

SUMMARY AND TERMS OF REFERENCE

FOR

PHYSICAL TRADE & MARKET DEVELOPMENT FOR COMMODITIES IN PAKISTAN

STORAGE, COLLATERAL MANAGEMENT AND
WAREHOUSE RECEIPTS

PROJECT

28 April 2010

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1. Introduction

Pakistan's agriculture commodity sector suffers from a compound problem of a lack of both infrastructure and market structure. The resulting inefficiencies impact all market participants and keep the sector from becoming competitive. On the infrastructure side, there is a lack of warehousing and storage facilities. In the market, there is a lack of standardization, independent verification, collateral management, commodity financing, and transaction data. The result is an opaque and illiquid market where there is a lack of financing, trading opportunity and significant wastage. At the base of the value chain, farmers are most harmed by wastage, price fluctuations, and an inability to access finance.

The Government of Pakistan's (GOP) Poverty Alleviation Strategy targets a stable macroeconomic policy environment and identifies the agricultural sector as the critical element in the economy to generate growth and employment in rural areas. New policies welcome market influences to shape private and public decision-making.

Additionally food security in grains is a major priority for the GOP. The maintenance of a strategic grain reserve, particularly for wheat, is a key GOP consideration for providing a degree of price stability. One option is to integrate the strategic grain reserve with a system of public/private storage facilities with a private electronic warehouse receipt system to create an open, transparent, and efficient system for grain purchases and sales, cost-effective storage of grains, import and export of grains, and maintenance of a strategic reserve.

To address these multiple and interlinked challenges, the State Bank of Pakistan, in conjunction with the National Commodities Exchange Limited (NCEL) and Karachi Stock Exchange has **proposed to facilitate the establishment of a National Collateral Management, Bulk Handling Company and Electronic Warehouse Receipt System as a private sector initiative.**

The proposed warehouse and electronic warehouse receipt (EWR) system will facilitate in the following:

- Reduce risk in agricultural markets and improve food security.
- Increase credit access and mobilization for small farmers by creating a secure collateralization and trading platform.
- Enhance market power of subsistence and economic farm holders by providing storage facilities which enable them to choose when to sell their crops.
- Facilitate in enhancing the standardization, quality and transparency of commodities and related storage facilities.
- Reduction in post harvest / storage losses.
- Develop a commodities market which increases competition, smoothes market prices and enhances dissemination of market / price information and international trade.

In order to facilitate the establishment of commodities physical trade and market development, the stakeholders have proposed a technical assistance program to be led and managed by the

Competiveness Support Fund (CSF), in partnership with a committee which includes representatives of the stakeholders.

The program would assess best practices from other countries such as Canada, Brazil, India, South Africa and U.S.; design the market structure and operating terms; prescribe legal frameworks for transactions; prepare feasibility / business plan for the subject company and prescribe the process for identifying and securing the private sector investors. CSF may coordinate with other projects being undertaken simultaneously, which have synergies to the existing project and include International Finance Corporation (IFC) project in Punjab. However, the existing project is to remain independent from other projects, which may be integrated with the overall operational structure subsequently.

Objective of the TOR

The investment for a management company, warehouse infrastructure, and EWR systems would be done by the private sector as commercial enterprises, with or without targeted public support. Before such a market can be properly developed, technical assistance is required to provide a map and design for how such a market can most efficiently function and be implemented. As the structure will require a complex set of linkages between growers, banks, exchanges, warehouse providers, and other stakeholders, public sector support is required to carry out this scope of work with the goal of designing the framework within which the private sector can invest. The TOR is designed in two phases, of which Phase 1 will be launched immediately.

The required analyses and reports will be done in two phases.

Phase 1:

Phase 1 will draw upon existing studies and review additional best practices where necessary, to develop detailed operational structure, legal & regulatory framework, warehouse receipt system and financial feasibility.

Phase 2:

Phase 2 will provide facilitation project implementation and accordingly investor identification.

