WAREHOUSE RECEIPT FINANCING
A BANKING PERSPECTIVE

FINAL REPORT

June, 2006

This publication was produced for review by the United States Agency for International Development. It was prepared by J. D Longwell of PRIME International, subcontractor for Chemonics International Inc.

Rural SPEED

Rural Savings Promotion & Enhancement of Enterprise Development

WAREHOUSE RECEIPT FINANCING - A BANKING PERSPECTIVE

FINAL REPORT

The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

Rural SPEED
A USAID funded project
Contract No. PCE-I-00-99-00003-00, TO 826

This report submitted by Chemonics International Inc. / June, 2006

Table of Contents

EXECUTIVE SUMMARY

Warehouse receipt financing is not entirely new in Uganda. Several commercial banks have provided financing to producers and traders against stored inventory evidenced by warehouse receipts. This financing has been geared primarily to high-valued products, such as coffee and cotton, destined for the export market. Such financing has been limited with respect to maize and other staple crops for domestic consumption.

What was lacking, until very recently, was a formal set of rules and regulations governing the issuance and negotiation of warehouses receipts, and the duties and responsibilities of the parties to a warehouse receipt financing transaction. Early in 2006, a warehouse receipt bill was approved by the Ugandan Parliament. Several amendments to the law were later proposed and approved by Parliament, and it is my understanding that the law has been finalized and enacted. The existence of a law that defines the parameters of warehouse receipt financing gives banks more latitude in adopting the appropriate policies and procedures for the development of lending and collateral-management strategies, as well as appeasing the banks' legal experts who have been reluctant to endorse this type of financing without a formal set of rules and regulations in place.

Although the legal framework sets the stage for a broader use of warehouse receipt financing in Uganda, there is still much work to be done by the banks - as well as all the parties in the warehouse-receipt chain – in thoroughly appreciating the benefits and risks of this enhanced form of inventory financing, and developing the methodologies for adopting it as a new product line. Credit approval and monitoring systems must be modified and deepened to evaluate both the direct borrower risk, as well as the several counter-party risks inherent in this type of financing. "Back office" systems and controls also need to be in place to prevent errors and assure that the banks' responsibilities to their borrowers, the warehouse operator and the end buyers are met in a timely and efficient manner.

The benefits, however, achieved through improved inventory control, higher quality and grading standards, the likelihood of better selling prices for borrowers, and the protection and control afforded by the collateral management company, should offset the additional costs associated with warehousing receipt financing in general. Whether that benefit will translate into increased lending, at reasonable terms, to maize producers in Uganda will be a function of the cost-benefit analysis undertaken by each bank. In this regard, the perceived credit risk of the borrowers, coupled with potential small depositors, could translate to higher servicing and administrative costs that might make lending to these producers or their trading company partners unattractive to banks.

1.0 BANKING ISSUES RELATED TO WAREHOUSE RECEIPT FINANCING IN UGANDA

a. Background and Methodology

During a seven-day period in June 2006, the consultant visited four commercial banks in Kampala that have either participated in warehouse receipt financing for maize or have shown an interest in such financing. Those banks were: Allied Bank International Ltd., Barclays Bank of Uganda Ltd., Stanbic Bank and Standard Chartered Bank. In each case, I met initially with a senior executive of the bank who then introduced me to the appropriate relationship manager or someone from the commercial banking area. There was other bank staff in these meetings who work in a supporting role for either the commercial banking area or the credit department. In at least two meetings, there were representatives from the operations group where the control and monitoring of warehouse receipt lending is administered.

Reports on the individual meetings, along with observations and recommendations, are attached to this report as Appendix II. These reports are intended to be informational documents for Rural SPEED personnel as well as an input document for the banks. For purposes of confidentiality, individual reports will be distributed only to the respective banks and to Rural SPEED personnel.

b. Loan Evaluation and Approval Considerations

All four banks appear to have credit policies and procedures that are generally in conformity with international standards. This is particularly true for the three international banks (Barclays, Stanbic and Standard Chartered Bank) which ultimately report to Johannesburg or London. All of the banks are in the process of considering or have developed credit procedures for warehouse receipt financing.

In at least two cases, the banks must consider internal requirements that govern the booking of assets backed by inventory. It is often argued that lending against commodity inventories constitutes taking a trading position in the goods. If that is the case, banks can generally get around this issue by booking the corresponding loan asset offshore.

A critical issue for borrowers is the bank's ability to evaluate and approve credit facilities in a timely manner and to assure efficient disbursement of funds. The nature of maize production and marketing in Uganda is such that funds are required at a specific time during the crop cycle and, if the bank cannot meet this schedule, then it will fail to meet the borrower's needs. It appears banks have been insensitive to these financing requirements and have often taken their time to process loan applications. This issue is, in part, a reflection of Ugandan creditor rights laws and regulations, and the business climate in general.

The most critical factor affecting a Ugandan bank's credit decision - and one with significant implications for the borrower - relates to the banks security position on the stored collateral. It is explicitly stated in the Collateral Management Agreements reviewed by the consultant that it is the collateral manager and not the bank that has the first security interest in the stored commodities[1]. For a lender that is specifically approving its credit on the value and control of the collateral, this arrangement is clearly unacceptable.[2] Further complicating this issue is the unreliable performance of the Registrar of Companies in properly managing the liens filed by banks and other creditors. These records are frequently lost or misfiled, making it very difficult for a creditor to determine his security in an asset and his position vis-à-vis other creditors or lien holders.

[1] These agreements were provided by one of the two principal collateral management companies involved in warehoused inventory control in Uganda. I did not have the opportunity to review documentation from the second company and, therefore, cannot comment on the issue of inventory security interests in that agreement.

[2] The clause regarding the collateral security issue can be used as leverage by the commodity management companies to win concessions from the bank. For instance, some of the banks noted that they have been able to negotiate a first position on the collateral in exchange for guarantying the monthly storage fees (generally around US$ 2,000 per month flat). Each bank must, therefore, determine if this trade off is acceptable.

