

Discounting of Letters of Credit; A Legal Analysis

Mohammad Tagi Rafiei*

Akbar Tamizi†

Received: 14 May 2018

Approved: 04 Sep 2018

Letter of Credit is an international payment instrument whereby the issuing bank undertakes to pay the beneficiary, against presentation of certain stipulated documents, according to the conditions of the Letter of Credit. Discounting of LC for the short-term financing of the seller, due to the independent and irrevocable undertaking of the bank to make payment, is prevalent. Beneficiary gets the amount of the credit immediately (after discount rate deduction) in consideration of the assignment of the credit in discounting practice. Now, the main question is: how will the assignment of rights and proceeds under the Letter of Credit be executable and what will be its consequences? Hence, by surveying different methods of assignment of rights in accordance with LC, we study discounting Acceptance and Deferred Payment LCs as two kinds of deferred LCs. In discounting practices of LCs, if a fraud being discovered after the discounting transaction but before the payment due date, the discounting bank would be able to recover payment from issuing bank or confirming bank. According to our analysis, the most promising way for the assignment of rights and reducing the risk of discounting for the discounting bank is "Negotiation" of LC. Acceptance LC makes a favorable opportunity for discounting purposes because it includes bill of exchange as a negotiable instrument, and there is an organized secondary market for Acceptances.

Keywords: Assignment, Negotiation, Deferred, Acceptance, Fraud

JEL Classification: K22, G32

1 Introduction

Letter of Credit is an international payment instrument whereby the issuing bank undertakes to pay the beneficiary, against presentation of certain stipulated documents, according to the conditions of the Letter of Credit. Documents presented by seller indicate fulfilment of seller obligations in the underlying sales contract. Nowadays, Letters of Credits referred to as the most common method of payments in international commerce. (Rafiei, 2008)

There are two fundamental doctrines that underlie the operation of letters of credit: Doctrine of Autonomy and Doctrine of Strict Compliance. According to Doctrine of Autonomy, letters of credit are transactions separated from the underlying contract. The bank turning on the letter of credit

* University of Tehran, Iran; rafiei@ut.ac.ir (Corresponding Author)

† University of Tehran, Iran; tamizilaw@gmail.com

faces with one subject only, whether the documents presented by seller conform to the documents specified in the credit. Likewise, on the basis of Strict Compliance Doctrine, receiving bank has the right to reject the non-complying documents. (Schmitthoff, 1999)

Though, according to the Doctrine of Autonomy the bank obligation to pay the credit amount is independent from execution or non-execution of buyer obligations toward the seller and/or issuing bank and from the underlying contract conditions. But, there is an exception in this general rule referred to as Fraud Exception. It means that in case the beneficiary commits a fraud in performing his obligations, the opening or approving bank should suspend payment of the credit amount to the beneficiary. No conventional definition given for the fraud and because of its connection with "Public Policy" it may have different referent in each country. (Xiang, G., & Buckley)

In addition to its main performance as a method of payment in international commerce, letter of credit has been used as commercial financing instrument. Considering this latter function, letters of credit have been used in 8.8% of all export transaction in the United States in 2012. (Nipemann & Tim, 2013) A financing technique in the context of letters of credit is "Discounting of Deferred LCs". Discounting of LC means that beneficiary of deferred LC collects the discounted price of credit in cash (after deduction of bank interest) against assignment or negotiation of the LC in order to finance the required cash flow. (Berger, 2004)

Considering the above definition, there are two significant subjects regarding the legal dimensions of discounting letters of credit: a) Discounting the LC and cash payment of the discounted price is completed against transfer of rights and proceeds of the LC, b) Discounting only applies to deferred LC which according to it payment of the LC price delayed to certain date after presentation and acceptance of deferred documents. Here the question is the form and effects of transferring the rights and benefits from the LC and whether transfer of the LC and type of the credit may affect the process.

Transfer of rights and proceeds of the letter of credit and negotiability of it are determinants in answering the above questions. Deferred letter of credit may come with/without draft. Whereas draft, as a negotiable instrument has significant role in discounting the letter of credit both propositions above are considered.

