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MECHANISM FOR MANAGING PAYMENT RISKS IN INTERNATIONAL TRADE

In the modern practice of supporting trade and logistics operations of domestic companies, in conditions of increased volatility in the financial and commodity markets and increased risks of non-payment, lack of guarantees, etc., forms of settlement are often used, which ensure guaranteed receipt of revenue for shipped goods or performed works or provided services. The main form of payment, which to the greatest extent guarantees the seller the receipt of payment for goods, work, or services is a letter of credit. The integration of the economy into the world market and the processes of globalization create conditions under which the buyer and the seller can optimally and timely fulfill their obligations regarding payments for goods and services. Modern market relations contribute to the development of payment instruments that will allow entities to minimize the risks of trade operations. A letter of credit is one of such effective payment instruments. The research is based on the hypothesis that the use of the letter of credit form of payments in the modern globalized environment allows business entities to expand the boundaries of their activities and enter new markets by minimizing the risk of non-fulfillment of obligations under concluded contracts. The essence and necessity of using

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МЕХАНІЗМ УПРАВЛІННЯ ПЛАТІЖНИМИ РИЗИКАМИ У МІЖНАРОДНІЙ ТОРГІВЛІ

*У сучасній практиці підтримки торго-
вельних та логістичних операцій вітчизняних
компаній, в умовах підвищеної волатильності
на фінансовому і товарному ринках та
посилених ризиків неплатежів, відсутності
гарантій тощо часто використовуються
форми розрахунку, що забезпечують гаран-
товане одержання виручки за відванта-
женої товар або виконані роботи чи надані
послуги. Основною формою платежу, що
найбільшою мірою гарантує продавцеві отримання оплати за товар, роботу чи послугу, є
акредитив. Інтеграція економіки у світовий
ринку та процеси глобалізації створюють
умови, за яких покупець і продавець можуть
оптимально та завчасно виконувати зобов'язання щодо розрахунків за товари і послуги.
Сучасні ринкові відносини сприяють роз-
витку платіжних інструментів, які дозво-
ляють суб'єктам мінімізувати ризики торго-
вельних операцій. Акредитив є одним з таких
ефективних інструментів платежу. В основу
дослідження покладено гіпотезу, що викорис-
тання акредитивної форми розрахунків у
сучасному глобалізованому середовищі дає
зможу суб'єктам господарювання розши-
рювати межі своєї діяльності та виходити
на нові ринки шляхом максимального зниження
ризиків невиконання зобов'язань за укладеними
договорами. Досліджено сутність та*



letters of credit have been examined, and the regulatory and legal framework governing the letter of credit form of payment have been studied. The types of letters of credit and the key participants in the calculation process have been systematized. The current state of the use of the letter of credit form of payment in Ukraine and the cost of servicing letters of credit by banks have been analyzed.

Keywords: letter of credit, contract, settlements, issuing bank, beneficiary, notification, risks, exporter, importer, Unified rules and customs for documentary letters of credit.

необхідність використання акредитивів, вивчено нормативно-правову базу, якою регулюється акредитивна форма оплати. Систематизовано види акредитивів та ключових учасників процесу розрахунків. Проаналізовано сучасний стан використання акредитивної форми оплати в Україні та вартість обслуговування акредитивів банками.

Ключові слова: акредитив, договір, розрахунки, банк-емітент, бенефіціар, авізування, ризики, експортер, імпортер, Уніфіковані правила і звичаї для документарних акредитивів.

JEL Classification: F40, G21, L14.

Introduction

Letters of credit are used both in domestic and international business and financial practice to minimize the risks of non-fulfillment of obligations by partners under a contract. In the absence of complete trust between the parties, they prefer to involve a financial intermediary (bank), which guarantees the supplier timely receipt of payment for delivered goods (works, services), and the buyer – that the supplier will not receive the money before delivering the specified goods (works, services) under the contract and issuing all the agreed-upon shipping documents (Shpylovyi, 2015, p. 50).

The need to use a letter of credit form of settlement is due to the potential riskiness of a future transaction for one of the parties to the agreement (either the seller or the buyer). So, if the seller of the goods is not sure that payment will be made according to the contract, a payment guarantee can be used as an obligation of the bank to pay if the seller or the buyer (depending on the type of guarantee) fails to fulfill their obligations regarding payment or delivery of goods. However, a guarantee is not a form of settlement under the contract, but serves the function of "insurance" against the risks in case of non-performance of the contract terms.

