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Treatment of Letters of Credit in the Philippines' External Sector Statistics

Prepared by the Bangko Sentral ng Pilipinas

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A letter of credit is a written commitment to pay, by a buyer's or importer's bank (called the issuing bank) to the seller's or exporter's bank (called the accepting bank, negotiating bank, or paying bank). It is a formal trade instrument and is used usually when the seller is unwilling to extend credit to the buyer. For this purpose, the international banking system acts as an intermediary between exporters and importers.¹

Recording of transactions in the Balance of Payments (BOP)

Transactions involving letters of credit are reported by the issuing resident bank to the Bangko Sentral ng Pilipinas (BSP) in the Consolidated Statement of Assets and Liabilities or Foreign Exchange Form 1 (FX Form 1). Opened letters of credit are reported in the FX Form 1 under Schedule 10. Payments are subsequently recorded under Schedule 11 (even if the foreign exchange used for payments were not purchased or sourced from the banking system).

Schedules 10 and 11 are submitted by banks to the BSP-International Operations Department which is responsible for the management of external debt, foreign investments and other foreign exchange transactions.

In the Philippines' BOP and external debt statistics, transactions related to import letters of credit are not reported. This treatment is consistent with Paragraphs 5.9 (a) and 5.13 of the Balance of Payments and International Investment Position Manual, 6th edition (BPM6). Paragraph 5.9 (a) provides that unrealized commitments such as lines of credit, loan commitments and letters of credit do not give rise to financial assets. Paragraph 5.13, in particular, states that such unrealized commitments "assure that funds will be made available, but no financial asset (i.e., loan) is created until funds are actually advanced...Only if the financial corporation providing the facility makes funds available will it acquire an actual asset, to be recorded in its balance sheet." The treatment of letters of credit was further validated with banks which indicated that entries involving letters of credit are considered off-balance sheet items and therefore, no liabilities are recorded in their books.

¹ www.businessdictionary.com