Chapter 4
Documentary Collections

A documentary collection (D/C) is a transaction whereby the exporter entrusts the collection of payment to the remitting bank (exporter's bank), which sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. D/Cs involve the use of a draft that requires the importer to pay the face amount either on sight (document against payment—D/P) or on a specified date in the future (document against acceptance—D/A). The draft lists instructions that specify the documents required for the transfer of title to the goods. Although banks do act as facilitators for their clients under collections, documentary collections offer no verification process and limited recourse in the event of nonpayment. Drafts are generally less expensive than letters of credit (LCs).

CHARACTERISTICS OF A DOCUMENTARY COLLECTION

Applicability

Recommended for use in established trade relationships and in stable export markets.

Risk

Exporter is exposed to more risk as D/C terms are more convenient and cheaper than an LC to the importer.

Pros

- Bank assistance in obtaining payment
- The process is simple, fast, and less costly than LCs

Cons

- Banks' role is limited and they do not guarantee payment
- Banks do not verify the accuracy of the documents

Key Points

- D/Cs are less complicated and less expensive than LCs.
- Under a D/C transaction, the importer is not obligated to pay for goods prior to shipment.
- The exporter retains title to the goods until the importer either pays the face amount on sight or accepts the draft to incur a legal obligation to pay at a specified later date.
- Banks that play essential roles in transactions utilizing D/Cs are the remitting bank (exporter's bank) and the collecting bank (importer's bank).
- While the banks control the flow of documents, they do not verify the documents nor take any risks, but can influence the mutually satisfactory settlement of a D/C transaction.

Typical Simplified D/C Transaction Flow

1. The exporter ships the goods to the importer and receives in exchange the documents.
2. The exporter presents the documents with instructions for obtaining payment to its bank.
3. The exporter's remitting bank sends the documents to the importer's collecting bank.
4. The collecting bank releases the documents to the importer upon receipt of payment.
5. Or the collecting bank releases the documents on acceptance of draft from the importer.
6. The importer then presents the documents to the carrier in exchange for the goods.

7. Having received payment, the collecting bank forwards proceeds to the remitting bank.
8. Once payment is received, the remitting bank credits the exporter's account.

Documents Against Payment (D/P) Collection

Under a D/P collection, the exporter ships the goods, and then gives the documents to his bank, which will forward them to the importer's collecting bank, along with instructions on how to collect the money from the importer. In this arrangement, the collecting bank releases the documents to the importer only on payment for the goods. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

Time of Payment: After shipment, but before documents are released

Transfer of Goods: After payment is made on sight

Exporter Risk: If draft is unpaid, goods may need to be disposed

Documents Against Acceptance (D/A) Collection

Under a D/A collection, the exporter extends credit to the importer by using a time draft. In this case, the documents are released to the importer to receive the goods upon acceptance of the time draft. By accepting the draft, the importer becomes legally obligated to pay at a future date. At maturity, the collecting bank contacts the importer for payment. Upon receipt of payment, the collecting bank transmits the funds to the remitting bank for payment to the exporter.

Time of Payment: On maturity of draft at a specified future date

Transfer of Goods: Before payment, but upon acceptance of draft

Exporter Risk: Has no control of goods and may not get paid at due date

When to Use Documentary Collections

Under D/C transactions, the exporter has little recourse against the importer in case of nonpayment. Thus, the D/C mechanism should only be used under the following conditions:

- The exporter and importer have a well-established relationship.
- The exporter is confident that the importing country is stable politically and economically.
- An open account sale is considered too risky, but an LC is also too expensive for the importer.