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Classic Forfaiting: The Primary Market

Presented

by

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LONDON FORFAITING

Objective

- Define Primary Forfaiting.
- Explain the role of the Primary Forfaiter.
- Provide a understanding of the mechanics of a Primary Market (Classic) Forfaiting transaction.
- Highlight the recent evolution of the Primary Forfaiting Market.

Uniform Rules for Forfaiting

International Chamber of Commerce
The world business organization

IFA

Uniform Rules for Forfaiting have been established by the International Chamber of Commerce (ICC) in co-operation with the International Forfaiting Association (IFA)

These Rules are currently in draft form but are likely to be approved Q3/2012

Definitions used in this presentation are based on those used in the draft Rules

What is Forfaiting?

ICC Uniform Rules for Forfaiting

*"Although Forfaiting has traditionally been defined as the without recourse discounting of trade-related receivables, **modern forfaiting has evolved considerably** over the last 20 years and **now encompasses many more instruments, structures and concepts** than has previously ever been the case.*

*As a versatile and flexible approach to raising finance for international trade **it has considerable benefits for both providers and recipients of finance**.*

*It is important to lay emphasis on the fact that **forfaiting facilitates and enables the provision of finance to the international trade community**.*

*It is **more** therefore **than just an instrument of payment** such as a letter of credit (although it can employ these) or a source of limited domestic financing."*

Traditional Forfaiting

- *"Forfaiting has traditionally been defined as the without recourse discounting of trade-related receivables" – ICC Uniform Rules*
- Forfaiting is a FLEXIBLE discounting technique that can be tailored to the needs of a wide range of counterparties and domestic and international transactions.

  Key characteristics:
  - Up to 100% financing without recourse to the seller of the debt.
  - Debt is usually evidenced by legally enforceable and freely transferable payment obligations e.g. a bill of exchange, promissory note or letter of credit.
  - Debt instruments are typically denominated in major currencies, with US Dollars and Euro being most common.
  - Finance can be arranged on a fixed or floating interest rate basis.

Role of the Primary Forfaiter

- *"Primary Forfaiter - means the Party who first purchased or otherwise acquired the Payment Claim from the Initial Seller"*
- The Primary Forfaiter generates trade related receivables from the Primary Market, which will either be held until maturity or sold into the Secondary Market.
- *"Primary Market - means the market where a sale of a Payment Claim by an Initial Seller is made to a Primary Forfaiter."* The Primary market is comprised of exporters, suppliers and borrowers.
- For the purposes of this presentation we will focus on exporters.
- These activities can be broken down into three phases.

Definitions in Italics extracted from ICC **Uniform Rules for Forfaiting**

The forfaiting transaction.

Definitions

Forfaiting Transaction - the sale by the Seller and the purchase by the Buyer of the Payment Claim on a without recourse basis

Seller - the Party selling the Payment Claim

Buyer - the Party buying the Payment Claim

Payment Claim - all the rights to receive or recover payment from the Primary Obligor and the obligation of the Primary Obligor to make payment of a specified amount on a specified date or dates or on demand.

Primary Obligor - the person primarily responsible for the obligation to make payment of the Payment Claim.

Definitions extracted from ICC Uniform Rules for Forfaiting

Phases of a Forfaiting transaction

THE DUE DILIGENCE PHASE

This phase involves carrying out due diligence on the Exporter, the Underlying Trade Transaction (*the transaction pursuant to which the Payment Claim arises*); and the Forfaiting Transaction.

Verifying compliance with all anti-money laundering and other regulatory requirements to ensure that the proposed forfaiting transaction is both financially viable and represents a bona fide movement of goods.

Phases of a forfaiting transaction cont.

THE PRE-CONTRACT PHASE ***(including pricing)***

This phase covers structuring the proposed forfaiting transaction, guiding and advising the exporter on any documentary requirements and pricing of the proposed Forfaiting Transaction.

This phase is affected significantly by the results of the due diligence phase and frequently the timing of the two phases overlap.

Phases of a forfaiting transaction cont.

THE CONCLUSION OF THE TRANSACTION PHASE

This phase essentially comprises the documenting and performance of both the Underlying Transaction and the proposed Forfaiting Transaction, including the satisfaction of conditions to the discounting of the relevant Payment Claim and the Client/Exporter meeting any documentary requirements laid down by the Primary Forfaiter.

Phases of a forfaiting transaction cont.

THE CONCLUSION OF THE TRANSACTION PHASE CONT.

The Primary Forfaiter issues a Forfaiting Agreement setting out the terms of the Forfaiting Transaction.

The Agreement details conditions to be met prior to conclusion and any representations to be given by the exporter in relation to both itself and the Underlying Transaction.