It is noteworthy that in Law of Iran, legal basis for discounting letter of credits is Circular No 16 on Liability Purchase Contract, annexed to Chapter 3, Usury Free Banking Operation Law passed in July 24, 2011 by Council of Ministers and Directive passed in the meeting dated August 16, 2011 by

Money and Credit Council. Legal Department of the Central Bank replying the inquiry from a bank regarding the possibility of discounting letters of credit stated, "The same as discounting a draft by a bank, letters of credit may be discounted by bank. Whereas in letters of credit, the bank is indebted to the applicant for the LC price, such termed debt may be sold and discounted in the form of a debt." (Hejini Nejad et al., 2016)

2 Assignment of Rights in Letters of Credit

Assignment and its effects are significantly important especially in forfaiting¹ market because it enables the beneficiary in deferred LC to refer the forfaiting market in order to sell his rights to the buyer in discounted price. Whereas buyer is an independent person in this process and not a party to the letter of credit, the forfaiter may benefit from the credit through assignment only. (Ellinger et al, 2005)

Assignment of rights and proceeds in letters of credit may be made through assignment of proceeds and benefits of a credit, transfer of the credit and/or negotiating the letter of credit. The above processes are studied in detail in the next section.

2.1 Assignment of the LC Proceeds

According to Art 39, UCP 600², the beneficiary may always assign proceeds of the credit to a third party in which there is no limitation. Even a credit is not stated to be transferable shall not affect the right of the beneficiary to assign any proceeds to which it may be or may become entitled under the credit. Assignment of the proceeds means that the beneficiary assigns proceeds of the letter of credit irrevocably to a third party. In this case the notifying bank, on the basis of the beneficiary's request, would notify the transferee that in case the credit proceeds are collected the specified amount would be paid to the transferee. Proceeds of credit are cash, accepted draft or other payable letter of credit through accepting the payment or giving credit by issuing bank or any other person specified in the letter of credit (Section 114-5, Uniform Commercial Code). However, ownership of the claim is suspended until collection of the fund. Therefore, the beneficiary, who would be the bank creditor on the basis of issuing credit, may finalize and accomplish

¹ Forfaiting is a method of trade finance whereby the forfaiter purchases, on a without recourse basis, unconditional debt obligations arising from the provision of goods or services which are due to mature at a future date.

² Latest version of Uniform Customs and Practices for Documentary Credits- UCP600 prepared by International Chamber of Commerce and applies since July 1st, 2007.

the referred claim by presenting credit-complied documents. In letter of credit law the former right is referred to as “Ownership of Credit-Resulted Claim” and the latter as “Withdrawal Right” of the credit price (Bana Niasari, 2016).

Assignment of credit proceeds does not mean to create a right for assignee toward the original letter of credit, therefore in assignment of the proceeds, only the right to collect proceeds is transferred to the assignee with no other right to execute the obligations derived from the credit and fulfilment of what depended on. (Ghorbanian, 2015) Assignee has no role in fulfilment of the proceeds of the credit and does not obtain the right to draw a bill or execute it according to the letter of credit. (Khoeini & Ghorbanian, 2013) For this reason, assignment of the proceeds creates no deposit guarantee for the assignee before fulfilment of the conditions and certainty of the claim. But by the approval of presented documents by the issuing bank, the beneficiary may assign this claim as an asset according to the bank commitments. (Ward, 2009) Assignment of the credit proceeds before presentation of the documents may be advantageous when the beneficiary decides to supply materials required for production but has no sufficient budget for this objective. But assignment of credit proceeds after presentation of documents applies to the termed letter of credit. (Hosseini & Eskini, 2014)

Assignment of the LC proceeds shall be subject to regulations and provisions of applicable law. For instance, in some countries notification to the debtor is necessary for the credit assignment while in other countries such necessity is not applied. In addition, in many countries the credit proceeds assign according the regulations governing debentures. (Reinhard, 2011) In assignment of the credit proceeds, the payment claim would be assigned with all its properties, limitations and defects it have/may have then but all the transferor rights are not transferred to the transferee, including the withdrawal right. So, based on the common practice in forfaiting and discounting markets, only the confirming bank accept to discount the credit against assignment of its proceeds. Therefore the discounting bank is not protected against the risk of fraud which means that if fraud is proven in the letter of credit, the discounting bank may not refer the issuing bank in its maturity to claim the credit amount.

