



# The ITFA Muse

Tuesday, 23 February 2016

## CHAIRMAN'S MESSAGE - Sean Edwards, ITFA Chairman / Head of Legal at SMBC

With the first month of 2016 already behind us, it is with great pleasure that I am writing this second newsletter of the year, as I am sure that the upcoming months will not only bring with it challenges but will also provide us with a number of opportunities. And what a start to the year we've had so far!

If we thought that the worst of the market correction and volatility in emerging markets and commodities in the latter trading sessions of 2015 was over, we were mistaken. Markets woke up to a crude awakening in the first six weeks of 2016. From weakness in the Chinese economy to lower commodity prices and global economic data persistently disappointing to the downside, markets witnessed a marked increase in risk aversion as the capital flight to safety caused a widespread correction in equity and corporate bond markets.

Markets were offered some respite following market-friendly statements from the European Central Bank, US Federal Reserve and Bank of Japan towards the end of January, only to resume their downward trajectory shortly thereafter.

The market for short-term trade receivables has, nevertheless, remained fairly resilient. And for good reason. These receivables are low-risk, as the recently published ICC Trade Register has shown, SME-friendly and compatible with many sanctions regimes. It is possibly for these reasons that we are seeing much new or renewed interest in forfaiting from Russia and Africa.

Turning to this issue of the ITFA Newsletter, Edward George - Head of Group Research at Ecobank, takes us through the challenges the African continent is facing with a wide trade finance gap, and what needs to be addressed to narrow it down significantly.

May I take the opportunity to remind you all that, as promised, the ITFA Events Calendar for 2016 has now be launched and can be viewed on our ITFA website. We encourage our members to access this page on a regular basis, in order to be informed of all upcoming ITFA events. Watch [this space](#) for more.

We look forward to hearing from you with any feedback you may want to share with us by sending an email to myself, any of the Board Members or to our general email, [info@itfa.org](mailto:info@itfa.org).

Best wishes,  
Sean Edwards

Posted by [Alexia Vella](#) at 12:25 No comments:

Recommend this on Google

Labels: [FEB 2016](#)

Monday, 15 February 2016

## AFRICA'S TRADE FINANCE GAP - WHY IS IT SO LARGE, AND WHAT CAN BE DONE TO CLOSE IT?

The Newsletter of the International  
Trade & Forfaiting Association



February 2016



### Contact us

For information about [ITFA](#) please visit [www.itfa.org](http://www.itfa.org) or send an email to [info@itfa.org](mailto:info@itfa.org) [www.itfa.org](http://www.itfa.org)



### Issue Contents

- ▼ 2016 (10)
  - ▼ February (5)
    - CHAIRMAN'S MESSAGE - Sean Edwards, ITFA Chairman /...
    - AFRICA'S TRADE FINANCE GAP - WHY IS IT SO LARGE, A...
    - ITFA AND GTR RENEW PARTNERSHIP AGREEMENT FOR 2016
    - NEW ITFA MEMBERS
    - UPCOMING EVENTS - SAVE THE DATE
  - January (5)
- 2015 (59)
- 2014 (23)