To compensate for the collateral security dilemma, banks generally ask the borrower to post additional assets. For the borrowers with the where with all, this often takes the form of a debenture. However, this requirement is clearly to the disadvantage of the borrower, since the debenture requirement is usually in excess of 100 percent of the total value of the stored collateral (not just the financed portion). This is an untenable situation for the borrower and it is difficult for this consultant to understand why a borrower would be willing to accept such a condition (e.g., if he can posted additional collateral in excess of the loan amount, then why seek bank financing in the first place?).

The solution to this problem is for the banks and the collateral managers to negotiate an acceptable comprise that would give the bank first lien on the commodities and free up the borrower from having to post additional collateral.

c. Operational Considerations

In addition to proper credit policies, each bank must assure that the appropriate systems and controls are in place to manage all aspects of a warehouse receipt financing program. The last thing needed after a credit is approved is for the bank to become “its own biggest credit risk” because of back room errors.[3]

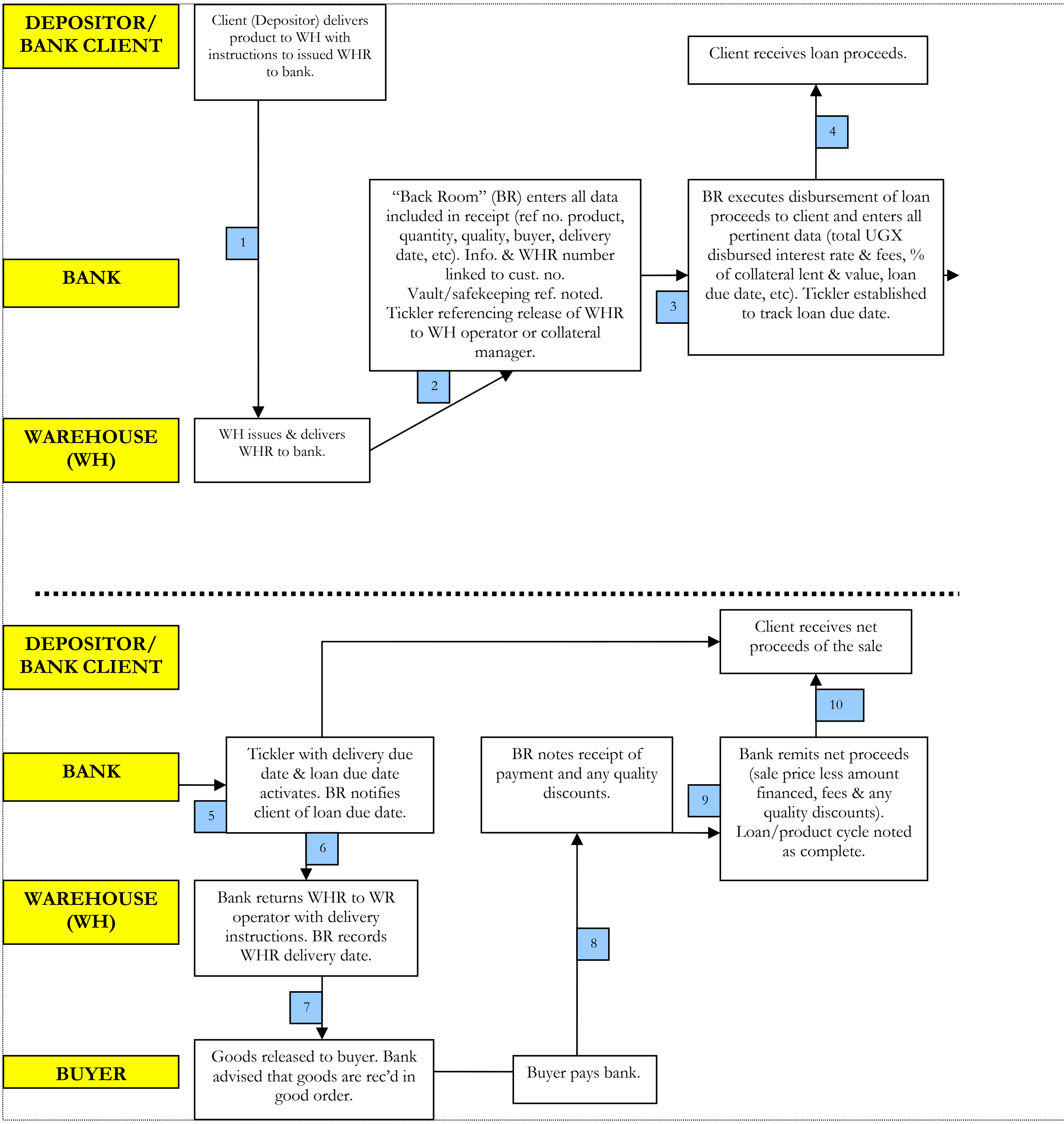
Three banks noted that they do not currently have the appropriate policies and procedures, systems and trained personal to manage an expanded warehouse receipt program. Only one bank has software specifically geared toward warehouse receipt financing. This software was introduced by the bank’s South Africa office that also provides on-going training on the software system.

For banks at the pilot stage of warehouse receipt financing, it may be possible to manage and control the collateral program with existing software, such as an Excel spreadsheet. Even in these cases, a back room person or persons experienced in programming and customizing such a system must be fully engaged from the outset. Only when they understand the flow of the transaction, and all points of risk along the chain, can the back room personnel begin to design effective systems and controls.

The issue then becomes one of training and building the necessary depth and knowledge within the back room. A bank might have someone who is technologically-oriented who can develop an effective warehouse receipt monitoring and control system. That person, however, may or may not be capable of communicating the intricacies and proper use of the system to his or her colleagues. In such cases, the system developer must work hand-in-hand with an individual specialized in technology training and coaching. That individual may be already be an employee of the bank or might be an outside contractor specialized in this field. Regardless, several people should be the recipients of such training in order to assure proper coverage in case the primary person responsible of the administration of the program is out of the office or is otherwise not available to perform this function.

How should such a system be designed and what factors need to be incorporated? The bank has several operational responsibilities in a warehouse receipt financing program. A simple flow diagram shows some of the processes and procedures that banks must incorporate in their back room to control and monitor a successful warehouse receipt financing program.

[3] The banks lumped all of the operational issues involving the monitoring and control of collateral as “back room”.


