Forfaiting, trade finance and the International Chamber of Commerce (ICC)

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1. Background considerations

1.1 Some generalities

In his research Nis Clausen has been oriented mainly towards law & economics and law and finance. The law related to trade finance may not per se be one of his particular areas of interest, but it is an area of law which is closely related to i.a. finance and credit. I have here chosen a topic which is part of trade finance, although it is hardly the best known and most used arrangement, namely *forfaiting*. One reason, and maybe the best one, for discussing forfaiting is that The International Chamber of Commerce (ICC) is preparing a set of rules covering forfaiting transactions, which are due to be in force in 2013. ICC has for several years cooperated with the International Forfaiting Association concerning such rules. ICC and its trade financing groups have regarded forfaiting as a practical financing tool beside other related arrangements which it has regulated.

Forfaiting is basically related to the sale of a payment claim on a *without recourse* basis. Traditionally it has been used mainly together with bills of exchange (or promissory notes); at least this seems to be the situation in English and commonwealth countries. Forfaiting seems to have had rather limited use in Scandinavia. There may be an increased use of forfaiting in present international business as a tool of finance.[1] This may to some extent be a consequence of new rules on capital requirements for banks which seems to lead to a growing use of alternative financing methods.

[1] Cf. Schmitthoff's *Export Trade. The law and practice of International trade*, 12th ed., by C. Murray, D. Holloway & D. Tomson-Hint, London 2012 p. 269 et seq.

Trade finance is an intersection where sales law, the law of carriage, insurance law and trade finance law (including payments) meet.[2] It is also an intersection where law has developed on various levels and in different shapes. This is a reason why trade finance has particular interest in international business particularly where payment and financing is involved.

1.2 Some overriding aspects concerning trade finance

Various financing methods have developed over time, locally as well as internationally. They have developed as competing tools but also in parallel and sometimes in conjunction with each other. For obvious reasons cash payment is rare in international business. Zug um Zug transactions (payment in exchange for delivery) are practically hard to achieve, but various methods have been created aiming at reducing risks of the seller and the buyer respectively and achieving a balance of risks which somewhat mirrors the Zug um Zug method.[3]

Advance payment or clean credits are methods which place the main economic risk on the buyer and the seller respectively. It has therefore been necessary to create various methods aiming at securing payment for the seller and delivery of the goods for the buyer. This may be achieved through various types of payment methods, financial guarantees and related tools. The practical problems turn around property in goods, documents, financing, financial security and payment. Hence various techniques have evolved which deal with these questions.

The bill of exchange which has a very long history as a means of payment in international trade is still an important payment instrument in certain geographical areas and in certain trades.[4] Together with the bill of lading the

[2] See in Scandinavian law i.a. Selvig, *Fra kjøpsrettens og transportrettens grenseland*, Oslo 1975 and Gorton, *Rembursrätt*, Lund 1980 p. 18 et seq and 128 et seq.

[3] Cf. *Goode on payment obligations in commercial and financial transactions*, 2nd ed. by Charles Proctor, London 2009 i.a. pp. 8, 15 and 151. See also Gorton, *Rembursrätt*, Lund 1980 p. 18 et seq.

[4] See further below in 3.2. In present trade electronic payments play an increasingly important role. See i.a. Chalmers & Guest, *Bills of exchange*, 17th ed. London 2009 particularly in sec. 2-109 et seq. In Swedish law see e.g. Herre & Karnell, *Check- och växelrätt*, Stockholm 1992 and in particular Hult, *Lärobok i värdepappersrätt*, 2nd ed. Stockholm 1958, p. 75 et seq. This was for a long time a standard book in Swedish legal literature in this area of law. It came out in a new print in 1969, and it treats various characteristics of these

bill of exchange has influenced the development of negotiability and transferability related to various documents. In particular art. 9 in the Swedish Bill of Exchange act (Växellagen 1932:130) may have an impact in relation to forfaiting.[5] It is here prescribed that a non-recourse clause, whereby the drawer of the bill of exchange excludes his payment liability, shall not be enforceable.[6] This particular provision may turn out to be somewhat hard to reconcile with forfaiting, although it may work with other payment instruments.