2.2 Transfer of Letters of Credit

Transfer of letters of credit means that the beneficiary assigns the credit in whole or in part to another person. In the credit transfer, transferee would own the credit benefits and rights but should execute its obligations and drive benefits therefrom. For instance, transferee is required to deliver the signed

commercial invoice and bill in execution of the credit terms and conditions. (Kashanizadeh, 2009) Therefore, transfer of credit requires replacement of another person with the beneficiary regarding all beneficiary-issuing bank relations. (Pawlowic, 1992) There is however a difference that the second beneficiary would not be the deputy as the result of credit transfer but the obligations transform and the relationship between the issuing bank and first beneficiary terminates and replaces with relationship between the issuing bank and second beneficiary in a new letter of credit. Consequently, defects and defenses available against the first beneficiary are not available against the second beneficiary. (Bana Niasary, 2016)

Transfer of credit is used where the seller is not the main manufacturer of products and decides to transfer part of the credit to the main manufacturer. (Shiravi, 2011) In fact transfer of credit makes it possible to make pre-shipment finance available for seller (Bana Niasari, 2016), but it is not an appropriate technique for discounting the credit.

According to Article 38, UCP600, letter of credit shall be transferable to the extent and in the manner expressly consented to the LC. On the other hand even if the letter of credit is transferable, the bank has no obligation to transfer the credit and such transfer requires the bank agreement. As well transfer of credit may be possible only once and a transferred credit cannot be transferred at the request of a second beneficiary to any subsequent beneficiary while a credit may be transferred in part to more than one beneficiary provided partial drawings or shipments are allowed. In transfer of the credit, the credit amount may be decreased or changes are applied in some credit terms upon parties' agreement. (Bana Niasary, 2016)

Then, the purpose and efficiency of transfer of credit differs with the objectives in assignment of letter of credit in discounting and it is not appropriate to be used in discounting practices because, the credit would be assigned to discounting party and assignee should be able to obtain the credit proceeds and rights. In addition, secondary market and possibility of reassigning the credit is significantly important while transfer of the credit creates no such possibility.

2.3 Negotiation of Letters of Credit

According to Article 2, UCP 600, negotiation of letter of credit means the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank. According

to UCP 500 only credits entailing presentation of bill are negotiable but according to the above definition letter of credit may be negotiated without using a bill. (Schults, 2009) Considering the above article, conditions required for negotiation of credits are: a) Negotiability of credit shall be stipulated in the letter of credit, b) Necessity to allow the secondary bank or banks to negotiate the credit in which a certain bank may be identified as negotiating bank or in general each bank may be allowed to negotiate the credit, c) Buying the credit and payment of the price or commit to pay the price and then to pay it all-out before the reimbursement date by the specified bank. (Dole, 2008) Commitment of the issuing or confirming bank toward the main beneficiary renders null by negotiation of the credit and issuing or confirming bank would be committed toward the negotiating party. (Nikbakht & Bana Niasary, 2012)

Negotiable letter of credit opposes the straight letter of credit. Straight letter of credit means the credit through which the issuing bank is committed to a definite person as the beneficiary. In straight letter of credit when a person purchases the bill from the beneficiary before being accepted, the purchaser obtain the rights and benefits of an ordinary purchaser which means that in case the bank omit to accept and pay the bill, buyer may refer the seller not the issuing bank. However in negotiable letter of credit the purchaser of the bill has direct right toward the issuing bank which the bill is issued on it and may claim for the bill to be accepted complying with the letter of credit. (Harfield, 1952)

Negotiation of credit differs from transfer of credit or assignment of proceeds and the rights and the benefits of negotiating bank are effectively secured in credit negotiation. As a result of credit negotiation two kinds of rights are created for nominated bank: First, the rights transferred form the credit beneficiary and second the rights resulted from direct commitment of the issuing bank against the negotiating bank. It is noteworthy that as the result of credit negotiation only positive aspects of the relationship between issuing bank and beneficiary transfer to the negotiating bank which means that negotiating party would own the rights and benefits of credit without accepting the guarantees and commitments of the beneficiary. In addition, the rights transferred to the negotiating party as the result of credit negotiation lack the possible defects of the issuing bank against the beneficiary. It means that defects and defenses available against the beneficiary are not available against the negotiating bank. Therefore, credit negotiation is an appropriate arrangement in discounting letters of credit.