DEPOSITOR/ BANK CLIENT
BANK
WAREHOUSE (WH)
Client (Depositor) delivers product to WH with instructions to issued WHR to bank.
1
WH issues & delivers WHR to bank.
2
"Back Room" (BR) enters all data included in receipt (ref no. product, quantity, quality, buyer, delivery date, etc). Info. & WHR number linked to cust. no. Vault/safekeeping ref. noted. Tickler referencing release of WHR to WH operator or collateral manager.
3
BR executes disbursement of loan proceeds to client and enters all pertinent data (total UGX disbursed interest rate & fees, % of collateral lent & value, loan due date, etc). Tickler established to track loan due date.
4
Client receives loan proceeds.
DEPOSITOR/ BANK CLIENT
BANK
WAREHOUSE (WH)
BUYER
5
Tickler with delivery due date & loan due date activates. BR notifies client of loan due date.
6
Bank returns WHR to WR operator with delivery instructions. BR records WHR delivery date.
7
Goods released to buyer. Bank advised that goods are rec'd in good order.
Buyer pays bank.
8
BR notes receipt of payment and any quality discounts.
9
Bank remits net proceeds (sale price less amount financed, fees & any quality discounts). Loan/product cycle noted as complete.
10
Client receives net proceeds of the sale

2.0 RECOMMENDATIONS

Most of the recommendations regarding a warehouse receipt financing program in Uganda are contained in the body of this report. The most important considerations, however, are summarized below:

- Using the recently-enacted Warehouse Receipts System Bill to establish the overall credit and administrative framework for financing against warehouse receipts. The bill has many standard provisions that provide the fundamentals for a workable commercial public warehouse system in Uganda. It could (and should) be improved to more clearly define collateral security issues and be made complementary to other Ugandan statues governing financing and the security interests of creditors. In this regard, it might be worthwhile for Rural SPEED to contract with a bank credit expert to help analyze and refine the banks' policies and incorporate specific procedures to evaluate loans based on warehouse receipts.

- Continue to develop and refine credit policies and procedures. These should address not only the direct risk of the borrower, but also the secondary-risks of counter parties, including the buyer(s), warehouse operators, the collateral manager, the insurance companies and even the government entity responsible for filing and maintaining security liens[4]. Again, a bank credit expert as noted above might warrant consideration.

- Incorporating the risk of price changes. Producers, traders and bankers all need maize pricing parameters in order to make appropriate credit decisions. Except at harvest when there is a strong cash market, price discovery in Uganda is difficult and unrefined. To meet the needs of the various interested parties, the best alternative is to develop a simulation of reference prices based on historical pricing information, the closest regional trading markets offering prices for comparable maize qualities and quantities, and recent trends and demands from traders and buyers. Sensitivity analysis can then be applied to this information to determine how much of a "shock" borrowers and their lenders can absorb before adversely effecting the credit.

- Negotiate more favorable terms with collateral management companies. As discussed above, the bank generally has a secondary security issue to the collateral manager. By its very nature, warehouse receipt financing relies first and foremost, on the value and control of the underlying collateral. Without the control afforded by a strong security position, banks will be unmotivated to pursue this business, especially for lower-valued commodities like maize.

- Require less stringent secondary collateral from borrowers. This is closely related to the point above. If the banks can negotiate a first-lien position in the Collateral Management Agreement, then the need for secondary security from the borrower is lessened. As it stands now, the secondary collateral requirements are prohibitive for most, if not all, maize farmers and will result in marginal usage of a warehouse receipt financing program by these producers.

- Incorporate reliable and consistent "back office" procedures for managing warehouse receipts and corresponding loan assets. This is both a systems and a training issue. All banks should strive towards incorporating software geared towards collateral lending - in particular, warehouse receipt financing. This can perhaps best be accomplished through the support of parent banks that have already developed warehouse receipt financing programs. Where such support is not available, the bank will need to look at contracted experts, either locally or outside of Uganda.

[4] This function is housed with the Registrar of Companies. All of the banks I met with noted that this entity does a poor job of record keeping and is subject to corruption.

3.0 CONCLUSIONS

Warehouse receipt financing is a specialized type of banking that requires expertise in a number of areas to be successful for banks, their borrowers and other parties in the supply chain. Particularly challenging to Ugandan bankers are the issues of managing a warehouse receipt financing program in a difficult market where government and corporate ethics are sometimes questionable, markets are thin, pricing is erratic, and perfecting security positions in collateral is difficult.

The success of a warehouse receipt financing program for basic staples like maize can pose unique challenges to lenders due to limited financial information on borrowers, small transaction size, collateral security issues, less-than-perfect price discovery mechanisms and simply the costs of administrating such a program versus the perceived benefits. For the near term, ongoing support and guidance from Rural SPEED and similar organizations will be required to motivate lenders to participate in such a program.

APPENDIX 1 ROUND TABLE PRESENTATION.

**WAREHOUSE RECEIPT FINANCING:
A BANKING PERSPECTIVE**

USAID | UGANDA FROM THE AMERICAN PEOPLE

Rural SPEED Rural Savings Promotion & Enhancement of Enterprise Development

- *Rural SPEED* = Rural Savings Promotion & Enhancement of Enterprise Development
- *Rural SPEED's* goal is to deepen & strengthen access to financial services in Uganda's rural communities
- To achieve that goal, one the primary focuses of *Rural SPEED* is to develop and help implement an initiative to expand agriculture financing by Ugandan banks through the use of warehouse receipts

USAID | UGANDA FROM THE AMERICAN PEOPLE

Rural SPEED Rural Savings Promotion & Enhancement of Enterprise Development

WAREHOUSE RECEIPTS - DEFINED

Documents issued by warehouse operators as evidence that specified commodities of stated quantity and quality have been deposited at particular locations by named depositors.