The legal nature and peculiarities of making payments through a letter of credit in Ukraine are the subject of research by many scholars. The main approaches to defining the essence of a documentary letter of credit and its advantages, as well as the legislation in this field, have been examined in the works of Leshanych (2017), Burkovska and Pavlenko (2020), Tovkun and Menkova (2021), and others. In particular, the authors emphasize the importance of using the letter of credit form of payments, taking into account the modern regulatory and legal requirements. Similar definitions of the letter of credit are used in scientific articles. Some authors, including Fimiar (2012), point out that it is "a firm commitment of the bank, issued on the basis of the buyer-client's instruction, to pay the seller of goods or services a specified amount of money upon timely submission of documents specified in the letter of credit, confirming the shipment of goods or the performance of services".

In turn, Shpylovyi (2015) interprets a letter of credit as "a form of settlement in which the buyer's bank makes a payment to the supplier upon submission of the specified documents," which emphasizes the use of a letter of credit in conducting international transactions.

A significant number of foreign and domestic scientific works are devoted to the study of the legal status of the parties to an agreement using a letter of credit, their functions, as well as the classification of letters of credit. In particular, among foreign authors, Biswas (2011) should be noted, who examines the essence, principles, and mechanism of concluding a letter of credit agreement, as well as the legal basis of the obligations of the issuing bank. Soni (2014) investigates the role of documentary letters of credit in international sales agreements and also substantiates why a letter of credit is a separate contract from the one on which it is based. In the work of Mahendra Soni (2024), it is emphasized that a letter of credit agreement usually involves the participation of five main parties. The first two parties are the seller (applicant) and the buyer (beneficiary), who carry out trade transactions, while the other three parties are the issuing bank (which issues the letter of credit), the confirming bank, and the negotiating bank, respectively.

The implementation of foreign economic activity by enterprises is a necessary tool for existence within the system of economic and market relations. The use of letters of credit in the practice of foreign economic activity was studied by Shpylovyi (2015), Diachek et al. (2018), Tovkun and Menkova (2021). The authors justify that a letter of credit is a positive alternative to advance payments and provides the parties to the contract with additional guarantees. A letter of credit, as a form of cashless payments, flexibly allows the interests of all parties to the contract to be taken into account, which is evidenced by both the possibility of its transfer and the possibility for the payer to obtain credit upon opening the letter of credit.

The foreign practice of using letters of credit, including as a means of reducing risks during crisis periods, is thoroughly revealed in the work of Crozet et al. (2022). It is noted that the ability of trade partners to mitigate risks associated with international trade operations is particularly important during periods of increased uncertainty. The authors point out that the dependence of products on letters of credit has a direct impact on the stability of trade flows. In particular, during periods of increased uncertainty, the export of products insured through letters of credit is more resilient.

In turn, the current issues of using letters of credit in Ukraine regarding the structure of international banking operations for import and export agreements, the volume of agreements concluded with letters of credit, and the cost of services provided by domestic banks under documentary letters of credit were studied by domestic researchers, including Mangushev (2020) and Burkovska and Pavlenko (2020). It has been established that the use of letters of credit in Ukraine is a rather complex process due to the lack of proper interaction between Ukrainian banks and foreign partners. Foreign banks, especially European and American ones, demonstrate distrust towards the domestic banking system. Documentary letters of credit are mainly used

by Ukrainian enterprises for settlements when cooperating with European and American countries to ensure compliance with all their requirements. Ukraine also tries to use documentary letters of credit when concluding agreements with countries whose economic situation is risky, which allows avoiding non-fulfillment of requirements under letters of credit and guarantees Ukrainian sellers payments of funds under contracts (Burkovska & Pavlenko, 2020, p. 42).

Despite its effectiveness, the use of the letter of credit form of payments in Ukraine is accompanied by a number of problems. First of all, there is an insufficient level of trust in the Ukrainian banking system from foreign financial institutions, which causes difficulties in confirming letters of credit and increases their cost. A significant number of international banks limit cooperation with Ukrainian banks due to country risks and regulatory instability, which considerably complicates payments in foreign trade operations.

A significant problem is the high cost of documentary operations, in particular commissions for opening, confirming, notifying, and checking documents, which makes letters of credit less accessible to small and medium-sized businesses. Additional expenses related to the need for making amendments, sending documents, or extra verifications increase the overall cost of the financial instrument, reducing its attractiveness.

The state of martial law in Ukraine also has a significant impact on the use of letters of credit, which has led to a reduction in foreign trade activity, changes in logistics routes, and a decrease in the number of international settlements using letters of credit. High military risks necessitate additional guarantees from foreign banks, which further complicates the use of the letter of credit payment method.

The research is based on the hypothesis that the use of the letter of credit form of settlements in the modern globalized environment allows business entities to expand the scope of their activities and enter new markets by minimizing the risk of non-fulfillment of obligations under concluded contracts.

