

RURAL FINANCE

case of

Warehouse Receipt Finance

Structured Trade Finance: Commodity-Backed Finance

December, 2021

Sources of Material & Content: IFC, FAO

Context

Investments in agriculture value chains: insufficient to achieve development goals

Goal Worldwide: increase investments from billions to trillions, public,private, local and global

Crowding-in private investment requires:

- Expand space for private sector with better focus scarce public finance on public goods/services
- Improve policy and regulatory environment to address market failures & limited private sector participation
- Improve incentives, reduce transaction costs and risks for private investment
- Robust reform and investment program after inclusive public-private dialogue

Context

- Commercial agriculture: not standalone sector- dependent on water, energy, infrastructure and ICT
- Private finance for agriculture sector limited primarily due to risks:
 - Risk Profile – including climactic and market risks, especially with perishable products
 - Political interference – importance to economies and food security
 - Scale – commercial investments small in relation to other sectors (on-farm are even smaller)
 - Fragmentation – supply chains disjointed; rely on multiple intermediaries

Goal of the World Bank Group

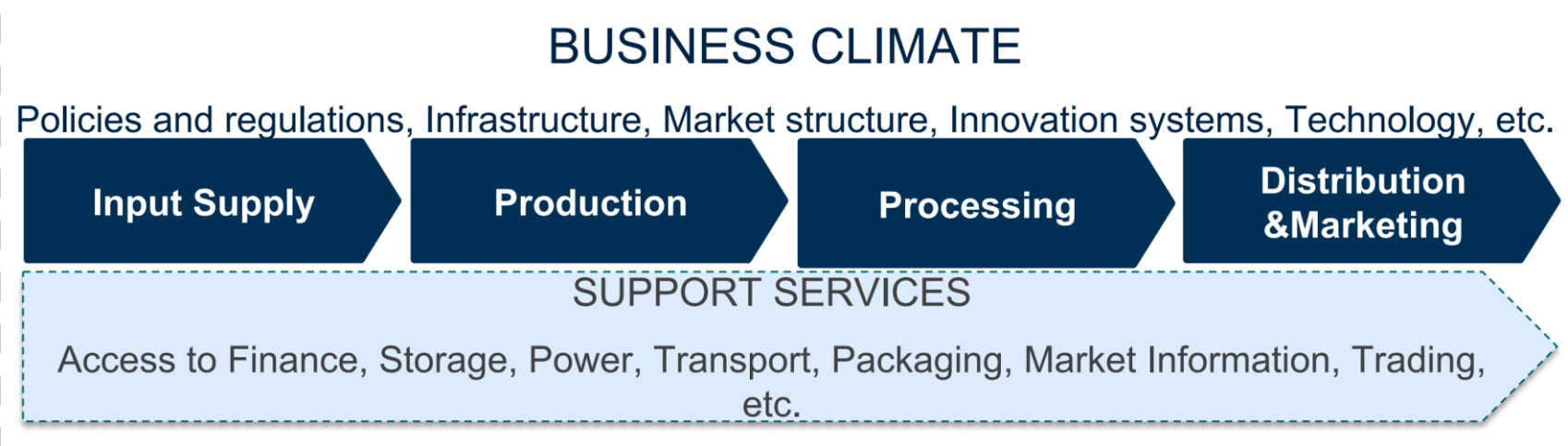
Enlarging functions of rural financial services

Diversifying financial services: providing tailor-made savings products with added features

Promoting agricultural value chain (AVC) finance: financing with the chain to fit nature of value chain and actors involved

Agricultural Value Chains

- Agriculture value chains mainly small-scale and some large-scale participants
- 450 million private smallholder farmers—subsistence and commercial
- SMEs dominate input suppliers, traders, processors, distributors and marketers
- Value chain an interdependent “ecosystem”
- Potential “disruptive” changes to agriculture value chains:
 - ❖ Urbanization and changing dietary preferences
 - ❖ Technology – digital, physical, scientific



Warehouse Receipt Financing (WRF)

Proven instrument for farmers, traders, processors, exporters to obtain finance secured by goods deposited in warehouse

Warehouse operator issues receipt for stored goods, to be used as portable collateral to get loan from banks

WRF very interesting for rural small and medium enterprises, unable to borrow due to lack of sufficient collateral

Principles of lending against stored commodities from ancient times (the first written records come from ancient Mesopotamia)

For agriculture to contribute to economic development > needs proper credit system

Postharvest credit in the form of warehouse receipt finance critical in emerging economies

Efficient warehouse receipt finance encourages storage, increases liquidity in entire commodity chains, reduces price volatility, access to new financing tool, gives incentive to invest in production