The International Chamber of Commerce (ICC) has come to play a significant role in the drafting of various instruments which are, of course, not legislation, but which have come to play an important role in the development of international trade finance law.[7]

In this perspective *lex mercatoria* is also an important although not very precise element. One may say that lex mercatoria, usage and practices and standard documents have developed in parallel over the years.[8] Lex mercatoria stems back to at least the medieval times where it developed in relation to trade centers that grew up both in Southern Europe and in Northern Europe.

instruments. Eberstein, *Den svenska växelrätten*, Stockholm 1934 is still the in depth study in the area in the Swedish legal literature.

5 This provision corresponds to the same one in the Danish Vekselloven. The bill of exchange legislation is common Nordic legislation based on the 1930 Geneva Convention on the Unification of the Law relating to Bills of Exchange. Neither the Check Act (Checklagen 1932:131) nor the Act on Promissory Notes (Skuldebrevslagen 1936:81) has any corresponding provision setting out unenforceability of a non-recourse clause. Both acts set out that all debtors are liable jointly and severally, but does not contain any rules on "non-recourse clauses".

6 A discussion on the liability of the different parties to the bill of exchange is found in Hult p. 86 et seq. There he points out that the other parties in the chain may rely on a non-recourse clause but not the drawer.

7 ICC has also contributed to the development of several standard form contracts, which is an area where several other international organizations have been involved, such as Orgalime, FIDIC etc. It should also be underlined that one of the best known instruments designed and drafted by ICC is the Incoterms (presently in the form of Incoterms 2010). ICC also plays an important role with respect to dispute settlements, and particular rules on arbitration have been designed by ICC. Apart from more specific financial contracts which may have been dealt with by different organizations ICC is the only international organization which has played a particularly significant role with respect to trade finance law.

8 See i.a. Goode, *A new international lex mercatoria?* 1999–2000 Juridisk Tidskrift p. 253 et seq. and Schmitthoff, *Commercial law in a changing economic climate*, 2nd ed. London 1981.

There are also traces of an ancient lex mercatoria in some Middle East countries.[9]

Several references are made to lex mercatoria or trade practice in various ICC documents. Also the preambles of the Unidroit Principles of Commercial Contracts (PICC) as well as the Principles of European Contract law refer to the lex mercatoria.[10]

Against the background of some general comments on the custom & principles related to documentary letters of credit (UCP 600), the rules on demand guarantees (URDG 758) and the rules on standby letters of credit.[11] Below I shall mainly address some principles and touch upon a new set of ICC rules with respect to forfaiting, which are due to be published shortly. These rules form part of certain other ICC rules and principles which have been developed within the area of trade financing. Forfaiting is a method to create financing, which has been in use for some time. It may not be one of the most used methods, but it is often closely tied to the use of bills of exchange (and promissory notes) and/or documentary credits.

One may, of course ask, to what extent there is need of forfaiting as a particular and separate payment and financing method considering the number of other existing arrangements. It may then also be questioned whether there is need of particular rules on forfaiting.[12] Apparently the market seems to have found such need, and one reason may be the increased capital requirements introduced and discussed in the Basle Rules (II established and III still discussed) which will increase the costs of credit. It may therefore be useful for a customer in need of financing to have the choice of different arrangements. It should, however, also be kept in mind that arrangements such as credit insurance may play a role in this connection. Similarly, government institutions, such as Credit Export Guarantee Organizations, have an important function in this connection.[13]

9 In particular accounted for in Holdsworth, *The origin and early history of negotiable instruments in English law*, London 1955.

10 Reference could also be made to De Sousa Santos, *Towards a new legal common sense. Law, globalization and emancipation*. London 2002 at i.a. p. 211 et seq.

11 The rules on Standby letters of credit have not been drafted and developed by ICC, but ICC has endorsed the use of it, see below in 3.

