



Today I'm going to talk about trade finance in Africa and the impact of the Eurozone crisis

The global trade finance community has gone through a traumatic period over the past two years, as European banks have retrenched and liquidity has dried up.

Sub-Saharan Africa has not been immune to the fallout, facing rising trade finance costs and the withdrawal of financing lines.

But the story for the region has been mixed, reflecting the differing fortunes of the main players driving Sub-Saharan Africa's trade flows.

[Despite the cooling of the Chinese economy and the ongoing debt crisis in the Euro Zone, demand for many African commodities has remained healthy, keeping prices and earnings high.

But these gains have been offset by a surge in costly food imports, which continue to be driven by Africa's high urbanisation and population growth rates.

In this environment the major players have prospered at the expense of the

SMEs who have seen their already limited sources of finances further squeezed.

This is choking off the emergence of new major players, and has further cemented the grip of a handful of multinational traders on the region's commodity trade.

Ultimately the health of the wider global economy hangs over Africa's trade sector, with the threat of faltering commodity demand & the ongoing Eurozone crisis darkening the outlook]

The global turnover of commodity trade finance is around US\$1.5tr a year

Although Africa is only a small slice of this, the continent still requires tens of billions of dollars to finance its trade

In the past the vast majority of this finance was provided by European banks, which themselves sourced the dollars – which are used for over 80% of trade transactions – from international capital markets

But with the Eurozone crisis forcing these banks into leverage induced retrenchment, the picture is changing radically

World trade finance volumes have fallen in 2012

Trade volumes have also fallen

Trade finance volumes, first 9 months 2012

Type of trade finance	Volume (US\$ billion)	% change year-on-year
ECA financing	78.4	78%
ECA guarantees	40.6	-13%
Short-term	29.0	-23%
Syndicated	8.7	-83%
Pre-export loans	5.2	-71%
Total	123.9	-15%

- Global trade finance volumes fell by 15% yoy in Q1-3 2012, to US\$123.9bn
- Syndicated loans, pre-export loans & short-term facilities have all collapsed
- This reflects retrenchment of many commercial banks & higher cost of dollars
- Growth in ECA financing has been the exception
- World trade volumes fell by 8.4% yoy in Q2 12, and continue to fall

Source: Dealogic.

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The most immediate impact has been a slump in global trade finance volumes

According to Dealogic, global trade finance volumes fell 15% yoy in the first nine months of 2012

Total volumes, including ECA financing, structured commodity finance, supply chain finance, short-term facilities and syndicated loans, reached their lowest level since 2010 at US\$123.9bn, down from the US\$134.8bn in the same period last year.

Syndicated trade finance loan volumes fell by a whopping 83% in the same period, to US\$8.7bn, pre-export loans by 71%, to US\$5.2bn, and short-term facilities, including letters of credit, guarantees and documentary credit, by 23% to US\$29bn.