The following TOR for the technical assistance outlines the work that CSF will manage and have experts and consultants carry out to achieve this objective.

About State Bank of Pakistan

The State Bank of Pakistan (SBP) is the central bank of Pakistan. It performs both traditional and developmental functions to achieve macroeconomic goals. The traditional functions include the primary functions of issuing notes, regulation of the financial system, serving as the bankers' bank and lender of last resort, banker to Government, and conduct of monetary policy. Secondary functions include agency functions like management of public debt, management of foreign exchange, and advising government on policy matters. The non-traditional or promotional functions include development of the financial framework, institutionalization of

savings and investment, provision of training facilities to bankers, and provision of credit to priority sectors.

About National Commodities Exchange Limited (NCEL)

NCEL is the first technology driven, de-mutualized, on-line commodity futures exchange in Pakistan. NCEL's shareholders are National Bank of Pakistan, Karachi Stock Exchange, Lahore Stock Exchange, Islamabad Stock Exchange, Pak Kuwait Investment Company (Pvt.) Limited and Zarai Taraqati Bank Ltd and it is regulated by Securities and Exchange Commission of Pakistan.

About Karachi Stock Exchange (KSE)

Founded in 1947, the KSE is Pakistan's largest and oldest stock exchange. As of December 2009, 654 companies were listed with a market capitalization of Rs. 2.561 trillion (US\$ 30.5 billion) having listed capital of Rs. 705.873 billion (US\$ 10.615 billion). The exchange is owned by 200 members/brokers.

About Competitiveness Support Fund (CSF)

CSF is a joint initiative of the Ministry of Finance, Government of Pakistan, and the United States Agency for International Development (USAID) established to reposition the Pakistan's Economy on a more global competitive footing. CSF is supporting Pakistan's goal of a more competitive economy by providing input into policy decisions, working to improve regulatory and administrative frameworks and enhancing public-private partnerships within the country. The CSF is also providing technical assistance and co-financing for initiatives related to entrepreneurship, business incubators and private-sector led initiatives with research institutes and universities that contribute to creating a knowledge-driven economy. CSF activities are helping all producers along the value chain that contribute to ultimate product quality. By obtaining better value and better prices for quality products, and improving cooperation throughout the Pakistani economy, the CSF is contributing to poverty alleviation by providing more income for producers and better employment prospects for employees.

2. Operating Structure

Growers of commodity crops in Pakistan often lack proper facilities to dry, clean, process and store their grain, which causes significant losses and stunts the ability to reach higher value markets. Furthermore, the inability to store their harvest causes growers to have to sell at times not of their choosing, which limits their pricing power and ability to access finance. To create depth in the market and develop a physical backbone for the trading markets, a network of warehouses need to be put in place across the country for the benefit of growers. In addition to the physical infrastructure, the warehouses must be properly managed and be able to provide reliable testing, grading, standards verification, IT support, commodity care, and logistics. An efficient EWR system needs to be developed and integrated with the physical storage. The system would then need to be integrated with existing system infrastructure (trading, inventory management and banking) where possible. Core elements of this system need to include an enabling legal and regulatory framework, regulatory and supervisory authority, licensed and supervised warehouses, and bank engagement in warehouse receipt financing. Such a system could also serve as a key mechanism in the GOP's overall food security strategy.

The proposed collateral management / bulk handling company or companies shall:

- Establish and manage warehouses throughout the country.
- Provide testing and standardization service for commodities stored at the warehouses.
- Provide designated delivery points for trades executed on NCEL.
- Manage an electronic warehouse receipts system integrated with the trading, clearing, and settlement systems of NCEL.
- Provide collateral management services for banks so that collateralized commodity financing of warehouse receipt system can be encouraged.

Warehouse Facilities

The warehouse network would have to have wide geographic penetration in order to make it easy for growers to transport their crops. It is estimated that approximately 200 warehouse facilities will be needed across the country initially, eventually rising to about 400 warehouse facilities. Preferred locations of warehouses should also be indicated, along with storage capacity.