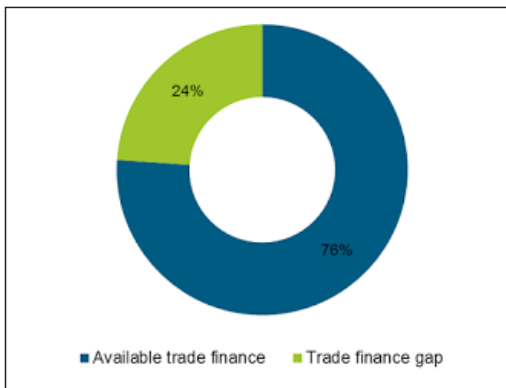


## - Edward George, Head of Group Research, Ecobank



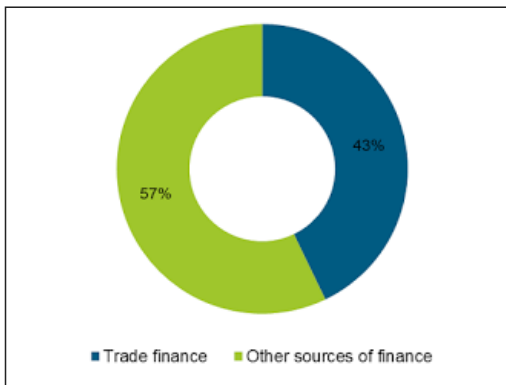
Africa's economic development has long been dependent on commodity trade flows. The continent sits on a large share of the world's hydrocarbon and mineral reserves, and shipped an estimated US\$500 billion worth of commodities to global markets in 2014, via well established trade corridors. Africa also has a vibrant intra-regional trade, controlled by a network of informal traders who shift huge unrecorded volumes of food and consumer goods to African markets. Despite the size and diversity of Africa's commodity flows, African trade is operating at a fraction of its potential, owing to the poor availability of trade finance.

So just how bad is the trade finance gap? According to a study by the African Development Bank (AfDB), Africa's trade finance volumes totalled US\$350bn in 2014, leaving a gap of US\$110bn.



This means that around one quarter of all trade deals are unable to secure financing, severely constraining Africa's ability to grow (**Chart 1**).

**Chart 1 - Africa's trade finance gap, 2014**



The situation is even worse for intra-regional trade, which received just US\$60bn of finance in 2014, forcing African traders to seek alternative sources of finance for an estimated 57% of trade deals (**Chart 2**).

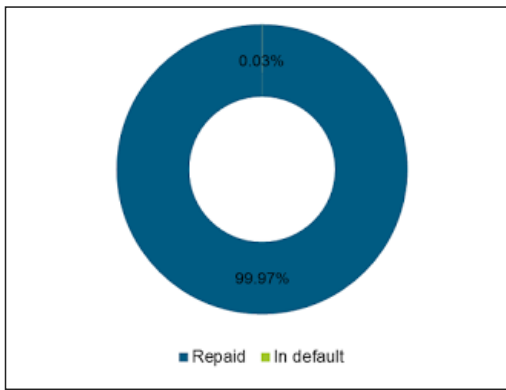
**Chart 2 - Funding for Africa's intra-regional trade, 2014**

Given that the estimate of official intra-regional flows, at around 15% of total volumes, hugely underestimates the true size of flows (because it does not capture informal trade), it is likely that trade finance is available for less than a quarter of all intra-regional flows.

### **Chart 3 - World trade finance default rate (ICC)**

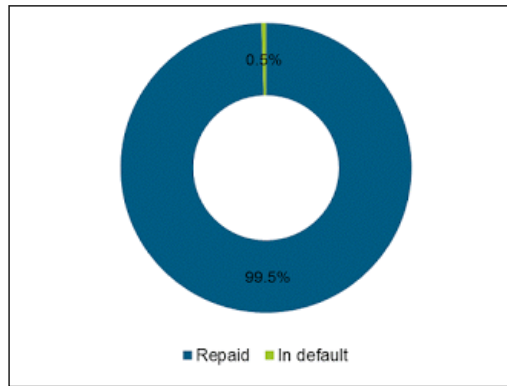
The size of the trade finance gap is puzzling as trade finance is remarkably low risk. According to research by the ICC, out of 2.4mn transactions worth US\$2.4 trillion in 2014, short-term trade finance customer default rates ranged from a low of 0.033% to a high of 0.241% (**Chart 3**).

This compares with a 1.38% default rate reported by Moody's for all corporate products. Some experts have questioned this estimate, arguing that it includes only LCs, and not corporate defaults, and that it does not factor in the refinancing of many failed trade deals (often by using overdrafts).



Nonetheless, an estimate by Afreximbank puts the level of African trade finance defaults at between 0.4% and 0.5% (**Chart 4**). Clearly trade gets paid, as the saying goes.

So why is Africa's trade finance gap so huge? In reality, the shortage of trade finance reflects a mixture of factors stemming from the perception that African markets are high risk. Many providers of trade finance – most notably Asian and Middle Eastern banks – have long sought to increase their exposure to African trade flows. But their lack of knowledge of local markets and their concerns over political instability have prevented deals from getting past the credit committee.