Different warehousing arrangements

- **private warehouse**, production and warehousing under same roof; control by same entity: very risky as collateral for loans
- **field warehouse**: a collateral management or credit support company controls warehouse of depositor (producer/customer) or public warehouse by leasing it
- **public warehouse** a large storage serving many businesses, e.g. a port or major transit center, operated by a warehouse operator, stores commodities for third parties for a fee; Public warehouse operators issue WR acceptable as collateral by banks; quality of receipt as collateral depends on legal and regulatory regime in the country, and financial status and integrity of warehouse operator

Advantages of different warehousing

- availability and integrity of public warehouses in rural areas;
- cost structures;
- types/sizes of transactions;

and

- quality of legal and regulatory environment

If no well-functioning legal and regulatory framework, if short supply of reliable public warehouses in rural areas, then field warehousing since field warehouse is on or near location to deposit commodities, and especially if borrower needs ready access to commodities, such as for processing operations.

Benefits from presence of network of reliable public warehouses in rural areas

Whereas financing against security of field warehousing bespoke transaction, with relatively high banking charges (and little possibility for banks to compete with each other), public warehouses acceptable to banks can be used by a wide range of commodity owners to obtain ready access to finance.

Well-developed public warehousing system contributes to commodity & rural financial market development, e.g.

- involvement of **independent grading and quality certification** of stored goods by warehouse operator,
- **transparency** in commodity marketing,
- and **tradable warehouse receipts**, commodity transactions easier/ faster
- development of **commodity exchanges**, which require quality certification, delivery points
- For banks, WR = possessory pledge, and superior to pledging of assets in the borrower's possession

What is Warehouse Receipt Finance?

Use securely stored goods as loan collateral

Clients, such as farmers, traders, processors, etc...deposit commodities in secure warehouse against receipt certifying deposit of goods of a particular quantity, quality and grade

Clients use receipt as portable collateral for loans from banks

Warehouse Receipt (WR) gives right to withdraw specified amount, quality of commodity any time from warehouse

Warehouse manager liable for guaranteeing safety, quality of stored commodity

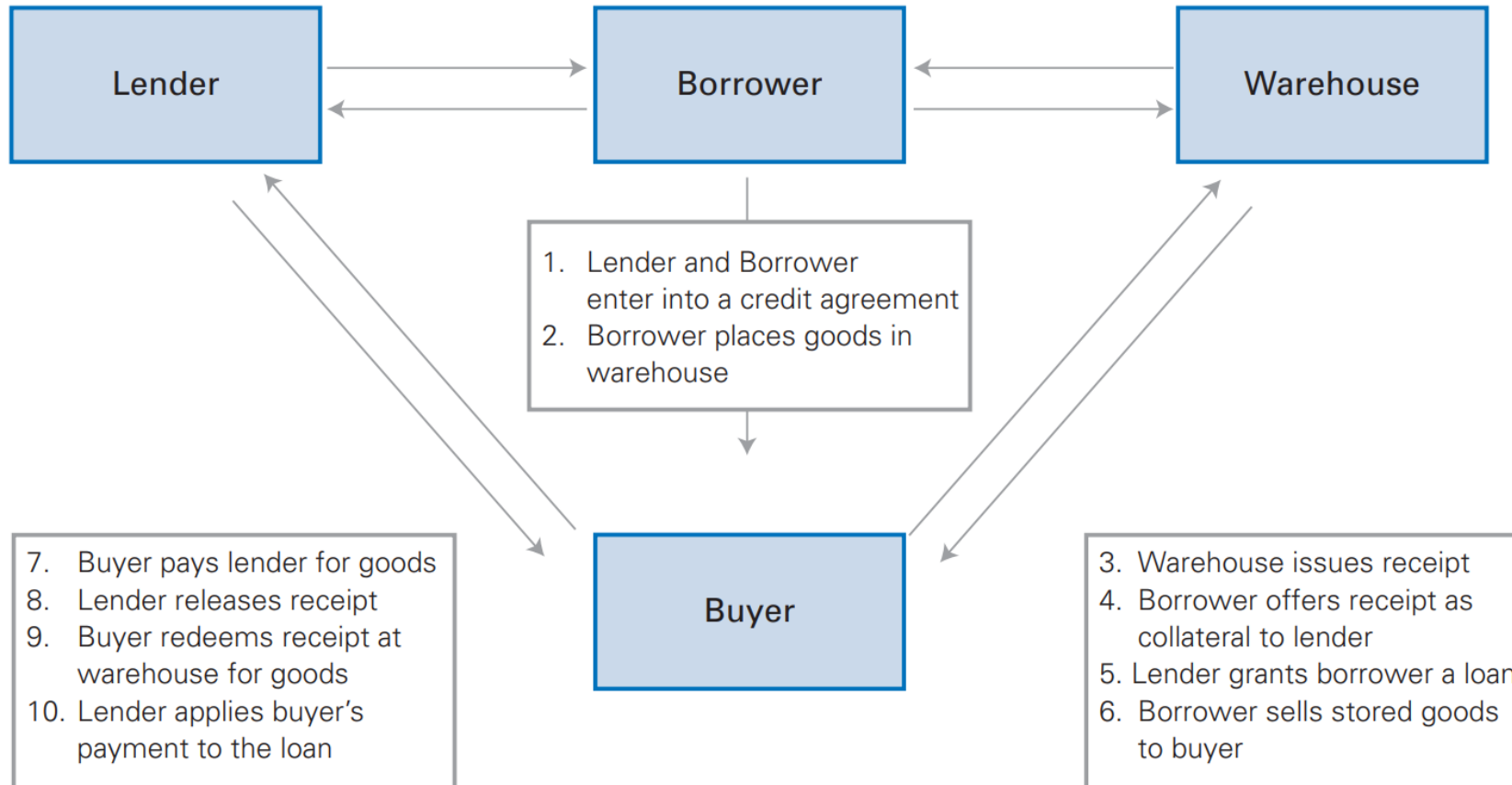
WR transferred to bank, bank makes loan equivalent a certain percentage of value of stored commodity