The Agreement also includes details of any other conditions including payment of commitment fees, provision of "Know Your Customer" documentation, further assurance obligations on the Customer.

Matters which should always be covered

- The capacity and authority of the Exporter and Primary Obligor to execute and perform, and the authenticity and binding nature of the signatures of those parties on the documents provided to the Primary Forfaiter prior to payment of the discounted payment.
- The legal existence and freely transferable nature of the relevant Payment Claim and the rights under any Credit Support Document (*obligation of a person other than the Primary Obligor to make payment in respect of the Payment Claim*).
- Confirmation that the Payment Claim and any Credit Support Documents are not affected by any encumbrance, set-off, counterclaim, equity or other preferential right in favour of any third party.
- The enforceability of the Payment Claim and the obligations of Obligors under any Credit Support Document and the enforceability of the obligations of the Exporter under the Forfaiting Documentation.

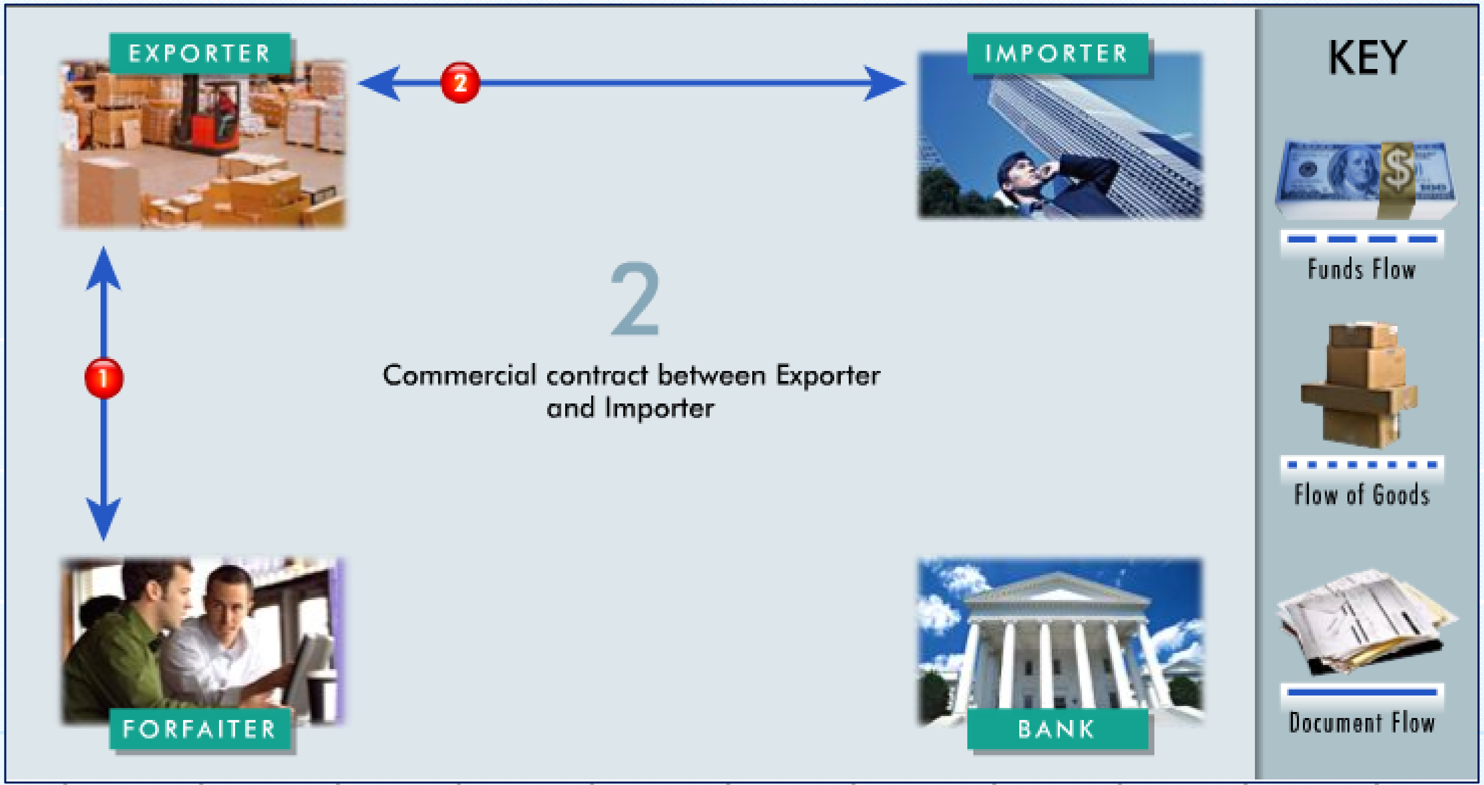
Matters which should always be covered

- The obtaining of all consents, approvals and other authorisations necessary for payment of the Payment Claim to be made at maturity and for any Credit Support Document to be enforced.
- Payments under the Payment Claim and any Credit Support Document being capable of being made free and clear of deductions and other taxes.
- The performance by the Exporter of its obligations under the Underlying Transaction and the Forfaiting Documentation.
- That there have been no amendments to any documentation relating to the Underlying Transaction (or otherwise provided to the Originator in connection with the forfaiting transaction) and there will be no such amendments without the Primary Forfaiter’s consent

How Forfaiting Works

1. Forfaiter commits to purchase deal from the Exporter

How Forfaiting Works



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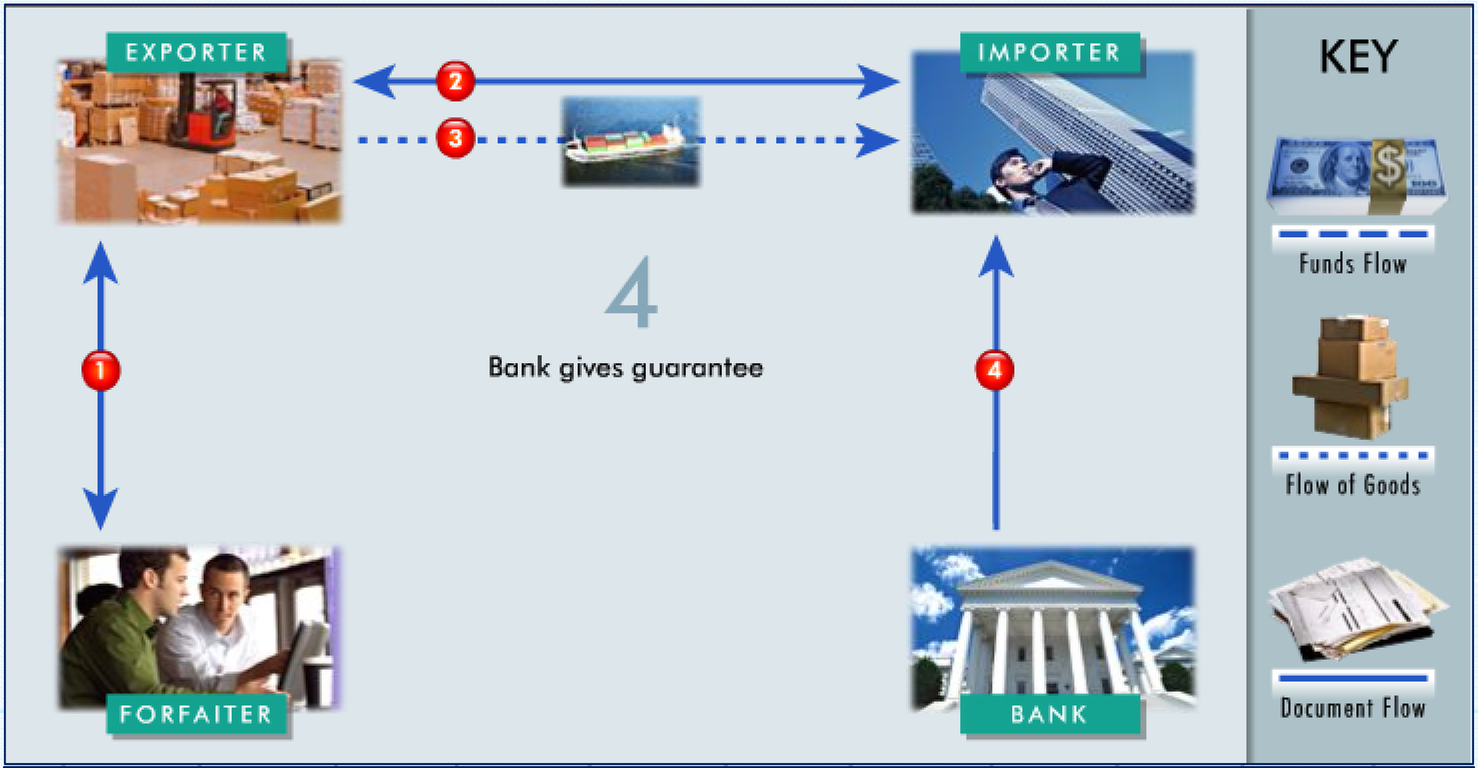

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3. Delivery of goods from Exporter to Importer
4. Bank gives guarantee