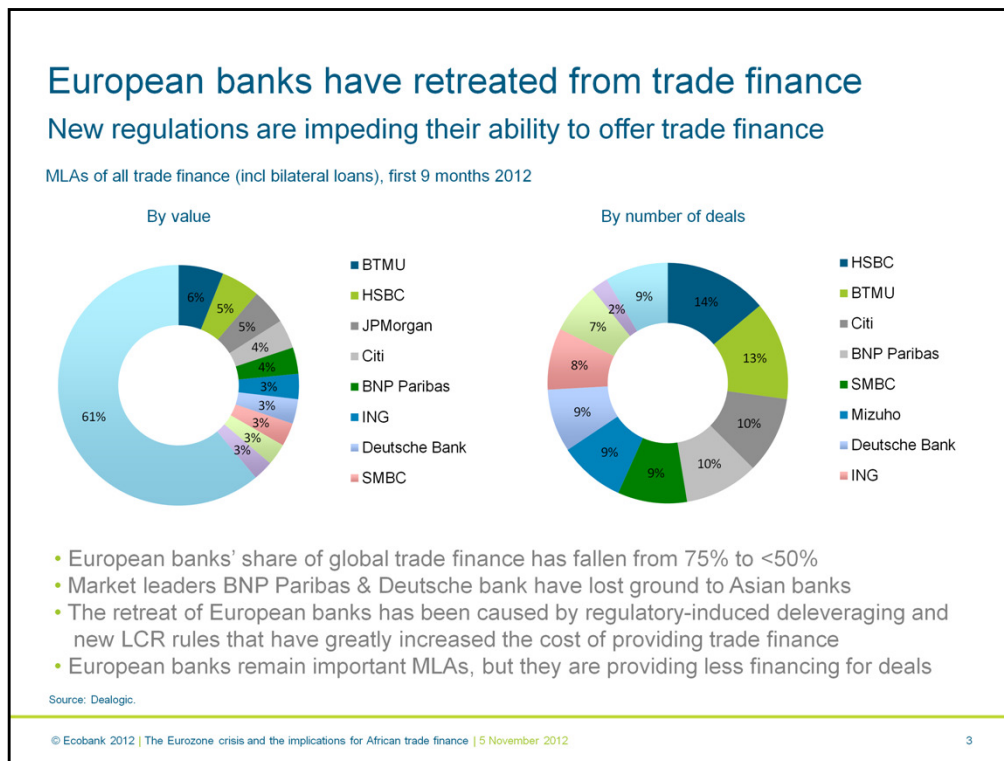
The one exception has been Export Credit Agency (ECA) financing, which surged by 78%, and which I will come onto shortly

The fall in trade finance is in part a consequence of lower trade volumes

According to the World Bank, after rebounding strongly in Q1 12 world trade volumes fell by 8.5% yoy in Q2 12, and contracted month on month by 4% in July and 5% in August

This downward trend is choking off demand for trade finance

Another factor is the higher cost of raising dollars on the international capital markets



But by far the most significant factor has been the ongoing retrenchment of European banks which has exacerbated an already difficult situation

The total volume of trade finance handled by European banks has fallen from around 75% in the early 2000s to less than 50% now, and it is likely to fall further

This has been reflected in the figures for banks acting as Main Lead Arrangers

According to data from Dealogic, looking at all trade finance (including bilateral loans) during the first 9 months of 2012, European banks have dramatically lost ground to Asian & American competitors

BNP Paribas – which in its heighday handled as much as 40% of global trade finance flows, is in fifth position with 4%, while Deutsche Bank is down in 6th with 3%

BTMU from Japan and HSBC – both with major Asian operations – have surged to top spot, while American banks JPMorgan and Citi are within the top four

The main reason for the European banks' retreat from trade finance has been regulatory induced deleveraging

Under new Basel III rules – and a host of new domestic banking regulations

– European banks have been forced to reduce the size of their balance sheet and reduce risk, forcing them to cut or reduce trade finance credit lines to their clients

Moreover, new rules on Liquidity Coverage Ratio (LCR) are making it increasingly difficult, if not impossible, to offer trade finance. Under Basel III banks need high quality assets to cover stressed outflows for over 30 days. Trade finance will be heavily penalised, with 100% considered under the LCR. This has led to 75-100 bps increase in cost, and for many banks that are starved of capital it is just not viable to allocate capital to trade finance

Hence many European banks have cut unused trade finance lines to their smaller clients, focusing their efforts on their major clients

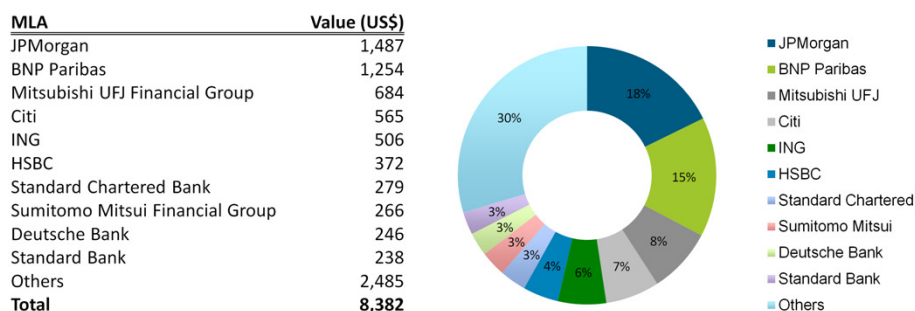
As a result, there has been an increased focus big ticket deals (Cocobod, Sonangol) and major customers, leaving the SMEs out in the cold

