Chapter 10
Forfaiting

Forfaiting is a method of trade finance that allows exporters to obtain cash by selling their medium-term foreign accounts receivable at a discount on a "without recourse" basis. A forfaiter is a specialized finance firm or a department in a bank that performs non-recourse export financing through the purchase of medium-term trade receivables. Similar to factoring, forfaiting virtually eliminates the risk of non-payment, once the goods have been delivered to the foreign buyer in accordance with the terms of sale. However, unlike factors, forfaiters typically work with exporters who sell capital goods, commodities, or large projects and needs to offer periods of credit from 180 days to seven years. In forfaiting, receivables are normally guaranteed by the importer's bank, which allows the exporter to take the transaction off the balance sheet to enhance key financial ratios. The current minimum transaction size for forfaiting is $100,000. In the United States, most users of forfaiting are large established corporations, but small and medium-sized companies are slowly embracing forfaiting as they become more aggressive in seeking financing solutions for countries considered high risk.

CHARACTERISTICS OF FORFAITING

Applicability

Ideal for exports of capital goods, commodities, and large projects on medium-term credit (180 days to seven years).

Risk

Risk inherent in an export sale is virtually eliminated.

Pros

- Eliminates the risk of non-payment by foreign buyers
- Offers strong capabilities in emerging and developing markets

Cons

- Cost is often higher than commercial lender financing
- Limited to medium-term transactions and those exceeding $100,000

Key Points

- Forfaiting eliminates virtually all risk to the exporter, with 100 percent financing of contract value.
- Exporters can offer medium-term financing in markets where the credit risk would otherwise be too high.
- Forfaiting generally works with bills of exchange, promissory notes, or a letter of credit.
- The exporter is normally required to obtain a bank guarantee for the foreign buyer.
- Financing can be arranged on a one-shot basis in any of the major currencies, usually at a fixed interest rate, but a floating rate option is also available.
- Forfaiting can be used in conjunction with officially supported credits backed by export credit agencies, such as the Export–Import Bank of the United States.

How Forfaiting Works

The exporter approaches a forfaiter before finalizing a transaction's structure. Once the forfaiter commits to the deal and sets the discount rate, the exporter can incorporate the discount into the selling price. The exporter then accepts a commitment issued by the forfaiter, signs the contract with the importer, and obtains, if required, a guarantee from the importer's bank that provides the documents required to complete the forfaiting. The exporter delivers the goods to the importer and delivers the documents to the forfaiter who verifies them and pays for them as agreed in the commitment. Since this payment is without recourse, the exporter has no further interest in the transaction and it is the forfaiter who must collect the future payments due from the importer.

Cost of Forfaiting

The cost of forfaiting is determined by the rate of discount based on the aggregate of the LIBOR (London inter bank offered rate) rates for the tenor of the receivables and a margin reflecting the risk being sold. The degree of risk varies based 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. However, forfaiting can be more cost-effective than traditional trade finance tools because of many attractive benefits it offers to the exporter.

Three Additional Major Advantages of Forfaiting

Volume: Forfaiting can work on a one-shot deal, without requiring an ongoing volume of business.

Speed: Commitments can be issued within hours or days depending on details and country.

Simplicity: Documentation is usually simple, concise, and straightforward.

Forfaiting Industry Profile

Forfaiting was developed in Switzerland in the 1950s to fill the gap between the exporter of capital goods, who would not or could not deal on open account, and the importer, who desired to defer payment until the capital equipment could begin to pay for itself. Although the number of forfaiting transactions is growing worldwide, industry sources estimate that only 2 percent of world trade is financed through forfeiting. U.S. forfaiting transactions account for only 3 percent of that volume. Forfaiting firms have opened around the world, but the Europeans maintain a hold on the market, including in North America. Although these firms remain few in number in the United States, the innovative financing they provide should not be overlooked as a viable means of export finance for U.S. exporters.

Where to Find a Forfaiter

The Association of Trade & Forfaiting in the Americas, Inc. (ATFA) and the International Forfaiting Association (IFA) are useful sources for locating forfaiters willing to finance exports. ATFA and IFA are associations of financial institutions dedicated to promoting international trade finance through forfaiting. ATFA is located in New York, and its Web site is *www.afia-forfaiting.org*. IFA is located in Switzerland and its Web site is *www.forfaiters.org*.