The strategy for how the warehouses will be developed and owned needs to be assessed for their operational and financial advantages and disadvantages. Potential arrangements could include wholly-owned, leased, or franchised facilities and a mix thereof. Differences and tradeoffs might include cost structure, quality, and operating risk. A list of preferred warehouse and collateral management companies currently operating in the countries being studied and suitable model for the Pakistan market should be provided. The operation and management of a GOP strategic reserve would also be considered in the context of privately or publicly managed warehouses. The efforts of IFC to this regard may be utilized.

Warehouse Receipt Systems

The key to the success of the market structure is that the operations of warehouses must be properly managed by the right people with the right tools. All of the facilities in the network must be equipped with and linked by software systems to manage deliveries and EWRs. The efficient linkage of the software systems will allow for the stored crops to be traded or used as collateral. A list and analysis of the comparative qualities of existing EWR and collateral management systems will need to be developed.

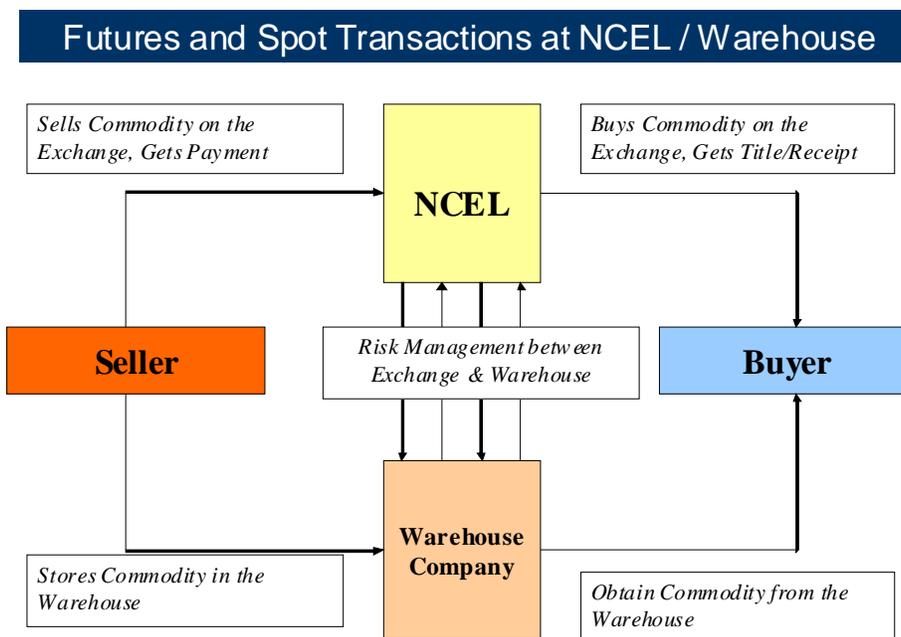
The Warehouse Company would derive revenues from fees charged to the users, including:

Receipt transaction fee – A fee would be charged based on the creation and transfer of warehouse receipts

Standards assaying and verification transaction fee – A fee would be charged based on the volumes that are assessed