Their constrained capital is reflected in the fact that BNP Paribas and Deutsche Bank remain important MLAs, but given their small share of the total value of loans this indicates that they are contributing less than capital than in the past

But they are holding their ground in Africa

Long-standing trade ties remain strong

MLAs of Middle East & Africa ECA financing, first 9 months 2012



- A total of US\$8.4bn of financing was arranged for Middle East & Africa in Q1-3 2012
- European banks have retained their market share, but the number of deals is smaller
- American & Asian banks have increased market share, thanks to their access to dollars

Source: Dealogic.

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In Africa, however, European banks appear to be holding their ground

According to Dealogic, a total of US\$8.3bn of ECA financing was arranged for the Middle East and Africa in the first nine months of 2012

This is the only data available that actually covers Africa

Given Africa's heavy dependence on commodity exports, the majority of trade finance takes the form of short-term finance backed by commodities, whether agricultural (cocoa, coffee, tea, cotton, sugar, grains & palm oil) or mineral (metals and their ores). In West Africa around 80% of trade is financed with 90-180 day facilities.

Looking at the data, what is clear is that BNP Paribas continues to play a very significant role, as do ING (who owns?), Stan Chart and Deutsche

This reflects European banks' longstanding ties with Africa, which go far beyond the purely commercial, as well as the fact that banks like BNP have continued to arrange big ticket deals and thus keep a grip on their market share

But the American and Asian banks have clearly gained market share on them, above reflecting their relative ease in raising dollars for finance

Both American and Asian banks have been awash with liquidity over the past year, in sharp contrast to the Europeans who have struggled to persuade clients to take euros for trade finance transactions, although they have not always been ready to lend because of the negative global outlook

ECAs & regional banks have taken up some slack

But they are unable to fill such a large vacuum

Recent trade finance initiatives in Africa

Organisation	Total finance (US\$ million)	Objective
AfDB	1,000	Long-term finance to support intra-African trade Export credits for machinery, vehicles, commodities & aircraft
US Ex-Im	1,500	
AfDB, Citi & IFC	175	Revolving facility for short-term export & import trades Financing for critical commodities (ie food) and improved warehousing facilities
GTFP (IFC)	5,000	

- ECAs have increased financing by 78% in Q1-3 12 to US\$78.4bn
- US Ex-Im, China Exim, Sinosure, CDB & AfDB have increased provision of trade finance
- Japanese, Asian & Australian banks have also taken up some of the slack
- Regional banks (e.g. Ecobank) & Arab banks are increasing their market share
- But even together they are too few to fill the vacuum left by the sudden retreat of European banks, and trade finance shortages persist

Source: Ecobank.

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Export Credit Agencies (ECAs) have stepped into the void, increasing the provision of trade finance by 78% in first nine months of 2012, to US\$78.4bn

This is a huge increase on just US\$35bn for whole of 2007/08, and US\$28.5bn in first six months of 2011

ECA finance has primarily been used for transport infrastructure projects

The advantage of these structures is that they shift credit risk away from the asset sector and transaction to the ECA itself, and they have fixed interest rates rather than the more standard floating rate associated with ECA loans.

But there are now a host of programme aimed specifically at commodities, and in particular food

A key programme has been the AfDB's trade finance programme, which has been several years in the making

It is due to launch in early 2013 and will initially provide US\$1bn in long-term finance to support intra-African trade; it is hoped this will be expanded over the coming years

US Ex-Im has stepped involvement recently, providing US\$1.5bn of US

export credit to region in Q1-3 12, more than whole of 2011

Has also agreed US\$2bn of financing for US-made technology for clean energy in South Africa, and US\$1.5bn financing for Nigeria's power sector to boost output tenfold