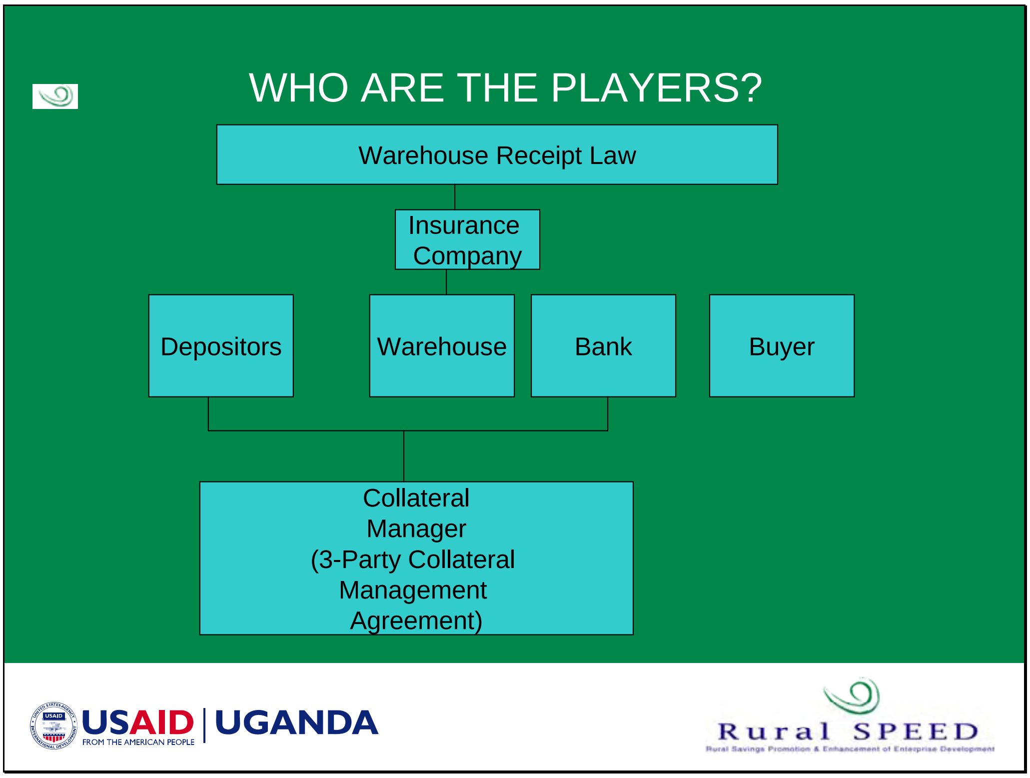
USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

- Warehouse Receipt financing is well developed in the U.S., Canada and other Western countries
- There is an established set of regulations and procedures governing Warehouse Receipt financing
- Since Warehouse Receipts are negotiable in these countries with many large transactions (which are often bundled), there is a fairly “deep” secondary market for these instruments
- On the African continent, Warehouse Receipt programs are used in South Africa, Zimbabwe and Zambia. The Zambia model may be the most comparable to Uganda since it is new (2001) and still evolving

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development



<Collateral Management Company> *<Warehouse Receipt N°>*

ISSUED TO: *<Uganda Commercial Bank>*	**COLLATERAL MANAGEMENT COMPANY** **Ref: 123-ADCD4/56**
This is to certify that the undersigned has received the following Goods for storage in apparent good order and condition (except as noted) subject to the Collateral Management Agreement between *<Collateral Management Company>*, *<Farmer Association or Trading Company>* and *<Uganda Commercial Bank>* dated 30-June 2006	
DESCRIPTION OF GOODS	**REMARKS/NOTES**
Maize Grains	
GROSS WEIGHT: 15.20 MT	**QUANTITY:** 15.2 Metric Tons
NB OF PACKAGES: 304 BAGS	**DATE RECEIVED:** 1 July 2006
LOCATION OF STORAGE: **Uganda, Kampala**	

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

INSURANCE: All risks covered by *<Collateral Management Company>* through *<Causality Insurance Company>*

Delivery or partial delivery or the goods will only be made upon written instructions for *<Uganda Commercial Bank>* in accordance with the Collateral Management Agreement above-stated.

THIS RECEIPT IS NOT A DOCUMENT OF TITLE AND CANNOT BE NEGOTIATED OR TRANSFERRED OR USED AS COLLATERAL SECURITY IN ANY MANNER.

<COLLATERAL MANAGEMENT COMPANY>

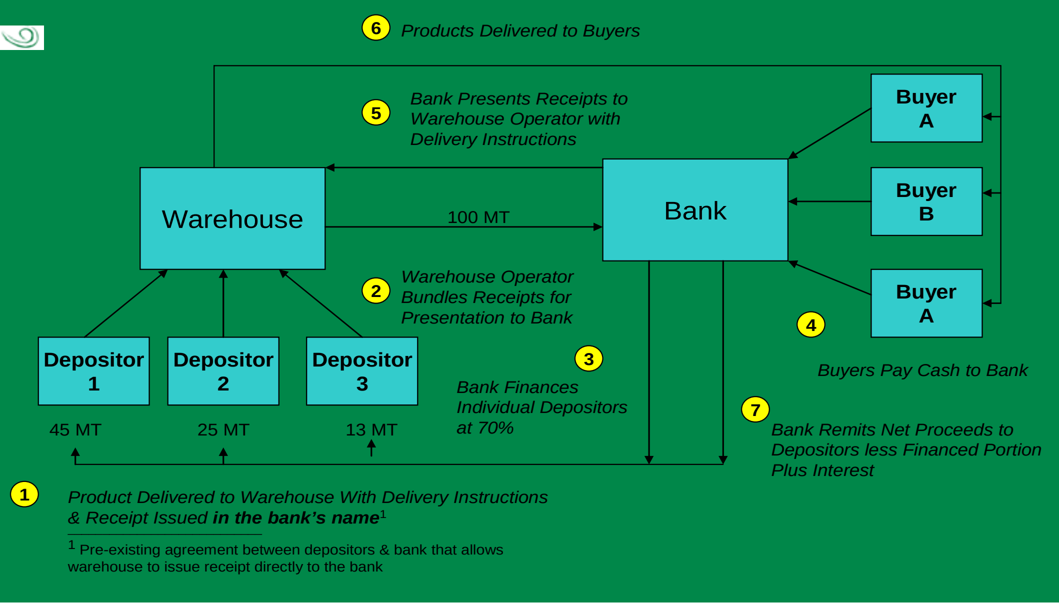
____

Authorized Signature

2 July 2006

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development



USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

Warehouse Tracking Sheet - Maize

Buyer	Receipt No.	Tons	Date Received at Warehouse	Quality	Buyer	Scheduled Delivery Date	Financed	Bank	Receipt Issued to Bank
Buyer #1	003-D-201	45	20-Jul-2006		WFP	23-Sep-2006	Yes	Allied	Yes
Buyer #2	023-F-663	25	6-Aug-2006		WFP	31-Oct-2006	Yes	Barclays	Yes
Buyer #3	211-R-046	30	18-Aug-2006		WFP	2-Nov-2006	Yes	Stanbic	Yes
Buyer #4	066-A-001	20	18-Aug-2006		WFP	15-Nov-2006	Yes	StanChart	Yes
Buyer #5	071-Q-436	55	18-Aug-2006		Kenya Mills	26-Nov-2006	No	N/A	No
▪									
▪									