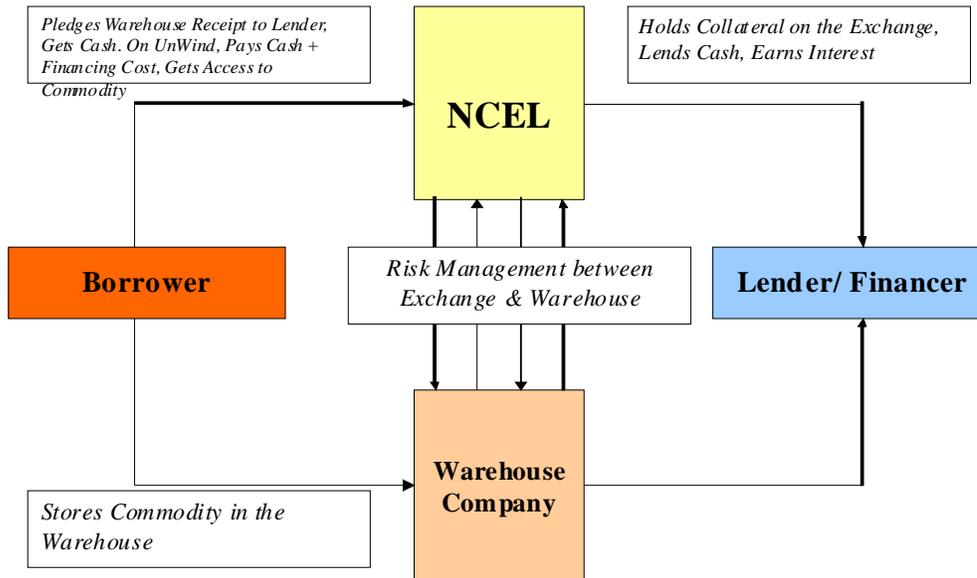
Storage fees – The crops stored will be assessed a fee based on time, quantity, and value of the commodities stored

Once the warehouses and exchange are linked up by the EWR system, then buyers and sellers are easily linked up into a functioning and transparent futures and spot market.



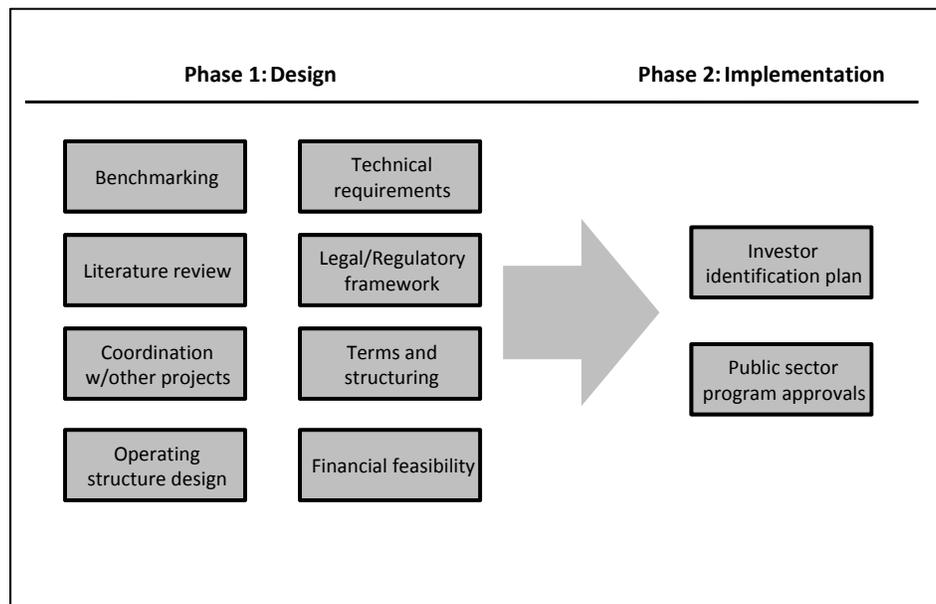
Likewise, linking to banks will facilitate the collateralization and financing for commodities.

Financing Transactions at NCEL / Warehouse



3. Project Scope

The goal of the first phase will be to have deliverables produced that can be used directly to launch the proposed operating structure. The first phase will start at a high level by analyzing examples from other countries mentioned earlier, before comparing it to the current situation in Pakistan and utilize existing studies. It will then assess the micro-level assets and constraints that the market structure will be able to utilize or have to deal with. The assessment will draw as much as possible on previously completed studies and data. Combining the macro and micro-level research design of how the operating structure would be deployed and operated; the legal & regulatory framework, supervisory framework, appropriate warehouse network; how terms with participants should be structured; and a financial feasibility analysis will be made. Upon completion of Stage 1, implementation will be initiated including investor identification.