At maturity, client (e.g., a farmer) sells commodity to buyer who either pays bank directly, or pays borrower who repays bank

Upon receipt of funds or acceptable payment instrument (e.g., a confirmed Letter of Credit), bank surrenders WR to buyer or seller (depending on case), who then submits WR to warehouse, which releases commodity

If default on loan, bank uses WRs in its possession to take delivery of and sell commodity stored in warehouse, to offset the amounts it is due

Basic features of a warehouse receipt financing transaction



Elements of WR Financing System

Enabling legal environment and institutional knowledge to instill trust among financiers, commodity market participants

With high degree of confidence, financial community to lend against WR, interest rates will be reduced

Core elements of well-developed WR system:

- an enabling legal and regulatory framework;
- a regulatory and supervisory agency;
- licensed and supervised public warehouses;
- insurance and financial performance guarantees;
- banks familiar with use of warehouse receipts.

Enabling legal framework- related rules and procedures

- i) WR's legal status as a document of title or pledge;
- ii) Rights and obligations of depositor and warehouse operator;
- iii) Perfection of security interests (registration of the warehouse receipt or pledge);
- iv) Protection of WR against fraud, and financial performance guarantees;
- v) Priority for claims of holder of WR in case of borrower default or bankruptcy
- vi) Clear procedures in case of bankruptcy of warehouse operator, administration of financial performance guarantees

Well-functioning mechanism of control/oversight of public warehouses

Government regulatory agency to license and inspect public warehouses, public warehouses' proven financial stability

Protect investor if WR traded in financial markets

Bank chooses from several national or international collateral managers, most likely with accreditation process for evaluating operational standards & credit standing of partners

Regulatory agencies functions:

- organizing, implement licensing process;
- maintain public registers of public warehouses;
- conducting initial, periodic, special examinations of financial, operational and technical conditions of public warehouses, quality, quantity of stored goods;
- if a system of paper WR, then collect orders for printing of WRs
- arbitration in case of conflict among warehouse operators, depositors and financial institutions

Licensed and Supervised Public Warehouses

Public warehouses: high levels of technical and financial, monitored by a regulatory agency

Public warehouses ideal counterparts for commodity exchanges- offer safe, efficient delivery Mechanisms

Ensure integrity, solvency of public warehouses:

- minimum capital requirements;
- minimum storage capacity;
- performance guarantees (backed by bonds and/or insurances);
- periodic reporting requirements on business operations to the regulatory agency;
- publication of storage fees;
- insurance against fire, flood and earthquake;
- warehouse can have a laboratory, or access to one, for grading
- depositors, operators access to independent laboratory for dispute resolution