USAID | UGANDA FROM THE AMERICAN PEOPLE

Rural SPEED Rural Savings Promotion & Enhancement of Enterprise Development

Bank Tracking Sheet – Maize (Simplified)

Client	Customer No.	Receipt No.	Tons	Price/Ton (UGS)	Value (UGS)	% Financed	Amount Financed (UGS)	Date Loan Funds Disbursed	Loan Due Date	Buyer	Receipt Released to Warehouse
Buyer #1	783657-653	003-D-20	45	425,500.00	19,147,500	70	13,403,250	25-Jul-2006	27-Sep-2006	WFP	26-Sep-2006
Buyer #2	089321-005	023-F-663	25	420,875.00	10,521,875	60	6,313,125	10-Aug-2006	10-Oct-2006	WFP	10-Oct-2006
Buyer #3	400749-344	211-R-046	30	411,162.50	12,334,875	70	8,634,413	25-Aug-2006	24-Oct-2006	WFP	25-Oct-2006

USAID | UGANDA FROM THE AMERICAN PEOPLE

Rural SPEED Rural Savings Promotion & Enhancement of Enterprise Development

OTHER TRACKING AND MONITORING ISSUES FOR BANKS

- Confirm Delivery
- Extra Collateral
- Price Movements Over Life of Loan

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

CONCLUSIONS

- Finalization of Warehouse Receipt Law (Everybody Knows the Rules of the Game)
- Borrowers with Sufficient Volumes and Financial Strength (Associations and Larger Traders)
- Reliable Warehouse Investors and Operators (Financial Incentives)
- Strong and Consistent Buyers (WFP, Kenyan Importers, etc.)
- Collateral Management Agreement Acceptable to All Parties
- Adequate and Verifiable Security (Free and Clear Title to Goods)
- Good Market Information (Prices)
- Internal Policies and Controls at All Levels (Credit, Administration, Monitoring, etc.)

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

RECOMMENDATIONS

- Proper procedures & controls (make sure you are not your own biggest risk!)
  - Credit
  - Operations
- Tracking systems
  - Software
  - Training
- Collateral control and management
- Due diligence on collateral manager
- Negotiate CMA to *your* advantage
- Reasonable security from Borrowers
  - 120% debentures, etc. won't cut it (if he has the where with all to post that kind of secondary security, then why does he need a bank??)
  - Eventually many of these producers (especially those who export) will start getting credit from buyers

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

There is No Magic Formula

Everybody Must Make Their Own Decision

Timeliness is Important

It's Time to *SPEED* Towards a Successful Warehouse Receipt Program

Thank You!

USAID | UGANDA
FROM THE AMERICAN PEOPLE

Rural SPEED
Rural Savings Promotion & Enhancement of Enterprise Development

APPENDIX II -- MEETINGS WITH BANKS

Over a seven-day period, from 20-June and 28-June, four banks were visited. The four banks were: Allied Bank International Ltd., Barclays Bank, Standard Chartered Bank and Stanbic Bank. The purpose of these visits was to i) meet the appropriate people within the banks who were involved or would likely be involved in the approval, execution, management and administration, and control and monitoring of a warehouse receipt program, ii) assess the level of involvement and commitment by the banks to a warehouse receipt financing program, iii) assess their current level of knowledge and expertise in warehouse receipt financing, iv) to understand any constraints the banks might have on lending against warehouse receipts, and v) to evaluate training needs and other follow up issues with the banks.

A summary of the meetings with each bank is attached. The summaries are written in such a manner that they can be shared with the banks.

ALLIED BANK INTERNATIONAL LTD.
45 Jinja Road, Kampala

Date of Meeting:
21 June, 2006

Personnel in Attendance:

Christopher Kigenyi – Executive Director
Lameck Otim – Manager Corporate & Institutional Banking
Richard Oola – Credit Administrator
Alex Kiwanuka – Corporate Relationship Officer

Discussion:

1. Allied Bank is currently going through an ownership change from the Fortis Group to The Bank of Africa. This ownership is not expected to materially affect the banks operations and is not seen as a constraint to proceeding with a warehouse receipt financing program.

2. Allied was previously structured along functional lines, with various departments acting independently. This year, the bank has implemented a new structure whereby duplication has been eliminated by centralizing shared services and support, including credit. Product groups include corporate banking, consumer bank and small and medium-sized business lending.

3. Allied has engaged in warehouse receipt financing programs in the recent past, specifically for coffee producers in eastern Uganda. Last year, a pilot program was aimed at consignments of UGX10 million (approximately US$6,000) with the goal of meeting client's needs through appropriate credit structures. The parameters of the program were as follows:

   - Loans for up to 50% of stored product
   - A 30-day turnaround of inventory
   - Price protection (if prices were to decline by 20%, Allied would exercise its right to sell the product)
   - Fees of 2%, collected after sale of the product rather than up front
   - A 5MT minimum deposit in the warehouse

Due to a poor coffee crop last year, the producers were unable to deposit the 5MT minimum so the program was not used. Allied is committed to offering the program again on the upcoming harvest and is also willing to structure a similar program for maize.

