Mezra Forfaiting

What is forfaiting ?

Mezra Forfaiting – What is forfaiting ?

- Forfaiting is a proven method of providing fixed-rate financing for international trade transactions. In recent years, it has assumed an important role for exporters who desire cash instead of deferred payments, especially from countries where protection against credit, economic and political risks has become more difficult.

- Forfaiting goes beyond credit insurance cover provided by government and private institutions, which usually require partial risk retention by the exporter, and provides the exporter with cash at the time of shipment, and on a non-recourse basis.

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- In Forfaiting, the importer’s bank usually guarantees a series of promissory notes or bills of exchange, which cover repayment of a supplier’s credit, provided by the exporter to the importer, for a period of from 180 days to 7 years.

- These notes or bills (“notes”) are usually structured to mature semiannually, and the face amounts of such notes include principal, and a fixed interest rate paid by the importer for the supplier’s credit.

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- The notes are initially given to the exporter at the time of shipment (or performance of other services) and become its property. The notes represent the unconditional and irrevocable commitment of the buyer and/or its bank (where the latter has added its guarantee) to pay the notes at maturity.

- The payment of these notes is independent of, and without any direct relationship to, the underlying commercial contract, which usually provides for other remedies to ensure the exporter's due performance.

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- Once the exporter becomes the bona fide owner of the notes, it can sell them to a third party at a discount from their face amounts, for immediate cash payment. This sale is without recourse to the exporter, and the buyer of the notes assumes all of the risks. The buyer's security is the guarantee of the importer's bank. The notes can be denominated in U.S. Dollars or almost any major currency.
- A commitment to purchase the notes from the exporter can (and in many cases should) be made in advance for reasons explained below.

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Forfaiting documentation.

- Promissory Notes / Bills of Exchange in international format with bank aval or guarantee; OR Conformed copy of underlying letter of credit including any amendments
- Conformed copy of commercial invoice and shipping documents
- Confirmation of the authenticity and validity of all signatures appearing on the documentation

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The following additional documentation is required for transactions where there is a letter of credit :-

1) Conformed copy of letter of credit and any amendments
2) Conformed copy of all letter of credit documentation
3) Assignment of proceeds in favour of the financing bank
4) Notification of assignment to the issuing and advising banks

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The following additional documentation is required for transactions where there is a letter of credit :-

5) Acknowledgement of issuing bank and advising/confirming bank of the assignment and confirmation that they will pay at maturity directly to financing bank.
6) Confirmation by the letter of credit issuing and advising/confirming banks that documents under the letter of credit have been taken up by applicant

Mezra Forfaiting – Advantages of Forfaiting.

- The ability to offer supplier credit to importers in more difficult countries at fixed rates;
- The ability to realise a cash sale;
- No interest rate fluctuation risk;
- No credit risk; or credit administration with related costs;
- No collection problems at maturity and related costs;
- Simplicity and rapid execution;
- Positive effect on balance sheet.

Mezra Forfaiting – flowchart