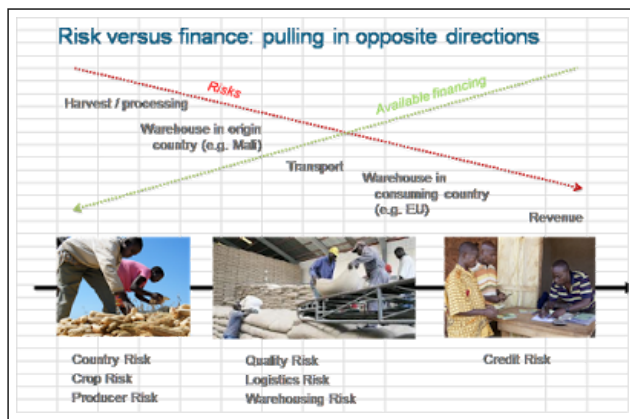


**Chart 4 - Africa's trade finance default rate (Afreximbank)**

African markets are risky, it's true. But the perception of that risk is skewed. There are at least a dozen African markets with a better track record on governance, macroeconomic stability and trade openness than any of the BRICS, or even Southern Europe.

The asset creditworthiness of borrowers is another constraint. Without a track record, collateral or transparent financials, many traders cannot be financed by banks, as the performance and credit risks are too high. And for those traders that do secure finance, the SOL and balance sheet limitations of confirming banks restrict the volumes available, preventing traders from scaling up their operations. Liquidity constraints also scupper many deals, as the most reliable deals (such as Cocobod and Sonangol) suck up available financing and crowd out new entrants. A final factor to consider is the wave of de-risking that is occurring in African markets. Multinationals are exiting relationships with correspondent banks out of fear of sanction under Draconian AML and KYC regulation, or simply because the cost carrying out DD is too high. This could kill off correspondent banking in Africa, removing another source of finance for local traders.

The end result of these factors is that the bulk of trade finance is available at the end of the value chain, close to the final market. This financing often takes the form of multi-billion dollar PFXs and RCFs for multinational trading houses and offtakers, which feed the financing down the chain to the processors and local traders. The concentration of financing at the end of the chain reflects the declining level of risk as commodities pass through it. Let's take a typical African value chain, producing maize flour for export to the sub-region (**Chart 5**). Dozens of risks impact the flow of the commodity through the chain, from the risk the crop won't be produced (country, crop & producer risk), the risk that it will be lost or damaged as it moves down the chain (quality, logistics & warehousing risk), to the risk that the bank will not be repaid (credit risk).



**Chart 5 - Risk versus finance: pulling in opposite directions**

The level of risk determines the level of financing. If an African trader has a shipload of bagged & graded rice en route to its final destination, a bank might finance up to 100% of its value, secure in the knowledge that the trader can make the margin he needs for a profit. But the proportion of financing tapers as we move up the chain, so that as the level of risk increases, conversely the availability of financing decreases. As a result, there is more financing available for commodities stored in a bonded warehouse at an international port, than for a warehouse up-country. In a bonded warehouse, the bank can re-export the goods if there is a default; in an up-country warehouse, the bank must factor in transport, quality & country risk. When pre-financing the crop itself, banks typically finance just 25% of the total value of the crop. And some banks refuse to pre-finance at all, only joining the value chain once the commodity has been produced.


As a result, the big international banks tend to be involved at the far end of the value chain, while local banks, such as Ecobank, tend to finance the middle of the chain – the local buyers and processors. But this financing is not strictly speaking trade finance. Rather, it is working capital or overdrafts, secured against the balance sheet. Under this model, the bank extends a facility at the start of the season to a producer or processor, who uses the funds to purchase inputs, pay for transport and buy feedstock, and repays the bank once the goods have been sold. But the level of financing available is limited by the bank's SOL and the client's balance sheet, as most small-scale traders have no real assets. This prevents small traders from scaling up their operations, which is essential if they want to compete with the established players. Instead, they are forced to focus on niche commodities, or to become an extension of the trading houses' own value chains.