12 It should be kept in mind that forfaiting is a particular legal technique in use with respect to the transfer or assignment of debt, and like factoring and other arrangements there may arise questions in relation to certain rules concerning transfer, assignment etc.

13 In Sweden Exportkreditnämnden (EKN) has such role.

2. The role of ICC in the field of international business and finance

Before delving into questions related to forfaiting more specifically some words should be mentioned about the role of ICC with respect to trade finance. ICC is involved in several different ways as regards international trade and business and also plays a distinctive role in the development of rules and principles in this particular area. It is also an important organization when it comes to the development of business and trade conditions. ICC is a private organization and thus not a legislator, but it has important functions with respect to the development of standard documents, rules, policies etc. ICC has its main office in Paris but it is represented in several countries by national committees. There are thus particular national committees with respect to i.a. trade finance and commercial practice.

Apart from the Incoterms the most spread ICC instrument is the Uniform Custom and Practices related to letters of credit.[14] The latest version is from 2006 (the so-called UCP 600) and it is a globally used set of rules. Already its caption refers to custom and practice, and UCP is sometimes referred to as trade usage. It is questionable whether UCP 600 may formally have reached such status, but their global and monopoly like use may speak for such characterization.[15] The Uniform rules on Demand Guarantees (URDG) are much younger and were preceded during the 1970's by the so-called Uniform Rules on Contract Guarantees. In 1992/93 the first version of the URDG was published as the first international instrument in this legal area, but it took some time before they came to be used in practice. Through the introduction of URDG 758 in 2009 the rules have caught some more use worldwide, although they are far from the global reach of the UCP 600.[16]

The launching of new ICC rules on forfaiting means a new step in the development of ICC rules related to trade finance. Time will show to what extent these rules will be used in connection with international sales transactions. It must again be emphasized that forfaiting is a trade finance tool on its own merits, but that it serves similar purposes as other instruments in use and may also be used in close relation to documentary credits where payment is made through bills of exchange and promissory notes.

[14] In this context also the ICC Rules on collection merit mentioning.

[15] It seems that virtually all documentary credits refer to the UCP.

[16] In particular reference could be made of Kurkela, *Letters of credit and bank guarantees under international trade law*, 2. ed. 2008.

3. Further with respect to trade finance law

3.1 Some general observations with respect to the assignment and transfer of debts etc.

Before delving into certain particular features of forfaiting some words need to be mentioned on some other trade finance tools and also on some legal techniques related to trade finance. Thus transfer or assignment of debts could be used to create financing.[17] Hence an exporter could use his debts to obtain finance *with* or *without recourse* by transferring to a financer what is owed to him.[18] In the former case the transferor having received payment from the transferee with security in the debt transferred remains ultimately liable in case the previous debtor in the payment chain would not pay, but in the latter case the transferor by *selling* the debt is relieved of his duty to pay. The former transaction is therefore rather a kind of loan to the transferor from the financer which will be repaid, whereas the latter one is a sale. The parties involved in such transaction are thus the original debtor, the original

[17] The terminology and the understanding of concepts such as assignment (cf. also novation), transfer, negotiation is not exactly the same in all legal systems and I have here used the terms without making a clear distinction between them. It must, however, be underlined that the different concepts may have a particular meaning in one legal system without necessarily being applied in exactly the same way in another legal system. It is therefore important to make certain whether a particular meaning is tied to the concept used in the individual case. See in Swedish law i.a. Hult, p. 19 et seq. and 39 et seq. Rodhe in his *Obligationsrätt*, Lund 1956 makes a thorough analysis of "överlåtelse av fordran" (transfer of claim) on pp. 134 et seq. and p. 739 et seq. and of "överlåtelse av skuld" (transfer of debt) on pp. 608 et seq., 642 et seq. and 717 et seq. Martinsson, *Kreditsäkerhet i fakturafordringar – en förmögenhetsrättslig studie*, Uppsala 2002, deals with certain questions related to factoring and general debt matters. Particularly on p. 106 et seq. he treats questions related to various forms of financial security in invoice claims. On p. 111 he mentions the difference in relation to the purchase of debt, but he also points out the use of various payment techniques which have been developed, sometimes not very different from each other.

