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LETTER OF CREDIT POLICY

The Finance and Administration Committee recommends the adoption of the recommendation contained in the following report dated March 20, 2013, from the Commissioner of Finance.

1. RECOMMENDATION

It is recommended that:


2. PURPOSE

This report establishes a new letter of credit policy that will guide operating practices with respect to the delivery and use of letters of credit.

3. BACKGROUND

Letters of credit provide financial protection for contracts and planning agreements

Issued by financial institutions, a letter of credit may be requested by the Region to guarantee payment or provide financial protection from counterparties who fail to meet contractual obligations. In some cases, it may also be accepted as an alternative to other forms of performance security such as a surety bond.

The Region relies on letters of credit to provide purchase protection for certain types of purchases and contractual agreements. They are particularly important for high-value purchases that present elevated financial risk.

Letters of credit are also requested from developers in order to guarantee development charge prepayments. Depending on the type of development, the letter of credit may be held, drawn in equal annual amounts or drawn completely following the achievement of a development milestone.

Letters of credit received by the Region are forwarded to the Finance Department for safekeeping and administration. According to Finance’s registry as of January 18, 2013, the Region is holding 760 letters of credit with a total value of more than $253 million.
All letters of credit submitted must be in an irrevocable and standby form to allow for collection at any time during the contract or warranty period.

**Different international standards exist for letters of credit, and they can be issued by any financial institution**

The Region sometimes receives letters of credit issued by foreign banks and credit unions. These institutions abide by differing credit standards and their financial health may not meet the minimum investment requirements described in the Region’s Investment Policy. By defining minimum acceptance requirements for letters of credit, exposure to credit risk can be reduced.

Until now, the Region has used the *Uniform Customs and Practice for Documentary Credits (UCP600)* standard for its letters of credit. This standard is geared primarily towards commercial trade dealings and does not provide clear instructions for standby transactions, which are the type usually entered into by the Region. Standby letters of credit act as an insurance policy by allowing the Region to draw funds as required, whereas commercial letters of credit are almost always used as a primary method of payment.  

**The Region will manage financial risk more consistently by enacting a letter of credit policy**

Clarifying acceptance criteria for letters of credit will help to protect the Region from default risk from financial institutions that may not be able to honour the letter of credit.

While internal operating procedures have guided the administration of letters of credit up to this point, the Region has never enacted a letter of credit policy.

**A number of Ontario municipalities have enacted letter of credit policies**

Letter of credit policies have been formally enacted by several municipalities in Ontario, including the City of Brampton (2001), the City of Hamilton (2002), the City of Guelph (2011), and the City of Waterloo (amended 2012). Like the Region, most municipalities in Ontario include standard letter of credit templates as part of their respective purchasing and tender documents.

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4. **ANALYSIS AND OPTIONS**

**The proposed Policy will clarify requirements for letters of credit**

The Letter of Credit Policy describes format requirements for submitted letters of credit, minimum credit rating expectations for issuing financial institutions, procedures when
warranties for goods and services are provided, and alternatives where a letter of credit is not deemed to be feasible.

**The Region should adopt the International Standby Practices standard (ISP98)**

In 1998, the International Chamber of Commerce introduced the *International Standby Practices standard (ISP98)*. In addition to typical credit definitions, this standard includes 89 defined rules for standby letters of credit. It has recently been adopted by the Province of Ontario, the Ontario Power Authority, and the Internal Trade Secretariat Corporation for letters of credit pertaining to the Agreement on Internal Trade (Canada). York Region would be the first municipality to adopt it. The proposed Policy would move the Region to the *ISP98* standard.

**Letters of credit that the Region currently holds or has already requested will not be subject to the new Policy**

The Policy will apply to all letters of credit requested by the Region on or after the date that the Policy is enacted.

Any letters of credit held by the Region prior to enactment of this Policy will be submitted to the Director, Controllership Office in the Finance Department and held until their renewal, expiry or draw date, whichever comes first. Where a letter of credit has been requested prior to enactment of this Policy, it will be executed in accordance with previous operating practices and held by the Finance Department until the renewal, expiry or draw date, whichever comes first.

With the exception of automatic renewals, a letter of credit that requires renewal or reissuance will be subject to the terms set out in the new Policy.

**Link to key Council-approved plans**

Implementing the proposed Letter of Credit Policy is consistent with the Region’s priority to manage its finances more prudently.

5. **FINANCIAL IMPLICATIONS**

The Letter of Credit Policy will promote consistency in the administration of letters of credit and better protect the Region from counterparty default and non-delivery.
6. LOCAL MUNICIPAL IMPACT

There are no financial implications to local municipalities associated with the implementation of the Letter of Credit Policy.

7. CONCLUSION

The Letter of Credit Policy will standardize operating practices and improve consistency for the delivery and use of letters of credit. Letters of credit that the Region currently holds or has already requested will not be subject to the new Policy. All letters of credit submitted to the Region must be in an irrevocable and standby form to allow for collection at any time during the contract or warranty period, and are to be forwarded to the Finance Department for safekeeping and administration.

