

Mykhailiuk Galyna,

THE ESSENCE OF FORFAITING UNDER THE UK LAW

Business covered by the Second Banking Directive includes most (but not all) forms of investment business covered by the Financial Services Act, money transmission services, credit cards and other means of payment and safe custody services.

The single passport is not available to European branches of non-European banks («European» means EC states and EFTA states which implement the European Economic Area Treaty). Non-European banks may however set up subsidiary banks in Europe, which will then have the benefit of the single passport.

The evidence suggests that way the countertrade deal is financed obviously depends on the structure of the contracts and the requirements of the exporter. The more usual form of financing is Forfaiting. This is an arrangement whereby the exporter sells export receivables to a financial institution without recourse. Such an arrangement results in the exporter receiving funds immediately and no longer having the risks and problems attached to collection. A financial institution is only likely to agree to this if the bills or notes are accompanied by a security in the form of a bank guarantee, a standby letter of credit or an aval, if permitted, or an insurance policy or bond.

Forfeiting may be used for many trade instruments including promissory notes, letters of guarantee, bills of exchange, documented receivables and book debts. It has many advantages to the exporter besides immediate payment: the export receivables are cleared from the exporter's balance sheet, he no longer has to be concerned about collection and there is no problem with export insurance or risk with exchange rate fluctuations [4, p. 86].

Furthermore, Forfeiting is a type of non-recourse finance which assists the export seller's cash flow whilst giving the buyer a period of credit. The seller draws a term bill of exchange on the buyer, the bill is being drawn "without recourse" to himself. The bill is accepted by the buyer and backed by the buyer's bank, which may either execute an aval on

the bill or give a separate guarantee [5, P.927]. Civil law jurisdictions generally recognise the concept of an *aval*, a form of suretyship undertaken by the indorsement of a bill of exchange which renders the surety liable to subsequent and prior holders in the event of default by the party for whose account it is given. But English law does not recognise a guarantee given by way of an *aval* (*G & H Montague GmbH v Irvani* [1990] 2 All ER 225, CA) [7].

The seller may then indorse the bill “without recourse” and discount it to his own bank (the Forfeiter). Alternatively, the buyer may make a promissory note which is guaranteed by his bank before being indorsed “without recourse” by the seller and sold to the Forfeiter. The advantage of this form of finance from the seller’s point of view is that he receives an immediate payment of the cash value of the bill or note (less the usual charges and a discount fee) without recourse should the buyer default on payment. However, the Forfeiter has the *aval* or guarantee of the buyer’s bank to fall back on if the bill or note is dishonoured by non-payment. Usually, the Forfeiter will itself sell the bill or note on into the forfeit market [5, p. 927].

Forfaiting is used for international trade transactions. Normally, a Forfaiting house would not expect to handle transactions worth less than 100,000 €.

Traditionally, Forfaiting is fixed rate, medium term (one to five years) finance, but Forfaiters have become very flexible about the terms they will accept.

It is important to realise what kind of information does a Forfeiter need. The Forfeiter needs to know who the buyer is and his nationality; what goods are being sold; detail of the value and currency of the contract; and the date and duration of the contract, including the credit period, number and timing of payments (if any interest rate is already agreed with the buyer). He also needs to know what evidence of debt will be used (either promissory notes, bills of exchange, letters of credit), and the identity of the guarantor of payment (or *avalor*).

Documents usually required by the Forfeiter from the exporter are the following:

- a) copy of supply contract, or of its payment terms;
- b) copy of signed commercial invoice;
- c) copy of shipping documents including certificates of receipt, railway bill, airway will, bill of landing or equivalent documents;
- d) letter of assignment and notification to the guarantor;
- e) letter of guarantee, or *aval*.

The *aval* is the Forfaiters’ preferred form of security of payment of a bill or note. For *aval* to be

acceptable, the *avalizing* bank must be internationally recognized and credit worthy.

The most important point to remember is that any guarantee should be irrevocable, unconditional, divisible and assignable.

Once the Forfeiter has all this information, indications or quotations can be given immediately by phone or fax. A commitment can be given prior to contract or delivery, and options can be given to assist the exporter in the final negotiation of the contract.

The question of the effect of any possible assignment assumes particular significance in the context of the Forfaiting market, which (looked at simply) enables a beneficiary under a deferred payment letter of credit to go into the marketplace and sell his entitlement at a discounted price, not to a confirming bank but to a Forfeiter. Since the Forfeiter is an independent party, i.e. not party to the credit, the basis upon which a Forfeiter becomes entitled to the proceeds of the credit can only be by way of assignment [2, p. 23].

Langley J.’s decision is likely to have most impact in the context of the Forfaiting market, but even in that context there is nothing offensive in the proposition that the Forfeiter, whose right depends on assignment, should be in no better position vis-a-vis the debtor than the assignor. This is no more and no less than a straightforward application of the principle known to every law student, expressed neatly in the Latin phrase, *nemo dat quod non habet* (*Banco Santander SA v Bayfern Ltd*) [6].

As far as possible, Forfaiters will ensure that the buyer, not the seller, incurs charges involved in a Forfaiting transaction. Sometimes this will involve changes to the structure of deals concluded, but Forfaiters stress their flexibility in tailoring deals to suit the porter’s needs. When faced with competition for the contract, exporters may choose to absorb some of the fees or financing cost to make the transaction more attractive to their buyer.

Charges depend on the level of interest rates relevant to the currency of the underlying contract at the time of the Forfeiter’s commitment, and on the Forfeiter’s assessment of the credit risks related to the importing country and to the *avalizing* (or guaranteeing) bank.