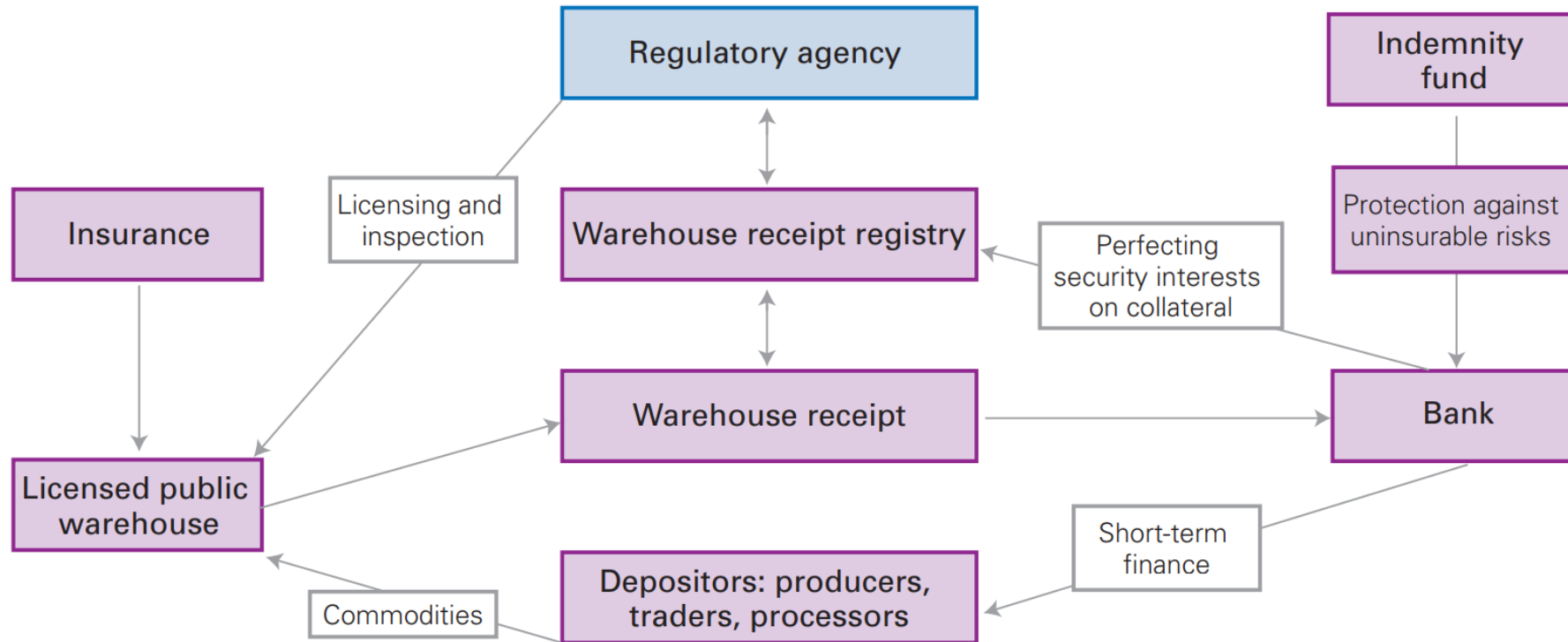
Insurance and Financial Performance Guarantees

Insurance for warehouse operator for premises, goods, staff risks, professional indemnity insurance against theft, fraud, negligence by operator's staff

Stable, Predictable Market

Policy environment: incentives for storage, financing: governments to refrain from heavy market intervention

Possible elements of a well-developed warehouse receipt system



World Bank-IFC

Structured Trade Finance-Commodity Backed Finance

Global Warehouse Receipt Program

Structured Trade Finance

- Trade finance to exporters, importers, trading corporations for carrying out trade Highly specialized for financing high value exports and imports
- Trade finance pivotal role in free flow of commodities
- Structured trade finance products primarily in commodity sector by traders, producers and processors
- Banks tailor it based on needs of client
- Structured trade mainly warehouse financing, working capital financing and pre-export financing
- Trade Finance Letters of credit, bank assurances, trade credit insurance,
- Progress in information and communication domains help track physical risks in supply chain between exporter and importer.

IFC's Global Warehouse Finance Program (GWFP)

Objective GWFP: increase working capital to agricultural producers or traders by leveraging their commodities in storage

GWFP increases banks' liquidity or risk coverage backed by warehouse receipts, to provide financing of short-term loans or guarantees to agricultural producers and traders

About 75 percent of the world's poor in rural, farming and agriculture

GWFP program part of IFC's efforts to **alleviate poverty**

Farmers need to sell commodities earlier than desired due to urgent financial needs

Warehouse receipt financing:

- secured lending to farmers - secured by own commodities deposited in warehouses
- enabling better managing timing of sale of crops
- beneficial for farmers, unable to obtain financing due to lack of sufficient loan collateral
- allows banks to shift risk from borrowers' fixed assets to commodities

IFC's Global Warehouse Finance Program (GWFP)

Program Structure:

(i) **Credit Line:** IFC offers short-term loan to bank to on-lend to farmers, agricultural commodity producers, or traders against warehouse receipts as collateral

(ii) **Funded or Unfunded Risk-Sharing Facilities:** IFC participates up to 50% of short-term loans to agricultural commodity producers or traders against warehouse receipts as collateral. Banks transfer credit risk to IFC from the portfolio they originate; Assets on bank's balance sheet, risk transfer with partial credit guarantee from IFC