CSF will manage the project by hiring and providing oversight for the work of experts and specialists, in consultation and partnership with the CPTMD Committee. Consultants and specialists will be brought on throughout the process when necessary.

Phase 1: Design

Components

1. *Benchmarking*

A benchmarking study would be conducted of other countries with similar warehouse and warehouse receipt systems in place. The comparison countries may include Canada, Brazil, India, South Africa and US, though the final set of countries may be subsequently adjusted. The study would look at how the systems in each country emerged, how they are structured, how they are owned and managed, and what factors have led to their successes and failures. The work will be carried out through secondary research and consultations with local experts in the comparison countries.

2. *Macro-level assessment of Pakistan*

The technical team will collect and assess reports and studies that have already been completed on related topics in Pakistan. Reports include those completed by NCEL, DFID, World Bank, and ADB. The data and findings will be used by the team to get an understanding of the current situations and recommendations for improvement. The findings from such studies will be compiled and considered as the team proceeds in its work.

3. *Operating structure design*

Based on the observed precedents from the benchmarking and macro-level assessment, a broad outline will be developed for how the operating framework will be developed, including recommendations for how much storage capacity is necessary taking into consideration Pakistan's commodity production and where the facilities should generally be located. Additionally, details need to be provided on how the EWR system will be integrated and connected to other participants such as NCEL and the banking system.

4. *Legal, Regulatory and Monitoring Framework*

Warehouse receipts must be functionally equivalent to stored commodities. The rights, duties, and liabilities of each party involved in the EWR system must be clearly defined. Although the basic transaction underlying a warehouse receipt is fairly straight forward, a proper legal, institutional, and monitoring framework will allow it to attract a wide spectrum of commodity market participants and financial institutions. Such a framework will ensure reduction in transaction costs, reduce fraud and basic standards including financial and physical are being met. The legal, regulatory and monitoring framework should cover, warehousing, warehouse receipts and related financing and trading.

5. *Technical requirements*

Specifications need to be developed for linking the physical and soft infrastructure. The physical infrastructure specifications will include recommendations for how the facilities

should be set up and what types of characteristics and features it should have. Minimum specifications should be set for the temperature, humidity, and pest control mechanisms.

A detailed recommendation for the requirements for IT and EWR systems should be developed. The requirements for provision of quality grading, standardization, and servicing should also be outlined.

6. *Structure and terms of agreements*

The network will have to be intertwined with other market participants so the structure of those relationships should be clearly planned out in advance. First, each facility in the network will have a relationship with growers who bring their harvest for surveying and storage. The terms, conditions, and pricing strategy for how the facilities will take in and charge for commodities should be outlined.

On the other end, the facilities will be connected with NCEL and the banking system so that the stored commodities can be traded or used as loan collateral. The terms and conditions for how the Company will interface with these financial institutions will also need to be drawn out.

As previously mentioned, the network of warehouses may include a combination of owned, leased, and franchised facilities. Included in the recommendations at this stage will be how the lease and franchise agreements should be structured to minimize risk and maximize operational quality in grading and collateral management. Franchise and accredited agreements will be more complex and the key terms of such agreements, including the setting of franchise fees, treatment of intellectual property, quality standards, and remedies for failure to perform will have to be considered in detail.

7. *Financial feasibility & Fiscal Incentives*

When all of the previous design elements, including the network plan, technical specifications, and the business terms for relationships with external parties are combined, financial feasibility studies can be completed for the various components. A feasibility study is required for the bulk handling company or companies, collateral management operations, and EWR services. The financial projections for each would include a cost budget, financing plan, cash flow analysis, breakeven analysis, pro forma income statements, balance sheets, and a valuation. The feasibilities may be conducted with the co-ordination of IFC.

In addition, recommendations should be made on what fiscal incentives and concessions may be provided by the federal government to attract the private sector in this initiative serving the national interest. These incentives / concessions may include taxes, duties and land.