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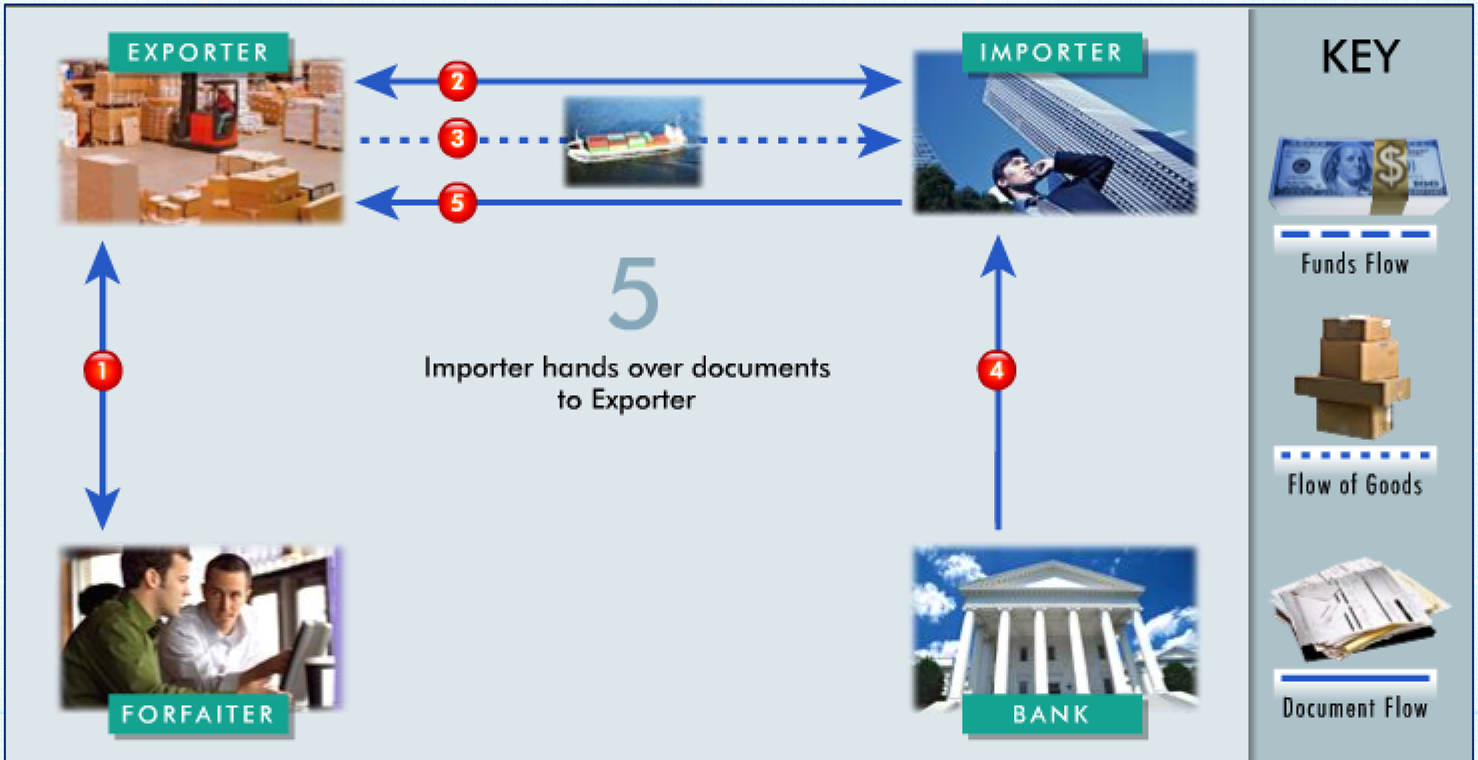

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4. Bank gives guarantee
5. Importer hands over documents to Exporter