The purpose of the article is to determine the legal nature and economic essence of a letter of credit as a means of reducing payment risks, as well as the role of banks in providing services for the maintenance of documentary letters of credit. To achieve this goal, the following research methods were used: induction and deduction, analysis and synthesis for studying the theoretical aspects of the application of the letter of credit form of payment in domestic practice; systematization and generalization – to reflect the volume of operations under documentary letters of credit and the cost of bank services in their servicing.

The theoretical and methodological basis for writing the article were the works of foreign and domestic scientists on the issues of regulation and development of the letter of credit payment form, the legislative acts of Ukraine in the field of using letters of credit, as well as official statistical data of the National Bank of Ukraine as a regulator of the financial market and of certain domestic banks.

The main part of the article consists of three interrelated sections. The first section examines the economic essence and current issues of normative and legal regulation of letters of credit in Ukraine. The second one considers the role of banks in the use of the letter of credit form of settlements. The third is the practice of using letters of credit in Ukraine.

1. Economic essence and current issues of normative and legal regulation of letters of credit in Ukraine

A letter of credit (from Latin – *accre-ditivus* – fiduciary) is a form of settlement based on a contract that contains the obligations of the issuing bank, under which this bank, on behalf of the client (the applicant of the letter of credit) or on its own behalf, undertakes to make a payment in favor of the supplier of goods or services and instructs another (executing) bank to make this payment against documents that comply with the terms of the letter of credit.

The conclusion of letter of credit agreements in any case requires compliance with the current legislation of the countries in which the subjects of trade relations are located and the implementation of international standards, which will ensure the responsibility of the parties, the fulfillment of letter of credit obligations, and minimize risks: the seller receives funds regardless of the buyer, as the bank acts as a guarantor of the letter of credit payment; the buyer reduces his risk regarding the supplier's failure to fulfill obligations to ship and deliver the goods.

This mechanism allows minimizing costs from fraudulent schemes and ensures the reliability of international trade relations, especially when entering a new unfamiliar market. At the same time, the economic security of both parties to the contract is ensured. The exchange rates at which settlements are made are clearly specified in the contracts and are determined according to the rates of national banks (Burkovska, Pavlenko, 2020, p. 40).

In Ukraine, work with the letter of credit payment method is regulated by the following normative and legal acts:

- by the unified rules and practices for documentary credits (*Uniform Customs and Practice for Documentary Credits*), developed by the International Chamber of Commerce. Currently, there are two valid editions of these rules: UCP 500 (edition of 1993) and UCP 600 (edition of 2007);
- by the Resolution of the Board of the National Bank of Ukraine № 514 "On Approval of the Regulation on the procedure for banks to conduct transactions under letters of credit" (2003, December 3);
- by the Civil Code of Ukraine (2003);
- Law of Ukraine "On Banks and Banking" (2001).

Moreover, a letter of credit is a contract, separate from the contract of sale or any other document that has the validity of a contract on which it is based. This position is indicated in a number of regulatory legal acts (*Table 1*).

Table 1

Interpretation of a letter of credit in the regulatory and legal framework

Regulatory legal act	Definition
Uniform customs and practice for documentary letters of credit (p. 2)	Refer to any agreement, whatever it may be called or designated, according to which a bank (issuing bank), acting at the request and on the instructions of the client (applicant) or on its own behalf: (I) must make a payment to a third party (the beneficiary) or by his order, or accept and pay the bills of exchange (drafts) issued by the beneficiary, or (II) authorizes another bank to make such a payment or to accept and pay the bills of exchange (drafts), or (III) authorizes another bank to negotiate against the stipulated documents in compliance with the terms and conditions of the letter of credit
CCU (Art. 1093)	In the case of settlements under a letter of credit, the bank (issuing bank), on behalf of the client (payer) – the applicant of the letter of credit and in accordance with his instructions or on its own behalf, undertakes to make a payment under the terms specified in the letter of credit, or instructs another (executing) bank to make this payment in favor of the recipient of the funds or a person designated by him – the beneficiary
Regulations on the procedure for banks to carry out transactions under letters of credit (p. 4, p. 6)	"A monetary obligation of the issuing bank to fulfill the obligations against proper representation." "A letter of credit is an agreement that is separate from the contract on which it is based"

Source: IAS Consultant (n. d.); Civil Code of Ukraine (2003, January 16); Resolution of the Board of the National Bank of Ukraine № 514 (2003, December 3).

In general, in practice there is a fairly large number of types of letters of credit (*Figure 1*). The main ones are cash and documentary.