The solution to breaking this log-jam is well known – indeed, there is nothing new in the world of trade finance. Structured lending, using a collateral controller to ensure the security and quality of the commodities, can enable traders to scale up the volume of goods to many times the value of their balance sheet, while giving banks the comfort that, in the event of a default, they have security over the goods and can liquidate the position. However, these structures are expensive and time-consuming to construct, and require reliable partners to ensure the quality and free movement of goods through the chain to their final destination. For most banks it can prove too complicated to put together financing for small producers near the start of the value chain. Indeed, many will not consider deals worth less than US\$10m. This is because, for small ticket deals, banks cannot justify the time and expense to comply with KYC and AML regulation, especially in unfamiliar markets.

Trading houses have stepped into the breach, filling the financing gap with a variety of models. The most popular at the moment is pre-payment and invoice discounting, although trading houses can offer direct financing for their most reliable suppliers. They are even developing financial services of their own, becoming more like trade finance banks; for example, Cargill offers its clients a package of futures & options, price risk management and input finance. This has cemented the trading houses' grip on the sector, and is choking off the emergence of new players. By recycling the money given to them by banks, and using it to finance their suppliers, trading houses have been called 'shadow banks'. But this is not entirely accurate: trading houses do not operate under the same regulations or scrutiny as banks. Perhaps a better description would be 'shadow financiers', providing the liquidity to ensure the flow of commodities through the chain. The key losers in this process are those at the start of the chain – the farmers and local producers – who are starved of the finance they need to invest in inputs and machinery. Government subsidy schemes and micro-finance have provided some assistance, but the financing gap remains vast.

The solution to this problem is to finance the entire chain as one vertically integrated and harmonious flow of commodities, money & services. This chain runs from the farmers at the start, through the traders and processors in the middle, to the offtakers and consumers at the end. Value chain financing is not a replacement for conventional finance. But it is ideal for linking together commodity flows that are financed separately, in this way reducing the concentration of risk at any one point in the chain. When all of these flows operate as one chain, it is easier to mitigate the risks. And if you know all the players, you can be flexible with repayments (many traders slip a few days over their 90-day financing limit).

But the task of knitting together the value chain is formidable, especially in Africa where economic activity is fragmented and most agricultural production is by smallholders. The multinational trading houses and offtakers have had some success in creating value chains in Africa, producing minerals from 'pit to port', and food and cash crops from 'farm to fork', or 'seed to shelf' (to use Olam's phrase). The integrity of these value chains makes them attractive for finance, and syndications for the largest traders continue to be oversubscribed by banks. But in Africa these value chains are the exception, rather than the rule, and Africa will only be able to break the trade finance log-jam when such value chains become commonplace. This will require regulatory support from governments, as well as cooperation between local and international banks, the former leveraging on its local knowledge and relationships with key stakeholders, the latter on its structuring expertise and large balance sheets. Ultimately, this process will be driven by the next generation of African champions, who will aim to emulate the success of former African start-ups such as Dangote, Olam and ETG.

Posted by [Alexia Vella](#) at 05:18 [No comments:](#) 

 Recommend this on Google

Labels: [FEB 2016](#)

## ITFA AND GTR RENEW PARTNERSHIP AGREEMENT FOR 2016

The ITFA Board is pleased to announce that ITFA and GTR (Global Trade Review) have renewed their partnership agreement for the second year running. As in the past, 2016 will see the two institutions working together for the mutual benefit of the trade finance and forfaiting community.

Signed last month, the formal agreement will ensure that ITFA and GTR will join forces to provide their uttermost to the industry. By combining their strengths and areas of expertise, they are sure to influence the trade finance market in a positive manner.

Shannon Manders, GTR editor, commented on the agreement:


"As part of this ongoing agreement, we will seek to collaborate as institutional partners at one another's events and co-operate on industry-related survey generation and interpretation. GTR's news stories will also continue to be accessible via the ITFA website.

The renewal of the agreement is certainly an indication of the growing need for independent news and market analysis amongst ITFA members and the wider trade finance industry. In turn, it will enable GTR to broaden its global reach through ITFA's respected network of professionals."