Recent agreement between AfDB, Citi & IFC will provide US\$175m 3-year revolving credit facility for short term trades for exporters & importers

Short-term revolving nature of financing should total impact of US\$700m in trade finance

But perhaps most significant is the IFC's Global Trade Finance Program (GTFP), currently worth US\$3bn but which is due to be increased to US\$5bn

The programme is focused on financing 'critical commodities', which means food security above all, and improving warehousing

Japanese, Asian & Australian banks have also taken up some of the slack

Regional banks (e.g. Ecobank) & Arab banks are increasing their market share

In the case of Ecobank this has particularly been for smaller clients who have been unable to secure financing from the big banks

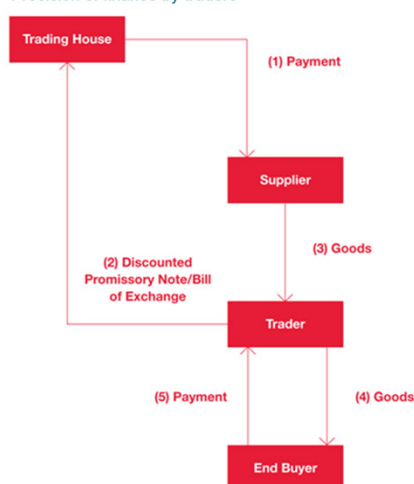
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Trade financiers are adapting their models

Trade houses are increasingly self-financing

- Bank-provided debt facilities are becoming less available, prompting interest in other models:
- **Pre-payment**
Buyer makes prepayment for part or all of cost of goods which trader passes on to producer;
- **Ownership structures**
Forfeiting & repo
- **Trade houses providing trade finance**
They buy goods from supplier and make profit from discounted bill of exchange
- **Supply chain finance**
This has grown from close to zero in 2011 to US\$4.3bn in Q1-3 12

Provision of finance by traders



Source: HFW, *Commodities Bulletin*, October 2012.

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The trade finance market has responded in a number of ways to this situation, adapting pre-existing models to get around current restraints

With bank provided debt facilities no longer available, alternative structures are taking their place

They include pre-payment arrangements, ownership structures, such as Forfeiting and Repo, and trade houses financing their own suppliers

As the next speaker will be discussing the structuring of trade finance deals, I won't go into much detail

The pre-payment model involves the buyer prepaying for part or all of the goods, with the payment passed by the trader to the producer. Various security arrangements ensure that the trader does hand the funds onto the supplier, and security over goods in transit can be included

Forfeiting and repo involve traders selling goods to financial institutions and then buying them back at a premium at a later date, before selling to the final offtaker

This model can be attractive to banks as it offers them some security over the goods, but it has its complications

But perhaps the most interesting development is trade houses providing trade financing themselves for their suppliers and taking increased risk participation in trade finance deals

Just recently Ecobank has been involved with a deal in Chad for which Vitol has put up US\$300m of its own capital; 3 years ago this would never happened