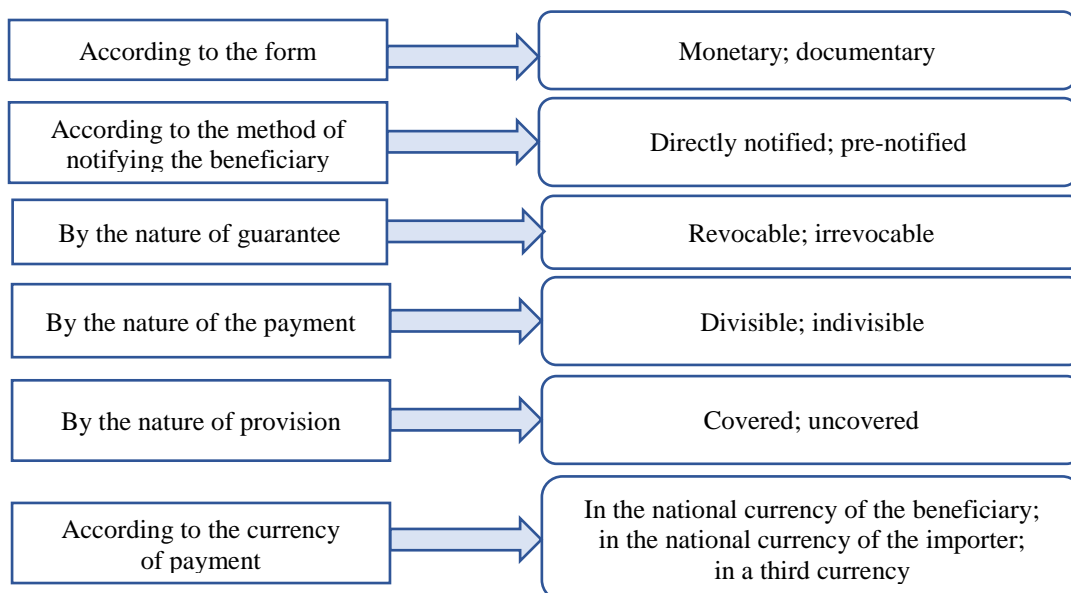


Figure 1. Classification of the main types of letters of credit

Source: (Burkovska & Pavlenko, 2020, p. 41; Diachek et al., 2018, p. 74; WikiLegalAid, n. d.; Mahendra Soni, 2024, p. 3768).

A *cash letter of credit* is issued by a bank to its client granting the right to receive the full amount specified in it or in separate parts in other banks within a specified period of time. Worldwide, more than 90% of all settlements by letters of credit are carried out in documentary form.

A *documentary letter of credit* is a contract filled out on a standardized form, in which the bank that opens the letter of credit (the issuing bank) undertakes the obligation to make a payment of the amount specified in it to a third party (the beneficiary) on the order and at the expense of the buyer – in the case of cash settlements, or to accept a draft (in the case of credit settlements) against the presentation by the seller of the package of documents specified in the contract, which confirm the delivery of goods in accordance with the terms of the contract (Leshanych, 2017, p. 129).

In general terms, the use of the letter of credit form of settlement involves the following main stages:

- the buyer and the seller conclude an agreement for the supply of goods or the provision of services;
- the buyer contacts their bank with a request to open a letter of credit in favor of the seller;
- the buyer’s bank issues a letter of credit specifying the terms;
- the seller receives a letter of credit and delivers goods or services in accordance with the terms of the agreement;
- after fulfilling the terms of the agreement, the seller presents to the bank their documents confirming the fulfillment of the terms;
- the buyer’s bank makes payment to the seller according to the terms of the letter of credit.

Let’s consider the main participants of the letter of credit form of settlements (*Table 2*).

Table 2

Participants of the letter of credit form of settlements

Participant	Role in conducting settlements
Notifying bank	At the request of the issuing bank, it notifies the beneficiary or instructs another notifying bank to notify the beneficiary or another notifying bank
Beneficiary	A letter of credit is opened in his favor
Beneficiary’s bank	Serves the beneficiary under the letter of credit
Issuing bank	On behalf of the applicant of the letter of credit or on its own behalf opens a letter of credit in favor of the beneficiary
Executing bank	It provides for the execution of a letter of credit
The applicant of the letter of credit	By his order, a letter of credit is opened at the issuing bank
Negotiating bank	Has the authority from the issuing bank to carry out negotiation – the purchase and/or considering of bills of exchange (drafts) and/or documents that constitute proper representation, as provided by the terms of the letter of credit, by providing an advance or agreeing to provide an advance to the beneficiary no later than the banking day on which the negotiating bank receives reimbursement

End of Table 2

Participant	Role in conducting settlements
Confirming bank	Adds its confirmation to the letter of credit on behalf of or at the request of the issuing bank
Reimbursing bank	Has the authority from the issuing bank to ensure reimbursement under the letter of credit to the confirming (executing) bank or another bank in accordance with the given payment instructions
Transferring bank	Carries out the transfer of a letter of credit, or, if the letter of credit is executed in any bank, is directly authorized by the issuing bank to carry out the transfer and which carries out the transfer of the letter of credit (may be the issuing bank)

Source: (IAS Consultant, n. d.; WikiLegalAid, n. d.; Koliesnikova at al., 2012, p. 138; Mahendra Soni, 2024, p. 3765).