In negotiable letter of credit there is only one form of discounting: Negotiating bank purchases documents that appear on their face to constitute

a complying presentation from the seller (beneficiary) as a short-term investment. According to Article 12 UPC 600, the nominated bank has no obligation to negotiate the credit unless the obligation is accepted by the bank clearly.

Negotiation against documents which appear on their face to constitute a complying presentation are considered as payment of consideration with approval of the conformity of the documents with the credit conditions by the nominated bank according to UPC 600. When the nominated bank presents the documents to the issuing bank, it usually has discounted the price of documents. According to Para c, Article 7 UCP 600 repayment of the credit price by issuing bank depends on the fact that weather the nominated bank has negotiated a conforming presentation and presented the documents to the issuing bank. The article indicates that in terms of UCP regulations, deposit of the bill and document amount by the nominated bank to the issuing bank is not considered as negotiation of the credit without negotiation of said documents. Once the documents presented to the issuing bank the nominated bank has no possibility to negotiate the documents, then the issuing bank has to perform its obligations according to the credit conditions in case the documents prove to be conforming. This performance occurs by payment of the price to the beneficiary at sight, and by accepting the bill in termed bill. Acceptance of the bill usually notifies to beneficiary through the nominated bank and where the nominated bank is the beneficiary's bank the credit would be discounted upon the beneficiary request. Now it should be investigated that if discounting and payment of the credit amount constitute negotiation of credit under such conditions or would be considered as purchase of the bill only. There may be two situations: On the one hand official request to the nominated bank made according to the negotiable credit to finance the payment against conforming documents and then they present to the issuing bank to claim the contract reimbursement. In this term discounting the bill or document price is accepted based on a negotiable credit and not negotiation of conforming documents. Consequently, the nominated bank should proceed for repayment of the amount paid for discounting relying on the bill and not the letter of credit. If we say that discount still considered with the credit, the result would be that the nominated bank may claim for repayment without payment of specified consideration against the bill, according to the credit conditions.

UCP has no clear solution for this problem. There are cases accepting the second view¹ and considered discounting of negotiable letter of credit after approval of the document conformity and acceptance of the bill by issuing bank as credit negotiation. It should be noted that the date in which the nominated bank perform the discounting should not be beyond the period anticipated in letter of credit for negotiation of the credit.

In negotiable letter of credit even where seller commits a fraud, seller may collect the price from issuing bank provided that negotiating bank has acted in good faith and purchases the documents which on their face conform to the credit conditions. This is part of the contract between issuing bank and negotiating bank. Only when the negotiating bank involves in the fraud, the public policy should prevent collection of any amount form the issuing bank. (Hugo, 2002)

Nominated bank is responsible toward the negotiating bank to discount the negotiable letter of credit in good faith and pay the price to the beneficiary before the specified time. In addition, according to Para g Article 14, UCP 600, a document presented but not required by the credit will be disregarded and may be returned to the presenter. Now if the bank, in the process of examination of documents, may treat a document indicating the beneficiary fraud, but it is not included in the documents specified in the credit, would the bank be permitted to disregard the evidence. And if do so, does the bank have good faith in discounting the credit?

Good faith in discounting letter of credit means that the nominated bank performs based on a logical belief that the beneficiary is eligible to receive the credit amount according to the apparent conformity of the documents. The criterion for bank good faith is subjective and not objective. Then proving that the nominated bank had no knowledge of the facts, being informed of which an ordinary person would not discount the credit, suffices as evidence of good faith. The fact that the issuing bank or the applicant, before discounting the credit amount, have notified the nominated bank that documents presented by the beneficiary are forged or not authentic and no product has been shipped may not be considered as lack of the nominated bank good faith because the subject may involve the bank in the dispute between beneficiary and the credit applicant while the principle of credit autonomy keeps the bank harmless in this regard. But, if the circumstances appear in which the single reasonable and true justification of the nominated bank from the buyer fraud is that the beneficiary tried to cash the credit in a decisive manner, the bank's good faith