Deliverables

- Benchmarking report of international best practices in earlier identified countries regarding their warehousing and EWR structure.

- Recommended design for the operating structure
- Legal, regulatory and monitoring framework for warehousing and EWR system
- Technical requirements for facilities, IT, and HR
- Structure and terms of agreement with market participants and contractors
- Financial feasibilities for the main management company and warehouse operations

Resources

Phase 1 will require the following:

- International Agriculture & Warehouse Consultant
- Local Agriculture & Warehouse Consultant
- International EWR Expert
- Legal counsel

Timing

Phase 1 will be started immediately and may require 2 months to complete.

Phase 2: Implementation

Throughout Phase 1, CSF and the CPTMD Committee will coordinate with and oversee the work of other complementary projects to make sure that all of the work is being prepared in a manner in which it can be integrated. At the conclusion of Phase 1, CSF, the CPTMD Committee, and the technical team may hold meetings with other organizations to coordinate the steps that need to be taken to implement the design. The Committee will accordingly decide to move forward with Stage 2 as an independent project and incorporate other programs including that of IFC as and when it deems appropriate.

Components

8. *Investor identification plan*

The ultimate goal is to have the network and its management owned and operated fully by the private sector. A profile will be created for the requirements and desired characteristics of such private sector investors. The study may also identify candidates that would be suitable. If it is determined that no such investor currently exists but that it needs to be a consortium built from various different investors, the options for the structure of the consortium can also be considered.

Subsequently, a plan will be created for the process of advertising, evaluating, and negotiating with the investors. Included in the plan will be specific documentation that can be used during the process. CFS may co-ordinate with IFC to implement this component of stage 2.

9. *Public sector program approvals*

In addition to private sector investors, there are public programs under which the proposed design could qualify for funding. Donors such as USAID could provide funding. If such opportunities are available and desirable, CSF and the CPTMD Committee would assess and decide to obtain the funding accordingly.

4. Project Timing

Both stages are expected to be completed within 4 months.

5. Requirements for Consultants and Request for Proposals

The general criteria for experts and consultants identified previously are as follows:

Designation	Requirements
International Agriculture & Warehouse Consultant	<ul style="list-style-type: none"> • Expertise in grain storage and handling • Experience in design and management of grain storage facilities and/or support systems • Understanding of post-harvest systems • Experience and knowledge of agro-economics in South Asia and other developing countries • Track record for providing quality technical assistance for donor agency programs in developing countries • Experience leading teams of consultants and experts
Local Agriculture & Warehouse Consultant	<ul style="list-style-type: none"> • Expertise in grain storage and handling • Understanding of post-harvest systems • Expertise on agriculture and agri-business in Pakistan • Track record for providing quality technical assistance for donor agency programs in Pakistan
International EWR Expert	<ul style="list-style-type: none"> • Expertise in designing, setting up, and operating EWR systems • Experience in working with various EWR systems and ability to compare different options
Legal counsel	<ul style="list-style-type: none"> • Expertise in analyzing the agriculture law and policies of Pakistan • Experience in commercial law and setting up of companies and various forms of contracting • Experience in tendering for investment

Proposals are requested from interested parties for each of the previously outlined roles for Phase 1 only. Proposals will be accepted from firms, individuals, and consortia. Please specify the role you are proposing for and include in the proposal:

- 1) Proposed methodology for carrying out respective role within the TOR, including:
 - a. How you would lead, coordinate with, and/or support the other expert parties.
 - b. A breakdown of the required tasks, tools, and approaches used.
 - c. Timing required for the tasks.
- 2) Experience in specific areas that are applicable to this TOR.
- 3) Profile of key team members to be assigned to the project.
- 4) References (3) from clients in related engagements.
- 5) Professional fee proposal.

Proposals must be submitted before 21st of May 2010. Questions and submissions should be made by email to cptmd@csf.org.pk.