Thus, when using a letter of credit, the maximum participation of banks in making settlement is ensured. The most complete payment security for the beneficiary is achieved, since a letter of credit, by its nature, is a monetary guarantee of payment for the shipped goods provided by the bank that opened the letter of credit.

2. The role of banks in the use of the letter of credit form of settlements

The key banks when using the letter of credit form of settlement are:

- the notifying bank, called upon to confirm the legality and inform the bank’s client (the beneficiary/exporter, that is, the supplier) about the terms of the letter of credit, which are the client’s payment obligations;
- the issuing bank, obligated to set the terms and determine the obligations in letters of credit.

The notifying bank has significantly less responsibility to the client in performing the letter of credit part of the contract. Therefore, under modern conditions, there has arisen a need to exclude such an institution as the notifying bank from the process of financing logistics and trade operations, which has been facilitated by the digital revolution and the digitalization of logistics as a whole (see *Figure 2*). In most cases today, there is no need to verify the letter of credit manually, as transactions are processed efficiently, and it is sufficient to send an electronic or paper version of the document.

Letters of credit with such notification increase the security of the client’s operations. The simplest explanation is that fewer parties are involved in the letter of credit, which means there is a lower likelihood of misunderstandings between the institutions and the beneficiary. As noted, the notifying bank is responsible for processing and delivering the letter of credit to the exporter, but does not have all the information about the document that the issuing bank has. It also reduces the costs and time required to verify the validity of letters of credit and notify additional conditions, since all this can be done at the issuing bank.

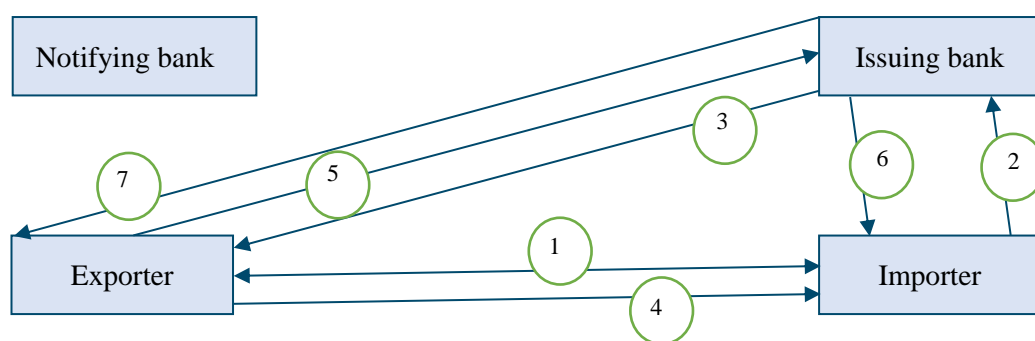


Figure 2. Letter of credit scheme with direct notifying

- 1 – purchase/sale of goods;
- 2 – letter of credit application;
- 3 – issuance of a letter of credit;
- 4 – cargo delivery;
- 5 – presenting the volume of documentation;
- 6 – documents on the issuance;
- 7 – the process of payment and acceptance of payments.

Source: (Shkuro, 2024, February 20).

However, direct notification also has its own risks, in particular:

improper provision of services by the issuing bank (this problem can be solved with the involvement of external supervisory bodies and audit inspections, which confirm that the issuing bank assumes and fulfills all obligations to the beneficiary. The most important thing is to quickly notify about any changes in letters of credit, etc.);

false beneficiary identification data (not only the issuing bank can act as a party that fails to fulfill its own obligations. To prevent dishonesty and fraud on the part of the beneficiary, it is sufficient to go through the KYC (Know Your Customer) process, check all the documentation registered for the client company’s financial report, etc.).

In the process of executing a letter of credit, the proper set of documents is submitted to the executing bank, where they are verified and a decision is made regarding payment under the letter of credit. The letter of credit must specify *documents* sufficient for the seller and buyer to fulfill the terms regarding delivery and payment. The most common among them are: commercial invoice; certificates (of origin, quality, etc.); transport documents (which may vary depending on the type of transport); insurance.