[18] There seems to be a difference in terminology where in Swedish law we would normally distinguish the claim (what is owed to the transferor) and the debt (what is owed by the transferor to somebody else), cf. Rodhe in footnote 17 above. Rules related to the transfer of a claim or of a debt would also be covered somewhat differently. If I have understood correctly the word "debt" is used to cover both situations in English law (and it is of course depending on from which side one sees it), but the rules applicable may still like in Swedish law differ. Like in Swedish law there is in English law a certain difference in approach between the two.

creditor (the transferor) and the purchaser of the debt (the financer, the transferee).[19]

Some words shall below be mentioned with respect to some of the different trade finance tools in use.

3.2 Bills of exchange

Based on the idea mentioned previously, bills of exchange have been used as payment instruments for a long time in order to enable an exporter through discounting to obtain cash before the debt falls due. The bill of exchange (like the bill of lading) has its roots in *lex mercatoria*, but is now subject to legislation in many countries. Such legislation is in many cases based on the Geneva Convention on the Unification of the law related to Bills of Exchange,[20] but as far as English law is concerned the situation is different, and here the Bill of Exchange Act of 1882 as amended has developed out of common law.[21] The Swedish legislation, Växellagen (1932:130) is based on the convention.

The bill of exchange is a "negotiable" document,[22] and the idea is that it

[19] Like in most international trade finance the structure is normally based on an underlying transaction (a sales agreement) to which several other contracts will be connected, such as carriage, insurance and finance (sometimes a letter of credit). The finance part may involve various tools in order to arrange payment for the exporter through various payment methods. This is also where e.g. forfaiting may come into the picture by opening up for the transfer of a debt. In his book *Factoring. The law and practice of invoice finance*, 3rd ed. London 1999 on p. 222 Salinger refers to various ways of creating financing through the purchase of debt or the use of debt as security. He there also compares superficially factoring with leasing, block discounting and forfaiting as "other arrangements of similar nature". See also Guild & Harris, *Forfaiting, An alternative approach to trade financing*, New York 1986 (but a later version has also been published), *Benjamin's sale of goods*, (gen. ed. M. Bridge), 8th ed. London 2012 par. 22 – 072, Bridge, *The international sale of goods. Law and practice*. 2. ed. London 2007 i.a. 6.16 and Schmitthoff's *Export trade*, p. 269 et seq.

[20] Several European states but also a number of countries in East Asia etc. have adopted this convention.

[21] This has also had an impact on several Commonwealth countries. In the United States art. 3 on commercial papers in the Uniform Commercial Code are applicable. Efforts were made to reconcile the two systems through the Uncitral Convention on Bills of Exchange and Promissory Notes from 1968, but this has been adopted by some few countries only.

[22] As mentioned above negotiability, assignability and transferability are concepts used sig-

should be transferable from one creditor to another. The basic idea is that the transferring party remains liable to the next holder, but where forfaiting is involved the payment liability is excluded through a non-recourse clause, and instead the payment liability will be taken over by the transferee (the forfaitor). Undoubtedly, there are always financial risks involved in such transactions, and the law related to the transfer of debt varies between different jurisdictions.[23] The Swedish bill of exchange act (Växellagen) in chapter 6 sets out provisions regarding the payment of bills of exchanges and chapter 7 concerns recourse for the non-acceptance of a draft and the non-payment of a bill of exchange. The bill of exchange is based on recourse between those who are involved in the bill of exchange chain, and in some countries clauses excluding recourse are not enforceable. As mentioned this is the case in Swedish law where art. 9 sets out that a nonrecourse clause in a bill of exchange is not enforceable with respect to the drawer.[24] There is no equivalent provision in the English bill of exchange act but here nonrecourse clauses are enforceable.

The use of bills of exchange is not uncommon in connection with documentary credits and is frequently used in forfaiting, where the point of departure is related to payment by a bill of exchange (but also promissory notes could be used) on a nonrecourse basis.