Lorna Pillow, ITFA's head of communication and membership, comments by adding:

"ITFA prides itself in being the voice of the secondary market for trade finance, whilst also focusing on matters that are relevant to the whole trade finance spectrum. As far as ITFA is concerned, we always strive to achieve the best position for all members of our rapidly growing Association. By partnering with GTR again this year, we are continuously demonstrating and reminding our members of our constant commitment to provide them with

more information and value, which is one of ITFA's fundamental goals."

Posted by [Alexia Vella](#) at 05:16 No comments: 

 Recommend this on Google

Labels: [FEB 2016](#)

---

## NEW ITFA MEMBERS

The ITFA Board is pleased to announce the following two new members.

**Banco Bradesco S.A.** (the Bank), incorporated in 1943, is a private commercial bank that operates in Retail Banking, Investment Banking, Corporate Banking, Asset Management and Insurance among other Financial Services. The Bank offers a range of banking and financial products and services in Brazil and abroad to individuals, companies and local and international corporations and institutions.

The Bank operates in two segments: banking and insurance. The banking segment includes a range of banking activities, serving individual and corporate customers in the investment banking, national and international banking operations, and asset management and consortium administration operations. The insurance segment covers auto, health, life, accident and property insurance and pension plans as well as capitalization bonds.

In Europe the Bank operates through its subsidiary Banco Bradesco Europa in Luxembourg, and its branch in London. Bradesco is the 2nd largest private bank in Brazil. It has grown mainly through acquisitions such as: Banco do Estado do Maranhão, Banco Mercantil de São Paulo, Banco Ibi S.A., and the Brazilian operations of Banco Bilbao Vizcaya Argentaria (BBVA), J.P. Morgan Fleming Asset Management, American Express. Bradesco is constantly expanding and has recently acquired the Brazilian operations of HSBC.

Andre de Oliveira Miles will be the main delegate for all ITFA related matters.

Founded in 2007, **Scipion Capital** is one of the world's leading investment managers specialising in Commodity Trade Finance across Africa.

Headquartered in key trading centers, London and Geneva, with strategic on-the-ground operations across Africa, Scipion Capital seeks long-term capital appreciation by investing in opportunities across the African continent. It is one of only a handful of Africa-focused managers operating in the multi-billion dollar commodity trade finance industry. Moreover, the UK entity is regulated by the Financial Conduct Authority, AIFMD, and is regulated as an exempt advisor under the SEC.

Scipion Capital was established in anticipation of the effect Basel II regulations would have on Banks' capital adequacy requirements. It foresaw the implications it would have for banks withdrawing from the multi-billion dollar commodity trade finance market and the need for alternative sources of funding. Scipion Capital provides short-term self-liquidating asset-backed loans and is a crucial and unique link to global commodity trade - providing additional lines of credit to commodity producers, processors and traders.

Nicolas Clavel will be the main delegate for all ITFA related matters.

Posted by [Alexia Vella](#) at 05:14 No comments: 

 Recommend this on Google

Labels: [FEB 2016](#)


---

## UPCOMING EVENTS - SAVE THE DATE

May we take the opportunity to remind our readers of the **GTR Africa Trade Finance Week 2016** which is taking place on March 2-4 in Cape Town. This event is being held at The Westin Cape Town. Please contact [Elisabeth Spry](#) for more details or visit the GTR website.

Another well awaited GTR event taking place between 22-23 March is the [GTR Turkey Trade and Export Finance Conference 2016](#). Returning to Istanbul for its 10th year and with over 400 delegates expected in attendance, this two day event is now the largest annual gathering for Turkey's corporate, financial and state sectors to meet and discuss the latest trade, export and financing opportunities in the country.

We also wish to remind our readers about the [32nd BACEE Regional Banking Conference](#). This event is being held in Budapest between the 11-12 April 2016. To view the conference programme please [click here](#) or visit the website for other conference details.

Posted by [Alexia Vella](#) at 05:11 [No comments:](#) 

 Recommend this on Google

Labels: [FEB 2016](#)

---

[Newer Posts](#)

[Home](#)

[Older Posts](#)

Subscribe to: [Posts \(Atom\)](#)