Transport documents are used to confirm the fact of shipment of goods. In the case of transport documents and certificates, it is advisable that they are issued by impartial organizations (chambers of commerce and industry, carriers, inspections) to avoid forgery (ProCredit Bank, n. d.).

In the letter of credit part of the contract, the parties must specify the broadest possible terms of the letter of credit, so that after its issuance there

are no discrepancies that could lead to amendments to the letter of credit, increased costs, or refusal to make payments and termination of the agreement. In case of questions, it is advisable to request a preliminary review of the contract. The contract terms are always checked by the issuing bank of the letter of credit. Other banks can conduct a preliminary review only if there are doubts about the correctness of the contract's completion.

Banks provide services for the maintenance of documentary letters of credit in accordance with the International Rules for working with letters of credit, the current legislation of Ukraine, and the regulatory documents of the NBU. As a rule, banks provide services for the maintenance of documentary letters of credit only to their clients with active accounts.

When opening a letter of credit, banks require customers to provide coverage in the form of:

- 100% cash security (covered letters of credit);
- other types of security (uncovered letters of credit) – in this case, an additional credit agreement is concluded with the bank and the decision is made by the bank's credit committee.

The main commissions and expenses of banks when servicing a letter of credit are as follows:

Under an import (provided) letter of credit:

- commission for opening a letter of credit;
- commission for verification of documents under the letter of credit;
- commission for making a payment under a letter of credit;
- commission for sending a swift-message.

Under an export (received) letter of credit:

- commission for notification of letter of credit;
- commission for verification of documents under the letter of credit;
- postal expenses for sending documents to the correspondent' bank;
- commission for sending a swift-message.

In addition to the specified services, banks may additionally provide other services for a fee stipulated by the tariffs of the respective bank. In particular, most often such additional services include: preliminary verification of documents related to a letter of credit upon the written request of the client, processing of documents with discrepancies regarding the letter of credit terms, additional document verification, conducting inquiries/investigations on letters of credit at the client's request, and cancellation of a letter of credit. It should be noted that a number of banks offer letter of credit services to their clients, widely outlining their advantages, but detailed tariffs are not published on their websites.

Let's consider in more detail the tariffs for providing services related to letters of credit using the example of leading systemically important domestic banks (*Table 3*).

Table 3

The cost of providing services for documentary letters of credit of leading domestic banks, 2025

Services for letters of credit opened by banks	Cost and terms (x – amount of the letter of credit)			
	JSC CB "PrivatBank"	JSC "Sens Bank"	JSC "Ukrsibbank"	JSC "Kredobank"
Opening or increasing the amount of a covered letter of credit (in hryvnias / in foreign currency)	0.2% 100 ≤ x ≤ 2000 (USD)	0.2% 1 000 ≤ x ≤ 5 000 (UAH) 100 ≤ x ≤ 2 000 (USD)	0.2% 800 ≤ x ≤ 8000 (UAH) 200 ≤ x ≤ 4000 (USD)	0.3% 2 000 ≤ x ≤ 10 000 (UAH) 100 ≤ x ≤ 1 000 (USD)
Payment under the letter of credit (in hryvnias / in foreign currency)	0.15% 100 ≤ x ≤ 1000 (USD)	50 UAH / 0.15% of the payment amount 30 ≤ x ≤ 150 (USD)	0.15% of the payment amount 30 ≤ x ≤ 150 (USD)	0.15% of the payment amount 10 ≤ x ≤ 75 (USD)
Commission for obligations under an uncovered letter of credit (in hryvnias / in foreign currency)	2% per year – secured by property rights on a deposit, government bonds or under counter-guarantees of other banks; 3% per year – secured by property; (not less than 20 USD per month)	from 3% to 7% per year; but not less than 500 UAH for each month or part of it/ from 3% to 7% per year, but not less than 50 USD for each month or part of it	2 – 5% per year	from 2% to 4.5% (not less than 2 000 UAH for each year or part of the letter of credit validity) / from 2% to 4.5% (not less than 100 USD)
Forwarding of payment documents between banks (in hryvnias / in foreign currency)	According to the courier service rates	In the total incurred expenses, additionally increased by 20% VAT		
Increase of the letter of credit amount (in hryvnias / in foreign currency)		0.2% of the increase amount; 100 ≤ x ≤ 2 000 (USD)	0.3% (not less than 1200 UAH) 0.3% (not less than 300 euros)	0.1% 1 000 ≤ x ≤ 10 000 (UAH) 50 ≤ x ≤ 500 (USD)
Making changes (in hryvnias / in foreign currency)	50 USD	300 UAH / 50 USD	375 UAH 50 EUR	1 000 UAH 50 USD
Verification of documents provided under the letter of credit (in hryvnias / in foreign currency)		0.2% of the amount of documents; But not less than 500 and not more than 10 000 UAH / 0.2% of the amount of the documents; but not less 100 USD, and not more 1 000 USD		0.2% (but not less than 1 000 UAH, and not more than 3 000 UAH) 0.2% (not less than 75 USD, not more than 1 500 USD)