3.3 Documentary letters of credit

Some few words should also be mentioned with respect to documentary credit transactions since they are often connected with payment through a bill of exchange (or a draft – or for that matter a promissory note) and are not seldom also combined with forfaiting. Documentary credits have been used far back in time. While letters of credit had as their origin a letter entitling the holder to a possibility to obtain local money when traveling, the modern documentary letter of credit is a true trade finance instrument.[25] It

nifying various characteristics related to the nature of certain types of documents and transactions.

[23] It could also be mentioned that UCP 600 in art. 38 (transferable credits) and art. 39 (assignment of proceeds) recognize the differences and make a distinction between transfer of the letter of credit and assignment of the proceeds under a letter of credit.

[24] See the discussion in Eberstein p. 69 et seq.

[25] See i.a. Gorton p. 26 et seq. with references.

forms an important link in several international agreements related to the sale of goods. In a documentary credit arrangement the issuing bank on the instruction of the buyer will undertake irrevocably to pay to the beneficiary (the seller) the purchase amount against his presentation of certain agreed documents.[26] In some documentary credit transactions (and particularly in certain markets) a confirming bank will be involved as primary payer. Instead of a clean payment the bank may undertake to accept a draft. It is thus common in connection with letters of credit that payment is made by bill of exchange, something which is mirrored in the UCP 600, where art. 7 contain certain provisions "sight payment, deferred payment or acceptance" and also the negotiation, and art. 8 concerning the undertaking by a confirming bank set out similar provisions. In such situations documentary credit arrangements may also be connected with forfaiting. Although documentary credit is a separate arrangement it may be used together with forfeiting. If payment under a documentary credit will be made by a bill of exchange the beneficiary, unless discounting the bill, will obtain payment only at a later stage in accordance with the terms of the bill of exchange. If, however, the beneficiary decides to have the bill of exchange discounted, he will then receive the price immediately at the discounted rate. The beneficiary remains liable in payment unless it has obtained payment without recourse, which may then mean the involvement of forfaiting.

3.4 On demand guarantees

So-called on demand guarantees have gradually become more used in international trade as a financial security.[27] On demand guarantees have certain features in common with surety ship in English law but differ in that they are payable on demand, and like letters of credit they are independent of the underlying transaction.[28] The on demand guarantee is thus not per se a pay-

[26] Since ICC is also known for its arbitration rules mention could also be made of Docdex, a particular dispute resolution system with respect to disputes in connection with documentary credits. The parties to the letter of credit arrangement could thus agree to a particular dispute resolution system developed with respect to letters of credit, which are known as the Docdex rules.

[27] On demand guarantees are generally described as unconditional, irrevocable undertakings payable on demand, but as distinguished from documentary credits, they are not intended as payments but as financial security.

[28] See Drobnig, *Personal security*, in Principles of European Law, 2007 containing 4 parts, one general part, one on dependent personal security (surety ship guarantees), one part

ment device even if the use of it may amount to payment on demand. As mentioned the forfaiter may accept to purchase the bill only together with an aval, which could, however also be replaced by a separate on demand guarantee.[29]

3.5 Standby credits

Standby credits have their origin in US law where banking regulation did not allow banks to issue guarantees as part of their business. The issuance of guarantees was then allowed in connection with other business but not as a business on its own merits. US banks developed the standby credit as their method to compete with banks in other countries where such limiting legislation did not exist. The previous US rules in this respect have ceased, but the standby credit has remained as an alternative financial security in international commerce, and they are also often issued by other banks than US banks and also in other markets than the US. Standby credits are thus an alternative to on demand guarantees, and banks operating in international trade finance are often able to issue the one or the other in accordance with requests by the customer.

Standby credits will often by contract be made subject to the International Standby Practices (ISP98) issued by the Institute of International Banking Law & Practice, Inc. and endorsed by ICC.