The structure is depicted here on the right

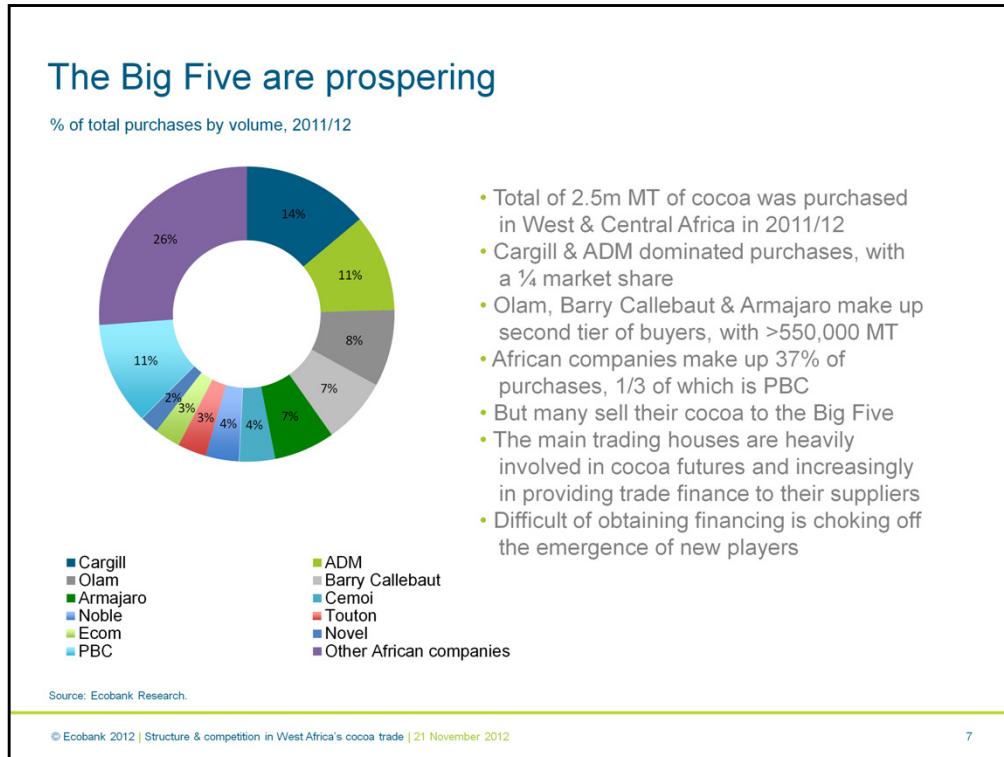
The trade house pays the supplier for the goods and then takes delivery of them, selling them on to the end buyer

The trade house makes a profit by receiving a promissory note, or discounted bill of exchange, of greater value than what they paid to the supplier

To protect the trade house it takes security over the goods in transit and is named on the insurance as the loss payee.

But traders financing their own deals and other traders is actually nothing new

Prior to the Russian crisis in 1998 this was the predominant way that trade houses financed their trade, but following the crisis they were forced to look for alternative sources of finance and started their complex relationship with commercial banks



Looking at Africa as a whole, it is clear that the Big Five trading houses dominate. Out of total sales of 2.5m MT of cocoa in CDI, Ghana, Cameroon & Nigeria last season, one quarter was purchased by Cargill & ADM.

Last season Cargill purchased 344,000 MT, and ADM 264,000 MT, mostly from CDI. The next rung comprises Olam, Barry Callebaut and Armajaro, with over 1/2m MT between them.

The exact rankings can change from year to year, but top five unchanged since last season.

Other major players are Cemai & Touton from France, Novel & Ecom from Switzerland, and Noble from Hong Kong.

African companies make up 37% of purchases.

But number skewed as 1/3 of that amount is made up by PBC, and many of them end up selling their cocoa to the Top Five.

But of course this is only one part of the picture – official cocoa purchases.

All the major trading houses also trade cocoa futures, and these have an enormous impact on the physical market.

Moreover, with the retreat of European banks from the trade finance space the trade

houses are increasingly taking up the slack themselves, providing financing for their suppliers through various models, such as prepayment structures and discounted bills of exchange

This has further cemented their dominance, and has raised the bar for securing finance ever higher

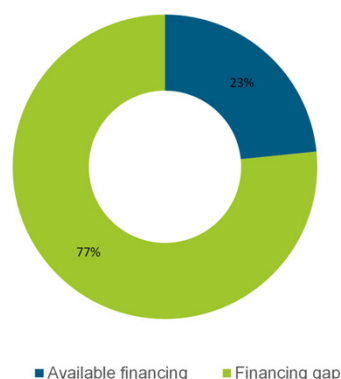
This is choking off the emergence of new players who could challenge their market power

SMEs are losing out

New entrants are starved of trade finance

- SMEs make up 90% of businesses in SSA and most are *de facto* in the informal sector
- 80% already have bank accounts, but lending to them is limited by their lack of credit history
- The IFC estimates total SME lending in SSA at US\$25bn-30bn, leaving a gap of US\$80bn-100bn
- The major losers are the 'Missing Middle', SMEs that fall between micro-SMEs and large SMEs
- Banks' focus on their main clients is starving SMEs of finance and choking off the emergence of new players to challenge the market leaders
- Banks could address this issue by having a portfolio of SME loans to spread the risk

SME financing requirement in SSA, 2012



Source: IFC.