Source: compiled by the authors based on materials JSC CB "PrivatBank" (n. d.), JSC "Sens Bank" (n. d.), JSC "Ukrsibbank" (n. d.), JSC "Kredobank" (n. d.), JSC "Pumb" (n. d.).

Thus, the use of letters of credit by Ukrainian enterprises requires a fairly significant allocation of funds, as concluding a letter of credit in banks requires the availability of substantial capital. Analysis of the tariffs for opening and servicing letters of credit in the leading banks of Ukraine shows that each bank sets a different pricing policy for issuing letters of credit in national and foreign currencies, which, in turn, does not vary significantly. It is also worth noting the minimum and maximum limits of certain services related to letters of credit, which business entities should pay attention to when opening a letter of credit.

3. The practice of using letters of credit in Ukraine

After the beginning of the full-scale invasion, the risks for Ukrainian exporters increased many times due to instability, the need to enter new markets, and growing distrust from foreign partners. In such conditions, letters of credit remained one of the most reliable forms of international settlements, since payment is guaranteed by the buyer’s bank only after all documents have been submitted. Confirmation of the letter of credit by a third bank is especially important when the importer’s bank has a dubious reputation or a low rating. However, currently, due to high military risks, confirmation from European banks is often required, which is one of the restraining factors for the use of letters of credit in Ukraine.

According to the official data of the NBU, the total number of letters of credit in 2024 was 16.6% higher than in 2023, but 61.2% lower than in 2021, indicating a significant decrease in the use of the letter of credit payment method in Ukraine since the beginning of the full-scale war (Table 4).

Overall, statistics indicate that domestic banks mostly provide letters of credit rather than receive them, and their share in foreign currency significantly exceeds that in hryvnias. If we consider the distribution of letters of credit by volume across groups of banks, the highest activity is observed in state-owned banks, especially in part of provided letters of credit.

Let’s consider letter of credit operations by the most popular types of economic activity according to NACE in 2024 in Figure 3.

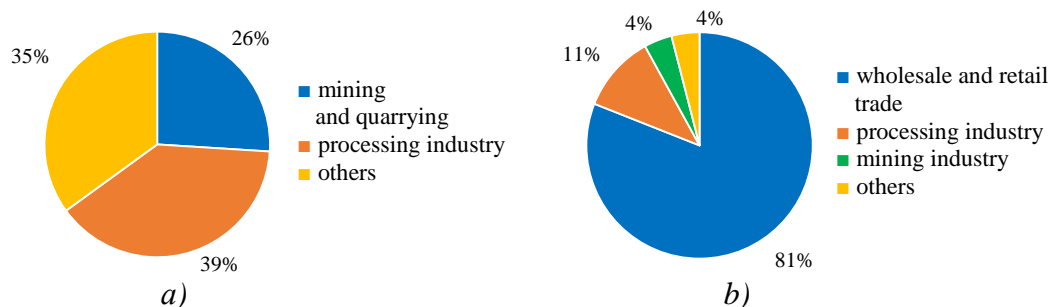


Figure 3. Structure of letters of credit provided by banks of Ukraine by types of economic activity as of January 1, 2025:
 a) in hryvnias; b) in foreign currency.

Source: (National Bank of Ukraine, n. d.).

Table 4
Operations with documentary letters of credit of Ukrainian banks in 2021–2024, UAH billion

Banks	Provided letters of credit								Received letters of credit															
	National currency, billion UAH				Foreign currency (equiv.), billion UAH				Quantity, un.				National currency, UAH billion				Foreign currency (equiv.), UAH billion				Quantity, un.			
Years	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024	2021	2022	2023	2024
with a state share	3.37	1.88	1.07	0.54	23.36	13.62	20.05	19.08	254	126	213	193	0.26	0.38	0.3	0.25	11.55	4.38	3.95	4.71	563	138	167	131
foreign banking groups	1.17	0.17	0.03	0.33	6.91	8.67	17.15	14.98	608	232	173	237	1.8	0.56	0.33	0.16	2.75	0.77	0.81	0.40	371	105	67	68
with private capital	1.17	0.46	0.05	0.48	1.72	0.34	1.37	3.58	549	96	243	394	1.84	1.62	0.49	0.18	4.53	0.97	1.13	1.71	476	115	75	71
Total	5.71	2.51	1.15	1.35	31.99	22.63	38.57	37.64	1411	454	629	824	3.9	2.56	1.12	1.59	18.83	6.12	5.89	6.82	1410	358	309	270

Source: (National Bank of Ukraine, n. d.)