For more information on this report, please contact Ed Hankins, Director, Treasury Office, at ext. 1644.

The Senior Management Group has reviewed this report.

(The attachment referred to in this clause is attached to this report.)
POLICY STATEMENT:

A letter of credit may be requested as a condition of a contract, development charge agreement or planning approval to help ensure that financial and/or performance obligations are met. In conjunction with the Region’s investment, planning and purchasing policies, this Policy establishes minimum standards for letters of credit in order to protect the financial interests of the Region.

APPLICATION:

This Policy applies to the acquisition, evaluation and administration of all letters of credit by or on behalf of the Region.

PURPOSE:

To define requirements for the use of a letter of credit, including:

• Acceptable letter format and content;
• Issuing financial institution requirements (including minimum credit rating expectations);
• Acceptable security alternatives; and,
• Regional staff responsibilities.

DEFINITIONS:

**Automatic Renewal:** a condition which states that a letter of credit shall be automatically extended without formal amendment for a specified period beyond the stated expiration date. Written notification must be received by the Region prior to expiration if automatic renewal is to be terminated.

**Counterparty:** the other party or parties to an agreement with the Region.
Counterparty Risk: the likelihood that a counterparty will default or not fulfill its obligations in accordance with terms set out in a contract.

Irrevocable: a form of letter of credit that may not be revoked or amended without the mutual consent of the issuing bank and the beneficiary (the Region).

Letter of Credit: a form of financial security issued by a financial institution that guarantees payment or performance by one or more counterparties to a beneficiary (the Region). At any time, the beneficiary reserves the right to draw upon the security up to a specified total in the event of default or non-delivery.

Schedule I Banks: domestic banks authorized under Schedule I of the Bank Act to accept deposits.

Schedule II Banks: foreign bank subsidiaries authorized under Schedule II of the Bank Act to accept deposits. Foreign bank subsidiaries are controlled by eligible foreign institutions.

Schedule III Banks: foreign bank branches of foreign institutions that have been authorized under Schedule III of the Bank Act to do banking business in Canada.

Standby: a form of letter of credit which only requires the presentation of an appropriate payment request to the issuing bank from the beneficiary (the Region) without further documentary evidence of obligation.

Surety Bond: A financial instrument that provides a guarantee to the owner (Region) that a contractor will meet performance and/or payment obligations under a contract.

Warranty: an express or implied term in a contract, such as an undertaking that goods or services contracted shall meet specified requirements as to design, quality or performance.

York Region: The Regional Municipality of York (“the Region”).

DESCRIPTION:

Agreements or contracts involving the Region may require a letter of credit to be issued to provide assurance that certain financial or performance obligations are met. This could include, but is not limited to:

- The purchase of goods and/or delivery of services, by or on behalf of the Region;
- Subdivision/development agreements, including development charge agreements; and,
- Site alterations/site plan approvals.
Format

The Region shall employ the standard format for irrevocable letters of credit attached as Appendix A.

The submitted letter of credit must:

• be printed on letterhead from the issuing financial institution;
• comply with the International Standby Practices (ISP98) or its successor as published by the International Chamber of Commerce;
• be denominated in Canadian dollars in an amount requested by the Region;
• include an automatic renewal provision where the agreement is to be in place for more than one year;
• indicate that the Region will be given 30 days notice by registered mail if the counterparty does not intend to renew;
• refer to a renewal schedule described in the agreement where the value of any letter of credit renewals or extensions are subject to changes from the original letter of credit amount; and,
• conform to the intent of the standard format provided in Appendix A. Any deviation from the standard format will be subject to review by the Region and may be refused for non-compliance.

A letter of guarantee or confirmation may be requested from time to time as evidence of capacity to secure a letter of credit. However, at no time shall a letter of guarantee or confirmation serve as an acceptable alternative to a letter of credit. Letters of guarantee or confirmation must indicate that the financial institution is willing to provide a letter of credit in a format and within a time period deemed acceptable to the Region.

Financial Institutions

Unless otherwise directed by Council, letters of credit conforming to the intent of the standard format requirements provided in Appendix A will only be accepted by the Region from Schedule I and II banks maintaining minimum credit ratings described in the Region’s Investment Policy, as amended from time to time. Letters of credit from trust companies, credit unions and Schedule III banks will generally not be accepted. In exceptional circumstances, they may be accepted subject to the review and approval of the Director, Treasury Office, Finance Department.