The big losers in this process are the SMEs, a sector which has traditionally struggled to raise finance but which is seeing the bar raised even higher

With European banks and new entrants from Asia focusing their efforts and capital on their largest clients – the major trade houses and multinationals – SMEs have been left in the cold

For them the availability of trade finance is constrained and, when available, costly.

The result has been to choke off the emergence of a new group of major players in the commodity trade, impeding the ability of small enterprises to grow into medium-sized players and gain the necessary scale to start competing with the long-established players.

This is a worrying trend going forward, as majors become ever larger – take the Glenstrata merger as an example – and the bar gets ever higher for new entrants

There is a real danger that they could develop oligopolistic behaviour, and arguably we have already seen signs of this

There are many challenges to overcome

- **KYC / AML**
Increasingly onerous requirements prevent large banks from considering deals worth less than US\$10m-20m. Lack of KYC standards between regulators further increases risk. KYC repository ('Cloud KYC') could be solution, but regulators are skeptical and in no mood to compromise.
- **Basel II & III**
Banks have tried and failed to get trade finance excluded from Basel III. Key issue is LCR which will greatly increase costs and put some deals (e.g. oil tankers) out of reach of all but the largest players.
- **Lack of capital**
European lenders likely to continue deleveraging for some time. With 80%+ of world trade transacted in dollars, Euros are not popular. RMB trade finance could plug some of the gap, but it's early days.
- **Loss of expertise**
With leading trade financiers leaving the sector, new solutions will be harder to find. Regional banks will not be able to replace cross-regional capacity & expertise of commercial banks.

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But there are other challenges to overcome

And I'd like to finish by quickly looking at the most serious ones

For all banks a growing constraint is the cost of compliance, particularly with new regulations relating to Know Your Client (KYC) and Anti-Money Laundering (AML) legislation, typified by new laws such as the UK Corruption Act and provisions resulting from the Dodd-Frank Act.

Banks are now required to carry out detailed and separate DD checks for each individual transaction, often when they have no physical presence on the ground in Africa.

This has greatly increased the costs, time and risks of structuring trade finance deals in Africa, with the result that major international banks will not consider deals worth less than US\$10m-20m.

Even trade finance programmes backed by the IFC, which has a AAA rating, have struggled to raise capital from banks who fear the unknown costs of KYC.

This has effectively denied financing to hundreds of small operators – from cotton farmers in Burkina Faso to cashew processors in Mozambique – even when the commodities they produce have been commanding record prices

on international markets.

Even the large trade houses could find themselves under strict capital requirements as European legislators aim to reduce risk in commodities trading

Africa is also nervously weighing up the impact on the availability of trade finance of existing Basel II regulations – most of which have not been implemented by the region's financial regulators – as well as those proposed in the current Basel III package.

Banks have long argued that trade finance should never have been included under Basel, given its short-term, self-liquidating and unleveraged nature and the extraordinarily low levels of trade finance default.

But regulators have stuck to their guns and the impact of bringing trade finance back onto banks' balance sheets has been to change the leverage and risk ratio calculations.

Higher capital requirements will inevitably limit banks' ability to issue LCs and reduce the availability of trade finance in the region

Moreover, with oil prices pushing ever higher than US\$100/barrel it could prove impossible for all but the largest traders to actually finance a tanker of oil

Ultimately Africa's access to trade finance is determined by the availability of liquidity internationally, rather than local factors, and the lack of capital suffered by many banks will continue to restrain the sector

European lenders likely to continue deleveraging for some time

With 80%+ of world trade transacted in dollars, Euros are not popular

RMB trade finance could plug some of the gap, but it's early days

And finally there is the loss of expertise – with leading trade financiers leaving the sector, and young blood shunning trade finance – always the unsexiest part of finance – for more lucrative sectors, new solution will be harder to find

As commercial banks step back, regional banks will not be able to replace their cross-regional capacity & expertise

Thank you

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