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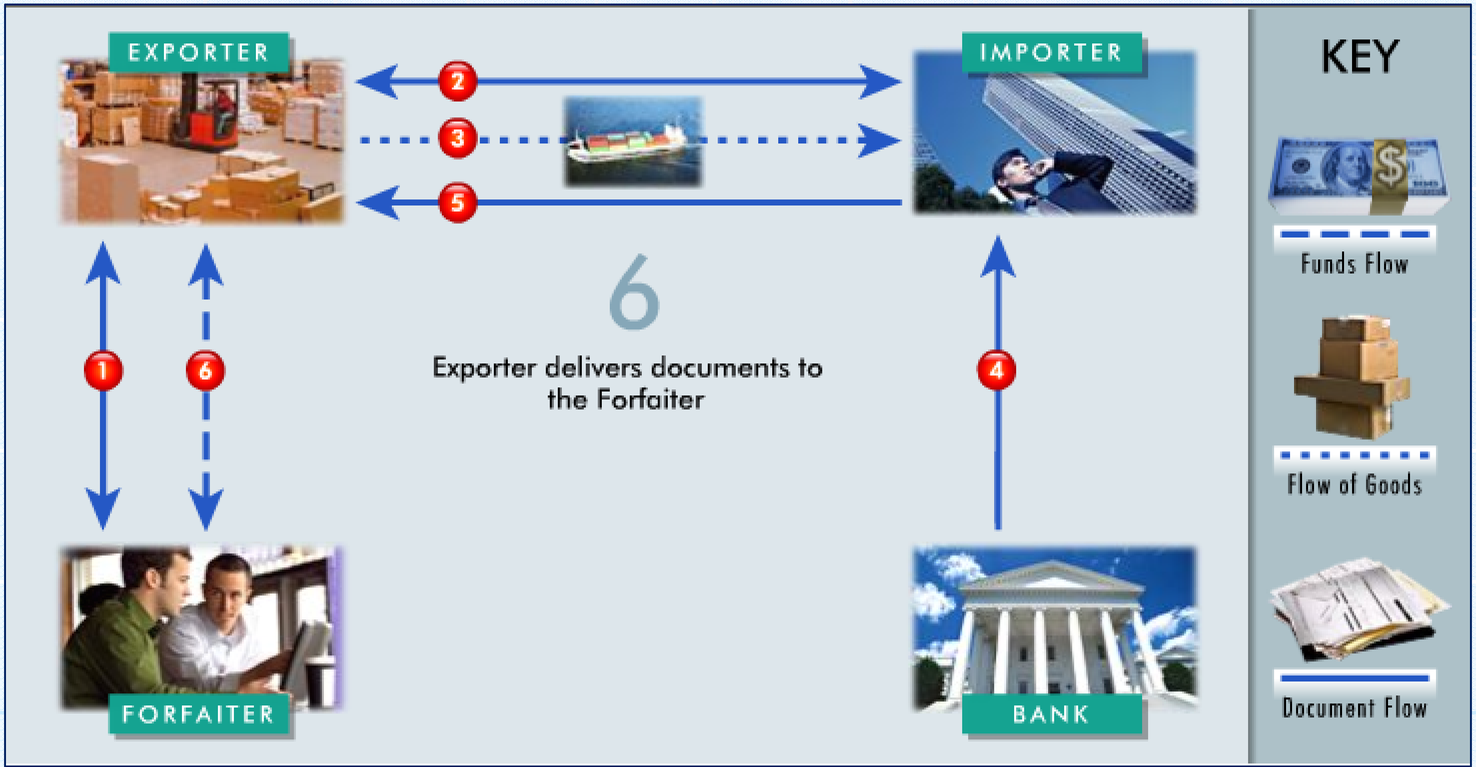

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6. Exporter delivers documents to the Forfaiter