If legal system non-existent for banks to lend money against warehouse receipts as collateral,

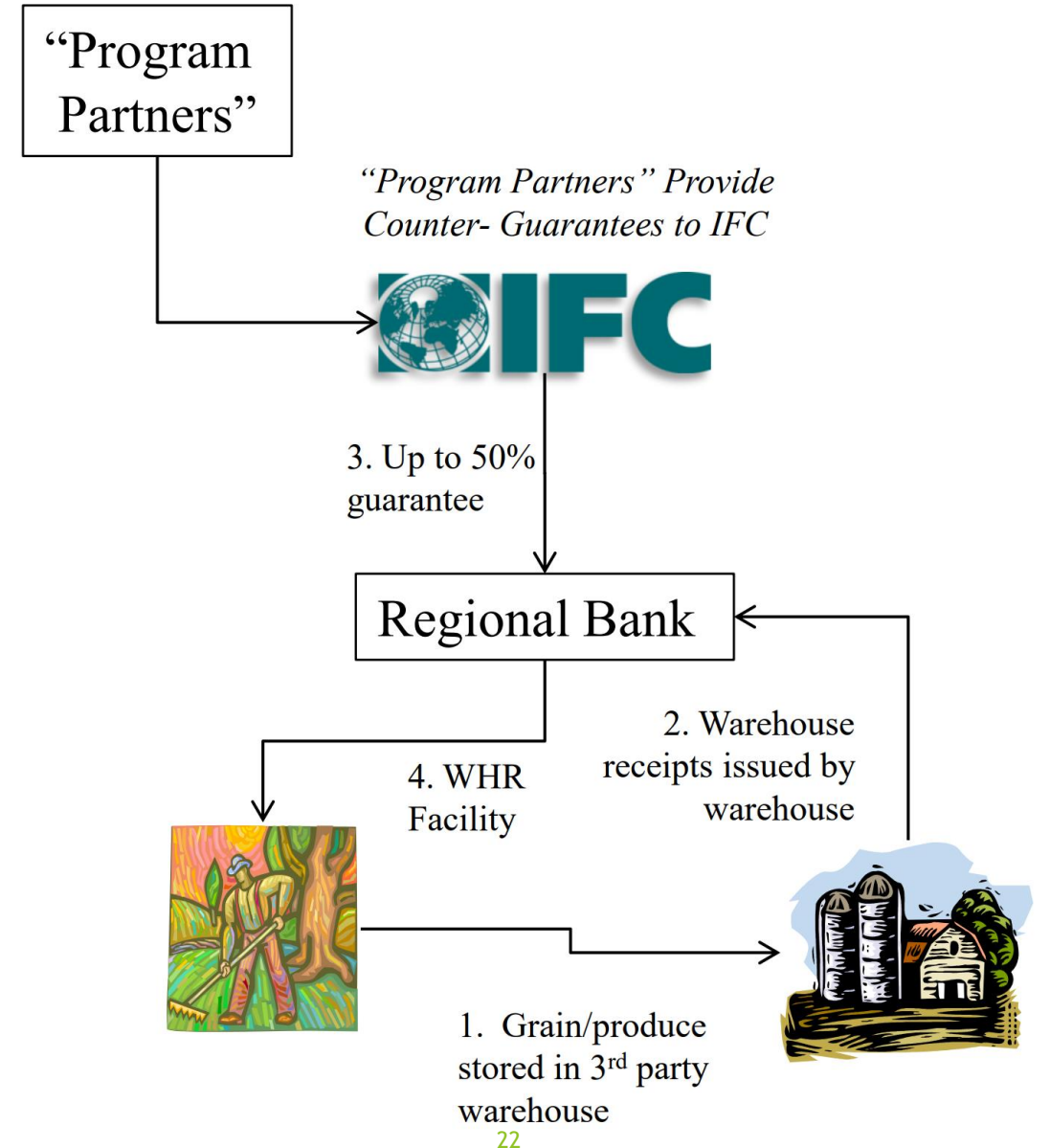
IFC works under a **Collateral Management Agreement (CMA)** to **pledge stocks** or **Stock Monitoring Agreement (SMA)** to monitor stocks, two agreements commonly used by banks

Results

Over \$6 billion in global trade, of which \$3 billion of trade in IDA countries, GWFP supported 750,000 farmers in 66 emerging market countries (29 IDA countries, 24 Sub-Saharan African countries, 7 fragile and conflict-affected countries)

Global Warehouse Finance Program (GWFP) Risk mitigation for bank's food/agriculture portfolio