¹ European Asian Bank AG v. Punjab & Sind Bank

would be under doubt. (Adodo, 2009) So in case negotiating bank at the time of credit negotiation and/or issuing bank at the time of credit price repayment to negotiating bank observed reasonable reason about the fraud, they should not pay the amount, unless the fraud risk may be applied. (Chae, 1998) Therefore when the applicant obtained no judicial order on non-payment of the credit amount as the result of fraud, disregarding the applicant claim on major fraud, the issuing bank or confirming bank have no responsibility to reject the documents and may proceed to pay the credit amount. (Chae, 1998)

3 Term in Letters of Credit

Considering the definition of discounting letter of credit, the topic “Discounting” shall be brought in term letters of credit only. Traditionally, claim and payment of term letter of credit executed by using term bill but today term letters of credit are common without using the bill. Using the bill as a commercial and negotiable instrument increases the complexity of letter of credit problems because legal subjects governing the bill as a commercial instrument are intermingled with the legal subjects of letters of credit. But on the other hand, considering the negotiability of bill and secondary market for discounting the accepted bills by the banks (banker’s acceptances) in different countries, there would be many benefits for the beneficiary, especially in the area of discounting. Therefore conditions, orders and effects of discounting on any accepted letter of credit and term bill are studied in brief.

3.1 Acceptance Letter of Credit

It is a form of letter of credit through which the issuing bank commits to accept and pay in maturity the bill(s) issued by the bank provided that conforming documents are submitted and other conditions of the credit are fulfilled. (Harfield, 1952)

In Acceptance Letter of Credit the beneficiary, in addition to shipment documents and other documents specified in the credit issue, should submit a bill with agreed maturity by the issuing bank. The issuing bank after examination of the documents and in case the documents fully conform to the credit conditions, accepts the bill and return accepted bill to the beneficiary. Utilization of bills in letters of credit has been long common practice in banking procedures in the USA and England. But the process was not common in European countries. Today the usage decreased to some extent in the USA and England. Now the bill has omitted and payment foreseen to be made in letters of credit on the basis of credit after a certain period, for instance being

payable from presentation of documents or the B/L date. This assisted the prevalence of deferred payment letter of credit in current time. (Hugo, 2002)

Bills used in letter of credit process should have certain procedural conditions. UCP regulations regarding the procedural conditions of bills have no certain proposal. But there are some conditions in International Standard Banking Practice (ISBP) prepared by International Chamber of Commerce. There are different ideas regarding the fact that if acceptance of bill in Acceptance letter of credit is considered as fulfilment of opening bank commitment based on letter of credit. In some countries, when the opening bank considers submitted document to conform the Acceptance letter of credit and accepts the bill, the bank commitments and responsibilities are fulfilled according to letter of credit and the bank should have bill commitment against the beneficiary or legal holder of the bill.¹ But others believe that opening bank commitment remain valid according to the letter of credit after accepting the bill and beneficiary may execute its rights through letter of credits in case the bill commitments from the bill accepted by opening bank is rendered invalid for any reason. (Dolan, 2013) Based on Art 7 and 8m UCP 600, acceptance of the bill does not mean the opening bank commitments and responsibilities to be fulfilled in letter of credits but by accepting the bill the opening bank is committed to the beneficiary (who is counted as holder of accepted bill) for two reasons: Firstly the commitments from opening letter of credit and secondly the commitment from accepting the bill. Non-payment of the bill in its maturity means both commitments to be violated and beneficiary has the right to refer the opening bank for any of the two reasons. (Hugo, 2002) Both commitments subject specific rules and orders but in case application of the rules governing the commercial documents and legal rules governing the letter of credits have different results, legal rules of letter of credits shall have the priority. (Bana Niasari, 2016)

Discounting the bank acceptance on the basis of letter of credits is relatively simple and plays a significant commercial role. Discounting the bank acceptance is the most prevailing method of discounting in international commerce and suitable market is formed for it in different countries.

If in the period between discounting and the bill maturity, fraud is proven in the letter of credits, the discounting party (buyer of acceptance bill) is secure. He would be counted as holder of the bill with good intention so that disregarding the title of the credit beneficiary. Therefore in case beneficiary

¹ First Commercial Bank v. Gotham Originals Inc., 101 A.D 2nd 835, 1985.