4. Forfaiting

4.1 What is forfaiting and how does it work?

I have already above given a short description of how forfeiting is working. According to the new ICC Rules for forfaiting a forfaiting transaction is determined as a "sale by the Seller and the purchase by the Buyer of the Payment claim on a without recourse basis on the terms of these rules."[30] Forfaiting thus denotes the purchase of debts falling due at some future date,

on independent personal security (indemnities/independent guarantees) and one on private persons (consumers) as guarantors.

[29] The aval is the particular guarantee inserted into the bill of exchange.

[30] This presupposes that reference is made to the forfaiting rules in the documentation. This is also set out in the forfaiting rules and corresponds to similar provisions in art. 1 of the UCP and the URDG respectively.

arising from deliveries of goods and services – almost exclusively export transactions – without recourse to a previous holder of the debt. Forfaiting is thus basically a purchase of a payment claim.[31] Forfaiting comes from the French word "à forfait" and thus conveys the idea of the surrendering of rights. This is a fundamental parameter in forfaiting, which is thus a method of trade finance which allows exporters to obtain cash by selling medium-term foreign accounts at a discount on "without recourse" basis.[32] This is thus the primary function of forfaiting, which thus resembles certain other methods, among others factoring.[33] A particular forfaiting market has developed over the years. The use of forfaiting seems to have varied at different times and depending on the market involved.

In practice forfaiting often seems to work along the following lines. The exporter approaches the forfaiter (the prospective purchaser of the debt) before finalizing the structure of the underlying transaction and negotiates for a deal in order to be certain to obtain the price. Once the forfaiter has committed himself and has set the discount rate, the exporter can include the discount rate into the sales price. The exporter may then accept the commitment by the forfaiter, and there enters into the underlying contract with the importer, and obtains, if required (which it often is), a guarantee from the importer's bank with respect to the documents required to complete the forfaiting. In accordance with the underlying transaction the exporter delivers the goods to the importer and delivers the documents to the forfaiter who

31 *Goode on payment obligations* on p. 15 i.a. distinguishes payments from other acts and sets out that there is a distinction between the purchase of a claim and payment in discharge of a claim. He also states:"Thus a person negotiating a bill of exchange does not pay the bill, he pays for it; the purchaser of a contract right does not, in handing over the purchase price, discharge the obligations of the debtor to the assignor, he buys it." This is an important distinction and it is also made in Swedish law.

32 See e.g. Guild & Harris, *Forfaiting* p. 20. Cf. also Chalmers & Guest, *Bills of exchange*. 17th ed. London 2009, sec. 2-109 – 2-110 and Bridge, *The international sale of goods. Law and practice*. 2. Ed. London 2007 sec. 6.16, where the author states that forfaiting is acceptable in the market "either because of the strength of the drawee buyer's credit rating or because the bill is supported by a bank in the buyer's country, which executes either a separate guarantee or backs the bill with an aval signature." This may also be the case where a promissory note is being used.

33 See i.a. Martinsson p. 107 et seq. and Schmitthoff, *Export trade* where on p. 263 et seq. a distinction is noted between "factoring, forfaiting, financial leasing and other forms of merchant finance."

verifies them and pays for them as agreed in the commitment.[34] Since this payment is without recourse, the exporter has then no further interest in the transaction, and it will instead be the forfaiter who collects the future payments due from the importer.[35]

In this type of transaction the seller, regularly the exporter in a sale or service transaction, thus sells his claim, which may be in the form of a bill of exchange or a promissory note, thereby protecting himself from any recourse by including the words "without recourse" in the endorsement. The seller of a forfaitable bill of exchange is usually an exporter who has accepted it in payment for goods and services and who wishes to pass all risk and responsibilities for collection and payment to the forfaiter (the purchaser of the debt) for immediate cash payment.

Forfaiting thus exists in parallel or competes with other similar methods and is regularly connected to a bill of exchange.[36] Over time other methods have evolved aiming at achieving the same or a similar end result. Factoring (without recourse) and certain types of credit insurance could be mentioned as some methods with similar goals although the legal techniques may vary and they may also be used under different circumstances.

