

THE STATUS OF COMMERCIAL BANKS WORKING WITH INTERNATIONAL LETTERS OF CREDIT: TRENDS, CHALLENGES, AND STRATEGIC IMPORTANCE*Akramjonov Saidaxmad Baxromjon ugli**The Banking and Finance Academy of the Republic of Uzbekistan*

Abstract: International letters of credit (LCs) remain one of the most secure and widely used instruments in global trade finance. This article explores the current status of commercial banks in facilitating international LCs, focusing on their role, operational dynamics, compliance requirements, and the challenges they face in today's complex and regulated global financial environment. The paper also examines the impact of digitalization and international banking standards on the effectiveness of LC operations. Through analytical insights and global case studies, the article concludes with key recommendations to improve LC service efficiency and mitigate risks for commercial banks.

Keywords: Letter of Credit, Trade Finance, Commercial Banks, SWIFT, UCP 600, Risk Management, Digitalization, International Banking

Literature review

The use of letters of credit (LCs) in international trade has long been a critical area of study within finance and banking literature. Scholars and institutional authors alike have examined the legal frameworks, risk mitigation functions, operational challenges, and evolving practices associated with LCs. This review outlines major contributions that have shaped the understanding of how commercial banks interact with and facilitate international LCs.

One of the most authoritative sources in LC governance is the Uniform Customs and Practice for Documentary Credits (UCP) developed by the International Chamber of Commerce (ICC). The most current version, UCP 600, provides standardized rules applied globally in LC transactions. As noted by Bertrams (2004), UCP rules offer commercial certainty by harmonizing LC practices across jurisdictions, thereby enhancing the reliability of banks acting as intermediaries in trade finance.

Scholars such as Sitkin and Bowen (2010) emphasize that commercial banks play multiple roles in LC transactions — including issuing, advising, confirming, and negotiating — each carrying distinct risks and responsibilities. These roles are not only operational but strategic, helping banks strengthen client relationships and generate fee-based income. According to WTO (2020), over 80% of global trade depends on some form of bank-intermediated finance, underscoring the central role of LCs in enabling cross-border commerce.

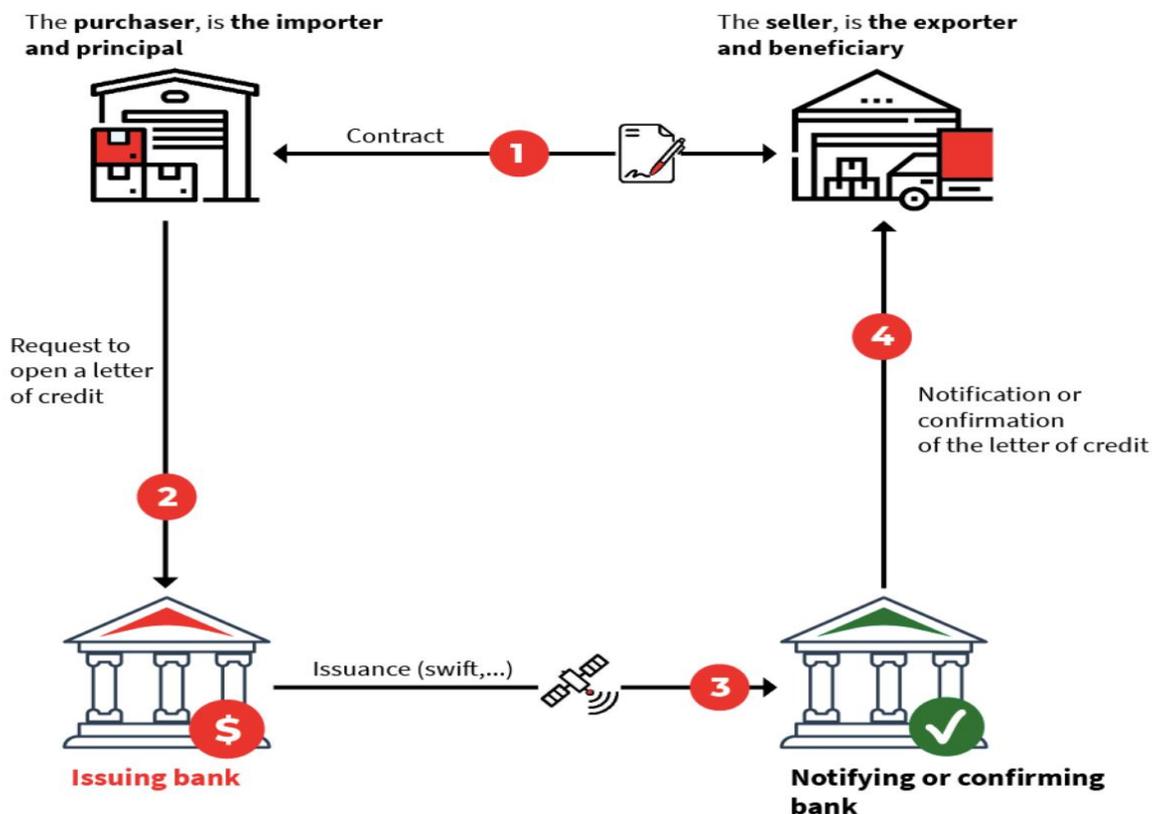
The literature also explores the common operational risks commercial banks face in LC transactions. Ellinger and Neo (2010) discuss how document discrepancies — which affect more than two-thirds of first LC presentations — create delays, legal ambiguity, and reputational risks for banks. Klapper and Randall (2019) further note that despite their