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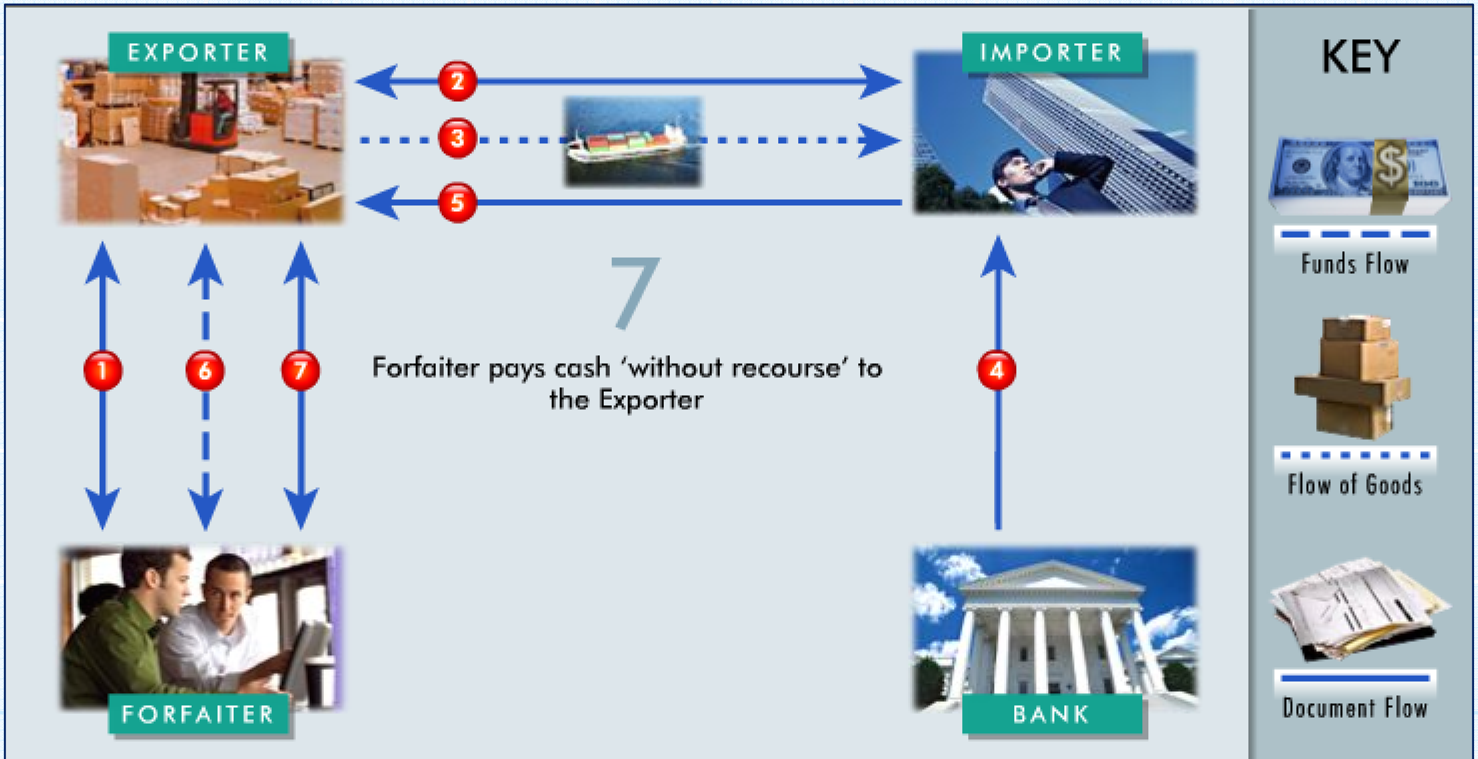

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6. Exporter delivers documents to the Forfaiter
7. Forfaiter pays cash 'without recourse' to the Exporter

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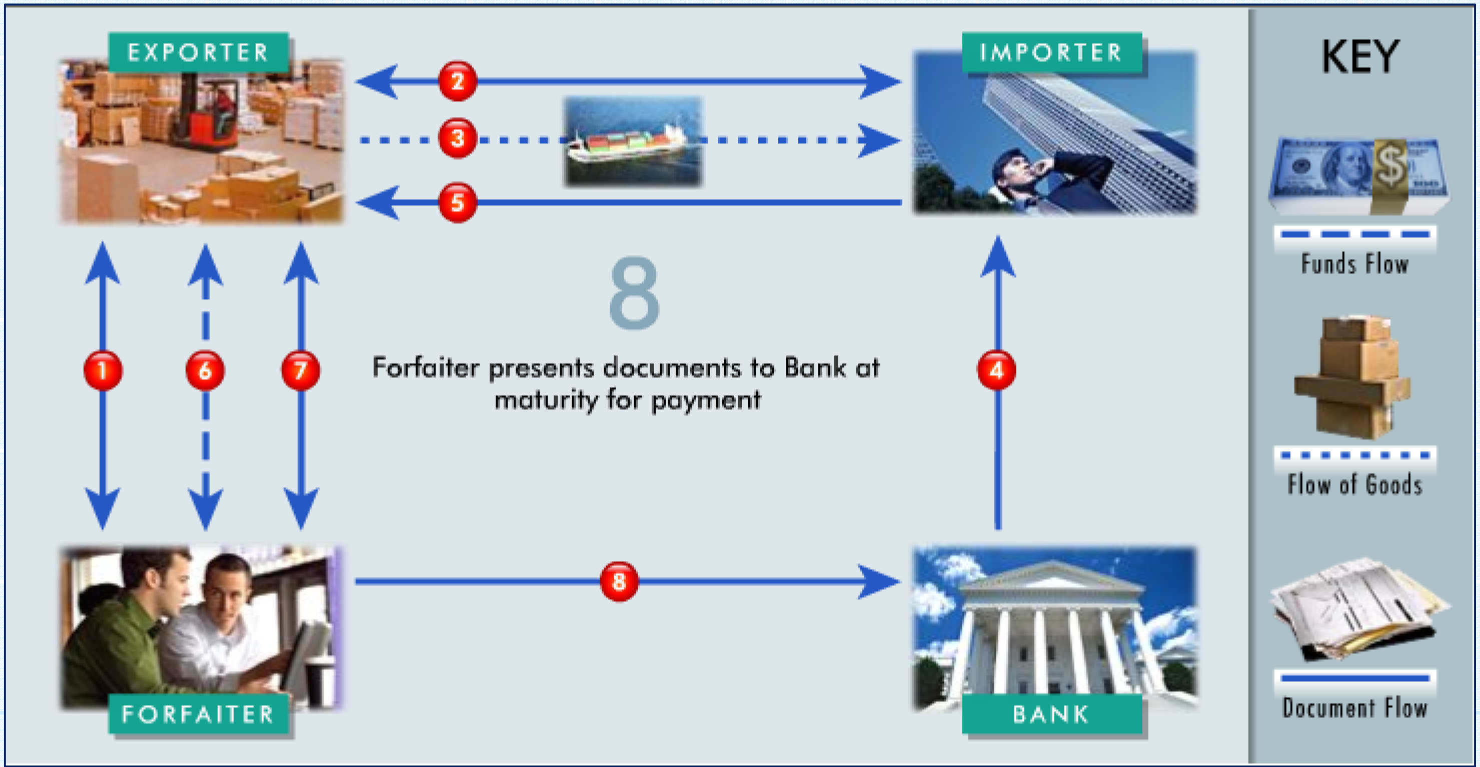