In connection with forfaiting the receivables are usually in the form of trade drafts (bills of exchange) or promissory notes often supported by *aval*, although any form of debt could at least in theory be forfaited. Some forms seem to be more frequent than others. The predominance of promissory notes and bills of exchange could probably be explained by their long history in trade finance and their characteristics as negotiable documents. The final choice of instrument used in international trade is subject to a number of

[34] This description also seems to mirror the understanding of the judge in a US case involving choice of law/jurisdiction, namely *Ai Trade Finance Inc.* v. *Petra Bank* 989 F2d. 76 US Court of Appeals, NY in section 3 of the judgment. The judge here also stated: "All burdens of debt collection fall upon the forfaiter, without recourse to the exporter. Upon maturity of the notes, the forfaiter typically presents them to the guarantor for payment."

[35] Obviously this sequence of acts may appear as not very different from certain other trade finance transactions but they differ in details. This is also where there is an obvious similarity with the documentary letter of credit arrangement. There may be certain circumstances where the without recourse clause may be set aside by a court.

[36] See i.a. Schmitthoff p. 263 et seq. who makes a distinction between disclosed and undisclosed factoring as well as direct and indirect factoring. It is there set out that: "Disclosed factoring is, in essence, founded on a legal assignment of the exporter's claim for payment of the purchase price to the factor as assignee."

economic, legal and political considerations, which will depend on the particular circumstances in the individual case.

Forfaiting contracts are generally standardized and their contents are often rather similar. They are comparatively short, and set out generally the rights and duties of the parties. The main items covered in a forfaiting contract refer to the exporter, importer, surety (or guarantor – if any), the goods or service covered, and the amount payable. There will also be mention of discounting conditions regarding bills of exchange, documents to be presented, etc.

4.2 The forfaiting agreement

Most forfaiters seem to use standard forms and the terms are relatively similar, but there are certain individual contractual solutions. The agreements are often rather short and regulate generally the rights and the duties of the parties. The main items covered in a forfaiting agreement concern exporter and importer, guarantor, merchandise and amount, discount terms and discount margin, document, last day for presentation etc. There is often a provision on jurisdiction and also one on changed circumstances. There is undoubtedly some similarity between the terms in a forfaiting agreement and those in a letter of credit.

4.3 Requirements in connection with forfaiting

Unless the importer, i.e. the primary payer, is a first-class obligor, any forfaited debt will require a financial security in the form of an "aval" or an unconditional on demand bank guarantee in a form acceptable to the forfaiter (the purchaser of the debt). This condition is important in view of the nonrecourse character of the business, because the forfaiter is then dependent only upon the security of the guarantee in case the party primarily responsible for the payment would fail to pay.

Forfaiting is thus mainly used in medium-term business (6 months – 5 years), but the individual forfaiter will determine his own limits largely following market conditions, and his assessment of risks involved in a particular transaction.

In forfaiting the purchase of bills of exchange is normally made by the purchaser of the debt (the forfaiter), who then deducts the interest (discount) in advance for the whole credit period. This means from a practical point of view that the exporter virtually converts his credit-based sale into a cash

transaction.[37] His sole responsibilities then lie in the satisfactory manufacture and delivery of the goods[38] and the correct drafting of the documentation concerning the transaction. This is also where forfaiting may come out as a comparatively attractive solution for the exporter.[39]

Forfaiting may in some countries be used as a relatively inexpensive alternative to other forms of export financing which are available and which may change over time. That being said, it will remain necessary for the exporter to determine the access to various methods and also compare the costs and risks involved with them.

4.4 Some note of the ICC forfaiting rules

Since the new forfaiting rules were not yet adopted and therefore at the time of writing this article not yet published, I chose here not to delve into the various solutions contemplated, but they generally follow what has been outlined above. Suffice it therefore here to mention generally that the rules make a distinction between a primary and a secondary market, where certain requirements are put on the "primary forfaiter" and the "initial seller" of the payment claim. Particular requirements apply with respect to the documentation.[40] Also the rules just as the UCP underline that they do not affect the relations in the underlying transaction.