Thus, the letter of credit form of settlements is most widely used in wholesale and retail trade, and the vast majority of provided letters of credit are in foreign currency (81% of the total number of letters of credit – 597 units). For comparison, in 2023, the same trend was observed, although the share was somewhat lower – 75%.

The second place in terms of volume is occupied by the processing industry (67 letters of credit). The mining industry prevails in terms of the number and volume of letters of credit issued in foreign currency. In the national currency, the amounts are insignificant, which indicates the use of letters of credit as an effective method of settlement primarily in the foreign economic activities of enterprises.

Conclusions

Therefore, letters of credit are a means of reducing settlement risks and a guarantee of complete security in relationships with counterparties. After all, during the supply of goods and the provision of services, risks may arise at various stages: from the procurement of raw materials, manufacturing, and storage of goods to the timely delivery/provision of services and payment. The use of letter of credit settlements allows protecting the interests of both the seller and the buyer in such situations.

In modern conditions, it is profitable to use letters of credit:

in business operations (for ensuring safe and effective international transactions, where the parties may be unfamiliar and geographically distant; for financing large projects that require significant capital expenditures, where it is necessary to ensure financial stability; for protection against the buyer's insolvency or uncertainties regarding the fulfillment of the terms of the agreement);

for financial support (obtaining a financial loan through a bank for further use for personal needs; for the distribution of finances into parts for better management and optimization of financial resources; for increasing the amount of financial funds that can be used in one's own interests).

The authors have studied the significant role of banks in providing services for the maintenance of documentary letters of credit – from establishing the legality of the terms of indicated settlement instrument to the process of payment and acceptance of funds. At the same time, there are several significant problems with the use of letters of credit in Ukraine, one of which directly concerns banking institutions. First of all, it is a low level of trust in Ukrainian banks on the part of foreign partners, due to which the latter establish such terms for servicing letters of credit, which are often unacceptable for domestic banks. For the proper development of Ukrainian banks on the world stage, it is necessary to improve the system of international settlements at the state level, bring it in line with modern trends, and enhance the image of both Ukrainian companies and banks.

A significant problem is the war on the territory of our state, which has greatly limited the foreign economic activity of business entities and the use of the letter of credit form of payment accordingly. The conducted research indicates a significant reduction in the use of the letter of credit form of payment in Ukraine – more than half of the number of opened letters of credit since the beginning of the full-scale invasion. Due to high military risks, letter of credit settlement often requires confirmation from European banks as guarantors, which is one of the restraining factors today.

An important factor is the cost of a financial instrument, which depends on the amount, term, level of risk, security, bank tariffs, and involvement in international programs. For letters of credit, commissions are usually provided for notification, confirmation, as well as an annual charge of 1–3%. The authors conducted an analysis of the tariffs for opening and servicing letters of credit at leading banks in Ukraine, which revealed different pricing policies for issuing letters of credit in national and foreign currencies. At the same time, it was established that concluding a letter of credit in banks requires the availability of significant capital for domestic enterprises.

The authors confirmed the hypothesis that under modern conditions of increased volatility in financial markets, a letter of credit acts as an effective means of reducing settlement risk, ensuring the economic security of both parties to the concluded contract and expanding the scope of their foreign economic activity by minimizing the risk of non-fulfillment of obligations under concluded contracts.

Future scientific studies on this issue have broad prospects in terms of securing payments when choosing a form of settlement by business entities.

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Conflict of interest. The authors declare that they have no financial or non-financial conflicts of interest regarding this publication; they have no relationships with government bodies, commercial or non-commercial organizations which could be interested in presenting this point of view. Considering that two of the authors work at an institution that is the publisher of the journal, which could create a potential conflict or suspicion of bias, the final decision on the publication of this article (including the selection of reviewers and editors) was made by those members of the editorial board who are not affiliated with this institution.

The authors did not receive direct funding for this study.

Belianko L., & Herbich L. (2026). Mechanism for managing payment risks in international trade. *Scientia fructuosa*, 3(167), 208–224. [http://doi.org/10.31617/1.2026\(167\)12](http://doi.org/10.31617/1.2026(167)12)

Received by the editorial office 09.07.2025.

Sent for revision 10.08.2025.

Accepted for printing 22.09.2025.

Published online 19.06.2026.