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8. Forfaiter presents documents to Bank at maturity for payment

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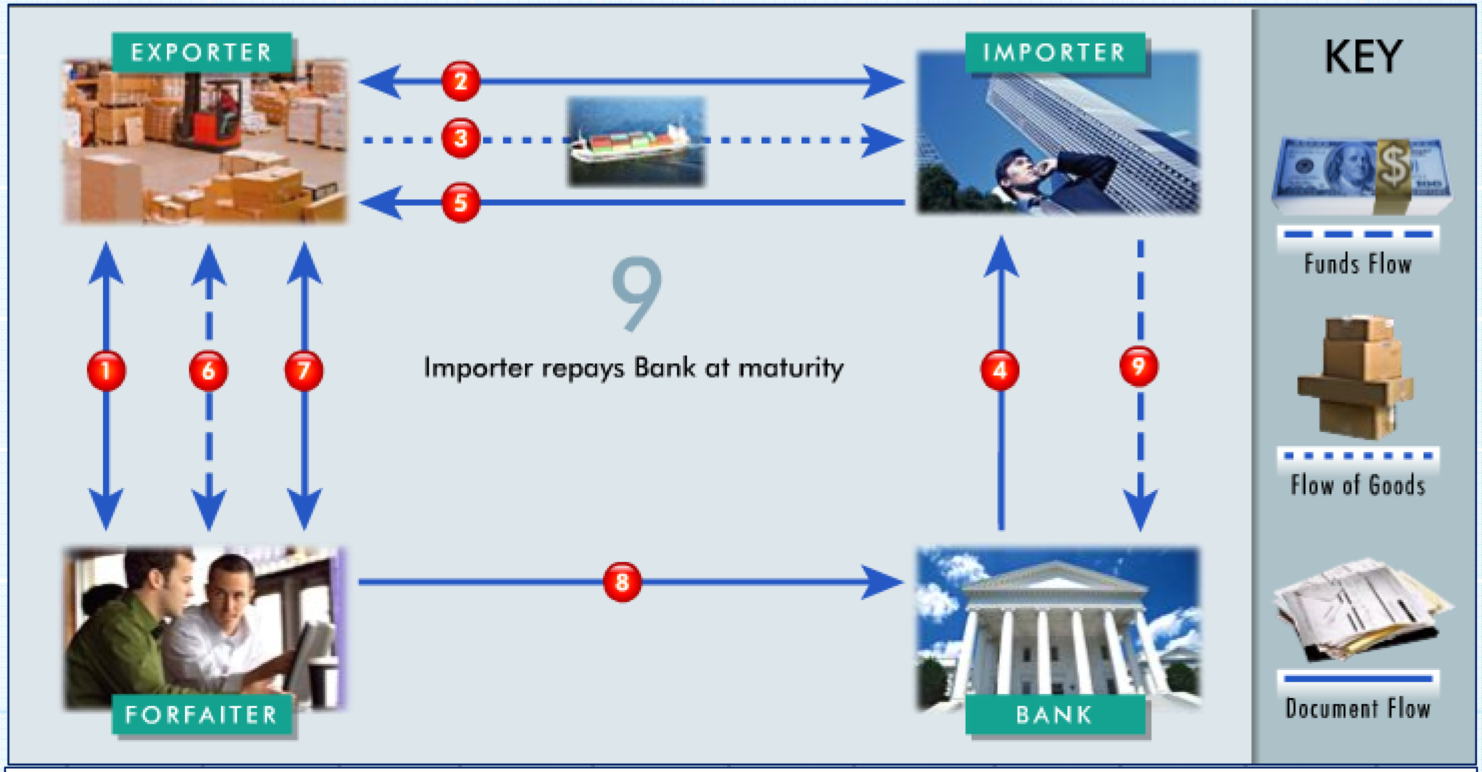