Observations and Follow Up:

Allied Bank is a prime candidate for participation in Rural SPEED's warehouse receipt financing program. Its smaller size (vis-à-vis the larger international banks) and flat management/approval structure is seen as an advantage to implementing an efficient warehouse receipt financing program in a timely manner. Furthermore, the bank's executive director – Mr. Christopher Kigenyi – has experience in warehouse receipt financing with other Ugandan banks as well as with one of the collateral management companies (ACE).

The challenge for Allied bank will be to develop policies and procedures that are appropriate to the maize industry in Uganda. The fact that the bank has already developed a strategy of warehouse receipt financing to the coffee sector is an advantage since that procedure can be modified to meet the characteristics and unique risks of the maize sector.

Recommendations:

1. Training of key personnel, mainly in the areas of credit and administration and management of warehouse receipts, will be important to the success of their program. It is recommended that a consultant with the appropriate background in these areas spend additional time with Allied in order to assist with the development and implementation of a successful warehouse receipt program.

2. As Allied increases its lending under warehouse receipts, it is likely that their back-office operations will need to be enhanced. Based on its current activity level, Allied may be able to management the program through a simple Excel spread sheet program. I believe, however, that bank will quickly outgrow this approach and, in anticipation of that, I suggest that Allied begin to explore collateral management software.

BARCLAYS BANK OF UGANDA LTD.
Barclays House
Plot 4, Hannington Road, Kampala

Date of Meeting:
22 & 23 June, 2006

Personnel in Attendance:

James Agin – Corporate Director
Ronald Buya Were – Corporate Manager
Samuel Edem-Maitum – Corporate Manager's Assistant
Lillian Nagenda Baingana – Credit
Stephen S. Segujja – Head of Transactional Sales, Corporate Division

Discussion:

1. An approved legal structure is seen as the major constraint to developing a warehouse receipt "program"; however, the bank can likely proceed if they view this type of financing as an enhanced form of collateral lending, which they already do.

2. Another issue faced by Barclays relates to how collateralized loans are classified. There are different views within the bank's management as to whether inventory financing should simply be viewed as collateral lending or whether it constitutes the bank taking a trading position in the collateral – something that is not permitted under Barclays charter. It was acknowledged, however, that this hurdle could be dealt with by booking the loan asset offshore. This is apparently the approach taken by other Barclays offices in the region.

3. Price risk is not viewed as a major constraint to warehouse receipt financing. Management generally considers price discovery in the Ugandan market to be sufficient to cover this risk. The bank is also protected by its requirement that additionally collateral be posted should price movements be deemed detrimental to Barclays position with the client.

4. Barclays takes comfort in the fact that the principal buyer of maize in the Uganda market is the World Food Program (WFP). Barclays was pleased to learn that WFP is in the process of requiring that maize suppliers supply a portion of their product from a stock position.

Observations:

As an international bank with an extensive presence in the region, Barclays likely has sufficient policies and controls in place to manage a warehouse receipt financing program. However, it would be useful for the bank to receive additional coaching on the unique characteristics of the Rural SPEED warehouse receipt financing program for maize, especially in regards to how warehouse receipts might be "bundled" in order to meet minimum transaction size requirements.

Follow up:

Barclays Bank personnel had some specific questions on the proposed warehouse financing program which were relayed to them by email. Those questions with responses are outlined below:

a. *How long can quality standards be maintain in the warehouse (in cases where deliveries were delayed or renegotiated)?* No longer than the next crop cycle. Six months maximum.
b. *How much product can WFP absorb? What if there is an excessively large harvest?* WFP currently purchases about 80% of the national crop. The 20% excess goes either to local millers for public-sector consumption (schools, prisons, etc.) and/or to the export market, mainly

Kenya. Because the warehouse receipt program is expected to improve quality and standards, there is strong potential for the export market to grow – likely at premium prices compared to the local market.

c. *Is WFP from time-to-time forced to accept lower prices from traders?* No. Prices are specified in the contact and are non-negotiable. If anything, it is the suppliers who face the prospect of low price from WFP given its dominant position in the market. It is true, however, that the WFP must sometimes accept lower quality maize because that is all traders may have available.

d. *Has Barclays been active under similar programs in other African countries.* Yes, I was able to confirm that Barclays has participated in a similar program in Zambia. You might want to contact your colleagues there for specifics.

e. *Is WFP buying forward, thus locking in prices?* Although it's still a limited practice, WFP is beginning to work under forward contracts to a maximum tenor of 90 days.

f. *Does WFP require stock purchases?* Yes. Recently WFP specified that a certain percentage of maize under their contracts (30 40% - but I'm not completely sure of that) come from stock purchases. This is a built-in incentive for traders to have at least some portion of their grain in warehouses.

g. *U.S. and Zambian warehouse receipt laws.* As we discussed, I don't know how pertinent the U.S. law is to the current situation in Uganda. The U.S. warehouse law has been in place since 1916, is very lengthy and includes a number of amendments that have occurred over the years. Furthermore, since the Ugandan law is largely drafted (there are several modifications under consideration, however), I'm not sure it would be of much help at this point.

The one important provision that the proposed Ugandan law is lacking -- and which is well incorporated into the U.S. law -- is that it lacks the provisions of Article 7 of the Uniform Commercial Code (UCC) that allows creditors to secure their advances against warehouse receipts free and clear, and gives warehouse receipt holders a position ahead of general creditors. This is, obviously, a major concern to banks and points out the importance of commercial banks' involvement in any modifications that are being proposed to the new law. I understand that one bank in Kampala, at the request of MTTI, has designated a representative to liaison with the government and other involved parties with respect to the warehouse receipt law. I believe it is important for other banks, either individually or collectively – perhaps through the Uganda Bankers Association -- to have input into the warehouse receipt law, specifically in regards to the issue noted above.

