

Structured Commodity Finance

EBRD's Experience and Potential Solutions for the Future

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Presentation Structure

- EBRD's Experience

- WHR Programmes
- Repo Structure in Russia
- Other

Part 1

Part 2

- Potential Future Structures

- Ownership based structures
- Using commodity hedges
- Limitations and risks

Part 1

Part 2



Warehouse Receipts

Part 1

Part 2

Principle

- Commodity owner gets receipt against deposit of goods in silo / warehouse
- Bank issues loan secured by warehouse receipt
- Receipt value is guaranteed by certification of issuing warehouse and indemnity fund (“IF”)
- Receipt must be enforceable without court order



Working Systems...

Part 1

Part 2

- Warehouse Receipt Programs (“WHR”)
 - The WHR provides finance access to owners of grains or commodities.
 - The system was successfully implemented in 8 countries, with some teething problems.
 - The WHR system works without further EBRD funding needs in these countries.

<u>Country</u>	<u>WHR Program</u>	<u>Issue</u>
Bulgaria	Since '98, w IF*	Tax
Czech rep.	Since 2000, no Indemnity Fund	
Hungary	Since '94, no IF	
Kazakhstan	Since '01, w IF	
Lithuania	Since '02, w IF	
Poland	Since '03	IF
Romania	Since '03	Usage
Slovakia	Since '98, no IF	

(*Indemnity Fund)



... and Work in Progress

Part 1

Part 2

- The WHR system needs crucial elements to work: out-of-court settlement procedure and indemnity fund (“IF”).
- In Moldova and Serbia the law includes the creation of an IF.
- In Ukraine a new law should be approved to create the IF.
- The Russian grain traders are using a private WHR system as the law does not allow for out-of-court settlement.

<u>Country</u>	<u>WHR Program</u>	<u>Issue</u>
Moldova	Law passed end 2005	Implement
Russia	Private RGU WHR	Out-of-Court
Serbia	Draft Law	
Ukraine	WHR Since 2004	Indemnity Fund

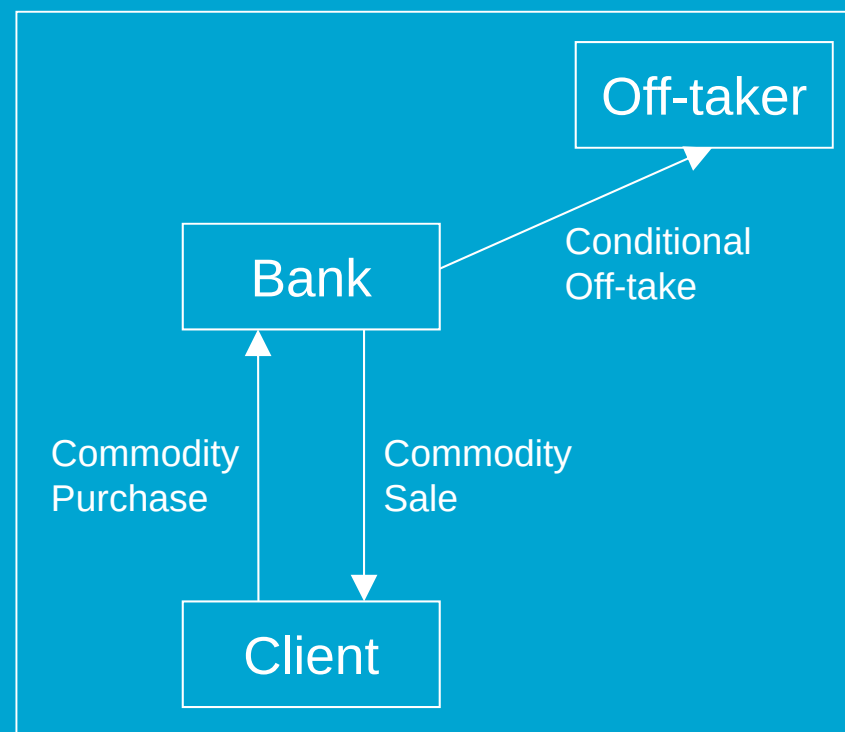


Repo Structure in Russia

Part 1

Part 2

- Basic Principles:
 - Repo provider (Bank) takes outright ownership of the commodity (no out-of-court settlement issue).
 - Fixed price sales contract is entered with same domestic commodity seller (Client).
 - Performance under sale contract is backed by off-take arrangement with reputable foreign trader.
 - Stocks are monitored by external agent.