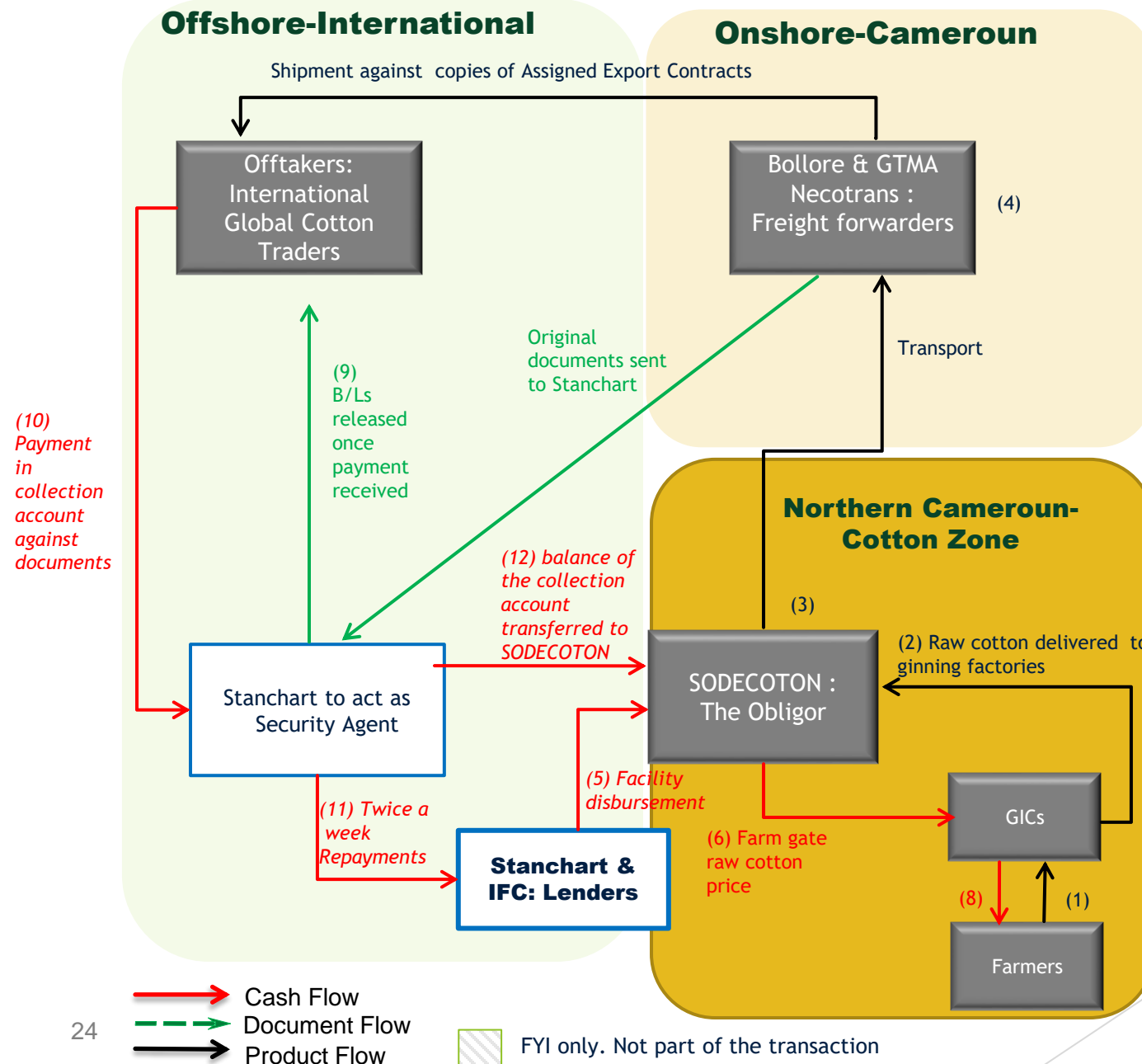
- Program works with banks to promote the acceptance of WR or collateralized inventory schemes (such as Collateral Management Agreement - “CMA”)
- IFC can take risk of the bank or warehoused commodities
- Critical to assess the bank's commodity management experience
- Bank could support increased use of WR or CMA by trading companies or producers



Example of Transaction structure

- A. Secured structure: Overview**
- B. Security Package and Legal Enforceability**

A. Secured Structure: Overview



1. Raw cotton harvested by individual farmers and stored at "collection points by farmer cooperatives "Groupe d'Initiatives Commum (GIC).
2. Raw cotton transported by Sodecoton trucks from GICs storage zones to ginning factories
3. The bulk of the lint cotton stock is held at different ginning factories. The company maintains stock in Douala and Ngaoundere (for stock transported by train)
4. The stock in transit is minimal (less than 10 % at any given point in time)