I have attached a draft of the Zambian warehouse receipt act which is still pending Gov't of Zambia final approval. As far as I can tell (and I have only had the chance to briefly look at the document) it also lacks clarity regarding security interest of creditors (although this is at least partially addressed in a paper addressing proposed modifications to the law). *

* Specifically, Section 3.3(e) of the document entitled "Overview of the Case for Legislative Framework in Support of a Warehouse Receipt System" recommends that:

Recognition of warehouse receipts in relation to commodities deposited with a participating warehouse as a superior document of title conferring superior rights over and above all other interests in the underlying commodities if at the time of the deposit
there are no pre-existing agricultural charges

After our meeting, I discussed with Richard Pelrine, Rural financial Advisor with *Rural SPEED,* the timing of the warehouse receipt program and how soon we are likely to see some activity. Based on that conversation, it sounds like things are moving along quicker than was indicated in our meeting and there are warehouse operators that may be up and running in time for the upcoming maize harvest (July-August). Given the importance of some the potential investors in these warehouse – at least one which was discussed in our meeting and who is a current customer of Barclays - there should be bankable transactions coming up shortly. Therefore, the timeliness of our meeting appears to be fortuitous.

STANBIC BANK
17 Hannington Road
Crested Towers Bldg.
10^{th} Fl., Short Towers
Kampala

<u>Date of Meeting:</u>
27 June, 2006

<u>Personnel in Attendance:</u>

Anne Aliker – Executive Director, Corporate & Investment Banking
Kagaba Muhumuza – Relationship Manger, Structured Commodity Trade Finance
Boaz Buhamizo – Head of Credit Support
Erina Namayania – Credit Evaluation Manager, Retail & Personal Banking

<u>Discussion:</u>

1. Stanbic is farther along than any other bank in Uganda with regards to financing against warehouse receipts and in developing the proper systems, controls and monitoring systems for the success of such lending. Anne noted that most of Stanbic's efforts to date have been in origination and relationship management (front office) and it is the back office functions – the systems and monitoring – that require additional focus. She noted that Stanbic has done several deals under warehouse receipt structures and that the results have been mixed. From a credit perspective, she made note that the bank's decisions are based on the interplay of balance sheet financing and collateral-based financing and that both are fluid throughout the loan cycle, requiring on going evaluation based on current and ever changing information.

2. Kagaba led the rest of the morning meeting. As the relationship manager for structured finance at Stanbic, he has had the most contact and experience with the various parties to warehouse receipt financing programs. His background as an attorney and former position with ACE (one of the three principal collateral management companies in Uganda) is a plus with respect to his current position.

3. Regarding the status of the warehouse receipt law, Kagaba believes that Parliament has passed the law, but that amendments which were proposed and approved have not yet been included in the final draft. It is likely that the pending issues regarding the finalization and implementation of the law will not occur until after the upcoming general elections (*I later learned that the amended law has, in fact, been implemented and is currently in effect)*. The next issue will be for the law to be tested in court and Kagaba believes that could occur fairly soon after the law is implemented.

4. To date, Stanbic's warehouse receipt financing was been geared towards export crops, mainly coffee and, to a lesser degree, cotton. He used the example of one client in the coffee business where warehouse receipt financing has been successful based on the high cash flow of the borrower and a debenture in which Stanbic has the primary security position (a legal lien could not be perfected on the warehouse receipts, so the collateral is considered secondary to the debenture[5]). The structure of these transactions is as follows:
    a) Stanbic enters into a three-party agreement with the coffee client and a collateral management company (in this case, ACE)
    b) The coffee is transformed at the warehouse and ACE determines the value of the product as it is processed from raw beans to a processed product of varying grades.

[5] In this case a debenture works well, but not all clients have the financial where with all to issue these kinds of instruments.

c) Stanbic bases the amount it will finance based on these grades. The advance rate is 90% with a 60-day repayment cycle.
d) The repayment flow is as follows:

Trader advises the bank of exports and asks for a release of product (client authorizes that the warehouse receipt be issued in the name of the bank)

Collateral Manager (CM) reports as the trucks leave the warehouse

Exporter sends shipping documents to Stanbic for collection

When proceeds are received from the importer, through Stanbic's correspondent bank, the loan is liquidated and the 10% not financed is remitted to the customer

5. Although the bank always prefers a first position on any collateral or guarantees, the fact is they can't always get it. In such cases, other migrating factors must be considered and weighted. With respect to the Collateral Management Agreement, this is negotiated between the three primary parties -- Depositor, CM and Bank (although the Depositor really has very little leverage). Often if the CM is willing to give the bank a first lien on the collateral, then it will require the bank to guarantee the payment of the CM's fees, which the bank generally does only if the fees are considered reasonable[6].

6. The Register of Companies is responsible for filing and keeping track of the security interests of creditors. Their performance in this role has been less than stellar and often records cannot be located.

7. In addition to borrow risk, Stanbic also performs due diligence on the CMs. There are two principal CMs in the Ugandan market. ACE has been here the longest (since about 1995) and has the most clients (over 100). They are adequately staffed and have experience in coffee, cotton and – to a lesser degree – maize. The other CM is Cotecna who has been operating in Uganda for about 2 yrs. They have fewer staff, but a bigger balance sheet. From a cost standpoint, both of these firms are about the same (USD1, 500 to 2,000 on average) and both provide weekly collateral updates[7]. Although SGS has a presence in Kampala, they are not a player in collateral management with respect to warehouse receipts. As a further control on collateral management, Stanbic will also conduct its own periodic spot checks of warehoused inventory.

8. With respect to maize, Stanbic's only activity has been under Rural SPEED's project with the Kapchorwa Commercial Farmers Association (KACOFA). With the enhancements provided by Rural SPEED and the performance of the Association, this is viewed by the bank as a successful pilot project. One of the problems that Stanbic (and, even more so, WFA) dealt with was the significant increase in the price of maize between the time the loans were disbursed and the time product was scheduled for delivery. Prices during that time increased by more than 100%. (from under US$200/MT to nearly US$400/MT). Although there was an economic advantage to KACOFA and its members as a result of this price increase, there was also a strong incentive for non-performance under the contracts with WFA. As of now, there are still deliveries pending under these contracts whose status is not clear.

9 KACOFA is seen as an evolving organization with a favorable outlook. The Association was formed only last year and, since then, has implemented an acceptable management and

[6] This is impractical in the case of coffee where transactions can reach into the millions of dollars and, instead of a flat fee, the CM bases the fee on the value of the inventory (generally 0.75%).
[7] These reports are limited to product intake, current stock and releases. If the CM inspects for quality, then the fees are increased accordingly and are considered to be prohibitively expensive by most market participants (ACE apparently provides some degree of quality assurance as part of its general CMA).

administration structure, hired an accountant and registered the company with the Ugandan authorities. Its members also have a reputation for producing high-quality maize.