Repo Debriefing

Part 1

Part 2

- What Can Go Wrong
 - System requires robust back-office system to monitor stocks and markets to assess potential value at risk.
 - Integrity of stocks and maintenance of their quality is crucial.
 - Performance risk of storage operators and off-takers is key element of structure.
- Examples
 - Net risk resulting from combination of forward sales, options and commodity swaps can be difficult to quantify.
 - Water in vegetable oil, foreign matter in bags or empty silo / warehouse.
 - Off-taker defaulting on falling market, backdoor sales or theft from silo / warehouse.



Structured Finance?

Part 1

Part 2

- EBRD Inventory Finance Experience
 - EBRD's experience is mainly based on asset based working capital finance.
 - Repo or ownership based structures are also limited due to taxation costs and recovery rules.
 - Market price risk management is limited due to absence of liquid local or regional commodity exchange.



Structured Finance Options

Part 1

Part 2

- Transfer of ownership based structures
 - Addresses some performance risks such as out-of-court ownership transfer and speed of liquidation of assets
 - Does not address market price risk, unless based on fixed price sale/off-take contract
 - Issues:
 - Financial strength of ownership vehicle
 - Stock monitoring
 - Tax (especially VAT recovery)



Commodity Exchange

Part 1

Part 2

- Structured Finance Solutions
 - Needs liquid local or regional exchange for specific commodity type
 - Exchange should be correlated to commodity market price

Benefit

- Addresses off-take performance risk
- Access to finance for low capital clients



Commodity Exchange

Part 1

Part 2

- Structured Finance Risks / Issues
 - Cost of hedging instrument
(transaction fees and margin calls)
 - Need robust back-office to manage operations
 - Tax issues related to ownership based structures
 - Monitoring of stocks quality and quantity

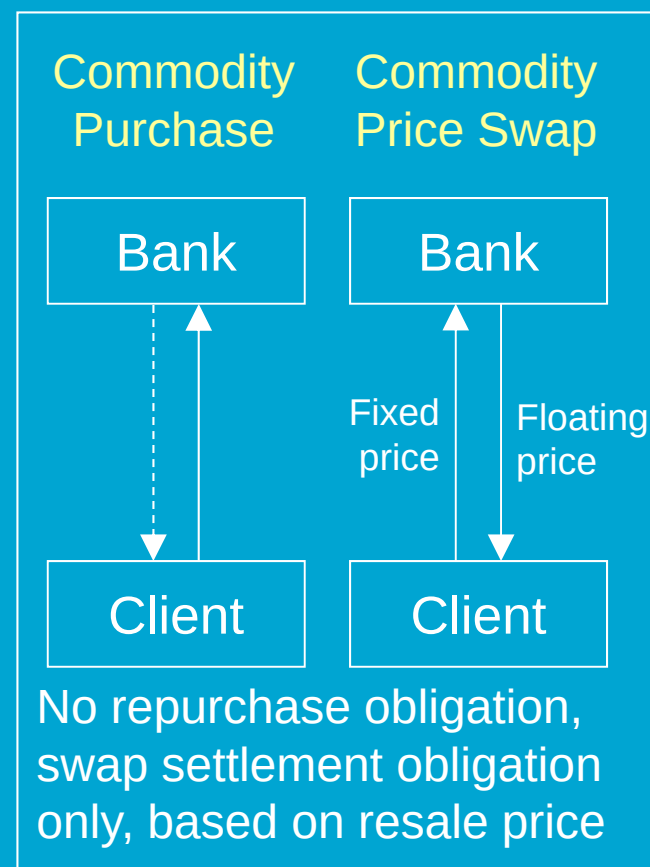


Using Commodity Hedge

Part 1

Part 2

- Total Return Swap (“TRS”)Parallel stock purchase and price swap
 - Interest based cost + hedging costs for client
 - Ownership vehicle and VAT recovery issues
 - Needs independent price reference only
 - TRS not off-balance sheet under IFRS
 - Swap ISDA obstacle to many potential users.



Using Commodity Exchange

Part 1

Part 2

- Cash & Carry

Parallel stock purchase and exchange forward

- Theoretically zero risk structure for the bank
- Applicable only to exchange deliverable commodities
- High transaction costs (exchange fees)
- True off-balance sheet structure under IFRS (under certain conditions)
- Ownership vehicle and VAT recovery issues.



Limitations and Risks

Part 1

Part 2

- Commodity Exchange Liquidity
 - May have seasonal liquidity, risk when closing out positions
 - Limited liquidity may reduce correlation with physical commodity market
- Basis Risk
 - Potential basis risk of regional exchange for region with no free movement of goods
 - Lack of correlation with world market prices.



Conclusions

Part 1

Part 2

- Structured finance opportunities can be developed without working exchanges, but with limitations.
- Exchanges offer additional solutions, but with limitations.
- Commodity finance tools must be considered in the context of each commodity, market and specific needs.



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