5. Facility disburses to allow Sodecoton to purchase raw cotton and finance the company's working capital needs

6. SODECOTON pays the GIC upon in cash subject to presentation of delivery report duly validated by the company's inspectors.
7. The company deduct input loans repayments and pay the difference to the GICs
8. Each GIC repays individual small holder farmers

9. Documents titles including B/Ls 9. B/Ls are released to offtakers against Cash payment.
10. Payments by reputable international offtakers into pledged collection account controlled by Stanchart as the Facility agent.
11. Lenders are repaid from the proceeds accrued in the collection account offshore
12. Balance of the collection account transferred to SOFITEK

B. Security Package and Legal Enforceability

	ذینفع	قابل اجرا	اجرا	
	Interest	Law	Perfection	Enforcement
بارنامه	Bill of Lading	EN/FR	Issued by the freight forwarders with original copies remitted to the Facility Agent. Released to offtaker against payment under Documentary Credit	A Bill of lading represents title to goods and is a negotiable instrument. Stanchart’s correspondent bank will hold the original copies until buyer’s payment.
قرارداد های صادراتی	Export contracts	FR	All export contracts and receivables thereunder are assigned to the lenders. Assignment of each export contract will be notified and acknowledged by respective offtaker. Acknowledgement of this assignments will be a condition of first disbursement.	SODECOTON default: Lenders have full right on the assigned contracts, payment should be made to collection accounts controlled by the Facility Agent; any attempt to divert in insolvency should fail, once the stock is on vessels. Offtaker default: Lenders able to sue offtaker directly to obtain a judgment under sales contract; Lenders should be able to enforce such judgment against offtaker’s assets, pari passu with other unsecured creditors.
جمع آوری وجوه در یک حساب	Collection Accounts	EN/FR	Pledge over the collection account in favor of the lenders	Blocking and sweep upon demand

SD

EN: English
FR: French

صادر شده توسط حمل و نقل با نسخه های اصلی به نمایندگی تسهیلات حواله شده است. در مقابل پرداخت تحت اعتبار اسنادی به واگذار شد off-taker

کلیه قراردادهای صادراتی و مطالبات ناشی از آن به وام دهندگان واگذار می شود. واگذاری هر قرارداد صادراتی توسط متصدی مربوطه اطلاع رسانی و تایید خواهد شد.

قبولی این تکالیف شرط پرداخت اول خواهد بود.

تعهد به حساب وصول به نفع وام دهندگان

بارنامه نشان دهنده مالکیت کالا و ابزاری قابل معامله است. بانک خبرنگار نسخه های اصلی را تا زمان پرداخت خریدار نگه می دارد. Stanchart

وام دهندگان حق کامل قراردادهای واگذار شده SODECOTON پیش فرض را دارند، پرداخت باید به حساب های جمع آوری شده توسط عامل تسهیلات انجام شود. هر تلاشی برای انحراف در ورشکستگی باید با شکست مواجه شود، زمانی که سهام در کشتی ها موجود باشد

offtaker وام دهندگان می توانند مستقیماً از Offtaker پیش فرض شکایت کنند تا طبق قرارداد فروش حکم صادر کنند. وام دهندگان باید بتوانند چنین قضاوتی را در برابر دارایی های آفتاکر، به طور موازی با سایر طلبکاران بدون وثیقه اجرا کنند.

A. Secured Offshore Structure (cont'd)

A fully secured pre-export facility:

(i) Periodic control and partial validation of lint cotton inventories

- Lenders to receive on a bi-monthly basis a comprehensive stock monitoring report from Sodecoton outlining localization of lint cotton per geographic zones: (i) ginning factories; (ii) stock in transit (on trucks or held in Bollore/ Necotrans managed transit warehouse in Ngaoundere); (iii) stock held in the Douala ports under the custodian of Bollore and GTMA Necotrans
- Lenders to receive on a monthly basis confirmation/validation from Necotrans and Bollore on the quantity of stock held in their respective warehouses in Douala and Ngaoundere