(seller) committed a fraud, the bank accepting the bill may not defend the seller fraud against the bill holder (discounting bank) claim. (Hugo, 2002)

3.2 Deferred Payment Letter of Credit

Deferred Payment Letter of Credit is a form of credit upon which the opening bank commits to pay the credit amount to the beneficiary in the specified dates (in the credit) provided that required documents are submitted and other conditions specified in the letter of credit are fulfilled. No bill is used in Deferred Payment letter of credits, and immediately after verification of the conformity of documents, the bank notifies its final and unconditional commitment to pay the credit amount in its maturity. (Hugo, 2002) Therefore, mere objective of termed letter of credit is to defer the payment date without changing the contents of payment commitment. (Reinhard, 2011)

Legally there are significant differences between Acceptance letter of credit and Deferred Payment letter of credit. Firstly, in Acceptance letter of credit the bank commitment is to accept and then pay the bill issued by the bank itself, according to the credit conditions but in Deferred Payment letter of credit the bank commitment is to accept unconditional payment obligation in the specified maturity. The bank letter to beneficiary indicating that the credit amount would be paid in the specified time is the only evidence indicating that the bank commitment according to the letter of credit is active and would be payable in the maturity. This evidence proves the bank debt to the beneficiary but contrary to bill it has no independent possessory value and may not be easily negotiated but benefiting the commitment subject to the rule of assigning civil claim. (McLaughlin, 1991)

Discounting Deferred Payment letter of credit is another form of more complicated credit discounting. As bill is not used in Deferred Payment letter of credit, it may not be discounted in Acceptance letter of credits.

There are different orders issued by courts in various countries on discounting Deferred Payment letter of credits and possibility of discounting bank referring the opening of confirming bank with prove of fraud of the beneficiary and most orders consider no such right for the discounting bank.¹ It means that in case effective fraud proven in the letter of credits, in the period between payment of the credit amount to the beneficiary by discounting bank and the credit maturity, discounting bank may not claim the credit amount form the opening or confirming bank. Basis of justification provided in this regard is that the discounting bank discounts the credit against assignment of

¹ To study some judgments issued by courts on the subject please refer to Hugo (2002).

the rights of the letter of credit beneficiary. On the other hand, according to a well-known rule “Nemo dat Qui non habet” (no one may assign to another person more than what he has). Therefore, same as the case in which the beneficiary could not refer the guarantor bank for payment in case of proved fraud, discounting bank has no such right as the beneficiary substitute. (Johnson, 2000)

On the contrary and in justifying the possibility of discounting bank referral to the opening of confirming bank there are two observations. Firstly, it may be said that when the opening or confirming bank accepts the termed commitment according to the letter of credit, they empower the beneficiary to pay the committed amount at any time, in whole or in part, to the credit maturity in their discretion. But, payment of the credit amount before its maturity has no effect on the buyer (credit applicant) rights and buyer has no payment commitment to the bank before the maturity. Criticize the idea, it is said that premature payment of the credit amount by the bank reverses the applicant orders through letter of credit opening application, in which buyer ordered the bank in his letter of credit opening application to pay the credit amount in its maturity (for instance 90 days after the B/L date) and if the bank neglects the order it would have no right then to claim repayment of the amount by buyer. In addition, premature payment of termed credit amount may influence the possible bank rights in repayment of the amount by the beneficiary. (McLaughlin, 1991) Replying the criticism, it is said that discounting bank doesn't lose the right to refer the applicant in whole by premature payment, but considering the contents of the applicant order and credit conditions, it has no right of referral to the maturity. In fact the relationship between the applicant and credit beneficiary should be studied on the basis of independent bilateral contract according to which a respite is foreseen in favor of the applicant for payment of the credit amount to the beneficiary and the relationship between the beneficiary and discounting bank should be considered according to the contract made for discounting the credit. None of the contracts term and conditions may influence the other contract.