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9. Importer repays Bank at maturity

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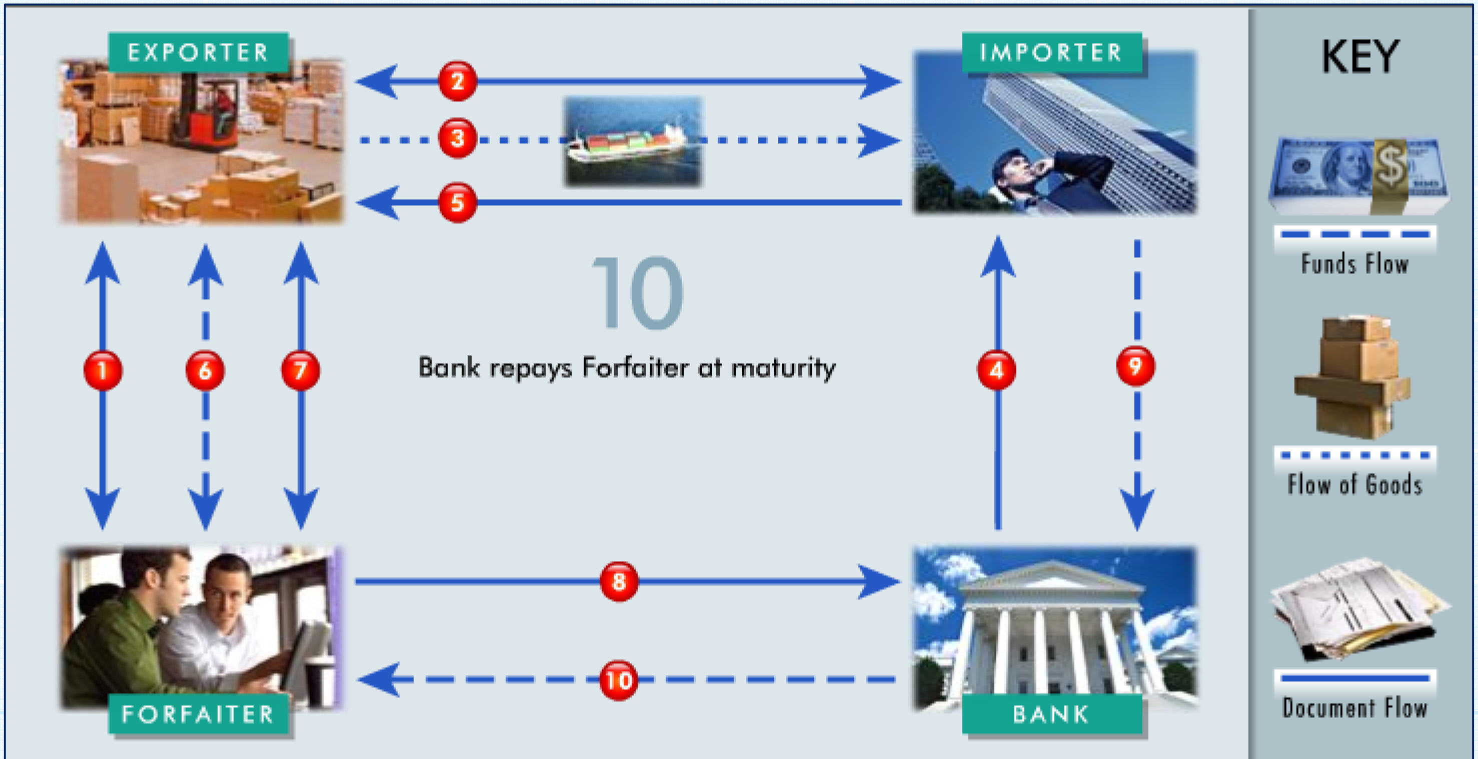

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8. Forfaiter presents documents to Bank at maturity for payment
9. Importer repays Bank at maturity
10. Bank repays Forfaiter at maturity

Maturity of the Forfaiting Market

- No longer a Capital Goods dominated market.
- No longer limited to Foreign Bank Risk.
- No longer the financing resource of last resort.