(ii) Assignment of export contracts

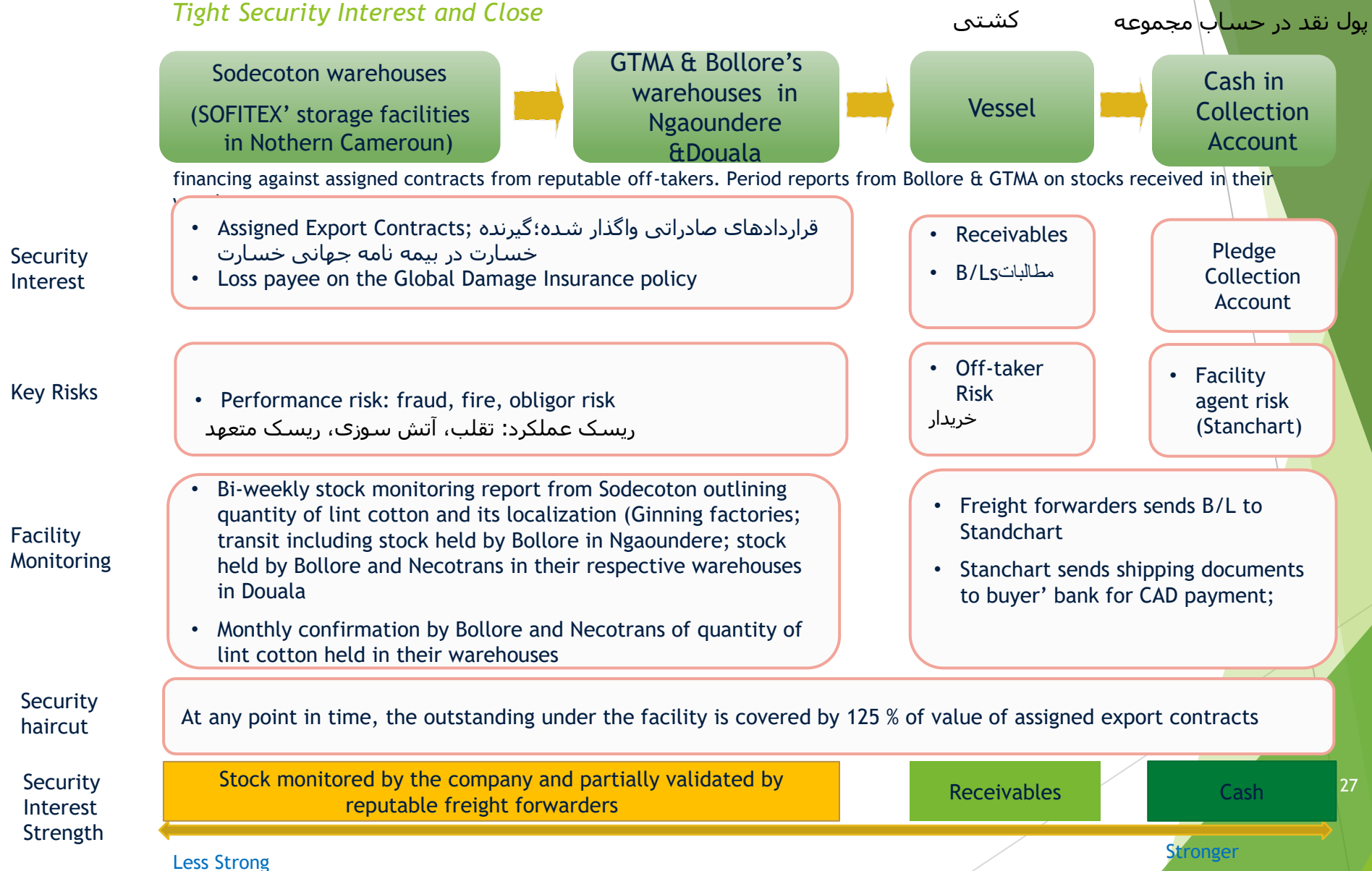
- Forward contracts with offtakers for a minimum of 125% of the outstanding; offtakers all being top names in cotton market (Louis Dreyfus Commodities, Cargill Cotton, Paul Reinhart, Olam, Noble, Ecom, etc) with payment under collection document on a cash against document basis.
- 70 % of the expected production is already sold at fixed price as of January 10th

(iii) Tight payment mechanism

- Payment from pre-agreed offtakers made into a Collection Account;
- Proceeds into the collection to repay the facility before any release to Sodecoton

A. Secured Offshore Structure (cont'd)

Tight Security Interest and Close



به گرو دارایی

نظارت بر تسهیلات

ارزش کمتر از ارزش بازار بر روی دارایی که به عنوان وثیقه برای وام استفاده می شود، اشاره دارد. به صورت درصدی از علامت گذاری بین دو مقدار بیان می شود. ... هنگامی که وثیقه در حال تعهد است، درجه کوتاهی مو بر اساس میزان ریسک مرتبط با وام دهنده تعیین می شود.

Structured Trade Finance

Funding and risk mitigation for bank's cross-border or domestic commodity trade portfolio

- Program supports large size cross-border & domestic trade of strategic commodities (e.g. energy, soft commodities, agricultural inputs) and used as collateral supporting lending

- Funded or unfunded risk participation with a partner bank, who can arrange for escrow, manage collateral, insurance, etc.

- Environment & social requirements to be met by facility

Illustration of a Structured Trade Finance Example:
Oil imports into Ghana