The second view says that premature payment of deferred payment letter of credit amount may be considered as a loan which does not use the letter of credit as loan guarantee. In this case the opening or confirming bank award the beneficiary an ordinary loan with no security for the period of deferred payment credit. Loan is independent from the letter of credit and beneficiary is responsible for repayment of the loan to the bank as a loanee. Meantime the bank is responsible for payment of the credit amount to him as beneficiary during the validity of the credit. Both above commitment and responsibility

are independent and award of loan to the beneficiary has nothing to do with payment of the credit amount to the beneficiary. Consequently the bank's right to claim repayment by buyer may not be endangered on the basis of Deferred Payment letter of credit. The beneficiary commitment as borrower to repay the loan may be bartered with the bank commitment in payment of the Deferred Payment letter of credit to the beneficiary in its maturity. But in this case loan is awarded against using letter of credit as a security for repayment and the bank deferred payment commitment is counted as awarded loan guarantee according to letter of credit, in fact the bank as holder of the security has the right to attach and sell the security (which is the deferred commitment by the bank). Consequently when the beneficiary gives this right to the bank the bank deferred payment commitment would be void and letter of credit should be considered to be paid. As such payment is made before the credit maturity, the loan type may endanger the bank's right to claim repayment by buyer.

Considering the above subjects, proving fraud in Deferred Payment letter of credit between discounting and credit maturity has high risk for the discounting bank because the risk of fraud by the beneficiary of Deferred Payment letter of credit may be imposed to the discounting bank. On the other hand bank commitment in Deferred Payment letter of credit is not a negotiable instrument and the beneficiary may not enjoy the benefits of doctrine of holder with good intention applied to the negotiable documents. (Dolan, 2013) Considering that opening bank may determine another bank to commit deferred payment, the bank permits to do advance payment or purchase deferred payment commitment accepted by that bank, then banks are permitted by the opening bank to discount deferred payment commitments.

4 Conclusions

Letters of credit in addition to their vital role in international payments have good privileges in short term financing, especially for the seller as the credit beneficiary based on the bank final commitment in payment of the credit amount. Discounting is the most prevalent form of seller's (beneficiary) financing through letter of credit. Discounting letter of credit is made for awarding credit to the discounting party, but to prevent problems by discounting bank in collection of the credit amount in its maturity from the issuing or confirming bank, some points have to be considered. As said, the main and primary form of assigning letter of credit, accepted in international regulations and courts in different countries, is the negotiation of credit. Therefore, to prevent potential risks of discounting letters of credit, especially

the risk of fraud, banks have to use negotiable credit in discounting letter of credit because in negotiation of credit, buyer bank is not the beneficiary representative and its rights are independent from the beneficiary and free from any possible defects and defenses based on the letter of credit. There are some requirements which should be considered by discounting bank for negotiation of credit to be completed.

Use of bill in the process of letter of credit may increase the complexity of letter of credit process but it would be useful in discounting letters of credit, especially when it is not issued as a negotiable letter of credit. The discounting of banker's Acceptances has an established market in most of the countries and discounting party as holder in due course of the bill may enjoy its benefits.

Deferred Payment letters of credit are deliberated and prevailed by the banks currently, but the nature of the bank commitment in Deferred Payment letter of credit and the bank responsibility in interbank relationship have no established situation in international regulations and judicial procedures in different countries. Discounting this type of credit may bring some risks to the discounting bank. Therefore, banks should be cautious while discounting Deferred Payment Letters of Credit.

In Iran, because of the stabilized legal regime for commercial documents, using the bill in letters of credit may be beneficial in discounting process and improve the banks legal and financial risks.

References

- Adodo, E. (2009). Establishing Purchase of Documents under a Negotiation Letter of Credit. *Singapore Journal of Legal Studies*, 32, 618-645.
- Bana Niasary, M. (2016). *Law of Letters of Credit (Commercial and Standby)* [1st Edition]. Shahre Danesh Press (in Persian).
- Berger, E. (2004). Putting Florida Buyers on par with International Buyers: A Cost-Benefit Analysis of Revising Florida Statute 675.109(1)(a)(4). *Florida Journal of International Law*, 16, 529-538.
- Chae, D. H. (1998). Letters of Credit and the Uniform Customs for Documentary Credits; The Negotiating Bank and the Fraud Rule in Korea Supreme Court Case 96 Da 43 713. *Florida Journal of International Law*, 12, 24-76.
- Dolan, J. F. (2013). Negotiable Obligations for Discount: Notes, Acceptances, DPUs and BPOs. *Banking & Finance Law Review*, 45, 99-107.
- Dole, R. F. (2008). The Effect of UCP 600 upon U.C.C. Article 5 with Respect to Negotiation Credits and the Immunity of Negotiating Banks from Letter-of-Credit Fraud. *The Wane Law Review*, 54, 736-789.
- Ellinger, E. P., Lomnick, E., & Hooley R. J. A. (2005). *Ellinger's Modern Banking Law*. Oxford University Press, Fourth Edition.