10. Pricing is a risk that must be considered as the warehouse receipt business evolves in Uganda. Currently, the mechanisms for hedging commodity price risks are very limited (although there is a commitment to develop the Ugandan Commodity Exchange). There is generally a fair amount of current price information available, but it is not reliable throughout the loan cycle (30-60 days). Furthermore, there is no information on crop quality. Stanbic does perform some degree of sensitivity analysis on various price scenarios.

Observations:

Stanbic has clearly done its homework regarding the identification of bankable clients and they recognize the factors that must be considered in evaluating their direct and indirect risks (e.g., counter-party risk, security interest risk, price and quality risks, etc.). However, recognizing the risks and implementing the policies and procedures to address them are two different things. Although I did not review the banks' credit practices in detail, it is likely that more work needs to be done to incorporate all risk factors that are unique to the structured finance business into the credit evaluation and approval process.

Improving back office operations is, by its own admission, one of the areas where the bank must dedicate additional resources. Currently, Stanbic is tracking its warehouse receipt financing on Excel spreadsheets. Improvements such as modern software, specifically designed for inventory and collateral management, the more timely and efficient distribution of loan proceeds, tracking collateral as it moves from receipt at the warehouse through delivery to the end buyer and staff training are all imperative to a successfully warehouse receipt financing program.

Finally, the issue of improving and perfecting the bank's interest in the collateralized inventory is critical to protecting and managing their exposure to the borrower and maintaining proper control of the inventory. This will require continued negotiations, possibly at the head office level, with the collateral management companies to secure the bank's security interests.

Recommendations:

1. Identify appropriate software to monitor and control all aspects of the warehouse receipt financing program.
2. Train back office personnel in the use of new software.
3. Increase the depth of back office personnel to assure proper execution and follow up on all aspects of the warehouse receipt finance program.
4. Look for ways to use personnel in the branch offices to perform certain functions, such as a double check on inventory status, monitoring client's performance under the terms of the loan agreement and evaluation of crop conditions in their regions.
5. Draw on the expertise and experience which may already exist in other Stanbic offices in the region, mainly South Africa and Zambia.

STANDARD CHARTERED BANK
5 Speke Road, Kampala

Dates of Meetings:
23- June and 28-June, 2006

Personnel in Attendance:

David Cutting – Managing Director/Chief Executive
Humphrey Mukwereza – Executive Director
Godfrey Mundua – Agric. Portfolio Mgr., Client Relationships
Margaret Makura – Head of Transactional Banking
Padde Cornelius – Manager, Trade Services
Sylvia Jague - Relationship Mgr.
Charles Okuni – Relationship Mgr.
Brenda Namugumya – Credit Analyst

Discussion:

1. StandChart already has experience in the warehouse receipt business based on their client base in the cotton industry. In those cases, the borrower is the cotton gin who is generally paying the growers in cash, but requires additional time to process and on-sell the product. As such, StandChart usually advances 80% of the stored value. These risks are acceptable to the bank based on the existing relationship, the financial standing of the ginner and the additional collateral - generally a debenture - that the borrower is willing to post. These debentures are often around 120% of the value of the commodity in storage, so StandChart is adequately covered even though they may not have a first security position on the warehouse receipt. The bank would like to expand its warehouse receipt program to include the coffee sector and, potentially, other high-valued crops.

2. It appears that most, if not all, of the bank's three-party collateral management agreements have been entered into with ACE. I asked about language in the agreement that refers to the security interest in the collateralized inventory and, specifically, whether the agreement explicitly states that the Collateral Manager (CM) and not the bank has the first lien on the goods. Godfrey wasn't sure, but agreed to look into it and get back to me. We spent some time discussing why the CM would insist on a first lien since they have no vested interest in the goods. I agreed to look further into that issue, but we speculated that one of the reasons might be so that the CM could use that clause as a negotiating tool in order to get the bank to guarantee the commodity storage costs (on average, US$1,500 - $2,000)/month).

3. We discussed the internal controls and procedures StandChart has in place (or needs to develop) to properly manage a warehouse receipt financing program I learned about the support provided by the other StandChart offices in the region as discuss in the "Observation" section below.

4. I was less clear on the bank's credit policies and procedures for warehouse receipt financing. We discussed the pending warehouse receipt law and its importance. However, this does not appear to be a make-or-break issue. More important is the identification of all the direct and indirect risks of warehouse receipt lending, including counter party risk, price risk and buyer risk.

5. StandChart is familiar with KACOFA and had been prepared to more forward with them during the last season. However, the bank believed it was at a competitive disadvantage vis-à-vis a competitor bank that has a branch office in Kapchorwa. That bank has maintained a relationship with the association for some time.

<u>Observations:</u>

StandChart certainly appears to be committed to warehouse receipt financing. Their focus, however, has been on the higher-valued export crops such as cotton and coffee. Although not on the same priority level, maize also holds interest if the transactions are large and the borrowers are acceptable. Although StandChart noted that they would be willing to finance the upcoming maize season with an association such as KACOFA, additional enhancements from Rural SPEED or a similar organization may be required to provide the final stimulus.

The bank appears to have good back room monitoring and control systems. They have received considerable support from StandChart Johannesburg and other offices in the region. This not only includes training, but also software specifically applicable to collateral management. I came away less clear on the bank's credit approval process and the policies and procedures that might be in place to address the unique lending risks of a warehouse receipt program.

<u>Recommendations:</u>

1. StandChart has most of the elements in place to move forward on a warehouse receipt program for maize. However, I detected some reluctance to actually "pull the trigger". I would suggest frequent contact with StandChart over the coming weeks to address any remaining questions or issues they have on the program.
2. Additional information on credit policies and procedures would be helpful. Follow up with the bank's credit director or manager would be the best approach. This could either occur at the local level or through email correspondence with the consultant.
3. Can Rural SPEED provide enhancements to the banks for the upcoming maize season? If so, this needs to be relayed to StandChart and other potential bank participants in a timely fashion so they can consider this as part of their due diligence and credit evaluation process.