Where an eligible financial institution fails to maintain a credit rating position that meets the minimum credit requirements described in this Policy, the Region shall forward a replacement request to the counterparty to provide a substituting letter of credit from a financial institution that meets the minimum requirements set out in this Policy. If a replacement letter of credit is not provided within 30 days of receiving the Region’s replacement request, the Region reserves the right to immediately draw upon the original letter of credit. The financial institution issuing the letter of credit shall not be party to the terms of any agreement or agreements that are related to the provision of security.
Financial Alternatives

Where a letter of credit is not deemed to be suitable or where a counterparty cannot provide it in the value or format requested by the Region, security deposits in an amount equal to the letter of credit amount may also be accepted in the form of cash (certified cheque, bank draft or money order) or surety bond. In all cases, cash shall be the preferred alternative to a letter of credit.

If an alternative form of security is provided in lieu of the requested letter of credit, the funds will be received and deposited by the Region and no interest shall accrue to the benefit of the provider. When financial and/or performance obligations have been met and any warranty periods have elapsed, the Region shall return the security deposit to the provider in the amount originally delivered. The Region may also return a portion of the security deposit in accordance with a renewal schedule described in an agreement.

RESPONSIBILITIES:

Commissioner of Finance & Regional Treasurer and/or designate:

- Maintains administrative authority and responsibility for the Letter of Credit Policy; and,
- Approves departmental operating procedures and processes under this Policy.

Director, Treasury Office, Finance Department and/or designate:

- Responsible for the implementation of, and adherence to, this Policy; and,
- Reviews and, if deemed appropriate, approves deviations or exceptions to this Policy, including letters of credit submitted from financial institutions that do not meet the minimum requirements described herein.

Director, Supplies & Services, Finance Department and/or designate:

- Incorporates letter of credit requirements into Regional purchasing documents; and,
- Ensures that resources and staff are available to support the consideration of financial risk mitigation for Regional purchases.

All staff involved in the acquisition, evaluation and administration of letters of credit:

- Read and abide by the requirements set out in this Policy; and,
- Forward any letters of credit received or retained at the department level to the Director, Controllership Office, and/or designate.
NON-COMPLIANCE WITH POLICY:

Non-compliance with this Policy could lead to disciplinary action, up to and including dismissal.

ATTACHMENT:

Appendix A: Letter of Credit Template

CONTACT:

For policy clarification, please contact the Director, Treasury Office, Finance Department.

APPROVAL INFORMATION

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<th>CAO Approval Date:</th>
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Committee: Clause No.: Report No.
Edocs. No. (of extract)

Council Approval: Minute No. Page: Date:

Xxxxx Edocs No. of Archived Policy if any
APPENDIX A

REGION OF YORK
STANDARD DOCUMENTATION FOR LETTERS OF CREDIT

(insert bank letterhead)

LETTER OF CREDIT NO.

DATE:

APPLICANT:

BENEFICIARY: The Regional Municipality of York
17250 Yonge Street, Box 147
Newmarket, Ontario, Canada
L3Y 6Z1

We hereby authorize you to draw on ____________________________
(Bank, Address, Postal Code)
for account of ____________________________ (name of Applicant)
up to an aggregate amount of ____________________________ Dollars ($______)
available on demand as follows:

Pursuant to the request of our customer, the said ____________________________,
we ____________________________
(name of Bank)
hereby establish and give to you an Irrevocable Letter of Credit in your favour in the total
amount of
____________________________ DOLLARS ($__________) CAD

which may be drawn on by you at any time and from time to time upon written demand for
payment made upon us by you which demand we shall honour without enquiring whether you
have a right as between yourself and our said customer to make such demand and without
recognizing any claim of our said customer.

Provided, however, that you are to deliver to us at such time as a written demand for payment is
made upon us a certificate signed by you agreeing and/or confirming that monies drawn
pursuant to this Letter of Credit are to be retained and used to meet obligations in connection
with:
The amount of this Letter of Credit shall be reduced from time to time as advised by notice in writing given to us from time to time by you.

This Letter of Credit will expire on ____________, but shall be deemed to be automatically extended without any formal amendment or notice to that effect, from year to year for successive periods of one year each from the present or any future expiration date hereof, unless not less than thirty (30) days prior to the present or any future expiration we shall notify you in writing that the bank elects not to renew this Letter of Credit for any such additional period. This notification shall be delivered by Registered Mail to the attention of:

Commissioner of Finance & Regional Treasurer
Regional Municipality of York
17250 Yonge Street, Box 147
Newmarket, Ontario, Canada
L3Y 6Z1

Upon receipt by you of such notice, you may draw by means of your demand accompanied by your above written certificate.

Partial drawings are permitted.

The drawings under this credit are to state that they are drawn under the

(Name of Bank, Address)

LETTER OF CREDIT NO. ________________.

(Number)

This Letter of Credit is subject to the rules set out in International Standby Practices (ISP98), International Chamber of Commerce publication No.590 and engages us in accordance with the terms thereof. This Letter of Credit shall also be governed by and construed in accordance with the laws of the Province of Ontario and the applicable laws of Canada except to the extent that such laws are inconsistent with the International Standby Practices (ISP98).

Authorized Signature

Authorized Signature (For Bank)