- First Commercial Bank v. Gotham Originals Inc. (1985). 101 A.D 2nd 835.
- Ghorbanian, H. (2015). *Guarantee and Payment Mechanisms Transferability in International Trade Law*. Ghanoon va Ghalam Press (in Persian).
- Harfield, H. (1952). Article 5- Trade Without Tears or Around Letters of Credit in 17 Sections. *Wisconsin Law Review*, 298, 299-311.
- Hejini Nejad, S., Gasemi Hamed, A., Arab Mazar, A. (2016). Juridical and Legal Review of Discounting Commercial Instruments. *Islamic Economy and Banking Journal*, 15, 193-199 (in Persian).
- Hosseini, S. M. R.; Eskini, R. (2014). The Legal Nature of Transfer of Credit in the Uniform Customs and Practice for Documentary Credits (UCP) Regulations. *Comparative Law Researches*, 18(2), 49-70 (in Persian).
- Hugo, C. (2002). Discounting Practices and Documentary Credits. *African Law Journal*, L. J. 101 20002, Available online at <http://HeinOnline.org>.
- Johnson, A., & Aharoni, D. (2000). Fraud and Discounted Deferred Payment Documentary Credits: The Banco Santander Case. *Journal of International Banking Law*, 15(1), 22-27.
- Kashanizadeh, H. (2009). A Comparative Study between Documentary Credit Beneficiary's Obligations in Relation to Each Other in the Uniform Customs and Practice for Documentary Credits (UCP600) and Article 5 of the Uniform Commercial Code of the USA (UCC). *International Law Review*, 26(4), 313-344 (in Persian).
- Khoeini, G., & Ghorbanian, H. (2013). Pilevar Satari, Amirhossein, Review of the Assignment of the Proceeds of Credit in LC Regulations (UCP500, UCP600, ISP98, URDG758, UCC) and UN International Convention on Independent and Guaranteed L/C. *International Law Magazine*, Vol. 48, 151-182.
- Nikbakht, H., & Bana Niasary, M. (2012). A Study in the Concept, Conditions, Effects and Nature of Negotiation of Letters of Credit. *Legal Research Quarterly*, 14, 367-412.
- Nipemann, F., & Tim, S. E. (2013). International Trade, Risk and the Role of Banks. *Federal Reserve Bank of New York Staff Reports*, 633, 1-69.
- Pawlowic, D. (1992). Letters of Credit: A Framework for Analysis of Transfer, Assignment, Negotiation and Transfer by Operation of Law. *Wayne Law Review*, 39, 1-65.
- Rafiee, M. T. (2008). Legal Analysis of Letter of Credit Contracts in Iran Law. *Private Law Views*, 5(12), 51-96 (in Persian).
- Reinhard, L. (2011). *Documentary Credits in Practice*. Translated by Hasani, Saeed, Mizan Press, 2nd Edition (in Persian).
- Schmitthoff, C. M. (1999). *Schmitthoff's Export Trade*. The Law and Practice of International Trade, translated by Behrooz Akhlaghi et al., Vol. 2, Samt Press.
- Schults, W. G. (2009). The UCP 600, A New Law Applicable to Documentary Letters of Credit, 21 SA Merc LJ, 228-248.
- Shiravi, A. (2011). *International Trade Law*. Samt Press, 3rd Edition (in Persian).

- Uniform Customs and Practices for Documentary Credits (UCP600)*. Tehran: International Chamber of Commerce.
- Ward, A. (2009). *Assignment and Documentary Credits*, University of Essex, School of Law, Papers, SSRN.com/so13/papers, Cfm Assignment and Documentary Credit.
- Xiang, G., & Buckley, R. P. (2003). *A Comparative Analysis of the Standard of Fraud Required under the Fraud Rule in Letter of Credit Law* [Translated by Bana Niasari, M.].
- McLaughlin, G. T. (1991), Should Deferred Payment Letters of Credit be Specifically Treated in a Revision of Article 5?, *Brooklyn Law Review*, 56(149), 149-165.