Art. 3 of the rules sets out that there is a sale of a payment claim from the seller to the buyer (of the claim), and that this will mean that the buyer shall have no claim against the seller or any prior seller for the non-payment of any amount due in respect of the payment claim except under certain circumstances.

The forfaiting rules contain an article concerning payment under reserve, but no jurisdiction or choice of law clause.

[37] Actually, the same result is achieved through a bill of exchange which has been discounted without recourse, which is not permitted under all legal systems.

[38] The risk for the manufacture and for the delivery of the goods are risks which basically lie with the exporter subject to the transportation clause and the risk distribution clause otherwise used in the underlying contract.

[39] The similarity with a documentary credit transaction is thus again obvious.

[40] Again this leads to some similarity with the letter of credit arrangement, where the UCP 600 are, however, more detailed and stringent in these respects.

4.5 Cost of forfaiting

The cost of forfaiting is determined by the rate of discount based on the aggregate of the LIBOR[41] rates for the tenor of the receivables and a margin reflecting the risk being sold. The degree of risk varies depending on the importing country, the length of the loan, the currency of transaction, and the repayment structure – the higher the risk, the higher the margin and therefore, the discount rate. Depending on the market and the market conditions forfaiting may, however, turn out to be more cost efficient than traditional trade finance tools, and if this is the case it may mean a method that may offer certain benefits to the exporter as compared to other methods.

4.6 Difference between factoring and forfaiting

As mentioned factoring and forfaiting represent in several ways rather similar techniques. Factoring was introduced in Sweden only during the 1960's/1970's.[42] Largely factoring is used more in connection with the financing of export involving consumer goods with credit terms between 90–180 days, whereas forfaiting seems to be more commonly used for financing of capital goods exports with credit terms of a few years. The forfaiting and the factoring markets seem to be separate.

Under forfaiting the political and the transfer risks are normally carried by the forfaiter, but they could be insured against the risk.

4.7 The settlement date

The forfaiting rules set out that the seller on the settlement date the Seller sells to the Buyer the Payment Claim without recourse and that the Buyer shall then not have any claim against the seller in case the buyer would not receive any payment. The settlement date has been described as the day agreed by the seller and the buyer, following determination by the buyer that it has received satisfactory documents for payment of the purchase price.

[41] London interbank offered rate or that particular mechanism to determine the rate which will have to be decided following the recent discovery of the interest scam in determining the interest rate.

[42] See e.g. Martinsson.

5. Some concluding remarks

From the above it is obvious that ICC plays an important role in the development of business law through other measures than legislation, but it also participates as an organization indirectly involved in the law making. ICC is by no means the only organization involved in such development, but it has come to have a gradually growing impact in the developing of principles and contracts of different types not least related to trade financing.

The forfaiting rules mark a new step in this respect, but it remains to be seen if and to what extent the new rules will catch on similar importance as some of the previously introduced instruments. Forfaiting may reduce the exporter's risk of non-payment in an export transaction, since its use will provide the exporter with funds (purchase price less discount and expenses) without the risk of meeting recourse claims. Forfaiting is no new invention, but it is the first time that there have been efforts to address generally questions and problems that may arise in this connection.

Apart from this positive aspect (seen from the exporter's point of view) forfaiting may also offer better possibilities in emerging and developing markets. There may also certain other additional advantages of forfaiting, related to volume, speed and simplicity of the forfaiting transaction. Thus forfaiting may work on a one-shot deal, it may be issued reasonably quickly, and the documentation is often fairly simple and straightforward (more so than documentary credits). The negative side of forfaiting is that costs involved in forfaiting are usually higher than in commercial lending. The use of forfaiting is also basically limited to medium-term transactions exceeding USD 100.000.

There has to my knowledge not been any case law in Sweden immediately involving forfaiting.

With the new rules in force, forfaiting will probably increase in use, and the new rules may prove to be a suitable set of rules clarifying certain points. To my understanding it is not absolutely clear how the forfaiting rules will be used and understood in relation to art. 9 in the Swedish (and Nordic) bill of exchange act, which is also based on an international convention, which has been adopted by several European countries.