Briefly, the interest cost is made up of:

- a charge for the money received by the seller, which covers the Forfeiter’s interest rate risk. In effect, this covers the Forfeiter’s refinancing costs and is invariably based on the cost funds in the Euromarket. Forfaiters calculate this charge on the LIBOR (LIBOR is the London Interbank Offer Rate) that is applicable to the average life of the transaction. On a five-year deal, for example, repayable by

ten semiannual instalments, the average life of the transaction is 2 – 3/4 years. The LIBOR rate for this period would be used;

- a charge for covering the political, commercial, and transfer risks attached to the avalor / guarantor. This is referred to as the margin, and it varies from country to country, and guarantor to guarantor;
- additional costs (which are also included in the Forfaite's calculations) include a "days of grace" charge; and when necessary, a commitment fee. Days of grace are an additional number of days interest charged by the Forfaite which reflect the number of day's delay normally experienced with payments made from the debtor country. These range from none to, say, 10 days on some countries.

Many houses claim that exporters get 100% finance in about two days after presentation of proper documents.

In a typical Forfait transaction, the sequences are as follows: the exporter approaches the Forfaite who confirms that he is willing to quote on a prospective deal, covering the export in x months' time bearing the aval of XYZ Bank.

If the transaction is worth 1€ million, the Forfaite will calculate the amount of the bills/notes, so that after discounting the exporter will receive 1€ million, and will quote a discount rate of «n» %. The Forfaite will also charge the "x" days grace and a fee for committing himself to the deal, worth "y" % per annum computed only on the actual number of days between commitment and discounting. The Forfaite will stipulate an expiry date for his commitment (that is, when the paper should be in his hands).

This period will allow the exporter to ship his goods and get his bills/notes avalized and to present them for discounting. The exporter gets immediate cash on presentation of relevant documents, and the importer is then liable for the cost of the contract and receives credit for «z» years at «n» % interest.

Many exporters prefer to work with Forfait brokers who, because they deal with a large number of Forfait houses, can assure the exporter of competitive rates on a timely and cost effective basis. Such brokers typically charge a nominal 1 % fee to arrange the commitment. This is a one-time fee on the principal amount and frequently is added to the selling price by the exporter. The broker frequently consults with the exporter to structure the transaction to fit the Forfaiting market.

An interesting comparison may be made between Forfaiting and official supported credits (through the country's Eximbank).

It should be remembered, that Forfaiting is a complementary method of finance to officially supported export credits. Nevertheless, Forfaiting does offer exporters some real advantages over EXIM.

Forfaiting allows the exporter greater flexibility in structuring a deal, particularly where goods are being supplied from a country where EXIM requirements on local and foreign content cannot be met under existing regulations.

Furthermore, if a buyer insists on 100% financing (only 85 % finance is available under EXIM rules), then Forfaiting could supply the remaining 15 %.

Typically, unless it is a very large or complex deal, a Forfaite will be able to indicate within a couple of days whether financing is available or not. It may take longer for EXIM to come through with a commitment.

In addition, Forfaiting is 100 % without recourse. Once the Forfaite has bought the paper the exporter can collect the cash and even forget the entire transaction. Finance can also be obtained for countries that are off cover from official export credit insurance (and there are no insurance premiums to pay).

Forfaiting is a flexible discounting technique that can be tailored to the needs of a wide range of counterparties, domestic and international transactions. Its key characteristics are:

- 100% financing without recourse to the seller of the debt;
- the payment obligation is often but not always supported by a bank guarantee;
- the debt is usually evidenced a legally enforceable and transferable payment obligation such as a bill of exchange, promissory note, letter of credit or note purchase agreement;
- transaction values can range from 100,000 € to 200 € million;
- debt instruments are typically denominated in one of the world's major currencies, with Euro and US Dollars being most common;
- finance can be arranged on a fixed or floating interest rate basis.

To conclude, Forfaiting provides a flexible, creative alternative to traditional or international trade financing methods, and is particularly useful for transactions with buyers in developing nations.

LITERATURE

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SUMMARY

Mykhailiuk G.O. The Essence of Forfaiting under the UK Law. —Article.

The problem issues of Forfaiting transactions regulation under the UK law are examined in the article. The key characteristics of Forfaiting as a flexible discounting technique are pointed out. The main sources of UK legislation and key aspects of the interest costs are determined.

Keywords: forfaiting, forfaiter, financing methods, bill of exchange, counterparties.

АННОТАЦИЯ

Михайлюк Г.О. Сущность форфейтинга в соответствии с законодательством Великобритании. — Статья.

В статье рассматриваются проблемные вопросы регулирования форфейтинговых операций в соответствии с законодательством Великобритании. Указаны ключевые характеристики форфейтинга в качестве гибкой техники дисконтирования. Определены основные источники законодательства Великобритании и ключевые аспекты материальной заинтересованности.

Ключевые слова: форфейтинг, форфейтер, методы финансирования, вексель, стороны при заключении сделки.

АНОТАЦІЯ

Михайлюк Г.О. Сутність форфейтингу за законодавством Великобританії. — Стаття.

У статті розглядаються проблемні питання регулювання форфейтингових операцій за законодавством Великобританії. Вказані ключові характеристики форфейтингу у якості гнучкої техніки дисконтування. Визначені основні джерела законодавства Великобританії та ключові аспекти грошової зацікавленості.

Ключові слова: форфейтинг, форфейтер, методи фінансування, вексель, сторони при укладанні угоди.