advantages, LCs are procedurally complex and heavily reliant on precise documentation, increasing exposure to human error and fraud.

The literature reflects a strong consensus on the enduring importance of letters of credit in international trade, particularly as a risk mitigation tool in volatile and trust-deficient environments. While traditional challenges—like document discrepancies and compliance burdens—persist, technological innovations such as eUCP and blockchain are reshaping the landscape. However, adoption remains uneven, and commercial banks must navigate a complex terrain of evolving regulatory standards, customer expectations, and systemic risks. This study builds on these insights to analyze the present status of commercial banks in facilitating and modernizing LC-based trade finance.

Introduction

The international letter of credit (LC) is a vital financial instrument used to secure transactions in global trade. Facilitated by commercial banks, it ensures that exporters receive payment as long as specific delivery and documentation terms are met, while importers are assured that payment will only be made upon compliance with the agreed conditions. In an era of growing trade volumes and economic uncertainty, commercial banks continue to play a crucial intermediary role in LC-based trade finance.



1-picture. Roles of commercial banks in letters of credit

Issuing Bank – typically the importer’s bank that issues the LC on behalf of its client.

Advising Bank – the bank that authenticates and forwards the LC to the exporter.

Confirming Bank – adds its own payment guarantee to that of the issuing bank.

Negotiating Bank – examines documents and advances funds to the exporter.

Banks thus act not only as guarantors but also as facilitators of trust, compliance, and capital flow in international trade.

Most LCs are processed through the SWIFT (Society for Worldwide Interbank Financial Telecommunication) messaging system, following UCP 600 (Uniform Customs and Practice for Documentary Credits), issued by the International Chamber of Commerce. These standardizations ensure a harmonized approach to document examination and payment obligations.

According to the International Chamber of Commerce’s 2023 Global Trade Finance Survey, while LCs still account for a significant portion of traditional trade finance (about 12–15% globally), there is a gradual decline in usage due to the rise of open account trade, supply chain finance, and fintech-based solutions.

Conclusion

Despite the evolution of alternative trade finance mechanisms, international letters of credit remain vital for global trade security and liquidity, especially in developing regions. Commercial banks continue to play an indispensable role in LC facilitation, balancing between risk mitigation, customer service, and innovation. As trade becomes more digital and regulated, banks must embrace technology, strengthen compliance, and adapt operations to maintain their relevance and leadership in global trade finance.

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