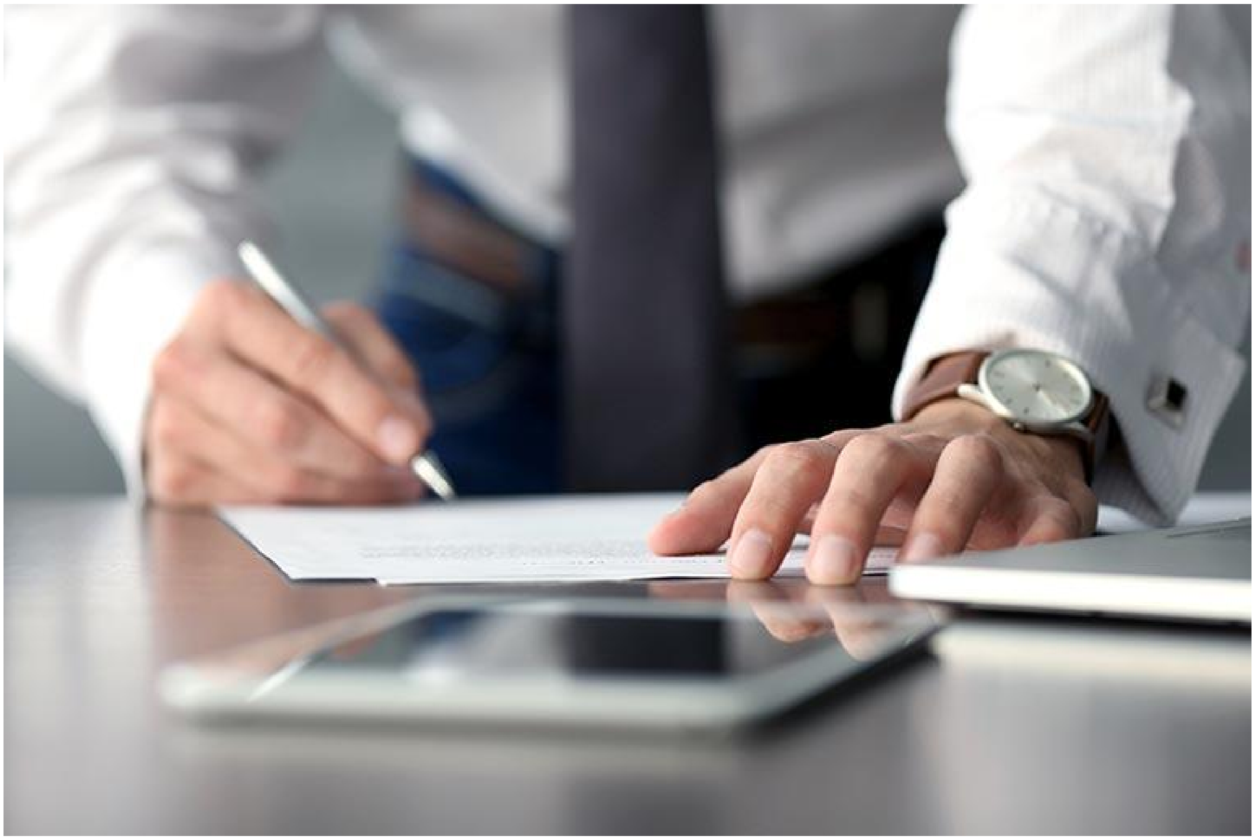
The ultimate goal of a letter of credit is to complete the transactions by following all the T&Cs of the LC contract. In contrast, a Standby LC is a secondary mode of payment which makes sure that the buyer pays the seller.

5. Nature of Instrument

A letter of credit is an instrument of payment while a Standby letter of credit is used as a backup method to ensure that the buyer pays on time.

6. Time Period

A letter of credit is a short-time instrument where the expiry depends on the goods received by the buyer (LC at Sight) or generally 90 days (Usance LC). On the other hand, a Standby LC is a long-term instrument where the validity is usually one year or mentioned within the terms of the instruments.



7. Geographical Scope

A **letter of credit service** is generally used by global traders in international transactions to mitigate payment risks. In contrast, an SBLC is often used in international trade but it is also frequently used in domestic transactions.

8. Cost

Apart from the bank's charges, a Standby letter of credit is more expensive than a letter of credit. The fees for getting an SBLC issued range from 1% to 10% of the amount covered while in the case of LC, it ranges from 0.75% to 1.50% of the amount covered.

Conclusion

Now you know that both LCs and SBLCs are the most extensive [trade finance instruments]() used in international transactions as well as domestic ones. Their issuance depends on the nature of the transaction and the requirements of the parties to the contract.

Originally Posted:

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